Update on Murray Goulburn's Capital Structure Proposal

Dear Supplier/Shareholder

Re: **Update on MG's Capital Structure**

As you are aware, Murray Goulburn Co-operative Co. Ltd (MG) is considering a capital structure to provide access to equity capital to effectively fund strategic operational and commercial initiatives to deliver a sustainable increase in the annual Farmgate Milk Price (**FMP**) consistent with MG's overarching strategy.

The MG Board announced a potential approach to a capital structure at MG's AGM in November 2013, with sixteen consultation meetings then held to discuss key aspects of the approach. These meetings were valuable and well attended. In March 2014 we wrote to all shareholders outlining what the Board and management had taken from those meetings, in particular identifying some key concerns from MG's shareholder base.

Following further detailed consideration of the proposed capital structure by the MG Board, a number of important modifications to the structure are being proposed. After taking into consideration feedback from suppliers, these modifications are aimed at ensuring the model to be employed by MG is suitable over the long term, giving MG's balance sheet the strength and flexibility to deal with changes in the market that MG operates in.

The purpose of this discussion paper is to outline in more detail these modifications. Under the proposed structure suppliers will continue to hold shares in the Co-op and capital will be raised by the issue of units in a unit trust, which will be listed on the Australian Securities Exchange (ASX). The unit holders in the trust *will not have voting rights* in relation to MG's operations and, as is the case today, only active suppliers will hold voting shares in MG.

This discussion draft will be the basis for a second round (Round 2) of supplier consultation meetings which will commence from Monday the 19th of May.

Following the upcoming round of supplier consultation meetings the Board will determine the next steps, but there will be further supplier discussion and consultation before the Board makes any final recommendation. An indicative timeline is outlined on page 11.

We look forward to engaging further with you as we progress with this process.

Yours sincerely

Philip W Tracy

Philip Tracy
Chairman

Gary Helou
Managing Director

Purpose of the Capital Structure

The main purpose of the capital structure is to:

- Fund MG's growth strategy of Operating Excellence and Innovation in order to deliver a sustainably higher Farmgate Milk Price (FMP).
- Invest in world-leading technology and automation for the efficient manufacture and supply of customised dairy foods destined for the growing demand of Asian and Australian consumers.
- Reduce the reliance of MG on debt funding and provide MG's balance sheet with the strength and flexibility to pursue market investment opportunities when they arise.
- Strengthen suppliers' balance sheets by providing suppliers with a market price for their shares to encourage reinvestment into the dairy industry.
- Ensure MG can remain competitive with other processors, both domestically and internationally.

Why does MG need to invest?

- MG's vision is to be the first choice dairy food supplier to consumers and customers in Australia and the major growth markets of Asia and the Middle-East.
- Customers and consumers value our food safety standards, regulations and our natural production environment – they want to buy finished goods from Australia, in addition to bulk commodities.
- The products that are driving demand are nutritional milk powders (baby/toddler formula), dairy beverages and consumer cheese.
- To capture these opportunities we must grow milk supply. To do this we need to invest in leading edge manufacturing and supply chain capabilities that will connect us to the Asian growth markets.
- We have identified capital investments of $500 million over the next three to five years to rejuvenate our manufacturing and supply chain infrastructure in the key product areas of nutritional powders, cheese and liquid milk.

Why can't the capital investment proposed be funded by debt?

In order to fund these projects the Board has considered a range of funding options over the past year. These included:

- Increasing MG's bank debt *(can only be done to a certain level, refer to explanation below).*
- Off balance sheet funding *(this has already been done via the sale and leaseback of the Laverton warehouse and the funding of the new pasteurised milk factories. Limited other opportunities exist).*
- Retention of profits *(this is difficult in the current environment as it reduces the FMP paid to suppliers).*
- Raising equity from farmer shareholders *(under the proposed capital structure existing suppliers will be given the opportunity to buy more shares in MG).*
- Raising equity from external investors *(this is the proposed capital structure).*

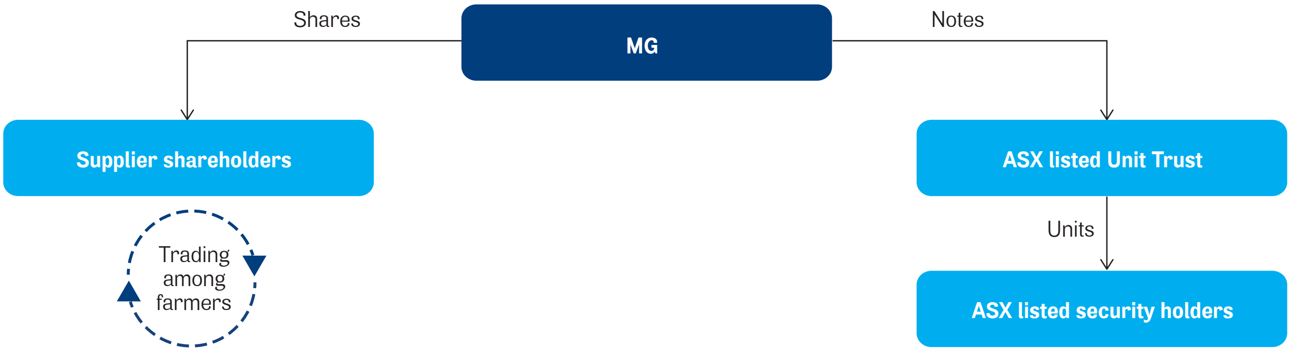
As noted above, MG is looking to fund the growth of the business via a number of different options as the scale of the investment required means that more than one source of funding is needed.

Undertaking a $500 million capital investment solely from available sources of bank debt funding would result in MG being very close to reaching its prudent and permitted peak borrowing levels. Situations outside the control of MG, such as a global financial event (e.g. the GFC); very high FMP that requires additional cash flow to pay suppliers; or other unforeseen dairy market or industry shocks that mean MG's cash flow is restricted for a period of time, may lead to MG being in danger of breaching these permitted peak borrowing levels. In addition, MG would also be restricted from pursuing any other opportunistic investments that may arise in the future if its available debt facilities are fully utilised.

We believe that a combination of equity (from both our existing shareholders and external investors) and appropriate levels of debt is the best and most responsible way to fund capital investment that will drive increases in the FMP. The level of funding required from external investors will be partially dependent on the level of funds raised from our existing shareholders although it is currently anticipated that approximately $250 million to $500 million of new equity capital would position MG to complete the current investment program without putting unnecessary strain on the balance sheet.

Structure overview

The structure that is being proposed has not changed fundamentally from that discussed with suppliers previously.



Suppliers will continue to hold shares in MG as they do today. It is proposed that the Share Standard will be set at 1 share for each 1 kilogram of milk solids (kg/ms) supplied to the co-operative. It is proposed that suppliers will be able to vote their shares up to the Share Standard (voting cap). Shares held above the Share Standard will be non-voting.

Suppliers will be able to sell any shares they hold in MG above the Share Standard (likely to be subject to limitations in some circumstances).

Indicative feedback from all the major banks that provide funding to MG suppliers is that they will attribute a market value to suppliers' shares when considering farm balance sheets.

Units issued by the Unit Trust (as shown in the above diagram) will *not have voting rights* in MG, but will have the same economic rights as a share owned by a supplier, which is primarily the right to the same dividend.

However, after taking into consideration the feedback provided by suppliers, a number of the rules that were originally proposed to accompany the capital structure have been amended to minimise changes to the current way in which MG deals with suppliers. Significantly:

- no penalties will be incurred by suppliers who do not hold enough shares to meet the Share Standard;
- the Supplier Share Offer previously discussed at supplier meetings will be optional and no supplier will be obliged to borrow money to acquire shares in MG;
- suppliers continue to acquire shares via share off-take at a minimum of 0.65 cents per litre ($0.09 per kg/ms); and
- share off-take would be mandatory for those suppliers below the Share Standard (it is mandatory for all suppliers today) and optional for those above the Share Standard.

These revisions to the structure are intended to minimise the impact on suppliers and to encourage new suppliers to join MG, both now and into the future. MG is seeking to attract higher volumes of milk that will in turn allow it to process at greater levels of efficiency and ultimately pay a higher FMP to all suppliers.

Summary

At the recent supplier consultation meetings a number of key questions were consistently raised. The table below is a summary of these issues, along with our responses. The following sections of this document expand on these items.

Topic	Feedback/questions provided by suppliers	Changes proposed/matters confirmed
Farmer Control	Active MG suppliers must always control the co-operative.	The proposed capital structure does not alter active dairy farmer control. The existing 100 per cent farmer control would remain unchanged. MG already has non-voting preference shares and will continue to have non-voting equity into the future. The model remains robust in relation to this issue.
	Will the number of units in the external unit trust be capped?	No. This is not proposed. The Board has carefully considered this matter but found that it would adversely impact MG shareholders by potentially reducing future liquidity in their share trading. No material benefits from capping the size of the trust have been identified or quantified.
	Can MG suppliers buy more shares at the market price to reduce the amount of external equity?	Yes. It is proposed that MG shareholders will be offered shares (above their Share Standard) at the market price – being the same price as units that are offered to external investors. This would reduce the number of units MG would offer.
Sharing up & the Share Standard	Suppliers should not be forced to share up to the Share Standard at day 1 and consequently forced to take on debt.	Suppliers will not be forced to share up and take up debt. Under the proposal sharing up to the Share Standard day 1 of the new structure will be optional and not compulsory as previously proposed. Suppliers who choose not to share up at day 1 will stay on an off-take arrangement similar to today until they reach the Share Standard at which point off-take becomes optional.
	If I buy the farm next door and grow my milk supply I should not be forced to share up to the standard straight way.	Under the proposal suppliers in this situation will remain on off-take arrangements similar to today until they reach the Share Standard at which point off-take becomes optional.
New Entrants	Young farmers must be able to join the co-operative as easily as they do today.	No suppliers, including young suppliers, will need to share up immediately. We propose to retain share off-take similar to today for suppliers below the Share Standard. MG will retain its existing Next Generation and Growth Incentive packages which are very supportive of new entrants and suppliers growing their farm business.

Topic	Feedback/questions provided by suppliers	Changes proposed/matters confirmed
Retirees	Will some farmers retire or leave MG to realise the capital gain from their shares?	It is possible that a higher share value may cause a minority of suppliers to genuinely consider retirement or leaving MG. We propose to amend the constitution so that retiring farmers can leave their equity in MG as non-voting shares (similar to preference shares today). If they choose to sell their shares we propose that retiring or exiting farmers can only do so over three years, in accordance with the Share Standard and any other limitations determined by the Board. Certain limits will apply to how quickly MG supplier/shareholders that hold more shares than is required under the Share Standard can sell down to the Share Standard.
Farmgate Milk Price (FMP)	The farmgate milk price must remain the primary objective and the Fonterra pricing model is not appropriate in Australia.	As a co-op, MGs primary goal is to maximise FMP – that has not changed. The objective of the capital structure is to pay a higher FMP. MG proposes to pay similar dividends to today when the FMP is in the lower range and only pay higher dividends (to shareholders and unit holders) when the FMP is higher. MG will not adopt a Fonterra-style milk price formula.
Preference Shareholders	How will MG involve preference shareholders in a future capital structure?	As previously advised, MG proposes to cancel all A class preference shares. The Board is currently considering whether B and C class preference shareholders may be able to participate in any proposed capital structure.
Banking Support	Have the banks supported the revaluation of MG shares and agreed to supply finance for them?	Yes. MG has met with the major bankers to the dairy farm sector and received preliminary support for the proposal.
Unit Price	What value will units be initially listed at?	This will not be determined until after the final capital structure has been approved by the Board, regulators and shareholders and a prospectus is issued.
Timetable	Don't rush this important change.	As stated in the shareholder communication on 3 March 2014, there are no set deadlines or timetables. We will proceed to formal consideration if and when the key elements of the structure are carefully designed and meet shareholder expectations. MG will determine next steps following consultation on this discussion draft. An indicative timeline is outlined on page 11.

Farmer control

Ensuring supplier control will be maintained has been the single most important factor for the Board in considering whether the capital structure being proposed is suitable for MG. The existing 100 per cent farmer control will remain unchanged. The proposed capital structure does not alter active dairy farmer control of MG.

As discussed above, any units issued to external investors will be non-voting in relation to MG. MG already has non-voting equity through preference shares (A, B and C class shareholders) and under the proposed structure will continue to have non-voting equity into the future.

In addition, the current constitutional protections will be retained:

- the ownership cap of 0.5 per cent of all shares in MG, limiting the influence of any individual shareholder;
- 90 per cent voting threshold to change the constitution as it relates to the ownership cap and listing of MG shares (as opposed to listing units); and
- a requirement for all active suppliers to hold at least 500 shares in MG and take part in a share off-take scheme (if below the Share Standard).

The Share Standard

MG's constitution already supports arrangements that are very similar to the proposed Share Standard. As shown in the table below, the proposed capital structure retains the key foundations of the existing constitutional arrangements.

	Current status quo	New proposal
Joining the co-op (new entrant)	• Must acquire 500 shares at $1.00 each. • No requirement to share up immediately. • All suppliers on share off-take at 0.65 cents per litre.	• Must still acquire 500 shares, but at market price. • No requirement to share up immediately. • If below the Share Standard – off-take is compulsory. • If above the Share Standard – off-take is optional. • Off-take can be at 0.65c/litre or 1c/litre or 2c/litre (i.e. 9 cents per kg/ms, 13 cents kg/ms or 27 cents kg/ms).
Soft voting cap	• Soft voting cap is 1 vote for every 5 litres of milk supplied. • Any shares above this ratio are non-voting.	• Voting cap to equal the Share Standard (i.e. 1 vote per 1 kg/ms). • Any shares above the Share Standard will be non-voting. • This would require a constitutional change.
Hard ownership cap	• Hard ownership cap is 0.5 per cent of the total shares (including preference shares). • MG has 323 million shares on issue (including preference shares). • Ownership cap is 1.62 million shares. • Off-take is stopped if supplier reaches the cap.	• No change is being proposed to the ownership cap.

It is proposed that the Share Standard be set at 1 share for each kilogram of milk solids expected to be received from a supplier in any year, based on their three-year rolling average historical production. Suppliers who do not hold shares up to the Share Standard will be required to continue to participate in off-take to acquire shares in MG over time at the market price. Participation in the share off-take above the Share Standard would be optional.

There will be no penalties for suppliers who do not meet the Share Standard. Suppliers who grow their milk production can simply resume share off-take at market prices or buy shares on market at any time.

The Share Standard will be used to determine whether a supplier needs to buy shares via off-take, or has shares available for sale, being the shares they own above the Share Standard.

The Board is also proposing to calculate future share off-take retention by reference to kilogram of milk solids as opposed to litres of production (as it is today) (e.g. change the 0.65 cents per litre to be 9 cents per kg/ms).

Supplier Share Offer

Ahead of any listing of units on the ASX, MG will formally provide suppliers that do not hold enough shares to meet the Share Standard, the opportunity (i.e. this would be optional) to buy more shares in MG to bring that supplier up to (or part way to) the Share Standard. It is proposed that the price of MG shares offered to supplier/shareholders who are below the Share Standard prior to the capital structure would vary based on tenure of their supply. It is proposed that longer-term suppliers will be offered shares at $1 per share while shorter-term suppliers will pay more than $1 recognising the time value of the up-front opportunity.

We also understand that some suppliers may be growing and a three-year rolling average calculation may not accurately reflect the likely future production of a supplier. Therefore, suppliers will be offered shares under the Supplier Share Offer up to the higher of:

- milk solids supplied to MG in the previous 12 months to 30 June; or
- the three-year rolling average milk solids supplied to MG to 30 June.

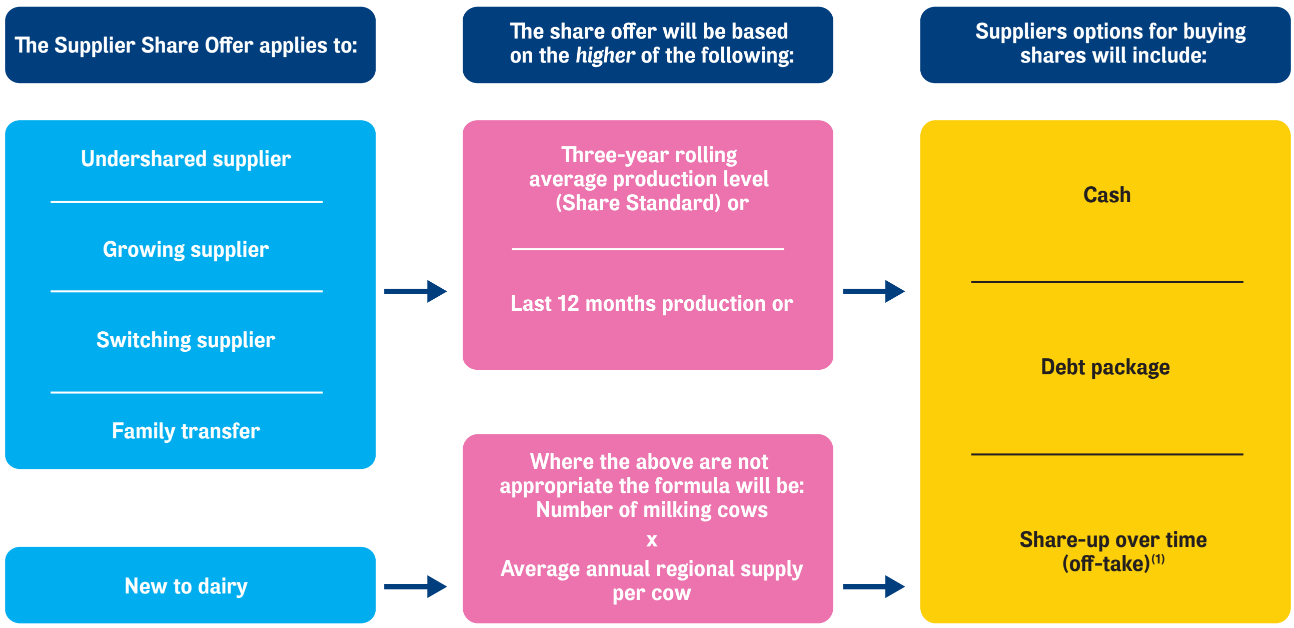
In the event that neither of the above are relevant, MG will determine the number of shares to be offered to a supplier based on an estimate of the number of milking cows and therefore milk solids production which would be supplied to MG. MG anticipates that this would only occur in extremely limited circumstances, if any.

Suppliers who are below the Share Standard will have the option to participate in the Supplier Share Offer. It will not be compulsory and those suppliers who do not wish to participate can simply remain on share off-take after the capital structure is complete, although the share purchase price will be market price rather than $1.

An outline of the proposed Supplier Share Offer is as follows.

Supplier Share Offer

It is proposed that MG supplier/shareholders who are **below the Share Standard** will be given the **option** to 'share up' through a Supplier Share Offer.



Suppliers who are at or above the Share Standard will also be given the opportunity to buy more MG shares at a market price being the price at which units are offered to external investors, up to a maximum of the ownership cap of 0.5 per cent of total MG shares. The Board believes this to be an important step as it will provide all suppliers with an opportunity to increase their stake in MG and will minimise the amount of capital that needs to be raised from external investors to fund MG's growth. Some farmers who take up the Supplier Share Offer may be required to sign a milk supply agreement with MG.

(1) The share purchase price will be a market price rather than $1.

New entrants

New entrants will be treated the same as they are today. A new entrant will be required to buy a minimum of 500 shares in MG in their first month of supply and will be placed on off-take until they reach the Share Standard.

New entrant packages will be available to encourage new suppliers to join the co-operative, or to assist existing MG suppliers investing to grow their milking herd as is the case today.

An outline of the support for new entrants is summarised below.

New entrant considerations

The following basic principles are being proposed, which will be consistent across all new entrants.

New entrant requirements	Share off-take	Incentives
Minimum 500 shares at entry (no change from today)	Below the Share Standard, share off-take is compulsory	Growth and Next Generation incentives will continue to be available
No need to meet Share Standard immediately (no change from today)	At or above the Share Standard, share off-take is optional	
Need to meet Share Standard over time (no change to today)	Minimum off-take of $0.0065/litre (optional $0.01 or $0.02/litre)	
	Supplier free to purchase shares on-market at any time	

Retirees

The Board is considering proposing a constitutional amendment to allow genuine retirees to leave their capital in MG in the form of non-voting ordinary shares. The non-voting ordinary shares would continue to be entitled to the same dividend as an ordinary share or a listed unit.

If suppliers do not support this amendment, retirees, regardless of their tenure with MG, will be required to sell their shares within three years after retirement under the rules proposed to manage the Share Standard. The Board believes that genuine retirees should have the opportunity to exit MG to suit their circumstances. However, suppliers, all of whom will retire at some stage in the future, will need to collectively determine if such a change to the constitution is appropriate.

Farmgate Milk Price ('FMP') mechanism

The Board has considered two FMP mechanisms:

1. A model similar to that adopted by Fonterra that determines a FMP based on prevailing prices in international commodity markets.
2. A model that aligns supplier and investor interests by paying a higher dividend when the underlying milk price is higher and a lower dividend when the underlying milk price is lower.

After detailed consideration of the two potential mechanisms, the Board is exploring a FMP mechanism that aligns the interests of supplier and unit holders. As such, unit holders and supplier/shareholders should receive higher dividends when suppliers are being paid higher FMP and lower dividends when the FMP is lower.
The benefits of adopting a model that aligns suppliers and unit holders are as follows:

1. allows MG to continue to maintain the primary objective of maximising the FMP to suppliers;
2. provides greater stability to the structure in the long term as suppliers and unit holders have their interests aligned;
3. allows MG to prioritise milk price over dividends in tougher economic conditions by paying a lower dividend (similar to today);
4. allows both suppliers and unit holders to share in the risks and benefits associated with the positive long-term macro economic trends for milk demand in growing Asian markets; and
5. allows suppliers and unit holders to share in the risks and benefits to the FMP from the capital expenditure being undertaken with new capital being raised.

The final details of the FMP mechanism is still a matter for consideration by the Board.

Other aspects of the structure relevant to MG shareholders

Preference shares

The proposed way in which each class of preference share will be dealt with is summarised in the table below.

Share	Description
A class	As previously announced, the A class preference shareholders have been offered a cash payment of $1.25 per A class preference share on issue. This payment will be made to A class preference shareholders by way of a capital reduction. Both A class preference shareholders and ordinary shareholders will have the opportunity to vote on this capital reduction at shareholder meetings to be held on 6 June. KPMG has undertaken an independent review of the proposal and is of the opinion that it is fair and reasonable to MG's shareholders as a whole including the A class preference shareholders.
B and C class	The Board is currently working through how to manage B and C class preference shares as part of the capital structure.

Constitutional change

The capital structure would be accompanied by a range of proposed constitutional amendments to allow MG to operate effectively under the new structure and to ensure suppliers obtain the full benefit of the structure being proposed. Each of these amendments would be put to suppliers separately, such that you have the opportunity to consider each of them independently and would require 75 per cent of present and voting shareholders at the meeting to approve.

Banking support for suppliers

MG has undertaken information sessions with all of the major banks that provide finance to MG farmers including ANZ, Commonwealth Bank, NAB, Rabobank, Rural Finance Corporation and Westpac. Each of these lenders has provided their indicative support for the structure. They have also provided preliminary confirmation that they will attribute a market value to ordinary shares in MG when considering the amount of funding that they would make available to individual farming businesses in accordance with their standard asset lending ratios and loan approval policies.

MG intends to go through a process of ensuring that each lender has a chance to consider any further enhancements to the proposed capital structure before their final confirmation is received. MG would then notify suppliers of the lenders who have indicated their support for the structure before it is voted upon, or highlight any lender who is unable to provide suppliers credit for the value of their shares when considering their borrowing capacity.

Timetable and next steps

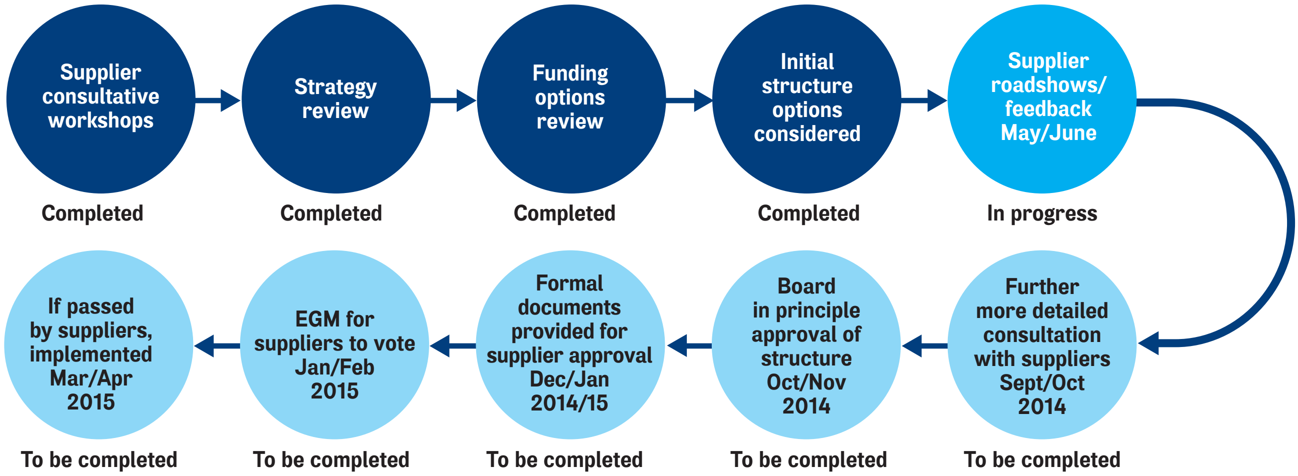
MG will now conduct a second round (Round 2) of consultation meetings across all supply regions to discuss this latest discussion paper.

We encourage suppliers to participate actively in these sessions and to ask all of the necessary questions to ensure you are comfortable that the capital structure is the right path for MG and ultimately the broader Australian dairy industry.

We understand that not all suppliers can attend the supplier consultation meetings, so please send through any questions via email to mgcapitalstructure@mgc.com.au.

As noted in our last correspondence to suppliers in March, the Board is not committed to a particular deadline for the capital structure as we believe it is important to ensure that any new structure meets MG's needs for the long term and that our shareholders have sufficient time to assess the merits of what is being proposed and provide feedback.

The following is an updated high level overview of the process we are undertaking.



The capital structure being considered by Murray Goulburn Co-operative Co. Ltd (**MG**) remains subject to supplier consultation, regulatory approval and further consideration by the MG Board. This document does not create an obligation on MG to proceed with a capital structure. If the Board determines to recommend a capital structure to shareholders, that structure will be subject to shareholder approval and the details of the structure will be specified in an Explanatory Memorandum and other materials sent to shareholders.

Important Notice

These materials have been prepared by MG for the sole purpose of providing information to shareholders on the potential capital structure of MG. No decision has been made to undertake a capital structure and the nature of any capital structure undertaken may change significantly from that referred to in these materials. These materials may not be reproduced in whole or in part without MG's prior written consent.

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These materials contain certain 'forward-looking statements'. Forward-looking statements can generally be identified by the use of forward-looking words such as, 'expect', 'anticipate', 'likely', 'intend', 'should', 'could', 'may', 'predict', 'plan', 'propose', 'will', 'believe', 'forecast', 'estimate', 'target' 'outlook', 'guidance'. The forward-looking statements contained in these materials involve significant elements of subjective judgement and assumptions as to future events which may or may not be correct.

You are cautioned not to place undue reliance on forward-looking statements as actual outcomes may differ materially from forward-looking statements. MG disclaims any responsibility for the accuracy or completeness of any forward-looking statements.

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