Supplier briefing

Murray Goulburn announces revised forecast, appoints interim CEO

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Dear Supplier

MG Responsible Entity Limited as the responsible entity of the MG Unit Trust today provided the following trading and FY16 outlook update to Australian Securities Exchange (ASX) in relation to Murray Goulburn Co-operative Co. Limited (MG).

To coincide with this release, the Board of Directors (Board) has prepared the following comprehensive briefing document to offer a deeper understanding of how today's guidance will affect you. A summary is as follows:

- MG has reviewed expected performance of the business for the final quarter of financial year 2016 (FY16).
- This review has concluded that the FY16 outlook of an Available Southern Milk Region Farmgate Milk Price (FY16 FMP) of $5.60[1] per kilogram milk solids (kgms) provided on 29 February 2016 is no longer achievable.
- MG now expects its FY16 Distributable Milk Pool (DMP) to be approximately $170 million to $220 million lower than previously forecast, resulting in an FY16 FMP of between $4.75 to $5.00[2] per kgms, which will include a reduction in the actual milk price paid to suppliers for the balance of FY16.
- Applying the Profit Sharing Mechanism (PSM) to the revised FY16 FMP, MG expects to achieve net profit after tax (NPAT) attributable to shareholders and unitholders of between $39 million to $42 million resulting in a fully franked dividend/distribution to shares/units of between 7.1 cents to 7.8 cents per share/unit for the full year (inclusive of the interim dividend/distribution of 3.5 cents per share/unit).
- MG has announced a reduction in the opening price for the remainder of FY16, to an FY16 FMP of $5.47 per kgms. This action will recover approximately $30 million of the reduction in DMP for FY16.
- Introduction of a Milk Supply Support Package (MSSP) to protect MG's milk supply in the long term by providing a milk support payment so that suppliers receive payments during FY16 equivalent to an FMP of $5.47 per kgms.
- The MSSP and its cash funding cost is to be recovered by MG from suppliers' milk payments for up to three years (from FY17 to FY19) and will not affect the operation of the PSM.
- Share offtake is voluntary for suppliers who hold shares above their share standard. The Board has also agreed that for FY2016/17, suppliers who hold shares below their share standard may also opt out of share offtake.
- Gary Helou will step down from his role, but will remain employed with the company for a short period to assist transition. David Mallinson, currently Executive General Manager Business Operations, has been appointed Interim Chief Executive Officer, while a search for a successor for Gary is undertaken.
- MG has confirmed that the Chief Financial Officer, Brad Hingle, has resigned from his position following Gary's decision to step down as the Managing Director but will remain in the business to assist with the finalisation of the FY16 annual results.

[1] For the purposes of the Profit Sharing Mechanism the Actual Weighted Average Southern Milk Region FMP of $5.56 per kilogram milk solids is used as the Actual Weighted Average Southern Milk Region FMP does not include the add-back of quality adjustments accrued from the supply of non-premium milk.

[2] For the purposes of the Profit Sharing Mechanism the Actual Weighted Average Southern Milk Region FMP of $4.71 to $4.96 per kilogram milk solids is used as the Actual Weighted Average Southern Milk Region FMP does not include the add-back of quality adjustments accrued from the supply of non-premium milk.

Trading update

With April 2016 now substantially complete, MG has reviewed the expected performance of the business for the balance of FY16. This review has concluded that the FY16 outlook of an FY16 FMP of $5.60[3] per kgms provided on 29 February 2016 is no longer achievable.

As advised by MG at its FY16 half year results, the achievement of this FY16 FMP was based on a number of factors including there being no unfavourable changes to the AUD:USD exchange rate and the continued strong performance of international ready-to-consume dairy food product sales to partially offset the underperformance of the Ingredients and Nutritionals segment as a result of the very low commodity prices.

As these factors have not eventuated, MG now expects its FY16 DMP to be approximately $170 million to $220 million lower than previously forecast, resulting in an FY16 FMP of between $4.75 to $5.00[4] per kgms, which will include a reduction in the actual milk price paid to suppliers for the balance of FY16.

Applying the PSM to the revised FY16 FMP, MG expects to achieve NPAT attributable to shareholders and unitholders of between $39 million to $42 million resulting in a fully franked dividend/distribution to shares/units of between 7.1 cents to 7.8 cents per share/unit for the full year (inclusive of the interim dividend/distribution of 3.5 cents per share/unit).

The Board is very disappointed that MG could not ultimately generate milk prices for FY16 either as disclosed in the Product Disclosure Statement published in May 2015, or as revised and notified to suppliers and investors on 29 February 2016. The Board remains committed to its strategy of shifting MG's product mix from commodity products to higher margin, value-added and ready-to-consume dairy foods and will continue to focus on transforming MG into a first choice dairy foods company. After careful review, the Board realises that greater focus is required to support the execution of this transformation, and will be implementing a series of changes within the business to support the continued transformation.

MG is aware that its suppliers will be particularly impacted by the lower FY16 FMP, in the face of difficult dairy farming conditions across much of MG's Southern Milk Pool Region. The Board is also today announcing a Milk Supply Support Package (MSSP), which will assist suppliers through this transition and ensure that unitholders are kept whole for the support. The package supports supplier cash flows for the balance of this financial year. The financial support and its cash funding cost will be recovered by MG from suppliers' milk payments for up to three years (during FY17 to FY19). This MSSP is explained in this letter and will not affect the application of the PSM.

Further detail regarding the primary drivers leading to a revised outlook can be viewed in the ASX release issued today and available by clicking here.

Changes to Executive Leadership Team

The Board today announced that Managing Director, Gary Helou, will step down from his role, but remain with the company for a short period to assist with the transition to an interim Chief Executive Officer (CEO) while a search for a successor for Gary is undertaken.

Following the MG trading update announced to the ASX today, the Board and Gary have agreed that the stewardship of the company going forward will be best served under fresh leadership. As a result, David Mallinson, currently Executive General Manager Business Operations, has been appointed interim CEO.

[3] For the purposes of the Profit Sharing Mechanism the Actual Weighted Average Southern Milk Region FMP of $5.56 per kilogram milk solids is used as the Actual Weighted Average Southern Milk Region FMP does not include the add-back of quality adjustments accrued from the supply of non-premium milk.

[4] For the purposes of the Profit Sharing Mechanism the Actual Weighted Average Southern Milk Region FMP of $4.71 to $4.96 per kilogram milk solids is used as the Actual Weighted Average Southern Milk Region FMP does not include the add-back of quality adjustments accrued from the supply of non-premium milk.

David is an experienced strategic, operational and financial leader and has held a number of leadership roles within the dairy industry over the course of his career. Prior to joining MG three years ago, he was Commercial Director for Fonterra Brands Limited, a consumer business which generated revenues of $3.6 billion and employed more than 12,000 people before being appointed Chief Financial Officer Fonterra Australia/NZ.

We are very fortunate to have within the ranks of our leadership team an executive with the breadth and depth of experience that David brings to MG. David has a track record delivering growth and operational turnaround programs and proven management experience across multiple geographies.

Prior to today, David has also been leading MG's Business Operations function which encompasses the breadth of MG's supply chain, from farm to market, and employs 1,700 of MG's 2,400 people, so he is well placed to assume the interim CEO position.

Commenting on his appointment, David said, "MG is a great business with a strong growth future. I firmly believe MG's value add strategy is the right direction for the company and I look forward to working with the MG team to execute the strategy, with discipline and rigour in the weeks and months ahead."

I believe history will judge Gary as a visionary leader who delivered a strategy that has transformed the industry. He has made a significant contribution to MG and has been a powerful driving force behind our transition to become a globally recognised, ASX-listed food business. We thank Gary for his passion, drive and leadership during what has been an important transformation period for MG.

Gary said, "During my time at MG, we have transformed the company's capabilities and capacity and in the process delivered two consecutive years of premium milk prices for Australian farmers. While maintaining this price has proven to be difficult in current market conditions, I firmly believe MG has the foundations in place to support a strong and successful business in the years ahead."

Finally, MG has confirmed that the Chief Financial Officer, Brad Hingle has resigned from his position following Gary's decision to step down as the Managing Director but will remain in the business to assist with the finalisation of the FY16 annual results.

Introduction of Milk Supply Support Package

Protecting MG's milk supply is of significant importance to the future profitability and growth of MG. The Board is aware of the difficult conditions many of MG's loyal suppliers currently face, particularly as the effect of El Nino persists across much of MG's Southern Milk Pool Region.

In light of MG's revised FY16 FMP forecast and the adverse impact this will have on suppliers in this challenging environment, the Board has also announced a MSSP which is designed to:

- support the sustainability of dairy businesses that underpin MG's milk supply in the long term;
- support suppliers' cash flows in the near term as difficult dairy conditions persist by not requiring suppliers to incur a full reduction in the opening price for the remainder of FY16 to offset the higher farmgate milk price that has already been paid so far this year;
- prudently manage MG's capital and balance sheet, and avoid permanent indebtedness arising from any support package (as well as ensuring that the financial cost of support is recovered over time from suppliers);
- ensure that MG's strategy and growth investment program is not impacted; and
- ensure that the support package does not distort the operation of the PSM to the disadvantage of unitholders and shareholders.

Today, MG has announced a reduction in the FY16 FMP opening price of $0.13 per kgms to $5.47 per kgms for the remainder of FY16. This action will recover approximately $30 million of the reduction in DMP for FY16 and represents approximately 15 percent of the anticipated milk payments for the balance of the financial year.

With the MSSP, MG has committed to provide a milk support payment above the actual FY16 FMP, such that suppliers will receive the cash equivalent of $5.47 per kgms in FY16. This will result in additional group borrowings at the end of FY16 of approximately $95 million to $165 million.

MG confirms that it has headroom within its existing funding arrangements, and this initiative is not expected to impact MG's planned capital investments. Against the increase in group borrowings, MG will recognise an equivalent asset on its balance sheet, classified as an Other Receivable, that will be amortised down over three years as the MSSP and its cash funding cost is recovered from suppliers.

To recover the MSSP and its cash funding cost, MG will deduct a fixed amount from future milk payments over the next three financial years. These deductions will include the cost to MG of additional interest incurred through funding the package (so that MG's interest costs are recovered from suppliers). Application of the PSM in future years will apply to the DMP before amortisation of the Other Receivable.

The Board also advises that they will work with management to limit the impact to suppliers over the repayment period, by setting company performance goals that focus on generating additional value to the DMP above full year budgets to match the financial impost. These will be reflected in the company's Short Term Incentive Plan.

The estimated annual impact of the MSSP, at the low end of the range, can be seen on the following page in **Table 1**, column E. It is important to note that the final level of the package can only be determined at the end of the financial year when year end accounts are finalised.

Suppliers are reminded that share offtake is voluntary for suppliers who hold shares above their share standard. The Board has also agreed that for FY2016/17, suppliers who hold shares below their share standard may also opt out of share offtake.

Further information

A series of Q&As are available as an appendix to this document and have been prepared to address the MSSP in more detail.

Specific information regarding the primary drivers leading to a revised outlook is available in today's ASX release, available on MG's website by clicking here. Further comment about management changes is also provided in an additional ASX release, available on MG's website at clicking here.

Next steps

- The final value of the MSSP will be determined once full year accounts have been finalised.
- At this stage, you do not need to anything to access the MSSP and MG will pay the FMP outlined in **Table 1,** column B.
- Your local Field Services team are available to assist with queries at any time. Senior members of the Supplier Relations team are also available to speak with suppliers about today's announcement and appointments can be scheduled through Field Services.
- Suppliers who wish to suspend share offtake should contact Field Services to complete the relevant paperwork.
- Furthermore, I will be joined by members of the Board and Executive Leadership Team during supplier meetings commencing next week. Details will be provided to suppliers as soon as they are finalised.

In conclusion, your Board notes there has been dramatic changes to the global dairy industry and commodity prices have fallen to near historic lows. It is the strength of our co-operative that has allowed us to put in place the MSSP which minimises the short term impact of this downward cycle.

On behalf of the Board of Directors, I'd like to thank you, our suppliers, for your patience and understanding during a challenging period.

Sincerely,

Philip Tracy
Chairman

Table 1	A		B		C		D		E	
	Original base opening price ($5.60 per kgms)		Revised opening price for May/June 2016 to reflect $5.47 per kgms price		Lower price to reflect $5.47 per kgms at the full year		Lower price to reflect $4.75 per kgms**		Difference between $5.47 per kgms and lower end of range**	
Month	**Fat $ kg**	**Pro $ kg**	**Fat $ kg**	**Pro $ kg**	**Fat $ kg**	**Pro $ kg**	**Fat $ kg**	**Pro $ kg**	**Fat $ kg**	**Pro $ kg**
July	3.88	8.55	3.88	8.55	3.80	8.37	3.33	7.34	0.47	1.03
August	3.51	7.74	3.51	7.74	3.43	7.56	2.96	6.53	0.47	1.03
September	3.39	7.47	3.39	7.47	3.31	7.29	2.84	6.26	0.47	1.03
October	3.39	7.47	3.39	7.47	3.31	7.29	2.84	6.26	0.47	1.03
November	3.39	7.47	3.39	7.47	3.31	7.29	2.84	6.26	0.47	1.03
December	3.39	7.47	3.39	7.47	3.31	7.29	2.84	6.26	0.47	1.03
January	3.59	7.90	3.59	7.90	3.51	7.72	3.04	6.69	0.47	1.03
February	3.69	8.14	3.69	8.14	3.61	7.96	3.14	6.93	0.47	1.03
March	3.73	8.22	3.73	8.22	3.65	8.04	3.18	7.01	0.47	1.03
April	3.88	8.55	3.88	8.55	3.80	8.37	3.33	7.34	0.47	1.03
May	3.96	8.71	3.38	7.42	3.88	8.53	3.41	7.50	0.47	1.03
June	4.03	8.88	3.45	7.59	3.95	8.70	3.48	7.67	0.47	1.03

**Columns D and E are indicative values only and calculated at the lower end of the declared range. The actual price will be calculated at the end of the financial year when final accounts are closed. Column E shows the approximate scale of the MSSP based on the lower end of the range.

Appendix 1

Q. What is the new forecast range?

MG now expects its FY16 Distributable Milk Pool (DMP) to be approximately $170 million to $220 million lower than previously forecast, resulting in an FY16 FMP of between $4.75 to $5.00[5] per kgms, which will include a reduction in the actual milk price paid to suppliers for the balance of FY16.

Q. How will the reduction to the opening price be applied?

A. A reduction to the opening price equivalent to $0.13 per kgms (or $0.01 per litre) will be applied via a reduction in base price milk payments for solids delivered in May and June 2016 (see **Table 1**, column B). Because the impact on the forecast was identified so late in the financial year, it was considered more sensible and fair to only apply a portion of the total impact in FY16 and to fund the majority via the MSSP over the next three years.

Q. What is the MSSP?

A. It is a payment package for MG suppliers that will allow the co-operative to make forecast payments to suppliers consistent with a $5.47 per kilogram milk price despite the fact that returns will no longer support this. The monies paid to suppliers under the package will be recovered over the next three years from milk payments. This means that the majority of the impact of the underperformance on milk payments in FY16 can be spread over three years rather than concentrated in the last two months of the financial year.

Q. How is the package funded?

A. The package is initially funded from MG's balance sheet and then repaid on a milk production basis from future milk pools. The level of the package as shown on the balance sheet should reduce to zero over the next three years.

Q. How much will I receive then pay back under the support package?

A. The package is defined as the difference in base milk prices for kilograms of fat and protein between the current base price and the lower base price required to deliver the final southern milk pool FMP, which will be finalised when MG closes its accounts for FY16.

For example, at the high end of the southern milk pool FMP range ($5.00 per kgms) for FY16, the package is equivalent to $0.47 per kgms to be funded over three years which means that MG would recoup $0.16 per kgms per year every year. At the low end of the range ($4.75 per kgms) the package is $0.72 per kgms and funded over three years. As a result, we would need to recoup $0.24 per kgms from the milk each year over three years to fund the package.

Q. Do I have to pay the money back?

Yes. MG will manage this via adjustments to the milk payments over the next three years. MG will clearly report the impact of this adjustment to suppliers.

[5] For the purposes of the Profit Sharing Mechanism the Actual Weighted Average Southern Milk Region FMP of $4.71 to $4.96 per kilogram milk solids is used as the Actual Weighted Average Southern Milk Region FMP does not include the add-back of quality adjustments accrued from the supply of non-premium milk.

Q. Over what period will I pay the money back?

A. The package will be repaid over the next three years. MG will do this in a fair and transparent way. MG may pay the package off ahead of this schedule subject to future business performance.

Q. Will this make MG uncompetitive?

A. It remains the Board's view that MG's strategic focus, combined with ongoing efforts to reduce cost in the business and drive efficiencies, will continue to safeguard against the impact of volatility in global dairy commodity markets and support MG to deliver a sustainably higher FMP over the long term.

Q. Will all suppliers be involved in the package?

A. All MG suppliers in FY16 will receive the package through the current milk pricing arrangements (known as the $5.47 equivalent) rather than the revised lower forecast.

Q. Do I have to take the package?

A. All MG suppliers in FY16 will receive the package by being paid under the current milk pricing arrangements (i.e. the $5.47 equivalent pricing) rather than the revised lower forecast of $4.75 to $5.00[6] per kgms.

Q. Will it impact my cash flow or flat milk incentive payments in the financial year?

A. As a result of the reduction in FY16 FMP opening price, payments for May and June 2016 will be lower (see **Table 1**, column B). Payments for April milk solids will be made as per previous pricing (detailed in **Table 1**, column A). All other incentives and charges remain unchanged.

Q. How will the support scheme be treated on MG's balance sheet?

A. Against higher debt, MG will recognise an equivalent asset on the balance sheet, as an Other Receivable, which will amortise down over three years as the capital is returned.

Q. How do I opt out of share offtake?

A. Suppliers are reminded that share offtake is voluntary for suppliers who hold shares above their share standard. The Board has also agreed that for FY2016/17, suppliers who hold shares below their share standard may also opt out of share offtake.

Suppliers who wish to suspend share offtake should contact Field Services to complete the relevant paperwork.

Q. Can I get additional finance from MG to support my business?

A. Field Services can discuss access to finance subject to the usual terms and conditions.

[6] For the purposes of the Profit Sharing Mechanism the Actual Weighted Average Southern Milk Region FMP of $4.71 to $4.96 per kilogram milk solids is used as the Actual Weighted Average Southern Milk Region FMP does not include the add-back of quality adjustments accrued from the supply of non-premium milk.