



13 March 2013

Dear Supplier-shareholders,

RE: Headline outcomes from MG's Milk Payment System Review

Following a comprehensive review undertaken by MG management and the Boston Consulting Group (BCG), MG is preparing several structural changes to the MG payment system for implementation in 2013/14.

At supplier meetings commencing in Maffra on 13 March 2013, MG will outline the process, results and outcomes of the milk payment review.

Prior to these meetings the MG Board wanted to provide all suppliers with the headline outcomes of the review as we are aware not all suppliers can attend.

The precise financial details of the changes outlined are now being finalised for the release of opening prices towards the end of the financial year.

Based on the input from farmers and the analysis of the likely impacts on returns, we are confident that the changes will not impact key farm systems decision-making - but will improve profitability and cashflows and provide the basis for a sustainable pricing system.

Background

The MG Board has completed the most comprehensive review of milk payments ever undertaken by an Australian dairy company.

The primary objective of the review was to recommend a milk pricing system that was based on fairness and profitability for MG members overall, across a range of farm systems and regions. The system should allow MG to develop a sustainable business that maximised the farmgate price for all members.

A range of factors were taken into consideration in fulfilling this objective, including:

- Supplier opinions about the payment system and its interaction with their farm business decisions;
- Farm production costs across systems;
- The seasonality of milk supply and MG's supply needs;
- The net return to MG of its products across months;
- Competitor pricing and product mix; and
- MG's strategy going forward



The review included a farmer survey with 580 responses, 16 farmer meetings and direct consultation with several of the industry's leading farm advisers.

This supplier consultation indicated that many suppliers supported the current pricing system but 33% were dissatisfied. Most farmers said that factors other than the payment system determined their farm system – however 15% of suppliers with seasonal calving herds and 45% with split calving herds said that the pricing system did significantly impact their farm decision making.

The review carefully examined the MG strategy outlined by the Board and Managing Director relating to growth in areas such as UHT, cheese, butters and spreads with an increased footprint for Devondale in Australia and overseas. This included an examination of peak versus off-peak returns for MG (the value of milk across months) and the competitive landscape for milk in Australia.

The increasing emphasis of the Australian dairy industry on consumer-pack and value-added ingredients such as infant formula was noted.

Headline Outcomes

Based on the careful examination of this comprehensive study, MG is planning to implement the following headline changes to the milk payment system for 2013/14.

Base price and seasonal incentives

A Simpler System – from next season MG will move from three base prices to a single base price. Currently the three payment options have different base prices and this will be abolished from next year in favour of a single base price.

Improve cash flow and profitability – MG will raise the base price during peak months vs. off-peak months, creating a flatter price curve.

Retain a flatter milk commitment to underpin markets – MG will retain a simpler flat milk incentive (currently known as the Domestic Incentive) with an improved cash flow structure to ensure MG can supply key markets and increase the milk price for all suppliers.

Balanced – MG's milk pricing system balances the profitability drivers of a range of farm systems and MG product mix objectives – maximising the milk price for all suppliers.

Fat and protein ratio

Reflecting market signals – MG will amend the protein to fat ratio to better reflect the recent increase in market value of fat products.

Productivity incentive, pick-up and volume charges

Fair market signals (milk handling costs) – the review found that current productivity incentive and volume charge fairly reflect the true costs to the MG business and therefore apportions milk handling costs fairly among suppliers. Consequently these will be maintained at similar levels but simplified. However pick-up charges will be amended to better reflect true costs.



Quality

A better milk quality system – the review recommended changes to the milk quality system but these would take more time to develop. Accordingly MG will develop a new quality policy over the next twelve months for implementation in 2014/15. This will include consideration of the introduction of milk temperature into the milk quality payment structure.

Conclusion

The MG Board and management understand that the milk payment system is important in distributing MG's revenues, milk handling costs and quality costs to its supplier- shareholders. We also understand that the system had evolved over many years and needed to be questioned in terms of its fundamentals.

We are very confident that this review provides the basis for a profitable farm sector based on the many farm systems in Australia and the profit that can be generated by MG in the marketplace.

We believe that these changes take into account the facts of our industry and company and demonstrate our determination to manage milk pricing in line with our shareholder's needs. We look forward to discussing the review with you further at our supplier meetings.

Yours sincerely,
Murray Goulburn Co-operative Co. Limited

Robert Poole
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