

25 October 2022



A2 Milk Limited (ATM)

The company will hold its Annual Shareholders Meeting at **11.00am Friday 18 November 2022.**

The location is **The Cordis, 83 Symonds Street, Grafton, Auckland.**

You can also join the meeting online [here](#).

Company Overview

The a2 Milk Company was founded in New Zealand in 2000 by Dr. Corran McLachlan. While studying at Cambridge University, he learned that proteins in milk affect people differently. He also learned that ordinary cows produce milk with different beta-casein protein types, called A1 and A2. Research over the years has demonstrated that many people who have digestive discomfort when drinking ordinary cows' milk find a2 milk easier on digestion. That is because a2 milk contains only the A2 protein and no A1.

The Company listed on the NZX in 2004 and is also listed on the ASX. It has a 19.8% shareholding in Synlait Milk (NZX: SML) and a 75% shareholding in Mataura Valley Milk. In recent times it has experienced some difficulties with changes in its CEO and senior management and a significant reduction in sales within China.

In October 2021 the company announced it was facing a class action by shareholders around its disclosures between August 2020 and May 2021. Its share price fell from \$21.50 to \$5.56 during that period. In May 2022 the company advised it is facing a second class action over this matter.

In February 2022 Bessie Lee retired from the Board and in March 2022 Sandra Yu was appointed to the Board.

Current Strategy

The strategy is to enrich people's lives through the provision of a2 milk.

Disclaimer

To the maximum extent permitted by law, New Zealand Shareholders Association Inc. (NZSA) will not be liable, whether in tort (including negligence) or otherwise, to you or any other person in relation to this document, including any error in it.

Forward looking statements are inherently fallible

Information on www.nzshareholders.co.nz and in this document may contain forward-looking statements and projections. For any number of reasons, the future could be different – potentially materially different. For example, assumptions may be wrong, risks may crystallise, unexpected things may happen. We give no warranty or representation as to any future financial performance or any other future matter. We may not update our website and related materials for changes.

There is no offer or financial advice in our documents/website

Information included on www.nzshareholders.co.nz and in this document is for information purposes only. It is not an offer of financial products, or a proposal or invitation to make any such offer. It is not financial advice and does not take into account any person’s individual circumstances or objectives. Prior to making any investment decision, NZSA recommends that you seek professional advice from a licensed financial advice provider.

There are no representations as to accuracy or completeness

The information, calculations, and any opinions on www.nzshareholders.co.nz and in this document are based upon sources believed reliable. The NZSA, its officers and directors make no representations as to their accuracy or completeness. All opinions reflect our judgement on the date of communication and are subject to change without notice.

Please observe any applicable legal restrictions on distribution

Distribution of our documents and materials on www.nzshareholders.co.nz (including electronically) may be restricted by law. You should observe all such restrictions which may apply in your jurisdiction.

Key

The following sections calculate an objective rating against criteria contained within NZSA policies.

Colour	Meaning
G	Strong adherence to NZSA policies
A	Part adherence or a lack of disclosure as to adherence with NZSA policies
R	A clear gap in expectations compared with NZSA policies
n/a	Not applicable for the company

Governance

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Directors Fees	A	See below.
Director share ownership	A	See below.
Executive Remuneration	A	See below.
Golden parachutes/handshakes	A	See below.
Director Independence	G	A majority of Directors are independent
Board Composition	A	See below.
Director Tenure	G	See below.
ASM Format	G	Hybrid Meeting.
Independent Advice for the Board	G	See below.

Directors Fees: We note the statement by a2 describing a table of fees as “*Remuneration and the value of other benefits paid to non-executive directors of the Company*”, implying that no other benefits (such as share options, special exertion payments etc) were paid to Directors.

NZSA would prefer clearer disclosure in the interests of transparency.

Director Share Ownership: There is no disclosure as to whether directors are required to own shares. While NZSA encourages share ownership by independent directors, it does not support compulsion as this reduces the pool of available directors, may compromise independence and removes the ‘market signal’ associated with share purchases.

Executive Remuneration: The CEO is paid a base salary and a short-term incentive (STI), both paid in cash, and a long-term incentive (LTI) paid by way of performance share rights.

NZSA encourages fulsome disclosure in relation to any incentive payments made to the CEO, including disclosure of measures (or measure ‘groups’), weightings, targets and the level of achievement associated with each component associated with any awards.

- For STI, the company offers excellent disclosure of the metrics, weightings and achievement vs target for the ‘high-level’ components that lead to the STI outcome (overall outcome = 95%).
- We note that the ‘target’ STI payment related to group performance is at 120% of base salary – with a maximum of 156%. The CEO also receives an “individual multiplier” with a range between 0-130%, potentially allowing the CEO to earn double his fixed remuneration in STI. For FY22, the amount earned was a company score of 95% (see above) multiplied by an individual performance factor of 110% = 105%. When multiplied by the STI target of 120% of fixed remuneration, the CEO will receive 126% of his base salary in STI (or AU\$2.25m).
- For FY22 LTI, the CEO was also issued ‘deferred’ rights from FY21 (approx. 480k rights) as well as FY22 (490k rights), a situation commented on by NZSA in last year’s report. NZSA remains unclear as to the formula used to issue the number of performance rights. If it is the same

multiplier as described above, the FY22 component alone has a face value of AU\$2.85m – although we recognise the eventual outcome value may be significantly different.

- We note that the company clearly discloses the vesting conditions of the performance rights issued, including both an EPS and Revenue CAGR hurdle. In theory, it is still possible for an LTI award to vest when total shareholder return has been negative, a position not supported by NZSA.

For LTI, NZSA believes it would be helpful to have a table setting out the current years actual LTI awarded (at face value) so shareholders can see the total theoretical value of the year's remuneration.

At target rates, this implies the ability for the CEO to earn approximately 3x his fixed remuneration in incentives, a level not common amongst New Zealand companies. While NZSA does not consider this best practice, it does acknowledge the 'Australian' nature of ATM's recruitment market for its CEO and the market practices common in Australia.

Golden parachutes/handshakes: We note that that the CEO received one-off 'transition payments' on joining a2 Milk, to compensate for the loss of entitlement from his previous employer. This comprised of an AU\$1.27m cash payment and shares in a2 to the value of AU\$3.7m (at the time of joining).

While we do understand that the company needs to compete effectively in recruiting an appropriate individual as CEO, NZSA does not support these types of payments as we do not believe they correlate to performance.

We note that a2 has previously paid similar transition payments to an incoming CEO.

We appreciate the disclosure of termination and notice periods in the annual report, essentially placing a 'cap' on the potential value of any termination payment.

Board Composition: Whilst the company includes a skills matrix in the Annual Report it does not attribute skill sets to individual Directors to demonstrate how they contribute to the governance of the company.

The company does not participate in the IoD's Future Director programme designed to develop and mentor the next generation of Directors. NZSA expects NZX50 companies to participate as part of a responsibility to develop and mentor the next generation of Directors.

We note the Annual Report does not include a full list of Directors other governance roles, although these are disclosed within biographies on the company's website and in the annual report.

The nature of the company's board indicates a commitment to thought, experiential and social diversity, with relevant experience for a2.

Director Tenure: NZSA looks for evidence of ongoing succession or 'staggered' appointment dates that reduce the risks associated with effective knowledge transfer in the event of succession. We also prefer a term maximum of 9-12 years, unless there are exceptional circumstances that may apply.

Directors of a2 were appointed between 2013-2022, with Julia Hoare the longest serving director. She has announced her retirement from the Board as at end-February 2023.

Independent Advice for the Board: NZSA looks for evidence, through disclosures, that a Board has access to appropriate internal and external expertise to support board assurance activities. We also look for evidence that Boards are across their risk management responsibilities.

a2 offers comprehensive disclosure of the key strategic, business, climate-related and financial risks that impact the business, as well as mitigations. There is also thorough disclosure of its risk management and governance processes.

The [Board Charter](#) states that Directors are entitled to seek independent external advice at a2's expense, with the prior approval of the Chair. Board members are also able to access the Company Secretary, although it is less clear as the extent to which other internal assurance staff have unfettered access to the Board.

Audit

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Audit independence	G	Good disclosure.
Audit rotation	A	See below.

Audit Rotation: Whilst the company ensures the Lead Audit Partner is rotated at 5 years as required by the NZX Listing Rules, it does not disclose if the Audit Firm is rotated at 10 years. Notwithstanding audit tenure, NZSA also expects disclosure of the appointment dates of the Lead Audit Partner and Audit Firm to improve transparency for investors.

Ethical and Social

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Whistleblowing	G	Good disclosure.
Political donations	A	Not disclosed if donations were made.

Political Donations: NZSA policy is that companies should not make donations to political parties. We expect disclosure to this effect, even if none have been made.

Financial & Performance

Policy Theme	Assessment	Notes
Dividends and Imputation	n/a	No dividend was paid.
Capital Raise process	n/a	n/a if no capital raised
Takeover or Scheme	n/a	n/a if no takeover

a2 Milk Company's share price fell from \$6.96 to \$5.94 (as of 18th October 2022) over the last 12 months – a 15% decline. This compares favourably with the NZX 50 which declined by 17% in the same period. The capitalisation of ATM is \$4.4b placing it 11th out of 130 companies on the NZX by size and makes it a mid-sized company.

Metric	2020	2021	2022	Change
Revenue	\$1,731m	\$1,205m	\$1,443m	20%
Gross Profit	\$969m	\$510m	\$664m	30%
NPAT ²	\$385.8m	\$80.6m	\$122.6m	42%
Gross Profit Margin	56%	42%	46%	9%
EPS ¹	\$0.52	\$0.11	\$0.165	50%
PE Ratio	30	70	36	
Capitalisation	\$11.4b	\$5.1b	\$4.4b	-14%
Current Ratio	3.69	3.99	2.66	-33%
Debt Equity	0.28	0.27	0.44	64%
Operating CF	\$427.4m	\$89.4m	\$203.8m	128%
NTA Per Share ¹	\$1.51	\$1.46	\$1.46	n/c
Dividend Per Share ¹	\$0.00	\$0.00	\$0.00	n/c

¹ per share figures based off actual shares at balance date (not weighted average)

² Attributable to shareholders of the company.

2022 was an improved year for ATM after a disastrous 2021. Revenues increased 20% to \$1,443m and Gross Profit was up 30% to \$664m on the back of an improved gross profit margin of 46%. NPAT was up 42% to \$122.6m. The company reported EPS of \$0.165 and this places ATM on a reduced but still high PE of 36.

Operating cashflow also increased 128% from \$89m to \$204m but this was mainly a function of working capital changes. Most notably, trade and payables increased by \$128m.

The company is in extremely sound financial position with a current ratio of 2.66 and a low debt equity ratio of 0.44. During the year the company took on a modest \$66m of long term debt and an additional \$41m was recorded as short term borrowings.

The company did not pay dividends but “considering its strong balance sheet position, the Company intends to execute an on-market share buyback of up to \$150 million. An on-market share buyback is considered to be the most appropriate form of capital management at this time”.

ATM has a cash balance of \$887m and has sufficient resources to return capital to shareholders.

The NTA remained steady at \$1.46 and the company trades at a large 307% premium to NTA.

In a detailed forward-looking statement on page 13 of the annual report, the company state that: “Revenue is expected to be down in FY23 compared to FY22 (12 months) due to increasing levels of insourcing and lower GDT pricing, and EBITDA is expected to be broadly in line with FY22 (12 months)”.

Resolutions

1. That the Board is authorised to fix the auditor's remuneration for the coming year.

This is an administrative resolution.

We will vote undirected proxies **IN FAVOUR** of this resolution.

2. To elect Sandra Yu as an Independent Director.

Sandra Yu was appointed to the Board 1 March 2022 and is therefore required to offer herself for election. She is the former head of Mead Johnson Nutrition's Greater China business and a member of Mead Johnson Nutrition's Global leadership team. Prior to that, she held various other senior executive roles at Mead Johnson Nutrition, including as the Global Marketing Vice President, responsible for the transition to new digital media and ecommerce channels globally. She was also appointed as the non-executive chairwoman to lead RB China advisory board after the merger between Reckitt Benckiser and Mead Johnson Nutrition in 2017. Prior to joining Mead Johnson, she held executive positions at Unilever, where she worked across Asia for thirteen years. She resides in China.

We will vote undirected proxies **IN FAVOUR** of this resolution.

3. To elect David Wang as an Independent Director.

David Wang was appointed to the Board 1 September 2022 and is therefore required to offer himself for election. He is the President of Asia Pacific for Buhler AG, a global leader in the provision of industrial solutions, which specialises in integrated plant equipment systems and related services for food processing and advanced materials manufacturing. He has held various senior executive roles including at Blackstone AVINTIV Inc and Dover Corporation where his responsibilities covered manufacturing, research and development, technology, and sales throughout Asia. He also worked with PepsiCo for almost 10 years in operations and supply chain. David resides in China.

We will vote undirected proxies **IN FAVOUR** of this resolution.

4. To re-elect Pip Greenwood as an Independent Director.

Pip Greenwood was appointed to the Board 1 July 2019. Currently she is also a Director of Westpac New Zealand, Spark New Zealand, and Fisher & Paykel Healthcare. She was previously a senior partner at law firm Russell McVeagh, where she spent over 10 years on the firm's board including acting as the firm's board Chair and interim CEO.

We will vote undirected proxies **IN FAVOUR** of this resolution.

Proxies

You can vote online or appoint a proxy at <https://vote.linkmarketservices.com/ATM/>

Instructions are on the Proxy/voting paper sent to you.

Voting and proxy appointments close **11.00am Wednesday 16 November 2022.**

Please note you can appoint the Association as your proxy. We will have a representative attending the meeting.

The Team at NZSA