Interim report | for the six months ended 31 December 2017

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CEO's report

Overview

Financial results for the half-year ended 31 December 2017 (NZ$)

Total revenue of

$434.7m

An increase of 70% over
the prior corresponding period (pcp)

EBITDA[1] of

$143.0m

123% ahead of the pcp

Net profit after tax of

$98.5m

150% ahead of the pcp

Basic earning per share (EPS) of

13.6¢

an increase of 147% on pcp

Operating cash flow of

$116.4m

and a cash balance of $240.2 million at period end

[1] 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 on page 7

CEO's report (cont.)

Revenue, earnings and cash flow continue to grow strongly

Half-year earnings exceed those for the 2017 full financial year

The Company made further substantial gains in revenue, earnings and cash flow in the first half of the 2018 financial year. Growth continued at a very strong rate in the infant formula business, and liquid milk sales were again higher in each of the Company's core markets.

Sales of *a2 Platinum*® infant formula again grew substantially in Australia and China supported by an increase in market share in those regions. Key first half sales events in China have also contributed to a strong 1H18 result, particularly in November and December. *a2 Platinum*® sales revenue was $341.0 million, 78% of the Company's total revenue for the half-year. Investment continued in building brand awareness and consumer engagement, expanding distribution for *a2 Platinum*® in multiple channels and adapting to new regulatory requirements in China.

Significant progress was achieved in the United States, with further growth in brand awareness, sales velocities and store numbers within the established footprint of California and the Southeast. The US business also further expanded geographically, culminating in the announcement in January 2018 that the *a2 Milk*™ brand would become available through major retailers across the Northeast region.

Fresh milk sales in the United Kingdom continued to build, driven by further improvement in sales velocities in-store and gains in distribution.

Total Group marketing investment increased by $10.0 million over the pcp, due primarily to programmes supporting growth in the United States and China.

The Company's cash position continued to increase along with growth in revenue and earnings. Net operating cash flow was $116.4 million, compared with $38.1 million in the pcp. Cash on hand at 31 December 2017 was $240.2 million, compared with $121.0 million at the end of June 2017. Working capital benefited from improved debtor days and timing of payments with suppliers.

This has been partially offset by an increase in infant formula inventory of $25.2 million as the Company seeks to build progressively to more sustainable levels during the year. This included an increase in China label inventory in response to regulatory changes from January 2018 and increasing demand.

The Board continues to consider the appropriate use of the Company's available capital in the best long-term interest of shareholders. This includes a review of opportunities to invest directly in blending and canning capability as part of our longer-term nutritional products sourcing plan, as well as continued consideration of an on-market share buyback and implementation of a dividend policy.

Strategic focus

The Company's growth strategy has three priorities:

- Building a broad portfolio of dairy-based nutritional products based on the A1 protein-free proposition
- Targeting attractive regions globally
- Continuing to invest in proprietary know-how and A2 protein expertise

Stage 4 *a2 Platinum*® infant formula, for children three years and over, was launched in Australia and China in August 2017 and has performed above expectations. The launch of a further specialised milk powder product is scheduled to occur by the end of the financial year and additional products are planned for the remainder of calendar 2018.

We progressed our strategy for growth in emerging markets through the launch of *a2 Milk*™ branded fresh milk in Singapore, and through discussions with potential partners in various other markets. The Singapore launch, in August 2017, achieved positive sales momentum with good in-store velocities. Shipments are now being made weekly from Australia and we are considering the potential to broaden the product range and distribution for this market.

We also established a small test market, for *a2 Milk*™ branded whole milk powder, with a partner in Vietnam.

CEO's report (cont.)

The Company remains committed to its low capital model supported by mutually beneficial medium-term relationships with processing and distribution partners, in line with its multi-site, multi-product and geographic diversification strategy. As part of this, the Company is continuing to assess its medium-term manufacturing strategy for nutritional products, including the possible ownership, either in full or in partnership, of blending and canning assets as part of the supply solution.

The agreement with our infant formula supply partner Synlait Milk is operating very well, with increasing order quantities being supplied and both management teams working to achieve efficiencies through increased throughput.

During the half-year, the Company continued to invest in enhancing and protecting its intellectual property, including support for scientific research and development and investment in brands, trademarks, patents and proprietary know-how across identified markets.

The Company expects broader interest in the A1 protein-free category over time. Given its pioneering heritage, its comprehensive suite of intellectual property and a business model focused solely on products free of the A1 protein type, the Company is well positioned to respond.

Board and Management

As announced in December 2017, Managing Director and CEO Geoffrey Babidge will retire during calendar 2018 and be succeeded by Jayne Hrdlicka. Ms Hrdlicka was CEO of Jetstar for more than five years before assuming another senior role with Jetstar's parent company Qantas Airways Limited. She has also been a senior partner at Bain & Company, focused on customer-oriented businesses. It is expected that she will join the Company around the commencement of the 2019 financial year. Mr Babidge will be available until December 2018 to assist the transition.

A reorganisation of the senior leadership team announced in June 2017 was completed in August with Peter Nathan appointed to the new role of Chief Executive Asia Pacific and Jane Xu appointed Executive Vice President China. The new structure is focused on maximising opportunities within the ANZ and China markets and across the broader Asia Pacific region over time.

ANZ

The ANZ business continued to grow strongly, with total revenue across all product categories up by 47% to NZ$304.3 million and EBITDA by 65% to NZ$116.4 million.

Revenue growth for *a2 Platinum*® infant formula was particularly strong, driven by continued growth in consumer awareness in Australia and China. *a2 Platinum*® remains the fastest growing infant formula brand by value in Australia, with market share in mainstream retailers up from ~26% to ~30%[2].

Fresh milk revenue rose by ~3% over the pcp. Market share by value for *a2 Milk*™ branded fresh milk rose to ~9.5%[3]. *a2 Milk*™ remains the only milk brand distributed through all six key grocery retailers in the Australian market.

Total sales of *a2 Milk*™ branded milk powder products – whole milk powder and skim milk powder (the latter introduced in May 2017) – were significantly higher than in the pcp.

The Company continued to invest strongly in its brands, through the highest national advertising spend in both the infant formula and fresh milk categories in the Australian market and through strong editorial media coverage. Both spontaneous and prompted consumer brand awareness grew sharply in both categories. *a2 Milk*™ was recently named the top brand of choice for Australian 'millennials'[4].

Close attention continued on the infant formula supply chain resulting in an improved level of inventory at the end of the half. The Company also introduced an on-line platform to improve access of *a2 Platinum*® for Australian consumers.

The Company continues to engage with and closely monitor the personal shopper ("Daigou") channel, recognising its importance as a continuing driver for the business.

As announced in December 2017, a confidential settlement was reached in respect of the legal dispute with Lion Dairy & Drinks Pty Limited whereby the parties agreed not to proceed with their cases against each other.

[2] Aztec Australian Grocery and Pharmacy Scan, 31/12/17 MAT
[3] Aztec Australian Grocery Weighted Scan, 31/12/17 MAT
[4] Number 1 brand on millennial shopping lists, *The Urban List, Food & Drink Survey May 2017*

CEO's report (cont.)

China and Other Asia

The China and Other Asia business recorded exceptional growth, with revenue up by 204% to $114.4 million and EBITDA by 252% to $48.3 million.

The business has a flexible multi-channel infant formula strategy in both China label (offline and online) and cross border English label (online) to best position the brand for growth in the medium term.

Total market share for *a2 Platinum*® infant formula in the targeted regions continued to grow rapidly. Consumption market share by value grew from ~3.5% (quarter ending 30/06/17) to ~5.4% (quarter ending 31/12/17) as measured by Kantar[5].

Increased marketing and sales investment remained a key driver of rising brand awareness. The announcement, in November 2017, of the publication of research findings from a major clinical trial conducted in China (see below) provided further impetus.

a2 Platinum® again participated successfully in key online sales events. In the major '11/11 Singles Day' event it was the top-selling infant formula on Kaola.com, second on JD.com and third on T-mall.

In the offline (bricks and mortar) segment, distribution grew to ~6,700 Mother & Baby Stores supported by an in-store communication programme including deployment of promotional staff who provide consumers with product and category advice. Further expansion is planned for this channel during the second half, backed by an enhanced marketing programme including investment in mainstream media in targeted provinces and in social media.

The China business also launched *a2 Platinum*® infant formula in Hong Kong, with distribution through ~350 high-end pharmacy outlets, supported by brand advertising in high-profile outdoor media. Hong Kong presents an attractive opportunity, both in regard to local consumers and as a channel for Mainland China.

The Company continues to strengthen the organisation in China, with further development in the latest period across all key functions including sales, distribution, marketing, quality, regulatory affairs and finance.

Synlait Milk achieved registration of our China label infant formula products with the China Food and Drug Administration (CFDA) in September 2017. Under regulations applying from 1 January 2018, only China label infant formula products (Stages 1, 2 and 3) registered by the CFDA are permitted to be imported into China through traditional channels. The registration process is comprehensive and includes testing of raw materials and finished products, certification of manufacturing standards and formulation assessment, and packaging changes in response to labelling and branding requirements.

The Company continues to monitor changes in the regulatory regime closely and respond as appropriate.

United States

The US business continued to progress its strategy to build brand awareness and sales velocities while further expanding its distribution footprint.

Investment continued in a multi-media marketing strategy including the *Love Milk Again* advertising campaign, an active editorial media programme, strong digital media and shopper marketing programmes. Sales velocities continued to grow in a number of key accounts.

a2 Milk™ is available in four variants (including chocolate) within the specialty milk segment, the fastest growing segment of the total milk category. At the end of the reporting period the Company had distribution in ~3,600 stores, in California and the South East and through natural retail chains including Sprouts Farmers Market (nationally) and Whole Foods Market (in seven of 11 regions).

It was announced in January 2018 that distribution would be expanded to major retailers across the Northeast region, building on a growing presence already in the natural channel in the region. The Northeast is home to ~60 million consumers and accounts for about 20% of the total milk category volume in the US. It includes New York, New Jersey, Pennsylvania, Connecticut, Rhode Island, New Hampshire, Massachusetts, Vermont and Maine. The *Love Milk Again* campaign and associated programmes are being broadened to support the expansion to this region.

Along with prior distribution growth in California, the South-East and the natural channel, the Northeast expansion is expected to increase total distribution numbers to ~5,000 stores across the US.

As previously advised, the financial outlook for the US business assumes investment of approximately US$25 million over the course of FY18 and FY19 before positive monthly EBITDA is achieved in the 2020 fiscal year. A significant component of this investment relates to building brand awareness and product trial in support of the growth in distribution.

[5] Kantar Infant Formula market tracking of Tier 1 and Key A cities comprising a substantial proportion of the total China infant formula market

CEO's report (cont.)

Meanwhile the Company is investigating specific new product opportunities for the US market to further capitalise on the expanded distribution.

United Kingdom

The United Kingdom business achieved further gains in revenue and positive operating earnings, driven by continuing improvement in sales rates and an expanding distribution footprint.

Volume sales of *a2 Milk*™ branded fresh milk increased by more than 50% against the pcp.

Improving sales rates reflect growing brand recognition achieved through the *a2tonishing* marketing campaign and improvements in merchandising, including increased in-store facings and greater point of sale presence.

Distribution grew from ~1,600 stores to more than 2,000, with gains across the three largest supermarket chains – Tesco, Sainsbury and Asda. In the UK's largest retailer, *a2 Milk*™ is now sold in stores comprising 70% of its weighted distribution. The distribution gains across all major chains are, in turn, creating new promotional and marketing opportunities.

As in the pcp, results also include a contribution from the sale of *a2 Platinum*® infant formula in the wholesale market.

The Company is continuing to assess opportunities for incremental business in Europe and the Middle East.

Science, research and development

A recently published clinical trial conducted in China, involving ~600 adult participants with self-reported lactose intolerance, found that those who consumed milk containing only the A2 beta-casein protein type had reduced acute gastrointestinal symptoms compared with those from milk containing the A1 and A2 beta-casein protein types. The authors said their findings demonstrated that, in some individuals, symptoms from consumption of conventional milk may be related to the presence of A1 beta-casein protein rather than lactose.

A pilot human study carried out under the New Zealand Government High Value Nutrition programme is now complete and being submitted for publication. The study compared the digestive effects of lactose-free milk, *a2Milk*™ and conventional milk amongst milk intolerant participants. Subsequent follow-on studies have now commenced.

A clinical study in China amongst pre-school children, examining digestive benefits of milk free of the A1 beta casein protein type has been completed and submitted for publication.

Studies in progress at the end of the period included a clinical examination at Pennington Biomedical Research Centre, in the United States, with regard to digestive function, inflammation and aspects of metabolic function and a clinical study in association with Monash University, in Australia, with regard to irritable bowel syndrome.

Outlook

The Company has delivered a very strong first half-year, and performance in January 2018 has been pleasing. Continued revenue growth is expected in nutritional products in ANZ and China, along with further growth in fresh milk in the United States in consequence of the Northeast expansion. The focus on growth initiatives in targeted emerging markets and new product development will continue.

Gross margin percentage was higher than expected in the first half primarily due to the higher proportion of infant formula sales, currency movements and favourable net selling prices relative to plan. This was partially offset by product cost increases and margin mix within nutritionals. Subject to currency movements and realisation of throughput efficiencies, the Company expects the gross margin percentage to be broadly consistent in the second half.

As advised at the annual meeting in November 2017, earnings growth in the second half will be tempered by a higher marketing expense, with a half-on-half increase now likely to be in the range of~NZ$35 - $40 million given the timing and scope of marketing programmes in China and the United States. This increased brand investment will further support future growth in these key markets.

Geoffrey Babidge
Managing Director & CEO
20 February 2018

CEO's report (cont.)

Reconciliation of EBITDA to net profit after tax (NPAT)

Earnings before interest, tax, depreciation and amortisation (EBITDA) is a non-GAAP measure. The Company believes that it provides investors with a comprehensive understanding of the underlying performance of the business.

	Half year ended 31 Dec 17 NZ $000's	Half year ended 31 Dec 16 NZ $000's	Movement %
EBITDA	142,989	64,075	123%
Depreciation & amortisation	(1,058)	(1,608)	(34%)
EBIT	141,931	62,467	127%
Interest income	795	443	79%
Income tax expense	(44,257)	(23,528)	88%
Net profit after tax (NPAT)	98,469	39,382	150%

Directors' declaration
for the six months ended 31 December 2017

The directors of The a2 Milk Company Limited are pleased to present the interim report for the six months ended 31 December 2017.

The interim report is unaudited and was authorised for issue by the directors on 20 February 2018.

Signed on behalf of the Board by:

David Hearn
Chairman & Executive Director

Geoffrey Babidge
Managing Director & CEO

20 February 2018

Auditor's review report
for the six months ended 31 December 2017

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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 20, which comprise the statement of financial position of the group as at 31 December 2017, and the statement of comprehensive income, statement of changes in equity and statement of cash flows of the group 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. 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 New Zealand Equivalent to International Accounting Standard 34: *Interim Financial Reporting* 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 New Zealand Equivalent to International Accounting Standard 34: *Interim Financial Reporting*. As the auditor of the group, 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 auditor 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 20, do not present fairly, in all material respects, the financial position of the group as at 31 December 2017 and its financial performance and cash flows for the six month period ended on that date in accordance with New Zealand Equivalent to International Accounting Standard 34: *Interim Financial Reporting*.

Our review was completed on 20 February and our findings are expressed as at that date.

Ernst & Young

Ernst & Young
20 February 2018
Sydney

Consolidated statement of comprehensive income (Unaudited)
for the six months ended 31 December 2017

	Notes	31 Dec 17 $000's	31 Dec 16 $000's
Sales		434,629	255,982
Cost of sales		(218,166)	(136,982)
Gross Margin		216,463	119,000
Other revenue		106	145
Distribution expenses		(13,031)	(9,526)
Administrative expenses	3	(21,757)	(13,707)
Marketing expenses		(26,007)	(16,037)
Other expenses	4	(13,772)	(17,328)
Operating profit		142,002	62,547
Finance income		795	443
Finance costs		(71)	(80)
Net finance income		724	363
Profit before tax		142,726	62,910
Income tax expense		(44,257)	(23,528)
Profit after tax for the period		98,469	39,382
Other comprehensive income			
Items that may be reclassified to profit or loss:			
Foreign currency translation gain/(loss)		2,189	(1,442)
Items not to be reclassified to profit or loss:			
Listed investment fair value gain		43,317	-
Total comprehensive income		143,975	37,940
Earnings per share			
Basic (cents per share)		13.64	5.51
Diluted (cents per share)		13.25	5.37

The accompanying notes form part of these financial statements.

Consolidated statement of changes in equity (Unaudited)
for the six months ended 31 December 2017

Six months ended 31 December 2017	Foreign currency translation reserve $'000	Fair value revaluation reserve $'000	Employee equity settled payments reserve $'000	Total reserves $'000	Retained earnings $'000	Share capital $'000	Total equity $'000
Balance 1 July 2017	(10,948)	13,372	9,739	12,163	95,017	134,302	241,482
Profit after tax for the period	-	-	-	-	98,469	-	98,469
Foreign currency translation differences – foreign operations	2,369	-	-	2,369	-	-	2,369
Listed investment – fair value movement	-	43,317	-	43,317	-	-	43,317
Income tax	(180)	-	-	(180)	-	-	(180)
Total comprehensive income for the period	2,189	43,317	-	45,506	98,469	-	143,975
Transactions with owners in their capacity as owners:							
Issue of ordinary shares	-	-	-	-	-	2,951	2,951
Share issue costs	-	-	-	-	-	(18)	(18)
Share-based payments	-	-	1,243	1,243	-	-	1,243
Total transactions with owners	-	-	1,243	1,243	-	2,933	4,176
Balance 31 December 2017	(8,759)	56,689	10,982	58,912	193,486	137,235	389,633

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	(1,800)	-	(1,800)	-	-	(1,800)
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	-	-	-	-	2,206	2,206
Share issue costs	-	-	-	-	(6)	(6)
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

The accompanying notes form part of these financial statements.

Consolidated statement of financial position (Unaudited)
as at 31 December 2017

	Notes	31 Dec 17 $000's	30 Jun 17 $000's
Assets			
Current assets			
Cash & short-term deposits		240,172	121,020
Trade & other receivables		75,435	72,874
Prepayments		46,400	35,957
Inventories	6	53,606	28,437
Total current assets		415,613	258,288
Non-current assets			
Property, plant & equipment		9,611	8,358
Intangible assets		13,905	13,281
Other financial assets	7	105,366	62,049
Deferred tax assets		3,155	1,954
Total non-current assets		132,037	85,642
Total assets		547,650	343,930
Liabilities			
Current liabilities			
Trade & other payables		123,502	71,350
Income tax payable		34,390	30,998
Total current liabilities		157,892	102,348
Non-current liabilities			
Trade & other payables		125	100
Total non-current liabilities		125	100
Total liabilities		158,017	102,448
Net assets		389,633	241,482
Equity attributable to owners of the Company			
Share capital	5	137,235	134,302
Retained earnings		193,486	95,017
Reserves		58,912	12,163
Total equity		389,633	241,482

The accompanying notes form part of these financial statements.

Consolidated statement of cash flows (Unaudited)
for the six months ended December 2017

	Notes	31 Dec 17 $000's	31 Dec 16 $000's
Cash flows from operating activities			
Receipts from customers		440,765	237,823
Payments to suppliers & employees		(278,627)	(175,695)
Interest received		795	443
Taxes paid		(46,491)	(24,448)
Net cash inflow from operating activities	8	116,442	38,123
Cash flows from investing activities			
Payments for property, plant & equipment		(1,568)	(614)
Investment in other intangible assets		(578)	(330)
Net cash outflow from investing activities		(2,146)	(944)
Cash flows from financing activities			
Proceeds from issue of equity shares		2,933	2,200
Net cash inflow from financing activities		2,933	2,200
Net increase in cash & short-term deposits		117,229	39,379
Cash & short-term deposits at the beginning of the period		121,020	69,361
Effect of exchange rate changes on cash		1,923	(361)
Cash & short-term deposits at the end of the period		240,172	108,379

The accompanying notes form part of these financial statements.

Notes to the interim financial statements
for the six months ended 31 December 2017

1 Basis of preparation

The a2 Milk Company Limited (the Company) and its subsidiaries (together the Group) 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 an FMC reporting entity under the Financial Markets Conduct Act 2013. The Company is also registered as a foreign company in Australia under the *Corporations Act 2001* (Cth, Australia). The shares of The a2 Milk Company Limited are publicly traded on the New Zealand Stock Exchange (NZX), the Australian Securities Exchange (ASX) and Chi-X Australia (Chi-X). The financial report is presented in New Zealand dollars, and all values are rounded to the nearest thousand ($'000), unless otherwise indicated.

The principal activity of the Company is the commercialisation of a2 Milk™ branded milk and related products as supported by the ownership of intellectual property.

These consolidated financial statements were authorised for issue by the directors on 20 February 2018.

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 NZ IAS 34 *Interim Financial Reporting* and IAS 34 *Interim Financial Reporting*, and have been the subject of a review by the auditors.

This interim report should be read in conjunction with the Group's annual report for the year ended 30 June 2017, available at www.thea2milkcompany.com.

The same accounting policies and methods of computation are followed in this interim report as were applied in the preparation of the Group's financial statements for the year ended 30 June 2017, other than the changes arising from the early adoption of NZ IFRS 9 (2014): *Financial Instruments*, noted below.

Changes in significant accounting policies

The Group has applied all of the new and revised Standards and Interpretations issued by the New Zealand External Reporting Board that are relevant to the Group's operations and effective for the current accounting period. Their application has not had any material impact on the Group's assets, profits or earnings per share for the half-year ended 31 December 2017.

Adoption of NZ IFRS 9 (2014) *Financial Instruments*

The Group has early adopted NZ IFRS 9 *Financial Instruments* with a date of initial application of 1 July 2017. The requirements of NZ IFRS 9 represent a significant change from NZ IAS 39 *Financial Instruments: Recognition and Measurement*.

The key changes to the Group's accounting policies resulting from its adoption of NZ IFRS 9 are summarised below.

As a result of the adoption of NZ IFRS 9, the Group has adopted consequential amendments to NZ IAS 1 *Presentation of Financial Statements* which requires impairment of financial assets to be presented in a separate line item in the statement of comprehensive income. Previously, the Group's approach was to include the impairment of trade receivables in other expenses.

Classification of financial assets

NZ IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). The classification of financial assets under NZ IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. Compared to NZ IAS 39, the standard imposes stricter requirements for determining those financial assets that can be recognised at amortised cost or fair value.

Under NZ IFRS 9, the Group's financial assets consist of: cash and short-term deposits and trade receivables, measured at amortised cost; and a listed equity investment measured at FVOCI.

Classification of financial liabilities

Under NZ IFRS 9, the Group's financial liabilities are trade and other payables, measured at amortised cost.

Classification impact

The adoption of NZ IFRS 9 has not had a significant effect on classification or the Group's accounting policies for financial assets and liabilities.

Impairment of financial assets

NZ IFRS 9 replaces the 'incurred loss' model in NZ IAS 39 with an 'expected credit loss' model. The new impairment model applies to financial assets measured at amortised cost, but not to FVOCI equity investments. Under NZ IFRS 9, credit losses are recognised earlier than under NZ IAS 39.

Given the nature of the Group's trade receivables, the expected credit loss model did not materially change the impairment allowance for doubtful debts.

Notes to the interim financial statements
for the six months ended 31 December 2017

1 Basis of preparation (cont.)

Adoption of NZ IFRS 9 (2014) *Financial Instruments* (cont.)

Transition

Changes in accounting policies resulting from the adoption of NZ IFRS 9 (2014) are applied retrospectively. There is no restatement of prior periods as there is no significant change in the recognition and measurement of cash and short-term deposits and trade and other receivables and payables under the new standard.

The Group has made an irrevocable election to classify the listed equity investment made in March 2017 at FVOCI, which does not result in any restatement of prior periods.

Other than cash and short-term deposits and trade and other receivables and payables, and the listed equity investment as noted above, the Group had no other financial assets and liabilities as at 1 July 2017, or in prior periods, requiring transition treatment consideration.

New standards and interpretations not yet adopted

Certain new accounting standards and interpretations have been published that are relevant to the Group's operations but are not yet mandatory for the 31 December 2017 accounting period. The Group's current assessment of the impact of these is set out below.

Accounting standard	Requirement	Impacts in future periods
NZ IFRS 15: *Revenue from Contracts with Customers*	NZ IFRS 15 will become mandatory for the Group's annual reporting period ending 30 June 2019. It replaces the existing revenue standard and interpretations and is based on the identification of performance obligations under a contract to determine revenue treatment.	The Group has commenced an implementation project to assess the impact of this standard. Material contracts have been reviewed, establishing that the Group's current contractual arrangements generally result in single performance obligations, with revenue recognised on delivery to the customer. It is expected that the implementation of the standard will result in minimal change to revenue recognition and measurement. Consideration is also being given to additional disclosures that may be required, including: the disaggregation of total revenue; information about performance obligations; movements in contract receivable and payables; and key judgements and estimates employed. The Group does not expect to adopt the new standard before 1 July 2018.
NZ IFRS 16: *Leases*	NZ IFRS 16 will become mandatory for the Group's annual reporting period ending 30 June 2020, replacing the existing leases standard. The new standard removes the distinction between operating and finance leases, recognising all lease assets and liabilities on balance sheet, with limited exceptions for short-term leases and low value assets.	As a right-to-use asset and a lease liability will be recognised for operating leases, the change will result in a more front-loaded expense pattern for operating leases as compared to current straight-lining, with lease expense allocated to interest and depreciation. The Group does not plan to adopt this standard early, and the full extent of the impact has not yet been determined.

There are no other standards that are not yet effective and that are expected to have a material impact on the Group in the current or future reporting periods.

Notes to the interim financial statements
for the six months ended 31 December 2017

2 Operating Segments

The Group's key performance measures are segment revenue and segment results before interest, tax, depreciation and amortisation (Segment EBITDA, a non-GAAP measure[1]). Further information and analysis of performance can be found in the CEO's report, which forms part of this Interim Report.

For management purposes, the Group is organised into business units based on geographical location along with a corporate function, and has three 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

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 assessed on segment EBITDA and is measured consistently with operating profit or loss in the consolidated financial statements.

Six months ended 31 December 2017	Australia and New Zealand $'000	China and other Asia $'000	UK and USA $'000	Total $'000
Consolidated sales	304,197	114,370	16,062	434,629
Other revenue	106	-	-	106
Reportable segment revenue	304,303	114,370	16,062	434,735
Reportable segment results (Segment EBITDA)	116,402	48,322	(8,374)	156,350
Corporate EBITDA				(13,361)
Group EBITDA				142,989
Reconciliation to consolidated statement of comprehensive income				
Interest income				795
Depreciation & amortisation				(1,058)
Income tax expense				(44,257)
Consolidated profit after tax				98,469

[1] A reconciliation of EBITDA to net profit after tax (NPAT) can be found on page 7

Notes to the interim financial statements
for the six months ended 31 December 2017

2 Operating segments (cont.)

Six months ended 31 December 2016	Australia and New Zealand $'000	China and other Asia $'000	UK and USA $'000	Total $'000
Consolidated sales	206,496	37,651	11,835	255,982
Other revenue	145	-	-	145
Reportable segment revenue	206,641	37,651	11,835	256,127
Reportable segment results (Segment EBITDA)	70,379	13,728	(7,712)	76,395
Corporate EBITDA				(12,320)
Group EBITDA				64,075
Reconciliation to consolidated statement of comprehensive income				
Interest income				443
Depreciation & amortisation				(1,608)
Income tax expense				(23,528)
Consolidated profit after tax				39,382

Revenue by product type	31 Dec 17 $'000	31 Dec 16 $'000
Infant formula	340,955	184,487
Liquid milk	69,386	60,762
Other	24,394	10,878
	434,735	256,127

Other segment information	Australia and New Zealand $'000	China and other Asia $'000	UK and USA $'000	Total reportable segments $'000	Corporate $'000	Total $'000
Segment assets						
31 December 2017	128,255	184,025	16,419	328,699	218,951	547,650
30 June 2017	101,472	108,816	10,877	221,165	122,765	343,930
Segment liabilities						
31 December 2017	23,823	87,155	6,503	117,481	40,536	158,017
30 June 2017	24,759	37,461	4,904	67,124	35,324	102,448

The China and other Asia segment includes assets and liabilities related to the infant formula supply chain from New Zealand to all markets.

Notes to the interim financial statements
for the six months ended 31 December 2017

3 Administrative expenses	31 Dec 17 $'000	31 Dec 16 $'000
Equity settled share-based payments	1,243	1,146
Salary and wage costs	15,159	8,769
Travel costs	2,441	1,861
Other administrative expenses	2,914	1,931
	21,757	13,707

The increase in salary and wage costs reflects increased resources to support growth in key markets.

4 Other expenses	31 Dec 17 $'000	31 Dec 16 $'000
Directors' fees and expenses	427	315
Consultancy, accounting and secretarial fees	3,455	4,624
Legal expenses	3,875	1,783
Depreciation and amortisation	1,058	1,608
Patents, trademarks and research and development	1,796	1,896
Occupancy expenses	964	769
Impairment of intangible assets	-	2,435
Other operating expenses	2,197	3,898
	13,772	17,328

Notes to the interim financial statements
for the six months ended 31 December 2017

5 Share capital	Number of shares	Share capital $'000
Movements in contributed equity:		
Fully paid ordinary shares:		
Balance 30 June 2017	718,238,067	134,302
Exercise of options	3,231,000	2,036
Vesting of rights	320,000	-
Partly paid shares fully paid	1,500,000	915
Share issue costs	-	(18)
Balance 31 December 2017	723,289,067	137,235
Partly paid ordinary shares:		
Balance 30 June 2017	8,750,000	-
Partly paid shares fully paid	(1,500,000)	-
Balance 31 December 2017	7,250,000	-
Total ordinary shares on issue:		
30 June 2017	726,988,067	134,302
31 December 2017	730,539,067	137,235

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.

6 Inventories	31 Dec 17 $'000	30 Jun 17 $'000
Raw materials	1,486	1,142
Finished goods	43,757	10,028
Goods in transit	8,363	17,267
Total inventories at the lower of cost and net realisable value	53,606	28,437

The increase in finished goods relates primarily to planned build in stock levels of infant formula for the China and ANZ businesses.

Notes to the interim financial statements
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7 Financial assets and liabilities

Other financial assets of $105,366,000 (30 June 2017: $62,049,000) consist of shares in Synlait Milk Limited, a dairy processing company listed on the New Zealand Stock Exchange. This listed investment is the only financial instrument carried by the Group at fair value and is classified at fair value through other comprehensive income; valued using Level 1 valuation inputs: quoted prices (unadjusted) in active markets for identical assets or liabilities.

The carrying amounts of cash and short-term deposits, and trade and other receivables and payables are a reasonable approximation of their fair values.

8 Reconciliation of profit after tax with net cash flows from operating activities	31 Dec 17 $'000	31 Dec 16 $'000
Profit after tax for the period	98,469	39,382
Adjustments for non-cash items:		
Depreciation and amortisation	1,058	1,608
Share-based payments	1,243	1,146
Net foreign exchange gain	(522)	(925)
Deferred tax	(1,202)	2,087
Impairment of goodwill, trademarks and project development costs	-	2,435
Changes in working capital:		
Trade and other receivables	(2,561)	(22,456)
Prepayments	(10,443)	(2,513)
Inventories	(25,169)	22,548
Trade and other payables	52,177	(6,462)
Income tax payable	3,392	1,273
Net cash inflow from operating activities	116,442	38,123

9 Net tangible assets per security	31 Dec 17 $	30 Jun 17 $
Net tangible assets per security	0.51	0.31

Corporate directory

Company	**The a2 Milk Company Limited** Level 10 51 Shortland Street Auckland 1010 New Zealand	**Auditor**	**Ernst & Young** 200 George Street Sydney NSW 2000 Australia
New Zealand share registry	**Link Market Services Limited** PO Box 91976 Victoria Street West Auckland 1142 New Zealand Telephone +64 9 375 5998	**Australian share registry**	**Link Market Services Limited** Locked Bag A14 Sydney South NSW 1235 Australia Telephone +61 1300 554 474
Legal advisors	**Simpson Grierson** Level 27 88 Shortland Street Auckland 1010 New Zealand **Johnson Winter & Slattery** Level 25 20 Bond Street Sydney NSW 2000 Australia	**Registered offices**	Level 10 51 Shortland Street Auckland 1010 New Zealand Telephone: +64 9 972 9802 Level 4 182 Blues Point Road McMahons Point NSW 2060 Australia Telephone: +61 2 9697 7000
Company directors	David Hearn (Chairman & Executive Director) Julia Hoare (Deputy Chairman & Non-Executive Director) Geoffrey Babidge (Managing Director & CEO) Peter Hinton (Non-Executive Director) Warwick Every-Burns (Non-Executive Director) Jesse Wu (Non-Executive Director)		
Corporate website	**www.thea2milkcompany.com**		

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