

Suspension of Milk Supply Support Package for the remainder of the 2016/17 season and revised Southern Milk Pool pricing



20 October 2016

Dear Suppliers

I made a commitment to notify you of market changes affecting MG as soon as they occurred. As you know, the dairy industry across southeast Australia is being severely impacted by extreme wet conditions and lower farmgate milk pricing. We recognise the severe financial strain this is causing your business.

Our absolute priority during this challenging time is to return cash to farmers' pockets while being financially prudent. Along those lines, I'd like to update you on our actions to achieve this:

- Recovery of the Milk Supply Support Package (MSSP) contribution will be suspended from 1 October 2016 until 30 June 2017
- As a result of this, an increase of \$0.09 per kilogram butterfat and \$0.18 per kilogram protein (the equivalent of \$0.14 per kgms) will be applied for milk supplied from 1 October 2016 to 30 June 2017¹, resulting in an average weighted available price of \$4.60 per kilogram milk solids (kgms)
- MG is also offering the option to receive this increase as a farmgate milk price (FMP) pre-payment from 1 December 2016 which will assist with farmers' cash flows in the coming months
- MG will also make an additional growth incentive payment of \$0.35 per kilogram butterfat and \$0.70 per kilogram protein available to eligible suppliers from 1 November 2016
- We have advised the market that the forecast full year NPAT of \$42 million will now be lower given revised expectations for milk intake
- Given the unexpectedly wet climatic conditions, we now anticipate a FY17 farmgate milk price² of \$4.70 per kgms, down from our previous expectation of \$4.88 per kgms. Achieving this also remains subject to commodity prices and foreign exchange not deteriorating.
- While this is a disappointing outcome, this revised forecast with no MSSP deduction still provides farmers with a higher net milk price than their current estimations.

Further details on today's announcements are included on the following pages.

Looking ahead

Dairy Australia's *Situation & Outlook Report*³ for October stated: "Preliminary data for the season to August reflects a 9 percent drop for the first two months of 2016/17. The south-eastern states are most heavily affected and will likely see further pressure from the ongoing wet conditions and floods. Victoria, Tasmania and South Australia all saw milk production fall by more than 10 percent for this period."

Due to the delay in the traditional peak milk production cycle, we may see an extended period of above average production in the coming months. We will continue to review this FY17 farmgate milk price, particularly where the downside risk posed by the current extremely wet conditions is concerned.

In response to a global oversupply of dairy products, we are committed to manufacturing the highest possible value products. We are ensuring our operations reflect the domestic and international market and tightly managing our costs.

¹ This does not apply to those who elected to make an early repayment of their MSSP contribution.

² 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

³ [Dairy Australia](#)

As we navigate a turbulent environment at home and around the world, I'd like to sincerely thank you for your ongoing and loyal support of the co-operative.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'DM', with a long horizontal stroke extending to the right.

David Mallinson
Chief Executive Officer (Interim)

Background to revised forecast

MG has announced initiatives to ease financial pressure on suppliers following the announcement of a revised forecast FY17 FMP of \$4.70 per kgms, if current conditions including climatic, foreign exchange and commodity prices continue. On this basis, the previously advised forecast NPAT of \$42 million will now be lower given revised expectations for milk intake.

We have experienced losses of approximately 10 percent to competitors and retirements which we have largely managed by focusing our manufacturing output on the highest value products. However the forecast revision announced today includes the provision of an expected additional milk production loss of 10 percent due to the seasonal conditions.

Impact of current climatic conditions

Just over a month ago, the Australian dairy industry was largely optimistic about a stronger season with good rainfall arriving at a particularly important time. Unfortunately heavy falls have continued and each of our dairy supply regions have been impacted in some form, particularly northern and western Victoria.

According to the Australian Bureau of Meteorology, last month was the second wettest September on record. As a result MG has announced the following initiatives to assist suppliers in these conditions:

Initiatives to ease financial pressure

1. Suspended recovery of the Milk Supply Support Package

Recovery of the MSSP contribution will be suspended for the remainder of FY17. This will result in an increase in price of \$0.09 per kilogram butterfat and \$0.18 per kilogram protein (which is the equivalent of \$0.14 per kgms) in relation to milk supplied from 1 October 2016 to 30 June 2017 (except for those suppliers who elected to make an early repayment of their MSSP contribution). This suspension of recovery will address some concerns over market conditions and the current milk pricing and will provide cash to our suppliers.

The extensive review of the MSSP continues and finalised outcomes are expected to be announced before the Annual General Meeting on 28 October 2016.

2. Advance pre-payment option

As a result of suspending recovery of the MSSP contribution, we will offer suppliers the right to receive a pre-payment of the \$0.14 per kgms announced today. The calculation of the pre-payment will be based on MG's estimate of a supplier's expected production for the period from 1 December 2016 to 30 June 2017 and is conditional on the supplier agreeing to supply MG for the remainder of FY17.

A true-up of the amount pre-paid against actual FY17 production levels will occur after the conclusion of FY17. Suppliers will need to elect to participate in the pre-payment by 11 November 2016. Further details of the option to receive the pre-payment are set out in Attachment 1.

3. Growth incentive payment to support milk supply recovery

MG will introduce an additional incentive payment of \$0.35 per kilogram butterfat and \$0.70 per kilogram protein which will be available for current suppliers in the Southern Milk Region with a net growth in Qualifying Milk Solids supplied from 1 November 2016 to 30 June 2017 (when compared to the prior corresponding period in FY16). As a loyalty payment, the additional growth incentive will be paid at conclusion of the financial year to those suppliers who are actively supplying at that time.

Further details of the additional growth incentive are set out in Attachment 2.

Attachment 1: Detailed terms of the advanced Pre-payment

Today MG has announced the suspension of the MSSP recovery for the remainder of FY17 and a resulting increase of \$0.09 per kilogram butterfat and \$0.18 per kilogram protein (the equivalent of \$0.14 per kgms) for milk supplied from 1 October 2016 to 30 June 2017 (other than for those suppliers who elected to make an early re-payment of their MSSP contribution). MG also now offers suppliers the right to elect to participate in a pre-payment of this amount in respect of estimated milk to be supplied for the period from 1 December 2016 to 30 June 2017 (Pre-payment), on the following terms:

The pre-payment will be based on MG's estimate of your expected production over the period from 1 December 2016 to 30 June 2017. For the purposes of this calculation, in most cases MG will use your actual production amount for the corresponding period in FY16. The difference between the estimated production amount and the actual production amount will be reconciled after the conclusion of FY17. If the amount pre-paid to you is less than the amount you are owed based on your actual FY17 production amount, MG will pay you a top up amount for the difference. If the amount pre-paid to you is more than the amount you are owed based on your actual FY17 production amount, MG will be entitled to recover that amount as an amount owed by you. In most cases MG will deduct any amount owing from your final milk payment for the financial year.

- If you wish to elect to participate in the Pre-payment you must complete and return a letter agreement which will be sent to you shortly. This letter agreement will need to be completed and returned by 11 November 2016 to receive your payment. MG will make the Pre-payment on 15 December 2016.
- A key term of the letter agreement is that to receive the Pre-payment you must commit to supply MG for the remainder of FY17. If a participating supplier breaches this Fixed Term Supply Commitment then, without limitation, they will be required to repay the Pre-payment to the extent that the Pre-payment relates to the period after cessation of supply.
- The Pre-Payment option can only be exercised at a farm level and not at a supplier level. All suppliers in respect of a farm, including those who are sharefarmers must make the same election. If different suppliers make different elections in respect of a farm, then all such suppliers will be deemed to have elected not to participate in the Pre-Payment.

We welcome growth through new suppliers and the Pre-payment offer will be made to new suppliers who commit to MG by 11 November 2016. New milk will help further lift returns for all suppliers.

Attachment 2: Detailed terms of the additional growth incentive

The additional growth incentive will be provided on the terms of clause 4.5 of the MG *Standard Milk Payment Terms* except as set out below.

1. The rate for the additional growth incentive will be \$0.35 per kilogram butterfat and \$0.70 per kilogram protein for all Growth.
2. Growth will be determined as the increase in Qualifying Milk Solids and butterfat and protein supplied from 1 November 2016 to 30 June 2017 when compared to the volume supplied in 1 November 2015 to 30 June 2016.