**TRANSCRIPTION**

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Hannah Lynch: Good morning, everyone and welcome to Synlait Milk's half year results conference call. My name is Hannah Lynch and I'm the corporate affairs manager here at Synlait. I'm joined in the room here today by Leon Clement, our CEO and Angela Dickson, our CFO. There'll be an opportunity to ask questions at the end of the presentation from Leon and Angela. But if your question is not answered, please feel free to follow up with me directly after the call. I'll now hand over to Leon.

Leon Clement: [Māori greeting] and welcome to Synlait's interim investor results presentation for the financial year for FY 21. Thank you very much for joining this morning. For those of you that have read forward in the presentation, or had a look at our guidance, you will see that we are signalling an outlook of broadly break even for the full year FY 21. Today's an opportunity for us to have a good look at the result for the first half, but also to help understand how we're thinking about our business going forward. It's been well signalled that the impact of the infant nutrition drop and our demand back in December has been well signalled how that's impacted our organisation. And today's an opportunity to further understand that, have a look at what's happening in the organisation. Talk a little bit about what we are doing about the situation and why we still feel really optimistic about the future in the medium to longterm.

Leon Clement: I've just got a couple of slides up front that I'll step through. And then I'll hand over to Angela to talk through the financials and I'll come back to then talk through our plan and the outlook going forward. Moving to our first slide. You'll see that revenue continues to be a key feature of some of those results, we're up 19%. Slightly different mix of what's driving that this half. We've got a full period impact of Dairyworks coming in there, and you can see the reference to that, at just over 112 million for the first half year. So, that's a good result, and Dairyworks continues to perform at or about the levels that we expected. Our core business revenue has also been supported by strong global dairy trade prices. So, commodity prices drive higher revenue outlook for us, but that has been offset by lower infant nutrition sales, which you'll see later on in the pack.

Leon Clement: The next metric there is the consumer package, infant formula sales, which is down 16% on period, but what's more relevant there is the considerable drop in infant base

powder production, which is down more than 60%. That's a core driver in our business and I'll come back a little bit later just to why that has a material impact on the way that we operate and perform. EBITDA 29%, largely driven by again, the infant nutrition drop and the decline on NPAT demonstrates the importance of keeping our plants full and the impact of those base powder production levels being down. NPAT at 6.4 million for the period down 70% on prior period. I'll just move through to slide three now, before I hand to Angela. This is a really important contextual slide for you to understand what's going on in our business and why a sudden drop and forward demand for our customers results in us, essentially, considerably dropping the utilisation of our factories, which drives our profitability for us.

Leon Clement: Many of you have been following Synlait for some time will know that we have a seasonal nature for the production in our organisation. In our first half we're predominantly focused on processing peak milk. New Zealand has a seasonal milk curve, which starts about October, what we call peak season and runs through till about December, January. During that period, our plants are largely focused on processing milk into commodities. Because the milk flow is so high, we can't slow our dryers down to make high value infant nutrition. The best time for us to produce our base powders for infant nutrition is typically between January to April, May. We call that our shoulder season and it's when we have a combination of high quality milk and capacity in our dryers to be able to run. As you can see from the chart, back in the shoulder season in the second half of FY 20, we were predicting that our infant nutrition business would continue to grow on the FY 20 levels.

Leon Clement: For those of you that remember we produced about... Or we sold about 50,000 tonnes of infant nutrition and the FYI 20 year. So our production plan and that shoulder season reflected that growth rate and was producing materials accordingly. What the suddenness of the drop and infant nutrition outlook coming through in December, we had to rapidly reset our production levels within our factories so that we could reset our inventories to a much softer forward outlook. That meant that the product that we'd produced in the second half of last year largely covered us for much more of the demand for FY 21. And essentially we turned our plants right down and experienced what's typically described as a classic bullwhip effect in the supply chain. This factor has been made slightly worse because of the seasonal nature of our business. It's also been further impacted by the fact that we're emerging from a significant investment phase and are carrying the costs of additional capacity that we have built.

Leon Clement: And finally, as we flipped the infant nutrition production over to ingredients, we faced quite a volatile commodity in ingredients market, with product mix diverging, markets and customer mix also diverging for us. And finally, the shipping delays have further impacted our results in this half. So I think it's really important we set the scene for the dynamic in our business at the moment. In a growth year, we typically produce more than we will sell because we're looking forward to a higher demand profile on the following year. In a declining year we're forced to produce less than we plan to sell as we reset inventories for a new outlook. That's the dynamic in our business at

the moment, it re stabilises as we get back in balance, but obviously this year we're resetting ourselves and that's having the impact on forward outlook. So I'll ask that you keep that context in mind as Angela walks through our financials and I'll return at the end to take you through what we're doing about it and why we remain optimistic about our future. Angela.

Angela Dixon: Good morning, everyone. Thank you, Leon. I'm just going to really focus on the half results for the year, but as you'll see, a lot of those drivers flow through, into our outlook. So starting on page five, the results at the glance, the impact of COVID and the ongoing recovery of our key customer is having a significant impact on production and profitability. I'll walk you through that. As Leon had outlined, both in this half and going forward. As Leon said we've got a net profit after tax of 6.4 million, and that's significantly down on same period last year. And you can see that in the graph to the right and revenue, while being up, has been significantly impacted by our infant formula volumes and our base powder production.

Angela Dixon: Therefor, EBITDA is down 29% for the half, and it has been further influenced by the full impact of depreciation and interest costs, as a result of that capacity bills and previous years continuing to flow through. On a more positive note, as Leon alluded to, Dairyworks is on track to deliver a full EBITDA growth of 15 to 20 million in line with what we have signalled in the past. Now onto page six, revenue in sales volumes, as I explained earlier, revenue is up 19% and it's predominantly through the inclusion of Dairyworks, our new acquisition last year, higher commodity volumes and GDT prices having an influence as well. Also, we have been impacted by the global shipping delays that everyone's well-versed about, and this is having an adverse impact on our ability to get product out to customers. This particularly impacted in December and January this year.

Angela Dixon: In a little bit more detail, the consumer packaged infant formula volumes were down about three and a half thousand metric tonne, as our key customer reset their profile through the year. China-label volumes did continue to grow in the half and English-label was the label that fell, reflecting the demand profile was the daigu channel issues. As emphasised earlier the biggest impact has been this base formula production, which is down over 60%. We have had some small offsets in the half through powders and creams, or otherwise referred to as ingredients, where we have had increased sales of about 11,000 metric tonnes.

Angela Dixon: We've also had some positive impacts through Lactoferrin. So our sales have remained strong at 21%, offset by a softer pricing as global capacity increases around the world. Liquid milk volumes continue to be stable, but remain below expectations. We will continue to work in collaboration with food stuff as we foster this partnership more. Pleasingly cheese and butter has head strong domestic demand through the COVID periods, we've had supported by an increase in the Australian market share. It's really pleasing to see the success of this acquisition come through into our results this half.

Angela Dixon: Moving on to page seven, production volumes from a production perspective, the half is being really positive. Utilising the capacity we do have given the dramatic shift in the mix that occurred in the last six weeks of the year. Firstly Lactoferrin, it's pleasing to see that we've got a further increase in production of about two metric tonnes or 16%. The team have had a great result, continuing to optimise the Lactoferrin extraction methods, and have worked that plant really well to get these results. You can see that on the bottom right-hand graph in the continued growth in our production of Lactoferrin. We've also had a positive milk collection this year, where we're up almost 18%, as Pokeno's come on stream. And we've got a North Island milk pool increasing. Our ingredients with powder and cream production increased almost 16,000 metric tonnes or 22% as the mix changed as I've stated earlier.

Angela Dixon: Our liquid milk remains consistent through the year. Now, moving over to what the impact therefore is on our gross profit on page eight. As A consequence of the volume and mix changes, our gross profit performance has been impacted and gross profit is down 28% to roughly 60 million. This was driven by the lower demand from infant formula as our key customer resets its demand profile and rebalances their inventories. The consequences on us is we need to also rebalance our inventories to align our production was that demand. The switch in the product mix impacts us significantly because we are moving our milk into a much lower margin commodity product. We've also had the unfortunate bad luck of a sudden switching from New Zealand dollars into US sales mix. Which results in an unfavourable FX position, which creates a further headwind as we didn't have the time to get the favourable hedges in place against the rising FX market.

Angela Dixon: In the later part of the half. Turning the page now to page nine, SG&A costs, always a favourite slide. As a consequence of this lower demand the costs are really strong focus in our business at the moment. And this will continue throughout the year. Discretionary costs have improved or we've had savings of three and a half million, half on half as this has been a conscious effort to reduce spend where it has been sensible to. We completed the receipt about organisational structure to reduce salary costs. This is starting to flow through in this half and more savings will be realised in the second half. These savings, as you can see in the graph to the right, is offset by the cost of Dairyworks coming in on the half as we didn't have Dairyworks in the FY 20 half. Depreciation continues to roll through from previous upgrades and technology costs are increasing as our business gets more sophisticated. Moving now to page 10, what's the impact on our cashflow, everything highlighting previously Synlait does typically have a seasonal cash flow just to the milk production curve that Leon talked about earlier.

Angela Dixon: You can see that in the graph to the right. We've also had an impact on cashflow this year because of higher global theory trade, pricing for milk. And as that price has increased, we've had to adjust our cash flows to our farmers. The Operating cash flow now is down roughly 70 million or 69 million in the half and it's quite a dramatic shift where we've been in previous years. Reflecting this lower margin mix and an increase in receivables. We've also got the Dairyworks receivables coming into that cashflow view this year, and we've also been impacted by shipping because shipping

continues to impact the timing of our cash collections as the product is delayed out heading out of ports.

Angela Dixon: We have managed to keep investing capital... More constraints this year, as we signalled that we would be moving out of the build phase and into our full up phase. The cost this year of 62 million of cashflow so far on our key projects. Our financing costs are up slightly because of the increased debt levels, which were partly offset by lower interest rates that we experienced in the period. Moving now to my last slide, page 11, with Net debt, a topic I guess everyone's really interested to understand given our outlook, the net debt has decreased to 485 million, and you can see how that compares to previous periods in the graph book to the right. We completed a $20 million... sorry, $200 million equity raise in November. And this did reduce debt.

Angela Dixon: As we've moved through this half, we have had to use some of that head room that we planned for, and that capital raise, to help cushion our business as we navigate through the issues of COVID-19. All our relevant banking covenants we meet in the half year and we have been proactively working with our banks and our banking syndicates to increase the leverage ratios, to ensure we've got the ability to navigate for the remainder of this year and meet all of our banking needs. So I feel like we're leaving the half in a really positive position to address the headwinds that are ahead of us. Now, I suppose on that note, I'll hand back to Leon.

Leon Clement: Thanks, Angela. So it's pretty clear that COVID has hit us late and it's important that as an organisation, we rally around what we can control as we move forward. I'm picking up on slide 13, which is a conceptual diagram to show what our focus is right now. In any business that I've seen successfully navigate through crises, those businesses have always found a way to focus simultaneously on two things. The first one is to how do we successfully mitigate the impacts of the crisis and the impacts on the business. And secondly, how do we simultaneously make sure that we're doing the right thing for our strategy and pulling forward value and accelerating

Leon Clement: And the delivery of execution through that plan. So I'd like to take you through how we're working through this. Firstly, on how we're mitigating the impacts of this current year, and secondly, how we're pulling forward value as the organic business recovers, and our waste yield and efficiency programmes start to deliver, and we start to extract growth from the recent investments that we've made. I'd like to really thank our staff and our teams and suppliers and our network who've been very supportive of making sure that we make these changes in a really agile nature, and the spirit on which they've leaned in to pulling forward some of the strategic value that's available for us. As you know, we've made significant investments previously, and we're really well-placed to emerge from this crisis as we pull together these two simultaneous focuses.

Leon Clement: So there's two slides on 14 and 15 that talk through around $22 million worth of costs and efficiencies that we're looking to extract from the business. I've acted really quickly to make some appropriate changes to our organisation given what's happening around us. The first slide focuses on operating cost savings. We've made

and worked through a significant organisational structure reset to ensure that we have the capabilities that we feel are appropriate for our organisation right now, and are aligned to our strategy. The savings within this financial year are just under 2 million for that. We also moved really swiftly in the new year, over the holiday period, to make sure that the labour levels against our factories were appropriately matched to the customer demand that we saw moving forward. That meant converting Synlait Pokeno to make sure that it focused predominantly on manufacturing ingredients only, and preparing for our new multinational customer, that results in a different shift and labour structure against that site. As did the changes that we made to our Auckland and Dunsandel blending and canning facilities, to adjust shifting operations, to look for the new demand outlook.

Leon Clement: And finally, we optimised our Dunsandel dryer network against a new product mix and made sure that we were segmenting our assets and facilities to ensure that they met what we saw going forward. Against that... And I should have... About $5.4 million worth of cost has come out of the organisation in if FY 21. As we see demand start to increase and the outturn period that will of course start to flex up, but it's an indication of the swift movement that our operations team took to adjust to the changes in our forward demand. The third area on that side is an ongoing focus that we've had on our discretionary spend, travels and consultancies, entertainment. All the usual things you'd expect us to be monitoring, so far this year $3.5 million has been pulled out about cost base there.

Leon Clement: The second slide on page 15, around the short-term impacts, there's a focus on extracting value chain, cost savings. A really great project that is delivered on time and to budget as our Dry Store 4 and rail siding project, which we see coming to life in May this year. We announced that some time ago, but it's important that we flag the efficiency that this will be bringing to Synlait as we continue to grow and invest in integrating manufacturing facilities. And really what this one does is moves us from a farm to can value chain all the way from a farm to a port value chain with containerized goods, trained between Synlait Dunsandel and Lyttelton port. This initiative takes 16,000 truck movements off the road. There's a great picture, an aerial shot on page 12, which shows the project and how it's making a difference for us, but it also generates a permanent annualised EBITDA contribution of $8 million from FY22 onwards. And we're looking forward to those benefits coming through into our organisation.

Leon Clement: In addition to that, the teams have been really focused on some waste reduction and yield improvement initiatives. And there's an annualised benefit that we've seen from the changes that the team have made dear of $3 million. And we continue to just focus on quality and right first time production metrics, which reduces rework and waste. So those are some examples of the great work that the team have been doing to adjust to the current situation and pull costs and efficiencies into our organisation, as we go forward and face the current challenges that we're working through. Picking up on slide 16, I just want to talk through what we're doing around pulling forward value and our strategy. And the first thing is to make sure that we're really focused on the right things. If you've been following Synlait for some time you'll notice that we've

narrowed up our strategic choices around the hands. Part of our framework here, our strategy, the nutrition, food service, and ingredients, and consumer foods pathways have been narrowed from five pathways that we had around growth down to two.

Leon Clement: This reflects a shift in the opportunities that we're facing and a focusing on the things where we believe we can create the most value. We haven't changed our purpose or ambition, and they'll continue to stay the same or the enabling strategy framework of net positive for a planet, a healthiest Synlait and a world-class value chain. It's really important. We don't compromise who we are or what we stand for, and we'll continue to balance people and planet at the same level of profit and our business. Moving to slide 17, it's also important to acknowledge that Synlait's moving from a build phase and an investment phase to create opportunities and reduce strategic risk and into a phase where we'll focus on filling the assets and opportunities that we've created and extracting new value from them. As we move into this phase, you can see that that's the opportunity to extract value from the significant investments we've made in Synlait Pokeno and our liquids plant and then our cheese categories.

Leon Clement: So essentially we're melding from a build it phase to a fill it phase and focusing on completing the investment with our new multinational customer and Synlait Pokeno this year as we move into realising some value in FY22 from that initiative. But essentially it also sets us up for some amazing opportunities. And it's really coming just at the right time for us. As we start to focus on building a more sustainable Synlait in the medium to longterm.

Leon Clement: The slide, page 18, I'm on now, just shows the assets that we now have to tap. We have a customer base that would be the envy of any main... any dairy processor in the world. We have a strong base in New Zealand and Australia with all the main retailers and New Zealand and a strong partnership with Woolworths Australia led by our Dairyworks team. We have a strong list of multinational customers in our repertoire, not all are listed here, but some fantastic names in that stable. And increasingly a strong set of partnerships emerging around China, Yili and Mengiau have been ingredients' customers for some time, but also you'll see the emerging domestic players of [inaudible], who are we are increasingly working with on specialised ingredients.

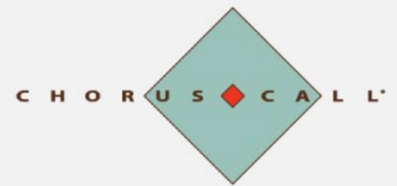
Leon Clement: We've also got a great set of categories, which are increasingly listed there that we can start to tap, to create opportunities against the facilities that we've built. Coming to slide 19, I wanted to provide some insight into the value that we are starting to chase as we look forward and our strategy. I've put this over three main horizons, the short term, the medium term, and the longterm. We're getting really focused on these initiatives and organising ourselves around teams that convert these into value. The pictures and opportunities on the slide are examples only, but as we start to total these up, we're eyeballing around $200 million worth of value coming from these opportunities. Now, before you all go and put these on your models, I just caution you that this does not include the headwinds that we would naturally face as part of this. It focuses on the new value that we would create, but some examples are in there.

Leon Clement: In the short term, we're excited about the pending launch of a differentiated ingredient stream. Our made with better milk proposition reflects that differentiated milk that we capture from our lead with pride programme, with our farmers. And we're looking forward to starting to capture the value that we see on that, we've got strong customer and trust in that proposition Later this financial year, we'll be launching our food service creams, starting with a beachhead in China. We're really excited about the quality of the product and the functionality that we're currently producing and looking forward to that making a significant contribution in FY22. It's been well canvased that we've got a new multinational customer that we're working on to develop in Synlait Pokeno, that customer and the new opportunity start to create value for us at the start of the FY23. So in just over 12 months time, and we also see opportunities, it was we'd go for what around Synlait branded consumer products.

Leon Clement: As you know, we've got fresh milk capability, which we're looking at, but we've also got a great quality Lactoferrin product. And whilst that product is a little bit hard to see, starting to think about immunity based propositions using our Lactoferrin as something that we're considering. And longer term, we have a product mix that's made in heaven for our dairy processing company, infant nutrition against cheese, with strong demand for both products, capturing the whey and casein interchange between those two products represents significant value opportunity for us. It will require some investment, but if we can get this right over time, we see strong value emerging in the longer term. And finally, we're continuing to progress our liquid infant nutrition products. As we start to build capability in that space against our advanced liquids theory factory.

Leon Clement: So moving now to slide 20, our guidance update. As we signalled earlier this month, Synlait's continuing to experience uncertainty and volatility within its business. This is due to the uncertainty of the a2 milk companies, expected demand for the remainder of FY21 and for if FY22. As we spoke to earlier this March, we don't have current sufficient confidence to forecast when this recovery will occur. This has two main impacts on Synlait. The demand for Synlait for consumer packaged infant formula remains uncertain, which in turn impacts the forward infant base powder production and the asset use and utilisation of our facilities. Secondly, Synlait's ingredients business. With the sudden drop in consumer packaged infant formula demand, combined with rapidly rising GDT prices, foreign exchange and changing product mix. This has created volatility for us and limits the returns that we would otherwise expect against a more stable demand profile.

Leon Clement: Finally, the expectation that global shipping delays will continue to further impact our FY21 result. We've considered the above factors and how they will impact Synlait's FY21 profitability. You will note the word uncertain is used a number of times in our guidance site statement, but we also think it's important we provide you with a signal of where we're heading. Our current outlook suggests a broadly break even FY21 impact result. Given the above sectors, while all of our banking covenant ratios have been met for this path, we've proactively engaged with our banking syndicate to increase our leverage ratios and manage any risk at the end of FY21. So therefore



the companies FY 21 business plan is fully funded by its current thinking syndicate. That concludes our presentation this morning. So we'll pause there for questions.

Leon Clement: Thank you.

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 speakerphone, please pick up your handset to ask you a question. Your first question comes from Stephen Ridgewell from Craigs Investment Partners. Please go ahead.

Stephen Ridgewell: Good morning team. Just firstly, on the guidance. I mean, given we've said two pretty large downgrades in pretty quick succession. I'm just wondering if you can give us a little bit more clarity or specificity on the key assumptions that are underpinning that guidance for break even input for the full year.

Leon Clement: Yeah. Good morning, Stephen. And thanks for the question. I think essentially what's significant and the assumptions that sit behind that is the uncertainty that we have around the allay to infant nutrition demand and what that looks like. And if FY22, I think the slide that we presented upfront shows that our forward view starts to inform how busy our factories are, especially in those shoulder seasons. And so what's materially changed from our position in December where we felt we had some confidence that a recovery may occur in FY22. As we signalled in March, we were no longer confident that we had sufficient evidence to be able to call that. And as a result, we can no longer get confidence that our factories will be turned back on in the second half. So that's one of the main assumptions. Another one is the significant volatility that's occurred around our ingredients business as a high-level of new ingredients business came back onto our plan.

Leon Clement: So as we reset our base powder production, what we do with the milk, as we flip it back to commodity products, that means in the rest of the financial year, we're selling far more ingredients products than we anticipated. And we're selling them into a market that has got somewhat abnormal for us. We've seen divergence of butter and AMF. We've seen divergence of customer buying patterns and markets. We've also seen sudden changes and effects that limited our ability to capture that.

Leon Clement: So those are assumptions that are driving the softening of our outlook and the reason that we're saying will be boldly break even against the uncertain scenarios that we're facing.

Stephen Ridgewell: That's helpful. I'm just wondering though, I mean, compared to the kind of demand level to approximately what you've seen in the last couple of months, for canned AF, are you assuming that that doesn't get better over the balance of the half? Is it what we should take into this guidance? Great.

Stephen Ridgewell: Okay. Thank you. And then just on maybe one for Angela, just on CapEx for the full year, I think you called out 60 odd million in the first half. Can you just remind us the

level of CapEx for the second half, and also just, just given the impact guide, roughly what you might expect being in the full year.

Angela Dixon: Thanks, Stephen. So, I'm just finding my page. I think we've always signalled that our new multinational customer will be roughly about 70 million spread over two years and that's expected to continue as planned. We have continued at the completion of our dry store, which Leon talked to, and that is operational from May, so that will have some cost still flowing into the second half of the year. We're continuing to do our ERP system and upgrade our systems across our business. And that will continue on in the second half of the year as well. And then this year in the 70 million or the 60 million that I talked about for the first half has also got the cost of buying the farms that happened last year, but the cash flow actually came through in this year in August. And then the rest is we are containing our operational cashflow tightly while ensuring that we are still spending what's necessary to get optimised

Angela Dixon: ...production out of our facilities and keep our assets in good shape. So, that's pretty much where we are from a CapEx perspective. So, guiding very similar to what I was at the full year result six months ago.

Stephen Ridgewell: And just on the net debt injury, any guidance here in terms of where that might land, just given those working capital moves you cited?

Angela Dixon: I'm not really keen to guide yet. We're still working through all the options around our balance sheet. We've reset the covenants, which allows us to consider a number of different scenarios we've got in our plan, and that's why our guidance talks to a broad breakeven position with a whole of uncertainty around it. And the key thing, Stephen, is we've been very careful about what we spend and we will continue to be very prudent, right through to the remainder of the year, given the scenario we're in.

Stephen Ridgewell: Okay, thanks. And just one last one from me, just with net debt to EBITDA, obviously lifting, if you look at the sort of run rate in the first half and with the guidance, and appreciate the comments that you're fully funded for this year, but that would presume, just given the company to [inaudible] preference for, call it two times net debt to EBITDA, you'd be needing a recovery into next year to remain within that target range for net debt to EBITDA. I mean, is an [inaudible] raising a possibility, if not, if it's not a preferred option, are asset sales also under consideration?

Angela Dixon: At this point in time, we said at the full year that we would continue to look at our balance sheet and work through other, additional options with our debt portfolio and that's the plan and it will continue on. I'm loathe to go back to the capital markets at this point, and further dilute our shareholders, this is what we are perceiving as a timing issue. We just don't know when the swingback is. So if we can avoid that, we certainly will be. And we'll just continue to work through what options we have in the debt markets to get a stable position for the years ahead.

Stephen Ridgewell: Okay. Thanks very much-

Leon Clement: Stephen, perhaps I can answer your question around asset sales. And I think it's building on Angela's answer. I mean, I think we're fairly, clearly signalling on page 23, that these are temporary resets of our covenants. And there is some work to lock forward, around what's an appropriate capital structure between equity and debt and how we'll move that forward. And Angela's committed to taking that forward, given the context of the current environment.

Leon Clement: You'll see from the levers that we've put forward around what we've done around it, we spoke to operating costs, we spoke to value chain efficiencies that we've got in place. We are doing a review of our structural cost space, and we'll be making sure that we have a look at what sits within that. Obviously, one of the levers in that bucket is asset sales, but no decisions have been made at this point.

Stephen Ridgewell: Okay. Thank you much. Appreciate it.

Operator: Thank you. Your next question comes from Chelsea Leadbetter from Forsyth Barr. Please go ahead.

Chelsea Leadbet...: Morning team. I guess, extending that last question a little bit further in terms of covenant changes, so my understanding or interpretation here, is that it's just a temporary change, i.e. just for this financial year '21 period, is that right? Or does it extend into 1H22 as well?

Angela Dixon: Yes. FY21. End of year FY21.

Chelsea Leadbet...: Okay. And in terms of the 7.5 times total debt to EBITDA, I guess it's quite a large change. I'm just interested in, I guess, who drives that number. And ultimately, are you trying to buy yourself quite a bit of headroom in case you need it? I'm just trying to understand, why take it to that level? And then secondly, what's the cost of this change for your interest bill in the second half?

Angela Dixon: Yeah, Chelsea, that's a really good question. Yes. And as both, I think, Leon and I have talked to today, there is significant uncertainty of the recovery of the rebuild in our infant formula. I've had very open, sharing relationships and directions with our banking syndicate in the last, wee while. But we've set that 7.5 times at what we think is appropriate, given the work we have worked through together on the different scenarios that could play out for our business, given the timing impact. So, that's pretty much how we got to that number.

Angela Dixon: In terms of the cost, it's fair to say you always pay. So it has cost us a little bit more, given that we are going to be stretching our net debt and asking for more capacity from the banks. And that has taken us into a slightly higher risk profile within the range, but it's all manageable within our facility at this point in time.

Chelsea Leadbet...: Okay. Are you-

Leon Clement: I think, Chelsea, the thought here is consistent with what we're saying, this is a temporary impact. What's being, I think, communicated via us through our banks is

that there's headroom around a broad range of scenarios that we're seeing there. We'll continue to do some work on that, but it also shows the confidence that they have in our medium to a long-term outlook here.

Chelsea Leadbet...: Okay. No, that's helpful. And Leon, you talked a lot at the beginning and, obviously, through the presentation about rebalancing and, obviously, the challenges that the sharp change in demand has created for the business. I'm just interested in how we think about when that has been rebalanced. Is this still kind of thinking into 1H22, is this still a challenging period here for you in terms of what that could look like?

Leon Clement: Yeah. Look, it does rebalance. It sort of takes a year to unwind as long as we get stability around that demand outlook. So I think, we've broadly signalled what we think the drop would be when we first assess the impact, just post the December downgrade. Assuming that's broadly stable and stays consistent over the next 12 to 18 months, our production levels start to realign with our infant nutrition sales to those levels, as long as they remain stable.

Leon Clement: But in this year, unfortunately, we are producing a lot less than we're selling. And that is painful on an organisation that has recently invested in capacity. So if we, all things being equal, have stable demand on this year's outlook, we would be performing materially better. Unfortunately, we're resetting inventory from a view that we had in the second half of last year, that we would continue to see growth on the 50,000 odd tonnes of infant nutrition sales that we made.

Chelsea Leadbet...: Okay. Thank you. I'll leave it there for now.

Leon Clement: Chelsea.

Operator: Thank you. Your next question comes from Adrian Allbon from Jarden. Please go ahead.

Adrian Allbon: Good morning. Again, just kind of, I guess, seeking a bit more clarification on, I guess, what both Stephen and Chelsea have asked already. In terms of the reset at the first half, the Canon performance was down 15%, the ISP production down 62. In the plan that you've agreed with the bank around the covenants, are you expecting any sort of ISP production in the second half? I presume you are.

Leon Clement: Yes we are, but at materially lower levels than historically, Adrian. So I think, what we're signalling is this dynamic is expected to continue for the rest of the year. And if you think about our seasonal production, normally we would be looking at this period, around February, March, April to really be ramping up infant nutrition production and base powder production for a forward view into FY22, that we'd be rebuilding on.

Leon Clement: Given, we don't have certainty of what FY22 looks like, it's not like we're not running our plants, but they're running at materially lower levels than historical. So just to give you an indication they're about a third as full as they were last year in totality. And that's what's causing us some pain because we've got a whole lot of expensive

plants, and some people that we can't let go, that we're continuing to pay for but we can't run product through them.

Adrian Allbon: And just related to that, what are you doing around the milk contracts into '22 and '23?

Leon Clement: We still want the milk pool because we still use that ability to switch between ingredients, products and infant nutrition as a natural hitch. We want our plants to be full, but we also prefer them to be full with a high-value product mix. So, no change to our milk contracts. We're going to continue to protect the milk pool that we have. We really just move the lever between our commodity and ingredients business. And there's an indication on that side of how we're looking to differentiate that part of our business, maybe with better milk and just leaving the flex for infant nutrition as and when that recovers.

Adrian Allbon: Okay. I think, at the year-end last year, you had a reasonable stockpile of the IFB powder. With the dramatic reduction and production, have you worked through that now? The IFB production across the second half, will that be new stuff, I suppose?

Leon Clement: We are working through that now as probably the best term. So I think, we're doing our best to smooth based-powder production, given we're now in the shoulder season. It's when we typically start to move towards that. And we're assessing what we think our FY22 demand will be, especially in that first half, to set those production plans. But over time, that inventory starts to moderate down to the new demand outlook. So, I'd expect it to be moderated by the end of this financial year.

Adrian Allbon: Okay. And then, I think, at the year-end in last year you provided a sort of a management estimate of the diversification drag, which I think was sort of the 20 to 25 million of impair, as with some of the stuff that you're indicating here, I think through slides 14 to 15, would your forward view on that be... like into '22, '23, would that be sort of 10 million less on some of these efficiencies that you're targeting? Is that the right way to think about it?

Leon Clement: I think we'd have to go away and do the maths against a slightly different scenario. The diversification drag is probably the cost of new optionality, which does include Synlai Pocono. But yes, I'm sorry, Adrian, I think we might just have to regroup on the maths around how we did that calculation last result.

Adrian Allbon: Okay. And then just final question, on slide 19, when you talked about 200 million of value, are you talking about additional impaired or additional EBIT, what's the reference here?

Leon Clement: It depends on the nature of the initiative and how it comes through in our P and L. It's indicative of a pipeline of value and you'd hope that most of it would drop to the bottom line, although some of them come with investment. So for instance, say the top right opportunity, around capturing the value of milk components, that would come with capital investment to invest in the required infrastructure to do that. And so you'd only see the value there dropping at an impact level.

Adrian Allbon: Okay. Thank you.

Leon Clement: It's indicative of the new value that we would look to create, and we'll continue to focus in on chasing that.

Operator: Thank you. Your next question comes from Richard Barwick from CLSA. Please go ahead.

Richard Barwick: Good morning, everybody. A couple of more detailed questions for me to start. When you talk about the sudden switch from NZ dollars to US dollars, re sales mix, are you talking about A2's English label weakness, but China label strength? To clarify.

Angela Dixon: Yeah, sort of. So most of our infant is paid for in New Zealand dollars. And when we've got to move that milk into our ingredients or commodity products, we sell all of that in US dollars. So our US dollars exposure is changed quickly overnight. And that's where we weren't able to put ourselves in a position to hedge for those. And at the same time, we had the foreign exchange market, around Christmas, moving up significantly. So that has certainly had a headwind for us this year and will continue into the second half as well.

Richard Barwick: All right, thank you. And then on slide 15, where we were talking about the $3 million under the efficiency initiatives, what's the timing associated with that $3 million? And also, if you're talking around sort of yield improvements, what sort of volumes are required to achieve that from here?

Leon Clement: Yeah, those are this year's improvements that will contribute to FY21 and are on an annualised basis, the $3 million is locked in. There are a mixture of opportunities that sort of cross there. Some of them sitting across our commodity and ingredients business, some on our infant. And they're broadly sized on our current mix. A lot of them, Richard, are around how we do things, like make sure that we get really close to the standard specified within the bill of materials. And whether or not, we can get much closer to the levels of protein and fat within the mix. And so that's where the opportunity sits. And they're largely agnostic to the product mix that we have.

Richard Barwick: Right. But presumably, if volumes... Okay, if you agnostic in the mix. No, that makes sense.

Leon Clement: So yeah, we broadly have stable volumes. It's just the volumes of infant versus ingredients. I would guess that these initiatives are spanned across both.

Richard Barwick: Okay. And then the last one, for me, just thinking back, some of the wording you've used around the December downgrade, the level of uncertainty that you have within the business. How does this work when, I mean, you are reliant on A2 demand or A2 volumes for the English label, what sort of visibility do you get from A2? Is that improving? Because I mean, it reads like you've got no visibility, if you go back to December, for instance. Is there a sense that that's improving or do you find out when the rest of the market finds out, in terms of what the demand outlook looks like?

Leon Clement: Well, I think that A2 have been reasonably clear that the December downgrade also came as a surprise to them and that's reflective in how they went to market around it. So for that instance, we broadly found out, as everybody else was, including A2 themselves. We get quite good forward forecast from A2. And we work collaboratively with them on that outlook.

Leon Clement: I guess what's changed is we've moved from a position in December, January, where we were taking that forward view and putting it back into our business and seeing what it could do, through to the fact that we decided that until we saw really clear evidence of a recovery, it was inappropriate for us to start guiding on that basis. So it's not so much the visibility that we get, it's the confidence that we have in that forecast that we receive that is changing our position on the outlook that we're taking.

Richard Barwick: Right. And just to be clear in terms of your... I know we're talking a mix effect here, but the production of the infant formula, it sounds like you've really only made the switch... post that December downgrade, there wasn't much of a change in your production ahead of

Leon Clement: No.

Leon Clement: That December downgrade. I'm just thinking about when we reacted post the December downgrade. There was probably a little bit of a softening that occurred in the first half, but it was immaterial. The big impact was post the December one, and I think the chart shows that. And whilst it's [inaudible], it probably gives you an indication of how we reacted. You combine that with making 45 to 50% of our base powder production in that four month window, we were assuming at that point that growth would continue on FY20. That's the inventory reset that we're experiencing.

Richard: Yep. Okay. All right. Great. Thank you. Appreciate that.

Leon Clement: Thanks Richard.

Operator: Thank you. Your next question comes from Andrew McLennan from Goldman Sachs. Please go ahead.

Andrew McLennan: Good morning, everyone. There's quite a few impacts coming through on your working capital, to say the least. I'm just wondering, receivables have clearly been quite dynamic, you provided some commentary around what was driving that outcome, but can you just provide a bit more detail and specifically around what factors you may think are permanent versus temporary?

Angela Dixon: If I got your question, right, Andrew, you wanted to just more colour on what are the drivers of our cashflow outlook and cashflow impact on the half? Is that right?

Andrew McLennan: Yeah, particularly on the half, just so we can get a better understanding of what factors are a permanent versus more temporary.

Angela Dixon: One of the biggest factors was the fact that GDT prices started increasing halfway through the half year. As that happens, that means we need to reset our milk pricing through our farmers to ensure that we catch up to where we think the end position will be. We started the year at an announced milk price of about $6.40 and our most recent milk price announcement was seven 20. That has significant impact in your payments out to farmers. We always... That's one of the reasons we have this cashflow impact in the first half of the year compared to the second. We make our biggest portion of that payments to farmers, in the first half of the year. We've also had the switch effect from going from high value margin products to lower margin value products in the last part, the last six weeks of the year. Plus we've had some delayed cashflow impacts around shipping, just because there's a certain quantity that's rolling through every month, so we just can't get out and that's not catching up.

Angela Dixon: Those are the predominant drivers of our cashflow being negative this year. We would expect that to get better as the year goes through because we will get the higher GDP prices on our ingredients flowing through and our revenue lines and our cash lines as we get the sales come through. At this point in time, we've effectively paid farmers ahead of when we get the milk receipts off the products. That's one of the phenomenons flowing through.

Andrew McLennan: Okay. In addition to that, you've had, as has been discussed earlier, the build up of inventory, within infant formula in particular, and you'll be working down by the end of the year. A lot of it is temporary and some of it quite unique. How significant is the factor on the returns? You said it was just for six weeks. Sorry, the high margin product impact was that a significant component of the impact to, I guess, receivables?

Angela Dixon: Yes, it certainly is when you compare a half on half. Yeah. I guess the component to look through is we do have receivable assignments for our big international players. We've had a significant volume of commodities products that we now need to sell in the world at the [inaudible]... And second half of the sales curve we've broadened out our customer base. That means we've gone. We were relying more on more general terms of trade rather than our receivables assignment, which gives us the cash right up front. There is a whole lot of factors in here. I hope that gives you a better clarity.

Andrew McLennan: Okay. The GDT trade means that your payment terms, the receivable terms will increase. That'll be an issue for the second half?

Angela Dixon: Yeah.

Andrew McLennan: Yeah. Okay. Also, just, I guess a bit similar to Richard's question earlier. What controls can you put on? Obviously the key issue here is with, with A2. It seems like a pretty asymmetric situation when it comes to information. I'm just wondering, are there better controls you can or have been able to put on this relationship and the information sharing, because it just seems quite an extraordinary limitation for your bill. Although this is a pretty unique situation in the middle East, but I'm just wondering if there's anything we can do better here?

Leon Clement: Yeah. I think it's a good question on something that we have been reflecting on internally and in our discussions with A2. I think it's a unique situation, but the dynamic of participants further up the value chain often experiencing more adverse and volatile impacts as well, documented and understood. There are certainly ways that we can address that. It's been less visible to us in terms of the risks that we carry, because we've broadly been following A2 up and investing ahead of its curve to create... To be able to meet the demand as it's growing. There are things that we can start to do both in the relationship and our own value chain to start to expand that planning window for the shoulder season.

Leon Clement: We can look at channelling meltdown to seasonal plants, like our cheese plants that gives us the opportunity to just broaden that. We can go to more just-in-time inventory models and more robust planning arrangements. We can also start to look at reshaping the nature of our contractual agreements. Certainly that's something that both us and NATO we're looking forward to in the second half that I think we'll look towards as we start to reset our relationship here.

Andrew McLennan: Okay, great. Thank you.

Operator: Your next question comes from Marcus Curley from UBS. Please go ahead.

Marcus Curley: Good morning. Just a couple for me. Can you just talk a little bit to, I suppose the guidance pointing to a lower second half profitability. Can you just talk a little bit to what the deltas are between the first half and the second half against the plan?

Leon Clement: Can I just understand the question Marcus, you're saying we've made the impacts [crosstalk] first half.

Marcus Curley: And breakeven for the full year, so you're going to go from plus six to minus six, if you take break evens literally. [crosstalk].

Leon Clement: Go ahead. Sorry.

Marcus Curley: Why are you 12 million profit worst off in the second half?

Leon Clement: Okay. I'm with you. Well, I think that there's two or three main sectors that are indicating why our second half flips from a small profit to assuming the broadly breakeven guidance materialises in the second half. The first one is our factories remain relatively quiet. As you know, in the second half, we typically turn our factories on to infant based powder production. That not happening has a significant impact on our second half relative to other periods. We were tracking through, I think August, September, October, November, the first half, still broadly with a stronger outlook until we got to December. We were still producing infant nutrition before the peak arrived that drove profit for us in that first half. We're now saying for all of the second half, we're broadly impacted by this impact, and that's coming through.

Leon Clement: The second major impact is what we've talked around ingredients. We've seen quite material shifts and the ingredients market probably from about December onwards.

What's pretty well signalled in the public domain is the rapid increase and dairy prices and commodity prices. Most of that demand is coming from China, but some of the challenges that we experienced there is around where that market demand comes from and where our key customer bases are formed. What that means is we move a lot of our ingredients into spot contracts, as opposed to some of the more longer term customised ingredients contracts that we have with some of our multinationals. They are less returning, than the contracted volume that we would have with the now ingredients space.

Leon Clement: What we've also noticed is that product mix factors such as the divergence of the butter price from the AMF price are having an impact. The milk price that we have to pay is derived on a notional producer model that assumes that we would have a butter plant. We don't have a butter plant, that's driving the milk price up, but we've seen butter diverge from IMF by as much as 18% this year. That has created some headwinds for us in the second half. Add to that, the assumption that shipping delays will continue to impact our year. Then I think it's fairly clear why the second half starts to look fairly challenging for us.

Marcus Curley: Great. Secondly, Leon, you spoke to your last milk price at seven 20, frontier has mid point $7.60. Is that a genuine sort of number that's in the plan? Because it's obviously quite a large variance at this stage.

Leon Clement: We gave the seven 20 update guidance in January. We do another one in May. We typically only do three a year Marcus and that's seven 20 has some upside to it. Our internal models are indicating that it'll be higher than that. We typically don't tend to respond to external factors. We provide three a year and good communication with our farmers on the factors that are driving that. We expect that that seven 20 number will increase.

Marcus Curley: Then just finally, when you articulated the issues around the A2 volumes, obviously you alluded to the fact that they're also managing down their own inventory levels. Do you have any visibility in terms of how much of this temporary impact reflects their inventory reductions at the moment, versus the underlying demand pitcher?

Leon Clement: No, I don't think we do have great visibility of inventory sitting within A2's network. I think that question's a better placed with them.

Marcus Curley: Sure. Okay. Thank you.

Operator: Thank you. Your next question comes from Kurt Gelsomino from Morgans. Please go ahead.

Kurt Gelsomino: Good morning, Leon, Angela, just a quick question from me. Maybe can you just talk through, I guess what you've assumed for lactoferrin pricing in the second half of 21. Do you expect them to be sort of broadly consistent with the first half of 21 or do you sort of expect them to lengthen further?

Leon Clement: I guess it's another factor where uncertainty prevails, Curt. We've got as signalled earlier, a lot of additional capacity globally coming onto the market against still relatively robust demand for high quality infant, lactoferrin. We're broadly assuming that it's relatively stable on our first half achievement and current scenario, but again, that has some fairly wide parameters around where it could swing. It's broadly stabilised for now, but there's still more capacity coming on the market.

Kurt Gelsomino: Awesome. Thanks for that.

Operator: Thank you. Your next question comes from Xavier Waterstone from QuayStreet. Please go ahead.

Xavier Waterstone: Morning guys. I just got a quick one about the inventories. Specifically the finished goods say there's been a reallocation from cost to net realisable value. It looks like there's about an 87% increase in volumes and inventory, but a 22% decline in average unit value. Could you just talk a bit about what's driving that and whether or not there's further risk of finished goods and write downs, if you don't get that buyer support through in demand, which result in getting converted into commodity powder?

Angela Dixon: We might have to come back to you on that one because the challenge with understanding our closing inventories is now that we've put dairy works into the mix, they have got a significantly different inventory profile cause they have a longer maturation on their imagery products. We've got a lot more commodity products coming into the business at the end of the year, but that we are expecting to be largely fully sold and not holding a lot of commodity products at the end of the year, apart from what impacts on shipping.

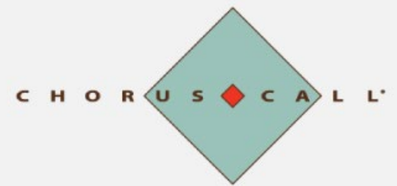
Xavier Waterstone: All right. Thanks for that.

Leon Clement: We might make this the last question. Thanks.

Operator: Thank you. Your next question comes from Nicholas Pointon from RNZ, please go ahead.

Nicholas Pointon: Good day, can you... Oh, sorry. Just to make sure... Good day, Nicholas from RNZ here. Sorry. I'm just a bit all over the place. Just want to go back to some of the conversations that were being had about banking covenants. I think Angela, you mentioned to say that you'd be loathed to go back to the capital markets and then Leon, you followed that up by saying that asset sales were just one lever and a suite of measures that could be taken to help pay down that debt position and whatnot. Could you just run through what other options there are available?

Leon Clement: I don't want those comments to be taken out of context. I think we're obviously facing a temporary challenge in our business as it washes through. We've gone to shareholders last year and raised $200 million to complete our investment phase and for the purposes of facing into the uncertainty, that was well signalled from COVID, which has emerged.



Leon Clement: We also signalled at the end of last year after the capital raise that we wanted to come back to our capital structure and work through how we finance debt. Against that we've got the optionality to consider structural cost implications for what we need going forward. The way that I would look at this, is this as a total package. I think it's fair to say that having gone to shareholders to support us for an investment cycle ahead and to make sure that we're well braced for uncertainty, we wouldn't want to go back there again when we've still got the two levers of debt and structural costs to be able to look back. Until we've fully worked through those options, it's not something that we'll be returning to in the immediate term. I Hope that provides you with some context for how we're looking at.

Nicholas Pointon: All right. Wonderful. Thank you.

Operator: Thank you. That concludes our question session at this time. I will now hand back to Leon for closing remarks.

Leon Clement: All right. Well, thanks everybody for your well-placed questions. I'm sure we'll have follow-ups with many of you. I hope that the key messages that you've taken out of today is that we're working through a temporary, but sudden impact on our business. We do have confidence that this will reverse, we just don't know when and that uncertainty is as reflected in our guidance statement. I hope that you've seen that we are taking appropriate action to mitigate the impacts and that we are continuing to be confident in our future, given the investments that we've made and the confidence that we can have on, on the forward picture. We'll close off there and hopefully we'll catch up with you all very soon. Thank you.

**[END OF TRANSCRIPT]**