TRANSCRIPTION

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[START OF TRANSCRIPT]

Operator: Thank you for standing by and welcome to the Synlait Half Year 2020 results 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: Good morning, everybody and thank you for joining the Synlait Half Year Results Investor Presentation. I'm joined here this morning by Nigel Greenwood, our CFO and Hannah Lynch. Who looks after corporate affairs and investor relations for us.

We've just loaded up quite a detailed pack, which we think is really important. There's some good context for Synlait given the current, both environment that we're in globally and the direction of travel of our business and the mode that we're in. There's a lot of detail in here. We encourage you to work through it. We won't be able to cover all of the slides today. However, we'll work through some of the more salient points and ensure the key takeaways are understood, open up for questions and then pick up, with many of you, in our subsequent sessions.

On the agenda today, I'm going to work through just what does COVID 19 mean for Synlait. We'll skip through our six months and review, and I'll flip to Nigel, who will pick up our financial performance. I'll come back in for outlook and a little bit of context here.

I'm moving to slide three of the investor presentation. Very, pretty uncertain world at the moment, isn't it? I suspect it's going to get worse and weirder before we return to a new normal. One thing I would say about the early signs of the sector impact is, dairy seems to be holding up pretty well. As evidenced by some of the GDT options that we've seen and some of the wider signals that we're seeing in our sector. At this stage, relative to some of the other sectors around the world, dairy seems to be holding up reasonably well and is resilient to this.

From a Synlait perspective, we have an Incident Assessment Team sitting on this every day, as many companies do. We've been focused on three main issues, two of which are still pretty light for us. The first one is making sure that we have a strong and robust supply chain and that those channels remain open. We're not seeing a significant operational impact to date. We've been monitoring and working closely with the strong relationships that we have with our raw material suppliers. Have on hooks from initial constraints there and things are largely getting better there, and also monitoring carefully the container space availability to ensure that we can hit shipping schedules for the export of our products. Broadly, we feel reasonably comfortable on supply chain at this stage. I don't foresee any immediate impacts, but obviously with the uncertainty out there, we are monitoring this daily as we go forward.

The second area that's really important to us, is making... with our plants, remain operational. We've moved swiftly and quickly there to really adopt the same approach that the New Zealand government has taken, which is to flatten the curve of the spread and many countries around the world are doing the same. It's our responsibility to do the same for our sites. So many of our staff who can, we're practical, had been asked to work from home. We've put in place reasonable travel restrictions for only essential business travel and we continue to make sure that we limit and direction with the key capability that we have to run our sites. We're running some detailed scenario planning for how attendance may impact our ability to do that. So far, we see that we have reasonable resilience. Should that develop and look at this stage, we're really hopeful with that, going to be our plans for operating. A call out to all our staff who we are really leaning on here.

From a product perspective, just to make sure that it's clear, that there's no evidence that food is likely to be a transmission risk of this virus. So European Food Safety and Ministry of Primary Industries here in New Zealand all support that position. It's important that, that's understood, as well.

So look at more through now, straight through to slide five. The key highlights on our half year financials. I think we did signal in our guidance update in February where we would be, so this shouldn't be a significant surprise. Revenue up 19% to $559 million supported by a 22% increase in consumer package sent from formula sales. Our EBITDA guideline is flat and consistent with where we were this time last half. You will see some dilution and our net profit after tax, 30% down versus last half, reflecting the higher depreciation and interest costs as we invest for future growth.

So it's important that it's understood that our EBITDA earning stream is largely stable. You'll see in our outlook, it's also, we're forecasting that to grow this year. The costs of both borrowing and running the depreciation on our new assets is what's pulling our bottom line a little bit back this year. But we do see in the longer term as emerging and pushing through that.

As I said at the start, the current milk price forecast of $7.25, reasonably encouraging to see GDC holding up well in the auction this week. But we will monitor that and see what happens going forward.

And not withstanding that, on slide six now. I'll speak through some of the challenges that we have had and I think it's important that we go through this just to make sure the key messages are understood. I was talked a lot in recent months about Pokeno and the uncertainty around our land and site there with the covenant. Really pleased to see that the Supreme Court will hear that case in April. The key message there, is if we won there, this thing goes away. If we lose in the Supreme Court, we're basically back where we are today, with the dispute with our neighbour on how we resolve that. So we're really comfortable with our legal position and we'll look forward to our Supreme Court hearing.

We recognise we have significant capacity to fill our customer pipeline is really exciting, but we don't have material announcements to make this time around. We are well progressed on material customer opportunities that will diversify both Synlait and fill up our new facilities. And I did want to clarify that despite the fact that this year we've seen our infant base powder sales drop away, and that's largely because of the dynamic in China, we are moving swiftly to rebuild that pipeline as we move into FY21 with multinational brand owners as they reset their supply options.

We did talk a little bit about the dynamic in China, about a deceleration of some of the growth in the market and that SAMR registrations were limiting opportunities for new entrance. The implication for us is that we pivot our focus to supporting The a2 Milk Company, to build a strong leadership position there and start to leverage that capability to partner with established players. We are seeing the China infant nutrition regulatory environment continue to move towards the Synlait model of integrated manufacturing. That's the model that we've invested in. It's the model where we take raw milk all the way through to the finished product in a can. It's the model where we hold the licence and market access requirements for our customers. It's the model where we invest heavily in quality and the regulatory systems to ensure market access is available.

So those changes that we talked around are starting to both shift our strategic direction to move and work with established players, leverage that critical credibility and protect the investment we've made across our value chain.

Talking about the long life commissioning and the long life line within our advanced dairy liquid plant, we've got a strong customer pipeline there. We're excited about the recipes. We're developing at our plants [inaudible 00:07:56]. We are seeing some commissioning delay with the knock on impact of the liquid milk line and do its peak sales, of our UHD, to kick off in the first half next year.

Covid-19, I've spoken to and the short term financial performance. We'll also cover off in a bit more detail as we go through.

Slide seven, I'll also go reasonably quickly through because there is more detail on the subsequent slides, but this is really how it led us up into our strategy. So our purpose of doing milk differently for a healthier world. Our growth paths of Infant Nutrition, Everyday Dairy and Foodservice, are our current and medium term focuses and we're making some good progress on our enabling strategy across people, planet, and enterprise.

Pulling out to slide eight. This one I stress that... I know this is a standard slide but it's important that everybody understands, that we are making investments to continue to strengthen this. A large portion of our capital investment has been to strengthen what we see as our core point of difference when we look across our competitive-cy and what our customers value and what creates competitive advantage for us. Differentiated milk supply, the integration of our manufacturing chain, how we navigate complex regulatory environments, and the quality testing are established and fundamentally key points of difference for us. Our investments and R&D are moved towards sustainable activity within the marketplace, we believe will be future differentiators. We fundamentally believe that customers value or simply can't do without some of these SVIX and that's really important as we go forward, particularly in our infant nutrition strategy.

On slide nine, there is, as we move in to Infant Nutrition. It's quite a bit of cheeks on here, but there's five key points that I want everybody to take away. The first one is that, we may look at infant nutrition, Covid-19 and naturally, we are seeing a small lift coming through from The a2 Milk Company on the first two months of the 2020 calendar year. So that's starting to lift positive demand signals that will come through in the first pass of this half. It's a little early to see how that will quantify out for the full financial year. But initial signals suggest that demand is holding up and growing initially and that'll bring forward some of the orders that we have in our pipeline.

I mentioned before we're moving quickly to rebuild our pipeline of IFB. Just to provide a bit more context here, the sales that dropped out of our expectations this year, we're roughly 50% with established players and 50% with emerging players that we're struggling to get registrations. Both of those existing sales were exposed to China. As we see multinational brand companies start to bring those manufacturing ingredients into their own network, we're also seeing them start to outsource and reset the supply expectations for their non China customers and their non China manufacturing footprint. And those are the opportunities we're hunting down and helping us rebuild our IFB pipeline, which is critical to support the investment in new assets and optimise them as we start to increase utilisation.

The third important point there relates to the section on our customers and The a2 Milk Company partnership, that we continue to value very much in terms of creating value for each other. I want to clarify, there was some perhaps either speculation or questioning when we did the recent guidance update, that perhaps historical margins and now HR relationship where we're looking to dilute or could be diluting as a result of that contract renegotiation. We have, at minimum, five and a half years to run on that exclusive supply agreement and we're really confident that historical margins can be protected, provided Synlait continues to generate manufacturing efficiencies. So, that's an important message. We want everybody to take away that our historical margins aren't under threat as a result of that renegotiation and we feel comfortable that we're creating value and sharing the benefits of scale with our partners.

Also, looking forward, you may have noticed I chose intention to participate in manufacturing and what we're looking forward to those discussions with The a2 Milk Company, as we consider that and their desire to have them potentially participating in manufacturing, as we also recognise Synlait's expertise. So we'll we'll move forward with those discussions and look forward to the recognition of all of the investment we've made across the quality aspects, our integrated manufacturing site and the fact that we hold the registration for a2's market access into China.

We also have strong customer pipeline. We've referred to this a number of times. But we have material opportunities well progressed with established players in the space and those are moving forward at a good pace. So those are the key items on the Infant Nutrition. It's a key slide for us, in terms of looking at that sector. I know you understand the impact on our business and overall there's some good signs there. Albeit with this, favourably in our future growth, we are working in the same rates and supporting that growth with the activity I've just spoken through.

Moving to slide 10, many of you think you joined the update that we had once, the Dairyworks acquisition had gone through. So the key news in the everyday dairy space, is this acquisition. Look, we feel we've got a really good business here with Dairyworks. We bought it at a strong multiple. It's got strong momentum at 7.1x EBITDA, which improved from the 7.5 we announced. There were some questions around how we saw the earnings streams develop. I just wanted to clarify that today, that we see a good stable earning streams based on that multiple of $15 to $20 million EBITDA, as growth momentum consolidates and we realise the synergies that we see with Talbot Forest GS. So we see some strong upside coming into our businesses as associated with that.

Also, I want to just remind those of you that are on the call that we had a transaction date, there of 1st of September, a settlement date of 1st of April. The retained earnings that were created through that period remain for the benefit of Synlait within the lock box and those earnings are total $7 million. So they will transfer to Synlait, as we sit along this transaction, on the 1st of April.

The chart on the middle, just demonstrates that there's material diversification around customer category and market concentration. And the chart on the right, just demonstrates how this delivers an opportunity for us to optimise our milk solids. We have a bias towards protein and fat within the cheese category that we're entering into here or growing. And it also allows us to participate in moving closer to the consumer and moving up the value chain.

Moving to slide 15, some quick updates on our enabling strategy and the work that we're doing on sustainability and for the environment. Some really good progress on nitrogen loss trials, alternative fuels and bio-diesel for logistics partners. We have a metric that we ran with Sustainalytics which feeds into some of our other key tools. I'm really pleased to share that Synlait now ranks third of all packaged food companies, with that risk score improving from 34.9 to 21.3.

Building a healthier Synlait on slide 12, some great progress there with our initiative and commitment to native trees, starting to build some good momentum. We've got our ERP project well progressed, completing the design stage there. Our engagement continues to improve. There's a chart on the top right there that shows some good progress there and that continues to be a strong support for our culture and the organisation that we're building and our people's commitment to our purpose and of course and what we're trying to create. And also safety rates continuing to drop now below 10. We see lots of opportunity for further improvement there and we need to continue to reduce that and ensure that our people go home safely every day.

I'm sorry, they're saying the world-class value chain, good progress against Dry Store 4. The IWS Programme and Manufacturing Excellence is also continuing to make good progress. And there's an example there, of Synlait Auckland reducing their unplanned downtime by 21% versus same period last year as we start to step up and use that facility more.

Safe food and market access, I've talked to this being a key point of difference across our value chain and actually it's testament to the work that the guys do here. In the last half, we've got three GACC registrations. The first one for our Synlait Auckland site for blending and canning infant formula registration. The second one, Synlait Pokeno recently received, get general dairy registration, which covers IFB powders. And also we got get registration for our Advanced Dairy Liquid facilities. So those are well positioned to hit market access into China.

I also hosted the minister of the State Administration for Market Regulation in November at our Pokeno site. It was a great opportunity for us to showcase that site and make sure that key officials within the charter regulatory seeing, understand the role that we're playing, in terms of tiffing, high quality New Zealand ingredients and moving them to provide nutrition for Chinese families. In healthier farming practises, some good progress there on our labour product programme, which continues to be our best in class product farming.

So, I'll finish up this, sort of, intro comments here. I'll now pass to Nigel, who's going to provide a bit of an update on our financial performance. I'll be back to talk through that, later on.

Nigel Greenwood: Good morning everyone. It's nice to join all of you on the call again. So looking at slide 15 results at a glance, so a net profit for the first half, was down 30% on the last year's first half. That's primarily as a result of the hard depreciation and interest costs that we incurred and now associated with the commissioning of both the Pokeno site and liquid milk plant. More good enough news that we had was, as Leon mentioned earlier, was a 22% increase on that and formula milk sales, we're fixing that we are still seeing strong growth in our core business.

We processed 8.5% more milk as a result of taking on milk supply and to support our Pokeno plant. However, we did sell less ingredient products in the first half, mainly due to delivery delays and product mix issues that we'll see high volumes of ingredient sales coming through in the second half which will support our full year guidance.

As we communicated back in February, the key reasons for a lower first half result were the increased interest manufacturing and SG&A costs associated with the Pokeno and Advanced Dairy Liquid processing plants. The lower sale volumes of our ingredient products than anticipated due to sales hike and product mix impacts and also the lower sales of our infant based products, due to the consolidation of the China infant nutrition market.

Moving on to sales, volume, and inventory. Total revenue is up 19% to $560 million. Again, reflecting the growth of our business, but also the higher quality price market. We are and this is this half, last year. We increased our sales of infant formula by 22%. But we are holding more every half year than we did this time last year by 9%. That's partly driven by increased milk that we're getting through Pokeno, but also for sales facing issues that I mentioned earlier that we'll see high volumes of products sold in the second half. And we had made a conscious decision to manufacturer high levels of infant base powder from fresh milk in the first half, in order reduce the amount of reprocessing we'll have to do in the second half as we ramp up our infant formula production. And also pleasing to see, lactoferrin volumes increase in production in the first half as well. As we now have both of our lactoferrin plants operating at capacity.

Production volume, I've already talked through the increased milk processed and the total production being up on last year. Product moves more towards consumer packaged infant formula with 19% last year, up to 24% this year. Again reflecting, converting our milk solids into higher value product production. Lactofferin production up. We now have both plants operating. With the acquisition of Talbot Forest Cheese, on the 1st of August last year, we now have produced 2000 tonne of cheese in the first half with that company. And our Advanced Liquid Dairy Packaging Facility processed 15 and a half million litres of cream for Foodstuffs, in the first half.

Gross profit performance. Well again, notwithstanding the

They've impact performance half on half. We are keeping our gross profit relatively low in ball, with last year at 83 million versus 86 million last year reflecting the shift towards formula, so that's driven by the increased sales of consumer packages performing, but it's offset by the drag that the Pokeno site in particular, is having on our financial performance in the first half. We've also introduced a new measure or new metric, because we are now manufacturing both powders and liquids, it no longer is possible to reflect a gross margin per metric tonne effectively. So we're now measuring the conversion of that kilogrammes of milk solid into higher value products, which is the gross profit per kilogramme solved. So you can see from the chart on the right that we are still maintaining a very strong conversion rate of our kilogrammes that we receive in and converting them into high profit performing products.

Overheads are up 27% to 37 million. That's again driven by increased focus on our growth opportunities but also the consequence of taking on new facilities such as Tolbert Forest Cheese and Pokeno, where they do bring increased overheads. As well as establishing our China office, we incurred some upfront costs and then the establishment of that, that will smooth out over time and of course we continue to see increases in our employee costs in the back office. Having said that, the last little point is very important, and this very challenging environment and uncertain environment in which we are all operating, we are having a very strong focus at looking at our overhead expenditure in the second half, and have a process underway to ensure that we manage that effectively. We only spend what we need to spend and we would expect to see some reasonably material reductions in our forecast overhead spend in the second half of the year as a consequence of the review currently under way.

Operating cash flow is down in the first half of last year. That predominantly is a result of the lower ingredient deliveries that we've experienced and seeing higher inventories being held at the half year. We are a seasonal business, we've always talked about being a seasonal business and we will see stronger operating cash flows come through in the second half through this sell out of our inventory, the increased sales of infant formula and also lactoferrin and so we remain positive about achieving a very strong overall operating cash flow for the full year.

Net net has increased, significantly from the first half last year. And of course that's as a consequence of the investments we made into Pokeno and liquid milk. The investment we made into Tolbert Forest Cheese as well. So its of no surprise. Having said that, we are now in a somewhat better position having done the bond issue in December last year, and we consider ourselves very fortunate when we got that completed and got that done at the right time because that reduces our exposure to our banking partners, and ensures that we've got committed debt facilities for over 180 million for the next five years.

We've still got some major investments to complete over the next half previously signalled to the market, being the payments for the dairy works acquisition of approximately 112 million and also as a purchase of our two dairy farms of 26 million. With all that said, our current forecast gives us confidence that we will remain within our banking covenants through to the end of the year, albeit at slightly higher ratios than previously anticipated, but we remain comfortable that we should achieve that outcome. And that's a completion of mo... of the slides that I'm presenting. And I'll now hand back to Leon.

Leon Clement: Thank you, Nigel. So I'll just move to outlook and some context slides for the dynamic within our business, which I think are also helpful and what's happened subsequent constant conversations with many of you. Look, Nigel mentioned this before and on slide 23, we really just want to flag that we are a seasonal business. We'll encourage you to continue to look at us on a year, on year basis and there are some key factors that have historically driven that that remained true. If anything, the seasonality of half on half or a lower first half and a stronger second half continue to evolve in our business.

The first one is, as you can see on the chart on the right as expectations that we will have a very strong first, second half and our infant nutrition business. You can see from the F1 19' second half that we had a run rate exiting near of 25000 odd tonne. We did feel that that was a good starting point for our four year forecast this year and clearly that was one of the reasons why we came out with this guidance update in February, we've seen in the first half that moderated down to 21500 tonne. We do see a strong second half coming back, which should land us just below 50000 and the consumer package is then performing the sales for the full year.

The other factor that as materially impacting us in the seasonality is as we've stood up our second plant and lactoferrin, we do see sales matching our production volumes and output. We've increased our consumer... our lactoferrin sales to 7.7 metric tonne. We see quite a significant build in the second half, and I would like to flag that we... both volume and prices will be well up on what we achieved last year. We did flag that we saw some moderation in our initial assumptions on pricing. That does not mean that we are seeing a decline in both price and volume versus same period last year for the second half, and lactoferrin continues to contribute really positively to our organisation. And finally, just to flag that the keynote's been running for four months, in the first half, it'll run for six months in the second. So that's another factor that supports both operational output overhead recoveries as we move them to the second half.

So four year outlooks. The slide on page 24 just peels back the onion a little bit on our impact outlook and we're just making sure that it's well understood that our earnings growth is forecast to grow this year at an EBITDA level and the key driver why MCAT is moderating to flat... to a soft declined as of the depreciation and finance and costs associated with us creating new opportunities. So EBITDA grow impact broadly flat to slightly declining, driven by a significant step up in the depreciation and financing costs, and they are coming because we are creating exciting new future opportunities for our business. At the start of this year, we expected that our earnings will grow through that and allow us to grow both EBITDA and impact, that hasn't transpired for the assumptions that we step you through in February. But look, we're still excited about the future of our organisation as we start to bring utilisation on to our plants.

And that's the key driver for us. So if you move to slide 25 I think it's just a really simple diagram that shows the dynamic in our core business and how that's being offset by the cost to accommodate future opportunities as we grow forward.

Effectively they are strong core business growth. If we did nothing and did not invest in new liquids or new capacity for infant nutrition as we have, we would see our core business growing circa 25 to $30 million this year. However, we would not be creating the future earnings' growth that we see in the opportunities that are out there, both for our customers and for ourselves. Offsetting that strong business growth of circa 25 to $30 million, are the cost to accommodate future growth and effectively it's a balancing figure this year. So those costs are again in the same range of 25 to $30 million.

At the start of the year, we felt that we potentially had 30 to 35, even $40 million that we'd have coming through on our core business. And as that was through, we would have also seen the cost to accommodate future growth be a little bit lighter. So at the moment as we start to fill facilities, this is a key dynamic in our business, and a core part of what's sitting in behind our forecast results this year. But also why we remain really optimistic about moving forward into next year. And then if you look at page 26 this is not a new dynamic for us. We've just done some analysis on the return on capital and employed profile. We are a capital intensive business and to create future opportunities we have to invest. And what you can see from the chart is every time we've invested, a return on capital employed has dropped a little bit, and then increased as utilisation and capacity has been filled.

So you can see that happen when we brought on our second dryer, you can see it on the shared drive where that net net operating asset comes up, return on capital goes down. And that's the same dynamic this year with a significant step up and our net operator adding assets, return on capital, moderating down a little bit of a sawtooth profile, in the return on capital, it'll start to grow again as we fill things up. Slide 27 just talks and gives a little bit of colour to how we develop customer opportunities, which is important because that's what we're chasing to fill up our plants. So now it's always focused on doing differently for a healthier world. We've focused on creating value of the products and the milk pool that we collect and that means we focus and put a lot of attention into creating high value customer opportunities, and attracting customers that value what we do with future growth.

And this is how we assess both potential markets and potential customers, how we take them through our pipeline. But it does mean that sometimes the higher value opportunities for us take longer to build. And that's the key message here. And we're working on a number of those opportunities that we look forward to updating you on. 28 just talked through a little bit about how we're thinking about, Pokeno. Look, these are illustrative slides, but as we commissioned that factory, we're largely doing so on an ingredients position. We start to populate more utilisation, higher growth with higher infant grade products would drive stronger returns and stronger overhead recoveries as we start to move through that and lift our return on capital employed profile for that facility.

So coming to the last slide around guidance and then some key takeaways from me just to finish up. The guidance update, we remain really comfortable with our range at the moment. There's a few things that are obviously developing because of the evolving situation with COVID-19 but look what... our range we're holding at 70 to 85 supported by strong consumer packaged infant formula sales. As we mentioned that the recent update, we've got the incremental costs of the keynote coming on. We have the infant based powders that have dropped away a little bit as we've seen that market consolidate. We're looking to build that pipeline again. We have the higher fixed costs as we invest in future growth opportunities and lactoferrin with strong pricing and volumes continues to contribute. Some of you may be wondering whether the dairy works acquisition has a material impact on our guidance range.

Yes, we will be picking up from the 1st of April and in extreme there, at an impact level that contributes about $2 million to our bottom line. But as we've seen, we've also seen a sort of... an escalation of the COVID-19 impacts and the wide uncertainty that exists when we made that, that initial guidance update. And those are some of the factors that are leaving us pretty comfortable with where we're sitting at the moment in terms of our range. So last slide for me and then we'll open up for questions. Slide 30 key takeaways from today. Our core business continues to perform well. It's an extension of the strong growth story that is part of what Synlait is about. We're really confident that we can maintain previous margins under the extended A2 milk company agreement that has us at a minimum, working out under exclusivity to July 2025.

Customer pipeline remains strong. We've got good material, material opportunity has well progressed across both our facilities. Dairy works is going to provide a great base for us to continue to build on, with an earnings stream in the next two years, developing a 15 to $20 million at an EBITDAR level. So despite the moderation and our expectations this year, I hope that gives you some context and into the dynamic that we're working through. As our core business and our new opportunities to continue to grow, grow. We will push through some of the costs that are coming online to create future opportunities and we remain really confident that we are building a strong and sustainable company that we can all be proud of and we think that you should be too. So those are the key, key takeaways from today, and concludes the key materials that we wanted to cover off. Obviously a lot of detail in the pack, a lot to understand, but we can open now for some questions.

Operator: Thank you. If you wish to ask a question, please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star two. If you're on a speaker phone, please pick up the handset to ask your question. The first question comes from Chelsea Leadbetter with Forsyth Barr. Please go ahead.

Chelsea Leadbetter: Thanks for the colour team, and morning. Couple of questions for now from me. If I can start with picking up on your comment, Nigel, around material reductions and OpX and some of the things you're putting in place or initiatives for the second half. Can you give us a little more context on the areas that's coming from? Just to try and understand the pathway and not just second half up but further out and then secondly, is that already effective into your guidance update?

Well, the obvious theory is out there. I mean clearly as an organisation right now, we basically are not travelling. So all this costs associated with the travel, will be significantly reviewed, and significantly reduced for the outturn period. Working on the assumption that the restrictions on travel will, the obvious ones will probably last through June, July period. Travel and entertainment. Again, that's part of a core business that you're constantly undertaking. That's likely to be a very minimised. Training and conferences, automotive sorts of con... expenditure is just going to be completely cut back. We're also, but... but in addition to that, we're also focusing on what our priorities are in the business, working under the terrain, what we need to make sure, that our teams are focused on the core priorities.

Nigel Greenwood: So some of the... some of the initiatives that we had that... But we would also... wanted to invest time and money into, we're probably going to put it on the back burner and focus on those core priorities that we need to make sure we deliver on this year and into the future. So really it's across the board. And I guess the message that I was wanting to ensure the market got was that Synlait as an organisation is not just standing back and saying well in this challenging environment we just keep on continuing to spend. We are going to be looking carefully at our expenditure to make sure that we focus it on where it makes a difference. I hope that gives you some context.

Chelsea Leadbetter: Yep. Okay. And is it already in the guidance range that you've, you've probably reiterated?

Nigel Greenwood: Yeah. Look you could argue that it isn't, because some of it was, I will say, because of our previous guidance, we had undertaken some assumptions around expenditure savings or less expenditure in the second half, but I think what we're saying now is we believe that there is even more that we can take out. Look, of course we remain... remain uncertain around the potential risks associated with the COVID-19, and so we need to be aware of that as well.

Chelsea Leadbetter: Okay. And I guess just changing tact a little bit, in terms registration and thinking about CEMAR in particular. You mentioned someone came down November 2019, and also it'd be good to get an update on how you're seeing that process in the current environment. Perhaps you know how we should think about getting registration for, A2 from Pokeno, and then perhaps where other finished infant formula customers are sitting because there hasn't been any mention, have you just put that on the back burner at this point or how do we think about that?

Leon Clement: Yeah, thanks Chelsea. Yes, we did host the minister of CEMAR and again it was a high level visit to make sure that we were showcasing the best that New Zealand has to offer, and I think it just was a great opportunity to demonstrate the world-class facility that we do have at the keynote. Look, I think in terms of registrations of what we are seeing, I suspect that the state administration for market regulation is also distracted by many other issues at the moment. So it's a little hard to see how the current situation will evolve. As we have spoken to previously, we are seeing some progress there and some with some registrations being completed, or given to players and other countries. We get to understand if that will evolve for New Zealand. However, look I suppose the way that we're thinking about it is, I think that the seminar process is now a little more embedded and in place.

We think that effectively the way that we're looking at this strategically, as it feels a bit more like we're moving towards fewer bigger players in China, sooner than we expected. And that's why we're saying "look we're just pivoting our focus and perhaps not holding out hopes that we'll be able to back the next big thing in infant nutrition." But it enhances our credibility and opportunity to partner with established players of which we see A2 being a strong... building a strong leadership position in China and making us more attractive to establish players in that space, and we think that the regulatory climate continues to evolve towards that and the regular regulatory climate continues to move towards the fact that we are an integrated model and supporting the fact that we have invested heavily in those aspects of our... of our value chain.

Chelsea Leadbetter: Okay. I appreciate the colour, and just last question. I guess in terms of what you're seeing with respect to supply chain at the moment, you talk about spec availability in shipping schedules, obviously I guess can you just give us an update on prioritisation and how that's sort of working at the moment, appreciate things are probably evolving pretty quickly, but just I guess, how that's working now and also what the costs... or has the been cost escalation and how you're seeing that?

Leon Clement: Yeah. Okay. I think around supply chain, there were two key areas that sort of emerged quite early. Can we get the ingredients we need? Particularly, been resourcing from plants around the world, and I think we've done some good work there. And whilst there was some initial risks that we saw emerge and we had been able to either look at contingency plans for those raw materials, and we've actually seen some operations start to restart again, and are up and running and supply chain seem open. We were able to air freight some product in to just make sure we had some extra cover with global airlines and the amount of movement starting to shut down pretty quickly. I'm unsure that's something we can rely on, but it's provided some good buffer for in the short term.

The secondary around supply chain was around shipping and the availability of containers, especially for outbound empty containers, as we saw supply chains start to shut down and we had some concern around the availability of those export containers probably as recent as last week. However, we are starting to see that unlock and look, I think that we've got great relationships with our shippers and because of that they're able to prioritise capacity for us. And at this stage I'm not seeing any pricing escalation coming out of that. So look, I'd have to say I was probably more nervous about this a week to 10 days ago, but increasingly feeling more confident as we're starting to see it unlock and, and hopefully it stays that way.

Chelsea Leadbetter: Okay. That's all for me for now. Thanks for the colour.

Leon Clement: Thank you.

Operator: Thank you, the next question comes from Aaron Yeoh with Goldman Sachs. Please go ahead.

Aaron Yeoh: Morning, Leon and Nigel. This question from me, just with regards to your comment from lactoferrin, it sounds like the overall outlook around that seems to have improved since February. Just wondering what you're observing in the market, I guess, which has sort of driven a sightlier sort of, rosy outlook.

Leon Clement: Mm. Yeah. Well, I guess there is may... Well thanks for the question, Aaron. I think what we're doing is clarifying that what we were saying

On our guidance update, as our expectations of pricing has moderated down. However, we still expect pricing and volume to be higher than last year. It's just that when we set our expectations for this year and our guidance at the start of the year, we expected higher pricing. And look, I will flag that a very small moderation in Lactoferrin pricing, one or 200 dollars a kilo, can have quite a material impact on what we expect coming off that. It is quite sensitive to our overall business in terms of the earning streams that we get from Lactoferrin.

The first point is. Are we calling that this is slightly rosier? No, I don't think we are. We're really just saying that, don't forget that our Lactoferrin sales will grow materially on last year, or be it our assumptions have moderated down from our earlier guidance. And that's what was one of the key factors in moving that assumption down. Having said that, I think we are seeing some firming, but it's in line with the expectations that we put out in our guidance statement. A little bit unclear on what exactly other drivers are, but we've got good leads and seeing price and firming out of China in particular for some of our customers in that space, but they're broadly in line with our current assumptions. I hope that helps there.

Aaron Yeoh: Yep. Sure. And then I'm just wondering in terms of how to think about the step up in cost in the first half, with relation to Pocono commissioning, and I guess specifically, how we should think about the second half operating expenses in relation to the first half? I know that obviously Pocono was running for, I guess, four months in the first half, and in the second half obviously it'll be fully running. Is that the proportion, an additional two months operating expenses? Is that how we think about it? Or were [crosstalk 00:46:01] start-up costs in the first half?

Leon Clement: No. Generally speaking, when I get questions like this one about thinking about Pocono in isolation, it gets problematic because we obviously operate our drives and allocate production to where it most makes sense. From your perspective, obviously you should assume that Pocono is going to be operating for the full second half, and it will be. There'll be a full second half, absorption of interest and depreciation costs associated with and manufacturing overheads associated with it. We'll also be processing all of the milk we received through Pocono in the second half as well, getting some recovery through overhead recoveries and margin on the products we make from that.

But from a modelling point of view, if you're thinking about it that way, then you need to look at it from a total demand perspective. What is our total anticipated demand for infant formula, for ingredients and Lactoferrin? How we allocate that to various plants is not really the key issue here. It's rather, what are the expected returns that we expect to get in that second half? We've provided you with very good insight in the outlook section of this deck to give you a lot more insight as to the volumes you might expect we're going to do for the full half, for second half and therefore for the full year. I think try to work out a P&L for Pocono in its own self, is not the most effective way to think about it, but I hope I've given you enough information to understand how that's going to work.

Aaron Yeoh: Yeah, sure. Thanks. And then, Leon, you mentioned I guess [Atour 00:47:43] intention with the optic participation in manufacturing. I'm just wondering, I guess on your understanding, why do you think Atour is working to participate in manufacturing, particularly given the fact that Pocono starting to ramp up and that single site risk isn't really as much of a risk as it was before?

Leon Clement: Although I can't comment on behalf of Atour around their intentions, but that side of what their intentions are to participate in manufacturing. And look, I think we're looking forward to the discussions with them and as long as they recognise the expertise that we bring. Look, I think that we bring a lot to the Atour partnership. We obviously play a strong role in helping ensure that they have market access into their key market and China. We've invested significantly over the history of the business and an integrated value chain, which we see the regulatory climate moving towards. And that's important as we move forward to protect the sheer value that we create.

The Atour semi model has been highly competitive from an infant manufacturing perspective and in terms of our competitive set, we continue to share the benefits of scale with Atour and we look forward to those discussions and ensuring that they're recognised some of those expertise in what we bring to the table.

Aaron Yeoh: Great. Thanks very much for answering my questions.

Leon Clement: Okay, thanks Aaron.

Operator: Thank you. The next question comes from Stephen Ridgewell with Craig, please go ahead.

Stephen Ridgewell: Good morning, just fill up on the discussion on overhead. Yeah, thanks for the colour really, Nigel, and where this customer might come from. I'm just wondering though, if you could help us quantify that. It was [inaudible 00:49:34] in the first half. What should we be thinking about overhead growth for the full year?

Nigel Greenwood: Now when you call overheads, we're referring to SGNA costs, right?

Stephen Ridgewell: Yes.

Nigel Greenwood:	Look, we haven't given specific guidance around what we expect our SGNA costs to be for the second half. But it's a fair question. How I'd like you to think about it is that, what's an easy way to think about it. Well, if we took the first half because you often get the impact of analysed labour costs. If you took that and doubled it for the second half and might be added a lot more if we did nothing different. That would be a starting point then assume, take off from that. The reasonable assumption that we're going to be doing a very deep dive and in terms of our ability to retain, restrict, spend only what we need to, to remove costs that are simply aren't going to occur now because we won't be undertaking a number of activities that I talked about earlier and that they could read. We're not talking material. I'm talking about in the millions. It's not the hundreds of thousands. That text give you some insight.
Leon Clement:	Can I just add a little bit for that? To Nigel's point, I think he's helping provide a bit of direction around how you might make assumptions for the second half. But strategically I want to clarify, we're not slashing and burning costs here. We're moderating investment to make sure that our businesses sit up appropriately for the new assumptions that we're seeing emerging. We're going to be moderating down on the growth that you've seen historically and making sure that our organisation is optimised and set up for success as we move forward in the future. Just from a strategic perspective, that's how we're looking at us.
Stephen Ridgewell:	That's helpful. Thanks. And then just on Pocono, it just came to the court hearing. It maybe the end of April or maybe I don't know what's going on at the moment, but Leon you implied in the prepared remarks that if the decision doesn't gain some way the business is not in a different position from now. If we're looking forward, some additional commentary on next that would say that think would be a potential range of outcomes here that some of those might be more negative from the company's current position and then in contingency planning the companies don't place if there is a poor outcome there.
Leon Clement:	Yeah, no, thanks for asking for clarification. Our legal advice is just for the Supreme court not to find an outcome that potentially is adverse for some way or limits our ability to operate the plant that comes subsequently with any action that the neighbour then needs to take against us and a subsequent high court hearing if we lose. The cases about the removal of the covenants, not the operation of the site. That's why we're framing it as, if we won here, this is solved. If we lose, we're broadly back to where we are today, where the neighbour would be obliged to take this case back to the high court and seek some damages or outcomes that we would then need to work through again. Which is why we're feeling pretty confident about our legal position around that and looking forward to the Supreme court case.
Stephen Ridgewell:	That's helpful. Thank you. That's all for me.
Operator:	The next question comes from Adrian Allbon with Jarden. Please go ahead.

Adrian Allbon: Well, good morning Leon and Nigel. Can I ask two questions please? You've obviously answered the question in quite a few different comments, but when you come back to your slide sets and you're talking about the Chinese infant formula arbitrary environments intending to move towards the sunlight integrated model. Is what you're suggesting that you've got some signals that SMR is going to ... which at the moment when you think about your plant investment really just finds the blending and canning path. Are you sending some signals that would come back towards the heavy end of the capital investment in terms of the spray dries and stuff like that? Or, are you saying some signal that you might have some staple between a SMR and a get licence for example?

Leon Clement: Yeah. Look, I think the answer to that is that we are seeing an evolution or I guess in some of the policy statements out of the regulatory and the policy sittings that we're seeing from regulators is that there is a movement towards the standardisation of how they register plants and how they want to see integration and an integrated model being part of setting ourselves up for ensuring market access for China. And look rather than getting into the interpretation of all the different policy settings. Probably the best way to describe it as why would you think the China regulator would think that. They would think that because they're trying to secure food safety for the industry and they want to make sure that players that participate in the industry have as much control around their interim value chain and players that have invested heavily to an integrated model like some may where we manage the flow of products from milk all the way through to finish products who hold the registrations. The registration for the safety of the product needs to sit against the factory.

And really we're just, I think highlighting and flagging that increasingly we're seeing this idea that a separate cleaning and kenning operation can source ingredients from a wider network of ingredients, players and spray drying is no longer a business model that we think will be sustainable. And the reason for that is that obviously regulators are wanting to protect the rest of multiple players participating in that value chain. And an integrated model is preferred and semis invested historically in that and we feel that we were well placed to benefit from that going forward.

Adrian Allbon: Okay, that's helpful. The second question, you touched on it when you concluded and you're saying confident and protecting your historical margins of the Atour milk agreement and the key driver there is your manufacturing efficiencies. But other than volume, what would be the key driver, we should understand operationally in terms of your ability to achieve that over time?

Leon Clement: Well. Well, two things. Volume gives economies of scale. As we've described through the whole nature of our capital investments when you establish a new facility, you've got overheads, you've got site services that you're running across those. And as we have volume washing through those plants, we will generate efficiencies that we've historically seen as we've done the same. Secondly, our IWS programme continues to deliver benefits for us and that programme is focused on eliminating losses around time losses, wasted yield losses. We've got Danzando operating really efficiently and moving forward with the extension of our new facilities, degenerate manufacturing efficiencies there are very attainable and I guess what I'm qualifying is that on the assumption that we continue to drive the manufacturing efficiencies that are available to us and we know are realisable based on our track record, we're really confident we can protect the margins that we've seen historically out of that relationship.

Adrian Allbon: Okay. The way that wave potentially would monitor that. Would they like you did last year, where you were able to process more milk versus what you've stated previous manufacturing capacities with?

Leon Clement: Yes. On the basis that also when we process infant nutrition, we are processing least milk because it has least milk followers then homo powder. And that's an optimization and product mix selection that we make that also drives really strong efficiencies for our partners because we're able to optimise our assets across that. But yeah, look I think it's fair to say that the more we start to process an infant nutrition and as that volume comes in, it's reasonable to us, we should be able to benefit from the scout opportunities that come with that and our own efficiency programmes.

Adrian Allbon: Yeah. I guess I was just trying to understand what other drivers there are other than the volume driver, which the Atour argument could be that they provide in the volume argument.

Nigel Greenwood: Adrian, Nigel here. Look, we often don't really talk about the reality that at any manufacturing operation, you always have times where you don't manufacture product right first time and whenever you don't you, you build in cost associated with delayed shipments, wheat testing the product to see whether it's big or not as big and even in some cases where you've manufactured product that history has to be written off to stop food.

Now we absorb all those costs within our cost of sales and whilst not undercutting what the level of aid those costs might well be. For the IWS programme, over time you build into the operating ethos, the way of the culture and the performance of the plans, absolute increased improvement and right first time production, which will have positive impacts on our overall cost of sales, of the manufacturer of that product. And it flows through the organisation, not just in the product write off, but in terms of the increased capacity you have to be able to not have to remove manufacture products and therefore process more milk. The overheads that you've incurred working through and resolving issues that occur with that. And that's all those headed costs associated with that type of impact can be taken out of the process and they can be material over time.

Adrian Allbon: Okay. No, that's useful in terms of basically just continuing to get better at what you do.

Leon Clement: Thank you. Probably got time for one more question.

Operator: Thank you. The last question comes from Marcus Curly with UBS. Please go ahead.

Marcus Curley: Good morning. I might try for three if I can. Just very quickly on the Atour discussions. Where are you at on their manufacturing intentions and when do you expect to publicise the outcomes?

Leon Clement: Thanks, Marcus. I'm not going to get going on where those conversations are at. We look forward to those discussions and the fact that they'll recognise in those expertise, but those conversations as they progress are confidential as they develop.

Marcus Curley: Yeah. Could you talk a little bit about any discussions with the government with regard to Coronavirus? And yeah, whether you'd be deemed an essential service. There are some suggestions that the government's going to move to shut down all non essential businesses by the end of the week.

Leon Clement: Unsure at this stage, Marcus, we've been feeding our comments up through our industry sector at this stage and our industry sector representatives are closely in touch with the NPR representatives. We'll continue fitting that up, but I'm uncertain around how we might be classified.

Marcus Curley: And then finally, Nigel, could you talk a little about where you think debt levels get to by the end of the year and what the debt to EBITDA looks like at that stage?

Nigel Greenwood: Yeah. Look, clearly it wasn't going to be hard and when we previously anticipated them, the thing was that the neighbour's ratio, you'll be aware Marcus is, if you have a lower EDITA than what you thought you're going to have that affects the bottom end of the curve. And if you then also have more debt because there's much cash flow coming in. It actually worked, but it's a double whammy a bit. What I'm trying to say is that it will substantially depend on where we land up at the end of the year in terms of our overall EBITDA performance. Which is a reasonable range right now as you can see. All I can say is even at the top end of that, well if you like at the bottom end of that EBITDA range, right? And therefore the consequential total debt position, we are still comfortable that we will lie within our existing bank covenants and that we'll not be at risk.

Having said that, they will be at a much higher level than we had earlier anticipated. It's manageable, we're obviously keeping a close watch on it and again, it's almost one of those moot points, your previous question. If what you just said happened that would definitely blow it all out the water, wouldn't it? But assuming that we continue to operate and we deliver on our expectations, we will live within our covenant levels.

Marcus Curley: I suppose where I was hitting with this is, I suppose when you look back at history of this business. Yeah, with gearing where it's likely to be at the end of the year. The businesses normally raise money, you've been obviously investing a lot, you've bought things. Is equity an active decision at the moment or, yeah. How do you think about equity?

Nigel Greenwood: Right. Look, we've also been through cycles before when we heavily invest in new assets and acquisition, of course, it takes us or our leverage to a higher level on the basis that very quickly with operating cash flows coming through funds, the performance of those businesses in subsequent years we get our debt levels down quite quickly. And especially based at the moment when we've got no other significantly announced capital investments in the pipeline. With that said it really is one of those things where obviously the board actively monitors and considers where the equity raising is going to be considered necessary. But we're also continuing to review our long range forecasts around performance of the business and wouldn't necessarily go to market to raise equity if they felt that the operating cash flows were going to bring debt down over time. It's really one of those things that right now of course it's not on the table but it is obviously considered it'll times.

Leon Clement: Marcus, I'll just say that and I think that's a bit of a no comment from Nigel for obvious reasons, but what we remain comfortable with our covenant levels and we are nearing or we are actually at the end of a significant investment cycle for the business. Our key role now first shifts through utilisation, summing up capacity, making sure we generate earnings to start to pay for the investments that we've made.

Marcus Curley: Okay. Thank you.

Leon Clement: All right, I think we'll conclude the call here. Thank you very much for joining. Obviously uncertain times for everybody, and I appreciate the time that you've given to sun lay, despite other global distractions. Thank you very much and we'll see many of you potentially online via VC in the coming weeks.

[END OF TRANSCRIPT]