# 2016 AGM Q&A Summary

## Key themes arising in questions from the floor on 28 October 2016

### 1. Is it legal for the Milk Supply Support Package (MSSP) to be treated as an asset?

The MSSP has been accounted for in accordance with all applicable accounting standards and has been thoroughly reviewed and approved by our external auditors, including as part of the 30 June 2016 accounts. It is treated as an asset on MG's balance sheet as an amount advanced to suppliers. The amount of the asset is required to be impaired (reduced) when suppliers cease to supply MG by retiring or transferring to a competitor. The advances are interest bearing over the life of the advance. The repayment of the MSSP advances occurs by MG withholding an amount of milk payments to suppliers and is expected to be recovered over the next six years.

### 2. Why were two separate and conflicting announcements made relating to MG's forecast milk pricing only a week apart?

Under its continuous disclosure obligations, MG is required to immediately notify certain matters via the Australian Securities Exchange (ASX), including where we see a material change in circumstances that will affect profit. MG announced the revised milk intake expectations for financial year 2017 (FY17) on 20 October 2016, as at that point it was clear that milk intake would be significantly lower than budget due to the combined impact of departing and retiring suppliers and very wet conditions. As part of that announcement we also reduced our full year forecast farmgate milk price to $4.70 per kilogram of milk solids (kgms) to reflect the reduction in our milk intake. Unfortunately at that time we were still awaiting the outcome of the independent expert's report on the MSSP review and were not in a position to announce the proposed amendments to the package, which were released a day before the AGM. This included $50 million in step-up payments to suppliers (funded through a deviation to the Profit Sharing Mechanism) which enabled an increase in the full year forecast farmgate milk price to $4.95 per kgms.

### 3. Why didn't MG scrap the MSSP?

As part of the review of the MSSP, the Board sought expert advice and an independent expert's opinion. The unanimous view was that writing-off the MSSP was not in the overall best interests of suppliers and unitholders. The Board believes that the recent announcements regarding the MSSP strike a sensible balance between maintaining a strong balance sheet and a competitive milk price. They provide the opportunity to deliver an increased farmgate milk price immediately and together with the extended recoupment period and the $50 million to $60 million in annualised cost savings from FY18, will ensure MG can be competitive on farmgate milk price now and into the future. These benefits for suppliers have been enabled by a $81.8 million pre-tax deviation in the Profit Sharing Mechanism compared to a full write-down of the MSSP of $183 million.

### 4. Why is MG borrowing $50 million this season to support milk price?

MG has lost approximately 350 million litres of milk or 10 percent of our milk production on an annualised basis through suppliers leaving the co-op or retiring from the industry. In order to address this situation and provide a more competitive farmgate milk price, MG has provided $50 million in step-up payments to suppliers funded through a deviation to the Profit Sharing Mechanism. The Board's view was that we needed to strike a balance between maintaining a strong balance sheet and addressing the obvious fact we needed a more competitive milk price to keep our supply in place. We were also clear that annualised cost reductions of $50 million to $60 million in FY18 are expected to more than offset the recoupment of the MSSP. The Board, with the unanimous support of the Special Directors, were of the opinion that these actions were in the overall best interests of suppliers and unitholders by supporting milk intake in FY17 and the future.

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**5. What is MG doing to address its high cost structure and asset base?**
Following the farmgate milk price reduction in April, we recognised that our cost structures needed to be reviewed. Costs rose in FY16 for two main reasons. MG's distribution costs were higher due to increased inventory holdings compared to FY15 and the shift of our product mix into Dairy Foods. We also had increased marketing costs to support the product releases of Devondale Milkshakes and 8 Bar iced coffees. However the general increase in costs across the business was not acceptable and we conducted a review of overheads, which identified annualised cost efficiencies of between $50 million and $60 million, primarily from reduced headcount (predominantly positions associated with head office and MG Trading), procurement benefits, and the efficiency benefits facilitated by new systems. MG's cost efficiencies program is well progressed with the upper end of $10 million to $15 million in savings expected to be achieved in FY17. The planned working capital release this year of between $100 million and $110 million is also on track to be delivered. MG will continue to proactively manage its production facilities to target additional savings. Production plans have been revised to best cater for lower milk intake and we will continue to review options to enable this cost base to remain competitive.

**6. How is MG going to get suppliers' trust back?**
The only way we can address the trust issue is by being open and transparent as a Board and management team and by consistently delivering upon our core objective of maximising the farmgate milk price to our suppliers. Issues that have consistently been raised by suppliers as being in need of review are whether we have the right Board structure and composition and also milk price transparency. We have announced that there will be a review of the structure and composition of the MG Board which will involve wide consultation with suppliers and other stakeholders, to ensure that all views are considered. Renewal is occurring from a Board perspective with four new Supplier Directors elected at the AGM and new two Special Directors to be appointed in due course after Peter Hawkins announced his intention to retire from the Board. A review of our pricing system has also been announced so that we can ensure the business sends the right market signals, while also balancing farmers need for cash against what the market is paying. This review will also require significant input from suppliers. MG is also committed to continuing to work with other members of the dairy industry to explore ideas for improving Australia's pricing transparency. We support the introduction of the proposed commodity milk price index, providing that it is independently managed and tailored for the benefit of all participants in the Australian dairy industry. In addition to rebuilding trust in our pricing by being disciplined, prudent and transparent, we also recognise the need for greater focus to be placed on the execution of our strategy. This includes the cost reductions we recently announced as well as improved business performance. We are also focused on providing clear and simple communications to suppliers and have introduced a Supplier Information Centre section of the MG website, which provides an extensive resource for suppliers to access our communication materials.

**7. What is the communications and marketing plan to improve the MG brand moving forward?**
We are aware that we need to rebuild the MG brand with suppliers and other stakeholders given the events over recent months. We are therefore conducting a review of MG's branding proposition. The outcomes of this review have not been completed and further stakeholder engagement is required before any decision can be made. We understand that all elements of our branding heritage are important and will continue to play a key role in positioning MG. MG is working on the development of a new advertising campaign which will have an emphasis on supporting Australia's 100% farmer controlled co-operative and how Australian dairy farmers are committed to high quality dairy products. After our successful sponsorship of the recent season of *MasterChef Australia,* we have decided to sponsor this program again in 2017. Further details on marketing and advertising activity can be found here.

**8. Have we still got confidence in our value-add strategy? Or are we better to focus on being a very efficient producer of traditional bulk milk products?**
The Board remains absolutely committed to the value-add strategy. We know that in the long run the concept of staying in commodity is not what delivers farmgate milk price. Our FY16 results demonstrated that MG's value-added product strategy is helping to offset the impact of exceptionally weak dairy commodity markets, with revenues only slightly lower year-on-year. Our Dairy Foods business in particular performed strongly and delivered another year of double-digit revenue growth despite the competitive domestic market with revenue of $1.3 billion (up 17.2 percent on FY15). MG's Devondale brand achieved global sales of $580 million (up 45 percent from FY15), a further

endorsement of the strategy to move into higher value-added products. Our farmgate milk price would be lower still if we didn't have a value-add strategy in place. However we are refocusing on achieving premium outcomes across all of MG's products, including consumer products.

**9. How are MG's new products and new plants going?**

The cheese plant is currently being commissioned and will be operational in December with four lines and room for two more lines. This includes two shred lines, a block line and a slice line – all highly automated. Our Devondale brand continues to grow and had sales of $580 million (up 45 percent from FY15) - a substantial brand platform to continue to build and add value to our business. This includes our new Devondale Milkshakes and 8 Bar iced coffee products, which have achieved good market positions as well as industry recognition for their innovation. We also achieved excellent growth in our food service channel, particularly for the cheese category, which was driven by organic growth and the acquisition of Caboolture, the market leading food service cheese shred brand. We also made a successful entry into new sales channels – the petrol forecourt market and also convenience market through Coles Express. These new developments have underpinned a solid performance by our Dairy Foods business in FY16 and should set us up well for future sales growth.

**10. Where are we at with the process of going forward with the $500 million that was raised last year?**

The first project – the new cheese cut and wrap facility at Cobram – is currently being commissioned. Two projects are outstanding. One is the UHT plant for which approximately $160 million was budgeted. We notified investors that this project is on hold at the time of our FY17 full year results announcement, not through any debt or lack of funding issues, just a simple fact that with excess milk in Europe and the prices currently being achieved in China does not sustain an investment of that size at this time. As an alternative, we are looking at a brownfields development at our current UHT facility and expect to update on this by the half year results in February 2017. The second is the nutritional plant which is the largest of the investments - $260 million to $300 million. We still intend to move forward with this investment and have recently announced we are considering other potential locations for the nutritionals plant to ensure that we have the most appropriate and cost effective location.

**11. Why is MG reviewing its Board structure?**

Over the past months, a range of views have been expressed and suggestions put forward regarding the most appropriate Board structure to serve the co-op in the future. As a result, the Board has been discussing for some time how best to take account of this feedback and capture supplier input. To that end, the Board intends to review its structure and composition, with the assistance of the four new Directors, before coming back to supplier/shareholders. Conducting a review is the most appropriate way forward and will involve wide consultation with supplier/shareholders and other stakeholders, to ensure that all views are considered. Ultimately, the structure of the MG Board is a matter for supplier/shareholders and any recommendations made will need to be put before them for consideration and, if required, voted on at a general meeting in accordance with our constitution.

**12. What value do Special Directors add and is it true that the Special Directors have a veto right over the rest of the Board?**

MG is a farmer co-operative and our Board structure reflects this fact. The Board is also supported by its Special Directors, who bring additional outside and professional experience to its deliberations. We are committed to securing a third Special Director and are in the process of doing so, as well as appointing a replacement for Peter Hawkins who has advised his intention to retire from the Board. It is not true that Special Directors have a veto. Each Board member has one vote on all deliberations around the table. Special Directors play an important role in any decision to deviate from the Profit Sharing Mechanism as any departure from it must be approved by a majority of the Board and by each Special Director. Furthermore, such a decision must be considered by the Special Directors to be in the interests of supplier/shareholders and unitholders as a whole and the Special Directors must ensure that the departure is supported by the opinion of an independent expert that it is in the interests of supplier/shareholders and unitholders.

**13. Are new suppliers required to contribute to the MSSP repayment?**

No – new suppliers are not required to participate in the MSSP repayment. Capped recoupment from individual suppliers was an element of the MSSP review announced on 27 October, meaning individual recoupment will not exceed individual support received in the FY16. By default this means that new suppliers will not be required to participate in the recoupment of the MSSP as they did not receive the overpayment in FY16.

**14. How is MG's inventory management tracking?**

MG is on track to realise a further $100 million to 110 million in inventory reduction in FY17 as announced at our full year results.

**15. What is the latest regarding the appointment of a new Managing Director?**

We have received significant interest in the Managing Director role and also have a very strong internal candidate in interim Chief Executive Officer, David Mallinson. David has done an outstanding job continuing to execute our strategy with discipline and rigour and we thank him for his commitment and leadership during this challenging period for the co-op. The Board is well progressed in the global search for the appointment of the Managing Director and expects to be able to make an announcement shortly.

**16. Should unitholders have voting rights or representation on the Board?**

No – this is not under consideration. When we went through the capital structure process, it was made very clear that the units don't carry a voting right. What they carry is a right to an income stream (distribution) that is equal to any dividend paid on MG shares. Shareholders carry voting rights in proportion to their milk production. So those that hold shares in excess of their milk production, don't get to vote above that level. So it's an equitable way of delivering voting rights to those that produce milk in proportion to what they deliver to the co-op.

**17. Would it be possible for MG to introduce a simple metric so that suppliers can evaluate Management's performance more easily?**

The Board looks at benchmarks from available information from all of our competitors that publicly produce their accounts. There is an enormous variation to some of the statistics that have been quoted in this meeting about MG's overhead costs. A lot of the variation is driven by the product mixes of the businesses themselves. Those that are bulk commodity often tend to be lower cost and lower overhead. Those that are really high in the value-add space tend to have a higher revenue line and also a higher cost structure. The challenge is to make sure that the one key element is the milk price, as this is the metric we are trying to maximise.