

Devondale Murray Goulburn Market Update

December 2014



Since our September update the global markets for key dairy ingredients continued to weaken caused by the combined impact of supply build up in export countries and slower demand due to stock build up in China and the Russian bans.

Long-term underlying dairy food demand from Asia remains strong, with a net reliability on imports to satisfy the ongoing growth in per capita consumption. However, international dairy prices have continued to weaken in the last quarter driven by increased supply from all of the main milk producing regions. Supply side issues have been exacerbated as Russian bans begin to have an impact and dairy stocks build in the European Union, particularly Skim Milk Powder (SMP) and butter. In addition to this, high stock build up in China has added further difficulties creating a trifecta of issues which underpins the current weakness.

In New Zealand, milk production is up four per cent, European production is up 5.5 per cent, USA production is up 2.5 per cent on last year and this has placed strong downward pressure on global prices.

Given continued growth in global demand and a recovery to normal buying patterns in China, the market will recover; however, given the current complexities at this stage of the commodity cycle, it is difficult to predict the timing and strength of this recovery.

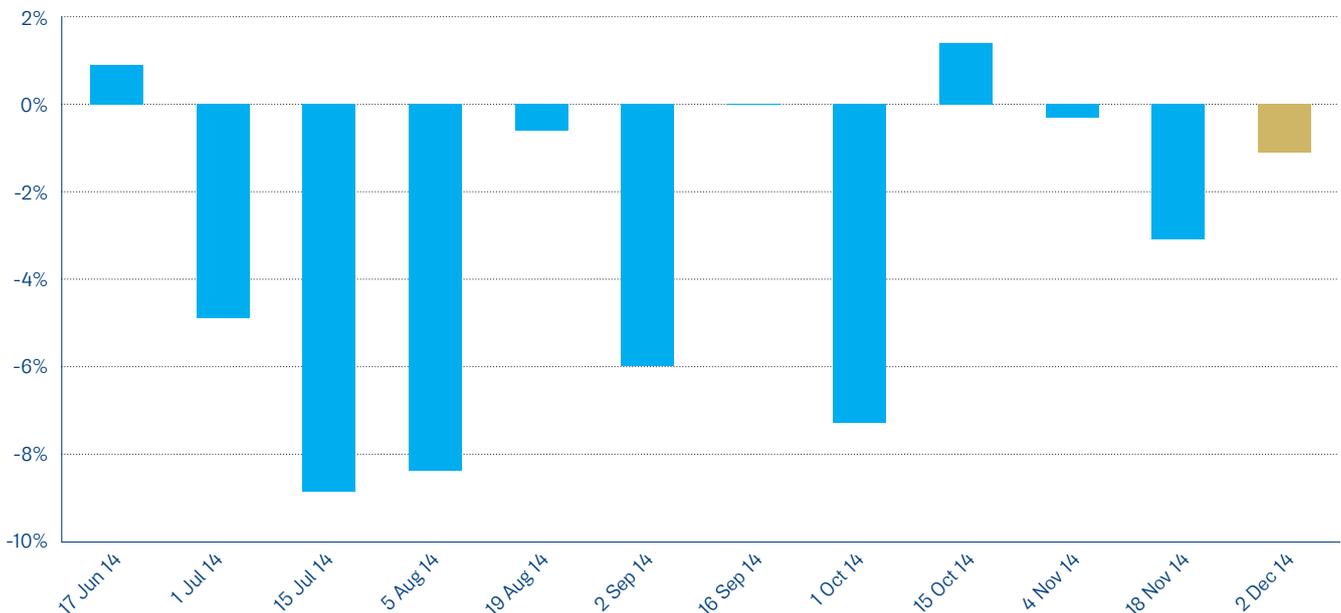
MG has worked hard on optimising product returns by focusing on mix and pricing, combined with ongoing efficiency drives on yield and conversion costs, to maximise the farm gate milk price for our suppliers/shareholders, despite the sharp decline in commodity prices. Accordingly, MG has maintained its full-year forecast at \$6.00 per kilogram milk solids on a weighted-average available basis.

International dairy ingredients

There has been a trend over the last 10 months of declining prices on the Global Dairy Trade (GDT) platform. GDT results do not necessarily establish global prices in all categories; however, it does shape and influence market sentiment and buyer behaviour. The trading platform results continue to underpin a negative sentiment in the market; however, the fundamental issue facing the market right now is increased availability from all major producing countries.

We also note that milk production quotas in the EU officially end at the end of this financial year. We expect that this will lead to supply growth in some EU countries, although this will be dependent on farmgate pricing and input costs.

Figure 1: Percentage change in GDT price index

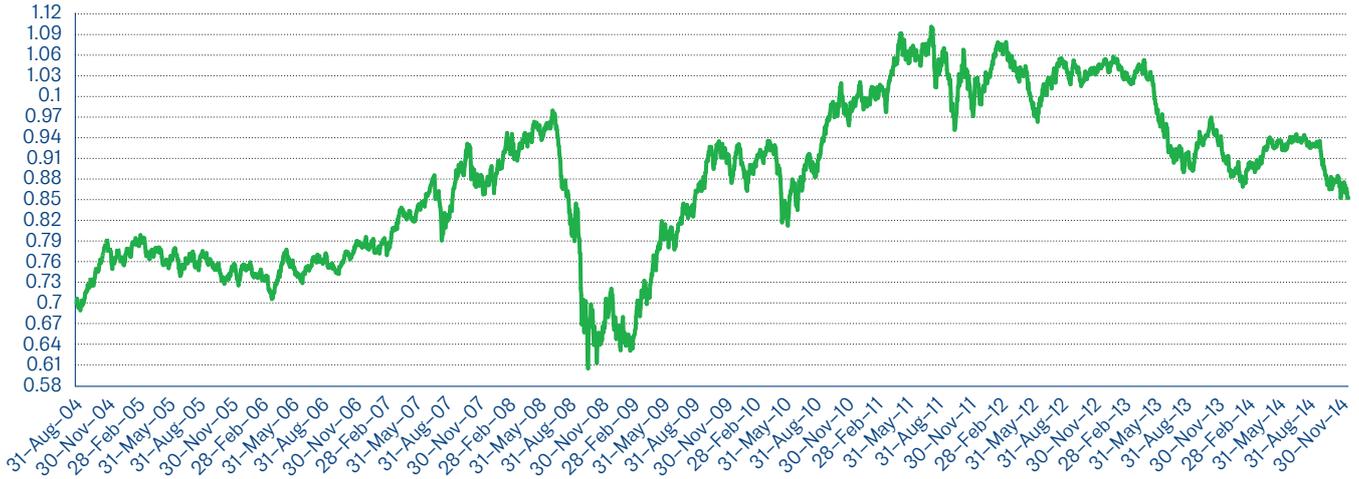


Source: Global Dairy Trade

Currency

The Australian dollar (A\$) has weakened considerably since MG's last Market Update – down from the low US\$0.90 range to the US\$0.85–0.87 range. This has improved A\$ returns for MG suppliers, but has only applied to part of the year's currency requirements, which limits the impact.

Figure 2: US\$ to A\$ exchange rates 31 August 2004 to 30 November 2014



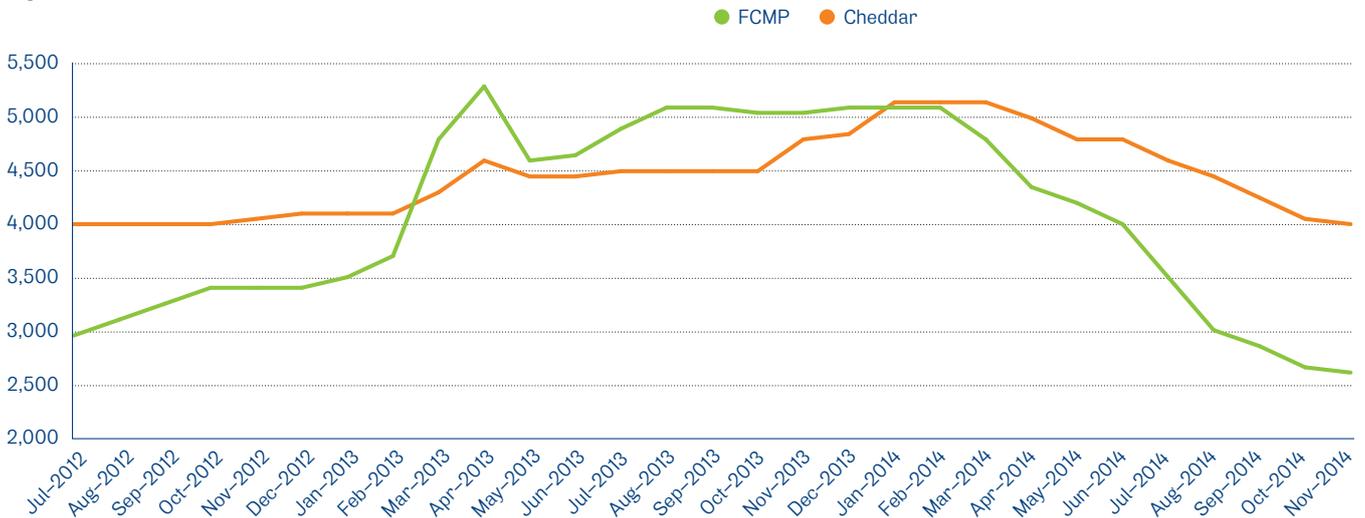
Source: Bloomberg

Product mix

MG continues to optimise its production, sales and marketing mix to maximise farmgate returns. This includes maximising international and domestic retail and food service sales volumes and maximising production of higher returning ingredients sales such as infant nutrition powder and cheese.

Major initiatives include the relaunch of the Devondale brand in China to support higher retail sales. In addition, MG has also maximised cheese production by directing as much milk as possible to the Northern Victorian milk plants. Generally, cheese is a less volatile product and provides improved returns when Full Cream Milk Powder (FCMP) and SMP are trading in the lower range. Much of MG's Ingredients portfolio is in value add high protein products for nutritional applications and speciality fats for Asian markets.

Figure 3: FCMP v Cheddar



Source: Dairy Australia

China brand relaunch

MG has relaunched its Devondale long life milk (UHT) in China in new bilingual metallic packaging and pack sizes, with pack designs implemented based on Chinese consumer research and feedback. The range, which comes in 200ml and one litre as well as associated family gift packs, reinforces MG's intentions to maximise the opportunities gained by the recent signing of the Australia-China Free Trade Agreement (FTA).

The new metallic UHT packs have a premium look and feel and feature a distinctive gold Devondale logo, reinforcing our brand's premium positioning in the market. The relaunch and expansion of the Devondale UHT range in China is part of MG's strategy to capture the value of the increasing demand by Asian consumers for safe, reliable dairy foods.



Australian dairy foods

MG has a strong presence in the Australian dairy food market, with approximately 50 per cent of revenues generated via Devondale, grocery and food service channels. These channels continue to perform well in 2014–15.

We recently won the Australian Grand Dairy award for our Devondale Original Butter, made at Koroit. This award reflects the great quality of milk produced by our farmers combined with the enthusiasm and commitment of the team at Koroit to make a high-quality, great-tasting product.

Another highlight has been the recent launch of our Devondale chilled milk range and the sales expansion of our dairy beverages portfolio.

Our 3D flavoured milk has recently begun being stocked in Coles. The product is targeted to mums of kids a little older than those who consume our very successful MOO product. As a result of this, our current share of UHT flavoured milk is 60 per cent, a real success in value adding to our business.

Our Liddell's lactose free brand continues to perform very strongly. Watch out for some new products in-store: Long life custard, which can be found in the dessert aisle, and ice cream (chocolate and vanilla) available from the freezer section.

Milk supply at MG

MG recorded strong milk growth to the end of quarter one in 2014, with milk supply ex-farm nine per cent up on the previous year. Milk supply growth was strongest in Gippsland, Northern Victoria/Riverina and Tasmania. Sydney NSW milk supply also entered its second year of full farmgate supply, as the Devondale Dairy Business Centre (Sydney) received local NSW milk.

Given very dry conditions in many key regions, it is expected milk supply growth will weaken relative to last year as the season progresses.

Important MG updates

MG welcomes China Free Trade Agreement

MG has welcomed the recent announcement of a Free Trade Agreement with China. Managing Director Gary Helou said a FTA with China was a vital step for the future of MG's more than 2,500 dairy farmer supplier/shareholders.

China is already the world's largest dairy import market last year, importing 2.2 million tonnes, an increase of over 40 per cent on the previous year. It is forecast that China dairy demand and dairy imports will continue to grow. Chinese customers and consumers trust the quality and safety of Australian dairy products, and increasingly seek it as a premium choice in both the ingredients and grocery dairy foods. Therefore it is vital that Australia has excellent and competitive access to the growing and strategic China market.

The first objective in this FTA was to begin to redress the disparity between Australia and New Zealand dairy trade, to China. Second was to achieve a pathway to total free trade, providing a competitive advantage and protecting Australia's long-term competitiveness in China. It seems these objectives have been delivered.

MG is already investing in its manufacturing and in market distribution footprint to provide world-class dairy foods to China and south-east Asian consumers. The China FTA will further cement MG as a first choice dairy foods supplier to the China market, and this will support higher farmgate returns to our dairy farmer supplier/shareholders.