**TRANSCRIPTION**

**Company: Synlait Milk**

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**[START OF TRANSCRIPT]**

**Operator:** Thank you for standing by, and welcome to the Synlait Milk full year results conference call. All participants are in a listen only mode. There will be a presentation followed by a question and answer session. If you wish to ask a question, you'll need to press the star key followed by the number one on your telephone keypad. I would now like to hand the conference over to Mr. Leon Clement, CEO. Please go ahead.

**Leon Clement:** Welcome to the Synlait Milk annual results call. Leon Clement here, sitting next to me is Nigel Greenwood, our CFO. We're calling in today from an early morning start in Shanghai, where we've completed a board meeting yesterday, but importantly, we're sitting in our brand new China office, which will be opening later on this evening, so that's by way of introduction where we're talking to you from.

Look, I will step through the presentation which has been posted online. I'll be referencing that document and I'll use page numbers to reference as we go through. The headline for us as is around three themes today. It's been a strong year of continuing to deliver strong results in terms of top line and bottom line growth. We've been really busy investing and sitting ourselves up for the future and we spent some time over the past 12 months really clarifying our direction. So I'll cover those as we sift through the presentation.

I'm going to kick off with with an overall strategic update and then I hand over the Nigel. He'll take us through some more detail in terms of the overall results and then hand back to me for some guidance and summary comments and then we can open up for questions.

So I'm just on page two of the deck at the moment which summarises those key themes I referenced, deliver, invest and clarify. Our result today is characterised by crossing the billion-dollar threshold in terms of top line for the first time, strong momentum in our top line increasing 17% to just over a billion dollars and that's a really strong milestone for the business. New profits increased 10% up to 82.2 million. So good solid underlying profit growth area for us. And importantly behind that result, as you guys know, we fund a lot of our activity off their balance sheet and our cash flows increased a healthy 39% to 136. 7 million. So good underlying cash flow result there as well.

That's underpinned by strong infant sales growth, up 21% with final infant volumes of 42907 metric tonnes. Also today we're announcing an average milk price across our supplier base of $6.58. That's made up of a base milk price of $6.40 and average incentive payments to our farmer network of $0.18. And look it does show that the strong that our farmers are doing in terms of supporting what we do for our customers and it's really important we continue to acknowledge the work they do given the uncertainty in the climate in New Zealand at the moment.

It's been a really big year of investing for the future: four main facilities have come online, with double lactoferrin, our Pokeno project has been a really big focus for us, and more on that later. We've stood up the advanced liquid dairy packaging facility, $134 million there, build and commission that in 18 months. And we took on the assets of Talbot Forest on the 1st of August.

Also announcing today, a new dry store facility, $32 million investment there for a 30,000 square metre warehouse facility. That unlocks, it's a really nice little project actually, it unlocks a lot of double handling that we have in our network. It provides greater control of our inventory and traceability, improves our sustainability for footprint and ultimately helps us serve our customers better. So that's got a good strong investment return behind it even though it's not a growth capex.

And then also we're bringing in 218 capable people. We've done that over the last 12 months, very experienced and high energy people. So a lot of the theme of our business has been delivering a good result whilst we keep investing for the future.

And finally we've clarified our direction. Spent a lot of time with the team working through our purpose and vision and our strategy and that now underpins everything we go and create a lot of meaning and clarity for our people. Every year is not without its challenges though, I'll just shift into page three and we want to be up front with you that, yeah, we've got some good results but we are dealing with some challenges. And that's the nature of our business. We're a growth organisation and that means that we do have to work through challenges at times. Obviously there's some uncertainty around Pokeno and the facility there. We'll come back to that in a deeper update later on.

We acknowledge the uncertainty that still exists around SAMR registrations and we are still awaiting the site audit, but the good news is that our Acara and Pure Canterbury brands had been approved subject to those site audits. It's just very hard to be unequivocal around timing for those site audits. We also had some challenges around commissioning our liquid dairy facility. They are one off losses. We've incurred $3.5 million losses there in in the past year. We're working really hard to stabilise that performance and we'll bring it back in line with expectation over the next few months.

Look I know the market's also keen to hear if we've got big main customer announcements to do, we've got none of those today. We are comfortable with our customer pipeline but no new announceable material agreements to announce. We are working hard through that and I realise there's a lot of capacity to fill them and those customer conversations remain top of mind for us. We announced earlier this year that the on hold on the US FDA registration process for Munchkin, as long as you put some uncertainty around our US market.

Overarching that the macro economic climate and and the regulatory environment environment for industry with national policy statements for fresh water management and zero carbon bills impacting farmer sentiment, and the wider industry is obviously going through some challenges at the moment. Those are the challenges that we're working through. We've got a strong plan to continue to work through them, and a strong and the business in the context of that, but being up front around the things that we're dealing with.

Shifting to slide four, just important to remind everybody that we do have a strong sustainable, competitive, differentiated value chain. We feel with established really strong differentiated belt supply and integrated manufacturing chain that's efficient, and you can see that in our underlying result this year. We deal with complex regulatory environments and get good outcomes for our customers and we work to ensure that quality standards are met and those hand in hand ensure market access is assured for our customers. We are focused on building and establishing two new points of difference across our value chain, a strong R and D and innovation capability to support the needs of our customers as they grow, and really dialling in to the commitment that we made around sustainability and making sure that it's a point of difference as well.

I'll quickly go through our strategy on page five here, eight strategic paths, five focused on growth and three enabling and setting up our business for the future. I'm skipping first through our growth strategy. We have been focusing and we must make sure we focus on delivering against our infant nutrition strategy and strategic path. That delivery is on track, 21% growth and the underlying sales there. We're awaiting brand registrations for China brands and the lactoferrin capacity doubled over the last period. That's provided some good contribution to our overall performance.

In terms of everyday dairy, that strategy has progressed. We've stood up the new facility at Dunsandel. We've taken on the assets of Talbot Forest and we're looking at new opportunities in that space. Then we move over to food service where we're really starting to develop that strategy. We've talked UHT creams being an opportunity that we can look at and optimises milk solids in terms of the value stream we get from surplus fat for the infant volume that we have.

We've greyed out the next big thing in sports nutrition and strategic paths, they aren't a focus for us at the moment. As I say, we do need to make sure we're managing and prioritising our activities as we go forward.

So skipping through some more detail on infant nutrition on page seven: Total infant formula volumes of 42,907 metric tonnes. That's up 21% on FY18 and right in the middle of our guidance range at 41 to 45. Obviously underpinned by strong partnerships with A2 milk and that's continued to grow for us. Our other brands are taking longer than expected to achieve registration. Our Acara and Pure Canterbury brands both have approved registration, but they are subject to a site audit, so that's some good news but it's hard to be unequivocal around the time for those site audits and we'll continue to work through e-Acara.

We're also looking forward to Pokeno coming online, another 45,000 tonnes there. The GACC facility registration for Auckland, we're expecting that in the near future and obviously we've got the capability to look at ready to feed infant nutrition products out of the liquid facility.

Moving to everyday dairy now, we did have some initial commissioning challenges around the everyday dairy facility. Overall gross margin contribution of $3.5 million loss through the period that we stood that up. We are working to stabilise performance and bring it back in line with expectations. The main thing is that we did meet the requirements of our customer and our customers really happy with what we've been able to deliver and to store. We're working through those learnings and they are one off losses which we will stabilise over time.

We're also looking at new opportunities and we do expect first sales off our long-life line to come into the second half of FY20 and as I mentioned we took on the assets of Talbot Forest Cheese and we estimate production there in FY20 at 5,000 metric tonnes.

So moving now to slide nine: Just some top line comments on what we're doing around our enabling strategy, net positive for the planet around environment, building a healthy Synlait around culture capability, processes and systems, and establishing a strong world-class value chain. I'll go into the details straight away. Net positive for the planet strategy on page 10: we're working through leading agriculture's response for climate change in New Zealand around dairying. We've got a strong baseline greenhouse gas inventory which gives us a starting point.

We've got some clear plans on the initiatives we can do to start to make a meaningful impact there, and as part of that we switched on New Zealand's first large scale electrode boiler in March to provide the process heat for our liquid facility. We're also looking at what we can do around minimising water usage and water degradation, obviously very topical aspects for the New Zealand industry and leading the way for animal welfare and the circular economy in New Zealand.

The activity around building a healthier Synlait: A strong focus on health and safety. We've got some improvement there, but we're not where we want to be, a 28% improvement and reduction in injury rate, but we need to continue to focus on that. Important that we continue to build our culture and capability. We do that through engagement, some strong focus on diversity and inclusion and we've got some reasonable improvement and metrics around that space.

And excited that in the past few months, we've launched a really strong programme to live our purpose called Whakapuawai, which is around a commitment to trees, to landscaping our Dunsandel site and working with milk suppliers on farms that would benefit from restoration and riparium planting and doing that for community areas as well. So obviously a really meaningful and topical interest area, given the announcements on water recently and we see a strong opportunity to partner with our farmers and community groups to support that. And then behind that we're also working on setting ourselves up for strong growth enabling systems and have a ERP project underway to make sure that we set ourselves up for future there.

And finally on the strategic side, the world-class value chain aspect. We are upgrading the declared capacity for some of our facilities today and that's been as a result of some of the great work the team has been doing on manufacturing efficiencies. So these are quite material increases in upgrading our capacity around the declared capacity. We're moving all of our driers at Dunsandel from 40,000 metric tonnes to 45,000 tonnes. We're moving the canning line capacity from 35 to 40, 12.5% and 14% upgrades to capacity, AMF also up 25% and that's a function of the fact that we were able to process 8.7% more this year. These are material improvements and the ability for us to get return from the assets that we have on the ground. We're also announcing a new dry store today, which I'll come back to. A strong focus around safe food and market access. We've got FSSC 22000 accreditation for Dunsandel, which is something our customers value. We're opening a new China office today. As I mentioned, we're working through the GACC registration for Auckland and we, we await the registrations for Acara and Pure Canterbury. A stream of work around transparency: B Corp is ESG work and CDP declarations that are in play there, and continuing to work with our farmers on healthier farming practises to ensure that they and we are best positioned for some of the changes impacting our industry around that space.

So the announcement on page 13 is for dry store four: it's a new 30,000 square metre facility and warehouse set down sandal and allows us to bring all of our offsite storage onsite. It reduces a significant amount of double handling and intra-warehouse movements. It allows us to get greater control over our inventories and improve customer service traceability and value add services. This is not a growth capex, but it's a strong efficiency based investment that drives a very good return for us. So $32 million going in there and there's a picture of the groundworks that are underway. Look, I do want to front the Pokeno issue as well, so talking to slide 14. Look, following on from the announcement at the end of August, we just did want to confirm that the oral hearing has been set for for the 21st of October. That's an oral hearing for the Supreme Court to decide if they will hear the case. We are on track in terms of commissioning this facility to take our first milk this month, so just a number of weeks away we will be able to get that running. We're very excited about The nature of the facility, it's a world class place with an engaged and capable team and it's backed by some of Waikato's best farmers that we were able to recruit as part of the process. So we look forward to updating the market on this milestone.

In terms of our discussions with with all parties, we've been saying we've been working with all parties. We have made what we believe as a reasonable offer to the counterparty and we're continuing to have conversations with all involved to make sure that we get an outcome that works for everybody. But we're confident that we won't prevent NZ IPL from achieving their own plans for the land, even if it does include a quarry. And we will remain really willing to work with them on this. But look, I do want to acknowledge this has created some uncertainty, but at the same time, that uncertainty and the public aspect of this, we're not going to be forced into an outcome that doesn't serve the needs of our shareholders best interests here. So we've all placed the time if that's what's required to do.

We think we're being reasonable around the legal position that we've reached and the offer that we've made. We're very comfortable with our legal position and did want to remind the market that the contractual obligation to procure the removal of the covenants was with the vendor. So when we say we're talking to all parties, it includes both the NZ IPL and the vendor of the land. We're working hard towards one of two outcomes here, either a reasonable settlement or we'll run this through the courts. We're really comfortable that our legal exposure here is not substantial. And we're determined, and our auditor's agreed with us, that that no provision is required under accounting standards in our financial statements. So that's an update on Pokeno. We'll continue to provide updates as they emerge and anything relevant.

So that's my strategic update. I'll hand over to Nigel now, he'll pick up around our financial results.

**Nigel Greenwood:** Good morning everyone. Page 16 of the slide deck, which is just the results at a glance. The overview as Leon already noted earlier in the presentation, we did have a good strong lift and our net profit after tax to 82.2 million over 74.6 million last year, and that really reflects the momentum that we had in the second half of FY19 that we did signal at the time of our interim results announcement.

We had strong consumer packaged infant formula sales at 21% to almost 43, 000 and we note that we did almost 25,000 metric tonnes of infant formula sales in the second half. Powders and creams sales increased 15% to almost 107,000 metric tonnes. And we also increased our lactoferrin volumes of sales to 21 metric tonnes from 16 last year. And in a very favourable pricing environment, which you will no doubt have seen from the gross margin slides that were included in the pack. I'll come to that a little later.

Really important to note that our manufacturing efficiencies enabled us to process 8.7% more milk on effectively the same driers and kit that we had last year and that really is a significant improvement and it's what's driven the ability for us to increase our production year on year with effectively the same underlying infrastructure. Our gross margin per tonne did contract a little bit, I won't go through that in detail now. I've got a slide coming up on that and I'll tell you exactly how that came about.

Sales volume and inventory on page 17: We exceeded $1 billion in revenue for the first time. That's a real milestone for the business. I do recall when I joined the company, way back in 2010 I think we were just around 200 million, in the last nine years we've grown the business to $1 billion in revenue. So we're very proud as an organisation to have achieved that on the back of 43,000 tonnes of infant formula, which was right in the middle of our guidance that we provided at the outset of the year.

Total powder sales increased to 150,000 metric tonnes and that has been enabled by manufacturing efficiencies. Overall, our product mix year on year is roughly the same as last year. So that really hasn't changed that much. We did reduce our finished goods inventory, however, by 12.7% to just over 23,000 tonnes. And that's on the back of some really successful supply chain processes as well as dealing with some impaired stock efficiently and quickly as we worked through the season.

Lactoferrin sales I've already talked to, and by the way those sales volumes don't include the sales that we make internally for our own internal use. Production volume already, coming back to the production manufacturing efficiencies again, did increase enabled us to increase our production volume about 5% to 146,000 times over 139,000 tonnes last year. Consumer packaged infant formula production increased as a share of total production to 30% over 26% last year. Overall we processed 8.7% more milk, 66.1 million kgMS from 60.8 last year and that included milk process and our advance liquid dairy packaging facility. And overall, we almost doubled our lactoferrin production from 12 metric tonnes last year to 23 metric tonnes in FY 19.

Slide 19, gross profits performance: as noted earlier, our gross profit per metric tonne was slightly lower in FY19 over FY18 and the key drivers for that is, firstly as we signalled throughout the year, the margin that we make on our consumer packaged infant formula sales are lower margins than we experienced on FY18 and that's on the back of the renegotiation of our supply agreement with the A2 milk company back in June and July last year. Changes to our customer mix also affected that. In FY18 we had sales to our China brand customers which are at materially higher margins than we experienced with A2 milk company and that also helped lift our margin per tonne last year that we didn't get in FY19. We've also increased our investments in people in front of assets coming online. So it does increase our manufacturing overheads as we bring those people on board for the new facilities that we're building. Whilst our profit has declined, our gross profit per metric tonne has declined, overall gross profit has increased due to the uplift in sales. That gross profit contribution from fresh milk of a loss of $3.5 million is also reflecting some initial commissioning challenges that we've had on that area.

Looking forward to FY20, the market should expect that our gross profit per metric tonne will reduce a little. And the reason for that is as we bring on Pokeno, we will be increasing initially the volume of our ingredient sales so our product mix will change and we will see more ingredients sales next year, which will bring out our gross profit per metric tonne down on FY19.

Overheads: We continue to invest significantly in people with 218 new staff joining Synlait in 2019 in advance of our new production facilities coming online. So our overheads increased by almost $8 million or 14.6% on FY18 and the largest driver of that is our employee costs. We continue to invest for the future. So the majority of the back office people that have come into the business are in the areas of research and development, business development and leadership capabilities. It's really important that we invest in these areas in order to enable the strategies that we've outlined to you early in the meeting.

Operating cash flow: This is a real call out for us and I think that you can see that whilst our EBITDA for the year was at $98.4 million was a very good return, what we've actually been able to do is through

Capital efficiencies, improve our operating cash flow to $136.7 million for the year.

You can see on the bar, on the bridge on that page, that working capital improvements enabled us to release $37 million in cash flow year on year, and that's mainly a combination of management efficiencies as well as the continued benefits from our receivables assignment programme. This year we introduced Nestle into that programme, so that by the 31st of July we had $109 million of receivables assigned versus $69 million at the end of FY18.

And net debt obviously has increased as a consequence of the large investments that we've made year on year to $333.6 million, and that's up from $114.9 million last year. So that is on the back of a major growth project that we've talked about throughout, or Leon referred to earlier in the presentation. And that also includes an $18 million loan that we secured to Talbot Forest Cheese that we settled on. We acquired that business on the first of August with a total purchase price of $37.8 million.

Important to note that at the end of the year, our leverage ratio was still strong at 2.2X, and so our balance sheet is still in a very strong position to enable the future growth, opportunities that we've been referring to. Lastly, the milk price update. Mentioned already, an average milk price is $6.58 per kilograms of milk solid. That's made up of a combination of our base milk price of $6.40 as well as additional $0.18 conceived as payments. This is a very strong milk price that we're paying to our families, and it's reflective of the relationship that we have with them. It's reflective of the new families that we brought on board when the wetlands of Waikato, and it's important that we continue to pay strong milk prices to our families. At times we'll be a little bit above the market; at times we'll be a little bit below. We'll see how that plays out in FY19.

We've also increased the level of transparency about how we determined that milk price, and we've included a table in our annual report that will help you better understand the whole process by which we use to identify the milk price that we pay to our families.

With that, I'll pass back to Leon to provide closing remarks and outlook for FY20.

**Leon Clement:** Thanks, Nigel.

So, just on page 25 of the presentation, we are increasingly diversifying our business in a way that we create value. We have made a decision to change the way we provide guidance away from infant and nutrition volumes. We expect FY20 profits to continue to grow. The rate of profitability growth will be similar to the year that we've just come through, '19 over '18. And we'll be able to deliver that at at least a similar rate.

We're expecting these earnings to be supported by strong momentum that we've gained in the second half of FY19 where we sold around 25 thousand metric tonnes of [inaudible]. We'll have a full year of operation of the advance theory facility, as I think we've all verbalised that. We'll continue to progress with our dairy strategy. We'll have a full operation of the elective serum and capacity coming off that, and we will have a contribution from Pokeno which will be commissioned later this month.

So that's the guidance slide, just coming to the last slide on final word before we open up the call for questions. Overall, three things stand out for me this year. We delivered a strong financial result. We set some good marks in terms of top line growth, but continue to support our customers to grow as well as demonstrated strong operating efficiencies in our network and getting more value for the assets that we have on the ground.

We've invested in the future. There's four new facilities that are either being built, commissioned or acquired, and we've brought on 218 capable people to help us run those facilities.

And, we've clarified our direction to make sure everyone's clear on what we're doing with the new ambition and strategy that has been launched.

So that concludes the presentation that Nigel and I have been through. We're spot on half an hour, which was the plan, so that's good. We'll now open up the call for questions.

**Operator:** Thank you.

If you wish to ask a question, please press \* 1 on your telephone and wait for your name to be announced.

If you wish to cancel your request, please press \* 2.

And if you are on a speaker phone, please pick up the handset before asking your question.

Your first question today comes from Arie Dekker with Jarden. Please go ahead.

**Arie Dekker:** Morning, gentlemen.

First question just around the FY20 outlook and get you to clarify a few things. The continuation of strong momentum in second half on finished infant formula at 25 thousand tonnes that compares to 17 to 19 thousand in the three preceding halves, so are you saying that we're talking about growth momentum into FY20 off that second half face will be at the same level you achieved in that second half, in terms of like 25% plus volume growth? Or do you mean something different in terms of, you've got a new base which is strong, and you expect momentum still from here on that base?

**Leon Clement:** Yeah, morning Arie.

Yeah, that's a good question. No we're not saying the rate will continue to grow on the '18 to '19 levels, in terms of the previous halves. We're saying that the strong momentum as a baseline performance for a half of 25,000 tonnes would be a reasonable basis for us to continue to grow from. If you double back, that might be a reasonable bottom line, bottom base for a forecast year but obviously we expect it to grow from there as well.

**Arie Dekker:** Yeah, that's helpful. Thank you. In terms of at least a similar rate of profit growth, I mean there's a lot of things happening in FY20 in terms of the plant coming on and obviously that creates a little bit of a drag in terms of interest and depreciation, what clarity can you, I mean profit growth was 10% in '19 over '18. What can you say there?

**Leon Clement:** We'll at least be able to deliver a similar rate as we've delivered over '18 to '19, so you're right that was 10%. We believe our guidance for FY20 is another 10% on what we've delivered this year of $82.2, and we could be up from there. But as you say, we've got a lot on during the year, and we do have some of those costs coming through; we've also got some strong [inaudible] as well.

**Arie Dekker:** Sure, just Acara and a pure Canterbury. I may not be exactly up to speed with what you said there. The site audit that those brands are now conditional on or subject to, where is that site audit to occur.

**Leon Clement:** The site audit will occur in Dunsandel.

**Arie Dekker:** Okay, yeah, so there's an audit for those brands required at Dunsandel. That's great.

**Leon Clement:** Correct.

**Arie Dekker:** Okay, thank you.

Just in terms of the amount of milk that you processed through the liquid milk plant in FY19, was that 3 million kgs of milk solids?

**Nigel Greenwood:** It was around a million litres, Arie, so it's roughly correct, yes.

**Arie Dekker:** So, obviously that accounts if that is roughly correct at 3 million kgs, that then accounts for half of your growth in milk solids. So how do I think about the efficiencies then? Are the efficiencies 4-5%? And more importantly to factor in for next year against those new capacity numbers that you gave on AMF and ingredients, the dryers, how much of that increased capacity did you utilise in those efficiency gains in FY19?

**Nigel Greenwood:** What we're really saying is that the efficiency gains in the dryers, the capacity growth we've been able to achieve in those dryers is material, it is significant. It means that we can continue to process the volume of milk that we are receiving from our families at the same time as we're manufacturing more infant formula base powder. As you are aware, normally when you manufacture more base powder, you displace milk because you can't process all the milk that you're receiving. What we're indicating is that we're comfortable that we will be able to continue to process the volume of milk that we're getting from our family supplier base without displacing milk.

**Arie Dekker:** Okay, I understand that.

On the commissioning status, you know milk going through the plant and that, can you comment on where that's at? How much of that is coming through? Or when it's going to start coming through? And also, what your commissioning contingency is with regards to any issues you might experience, where that milk would go, if you do have some issues around commissioning?

**Leon Clement:** Well we're a long way down the process, so we're not expecting significant issues in terms of closing it out. We're working through getting the plant ready to process fresh milk. We're on track to commission this month. It's the 12th of September today, so we'll do that sometime in September, which means we are pretty close. We've been working through contingency plans if we have issues. We've got good relationships with other processors in the region and can continue to balance up milk in those aspects. That's the status of that, and we remain on track to complete the facility and commission this month.

**Arie Dekker:** Great, and just two quick final questions for you Nigel.

Just operating costs, some guidance on what we might expect that to be in FY20. And also, where you see net debt, at this point, finishing in FY20?

**Nigel Greenwood:** On slide 20, I think you're talking about overhead?

**Arie Dekker:** Yep, overhead, yes.

**Nigel Greenwood:** On slide 20 of the presentation, we point to the fact that we expect a greater uplift to our overhead over FY19, around 20%. And a lot of that is the four-year impact of the hires that we've made during the course of FY19.

**Arie Dekker:** Thank you, and just net debt?

**Nigel Greenwood:** Net debt we're not providing guidance at this stage on our net debt position. By the end of the year, suffice to say that we're comfortable that we'll be able to manage our debt position with the capital expenditures that we've announced. For FY20, you can see, with the increased operating cash flow, our net debt position should be significantly better than it is at the end of FY19.

**Arie Dekker:** Thanks, guys.

**Leon Clement:** Thanks, Arie.

**Operator:** Thank you.

Your next question comes from Aaron Yeoh with Goldman Sachs. Please go ahead.

**Aaron Yeoh:** Morning Nigel and Leon. Couple questions for me this morning.

Firstly, Nigel probably more for you, with regards to the gross margin achieved for this year, the powders and cream gross margin 9.69% was pretty similar to what you guys achieved in the first half I guess. I'm just wondering, given the efficiencies you probably would've achieved through the improvements you made to your canning line, I'm just trying to understand why we didn't see more of an improvement there?

Were there further impacts because of the A2 contract?

**Nigel Greenwood:** First off, the efficiencies in respect of the blending and canning, that come through in the consumer package gross margin per tonne as you can there, which has improved year on year. With the powders and cream, that's just practically the production of our powders and cream on our dryer AMF Facilities, so that has softened a little year on year, and clearly that is impacted by the lower margin that we generate from the contract with the A2 milk company. That is primary cause for that margin reducing year on year.

**Aaron Yeoh:** On the comments around bringing people on ahead of assets coming on line. Which assets are you referring to specifically? Is it the liquid milk facility? Or does it also include Pokeno?

**Leon Clement:** All of those and the Talbot Forest assets as well. All of these facilities require people to run them. Typically, as part of commissioning, we recruit a team ahead of that time so they get familiar with the facility and they start to learn and get training on equipment. We do need to invest ahead of the curve in terms of standing up the costs to run those facilities before we get a return on them.

**Aaron Yeoh:** Right, okay. In terms of like which contributed more to that, was Pokeno a big contributor?

**Leon Clement:** The team at Pokeno is about 70 staff. I think there's around 30 or 40 at Talbot Forest and-

**Nigel Greenwood:** About 50 I think in the liquid milk, somewhere around there.

**Leon Clement:** So a large portion of the 2019 new roles we brought on half the staff of the facilities that we have.

**Aaron Yeoh:** And with regards to your commentary around second half '20 volumes for Pokeno just around the infant formula base volumes being more weighted to that second half, can you comment on any customer contracts relating to the new site? What gives you comfort around the second half?

**Leon Clement:** So we're talking about the liquid facility there, but you mentioned Pokeno. I think when we're talking about sales for the second half, we're talking about the liquid facility at Dunsandel. So we've started servicing Foodstuffs at South Island that's the private label contract that we have on fresh milk. We also have capability for a USD long life line in there. We always plan to commission that line second. We wanted to establish the rhythm with our anchor tenant, if I can use that word for Foodstuffs South Island. We're now moving to commissioning that line. That requires extended shelf life, and we are on track to have our first customer sales in the second half of this year.

If we could or were able to announce this specific customer, we would. But we're working through a mix of opportunities there that will allow us to get that facility up and running and driving strong in terms for us.

**Aaron Yeoh:** All right, I was actually referring to Pokeno because just on slide 19 of your presentation deck, it says here, "Expect gross margins of metric tonnes to reduce in FY20 with ingredient product comprising a higher share of overall production as Pokeno will be weighted to ingredients before producing infant based powder towards the end of financial year."

**Nigel Greenwood:** What I can say there is what we've previously guided the marker on. When we commission the dryer at Pokeno, the intent in the first half will be predominantly ingredient products only. As we said earlier, when you commission a brand new piece, you tend to focus on manufacturing ingredient products and we indicated also that we expect and anticipate that we'll be manufacturing IFB, infant formula bolt powders on that plant in the second half of FY20.

**Aaron Yeoh:** Okay, thank you.

**Nigel Greenwood:** You're welcome.

**Operator:** Thank you.

Your next questions comes from Adrian Albon with Craigs. Please go ahead.

**Adrian Albon:** Good morning, guys.

Just a follow up question on slide 19 around the gross margin, are you able to quantify for us how much that investment in people?

**Nigel Greenwood:** Are we able to quantify that?

**Adrian Albon:** Yeah.

**Nigel Greenwood:** I mean not really. We wouldn't be disclosing that level of detail, Adrian, but I think it's just a matter of when you commission a plant, a lot of these people come on in a vast of commissioning. Some of that cost can be capitalised as part of the commissioning of the plant. Some of it can't. And so, the consequence of that is that the stuff that you can't commission, it does go straight into manufacturing overhead. It's sort of a headwind in the year that we just finished. But we're not pointing to exactly what that number is.

**Adrian Albon:** Okay.

On the consumer packaged, is the right way to think about this margin, which is you call it 800 volume to metric tonne, is it all right to think about that there isn't actually any operating leverage on that? If you look at your second half, you've got 43% more volume than the first half. The actual consumer packaged margin has hardly moved.

**Nigel Greenwood:** Well, it is what it is. The reality is the costs, we still haven't got full efficiencies out of our RPD, our Auckland blending and canning plant. It is not operating at full capacity as you're aware. We did bring on extra shifts there, so sometimes you're burying a cost of bringing on an extra shift. It's like a step change, you bring on the cost of an extra shift but you don't necessarily fully utilise that shift but you need them because you've moved from a certain volume that you can do with one shift, but then need another shift to do the incremental volume. Really, you won't see a material uplift in the margin per tonne out of our consumer packaged until we've got that particular facility operating at full capacity. At that point, you should expect to see a step up.

**Adrian Albon:** Okay, so the way to think about the second half performance is effectively Dunsandel redlining being offset by Auckland's remaining slack.

**Nigel Greenwood:** There has been incremental volumes coming out of Auckland, but we've had to put on extra shifts in order to enable that, but you don't get the full efficiency of that extra shift. As you can imagine, you bring on the incremental costs, but you don't fully utilise it. But you need it anyway, otherwise, you can't produce the full volume of product. The Auckland operation is still providing a little bit of a drag on our overall margin per tonne.

**Adrian Albon:** Okay.

**Leon Clement:** I think you're thinking about it the right way, Adrian.

**Adrian Albon:** Okay.

On FY20, with the warehouse investment announced today, should we be thinking about cap ex for the business at about $80 million?

**Nigel Greenwood:** No, that would be too low. Just to give you a bit of an insight in terms of cap ex, obviously you've got the remaining capital expenditure associated with the Pokeno site - that's going to be around 50. You've got a little bit of cap ex still on liquid milk plant of about 15-20 million there. You've obviously got the dry store, about another 30. What else we've got?

Operational cap ex probably around 25 I'd say. You should be thinking about overall cap ex for the year that is underway or is about to get underway, I would report roughly around 130 to 150, something in that order, Adrian.

**Adrian Albon:** Okay, thank you for clarifying that.

**Operator:** Thank you.

Your next question comes from Nick Marr from Macquarie. Please go ahead.

**Nick Marr:** Morning guys.

Just a couple of easy ones. What were the IFB volumes for FY19?

**Leon Clement:** The IB?

**Nick Marr:** IFB.

**Leon Clement:** IFB

**Nigel Greenwood:** Yeah, just under 6,000. When you get a chance to read the annual report, if you look at the CFO section, commentary in the annual report, all of that kind of detail is set out in there.

**Nick Marr:** On elective serum plants, the capacity has gone from 17 to 20, is that reflecting internal use or is that just how you're running it?

**Leon Clement:** Uh, the 17 to 20 was sales as opposed to capacity, no?

**Nick Marr:** No, no I'm talking about the capacity slides in the back. It's gone to 17 tonnes from 20, the plant?

**Nigel Greenwood:** No, the capacity of the plant is 17 tonnes, you're talking on slide 30?

**Nick Marr:** Yeah. I was just saying that the first half '19 result, you had 20 in that number. What's changed?

**Nigel Greenwood:** Ah, I think if we had 20 before, the reality is that high-grade elective serum we're manufacturing on that plant, basically what we're experiencing is that the volume we can actually manufacture of that high-grade elective serum that is required and that gives it the ability to be sold to the infant formula industry does restrict the capacity of that plant a little. So we're just riding that back to what we consider to be a more realistic number.

**Nick Marr:** Sure, and thoughts on where margins, obviously FY19 was a good year and you've got some of those longer term contracts kicking in, is it going to be flat, down, or what's the outlook?

**Nigel Greenwood:** You mean with elective serum?

**Nick Marr:** Yeah.

**Nigel Greenwood:** Well it really comes down to the pricing in the international market. As you know, the pricing for elective serum over the last 12 months has escalated materially. And the question that we're all asking is if that's sustainable in FY20 financial year.

We know that there are some other lactoferrin plants coming online during it Y 20 internationally. So the best answer I can give, because, we don't have a crystal ball on this, as we expect lactoferrin pricing to soften during the course of FY20 down. And we've seen a bit of evidence for that already. So, that's probably where we're going. But it is hard to guess.

**Nick Marr:** Well thanks. And then just in terms of the outlook commentary, can you give us any colour on what you expect the roik on both the liquid plant and Pokeno to be in the FY20 year?

**Nigel Greenwood:** What we expect as-

**Nick Marr:** The roik.

**Nigel Greenwood:** Oh, the roik. Ah, no, we're not providing that information at the stage.

**Nick Marr:** Any kind of colour on, on the expected returns? I guess, if you kind of sit there and say you're expecting at least 10% profit growth, then you're going from a three and half million dollar gross margin loss, to some kind of profitability and liquid, plus some contribution Pokeno. Plus, your infant volumes could be up somewhere around the 15%. There's obviously something else going backwards in the business of ten percent's number.

**Nigel Greenwood:** I think the best way to think about it Harry is, when we do the business case, it's as we talked to a sort of, I already knew about these before we look at them and over the long term. So if you take the liquid milk plant, we historically said that the real returns we're going to get on that plant is when we start commissioning products of the long life milk line.

So, effectively we don't look at a returns on an individual asset on an annual basis quite in the way that you're talking. Same with Pokeno, and year one we'll be manufacturing predominantly ingredient product. So it's not until we start to lift the product mix here to IFB, that the returns will come at the dictations. I think from memory we said that a liquid milk plant had an internal rate of return of just over 20%, based on our model. And a Pokeno I think was about 22%. So, that's to know the time return as opposed to an individual annual return.

**Nick Marr:** Cool. And then just on the, the kind of increased capacity at the blini and canning facilities, what are your assumptions around the types of products, or how many difference you's are going through there. Because, obviously if you're just running one brand, like a two and long runs of safe stage three, it's obviously going to more efficient with less changeovers.

**Nigel Greenwood:** Yeah, look, I think compared to the outlook, they probably do reflect our view on customer mix going forward. Although the variation and the product isn't that significant. Often with infant nutrition, you're working off a very strong similar regulated base recipe. The bigger driver of those improvements in capacity or rated capacity, is just the improvement and stops and, and time based losses through those factories. So we feel confident, we can lift those in terms of the name pack rates that we're achieving in terms of production. But, the assumption is that, you know, we would expect we would still be able to hit those capacities with some shifts and customer maximum and a broader range of [inaudible].

**Nick Marr:** Okay, great. Thanks a lot.

**Nigel Greenwood:** Thanks for that.

**Operator:** Thank you. Your next question comes from Marcus Curly with UBS. Please go ahead.

**Marcus Curly:** Morning guys. Just a few. I just wanted to speak a bit more colour on the Pokeno legal case. Just in particular, can you confirm, I suppose at the investor day, you suggested that the, that you don't see any circumstances under which they close.

**Nigel Greenwood:** Yeah, we're confident we'll be able to commission the facility and we feel confident that based on the legal advice we've received, that it'll be allowed to run. And, I've provided some colour at the investor day, around some of the circumstances around how a court might look at that, and that remains the case.

**Marcus Curly:** Right. Secondly, could you just give us a little bit of colour in terms of whether there was any significant volumes from Pure Canterbury or Acara in the second half infant formula number?

**Nigel Greenwood:** No, no, there isn't. I mean, it's one of those things that we point out is, you know, it's just, we can't be certain when we going to get those SAMR approvals in place. So no, we've not included significant volumes in our FY20 assumptions.

**Leon Clement:** You were also asking about, I'm sticking out of this year and I think that's fair to assume that there were no significant volumes in there. Is that what I heard?

**Marcus Curly:** Yes. Well yeah. I suppose the implication was if you doubled second half as a baseline. Yeah, that's, yeah, that doesn't really include the material volumes are up.

**Nigel Greenwood:** Oh no. Yeah, No, no. Sorry Mark, was my misunderstanding. No. That's correct, because we can't actually manufacture and sell that product until we have the appropriate brand approvals in place.

**Marcus Curly:** Sure. I understand. And thirdly, just Nigel, in terms of basic ingredients, gross margins, I know you don't call it out as a number, but you know directionally, flat up or down in the year.

**Nigel Greenwood:** You made ingredient margin per tonnes?.

**Marcus Curly:** Yeah. So the basic ingredients. So not, bulking for the formula, but, the other components of powders and cream.

**Nigel Greenwood:** Ah, well of course that's a very interesting question. I guess that's why we, as you know Marcus, we tend not to disclose our margins to a tonne on the various individual product groups, like IFC, and ingredients, because we consider that to be commercially sensitive. So, it's embedded within that powders and cream number. But no we don't, and we're not specifically disclosing what the ingredient margin per tonne amount of that would be.

**Nigel Greenwood:** Let me put it to another way. You might assume that there's been an improvement there based on the fact that we've increased the volume that we have produced on the same level of tech. So almost by definition, it would be expected that a margin per tonne on our ingredient products would have improved year on year.

**Marcus Curly:** Okay. Understand. And then just on everyday dairy, obviously you talked about one off costs in the second half. Obviously you're bringing on a Temperate Forest as well. Could you give us any sort of perspective on a gross profit contribution from everyday as a, as a division and in FY20? Is a positive gross profit likely, or would be a zero number more of a baseline?

**Nigel Greenwood:** Yeah, again Marcus, we won't provide specific guidance but, I can give you a view that yes, we would absolutely expect to have a positive gross profit in FY20 on our liquid milk facility.

**Leon Clement:** Yeah. And our Talbot Forest facility.

**Nigel Greenwood:** Oh, and Talbot Forest.

**Leon Clement:** For everyday dairy we would expect a positive contribution.

**Marcus Curly:** Okay. Thank you.

**Leon Clement:** Great. Thank you.

**Operator:** Thank you. Your next question comes from Jonathan Snape with Bell Potter. Please go ahead.

**Jonathan Snape:** Yes, thank you. Just a couple housekeeping F1I team ones. First of all, in terms of liquids, are you able to quantify exactly what the commissioning costs, or one off costs, that you think you took against that three and a half million lost worth?

**Leon Clement:** Yeah, look, it's a mix of things. We had some challenges commissioning the overall... obviously, new capability to us and, and some of the components, plugging those together, meant that we didn't go live with the facility that was stable, and that meant that we had both time losses and material losses. So, the 3.5 million dollars is made up of the extra costs required to get it up and running. It's man hours, and the fact that we ran to a range of stops, but it also reflects wast and yield through the factory as well. So all of those things, even in recent months have been far more stable. The team, as you do stemming up a new facility that they're working through just improvement programmes every day and reducing stops, reducing waste, and improving yields.

**Jonathan Snape:** Are you able to quantify it though? Is it like four millions, 5 million? Something like that or less?

**Leon Clement:** Well, we're quantifying the losses, all the gross margin losses. Last year was 3.5 million. Now we're not spreading it out and-

**Jonathan Snape:** Okay. Okay and look just on Auckland. I think you made a comment earlier that it hadn't got GACC approval, but I think in the presentation it says it has. Which one is it?

**Leon Clement:** There may be some confusion there. We have, GACC approval for dairy, but not for infant nutrition in Auckland. We're awaiting infant nutrition registration.

**Jonathan Snape:** Okay. Look, just coming back to the FY20 guidance, and I don't want to put words in your mouth, but I'm trying to kind of figure out how all the various bits move to the at least 10%. And taking some of your comments earlier. I think in reply to Ari, is it fair to say that the 10% assumes effective, where you flat line your second half volumes, so you're talking somewhere around 50,000 tonnes of incident. You get the non-recurrence of these costs of liquids, positive contribution from cheese. It says your positive contribution from Pokeno, as well lactoferrin, but then you're not going to be capitalising anymore interest anymore, and you get to where the DNA. Is that fair to say that's where the baseline is, or are there other bits in there as well?

**Leon Clement:** There's a range of factors. I think of what you went through, you're correct. You could expect the baseline from infant nutrition volumes. If there was a range, it might be north of 50,000. I think we're saying that's a reasonable starting point for a low end range. And, we acknowledged that we are changing the way that we guide and, so this is a a gentle way to win everybody off it.

**Jonathan Snape:** I guess when I'm trying to figure out is, what kind of infant number have you have you put in there? Because, I would have thought consensus, looking at where people are for A2, would be a fair bit higher than 50,000 tonnes. So I'm trying to understand if the 10% is starting with a level of that second half annualised, or if you're looking at consensus, which I think is more like 53, and incorporating that in the baseline view of the 10%. I guess, I'm trying to figure out the Delta either way.

**Leon Clement:** I think that's moving into putting words in our mouth. I mean we, we... Shift in guidance, profit growth will be at a rate similar to 19 over 18. So, our guidance is shifting to the shape of our bottom line P and L, and that reflects the diversification of our business and that value gets created across the board.

**Jonathan Snape:** Okay. All right, thanks.

**Operator:** Thank you. Next question comes from Andrew Peros with Ausbil. Please go ahead.

**Andrew Peros:** Thank you. I'm just wondering if you could please quantify what your expected return is on that Frostline investment. And, I guess the timing of when that return should be expected. Is it from day one of commissioning, or is there some level of ramp up expected in, in generating that return?

**Nigel Greenwood:** Good morning, Andrew. Good question. The nature of this investment is, it's an efficiency based Capex. Whilst I can't be specific around the specific return that we're expecting. What we can say is that it's probably slightly lower than some of the business cases we put forward, for our gross based Catholics, but it is more certain, and the efficiency that comes off it, effectively once you get up and running starts pretty much from day one. So I hope that's helpful.

**Andrew Peros:** Okay. And then in relation to Pokeno. I'm not sure if you've said this in the past, so apologies if you have, but when do you start depreciating that asset?

**Nigel Greenwood:** When do we start to depreciating it? That would be on commissioning, and we've indicated our intent to commission that plant during the course of September. So, yeah, depreciation, [inaudible] and also, so two things happen when you're commissioning. One, depreciation of staff, and secondly, the capitalization of the, of the interest associated with the build stops.

**Andrew Peros:** Yeah, that was going to be my next question. So, I guess maybe just help us out here then. What's, what's the step up in DNA going into 20

**Nigel Greenwood:** Look, we haven't specifically guided and step up and get DNA, but you might, look, it'll be a north of 40 for FY20.

**Andrew Peros:** Okay. I mean some, you know, quantitative guidance around that would be helpful, if you can appreciate that. You're obviously spending a lot of money [crosstalk 00:13:56].

**Nigel Greenwood:** Hopefully what I just said, Andrew, is helpful, in guiding specifically where we don't, we wouldn't normally give you an exact number, but certainly as I said, north, slightly north of 40 would be where we would expect DNA to be in FY20.

**Andrew Peros:** Okay. And then in terms of the capitalised interest in 19, what was that number?

**Nigel Greenwood:** Oh look, off the top of my head. It's actually in my head. Again, you're not, I think it's about seven and a half in 19. The number of, the exact numbers sitting in the annual report, in my CFO report. I just don't have that in front of me right now. We do a complete reconciliation of our interest expense in my report.

**Andrew Peros:** Okay. But, and then in terms of FY20, very little or no capitalised interest?

**Nigel Greenwood:** Very little. There would be a little bit of capitalised interest on, on Pokeno, until we commission. So, that would be basically for the month of August, and part of September. There'll be a little bit of capitalised interest associated with the build of the dry store, and a little bit on the liquid milk plant, because we haven't quite commissioned our [inaudible] has a bit of capitalising on that as well. And that'll be about it. So you could work out. It'll be materially lift than we experienced in FY19.

**Andrew Peros:** Okay. Thank you.

**Nigel Greenwood:** Welcome.

**Operator:** Thank you. Once again, star then one to register a question. Your next question comes from Warren head with MG publications. Please go ahead.

**Warren Head:** Good morning gentlemen. Wonderful to see a good Canterbury company doing so well. Since I'm talking to you from Christchurch. Now, I want to get back past the production side if I may, and look at markets if I could, and the balance between supply and demand.

Now I notice in the annual report, talking about investing for growth. You have an interesting comment in there, where you talk about the business being essentially focused around one sector, one market, and one customer. So, I wonder if you wouldn't mind giving us a little bit more detail about market development, and where you are at in rebalancing that. And phase two of the question of course is, rate of milk collection and farmer acquisition, I imagine Pokeno was rushed by farmers to sign up. But in terms of managing the milk production side, I'm just wondering whether or not there were more farmers cued and how you're balancing that supply side with all the uncertainties, particularly now in Asia, and hold up in the United States on registration. How these two things meld up in your overarching strategic view of where you're headed. Rather than looking at under the bonnet. I'm interested here in where the vehicle is headed.

**Leon Clement:** Yeah. Great. Thanks for the metaphor. To clarify what, there's a lot of the question, but look, I think you're right to point to the fact that there's quite a bit of macroeconomic and geopolitical uncertainty in the world at the moment. And, you're right to point to the fact that we have a high level of concentration risk in the business, and, our business is still focused around the category of infant nutrition, and exposure to the Chinese market. So look, out our plans and our strategy as we presented today, is about being very clear that we do want to drive diversification into the organisation. We've been clear around where want to do that. That does mean diversification as well as focusing outside of categories and channels, but also into market opportunities. But when we're evaluating the growth opportunities that we see in front of us, we prioritise them around not just the economic value that they provide, but the strategic value that they provide against the intent to drive the car in that direction.

And that will give us just a greater diversification, should one significant market, move or otherwise. To your question around milk pull development. We tend to recruit the, not that we feel we need, we do that up front when we're commissioning facilities. And then what we do is, we start commissioning facilities around processing all of the ingredients that come from that milk stream. Typically, with a new facility, that means starting with the commodity or more base level ingredient, which is why Nigel was referring to the fact that the keynote this year will largely be running on ingredients. And, I see as we transition those facilities over to higher value. So the growth we tend to create is not so much in growth of the volume of pool that we take, but in the transition once we've stood up facilities to higher value products within those facilities. So look, we're not expecting future milk pool growth around either our White Keto milk pull, or our Christchurch, or Canterbury based milk pool in the near future. We would only pick that two additional processing facilities once they're announced. So I hope that covers your question. And, and as you point out there's a fair amount of global uncertainty, it's important that we continue to diversify the business.

**Warren Head:** And I guess somewhere in the middle there is an inventory status, and it would be interesting to know, whether or not, that's up, down, this year, or sideways. And, reflecting, capacity, utilisation in Christchurch and in Auckland.

**Nigel Greenwood:** Yeah Nigel here. We indicated that at finish goods inventory actually is down on last year, because we've been able to manage that more efficiently. If you go to the annual accounts and if you also look again in my CFO section, or my CFO report in the annual report, I provide more insight as to the total overall makeup of inventory. Because, our raw materials inventory is actually growing year on year. And that's mainly about the growth, because the raw materials are mainly used, and of course in the manufacturer of infant formula. So, so there has been a growth of raw materials or better yet because inventory has come down year on year.

**Warren Head:** Thanks very much Nigel.

**Nigel Greenwood:** You're welcome.

**Operator:** Thank you. There are no further questions at this time. I'll now hand back to Mr. Ball for any closing remarks.

**Leon Clement:** Ah, right. Well thanks guys for the call. I hope you found that useful. We remain available for a range of other calls that have been set up with you and, and we'll, we'll move into a roadshow with convention a week after next. So look, as I said at the start, it's been a really busy year. This remains an amazingly dynamic and energising place to work. It's relentless at times, but we really like it that way, and look forward to continuing with some my stories and, and in terms of delivery, the investment and the clarification that we've bought, through this year. So thank you.

**Operator**: Thank you. That does conclude our conference for today. Thank you for participating. You may now disconnect.

**[END OF TRANSCRIPT]**