Australian Dairy Farms Group

1 August 2018
ASX Code: AHF

- **FY2018 – a Transition Year – Transitioning from commodity white milk to value added products.**
- **Board's brief to management in June 2017:**
  - ***"move out commodity products and develop higher margin Own Brands and contract processing and packing while completing feasibility to go organic and move into infant formula production";***
  - ***"reduction in unprofitable revenue is necessary in once off game-changing transition to significant increases in Contract Packaging for short term gain;"***
  - ***"focus on the flexibility of the Camperdown factory and vast expertise of personnel;"***
  - ***"complete feasibility on conversion of farms to Organic;"***
  - ***"become genuinely Vertically Integrated from farm to export including organic infant formula within three years;"***

The financial year 2017-2018 has been a significant Transition Year for Australian Dairy Farms Group (AHF or the Group) to build on its solid farming production and high-quality farms and in its journey to establish a profitable, vertically integrated, factory processing base of consistent profitable revenue for the future, while the major transition to expand the vertical integration model to include becoming an ***Organic Infant Formula manufacturing*** is implemented.

Board's 2017/18 Brief to Management

The Board's brief to management in July 2017 was clear: ***"The Group must transition away from a primarily bottled white commodity, where the only real point of competition is "discount pricing," to using the flexibility of its Camperdown factory and the diverse combined skills and experience of its workforce to produce higher margin products with a material point of difference under the Group's own brand name and in contract manufacturing and packing for other market-leader products."***

Transitions

Transitions usually mean making hard and often costly decisions to 'break the mould' of the traditional business to move to new and more profitable activities.

Transitions mean genuine change and writing off historical costs. It also usually means that revenues for discontinued low margin activities take some time to be replaced by new higher margin activities.

By way of example, when the decision was made in September 2017, to discontinue supplying Aussie Farmers Direct with discounted pricing on bottled white milk. It was a decision to decrease sales by $6 million annually (Total FY2017: $6.6 million). It was also a fortunate decision as Aussie Farmers Direct was placed in administration on 5 March 2018, so AHF also escaped potential loss of trade debtors which could have been as much as $1 million had the contract not been discontinued.

In the 2017 financial year, sales of the Farmers Own branded bottled milk were approximately $5.7 million although the margins were low. Consequently, an opportunity to exit this contract in cooperation with the customer, was taken in June/July 2018 to create capacity for the opportunity for extended services (such picking and packing of customer orders for delivery) of the new 4-year high volume contract packing agreement for manufacturing high value-added products, referred below, which commenced late last week (week ending 27 August 2018).

Management has worked diligently to replace the revenue from Aussie Farmers Direct and other discontinued lines with sales of higher margin products including Camperdown Dairy's own brands of Free Range and Jersey Milk which, for new products and new brands have achieved strong acceptance and consistent growth since inception.

Contract Processing and Packing

Since early in FY2017, the management and processing team has concentrated its efforts on new replacement contracts for processing and packing of higher margin bottle milk and yoghurts, under the Camperdown Dairy brands and for others.

Several new milk supply and contract packing contracts have been developed providing some diversification of customer base and several others remain in negotiation. All these potential contracts have realistic margins and growth prospects.

Major Yoghurt Manufacturing and Packing Contract

On 23 April 2018, the Board advised the market of execution of a major new contract, negotiated over some six months, for milk supply and packing with an established international customer backed by supply contracts with a major national supermarket retailer. After limited refitting for specialised yoghurt manufacture in the Camperdown Dairy factory, production of a range of 10 specialised, on trend yoghurt products commenced in the last week. Some of these products will have national distribution and are expected to be in over 900 stores this month, and as a minimum, other products will launch into a wide range of supermarkets in NSW, Victoria and Queensland during August 2018.

A detailed announcement on this is imminent once the retail launch has commenced in coming weeks. The first stage of the contract is forecast to generate at least $5.5 million in Sales revenue in the first 10 months to 30 June 2019 with growth of more than 50% in the following year at attractive margins on expected volume growth as the products are extended to retailer outlets nationally. At the time of release of this update, the first production commenced on a major component of the new higher margin yoghurt and similar products commenced last week, backed by solid four-year production contracts.

The Board is pleased to advise that this part of the transition is progressing well with additional contracts under negotiation.

Transitions Usually Impact Financial results

Primarily because of these significant decisions to discontinue the low or no margin bottled commodity / conventional milk supply, the FY2018 financial results will be adversely affected with the projected results for FY2019 expected to be more positive, based on existing new contracts and several prospective ones in the course of negotiation. As the Group continues its transition to be a vertically integrated producer of a range of high value dairy products including organic infant formula, the achievements in replacing commodity milk with value added products is gaining momentum and the expectation is that this activity will provide positive cashflow from operations.

Guidance for FY2018 Financial Results

The FY2018 Results, which have not yet completed their annual audit have been affected by the following particular items:

- Material investments for future benefit including but not limited to
  - Organic Infant formula feasibility and associated costs
  - Organic conversion of farms – single largest dairy farm entity conversion to organic in Australia
  - Value added products and business development which has included branding, contacts legal fees, trials and other significant investments.
- Decreased revenue primarily from the planned reduction in production and sales of low margin or unprofitable white bottled conventional milk as discussed above.
- Non-cash impact of Employee Share Scheme issuance primarily to Chief Executive Officer and Director, Peter Skene who has been the primary driver and strategist of the significant changes that have been implemented in FY2018 to prepare for the expected return to maintainable profitability in FY2019 and beyond. This has been a once off amount for the next three years of transition to lead the transition and implementation of new facilities.
- Non-cash and unrealised decreases in valuation of farm properties. This represents close to $1 million of negative impact this year vs last year based primarily on annual market conditions and actual farm sales in the region. Sales of comparable farms has been very limited.

Assets and Liabilities

The net assets of the Group at 30 June 2018 total $30,474,171, an increase of $1,809,973 from the 2017 comparative. The key assets and liabilities in the statement of financial position at 30 June 2018 are:

- cash and cash equivalents of $2,331,700 (2017: $1,577,264);
- property, plant and equipment of $25,834,763 (2017: $25,973,270);
- intangible assets of $6,643,045 (2017: $6,649,168);
- biological assets (livestock) of $5,205,774 (2017: $5,426,719); and
- total borrowings of $10,478,421 (2017: $10,602,361)

Operating Results

The consolidated net loss attributed to members of the Group, after providing for income tax is expected to be $4,157,653 (2017: $2,179,348). This result is comprised of a net loss from the dairy processing segment of $1,380,104, net loss from the dairy farm segment of $245,552 and corporate costs and bank facility finance charges of $2,531,997.

Total income for the year ended 30 June 2018 is $19,902,214, down 20% against the 2017 comparative period of $24,972,709. This is a result of a $5,124,991 decrease in revenue from the dairy processing segment and a $54,496 increase from the dairy farm segment.

Total expenses for the year ended 30 June 2018 were $24,059,867, down 11% against the 2017 comparative period of $27,152,057. This is a result of a $3,717,967 decrease in expenses from the dairy processing segment, an increase of $524,618 from the dairy farm segment and an increase of $101,159 from corporate costs and bank facility finance charges. Included in corporate costs are non-cash equity-settled share-based payments to KMP in the year of $961,538 (2017: $1,017,661).

Review of Operations

- **Dairy Processing - Camperdown Dairy Company Pty Ltd (CDC)**

CDC reported a net loss of $1,380,104 (2017: $26,920 profit) and EBITDA of $907,223 (2017: 615,234 profit) for the year ended 30 June 2018.

Total income for the year is down 32% against the 2017 comparative period, predominantly because of the decline in sales of bottled white milk in accordance with management planning.

- **Dairy Farms - Australian Dairy Farms Trust and SW Dairies Pty Ltd**

The Group's dairy farms expect a net loss of $245,552 (2017: $224,570 profit) taking into account unrealised valuation reductions, and EBITDA of $174,619 (2017: $695,401) for the year ended 30 June 2018.

Total farm milk sales for the year are up 15% against the 2017 comparative period, predominantly as a result of an increased milk solids price of $0.70 during the year.

Operating costs have remained materially in line with the 2017 comparative, however there is a non-cash impairment to land and buildings carrying values of $388,075 (2017: $nil) following an independent valuation in June 2018 and independent valuation losses on livestock during the year of $544,037 (2017: $446,742 gain).

Audit

The FY 2019 Financial Accounts are currently at annual audit stage and will be released to market in full, with additional commentary on completion.

AUSTRALIAN DAIRY FARMS GROUP

Further Details

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Communications Policy

As a policy, because of the heavy demands on limited management resources and to ensure compliance with continuous market-wide disclosure regulations, AHF does not respond to individual security holder communications regarding the management of the business, the company or with respect of any opinion or analysis that is not contained in market releases and released financial reports.

AHF makes ASX market releases at times directors believe it would be helpful or necessary for investors and as required by the Listing Rules. For further information regarding our shareholder communications policy, please refer to AHF's website: www.adfl.com.au

About Australian Dairy Farms Group

***Australian Dairy Farms Group (AHF)** was the first ASX listed dairy farmer. Its initial focus was on aggregating high quality dairy farms in Victoria, initially in the South Western region with particular emphasis initially, on the famous Dairy Golden Triangle region of South West Victoria between Warrnambool and Colac south of the Princes Highway to the coast around Port Campbell.*

In April 2016 the Group completed the acquisition of Camperdown Dairy Company Pty Ltd - ACN 140 640 606 (Camperdown Dairy) – see announcement on http://www.adfl.com.au/announcements .

***Australian Dairy Farms Group** is listed as a stapled security comprising one fully paid share in **Australian Dairy Farms Limited (the Company)** and one fully paid unit in **Australian Dairy Farms Trust (the Trust).** Within the structure, the Company is the operator and manager of the dairy farm properties, which are leased from the Trust as the registered owner.*

Disclaimer – Forward Looking Statements

This announcement may include "forward looking statements" within the meaning of securities laws of applicable jurisdictions. These forward-looking statements are not historical facts but are based on AHF's current expectation, estimates and projections about the industry, in which it operates, and beliefs and assumptions. Forward looking statements may include indications of, and guidance on, future earnings or distributions and financial position and performance and involve known and unknown risks, uncertainties and other factors, many of which are beyond the control of AHF, and its officers, employees, agents, or associates, that may cause actual results to differ materially from any projections and forward-looking statements and the assumptions on which those statements are based. Readers are cautioned not to place undue reliance on forward looking statements and AHF assumes no obligation to update such information.