



1H FY2019 Half Year Results

27 February 2019

Slide 1

Good morning everyone and welcome to the results announcement for Bega Cheese for the first half of the 2019 financial year. With me today is CEO Paul van Heerwaarden and CFO Colin Griffin. Paul and I will present the first half results and Paul, Colin and myself will be available to answer questions following the presentation.

Slide 2

I will begin the presentation

Slide 3 – Value Proposition

Ladies and gentlemen.

It is fair to say that the first half of the 2019 financial year has been important in the perspective of the goals and strategy we have for the business while also presenting challenges.

I always think it is important to recognise the value we are continuing to build in the business and ensure we remain focused on the creation of value for all our stakeholders. The Bega business is increasingly recognised for our high quality infrastructure, iconic brands, our well established and experienced approach to our business, our diversified customer portfolio both in Australia and internationally, our strong relationships and reputation with our suppliers and continued business growth. It is these things that have seen the business consistently grow, manage through difficult or changing operating environments and make significant progress in creating the Great Australian Food Company.

Slide 4 – The Bega Integrated Business Model

I often comment on our goal to create an integrated dairy and food business that is able to respond to customers no matter where they are in the world who wish to understand the entire supply chain of the food they are considering purchasing.

Our approach to have connections right back to the farmers and communities that produce the raw materials that go into our products is driven not only by our philosophy but also the customers wishing to understand the provenance of their food, the manner and sustainability of production and the approach the business takes to its role in the community. Paul will speak in more detail on our business platforms and approach in his presentation.

Slide 5 – Key Messages

The first half of the 2019 financial year has been very important and successful from a strategic perspective albeit we have been impacted by some short term challenges affecting our financial performance. The key initiatives that stand the business in good stead for the future include our acquisition of the Koroit dairy manufacturing facility in western Victoria in August 2018 and the very

successful milk acquisition program immediately following the purchase. The Koroit acquisition has been followed in the last few weeks by our announcement that we will invest \$34 million on the construction of a lactoferrin facility on the Koroit site. During this period we have also been successful in negotiating a cheddar and mozzarella toll manufacturing agreement allowing us to continue to grow our business while avoiding additional capital expenditure particularly in an environment of falling milk production and over capacity in many milk supplying regions.

As we add to the infrastructure and capabilities it is also important to recognise when a facility will not be part of the long term future of the organisation and a decision must be quickly taken to close that facility. We announced today that we would be closing our Coburg cheddar and mozzarella factory. The facility is in a difficult location in metropolitan Melbourne and the capacity to expand or improve efficiencies at the plant was limited given its location and foot print and it was therefore concluded that business objectives and product supply requirements could be met more efficiently by rationalising our manufacturing network and closing our Coburg facility. We of course recognise that Coburg has been an important part of our growth for the past decade and appreciate the wonderful effort and important contributions staff at Coburg have made to the business.

In the branded and value added platforms of our business it has been good to see that our Bega Foods business has stabilised and while still extremely competitive in both Australia and internationally the team remain focused on meeting our business and financial goals.

Slide 6 – Financial Performance

With regard to financials it was a very challenging first half although I am pleased to report that revenue has increased some 6% to \$650 million with growth in ingredients being the main driver as a result of the Koroit acquisition.

A number of factors impacted our 1H earnings including milk price and milk volumes in some regions, slower first half sales in nutritionals, a significant build in inventory and associated funding costs as a result of the Koroit acquisition and corporate costs. As is always the case we believe it is appropriate to review the business from a normalised perspective. Our normalised EBITDA for 1H FY2019 was \$57.9 million a decrease of 21% and statutory EBITDA was \$39.6 million a decrease of 31%. Normalised profit after tax was \$18.9 million a decrease of 48% and statutory profit after tax \$4.9 million a decrease of 75%.

As previously announced the change in our business profile including the acquisition of Koroit has impacted the 1H versus 2H financials and as opposed to previous years we expect a greater balance between the two halves. Our guidance for full year remains at a normalised EBITDA of \$123 to \$130 million with recent farm gate milk price increases meaning the lower end of the range is more likely.

Paul will add further comment on the financials in his report.

Slide 7 – Strategic Focus

While the first half has been challenging and the business is impacted by acquisition and corporate costs, sales timing and milk supply pressure our strategic focus remains robust and the positioning of the business strong.

It is now important to realise the benefit of what has been a significant period of growth and change for the business. Our goal is to continue to grow our milk supply while directing that raw material into higher value ingredients and consumer good products. It will be important to work with our dairy farmer suppliers to overcome the impact of the drought and continue to investigate farming models

that are sustainable, efficient and cost effective in the regions in which they operate. We will continue to value add our ingredients utilising both our own and third party infrastructure to maximise efficiencies and product mix. Our consumer goods dairy and food business will maintain its focus on leveraging and growing our brands in both Australia and overseas. In branded, food service and contract manufacture of fast moving consumer goods, new product development and investments in efficiencies in all parts of the supply chain will remain important in a highly competitive market.

The business will continue to look outward while focusing on maximizing the benefits of recent acquisitions. While rationalisation continues in the Australian dairy and food industries we also recognise that innovation and start ups are increasingly important in business and with that in mind we have created a new ventures business platform in which the company may take equity positions in smaller, start up, innovative style businesses that will develop with entrepreneurial enthusiasm and the benefit of knowledge, experience and potentially supply from a larger business such as Bega. I will speak to you more at the conclusion of Paul's presentation but for now I will hand over to Paul for detailed analysis of the business.

Slide 8

Thanks Barry

Slide 9 – Delivering to Strategy

Before I speak in more detail on the first half financial performance and our business platforms I thought I would dwell for a moment on the delivery to strategy and our goal of creating “The Great Australian Food Company”. As Barry said it has been an important six month period in the company's history as we look to create a dairy and food infrastructure and supply chain that will be able to respond to our customers requirement wherever they may be in the world.

It is important to remember that we acquired Koroit in August 2018 and in fact if we are reflecting on the key transformations of the business it is equally important to recognise that we have owned Bega Foods only since July 2017. The successful integration of both of these businesses has been vitally important. Focusing on Koroit for a moment I am pleased to say the integration is going as planned as is our overall milk procurement program which sees Bega Cheese on track for an intake of between 1 and 1.1 billion litres of milk in FY2019. I will comment further on milk intake and the impact of the drought later in my report.

As we seek to grow and add value to our business we are clear on our objectives both corporately and operationally.

Forgive me if I repeat some of what Barry has already said but when reflecting on strategy delivery in the last six months I am pleased to report that we have completed the Koroit acquisition and are on target both in terms of integration and milk procurement albeit with a somewhat slower sales integration than we initially expected. We are very focused on establishing a sales rhythm for the Koroit production more in line with our overall business which we expect to have executed in the second half of this financial year.

Innovation is at the core of our growth strategy and we have recently launched a range of new products including gluten free Vegemite and Simply Nuts which is a 100% natural peanut butter product using only Australian peanuts supplied by our farmers based in Queensland. We continue to expand our organic infant formula business utilising fresh local milk supply and have recently announced a long term supply agreement with Bubs to supply goat infant formula utilising fresh milk supplied from their farms located in Victoria.

In addition to the above we have executed a long term lactoferrin supply agreement underpinning a \$34 million investment at Koroit, a third party mozzarella and cheddar manufacturing agreement, we have stabilised the Bega Foods business, integrated PCA and launched a new program to encourage expansion of our peanut crop and taken the decision to close our Coburg facility.

Our continuous improvement programs across the business are making an important contribution to our performance which we expect to be further enhanced once implementation of our new ERP system is complete.

Slide 10 – Business Highlights and Challenges

With regard to the 1H FY2019 financial performance there has clearly been both highlights and challenges.

I am pleased to report the continued growth of the business with revenue increasing by 6% to \$650 million and a record milk intake of 641 million litres which is an increase of 55% on the prior year. While it has been pleasing to have such a successful milk procurement program the impact of the drought has been significant in terms of both supply and competition for milk particularly in northern Victoria.

Much of the highlights in 1H FY2019 are directly related to our strategy. This includes the acquisition of Koroit and the increased milk supply, the further investments in lactoferrin and growth of our customer base and product portfolio for our contract manufacturing business.

In terms of challenges there is no question that the weather has played a big part in both a reduction of national milk production and increased competition for milk and in Queensland a decrease in forecasts for the size of the peanut crop. Our successful milk acquisition program and relative short period of ownership and transition of Koroit has led to a significant inventory build and associated debt which we expect to clear in the second half. Nutritional sales have been slower than forecast in 1H but again we are observing this to be timing rather than a change in the business environment. We would also observe significant cost increases in energy and insurance have impacted our overall business performance, with these cost increases alone being in excess of \$10 million.

The Fonterra and Kraft legal cases progress. While I can't comment on some of the specifics I can say that the Kraft case regarding peanut butter has been heard and we are awaiting judgement in the coming months. The Fonterra case regarding the Bega brand has also progressed with hearing dates scheduled for later this calendar year and early next year.

Slide 11 – Financial Performance

As Barry mentioned earlier the revenue increase of 6% to \$650 million was primarily due to the acquisition of the Koroit facility and the additional milk volume that we processed. We have also seen a decrease in revenue from our consumer packaged cheese business including processed cheese which is a declining category in the domestic market and a delay with the timing of the shipment of some bulk ingredient products towards the end of 1H. Sales of our nutritional products were lower in 1H FY2019 compared to the Prior Period due to sales timing which is forecast to flow through in 2H.

Bega continues to grow and diversify and our financial performance is influenced by a number of factors across our business platforms. Increased milk volumes and product mix optimisation with the acquisition of Koroit, the stabilisation of the Bega Foods business, the continued growth of the export branded business, an increase in the market price for lactoferrin and our continuous improvement initiatives have all contributed to an improvement in the financial performance of the business. The

current drought is having a significant impact on farmers not only in dairy but across all agriculture sectors in affected regions. A decline in milk volumes in northern Victoria, New South Wales and Queensland has seen significant competitive pressure on milk prices which is impacting all processors including Bega. As mentioned earlier we are also incurring increases in energy and insurance costs.

Slide 12 – 1H FY2019 Results

While there are a number of line items here clearly the major normalising adjustment is the costs of the Koroit acquisition, inventory value adjustment, capital raising costs and costs relating to our legal cases. We elected to normalise legal costs in the financial year as we expected the Kraft and Fonterra case to conclude in this financial year.

The Kraft case judgement is expected by the end of July but the Fonterra case is now scheduled not to be heard until the end of calendar year 2019.

Slide 13 – Balance Sheet

There has been significant change in the balance sheet in the last six months largely as a result of the acquisition of Koroit, most notably an increase in inventory of more than \$120 million and an increase in net debt of \$195 million. As previously mentioned there has been some sales timing issues in our nutritional business that have affected inventories. It is our expectation that we will decrease inventory significantly in the second half as we settle into the more predictable business rhythm with Koroit and bring to account sales in nutritional. It has been pleasing to see improvement in pricing on the global dairy trade platform over the last few months indicating strong demand for commodities which make up a substantial amount of the increased inventories we currently hold. Clearly our focus over the coming months as far as the balance sheet is concerned will be a reduction in inventory and net debt.

Slide 14 – The Bega Integrated Business Model

As the Bega Cheese business has developed and transformed over the past decade we have endeavored to evolve a business model that ensures we can respond to changes in the market and focus on investing in business platforms that leverage our core strengths and are relevant and competitive both now and in the future.

I will speak to the individual platforms on the slides that follow but feel this slide demonstrates well the integrated nature of our business with the objectives being to ensure we have scale and efficiency in bulk ingredients manufacture, provenance and control of our supply chain, agility in responding to markets and continued investment in both our strengths of today and opportunities for tomorrow.

Slide 15 – Bulk Ingredient and Nutritional Products

Our bulk ingredient and nutritional business manufactures a range of products from our factories including Lagoon Street in Bega, Tatura and Koroit. Please refer to the slide and provide an overview.

Slide 16 – Dairy Commodity and Farm Gate Milk Price

Overall global dairy commodity prices decreased in the first half with butter experiencing a significant decline of approximately 30% and skim milk powder increasing by 7% during the period. As we enter the new calendar year, commodity returns have firmed with skim milk powder prices increasing by 26% primarily due to the clearance of the European Union intervention inventory and slower global milk supply growth in Europe and the US. Butter pricing in the new year has also recovered with an increase of 20%. The forward outlook appears to be stable to firm, although this could soften to the

extent that New Zealand milk supply continues to grow at 7 to 8% and if the European spring is stronger than expected. The Australian dollar during the first half has depreciated which has provided further support for milk pricing.

Competition for milk supply is strong with the domestic market most impacted by the drought. Milk production in Australia for the first half is unfavourable compared to the prior year by 5.1%, lower by 267 million litres with northern Victoria, New South Wales and Queensland most affected. Drought is impacting farm inputs costs such as water and feed. It is expected that national milk production for the full year to be lower by 500 to 600 million litres.

Slide 17 – Branded and Third Party Packaged Product

Our branded and third party packaged product business manufactures a range of food service and retail products from our factories including Ridge Street in Bega, Strathmerton and Port Melbourne. Please refer to the slide and provide an overview.

Slide 18 – Domestic Retail Market

Dairy cheese across retail grocery has seen a turnaround in the last 12 months after two years of a deflationary environment, showing value ahead of volume for the first time in a number of years. A lot of this however has been driven by the performance of private label, with price competition subsiding a fraction after a number of years of sustained pressure. This is consistent across all retailers and across all major segments of cheese including natural, processed and entertaining cheese. Despite this, the category still experiences volume growth which is a good sign for the fundamentals of the category.

For 1H FY2019, Vegemite has seen a decline in sales as it has come off a very strong prior sales period in FY2018 following the announcement of the acquisition by Bega. However we have seen Vegemite back into growth at the start of calendar year 2019 on the back of some promotional and activation initiatives linked to the Australian Open, the new “Tastes like Australia” advertising campaign, some licensing arrangements including Arnott’s Shapes and strong in store executions with our retail partners.

Peanut butter has provided strong growth for the overall retail spreads category, particularly the “natural peanut butter” segment which has been steadily increasing its relevance within the category. With a higher dollar per kg and appeal to new consumers via health, natural and provenance credentials, this is an active space for manufacturers and retailers. Bega peanut butter has held share of the category at 60%, maintaining its position as Australia’s favourite peanut butter. This is despite a number of headwinds as part of the brand transition and Kraft’s attempted re-entry into the Australian market. This month sees the launch of Bega Simply Nuts which is a 100% natural peanut butter with nuts sourced from our Australian farmers. This product innovation should continue to grow our volumes, leveraging our experience and knowledge of the spreads category with our supply chain and production expertise following the PCA acquisition 14 months ago.

Slide 19 – Corporate Social Responsibility

At Bega we are very aware of our obligations to ensure we look after our people, our community and our broader responsibilities to society. We have continued to have a focus on safety in recent years and our safety performance has seen a significant improvement. As we have acquired several sites in recent years we needed to ensure that all new employees are appropriately trained and that our safety policies and procedures have been implemented.

We have adopted the United Nations Sustainable Development Goals as the basis for our sustainability objectives and reporting. A review with key stakeholders in FY2018 identified the material items we need to focus on. Several initiatives regarding packaging, nutrition, diversity, water management, our carbon footprint and ethical sourcing are included. These and other initiatives are included in the FY2018 Sustainability Report that was released last December.

Slide 20 and 21 - Infrastructure

The following two slides are largely self-explanatory. They do I feel demonstrate the growth and success of Bega Cheese and the foundations we have established for further growth. Please refer to the slides and I will briefly focus on each of our sites and their capability.

Slide 22 – Business Priorities

As we look to the 2H we continue our focus on the key external opportunities and challenges and internal initiatives to achieve our performance targets. These include our manufacturing footprint and supply chain cost structure particularly in segments that are coming under increasing competitive pressure. Our growth in milk volumes and expanded product mix capability at Koroit provides the flexibility across our network to manage challenges and competition we see in 2H for milk supply. Our plans to sell down inventory in 2H are well advanced and we are on track to achieve our forecast levels through to the end of the financial year. The implementation of the new ERP system across our entire business will continue through 2H into early FY2020. This project has been extended well beyond our initial timelines primarily due to the acquisition of the Mondelez grocery business and more recently the acquisition of Koroit. While the Fonterra case is now scheduled to extend well into FY2020 we do expect an outcome to the Kraft peanut butter case in 2H FY2019. It is premature to comment further on this case but we will provide further updates to the market when appropriate.

Slide 23 – Growth Horizons

I have provided an overview of each of our business unit platforms which will continue to provide growth through new innovation and business development both in Australia and in our export markets.

While we have had competitive pressures in the Bega Foods business acquired in July 2017 we continue to invest in capability, new channels and product innovation. I mentioned earlier that we have recently launched Bega Simply Nuts which is a range of natural peanut butter products and gluten free Vegemite. Our product development and marketing teams are developing a pipeline of new products that support our positioning regarding natural and healthy products targeting growth categories.

The nutritional business has provided significant growth in recent years primarily due to direct and indirect demand from China which is the world's largest infant formula market. Recent regulatory changes and increasing global capacity has impacted margins across the industry. Our core customers continue to support capacity utilisation and solid margin contribution. Access to increased supply of organic milk and goat milk for example will support growth in these categories with current and emerging customers.

The investments in lactoferrin that Barry and I have referred to previously in the presentation will increase our presence and relevance in this important channel and provide further opportunities to develop new products in this growing category. We have increased our traditional customer base in Australia and Asia into Europe and the United States providing us with increased reach to collaborate on new product innovation.

It is imperative given the challenges in the dairy industry with on farm profitability that we support initiatives to improve returns across the entire supply chain to ensure sustainable returns and incentivise further farm investment. We have announced and will implement pricing systems that particularly suit pasture based farms with an objective of improved margins on farm.

Despite the impact of drought on the dairy industry we remain optimistic that we can continue to grow this business with our diversified dairy manufacturing capability. The efficiency of our operations and flexibility of our product mix allows us to respond to market opportunities quickly. We will continue to expand our core portfolio of cheese product including mozzarella, cream cheese, cheddar, processed and Parmesan cheese as well as a range of butter products and milk powder products. These products and others provide a portfolio well positioned to support growth of our branded food service and consumer goods business.

Slide 24

Thanks Paul

Slide 25 – Where are we today

Ladies and gentlemen, it has been a significant and challenging 1H FY2019. There is no question that the business has taken an important step forward in dairy with the acquisition of Koroit and the subsequent successful milk acquisition program and lactoferrin announcement. A record milk intake and business growth did not shield us from difficult operating circumstances in 1H FY2019. The increase in farm gate milk price and other costs which we were not able to recover from the market has impacted both performance and outlook for the business. It is important to recognise however that our inventory build in 1H largely is a result of the Koroit acquisition and is expected to be significantly reduced in the 2H FY2019.

The dairy and food industry can be dynamic and volatile and it is important to evolve our business and ensure our strategy respond to the changing business environments we operate in. I believe the decision to acquire Koroit, invest in additional lactoferrin capacity, execute third party manufacturing arrangements and close Coburg will prove to add substantial value to our business. It is now important that we focus on consolidating and building our business. As Paul mentioned in his report we have many growth opportunities in our business, with infrastructure, product range and sales and marketing capability across our entire range of dairy and food products.

Our focus will be to leverage the infrastructure and assets at our disposal, grow the business, refine our inventory management and product mix and work with our dairy farmer suppliers to address the challenges the industry has been through particularly the impact of the drought, and in northern Victoria water policy.

Slide 26 – Outlook

As I look to the future I see both opportunities and challenges. The improvements in global dairy markets, particularly skim milk powder can be attributed to global supply being more aligned with global demand and previously held skim milk intervention stocks in Europe being eliminated.

Close to home weather conditions continue to impact both milk supply and the peanut crop and the upcoming autumn and grain crop for the coming year will be important in terms of supply for the remainder of this year and 2020.

While we have had a significant build up in inventory we are very confident in demand both for the current inventory and an ongoing basis. We are pleased with the integration of Koroit and its contribution to 1H FY2019.

I continue to be confident in both our business strategy and capability. Global demand for dairy continues to grow, consumers increasingly are concerned about the quality, sustainability and provenance of their food, new product development, our iconic brands, supply chains and infrastructure position us well for growth. Our investments in Koroit, lactoferrin and third party manufacturing arrangement position us well for FY2020 and beyond.

Slide 27 - Questions