27th February 2015

Freedom Foods Group Limited (ASX: FNP)

Half Year FY 2015 Financial Results

Freedom Foods Group Limited (FNP) has today released the Company's preliminary half year results for the 6 months ending 31st December 2014.

Highlights

- A very successful first half investing in the Company's capability and capacities for profitable growth consistent with its 3 year plan
- Commissioning of a state of the art Cereal based Nutritional Snack line 3 months ahead of plan, with launch of innovative nutritional snacks into the mainstream aisle commencing in January 2015
- Sales growth in Cereals in Australia and North America, reflecting growth in category and increased distribution
- Sales growth in non-dairy beverage, led by growth in branded and non-branded sales in the fast growing Almond Milk category
- Preparation for the launch of the Australia's Own Brand in China, in partnership with Shenzhen JLL, which occurred in February 2015
- Highly successful launch of Pactum Dairy Group (PDG) achieving sales of approximately $30 million in its first full half, tracking well ahead of its year 3 business plan with strong demand from customers from China, SE Asia and Australia. Capital expenditure plans have now been accelerated to meet this demand
- Launch of new and differentiated packaging for the Brunswick Specialty Seafood brand to consolidate its leadership position
- Recognition of a fair value gain in a2 Milk Company investment, net of tax of $52.2 million to the consolidated profit and loss account, reflecting a change in accounting treatment following the retirement of Mr Perry Gunner from the a2 Milk Company board.

Financial Summary

The Company reported a Net profit of $55.2 million, a material increase from the prior corresponding period. The Net Profit included a post-tax fair value gain of $52.2 million from the gain on reclassification of the a2 Milk Company investment.

The company achieved an Operating EBDITA of $6.3 million (including interest from Associates), a marginal decrease of 1.4% on the previous corresponding period, reflecting increased sales in all business units, with profitability impacted by commissioning of the new nutritional snack equipment reducing manufacturing recoveries and gross margin during the half. UHT operations and Specialty Seafood performed ahead of the prior year. The Company considers the operating EBDITA result satisfactory considering the significant investment and commissioning of plant being undertaken and adjustments required to the operating structure of the business in this phase.

Summary Financials

6 months to 31 December	2014	2013	
	$'000	$'000	% Change
Gross Sales Revenues (1)	64,231	59,303	8.3%
Net Sales Revenues (1)	55,528	51,273	8.3%
EBDITA (Operating) (3)	6,319	6,406	-1.4%
EBITA (Operating) (3)	4,777	5,117	-6.6%
Equity Associates Share of Profit (2)			
Pre Tax Profit (Operating) (3)	4,431	5,292	-16.3%
Pre Tax Profit (Reported)	57,399	5,562	932.0%
Net Profit (Operating) (4)	3,102	4,130	-24.9%
Net Profit (Reported) (5)	55,190	4,004	1278.4%
Interim Ordinary Dividend (cps)	$0.015	$0.015	-
Interim CRPS Dividend (cps)	$0.0135	$0.0135	-
EPS (cents per share)(Fully Diluted for CRPS)	36.35	2.78	1207.7%
EPS Operating (cents per share)(Fully Diluted)	2.04	2.77	-26.2%
Net Debt / Equity	14.3%	3.0%	378.1%
Net Assets per Share	116	77	49.8%
Net Tangible Assets per Share	102	63	61.7%

Notes:

1. *Gross Sales Revenues do not include revenues from group associate entity, Pactum Dairy Group Pty Limited. Net Sales Revenues in the table above differs from the Appendix 4D, as the Net Sales Revenue above includes intercompany sales eliminated from the statutory reported Net Sales Revenue figure. This treatment reflects the Group's arm's length trading policy between Group activities.*
2. *In the six months ended 31 December 2013, the group recorded $450k of equity accounted income related to the a2MC investment based on the estimated a2MC profit for the period. This estimate was subsequently revised in the financial year ended 30 June 2014 and the $450k was reduced to $nil to reflect the actual share of profits.*
3. *Operating EBDITA and EBITA excludes pre-tax abnormal or non-operating charges and gains with an add back of non cash employee share option expense of $180k and elimination of the fair value gain of $53.1 million due to the reclassification of the a2MC investment.*
4. *Operating Net Profit excludes abnormal and non-operating charges and gains with an add back of net non-cash employee share option expense of $126k and the elimination of net fair value gain of $52.2 million re a2MC investment.*
5. *The impact of the revision set out in Note 2 would have been to reduce the profit for the period to 31st December 2013 to $3.5 million.*

1. Cereal and Cereal Snacks

Freedom Foods continued to build momentum in its Cereal and Cereal based Snacks portfolio, with material investments in production capacity and capabilities for future growth. Significant capital expenditure occurred at Leeton, together with further investment in R&D and an increase in brand marketing.

The business delivered overall gross sales growth of 10% compared to the previous corresponding period. With a focus on its core product portfolio for future growth, the business is progressively reducing its presence in non-core categories including biscuits. The reduction in non-core products impacted sales in the period, with some resulting impact on margins and manufacturing recoveries.

Alongside our continued investment in sales and marketing, the business is investing heavily in R&D capability to drive growth in retail and other channels in the medium term. As well as increased marketing investment in building awareness of the brand, we are focussed on driving our innovation pipeline to meet the broader consumer market. A significant achievement to date from our R&D focus has been our range of products achieving 3.5 – 5.0 star ratings within the government health star rating system.

As part of ensuring best quality and growth in supply of key grains, the business developed its Freedom Farmer platform, with a number of key farmer groups engaged to build the Group's grains supply platform over the coming years. This will guarantee our strategy of being an integrated paddock to plate provider. Australian sourcing of all ingredients is a key source of competitive advantage for the Company.

1.1 Capacity Investment

During the half, the business invested $9 million in capital expenditure at Leeton, including completing the upgrade of Cereal extrusion and packaging capabilities to improve efficiencies and provide increased capacity in range and format for both Cereals and Cereal Snacks.

A significant part of the half year expenditure was incurred on the installation of a new state of the art automated nutritional snack line. Both these investments will significantly increase Freedom Foods production capability, with no material increase in cash overheads and a lower cost per case once completed.

1.2 Nut Free Snacks Launch into Mainstream

A successful launch of the first high rating nut free nutritional snack range into mainstream supermarkets occurred in January 2015. The requirement to bring forward the commissioning timeline of the new nutritional snack bar line at Leeton had an impact on manufacturing recoveries and gross margin during the half.

The launch will have a material impact on sales growth in the year from the expansion of distribution and product range. Our expanded capability will ensure the business can meet consumer demand for convenient snacking occasions in Australia, North America and Asia.

1.3 North America

In North America, our 80% owned subsidiary invested in building sales and distribution capabilities, increasing sales and store distribution within the Specialty and Natural Product Retailer markets. Considerable investment has been made in developing relationships with retailers including Sprouts, Whole Foods, Wegmens, Kroger and HEB.

The North America business will continue to build distribution and consumer awareness within existing and new retail stores, reflecting our unique proposition in Allergen Free and Non GMO Cereals and Cereal Snacks. New product launches in Cereal within the children's segment and plans for launch of a range of Allergen Free nutritional snack bars in 2015 will provide further sales and distribution growth.

With the North American business having established a strong consumer profile within the Allergen Free and Non GMO categories, the business will look to significantly expand distribution over the medium term through the application of additional sales and marketing resource. The Group is also considering options for increased scale in the North American market. The business remains focused on delivering its medium term sales target of up to 1 million cases of branded Cereals and Cereal snacks per annum.

1.4 Outlook

The focus for the business into 2015 and beyond is on increasing sales in Australia through building on its category leadership in the health channel and further growth in distribution channels, while establishing key products, channels and distribution for expansion of product into export markets in North America and Asia.

The Company is also investing to significantly increase its Cereal and Cereal Snack R&D capabilities to ensure it is leading in developing innovative nutritional solutions in these segments for its customers in Australia, China and SE Asia. An exciting innovation pipeline is in development, with new products in Cereals, Nutritional Snacks and new formats for convenience and food service channels.

Ongoing commissioning including installation of automated packaging capability in the 2nd half, while providing a lower cost base and significant capacity growth, will impact business unit profit performance. Once commissioning is complete, the emphasis will turn towards achieving the targeted production throughput and efficiencies.

2. UHT Liquids Business Group

2.1 Non Dairy Activities

Non-dairy production volumes increased during the period to support the growth of the Australia's Own and Blue Diamond brands, as well as private label requirements.

Non-dairy beverage sales continued the strong upward trend from the 2014 financial year with strong volume growth compared to the previous corresponding period, reflecting increased market share of Australia's Own Organic and Blue Diamond Almond Breeze brands within a category which is itself growing significantly. As at February 2015, the Almond Milk category accounted for 33% of the retail non-dairy category, compared to 28% at February 2014. Other alternative categories including Almond Coconut blends and Macadamia milk which also increased share and the Group is selling and developing products to increase its participation in these emerging categories.

The business continued to see the benefit of increasing its mix of other value added UHT products to a range of private label and proprietary customers.

The Company and Blue Diamond Almond Growers are examining the launch of Almond Milk into Asian markets based on the Group's Australian production base. This leverages both the free trade agreements between Australia and Asia as well as the Company's relationship and distribution base within these markets. The Company sees further opportunity to develop non-dairy UHT products from an Australian manufacturing base into China and SE Asia.

The Company is investing to significantly increase its UHT R&D capabilities to ensure it is leading in developing innovative UHT solutions in non-dairy and dairy applications for its customers in Australia, China and SE Asia.

The expansion of capabilities is reflected in the installation of 250ml Prisma Format and 330ml Prisma Dreamcap formats at PDG's Shepparton facility. These lines will be substantially allocated to PDG dairy based export customers, reflecting increased dairy demand into 2015.

New Facility in South West Sydney

With increasing demand from its private label and proprietary customer base for additional capacity and product format capability across non-dairy and value added dairy categories, the Company is investing for future growth through a planned expansion at a new site in Ingleburn in South West Sydney.

The planned new facility will provide for significant expansion in capacity and efficiency improvements compared to current operations, including providing more efficient and lower cost warehousing and logistics compared to current arrangements.

The acquisition of aproximately 66,000 sq. metres of land in Ingleburn is expected to settle on or around April 2015, once final sub divisions and other approvals have been obtained.

The new facility will provide for existing and new UHT packaging capabilities. This will allow customisation of beverage and food products for local and export markets with efficiency and speed, to meet the growing demand for high quality safe foods from Australia. It is intended that production will be marketed under the Company's brands and leading brands of key customers in Australia and Asia.

Construction of a warehousing and distribution facility is expected to commence in the 2nd half FY 2015, with UHT production commencing from later in 2016.

2.2 Dairy Activities

2.2.1 Pactum Dairy Group (PDG)

PDG commenced operations in April 2014 to provide innovative UHT dairy milk capability for customers in domestic and export markets.

PDG is a joint venture between Pactum and Australian Consolidated Milk (ACM), a major Australian dairy milk supply group.

Commencing volumes are tracking ahead of its 3 year business plan, with strong demand from customers for portion pack and 1 Litre volume from China and SE Asia. These customer requirements are expected to grow beyond their initial volumes as demand for milk increases, with Australian milk products providing the highest quality and safety at a comparative cost advantage compared to locally sourced milk.

During the half, the Company delivered sales of approximately $30 million and achievement of profitability during the later months of its first full half. The business is expected to process over 100 million litres in calendar year 2015.

The Group has established key relationships with major dairy manufacturers and brand owners including Bright Dairy (Shanghai), New Hope Dairy (Chengdu), Shenzhen JLL (Guangzhou), online retailer Yihaodian and a number of regional dairy manufacturers and distributors. Each of these relationships is complementary recognising as a separate strategy the level of diversification in local market distribution, product range and capability within China.

The Group has also developed other relationships for China and SE Asia including A2 Milk Company (for exclusive UHT supply into Australia, China and SE Asia) and selected retailers and distributors in China, SE Asia and Australia.

To meet expected expansion in milk volumes over the medium term, the Group is evaluating additional processing and filling capacity expansion, including expansion of warehousing and logistics capabilities. Opportunities to vertically integrate into other value added dairy product streams are also being reviewed, consistent with our customer's long term requirements.

Consistent with this strategy, the Company will acquire approximately 77,400 sq. metres of land adjacent to the PDG site at Shepparton in Victoria. The acquisition price subject to final adjustments is approximately $4 million to be paid in September 2015.

The acquisition of land provides the capacity and flexibility in developing longer term warehousing and distribution requirements for the Pactum Dairy operation. Existing warehousing capability on site is insufficient for long term requirements, particularly as the Group's objective is to build a low cost automated logistics function, with facilities for export containerisation. Additional customised manufacturing warehouse capacity will provide space for future expansion of processing and packaging operations at the site and potential expansion of other dairy processing capabilities in the future.

Detailed planning for and construction of an integrated manufacturing warehouse and distribution facility is expected to commence during 2015.

With the increasing scale of the PDG and Freedom Foods Group operations, the Group is augmenting management capability within the PDG business including the appointment of senior level commercial and operational resources. These are expected to be in place during the 2nd half of FY 2015.

With the commencement of operations and significant resourcing to meet the expected ramp up in volumes, the business recorded a net profit loss in the 1st half FY 2015. FNP equity accounted 1% of the loss in line with the current ownership structure. The Company has the capacity to obtain a 50% interest in PDG by converting convertible notes issued to it as part of its original investment. This is expected to occur in later stages of FY 2015, with the Company planning to consolidate PDG's sales and profit result consistent with the business's increasing profitability and returns.

2.2.2 Australia's Own Brand Partnership

The Group commenced production during the half of our "Australia's Own" branded "Kids Milk" to support its launch in China in early February 2015.

Australia's Own Kids Milk is being marketed and distributed through a long term 50 year partnership with Guangzhou based Shenzhen JiaLiLe Food Co. Ltd (JLL), which is owned and led by parties associated with the establishment of the largest selling ready to drink beverage in China. The arrangements reflect the strategic approach of our business model to engage established partners in foreign markets whom understand local business requirements. The initial product is a single serve 200ml pack, which is the first Australian milk product marketed specifically to the post-infant-formula toddler market in China.

Production commenced in late 2014 sourced from the Company's Sydney UHT facility. Increased capacity at Shepparton during 2015 will provide for long term sourcing from this facility.

2.2.3 Collaboration with Perich Group and New Hope Group

As announced in November 2014, FFG, the Perich Group and China's New Hope Group (China's largest private agricultural company) executed a memorandum of understanding to develop and implement growth in long term dairy milk supply through the establishment of new large scale intensive dairy farms in South East Australia for supply to Freedom Foods Group's UHT operations and other processing operations in Australia. These supply arrangements will complement sourcing from existing dairy farm supply to ensure the ability to meet long term supply requirements.

The arrangements envisaged will provide a unique collaborative business model to develop large scale dairy farms under Australian management and ownership. New Hope will be a core investor and partner in the operations, while continuing to market and distribute value added dairy products into China through New Hope Dairy.

The parties are evaluating a range of options including acquisition to develop further scale in dairy farm operations and greenfield farm development opportunities.

It is envisaged that Freedom Foods Group will make a strategic investment in the farm investment vehicle, with the majority of equity funds to be contributed by Perich Group, New Hope and potentially other strategic investors.

2.2.4 China Representative Office

The Group has had a representative in China since 2013. Consistent with the growth in our business in China, the Group will establish a China representative office in 2nd half of FY 2015 to provide for growth in its sales, marketing and supply chain requirements. While this team in China will initially be substantially engaged in supporting the dairy activities, the increased resource will provide a base for increased distribution of a broad range of the Company's products. It is anticipated that this office will also provide representation for alliance brands desiring to access China using the Group's Australia sourced production.

3. Specialty Foods

Brunswick sardines maintained its No 1 brand leadership position in Australia and New Zealand.

The business remains focused on positioning for growth into 2015 through category leadership of the Specialty Seafood channel, including new product opportunities aligned to consumer demand for convenience and superior health benefits. As part of this approach, the business introduced revitalized packaging and website content for the Brunswick brand. The Company sees further category and product expansion opportunities within the Specialty Seafood category in response to the brand and packaging repositioning.

The Paramount Salmon brand performed well during the period, increasing its share of category in its major retail trading partners.

Operating performance improved reflecting Company's increased management resourcing and focus on the business.

The business continued to utilise the procurement power of Bumble Bee Foods of North America, with Bumble Bee securing 2015 inventory requirements through priority access to salmon and sardine catch volumes.

4. A2 Milk Company Limited (a2MC), 17.8% Equity Interest

The Company is the largest single shareholder in the A2 Milk Company Limited (a2MC). a2MC owns and commercialises unique and comprehensive intellectual property rights relating to a2™ brand milk and related dairy products in a range of international markets including Australia.

a2™ branded milk is the fastest growing milk brand in the Australian market and the major driver of category growth nationally, accounting for approximately 9.3% of grocery channel market share by value. a2MC also markets a2™ Platinum™ infant formula to consumers in Australia and China, with infant formula being ranged nationally in Coles, Woolworths, Independents and Pharmacy.

a2MC's plan to enter the North American fresh milk market is progressing, with a launch expected to commence during calendar year 2015.

During the period, the Company reclassified how it accounts for the investment in a2MC. This resulted from the resignation of Mr P R Gunner from the a2MC Board in November 2014 and the determination by the Group that it no longer was able to clearly demonstrate that it exercised significant influence over a2MC. Significant influence was deemed to be lost at the conclusion of the a2MC AGM and therefore on this date the group has reclassified the investment to an Available for Sale investment (AFS) under the requirements of AASB 139 Financial Instruments: Recognition and Measurement.

At the date of reclassification, a fair value gain of $53.1 million ($52.2 million net of tax) was recorded in the statement of profit or loss. The investment in a2MC continues to be recorded at fair value, with any gains and losses arising from changes in fair value recognised in other comprehensive income and accumulated in the investments revaluation reserve.

The Company did not recognise any equity accounted profit from a2MC during the period. In the six months ended 31 December 2013, the group recorded $450k of equity accounted income related to the a2MC investment based on the estimated a2MC profit for the period, although this estimate was subsequently revised to zero in the full financial year ended 30 June 2014. The profit estimate of $450k was reduced to $nil in the second half of FY 2014 to reflect the actual share of profits derived for that period.

a2MC has indicated that it intends to list on the Australian Stock Exchange in March 2015. While it will remain a NZ incorporated company and retain its NZX listing, it is understood that the ASX listing will provide a2MC with improved access to capital markets and an overall improvement in liquidity of its shares.

The Company is pleased to have been advised of the improving performance of a2MC and the potential value enhancing opportunities associated with expansion of infant formula and its North American operation. As a result, the Company intends to maintain a strategic shareholding in the medium term, while retaining the option to realise capital from the investment to support growth opportunities.

During the period, the Company acquired additional shares in a2MC for a total net consideration of $538,000.

5. Capital Management

The Company held cash of $1.1m at 31st December 2014, with total borrowings of $26.4 million, comprising equipment finance leases and working capital facilities. There were no term debt facilities at 31st December 2014. Net debt at 31st December 2014 was $25.3 million. Net debt excludes financial assets and loans to Associate entities.

At 31st December 2014, the Company had lent \$14.6 million (\$12.8 million at 30 June 2014) to Pactum Dairy Group to support further capital investment and working capital requirements. The loan attracts interest at a rate of 8.0% per annum.

Net cash flow from operations was -\$1.9 million, reflecting a material increase in working capital requirements associated with inventory build for new product launches early in the 2nd half of FY 2015 and seafood inventory. The Company expects a substantial improvement in operating cash generation in the 2nd half, compared to the 1st half.

During the period, the Company invested \$16.7 million in core production facilities and repaid debt of \$1.1 million. The capital expenditure of \$16.7 million comprised commitments to expansion at Freedom's Leeton facility, expansion of packaging capabilities at Shepparton, a deposit paid for land and proposed building works at Ingleburn and a deposit paid for land at Shepparton.

6. Dividends

Consistent with the positive outlook for group performance, the Company will pay an interim fully franked dividend of 1.5 cents per ordinary share in April 2015. The record date for determining entitlements is 1st April 2015 and the payment date is 30th April 2015.

The Company's dividend reinvestment plan (DRP) remains open.

The Company will pay a fully franked converting preference share dividend to be paid in accordance with the terms of the converting preference shares. The record date for determining entitlements is 1st April 2015 and the payment date is 15th April 2015. There are 137,027 converting preference shares on issue.

7. Capital Investment Programme

The Group is now part way through a 3 pillar capital investment programme which will transform its operations over the next 3 years and provide the opportunity to become a leading Australian based Food Company with a strong export platform.

The 3 pillars of the programme involve the following:

- Cereal and Snack Production (Allergen Free). The Group has installed world class equipment to increase production capacity significantly for growth in sales and profitability over the next 3 years. Upgraded Cereal and new snack production lines have been commissioned and are ramping up to full efficiency over the next 6 months. The design of the upgrade provides for modular expansion at relatively low capital cost thereafter.

- Creation of Pactum Dairy Group and the development of a high speed low cost dairy focussed UHT facility at Shepparton. Operations commenced in April 2014 and the business is now profitable on relatively low volumes compared to the rated capacity. Significant expansion of throughput is expected to occur in 2015 as the third and fourth lines become operational.

- The development of a low cost high speed UHT processing and distribution facility at Ingleburn for non-dairy and dairy products with the potential for other food related products over time.

As in any major expansion or reshaping of a business, not all matters proceed to plan. Commissioning issues, shutdown of existing production etc. can occur. This is reflected in our slightly lower operating profit from our Cereals and Snacks operations for 1st half FY 2015 compared to prior corresponding period. At the same time, the effort from our business to achieve the outcomes detailed in this release has been outstanding.

The Group is well placed to capitalise on the capital investment programme from the efforts of the team to bring these plans to fruition.

Funding for these major growth programmes will be provided from existing capital, prudent expansion of debt financing and the medium term realisation of other assets. Where equity capital is required, it will be sourced through entitlements offers to all shareholders.

8. Outlook

The Group through its Cereals and Snacks and UHT business platforms continues to build on its capability and capacities for growth, investing in our brands, our manufacturing facilities, R&D as well as establishing key customer relationships in Asia and North America.

The Cereal and Cereal Snacks business is expected to continue to deliver improved results from revenue growth through innovation in new products, expansion of distribution channels in Australia and international markets, together with increasing manufacturing efficiencies from volume and cost efficiencies arising from the capital investment program at the Leeton facility. This, aligned with investment in building awareness of the brand across a broader consumer market open to healthier products, is expected to provide a strong base for growth into future years.

The expansion of UHT capabilities in Sydney commencing in 2016 will result in an increase in sales and profitability, with further growth opportunities through meeting the increasing demands of its private label and proprietary customer base, including under the Company's brands "Australia's Own" and "Freedom Foods" and leading brands of key customers in Australia and internationally.

The UHT dairy platform in Pactum Dairy Group provides a material opportunity to increase exposure to the growing demand for high quality and safe dairy products from South East Asia, including China aligned with our key strategic customers. With strong sales growth and delivery of profitability in the later stages of FY 2015, the Company plans to consolidate PDG's sales and profit result, consistent with the business's increasing profitability and returns.

The strategic investment in a2 Milk Company provides the Company and its shareholders a potentially significant value creation opportunity through a2 Milk Company's growth in Australia and international markets, in particular the opportunities associated with expansion of infant formula and its North American operation.

Overall the Company anticipates growth in sales and profits over the remainder of FY 2015, with the benefits of its multi stage capital investment programme delivering increased profits and returns from FY 2016 and beyond.

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