New Zealand Shareholders Association Inc.

NZSA®

Many Investors, One Voice

9 November 2023

Synlait Milk Limited (SML)

The company will hold its Annual Shareholders Meeting at **1.30pm Friday 1 December 2023.**

The location is **Synlait's Dunsandel facility, located at 1028 Heslerton Road, RD13 Rakaia, Canterbury.**

You can also join the meeting online here.

Company Overview

Synlait was co-founded by Dr John Penno in 2000. By 2005 the company owned eight farms and in 2007 constructed its first plant at Dunsandel Dairies, one of its larger farms. In 2010 Bright Dairy China took a major stake in the company and in 2013 SML listed on the NZX, going on to list on the ASX in 2016. Bright Dairy are the largest shareholder at 39% whilst a2 Milk hold 19.8%.

In 2017 the company acquired New Zealand Dairy Co. and in 2018 acquired land at Pokeno (north Waikato) for the construction of a nutritional powders plant. In April 2020, the company acquired Dairyworks Ltd, and August 2020 acquired farmland adjacent to Dunsandel to allow for expansion.

We have previously commented that whilst Bright Dairy owns 39% of the shares it appoints 50% of the Board. Whilst NZX have granted a waiver in this respect we note the NZX Code of Corporate Governance states at 2.8 "*A majority of the Board should be independent Directors*."

Disappointingly in October 2023 NZ RegCo reaffirmed the waiver despite it breaching the NZX Code.

Following a number of Board changes last year there have been further changes.

- In June 2023 Bright appointees Min Chen and Gui Min were replaced by Liu Rubing and Zhu Yi.
- In October 2023, the Chair Simon Robertson resigned from the Board having been appointed Chair in December 2022 and was replaced by Independent Director Paul McGilvary as Acting Chair. A search for a permanent Chair is underway.

In June 2023, the company announced it was divesting its DairyWorks and Talbot Forest Cheese businesses.

In September 2023, the company advised it had received notice from the a2 Milk Company purporting to cancel the exclusivity arrangements under the Nutritional Powders Manufacturing and Supply Agreement (NPMSA) for the a2 Platinum® and other nutritional products. In October 2023, the company advised it would enter into a confidential binding arbitration process with a2 to determine the validity of the notice of cancellation of the exclusivity arrangements.

Recent media from July 2023 shows that SML and a company associated with Director John Penno are involved in legal action over a company sold to Nasdaq listed VerifyMe.

Current Strategy

The company's purpose is "*doing milk differently for a healthier world*" with a focus on foodservice and advanced nutrition products.

It is committed to sustainability across three pillars of activity, environment, people, and enterprise.

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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	G	Directors are not required to own shares.
Executive Remuneration	A	See below.
Golden parachutes/handshakes	A	See below.
Director Independence	R	See below.
Board Composition	A	See below.
Director Tenure	R	See below.
ASM Format	G	Hybrid. See below.
Independent Advice for the Board and Risk Management	A	See below.

Directors Fees: Synlait discloses the fee pool approved by shareholders for the Chair, Committee Chairs, and non-executive directors as an alternative to disclosing the *total* fee pool available for directors. This alternative view is also supported by NZSA.

The company does not disclose whether other benefits (e.g., retirement benefits, share-based payments, or special exertion payments) are available or paid to Directors. We note that the table of payments to Directors is prefaced as "***total*** *remuneration*" [emphasis added]. Therefore, while NZSA doesn't believe that any additional benefits are paid, we would prefer more explicit disclosure.

The current disclosure does not preclude remuneration by way of share-based payments. Again, we would expect more explicit disclosure.

Executive Remuneration: The Annual Report discloses the CEO was paid a base salary and allowances. No short-term incentive (STI) or long-term incentive (LTI) was paid. There is no disclosure in the Annual Report or the Corporate Governance section of the company's website around an STI or LTI.

Golden parachutes/handshakes: There is no disclosure around any sign-on, retention, loss of benefits from a previous employee, take-over bonus or severance terms and payments for the CEO. In the interests of transparency NZSA expects to see disclosure as to whether these payments are offered.

Director Independence: Synlait operates under a waiver from NZ RegCo that allows major shareholder Bright Dairy (owning 39.0%) to appoint four directors to the Synlait Board (out of seven with an eighth due to be appointed) – including one "NZ-based director of good standing." NZSA believes that a Board should comprise of a majority of independent directors, for the benefit of all shareholders – regardless of ownership structure.

However, we also note that the company's constitution prevents Bright Dairy from voting on independent directors (a form of minority shareholders regime supported by NZSA).

In prior discussions with NZSA, the company has noted that investors have invested in Synlait with the understanding of the constitutional arrangement to ensure Bright Dairy's board representation, and the non-standard governance is well signalled by the 'NS' designation against the SML ticker code on the NZX. The company also noted that the arrangement cannot be changed without the support of the existing Bright directors (who hold a majority on the Board).

NZSA continues to advocate that the Board, particularly its independent Directors, should at least discuss a change to see whether there is any pathway to a majority of independent Directors.

Board Composition: The Annual Report does not include a skills matrix that identifies the governance skills required to govern Synlait, nor attributes those skills to individual Directors.

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

There have been significant changes to the Board over the past two years. While recognising the change to the Chinese-based Bright Dairy directors, NZSA holds some concern as governance stability. Particularly, we are concerned as to the significance of the departure of recent independent Chair Simon Robertson – both from a governance quality perspective, but also related to whether Synlait's capital management and/or funding strategy is likely to be successful.

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.

We note the Hon Ruth Richardson has served on the Board of Synlait and its predecessors since 2004 and Sihang Yang since 2010. Both are Bright Dairy appointees and not required to stand for re-election. Given their tenure, NZSA expects to see evidence of succession planning to ensure ongoing governance sustainability.

This is even more important given the reference to the legal action referred to above and that four of the seven Directors were appointed between January 2022 and June 2023.

Independent Advice for the Board & Risk Management: 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 or evidence that the company is across its risk mitigation approaches.

There is disclosure in the Board Charter that the Directors are able to access internal management and external advice as required to support decision-making. The Company Secretary has access to the

Board on governance matters, although it is unclear as to whether other internal audit staff enjoy similar unfettered access to the Board.

The company offers some disclosure of financial risks, and that it will disclose its climate risk when required in 2024 - but there is no other disclosure of business or operational risks, their mitigations, nor the processes by which these are governed. The company does allude to 'dairy commodity prices' risk in the Annual Report and how it manages this.

Audit

NZSA assessment against its key policy criteria is summarised below:

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

Audit Rotation: The company appointed PwC to replace Deloittes as its Auditor in 2021. The company ensures the Lead Audit Partner is rotated at 5 years as required by the NZX Listing Rules. NZSA also expects disclosure of the appointment dates of the Lead Audit Partner and Audit Firm in the Annual Report each year.

Environmental Sustainability

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment
Approach	A
Sustainability Governance	A
Strategy and Impacts	A
Risk and Opportunity	R
Metrics and Targets	G
Assurance	R

Overall approach: Synlait have been producing Sustainability Reports since 2019. These are released in December each year - therefore, this assessment refers to their **2022** Sustainability Report, alongside any further disclosures made in their 2023 Annual Report.

In response to the XRB's New Zealand Climate Standards, Synlait say they are currently undertaking a project to build on and leverage its existing sustainability reporting framework, with their first climate statement expected to be released in July 2024. Current disclosures seem to reflect a "work in progress" associated with environmental sustainability disclosure.

Sustainability Governance: In the absence of a skills matrix, it is difficult to assess the specific capability requirement on Synlait's Board. They do have human resources dedicated to sustainability resources by way of their People, Environment and Governance Committee.

Strategy and Impact: Synlait's sustainability framework is based on three pillars:

1. Net Positive for the Planet
2. A Healthier Synlait
3. World Class Value Chain

Synlait recognise that their industry is a significant contributor to New Zealand's greenhouse gas (GHG) footprint and when their sustainability framework was developed in 2018, they committed to not building any additional coal-fired manufacturing facilities.

However, they have not specifically identified the impacts of environmental risks and opportunities on their strategy.

Risk and Opportunity: Synlait mentions climate related risks and opportunities once in their 2022 Sustainability Report, but does not provide any detail. It is hoped that these will be disclosed in their inaugural climate statement next year.

Metrics and Targets: Synlait disclose their Scope 1 to 3 GHG emissions with comparative data from FY18. They have also disclosed many environmental targets for 2028, with 2018 as their baseline year.

Assurance: There is no mention of Synlait's emissions data or environmental reporting being subject to any external auditing or assurance.

Ethical and Social

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Whistleblowing	G	Good disclosure.
Political donations	G	No donations were made.

Financial & Performance

Policy Theme	Assessment	Notes
Capital Management	R	See below.
Takeover or Scheme	n/a	

Capital Management: No capital raising or dividend. There is some risk of short-term funding challenges, with the majority of their long-term debt maturing over the next 18 months. Compounding

this, the company has stated that it does not intend to raise capital from shareholders – looking to improve operational cashflow, sell assets (Dairy Works) and reduce costs as an alternative.

Synlait's share price fell from $3.50 to $1.42 (as of 4th October 2023) over the last 12 months – a 59% decline. This compares unfavourably with the NZX 50 which rose 1% in the same period. The capitalisation of SML is $310m placing it 60th out of 128 companies on the NZX by size and makes it a mid-sized company.

Metric	2020	2021	2022 (rest.)	2023	Change
Revenue	$1,302m	$1,367m	$1,397m	$1,321m	-5%
Gross Profit	$204m	$67m	$124m	$118m	-5%
NPAT	$74.3m	-$28.5m	$38.5m	-$14.1m	n/a
Gross Profit Margin	16%	5%	9%	9%	n/c
Inventory Turnover	5.06	4.81	5.05	4.98	-1%
EPS[1]	$0.414	-$0.13	$0.176	-$.065	n/a
PE Ratio	14	n/a	18	n/a	
Capitalisation	$1,063m	$756m	$686m	$310m	-59%
Current Ratio	1.00	1.45	0.84	0.90	7%
Debt Equity	1.46	1.11	1.11	1.13	2%
Operating CF	$103.8m	$15.8m	$233m	$39m	-83%
NTA Per Share[1]	$2.78	$2.94	$2.70	$3.23	20%
Dividend Per Share[1]	n/a	n/a	n/a	n/a	

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

Results for 2022 were restated owing to the reclassification of the Research and Development Tax Incentive. For more information refer to notes 2 and 21 in the financial statements.

Following these restatements, ***Revenues*** were down 5% to $1,321m, and a steady gross profit margin (9%) led to a decrease in ***Gross Profit*** of 5%. This contributed $118m, and after costs, a ***NPAT*** of -$14.1m was reported. Major contributors to this loss were increased Admin and operating expenses followed by increased sales and distribution expenses. Finance expenses also increased markedly from $15.7m to $29m.

EPS were -$0.065.

Despite our comments above, the company remains in a solid financial state with the ***current ratio*** at 0.90. Normally a ratio under 1 may indicate the inability to meet short term commitments but SML have large operating cashflows and sufficient facilities to meet commitments as they fall due.

The ***debt equity*** ratio is stable at 1.13. During the year the company retired $116m of non-current interest-bearing debt, however, took on $185m of short term loans. (we note the company has Asssets held for sale of $178m and this can be utilised to reduce the short term debt position).

SML's NTA increased to $3.23 per share. This is a function of reduced intangible assets rather than increased performance. SML trade at a huge 56% discount to NTA. The company may be better off liquidating and returning cash to shareholders or alternatively the market is of the view that the company has overstated its asset value in the balance sheet.

Operating cashflows were $39m, a large reduction on FY22. We note large working capital changes contributed to the lower cash flow. Inventory levels rose somewhat and *Inventory turnover* was relatively steady at 4.98.

In a comprehensive investor presentation, SML outline their strategy and provide some outlook for FY 24 summarising that "*the company's overall EBITDA performance is also expected to improve in FY 24, compared to FY 23"*.

On the 17th October, SML announced they had entered into arbitration with the A2 Milk Company.

On the 24th October, the company announced the resignation of the Chair, Simon Robertson.

Bright Dairy Holdings Limited is the largest shareholder with an almost controlling 39% stake. The A2 Milk Company owns 19.8% of Synlait.

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 amend the Constitution.

This is a special resolution requiring approval by a majority of 75% or more of the votes of those shareholders entitled to vote and voting on the resolution.

It is proposed to make three amendments to the Constitution.

1)Add two new clauses, '2.8 Purpose Statement' and '2.9 Stakeholder Consideration' to meet the requirements for Synlait Milk Limited to maintain its B Corp™ certification.

Certified B Corporations™ are businesses that meet the highest standards of verified social and environmental performance, public transparency, and legal accountability to balance profit and purpose.

2) Remove the now redundant additions to clause 8, Schedule 1 that were adopted at the 2021 Annual Meeting to allow the Board Appointed Director to be the Chair of the Board until the completion of the 2022 Annual Meeting; and

3) Remove clause 2, Schedule 1 as it is now redundant given the elapse of time since the Constitution was first adopted."

Full details are in the Notice of Meeting.

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

Proxies

You can vote online or appoint a proxy at https://www.investorvote.com.au/

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

Voting and proxy appointments close **1.30pm Wednesday 29 November 2023.**

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

The Team at NZSA