BUILDING VALUE

Synlait Milk Limited Interim Report 2017

OUR STRENGTH
COMES FROM OUR
SOLID FOUNDATION OF
VALUE-ADDED PRODUCTS

LEADERSHIP UPDATE

Graeme Milne
CHAIRMAN

John Penno
MANAGING DIRECTOR

EVERYONE AT SYNLAIT IS FOCUSED ON MAKING THE MOST FROM MILK.

Our strategy is to build strong partnerships with leading brand owners. We create value by manufacturing dairy-based products that our customers trust to protect and build their brands and markets. Our strategy enables us to manage a portfolio of customers, and to build and maintain strong manufacturing margins.

Because we are a small part of a large global market, we can be very specific about the categories and customers we target. We have built high specification plant, which we run at high capacity. We then continually focus our management time, milk and manufacturing capability on the highest returning opportunities.

We have been able to deliberately partner with dairy farmers who share our commitment to excellence around people, product and care for their animals and the environment.

Once again, we are pleased to present an interim report where our financial results demonstrate we are right on track.

GROWTH COMPANY

The Board and management of Synlait remain focused on growth. As a small player in a large global industry, and as a small part of the New Zealand dairy industry, we see significant opportunity to consolidate and grow our well-established infant formula business.

However, we are also continually exploring to find new areas of business where we can generate superior returns by leveraging our supply chain integrity and focus on quality.

Given the magnitude of these opportunities, it is important to focus on building the team and balance sheet strength to be able to execute opportunities as and when they are identified.

This interim report highlights the growth journey we are achieving in our existing business, the development and evolution of our senior leadership and our growing financial strength.

ONGOING GROWTH IN OUR INFANT BUSINESS

We believe that from the 2017 calendar year, the Chinese infant formula market will grow to over one million metric tonnes (MT) / annum, which is more than double the total volume of infant formula imported five years earlier.

There is a strong and growing appetite for imported infant formula in China. In the 12 months to July 2016 the total imported volume was 350,000 MT.

After recognising this opportunity early in the life of the company, and aggressively investing in people, plant and process, we believe that over the past two years we have become New Zealand's largest manufacturer of finished infant formula, with Synlait accounting for 30% of New Zealand's total export volume of finished infant formula in FY16.

After enjoying almost four-fold year on year growth in our finished infant formula business in FY16, we pointed to regulatory change in China and accumulated stock in the supply chain as the factors behind expecting modest growth in FY17, before a return to strong growth from late FY17.

Over the past six months, we have built increased clarity about the pending improvements to the Chinese infant formula regulatory framework. These changes have the objective of increasing the quality and safety of the products on offer to Chinese consumers, and significantly reducing the number of brands in the Chinese market.

Six months ago, the draft regulations indicated each company would be able to register a maximum of three brands. In the final amendments it became clear that the "three brand rule" would be applied at a manufacturing site level, rather than the company level.

At the same time it was signalled that the hurdles for each company to maintain registration would be higher, and that scientific differences between brands manufactured at each site would need to be greater.

These changes have been important for Synlait.

Firstly, it has led to a decision that our pending investment in a new infant formula blending and consumer packaging facility will be on a standalone site.

While this is likely to be more expensive than building on our existing site, this cost will be greatly outweighed by the risk mitigation a second manufacturing site will bring, and the value of being able to work with a larger portfolio of customers.

Secondly, the period of regulatory uncertainty in China provided the opportunity to explore a range of opportunities with existing and potential customers. This has left us clear that in the medium to long term we are best to partner with customers where we are able to develop close and exclusive partnerships.

We also wish to partner with both international and large Chinese companies that own brands in the China infant formula market.

While our final portfolio of infant formula customers exporting to China will be determined through the registration process, we are confident we will be able to maintain and grow our current portfolio of customers.

Our partnership with Munchkin Inc. provides us with an entry point to the United States (US) infant formula market.

The US is the second largest infant formula market after China at 146,600 MT / annum[1]. Although it is much smaller than China and only enjoys modest growth rates, it is a mature market with a small number of long standing brands. We support Munchkin's view that the market is ripe for disruption with a high quality product that has a meaningful point of difference, and in fact this has already happened in the non-milk segment of the baby food market.

The first shipments of Munchkin's Grass Fed™ infant formula for the US market are underway and will be ready to launch once the regulatory registration process with the US Food and Drug Administration (FDA) has been completed. Gaining FDA registration has been a significant process involving clinical studies proving the efficacy and safety of the Grass Fed™ product, and places us as one of only a few companies importing infant formula products into the US. Significant manufactured volumes are not expected until FY18.

FY17 INFANT FORMULA PERFORMANCE ON TRACK

Regulatory change and overstocking of some brands has meant the past six months has been a period of considerable uncertainty for the infant formula industry. We have seen sales through the first half of FY17 at lower volumes than during the second half of FY16. However, as stocks have cleared and greater regulatory clarity has emerged for our customers, we have seen order volume growth resume.

Orders received at the time of this report give us confidence that we will end the year close to our target volumes of 18,000 MT of finished infant formula, with increasing run rates between now and the end of the year.

To meet expected growth in demand for finished infant formula we are in the process of appointing a fourth shift to our blending and consumer packaging facility. This will see it capable of operating at full capacity from June 2017. We will be announcing our plans for a second blending and consumer packaging facility in the coming months.

We expect to support both blending and consumer packaging facilities with infant formula base powder manufactured centrally at our Dunsandel site. We are now underway with a $36.9 million investment into a second wet mix kitchen that will enable both of our infant formula-capable spray dryers to simultaneously manufacture fully formulated base powder. This will bring the site capacity for base powder to 80,000 MT / annum by November 2017.

We remain well positioned to continue growing our sales of finished and base infant formula powder in the years to come. We will remain focused on supporting our existing brand partners targeting the Chinese market, and will look to establish partnerships targeting other regions and markets.

1. Euromonitor International.

SYNLAIT LACTOFERRIN

The lactoferrin market is beginning to recover as demand catches up with the large increases in supply that occurred at about the time our product came to market. Spot prices are beginning to increase and we expect to be renewing contracts at stronger prices in the second half of FY17.

As part of working with Munchkin to gain US approval for Grass Fed™ infant formula, we have worked with the FDA to have our lactoferrin registered for use in infant formula in the US. This opens up a new market with fewer competitors and is a market ideally suited to our unique spray dried product.

DAIRY COMMODITY MARKETS

After a long period of weak dairy commodity prices, prices improved markedly late in November and December 2016 on the expectation of lower milk production in China, New Zealand, Australia and the European Union (EU).

This saw our forecast milk price for FY17 increase from $6.00 kgMS to $6.25 kgMS in early February 2017. However, soon after we had done this, prices sharply corrected downwards.

At this point, commodity prices are very unlikely to support $6.25 kgMS and if the current trend continues, New Zealand's farm gate milk price may finish below $6.00 kgMS.

We are confident that our milk suppliers have made significant progress in adjusting their businesses to operate profitably at lower milk prices. Often this has resulted in them producing less milk as they spend less on supplementary feed and off farm grazing.

Working closely with them, we have anticipated this and contracted additional dairy farm suppliers in 2016 to maintain high levels of plant utilisation. In FY17 we now expect to process 63 million kgMS from our milk suppliers. Alongside some milk from other manufacturers, this will translate into total sales of about 137,000 MT of product and represents a 20% increase on total sales volume on FY16.

We will not be increasing the number of Synlait milk suppliers for the FY18 season. As a result, we need to achieve manufacturing efficiency improvements to meet our infant formula base powder production targets and process all the milk we have contracted. We have been working hard on this and are confident this will be achieved.

SENIOR LEADERSHIP TEAM

As we build the business, we are continually seeking new talent at all levels.

The last six months has seen us make four significant appointments to the leadership team.

As Director of Sales and Business Development, Martijn Jager oversees our sales program, major new customer acquisitions, as well as product development, technical services, marketing and research functions. His 20 years of work experience in the international dairy industry includes various senior commercial roles, most recently with FrieslandCampina where he established their B2B infant formula and ingredients business in China from 2010.

Roger Schwarzenbach joined our leadership team in January 2017 as is our General Manager of Innovation and Technical Services. Roger works closely with Martijn to lead our innovation pipeline focused on new product development, supporting ongoing technical requirements of our existing product portfolio and providing technical support to our Operations team as they work to continuously improve production. Roger joined Synlait following his role as Technical Director for Glanbia Ingredients Ireland.

Boyd Williams joined Synlait in December 2016 and is Director of People, Culture and Performance. His responsibilities include organisational development, human resources, health and safety and corporate communications. Having worked with multinationals for more than 30 years, including Unilever and Bacardi Group, Boyd brings the commercial experience, technical knowledge and drive we need for our people and culture to thrive.

Neil Betteridge re-joined us in January 2017 in the new role of Director of Operations. Neil undertook a 12-month sabbatical to Tetra Pak in the Netherlands in 2016 and completed INSEAD's Advanced Management Programme in November as a recipient of a 2016 Prime Minister's Business Scholarship. He has played a key role in our growth since joining in 2007 and is now responsible for the manufacturing and supply chain processes across the entire business.

These senior appointments have been made to accelerate the rate of change in the business, and prepare us for our next opportunities.

FINANCIAL STRENGTH

The past few years have been a period of very significant investment in the manufacturing sector of the dairy and infant formula industries in Australasia. It is our view that the sector is now well over capacity in terms of plant and equipment, and more is being built. Inevitably, a period of consolidation will follow, and has already begun with some companies finding themselves in a weak position and looking to form partnerships or sell assets.

In such an environment, it makes little sense to build new manufacturing assets ourselves.

As our strategy and operational performance has begun delivering results, our Board has become increasingly focused on putting the company in a financial position to make strategic acquisitions as they become available.

In the 12 months to 31 January 2017 our net debt has been halved from $292 million to $147 million, and we are forecasting to half this again by the end of FY17. These significant gains have been made through a combination of strong operational cash flows and the $97.6 million of new equity raised with our rights issue in October 2016.

This new equity was initially used to pay down debt and subsequently will support our three year, $300 million capital expenditure programme. Furthermore, it allows us to continue investing in business opportunities, as we find them, to increase our work with new categories, products and customers.

Most of our corporate shareholders participated in the capital raise (Bright Dairy, Munchkin Inc., Mitsui) and institutional ownership increased post rights issue with 8.8 million shares being bought by funds and investment houses. FrieslandCampina did not participate in the capital raise and The a2 Milk Company™ have subsequently purchased their 8.17% shareholding.

Any acquisitions will focus on businesses or assets where we can leverage our supply chain, capability or customer relationships, and where possible will replace or defer capital investments we would have otherwise been forced to make to meet our customers growing demands.

DUAL LISTING

Following on from listing on the New Zealand Exchange (NZX) in July 2013 and from the rights issue completed in October 2016, we dual listed on the Australian Securities Exchange (ASX) in November 2016.

We have always enjoyed strong support from Australian institutional investors. We wanted to make our shares available to funds that can only invest in ASX-listed companies, as well as private investors in Australia where some of our most valuable products are available on the supermarket shelf.

We would like to welcome our new Australian shareholders to the business. We are working with various parties to ensure we build a good range of investment coverage amongst Australian brokers and investment advisors in this large market.

OUTLOOK

At this point we continue to expect growth in gross margin, driven by increased sales of ingredients and infant formula, will be largely offset by increased costs as we prepare for our next growth phase.

Accordingly, we expect modest year on year growth in net profit after tax in FY17, in line with our previous guidance, followed by higher growth in profit in FY18 and beyond.

We look forward to updating you with our full year results in September 2017.

Kind regards,

Graeme Milne, Chairman and John Penno, Managing Director and CEO

FINANCIAL UPDATE

Nigel Greenwood

CHIEF FINANCIAL OFFICER

OVERVIEW

Reported after tax earnings for the first half of FY17 (H1 FY17) is a profit of $10.6 million compared to $10.2 million for the same period last year (H1 FY16). Modest margin growth of $2.0 million before tax has been driven by increased powders and cream volumes. Synlait also incurred unrealised foreign exchange losses of $2.9 million in H1 FY16 that have not reoccurred in H1 FY17 following the refinance of the inventory financing facility in July 2016.

This was offset by increases in overhead costs ($4.7 million before tax) reflecting continued investment into our business development and planning capabilities for future growth.

FINANCIAL PERFORMANCE

SALES

For the period ended 31 January 2017, our revenue at $288.7 million is up 35.2% on last year's $213.5 million. Increased sales volume and higher dairy commodity prices have both driven increased revenue compared to the same period last year.

Total volume sold for H1 FY17 at 61,063 metric tonnes (MT) was 31.7% above 46,356 MT in H1 FY16.

	H1 FY17	H1 FY16	Change Vol	Change %
Sales (MT)				
Powders and Cream	54,695	41,102	13,593	33.1%
Consumer Packaged	6,349	5,246	1,103	21.0%
Specialty Ingredients	19	8	11	137.5%
Total	61,063	46,356	14,707	31.7%

Ingredient sales volumes have increased significantly compared to the first half of last year, predominantly as a consequence of increased milk collections and production levels during the period and higher levels of inventory carried over from FY16. Consumer packaged sales increased 21.0% over the same period last year but are 41.0% down from the second half of FY16, where sales volume was 10,753 MT. This was expected as our customers carefully managed inventory levels in response to uncertainty surrounding changes in Chinese infant formula regulations.

PRODUCTION

In September 2015, we commissioned our third large scale spray dryer (D3). Milk supply was increased in FY16 as a consequence and further increased in FY17 to bring the plant closer to capacity.

	H1 FY17	H1 FY16	Change Vol	Change %
Production (MT)				
Powders and Cream	75,886	69,132	6,754	9.7%
Consumer Packaged	7,088	5,714	1,374	24.0%
Specialty Ingredients	6	5	1	20.0%
Total	82,980	74,851	8,129	10.9%

Production levels are 10.9% up over H1 FY16 as a consequence of higher milk collections. However, with sales volumes 31.7% higher than last year, inventory levels have reduced by 2,225 MT to 42,960 MT.

GROSS MARGIN

Synlait generated a gross margin in H1 FY17 of $43.7 million, a $2.0 million improvement on the $41.7 million generated H1 FY16.

Margin growth has been driven by increased infant volumes with canned infant formula volumes increasing by 1,103 MT to 6,349 MT.

However, gross margin per MT has decreased from $900 / MT to $716 / MT. This is due to the dilutive impact of onerous contracts and carry over stock sold at low margins. Without this onerous contracts provision (which is a consequence of the seasonal nature of our business and is a timing variance), gross margin per MT for H1 FY17 would have been $818 / MT.

Onerous contracts provisions relate to product contracted for sale, but not yet shipped, at a price that is lower than the cost of the inventory allocated to this contract. These typically result in a rising price environment where there is a material time difference between contracting for sale and actual shipment. This is a timing variance between first and second half profit and is not indicative of full year results given that the market price for milk is determined upon the weighted average sales price achieved across the entire season.

OVERHEAD EXPENDITURE

In total our overhead expenses for H1 FY17 at $21.7 million is $4.7 million (or 27.6%) up over H1 FY16's $17.0 million. The key driver is increased employee costs, predominantly in the areas of business development and planning as Synlait reinvests for future growth.

EARNINGS BEFORE INTEREST, TAX, DEPRECIATION AND AMORTISATION (EBITDA)

EBITDA at $33.3 million decreased 5.0% on H1 FY16's $35.0 million, with the $2.5 million improvement in gross margin (excluding depreciation) being offset by overhead growth (excluding depreciation) of $4.5 million.

NET FINANCING COSTS

Net financing costs at $6.9 million were in line with H1 FY16's $6.8 million. Gross term debt interest costs have decreased by $1.8 million following the capital raise in October 2016 and strong cash flows enabling debt repayments in the second half of FY16. This has been offset by reduced capitalisation of interest following the commissioning of the third spray dryer during FY16.

$ million	H1 FY17	H1 FY16	Variance
Gross term debt interest	5.2	7.0	(1.8)
less capitalised interest	-	(1.5)	1.5
Net term debt interest	5.2	5.5	(0.3)
Working capital funding interest	1.5	1.3	0.2
Interest received	(0.1)	(0.1)	-
Loss on de-recognition of financial instruments	0.3	0.1	0.2
Net financing costs	6.9	6.8	0.1

EARNINGS PER SHARE

Our reported basic and diluted earnings per share (EPS) for H1 FY17 was 6.34 cents against H1 FY16's earnings of 6.99 cents.

The accelerated rights entitlement offer completed in October 2016, and ordinary shares issued to members of senior management who participated in the IPO incentive scheme, increased the number of shares on issue from 146,341,197 to 179,149,619. The weighted average number of shares on issue during the period was 167,309,098 (H1 FY16: 146,341,197).

FINANCIAL POSITION

OVERVIEW

Shareholders equity has increased by $169.8 million to $365.7 million (January 2016: $195.9 million). This is a consequence of the accelerated rights issue completed in October 2016 ($95.4 million, net of costs), earnings ($34.8 million) and favourable mark to market movements of derivatives ($39.5 million).

TRADE AND OTHER RECEIVABLES

At $62.0 million, trade and other receivables are up on H1 FY16's $44.5 million. This increase is predominantly driven by increasing dairy commodity prices which, coupled with increased sales volumes, have increased trade and other receivables.

INVENTORIES

Total inventory at $197.5 million is 21.0% higher than the $163.2 million held at the same time last year.

Whilst the volume of inventory on hand is lower (2,225 MT lower than January 2016), the valuation of inventory is higher as a consequence of a higher forecast farm gate milk price.

We have reviewed all our sales contracts for the risk a sales order value is lower than the weighted average cost of the product and have created an onerous contracts provision of $6.2 million (H1 FY16: $1.1 million). We have also performed impairment testing on this inventory and determined that no further impairment provisions are required in addition to existing provisions for distressed inventory and onerous contracts.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at $428.8 million decreased $11.5 million over the same time last year ($440.3 million) with depreciation exceeding additions for the period. There has been no capital expenditure of note during the first half of FY17, with spend on the new wet mix kitchen planned to start from the second half.

TRADE AND OTHER PAYABLES

Trade and other payables at $157.9 million is up $43.8 million (38.4%) on last year's $114.1 million.

The majority of this variance is driven by an increase in the amount remaining payable to milk suppliers (the milk accrual) as a consequence of advance rates normalising from the accelerated position seen in FY15 and FY16.

TOTAL NET DEBT

Total net debt for H1 FY17, including both current and term debt facilities, less cash on hand, was $146.6 million. This is a reduction of $145.4 million from January 2016 as a consequence of the accelerated rights issue completed in October 2016 ($95.4 million) and strong operating cash flows in the second half of FY16.

$ millions	H1 FY17	H1 FY16
Current debt	$66.4	$96.7
Term debt	$83.5	$196.5
Cash on hand	($3.3)	($1.1)
Total net debt	$146.6	$292.0

OPERATING CASH FLOWS

Operating cash flows at negative $14.2 million were $18.2 million down on H1 FY16's $4.0 million. The negative cash flow reflects the seasonal nature of our business where cash flows are weighted to the second half, whilst the reduction from the prior year is a consequence of the one off benefit from the first time assignment of The a2 Milk Company™ receivables to BNZ totalling $17.0 million as at 31 January 2016.

BANK FACILITIES AND COVENANTS

We have two syndicated bank facilities in place with ANZ and BNZ after refinancing the Mitsui trade finance facility.

1. Working capital facility (multi-currency) – reviewed annually and facility limit of $120.0 million
2. Revolver facility – matures 1 August 2020 and facility limit of $175.0 million

We have four key bank covenants in place within our syndicated bank facility agreement. These are:

1. Interest cover ratio - EBITDA to interest expense of no less than 3.00x based on full year forecast result
2. Minimum shareholders funds – no less than $296.0 million
3. Working capital ratio – inventory and debtors to working capital facility outstanding of no less than 1.5:1
4. Leverage ratio – Total debt to EBITDA is no greater than 3.75x

We were compliant with our bank covenants at all times during H1 FY17.

It should also be noted that all unrealised gains or losses associated with both our foreign exchange and interest rate swap derivatives within equity are excluded when determining our compliance with our minimum shareholder's funds bank covenant calculation.

Nigel Greenwood, Chief Financial Officer

FINANCIAL STATEMENTS

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SYNLAIT MILK LIMITED INTERIM FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED 31 JANUARY 2017

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DIRECTORS' DECLARATION

AS AT 31 JANUARY 2017

DIRECTORS' RESPONSIBILITY STATEMENT

The directors are pleased to present the interim financial statements for Synlait Milk Limited and its subsidiary, Synlait Milk Finance Limited, (together "the Group") as set out on pages 16 to 29 for the six months ended 31 January 2017.

The directors are responsible for ensuring that the interim financial statements present fairly the financial position of the Group as at 31 January 2017 and the financial performance and cash flows for the six months ended on that date.

The directors consider that the interim financial statements of the Group have been prepared using appropriate accounting policies, consistently applied and supported by reasonable judgements and estimates and that all relevant financial reporting and accounting standards have been followed.

The directors believe that proper accounting records have been kept which enable, with reasonable accuracy, the determination of the financial position of the Group and facilitate compliance of the financial statements with the Financial Markets Conduct Act 2013.

For and on behalf of the Board.

Graeme Milne
CHAIRMAN
28 March 2017

John Penno
MANAGING DIRECTOR
28 March 2017

INCOME STATEMENT

FOR THE SIX MONTHS ENDED 31 JANUARY 2017

		Group $'000		
		Six months ended		Year ended
		31 January	31 January	31 July
		2017	2016	2016
	Notes	Unaudited	Unaudited	Audited
Revenue		288,696	213,472	546,866
Cost of sales	4	(244,959)	(171,769)	(446,566)
Gross profit		43,737	41,703	100,300
Other income		367	310	536
Share of loss from associates		(481)	(734)	(1,151)
Sales and distribution expenses	4	(8,235)	(6,204)	(13,629)
Administrative and operating expenses	4	(13,464)	(10,827)	(25,004)
Earnings before net finance expense and income tax		21,924	24,248	61,052
Finance expenses		(6,746)	(6,813)	(14,485)
Finance income		95	138	18
Loss on derecognition of financial assets		(278)	(101)	(517)
Net finance costs		(6,929)	(6,776)	(14,984)
Unrealised foreign exchange (losses) / gains		-	(2,890)	2,326
Profit before income tax		14,995	14,582	48,394
Income tax expense		(4,384)	(4,355)	(14,011)
Net profit after tax for the period		10,611	10,227	34,383
Earnings per share				
Basic and diluted earnings per share (cents)		6.34	6.99	23.50

The accompanying notes form part of and are to be read in conjunction with these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

FOR THE SIX MONTHS ENDED 31 JANUARY 2017

		Group $'000		
		Six months ended		Year ended
		31 January	31 January	31 July
		2017	2016	2016
	Notes	Unaudited	Unaudited	Audited
Profit for the period		10,611	10,227	34,383
Items that may be reclassified subsequently to profit and loss				
Effective portion of changes in fair value of cash flow hedges		3,911	19,326	69,574
Net change in fair value of cash flow hedges transferred to profit and loss		-	(391)	218
Income tax on other comprehensive income		(1,095)	(5,302)	(19,542)
Total items that may be reclassified subsequently to profit and loss		2,816	13,633	50,250
Other comprehensive income / (loss) for the period, net of tax		2,816	13,633	50,250
Total comprehensive income / (loss) for the period		13,427	23,860	84,633

The accompanying notes form part of and are to be read in conjunction with these financial statements.

STATEMENT OF CHANGES IN EQUITY

FOR THE SIX MONTHS ENDED 31 JANUARY 2017

	Notes	Share capital $'000	Employee benefits reserve $'000	Cash flow hedge reserve $'000	Revaluation reserve $'000	Retained earnings $'000	Total equity $'000
Equity as at 1 August 2015		172,247	71	(36,218)	20,276	15,471	171,847
Profit or loss for the period		-	-	-	-	10,227	10,227
Other comprehensive income							
Effective portion of changes in fair value of cash flow hedges		-	-	17,422	-	-	17,422
Movement in time value hedge reserve		-	-	1,904	-	-	1,904
Net change in fair value of cash flow hedges transferred to profit and loss		-	-	(391)	-	-	(391)
Income tax on other comprehensive income		-	-	(5,302)	-	-	(5,302)
Total other comprehensive income		-	-	13,633	-	-	13,633
Employee benefits reserve		-	242	-	-	-	242
Total contributions by and distributions to owners		-	242	-	-	-	242
Equity as at 31 January 2016		172,247	313	(22,585)	20,276	25,698	195,949

The accompanying notes form part of and are to be read in conjunction with these financial statements.

STATEMENT OF CHANGES IN EQUITY (CONTINUED)

FOR THE SIX MONTHS ENDED 31 JANUARY 2017

	Notes	Share capital $'000	Employee benefits reserve $'000	Cash flow hedge reserve $'000	Revaluation reserve $'000	Retained earnings $'000	Total equity $'000
Equity as at 1 August 2016		172,247	435	14,032	20,276	49,853	256,843
Profit or loss for the period		-	-	-	-	10,611	10,611
Other comprehensive income							
Effective portion of changes in fair value of cash flow hedges		-	-	4,792	-	-	4,792
Movement in time value hedge reserve		-	-	(881)	-	-	(881)
Income tax on other comprehensive income		-	-	(1,095)	-	-	(1,095)
Total other comprehensive income		-	-	2,816	-	-	2,816
Issue of new shares		95,412	-	-	-	-	95,412
Employee benefits reserve		-	(17)	-	-	-	(17)
Capitalisation of employee benefits reserve		418	(418)	-	-	-	-
Total contributions by and distributions to owners		95,830	(435)	-	-	-	95,395
Equity as at 31 January 2017		268,077	-	16,848	20,276	60,464	365,665

The accompanying notes form part of and are to be read in conjunction with these financial statements.

STATEMENT OF FINANCIAL POSITION

AS AT 31 JANUARY 2017

		Group $'000		
		31 January 2017	31 January 2016	31 July 2016
	Notes	Unaudited	Unaudited	Audited
Current assets				
Cash and cash equivalents		3,307	1,128	2,045
Trade and other receivables	6	61,953	44,507	37,793
Goods and services tax receivable		5,117	914	656
Income accruals and prepayments		1,506	1,529	2,446
Inventories	7	197,455	163,218	73,885
Derivative financial instruments	10	27,082	678	33,049
Total current assets		296,420	211,974	149,874
Non-current assets				
Property, plant and equipment		428,795	440,252	433,889
Intangible assets		3,810	4,533	4,140
Other investments		343	1,242	824
Derivative financial instruments	10	8,022	1,507	1,729
Total non-current assets		440,970	447,534	440,582
Total assets		737,390	659,508	590,456
Current liabilities				
Loans and borrowings	8	66,350	96,658	46,546
Trade and other payables		157,886	114,070	55,598
Current tax liabilities		14,522	2,517	11,702
Derivative financial instruments	10	5,228	11,575	6,737
Total current liabilities		243,986	224,820	120,583
Non-current liabilities				
Loans and borrowings	8	83,528	196,513	168,908
Deferred tax liabilities		38,228	20,858	35,569
Derivative financial instruments	10	5,983	21,368	8,553
Total non-current liabilities		127,739	238,739	213,030
Total liabilities		371,725	463,559	333,613
Equity				
Share capital	9	268,077	172,247	172,247
Reserves		37,124	(1,996)	34,743
Retained earnings		60,464	25,698	49,853
Total equity attributable to equity holders of the Group		365,665	195,949	256,843
Total equity and liabilities		737,390	659,508	590,456

The accompanying notes form part of and are to be read in conjunction with these financial statements.

STATEMENT OF CASH FLOWS

FOR THE SIX MONTHS ENDED 31 JANUARY 2017

		Group $'000		
		Six months ended		Year ended
		31 January	31 January	31 July
		2017	2016	2016
	Notes	Unaudited	Unaudited	Audited
Cash flows from operating activities				
Cash receipts from customers		267,931	273,801	585,881
Cash paid for milk purchased		(201,489)	(153,541)	(275,444)
Cash paid to other creditors and employees		(76,152)	(116,592)	(207,099)
Net movement in goods and services tax		(4,460)	326	584
Income tax refunds		-	(19)	(19)
Net cash (outflow) / inflow from operating activities	5	(14,170)	3,975	103,903
Cash flows from investing activities				
Interest received		95	138	18
Acquisition of property, plant and equipment		(7,454)	(23,291)	(39,685)
Proceeds from sale of property, plant and equipment		16	3	80
Acquisition of intangible assets		(314)	576	(1,353)
Net cash outflow from investing activities		(7,657)	(22,574)	(40,940)
Cash flows from financing activities				
Receipt of cash from issue of shares (net)		95,412	-	-
Repayments of borrowings		(85,405)	(41,000)	(88,624)
Receipt of borrowings		-	56,947	82,081
Net movement in working capital and trade finance facilities		19,803	11,011	(39,100)
Interest paid		(6,721)	(8,760)	(16,804)
Net cash inflow / (outflow) from financing activities		23,089	18,198	(62,447)
Net increase / (decrease) in cash and cash equivalents		1,262	(401)	516
Cash and cash equivalents at the beginning of the period		2,045	1,529	1,529
Cash and cash equivalents at end of the period		3,307	1,128	2,045

The accompanying notes form part of and are to be read in conjunction with these financial statements.

1. REPORTING ENTITY

The condensed consolidated interim financial statements (interim financial statements) presented are those of the Group, including Synlait Milk Limited and its subsidiary Synlait Milk Finance Limited.

Synlait Milk Limited is primarily involved in the manufacture and sale of dairy products.

The parent company, Synlait Milk Limited, is a profit-oriented entity, domiciled in New Zealand, registered under the Companies Act 1993 and listed on the New Zealand Stock Exchange and the Australian Securities Exchange. Synlait Milk Limited is a FMC reporting entity under the Financial Market Conducts Act 2013 and its financial statements comply with that Act.

2. BASIS OF PREPARATION OF SIX MONTHLY FINANCIAL REPORT

The unaudited interim financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP) as appropriate for interim financial statements. They comply with International Accounting Standard 34 (IAS 34) and New Zealand equivalent to International Accounting Standard 34 (NZ IAS 34) Interim Financial Reporting and other applicable financial reporting standards appropriate for profit oriented entities.

Synlait Milk Limited is subject to seasonal fluctuations which have an impact on both revenue and production levels due to northern hemisphere dairy market demand and the dairy milking season. Synlait Milk Limited recognises this is the nature of the industry and plans and manages the business accordingly. Certain comparative figures have been changed to reflect current expense allocations between cost of sales, sales and distribution and administrative and operating expenses.

Items included in the interim financial statements of the Group are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The financial statements are presented in New Zealand Dollars ($), which is the Group's functional currency and are rounded to the nearest thousand ($000).

There have been no significant changes in accounting policies during the current period. The same accounting policies and methods of computation are followed in these financial statements as the most recent annual financial statements for the year ended 31 July 2016.

Milk accrual method

At interim reporting date, the milk accrual is a key management estimate. The milk accrual represents the amount the Group is forecasting to pay its suppliers for the current year less advance payments made during the period. The Group's policy is to value its inventory using the weighted average monthly milk price. Management's forecast of the milk price for the season is the basis of the calculation of the milk accrual and at interim reporting date requires judgement from management. Key assumptions in the calculation of the forecast annual milk price for the season include dairy commodity prices, on-farm milk composition, sales and production curve, annual foreign exchange conversion rate and other conversion costs.

3. SEGMENT INFORMATION

The Group operates in one industry, being the manufacture and sale of milk powder and milk powder related products. The Board makes resource allocation decisions based on expected cash flows and results of the Group's operations as a whole and the Group therefore has one segment.

Although the Group sells to many different countries, the Group operates in one principal geographical area being New Zealand.

Revenues of approximately 50% are derived from the top three external customers (31 January 2016: 58%, 31 July 2016 58%).

The proportion of sales revenue by geographical area is summarised below:

	Group $'000		
	Six months ended		Year ended
	31 January	31 January	31 July
	2017	2016	2016
	Unaudited	Unaudited	Audited
China	9%	8%	12%
Rest of Asia	39%	32%	33%
Middle East and Africa	20%	20%	16%
New Zealand	12%	35%	11%
Australia	15%	2%	9%
Rest of World	5%	3%	19%
Total	100%	100%	100%

4. EXPENSES

	Group $'000		
	Six months ended		Year ended
	31 January 2017 Unaudited	31 January 2016 Unaudited	31 July 2016 Audited
The following items of expenditure are included in cost of sales			
Depreciation and amortisation	9,929	9,462	19,984
Employee benefit expense	13,622	11,681	23,665
Kiwisaver contributions	340	286	557
Export freight	6,102	4,902	10,912
Rent	237	231	618
Repairs and maintenance	1,949	1,046	5,664
Consultancy	195	230	606
(Decrease) / increase in inventory provision	(1,926)	(410)	302
Increase / (decrease) in onerous contracts provision	5,277	(744)	(547)
Research and development	253	121	386
The following items of expenditure are included in sales and distribution			
Depreciation and amortisation	812	560	1,325
Employee benefit expense	3,285	2,094	5,791
Kiwisaver contributions	87	50	123
Rent	1,079	608	1,595
Repairs and maintenance	455	324	685
Consultancy	580	75	577
Donations	1	1	3
The following items of expenditure are included in administrative and operating			
Depreciation and amortisation	617	750	1,378
Employee benefit expense	5,197	3,936	9,278
Kiwisaver contributions	155	97	204
Repairs and maintenance	4	2	9
Directors fees	240	231	469
Share based payments expense	(16)	242	364
Consultancy and legal	1,102	1,216	2,471
ASX listing fees	402	523	1,814

5. RECONCILIATION OF PROFIT AFTER INCOME TAX TO NET CASH OUTFLOW FROM OPERATING ACTIVITIES

	Group $'000		
	Six months ended		Year ended
	31 January	31 January	31 July
	2017	2016	2016
	Unaudited	Unaudited	Audited
Profit for the period	10,611	10,227	34,383
Non-cash and non-operating items:			
Depreciation and amortisation of non-current assets	11,358	10,772	22,687
Gain on sale of fixed assets	-	-	(12)
Write off intangible assets	-	-	728
Share of loss from associate	481	734	1,151
Non-cash share based payments expense	(17)	242	364
Interest costs classified as financing cash flow	6,746	6,813	14,485
Interest received classified as investing cash flow	(95)	(138)	(18)
Loss on derecognition of financial assets	278	101	517
Deferred tax	1,564	1,956	2,427
(Loss) / gain on derivative financial instruments	(494)	(392)	218
Unrealised foreign exchange losses	-	2,890	(2,326)
Movements in working capital:			
(Increase) / decrease in trade and other receivables	(24,439)	24,368	30,607
(Increase) / decrease in income accruals and prepayments	941	696	(221)
(Increase) / decrease in inventories	(123,570)	(99,414)	(10,080)
(Increase) / decrease in other current assets	(4,460)	(408)	584
(Decrease) / increase in trade and other payables	104,106	43,148	(3,156)
(Decrease) / increase in current tax liabilities	2,820	2,380	11,565
Net cash inflow from operating activities	(14,170)	3,975	103,903

6. TRADE AND OTHER RECEIVABLES

The Group has derecognised trade receivables that have been sold pursuant to the terms of receivables purchase agreements that the Group has entered into with its bankers. The Group has assessed the terms of the agreements and has determined that substantially all the risks and rewards have been transferred to the respective banks. During the six months ended 31 January 2017, the Group has not entered into any new receivable assignment agreements with any new customers nor has it amended the terms of any existing agreements.

7. INVENTORIES

	Group $'000		
	Six months ended		Year ended
	31 January	31 January	31 July
	2017	2016	2016
	Unaudited	Unaudited	Audited
Raw materials at cost	15,184	19,380	14,093
Finished goods at cost	160,055	131,464	54,145
Finished goods at net realisable value	22,216	12,374	5,647
Total inventories	197,455	163,218	73,885

The valuation of inventory as at 31 January 2017 is higher than the valuation as at 31 January 2016 as a consequence of a higher forecast annual milk price. The volume of inventory held as at 31 January 2017 is in line with the volume held as at 31 January 2016.

The total inventory provision as at 31 January 2017 was $1.3 million (31 January 2016: $3.9 million; 31 July 2016: $3.2 million) of which $1.2 million related to finished goods and $0.1 million related to raw materials.

The total onerous contracts provision as at 31 January 2017 was $6.2 million (31 January 2016: $1.1 million; 31 July 2016: $0.9 million).

8. LOANS AND BORROWINGS

Interest bearing liabilities are recognised initially at fair value, net of transaction costs incurred. Interest bearing liabilities are subsequently carried at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the profit and loss component of the consolidated statement of comprehensive income over the period of the borrowings using the effective interest method.

	Group $'000		
	Six months ended		Year ended
	31 January	31 January	31 July
	2017	2016	2016
	Unaudited	Unaudited	Audited
Current liabilities			
Working capital facility (syndicated) NZD	14,100	-	25,200
Working capital facility (syndicated) USD	52,250	-	-
Trade finance facility (Mitsui)	-	33,837	21,346
Inventory finance facility (Mitsui)	-	62,821	-
	66,350	96,658	46,546
Non-current liabilities			
Bank loans	84,000	197,111	169,405
Loan facility fees	(472)	(598)	(497)
	83,528	196,513	168,908

In August 2016 the Group renegotiated its working capital facilities with its bankers to replace the existing facilities with Mitsui & Co. (NZ) Ltd. The Group negotiated a secured working capital facility of NZD $120 million with a USD $80 million sublimit that matures on 22 August 2017.

9. SHARE CAPITAL

During the six months ended 31 January 2017 the Group successfully completed an accelerated rights issue and raised $97.6 million of new share capital ($95.4 million net of costs). The capital raise is represented by the issue of 32,519,239 new ordinary shares.

During the reporting period 289,183 new ordinary shares were granted to participants of the IPO incentive scheme as a result of share options that were granted under the scheme vesting and being converted to ordinary shares. These shares were issued to the participants at no cost.

The Group had 179,149,619 ordinary shares on issue as at 31 January 2017 (31 January 2016: 146,341,197, 31 July 2016: 146,341,197).

10. FINANCIAL INSTRUMENTS

Cash flow hedge

As at 31 January 2017, the Group held $16.9 million of gains in the cash flow hedge reserve (31 January 2016: $22.6 million of losses; 31 July 2016: $14.0 million of gains). This reserve is shown within the Statement of changes in equity.

Commodity derivatives

During the period the Group entered into a small number of commodity derivative contracts to further support the Group's existing financial risk management strategy. The movement in the fair value of the commodity derivatives is included within the cash flow hedge reserve.

11. RELATED PARTY TRANSACTIONS

Parent entity

Bright Dairy Holding Limited hold 39.06% of the shares issued by the Synlait Milk Limited (31 January 2016: 39.12%, 31 July 2016: 39.12%). Bright Dairy Holding Limited is a subsidiary of Bright Food (Group) Co. Limited, a State Owned Enterprise domiciled in the People's Republic of China.

Other related entities

In June 2013 a subsidiary of Synlait Milk Limited, Synlait Milk Finance Limited, was set up primarily for holding all banking facilities for the Group and related interest rate swaps. Funds are loaned to Synlait Milk Limited and interest is charged at market rates.

In January 2015, the Group acquired 25% of the shares of New Hope Nutritionals, an infant formula company registered in China. This company owns and markets the "Akara" and "Akarola" infant formula brands in the Chinese market, which are exclusively manufactured by Synlait Milk Limited.

(a) Transactions with other related parties

	Group $'000		
	Six months ended		Year ended
	31 January	31 January	31 July
	2017	2016	2016
	Unaudited	Unaudited	Audited
Purchase of goods and services			
Bright Dairy and Food Co Ltd - Directors fees	72	72	111
Sale of goods and services			
Bright Dairy and Food Co Ltd - Sale of milk powder products	719	-	9,461
Bright Dairy and Food Co Ltd - Reimbursement of costs	(27)	(80)	(53)
Sichuan New Hope Nutritional Foods Co. Ltd - Sale of milk powder products	4,876	3,309	8,344

All transactions with related parties are at arm's length on normal trading terms.

(b) Outstanding balances

The following balances are outstanding at the reporting date in relation to transactions with related parties:

	Group $'000		
	Six months ended		Year ended
	31 January	31 January	31 July
	2017	2016	2016
	Unaudited	Unaudited	Audited
Current receivables (sales of goods and services)			
Bright Dairy and Food Co Ltd - Sale of milk powder products	250	-	264
Bright Dairy and Food Co Ltd - Reimbursement of costs	(162)	(241)	(118)
Sichuan New Hope Nutritionals Ltd - Sale of milk powder products	1,783	19	733

12. CONTINGENCIES

As at 31 January 2017 the Group had no contingent liabilities or assets (31 January 2016: $nil, 31 July 2016: $nil).

13. COMMITMENTS

The Group has awarded the contract for the construction of a new wet mix kitchen, although as at 31 January 2017 the contract has not been executed. The total value of the construction contract is $29.2 million (31 January 2016: $nil; 31 July 2016: $nil).

14. EVENTS OCCURRING AFTER THE REPORTING PERIOD

There were no events occurring subsequent to 31 January 2017 which require adjustment to, or disclosure in, the financial statements.

Deloitte.

INDEPENDENT REVIEW REPORT TO THE SHAREHOLDERS OF SYNLAIT MILK LIMITED

We have reviewed the condensed Group interim financial statements (interim financial statements) of Synlait Milk Limited and its subsidiary ('the Group') which comprise the consolidated statement of financial position as at 31 January 2017, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the period ended on that date, and a summary of significant accounting policies and other explanatory information on pages 16 to 29.

This report is made solely to the Synlait Milk Limited'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 Synlait Milk Limited's shareholders as a body, for our engagement, for this report, or for the opinions we have formed.

BOARD OF DIRECTORS' RESPONSIBILITIES

The Board of Directors are responsible for the preparation and fair presentation of the condensed consolidated interim financial statements, in accordance with NZ IAS 34 *Interim Financial Reporting* and IAS 34 *Interim Financial Reporting* and for such internal control as the Board of Directors determine is necessary to enable the preparation and fair presentation of the condensed consolidated interim financial statements that are free from material misstatement, whether due to fraud or error.

OUR RESPONSIBILITIES

Our responsibility is to express a conclusion on the condensed consolidated 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'). NZ SRE 2410 requires us to conclude whether anything has come to our attention that causes us to believe that the condensed consolidated interim financial statements, taken as a whole, are not prepared, in all material respects, in accordance with NZ IAS 34 *Interim Financial Reporting* and IAS 34 *Interim Financial Reporting*. As the auditor of Synlait Milk Limited, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.

A review of the condensed consolidated 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.

Our firm carries out other assignments for Synlait Milk Limited in the areas of other assurance services, taxation advice and other consulting services. These services have not impaired our independence as auditor of the Group. The firm has no other relationship with, or interest in the Group.

CONCLUSION

Based on our review, nothing has come to our attention that causes us to believe that the condensed consolidated interim financial statements of the Group do not present fairly, in all material respects, the financial position of the Group as at 31 January 2017 and its financial performance and cash flows for the period ended on that date in accordance with NZ IAS 34 *Interim Financial Reporting* and IAS 34 *Interim Financial Reporting*.

Deloitte Limited

28 March 2017

Chartered Accountants

AUCKLAND, NEW ZEALAND

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BOARD OF DIRECTORS

Graeme Roderick Milne (Chair of the Board) – Independent Director

Willem (Bill) Jan Roest (Chair of the Audit and Risk Committee) – Independent Director

Ian Samuel (Sam) Knowles – Independent Director

John William Penno (Managing Director) – Board Appointed Director

Min (Ming) Ben – Bright Dairy Director

Qikai (Albert) Lu – Bright Dairy Director

Sihang (Edward) Yang – Bright Dairy Director

Hon. Ruth Margaret Richardson (Chair of the Remuneration and Governance Committee) – Bright Dairy Director

SENIOR LEADERSHIP TEAM

John Penno – Chief Executive Officer and Managing Director

Nigel Greenwood – Chief Financial Officer

Boyd Williams – Director, People, Culture and Performance

Martijn Jager – Director, Sales and Business Development

Neil Betteridge – Director, Operations

Chris France – Director, Strategy and Business Transformation

Matthew Foster – General Manager, Supply Chain

Roger Schwarzenbach – General Manager, Innovation and Technical Services

Rob Stowell – General Manager, Integrated Business Planning

Quentin Lowcay – General Counsel and Commercial Manager

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MANAGING YOUR SHAREHOLDING ONLINE

To change your address, update your payment instructions and to view your registered details including transactions, please visit www.investorcentre.com/nz

General enquiries can be directed to enquiry@computershare.co.nz

Please assist our registry by quoting your CSN or shareholder number when making enquiries.

OTHER INFORMATION

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