Supplier Meetings – Western Region, Gippsland & NSW

Post-session Q&A summary

The following is a summary of key questions asked by MG suppliers at recent supplier meetings in Camperdown, Simpson, Timboon, Koroit, Heywood, Mount Gambier, Orbost, Maffra, Yarram, Leongatha, Warragul and Berry.

1. How will MG be able to hold milk supply if other processors step-up their prices?
We have to be competitive with our farmgate milk price and are fully focused on achieving this as we prepare to set our opening price for next season. The cost reduction program we announced last year has been extended to a full review of MG's entire asset and cost bases, with the objective of maximizing the size of our milk pool. We need to get our cost base right so we can deliver a strong farmgate milk price on a sustainable basis. We need to get everything right so that our suppliers stay.

2. Why is our farmgate milk price still behind others?
MG has a greater weighting to commodities than most other processors, and these were the hardest hit products in the two year downturn in dairy commodity prices. Although commodity prices have strengthened, MG's commodity price based contracts tend to be priced three to six months out, which means we haven't experienced the uplift of the gains yet. However, we do expect the impact of better prices to flow through in next year's farmgate milk price. There has also been an impact from lost milk supply, although a proportion of this reduction is related to very wet climactic conditions early in the season which we expect will come back.

3. Is there any chance we can get our opening price out earlier than usual to provide clarity for farmers?
We are regularly asked for cash flow projections to allow farmers to talk to their banks. Currently we are reviewing our milk payment system and our existing mechanism for providing an opening and closing price. Suppliers will understand that the opening price is based on budgets that have to be approved by the Board, and there are currently many variables resulting from the business review of MG's assets and distribution network. However, we are committed to giving our suppliers a degree of stability and comfort without exposing the co-op.

4. What can MG do to reward the loyalty of suppliers?
This issue is asked regularly at supplier meetings and the Board and management are very focused on it. How loyalty is recognised is one of the components of the milk payment review which suppliers are currently providing feedback on. Suppliers have different perspectives on loyalty. Some suppliers ask how their loyalty over ten, twenty, thirty years can be rewarded. Others ask how their loyalty over the last twelve months will be recognised. We need to balance the requirements of loyalty and the value of the milk pool. These are complex issues and we are giving them a good hard look.

5. What is the detail of MG's relationship with ACM?
MG has a milk broking relationship with ACM, which includes purchases, swaps and sales in Victoria and NSW. Like many processors MG engages in milk swaps, which provide a cost effective and efficient system for moving milk around the co-operative's areas of operation so we can tailor supply to our manufacturing needs.

6. How is it possible that 200 roles were cut from head office when there was a $100 million cost savings program only a few years ago? How confident are we that we will save costs?
Redundancies associated with the $100 million cost savings program a few years ago were focused on manufacturing roles and the removal of certain product lines. The reduction of 200 roles

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announced with our FY16 Results last August were primarily focused on head office as well as MG Trading and related to existing as well as budgeted roles, rather than only redundancies of current employees. This included existing vacancies that will not be filled, resignations that won't be replaced, conclusion of contracts and also redundancies. The other part of our cost reduction program announced last August has been focused on procurement across the business and we are in good shape to deliver significant cost savings.

7. Has lost milk supply impacted our ability to meet commercial contracts?
We have been working with our commercial partners to minimise the impact of lower milk intake. There is a general shortage of butter in the Australian market and also in a number of international markets. As we announced in our first half results, we decided to cease some low-returning sales due to our lower milk intake.

8. How is loss of milk impacting our manufacturing sites?
Milk losses have had an impact on our manufacturing, as they have caused unrecovered overheads and reduced efficiency at some plants. However we have been able move milk between our operations and change production plans to best cater for lower milk intake. There have been shift changes at some sites, but this is part of our normal practice of allocating our available milk to the best returning stream. We have also extended annual seasonal shutdowns in some cases for instance at Maffra. One of the drivers of the business review currently underway is aligning our organisational capacity and capabilities with future milk intake.

9. MG Trading's pricing doesn't always seem to be competitive – can this be looked at?
MG Trading business offers a range of incentives to MG suppliers including the Supplier Loyalty Program, additional finance terms and access to a range of technical services at no charge. Whilst there are always active competitors in the market, we continue to monitor our procurement and pricing to ensure we remain competitive in the dairy market place. There are a number of reasons why a customer will shop elsewhere, but MG Trading remains confident our influence in maintaining pricing pressure across the dairy community helps all dairy farmers, particularly MG suppliers, access competitive products in the market. We came across a good example of this at a recent supplier meeting. A supplier said that a fertilizer product was $25 cheaper via another provider. We took this feedback away and looked at the pricing gap he had identified. It turned out that the cheaper price via a competitor was just the retail price, whereas MG Trading's price was our on farm delivered price. When comparing like for like, the product available at MG Trading was $15/tonne cheaper. So in fact there was a price advantage at MG Trading and as always MG suppliers benefit from a discount to our advertised prices.

10. Is the international situation looking better or worse?
Our business in China is back to historical norms and more stable. From a macro perspective, there's significant oversupply in Europe, especially in skim milk powder, although a proportion of this inventory will be approaching its best before date. There has been a significant flow of European milk, priced at well below cost of production. The international market is almost a normalised environment, but we are still learning to cope post deregulation in Europe and with the Russian sanctions. The significant supply/ demand imbalance which caused the two year depression in dairy commodity prices is still present and there is potential for ongoing volatility in commodity prices. Full cream milk powder prices have recovered to be closer to long run averages. However, other dairy commodity futures are currently trading flat, which implies prices are likely to remain around this level. Certain markets are better and others are worse. However the situation is far more positive than it was this stage this year.

11. Why has the Board appointed a non–Supplier Chairman?
The Board unanimously agreed that John Spark was the best person to lead MG and decided that the selection of a non-supplier Director at this time was appropriate given the complex environment in which MG currently operates. This includes our ASX listing and requirements to engage with a large range of external stakeholders such as suppliers, investors, analysts, financiers, media, industry and government. MG is a large and complex international business with revenues of $2.7 billion in FY16. The Board's view is that John Spark and Ari Mervis add a powerful combination of skills and expertise to the management of MG, which complements the extensive dairy industry knowledge of the existing Supplier Directors.

12. Ari – why have you joined MG?

I believe this co-op and the dairy industry more generally are both very important contributors to our society. When the opportunity to lead MG first appeared, I knew that I would regret it if I let it pass by. Before accepting the role I also knew that I might live to regret doing so, but I did not want to miss the opportunity to lead this great business and help restore it to its former greatness.

13. Why are you reviewing the Board structure now – aren't there more pressing priorities?

The structure of MG's Board is reviewed from time and this is healthy. The review of the Board and the milk payment system review have both been instigated in response to supplier feedback. These issues are vital to the effective operation of the co-op and that is why we announced the launch of both reviews at the AGM. However what is front of mind currently is the business review and doing everything we can to improve our farmgate milk price for suppliers.

14. Is there any update on the legal and regulatory investigations into MG?

MG has been working constructively with the Senate Committee as it completes its dairy industry inquiry. The Committee was due to publish its report on 30 March 2017, but this has been postponed until 11 May 2017. There are also ongoing investigations into MG following last year's farmgate milk price reduction by the Australian Competition and Consumer Commission and Australian Securities & Investments Commission, but there is no further update at this time. Regarding the class action, the lead plaintiff has also made an application to expand the claim to include unitholders who purchased units on or after 27 April 2016 and who continue to hold any of those units. The Court has not yet determined this application. A third Directions Hearing was held on 9 February 2017 and the next stage of the proceeding has been scheduled to be heard on 10-11 May 2017.

15. What is your strategy for turning around the perception of MG?

MG is on a journey to rebuild the trust of its suppliers and other key stakeholder groups which will not occur overnight. Ari Mervis has prioritised supplier engagement and is undertaking one of the most extensive schedules of supplier meetings ever organised by the co-op in his opening weeks as the new CEO. He is committed to providing stability, reliability, transparency and predictability in the leadership and actions of the co-op. He has remarked at many of these supplier meetings that MG cannot just expect trust and loyalty – it has to be earned.

16. Is there any update on our Inventory position?

The sell down of inventory has been going well and we are focused on selling against the production curve in order to realise the best possible pricing. Inventory reduction is a key priority in our working capital reduction. We are on target to achieve $100 -110 million reduction in our working capital in full year 2017 and peak inventory holdings are down 15% year on year.

17. Is it true that small family farms are paid $1.20 per kgms less than large corporate suppliers?

No, this is not correct. Suppliers receiving our maximum farmgate milk price include both 'mum and dad' suppliers as well as larger corporate suppliers. Suppliers receiving our lowest farmgate milk price tend to be producers of low quality milk. As is the case with most processors, we have a range of milk payments with a small number of extremes at either end. Large and small scale producers receive milk prices across this range depending on the variables of incentives and contractual arrangements, as well as volume and collection charges – rather than just the size of their operations.

18. Does the Co-op offer preferential deals for larger suppliers – isn't this against the spirit of the co-operative?

MG's payment system and programmes are outlined in MG's supplier handbook and these are applied to all suppliers. MG is regularly required to consider applications under these terms or variations for suppliers including our very smallest to largest volume suppliers. We do this in accordance with internal procedures and the objective of any variation is to support the supplier while adding benefit to the overall Co-operative. Small suppliers can receive support under our programmes to a similar extent to larger suppliers.

19. What potential is there to increase the NSW milk price paid to suppliers following step ups in Victoria?

Our 2016/17 NSW-Sydney Market Region farmgate milk price is calculated using the Southern Milk Pool price plus freight charges. The step-ups that MG announced in October last year were debt funded and only applied to the Southern Milk Region.

20. Is there any update on our milk intake in NSW?

MG's milk intake in the NSW-Sydney Market region remains around 200 million litres annually, split between supply which is processed at our Erskine Park plant as daily pasteurised milk for Coles as well as our Devondale milk brand, with the remainder sold via commercial milk sales and used to manufacture a range of dairy products. MG has approximately 160 suppliers in the NSW-Sydney Market Region. We have only lost a handful of suppliers in the last season, mainly through retirements.