

IN THE AUSTRALIAN COMPETITION TRIBUNAL

of 2013

MURRAY GOULBURN CO-OPERATIVE CO LIMITED ("MG")
ACN 004 277 089

RE: PROPOSED ACQUISITION OF WARRNAMBOOL CHEESE
AND BUTTER FACTORY COMPANY HOLDINGS LIMITED ACN 071 945 232

Statement of: Robert Arthur Poole

Dated: 28 November 2013

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Filed on behalf of Murray Goulburn Co-Operative Co Limited

Prepared by:

Herbert Smith Freehills

Tel + +61 3 9288 1234

Email

Fax +61 3 9288 1567

Ref:

CJ:ALM:82230139

Address for service

Level 43, 101 Collins Street

MELBOURNE VIC 3000

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I, Robert Arthur Poole of Freshwater Place, Level 15, 2 Southbank Boulevard, Southbank in the State of Victoria, General Manager Shareholder Relations say as follows:

1. Where, in this statement:
 - (a) I use a capitalised expression, that term is as defined in the Glossary unless otherwise provided;
 - (b) I refer to information provided to me by a third person, including internal analysis provided to me by other employees of Murray Goulburn Co-operative Co Limited, I believe that information to be true and correct and, at the time I was provided with that information, I believed it to be true and correct, unless I state to the contrary.

2 Background and role

2. I am the General Manager Shareholder Relations of Murray Goulburn Co-operative Co. Limited (**MG**) and a member of MG's Executive. I have held that role since November 2011. Before then, I was MG's General Manager Industry and Government Affairs from about March 2008.
3. In the 14 years before joining MG I had the following roles:
 - (a) from 2004 to 2008, I was Deputy Chief Executive Officer of Australian Dairy Farmers' Federation;
 - (b) from 1997 to 2004, I was General Manager of the Australian Dairy Herd Improvement Scheme;

- (c) from 1994 to 1997, I was a Regional Manager with Rural Finance Corporation.
4. Before joining MG I was also managing partner of my family's dairy farm in Pyramid Hill with a herd of 200 cows for 15 years. I resigned from that position to avoid any question of conflict with my role in MG. I therefore have direct experience as a dairy farmer.
5. In addition to the above I have for the past three years held the following honorary roles within the Australian dairy industry:
- (a) President of the Australian Dairy Products Federation, a policy body for commercial/non-farm members of the Australian dairy industry which is open to entities operating in Australia that are engaged in the manufacture, marketing or trading of dairy products and/or dairy related products; and
 - (b) Vice Chairman of the Australian Dairy Industry Council, the national representative body of Australian dairy farmers and dairy companies.
6. In my role as General Manager Shareholder Relations I report directly to the Managing Director, Mr Gary Helou. I have responsibility for four divisions of MG's business, being Milk Supply, Field Services and Commercial Milk Sales, MG Trading, Corporate Affairs and Shareholder Information and Services. The head of each of those divisions reports directly to me. This is represented diagrammatically in the document attached as **RAP1**.
7. I present a Shareholder Relations Report to the Board each month with respect to those divisions of the business for which I am responsible.
8. As General Manager Shareholder Relations I have particular responsibility for:
- (a) managing the relationship with suppliers;
 - (b) maintaining and increasing milk supply;
 - (c) MG's milk payment system;
 - (d) ensuring that MG provides the services which suppliers require;
 - (e) facilitating access by suppliers to senior management and keeping suppliers informed about the business; and

- (f) managing a successful MG Trading business that meets budgets and provides excellence in farmer services.

3 Cooperative structure and operation of MG

3.1 Formation

- 9. MG was formed as a cooperative by a small group of Victorian dairy farmers in January 1950. It is an unlisted public company controlled by its dairy farmer owners and operates in accordance with co-operative principles, to the extent that they are consistent with its corporate structure.
- 10. I understand the co-operative principles by which MG operates to be principally as follows:
 - (a) the dairy farmers who supply MG also control the company;
 - (b) the suppliers elect the Board;
 - (c) the Board acts in the interests of the suppliers and in maximising returns to suppliers;
 - (d) management and the Board consult with suppliers and the suppliers have access to them;
 - (e) MG supports the suppliers through arrangements such as the provision of services to assist improve supplier milk production and reduce costs; and
 - (f) the distribution of milk proceeds, dividends, incentives and charges is done as fairly as possible taking into account, wherever possible, real benefits or costs incurred in the business.
- 11. These co-operative principles are in large part embodied within MG's constitution and its operating practice.
- 12. The current constitution of MG was adopted on 28 November 2012 (**Constitution**). A copy of the Constitution is attachment **RAP2**.
- 13. Rule 2.5 of the Constitution requires that any alterations to rules 2.5, 5.6.1(now 5.3.1), 12.2(a) and 14.14 require the passing of an affirmative resolution by members representing not less than 90% of all the ordinary shares and class ordinary shares in the capital of MG. In summary:

- (a) Rule 5.3.1 provides for the maximum number of ordinary shares which may be held by, or on behalf of any person;
- (b) Rule 12.2(a) permits the Board to refuse to register a transfer of shares at its discretion and without providing reasons; and
- (c) Rule 14.14 provides that subject to restrictions on voting affecting a class of shares, on a show of hands each member present will have one vote and on a poll each member present shall have one vote for each voting share held by that member.

3.2 Objects of MG

- 14. The Constitution (Rule 2.2) provides that in carrying on business, MG's primary object or objects shall be one or more of the following:
 - (a) the acquisition of milk and other commodities from its shareholders for disposal or distribution;
 - (b) the storage, marketing, packing, and/or processing of milk and other commodities of its shareholders; and
 - (c) the rendering of services to its shareholders.
- 15. The Constitution (Rule 2.3) further provides that additional objects of MG, ancillary to its primary objects, include without limitation:
 - (a) the manufacture, sale and disposal of products and commodities;
 - (b) providing for the welfare of suppliers and employees of MG;
 - (c) distributing incentive payments to suppliers in proportion to the supplies received by them. I understand there to be a typographical error in the Constitution and that the words "supplies received by them" should read "supplies received from them". MG operates as if the words read this way;
 - (d) providing loans and other financial accommodation to suppliers on such terms as the Board may approve from time to time and in compliance with all applicable laws; and
 - (e) carrying out all such other objects, acts, matters and things as may be directly or indirectly incidental to or conducive to the attainment of any of its objects from time to time.

16. MG operates for the benefit of its shareholders and employees. Its shareholders are the current dairy farmers from whom it presently acquires milk (sometimes referred to as 'wet' shareholders) and dairy farmers from whom it previously acquired milk and who have retained their shares (sometimes referred to as 'dry' shareholders).
17. In an operational sense, MG seeks to significantly increase the farmgate milk price as set out at page 5 of MG's 2013 Annual Report which is attached as **RAP3**. This philosophy is reflected for example in the performance measures it has established for the MG Executive and Managing Director, which is discussed in section 3.8 below.

3.3 Ownership of MG

18. The share capital of MG comprises five classes of shares:
 - (a) Ordinary shares;
 - (b) "NV" (or non-voting) shares. These are ordinary shares which have been converted upon a resolution of the Board;
 - (c) "A" class non-cumulative preference shares;
 - (d) "B" class non-cumulative preference shares; and
 - (e) "C" class non-cumulative preference shares.

(Rule 4.3)
19. Subject to the provisions of the *Corporations Act (Cth) 2001* and the Constitution, and without prejudice to the rights previously conferred on the holders of existing shares, the Board has a general discretion to issue shares and dispose of shares as it thinks fit. (Rule 4).
20. The minimum number of shares which can be held by a person in MG is 500 shares (Rule 5.2).
21. The maximum number of shares which a person can hold in MG is as follows:
 - (a) no person (other than a person described in (b) and (c) below) may hold shares in excess of more than 0.5% of the aggregate of all issued shares;
 - (b) a person who is a subsidiary of MG may hold shares up to 15% of the aggregate of all issued shares; and

- (c) a person who is an approved institution as declared by resolution of the Board may hold shares (other than ordinary or NV class shares) to 40% of the aggregate of all issued shares.

(Rule 5.3)

22. If the Board forms the view that a person's holding of ordinary shares is in breach of the maximum shareholding requirements, the Board may in its absolute discretion require that a number of those shares be disposed of or it may convert a number of ordinary shares into NV class shares, until such time as the breach is rectified (Rule 5.4).

Ordinary shares

23. Ordinary shares can only be held by a member who is a current supplier of milk to MG, to an associate of MG, or to any agent, authority or corporation nominated by MG (**MG entity**) (Rule 3.1 and Rule 5.1(a)). A supplier includes a sharefarmer in respect of a farm which is, or is in the process of becoming, a current and active supplier of milk to a MG entity or an individual who is a member of a company or partnership which is a current and active supplier of milk to a MG entity.
24. Ordinary shares give the holder the right to attend at, be heard and vote at any general meeting of MG (Rule 6.1).
25. The holder of an ordinary share is not entitled to vote at a general meeting unless all calls and other sums of money payable by that member in respect of those shares has been paid (Rule 14.17).

NV class shares

26. Ordinary shares may by resolution of the Board be converted into "NV" shares, and "NV" shares can be converted back into ordinary shares with the aim of ensuring that the "prescribed ratio" (as defined in Rule 5.1(c) of the Constitution) is maintained. (Rule 4.4(b)). The "prescribed ratio" is S:P where S is the number of ordinary shares held by the supplier at the end of a supply period and P is the volume (in litres) of milk supplied by the supplier to MG during the same supply period. In general the prescribed ratio is 1:5 or one share for every five litres of milk supplied in that supply period (Rule 5.1(b)).
27. NV class shares confer the same rights as ordinary shares except they do not provide any voting rights (Rule 6.2).

28. The purpose of converting ordinary shares into NV class shares is therefore to provide a mechanism for suppliers to exercise their vote at a general meeting in proportion to the quantity of milk supplied, subject to the maximum permissible shareholding of 0.5% of the aggregate of all issued shares. NV class shares may only be held by a supplier.

Preference Shares

29. If a member ceases to be a supplier the Board may by resolution convert that member's ordinary and "NV" shares into "A", "B" or "C" class non-cumulative preference shares or any other class of preference shares (Rule 4.4). Similarly where a member who holds preference shares is, or becomes, or resumes being, a supplier the Board may by resolution convert preference shares into Ordinary and "NV" shares (Rule 4.4(a)(ii)).
30. A holder of preference shares has the same right as ordinary shareholders to receive notices of general meetings and to attend and be heard at any general meeting of MG, but does not confer on the holder a right to vote at a general meeting (Rule 7.3). The classes of preference shares rank differently for the purposes of dividend payments (Rule 7.1, Rule 7.4).
31. The present number of shares issued in MG is set out in the table below:

Share Class	Issued Capital (\$)	Paid Capital (\$)
\$1 Ordinary (fully paid)(including NV shares)	267,435,435	267,435,435
\$1 "A" Preference	14,637,507	14,637,507
\$1 "B" Preference	8,833,992	8,833,992
\$1 "C" Preference	32,343,404	32,343,404
TOTAL	323,250,338	323,250,338

3.4 Voting rights

32. Only holders of ordinary shares are entitled to vote at a general meeting (Rule 14.14). Any change to these voting entitlements would require approval by 90% of existing shareholders of ordinary shares (Rule 2.5).

33. At a general meeting a resolution must be decided on a show of hands unless a poll is demanded. On a show of hands every member present who holds ordinary shares will have one vote.
34. A poll can be demanded by the chairperson, or at least five members able to vote, or members with at least 5% of the votes that may be cast on the resolution of a poll. On a poll, every member present shall have one vote for each voting share held by that member (Rule 14.14).
35. The Board may determine that at any general meeting a member who is entitled to attend at that meeting and vote is entitled to give their vote by a valid notice, to be delivered by post, fax, electronic or other means approved by the Board (Rule 14.21).
36. As dairy farmers who currently supply milk to MG are the only members who can vote at a general meeting and elect directors they ultimately have considerable influence over the management decisions of MG.

3.5 Dividends and surplus

37. Members are entitled to participate in dividends and any surplus in accordance with the type of share held by them as follows:
 - (a) holders of ordinary shares are entitled to participate:
 - (i) in dividends declared by the Board together with the holders of NV class shares, but subject to the specific rights of the holders of preference shares; and
 - (ii) rateably with the holders of NV class shares and preference shares in any surplus in proportion to the capital for the time being and from time to time paid up or credited as paid thereon;
 - (b) holders of NV class shares have the same rights to dividends and surplus as holders of ordinary shares;
 - (c) holders of preference shares are entitled to dividends out of funds available for dividends and to participate in any surplus depending on the class of preference share. This is more fully explained in Rule 7.4.

(Rules 6.1(a), 6.2 and 7.4)

38. In the past three financial years the final dividend paid or recommended has been as follows:

Share type	2011*	2012*	2013*
Ordinary shares and NV class shares	\$0.12	\$0.12	\$0.08
Class "A" preference shares	\$0.08	\$0.08	\$0.08
Class "B" preference shares	\$0.05	\$0.05	\$0.05
Class "C" preference shares	\$0.08	\$0.08	\$0.08
Total dividends paid	\$29,937,000	\$31,282,000	\$25,096,000

* Amount paid per share unfranked

The final dividend paid or recommended for 2011 is at page 32 of MG's 2011 Annual Report which is attached as **RAP4** and for 2012 and 2013 is recorded at page 36 of MG's 2013 Annual Report (Attachment **RAP3**).

39. In addition to payment of a dividend:
- (a) the Board may set aside, out of the retained earnings and reserves of MG in any year, such amounts as it thinks fit to establish a special distribution reserve from which it may allocate amounts to the credit of members who have supplied product to MG during that year (Rule 3.3); and
 - (b) declare a bonus to be paid out of the profits of MG by way of a dividend to members either by way of a payment or the allotment of fully paid shares (Rule 3.4).
40. MG does not at present pay suppliers an amount from a special distribution reserve or pay members a bonus.
41. Suppliers may elect to take dividends in the form of shares rather than cash. (Rule 19).

3.6 Acquisition and disposal of shares

42. A farmer supplier of milk to MG must acquire and retain an initial parcel of 500 ordinary shares at a price of \$1.00 per share before commencing supply. MG does not acquire milk from a supplier who does not hold ordinary shares in MG other than

on occasion from corporate dairy companies who acquire milk ex-farm and on sell. I deal with examples of these arrangements in paragraphs 150 to 155 below. For the purpose of this statement, when I refer to a supplier I am referring to a farmer supplier who produces milk and sells it directly to MG.

43. Save as set out below, further acquisition of shares by a supplier occurs only through a monthly share off-take scheme in which dairy farmer shareholders are paid the equivalent of \$.0065 per litre in shares for each litre of milk supplied in that month. This is the equivalent of 6500 ordinary shares for each million litres of milk supplied. As a consequence, suppliers acquire shares in proportion to the amount of milk provided.
44. The sum of \$.0065 is deducted from the farmgate price paid by MG and applied to the purchase of shares in MG. MG has occasionally suspended this scheme in times of hardship when milk prices are low or production reduced by drought. In that event suppliers have the option to receive payment of cash rather than shares. This occurred most recently in 2012. In the 2012 suspension, 85% of suppliers still opted to receive payment in shares rather than cash.
45. Shares in MG cannot be traded, other than via the Board approved sale process, and may only be transferred in very limited circumstances. MG permits the transfer of shares to immediate relatives, for example when a child takes over the running of a family dairy farm.
46. If a supplier stops supplying milk to MG they are entitled to redeem their shares at the price for which they were acquired (presently \$1.00) or retain the shares, which will then be converted to preference shares. The Board has the power to issue preference shares which at the option of MG or the holder are available to be redeemed.
47. Unless a supplier is party to a current fixed term commitment with MG or subject to the standard milk payment terms for the New South Wales – Sydney region, there are no restrictions on a supplier which prevent him or her from terminating supply, and at their option redeeming their shares.
48. Every supplier of milk to MG therefore holds a stake in MG which allows that person to vote and to receive a dividend in proportion to their shareholding.

3.7 Election of directors

49. The Constitution provides that (other than the managing director and special directors) there must be at least seven but not more than 10 directors, each of whom must have been nominated to the Board by a specific supplier region (**Supplier Directors**) (Rule 15.1(a)). The current Board of MG comprises a managing director, nine Supplier Directors and two special purpose directors.
50. In November 2012, the Constitution was amended to increase the number of special directors from two to three. The Corporate Governance Statement (at page 29 of the 2013 Annual Report (Attachment **RAP3**) notes that the Board will consider this during financial year 2014.
51. The Board operates in accordance with a Board Charter, a copy of which is attached as **RAP5**. The Board Charter provides that the Board's role is to represent all of the shareholders, as a whole, and to promote and protect the interests of MG. The Board's principal objective is to create and enhance shareholder value but in a manner which is consistent with the co-operative objective of maximising supplier returns.
52. There are presently three 'supplier regions' from which MG obtains supplies of milk, known as the Gippsland Region, the Northern Region and the Western Region (Rule 3.5). These are discussed more fully in paragraph 113 below. In its absolute discretion the Board may from time to time increase or reduce the number of supplier regions to not less than three or more than ten or establish, define or alter any one or more of the supplier regions in such manner as it thinks fit (Rule 3.5(b)).
53. Currently, three directors are appointed in respect of each supplier region, nine in all. The Board may increase or decrease the number of directors to be appointed in respect of any supplier region (Rule 15.1(b)). I understand the Board's policy is that the number of directors per supplier region ought reflect the quantity of milk acquired from each supplier region. At present the amount acquired from each supplier region is broadly the same (about 1 billion litres per annum) and the number of directors for each region is therefore the same. If MG acquired WCB the western region would then supply approximately 1.8 billion litres per annum and the Board could address this, for example by the appointment of a tenth supplier director to be nominated by the western region.

54. In order to qualify as a Supplier Director, a person must be a current supplier, hold at least 10,000 ordinary shares in that person's name and have been nominated by at least five supplier members allocated to that person's supplier region (Rule 15.5).
55. The Board may allocate any supplier member to a supplier region. Members allocated to a particular supplier region who hold ordinary shares may nominate one or more qualifying members as a proposed director to fill any vacancy (Rule 3.7). By this means, milk suppliers to MG have an opportunity to elect directors who are also suppliers and who farm in the same general region as themselves. This gives them a "voice" on the Board. However, all directors do represent all members (Rule 16.1).
56. If more persons are nominated as directors for a supplier region than there are positions available, the appointment of directors will then be determined by means of a postal ballot of members allocated to that supplier region in which only current suppliers can participate. In such a postal ballot members will have one vote for each voting share held by that member.
57. Supplier Directors are appointed for a three year period. Each supplier region appoints directors in consecutive years in the following sequence:
- (a) Gippsland Region – 2012 and each third year thereafter;
 - (b) Western Region – 2013 and each third year thereafter; and
 - (c) Northern Region - 2014 and each third year thereafter.
58. Each director appointed from a particular supplier region must retire from office in the same year in the sequence above, but will be eligible for re-election (Rule 16.4).
59. The effect of the above provision is that there is potential for one third of Supplier Directors to be changed each year. In my time at MG there has been significant renewal of the Board but in recent years, incumbents who have stood for the Board have been overwhelmingly re-elected.

3.8 Incentives – focus on increased milk price

60. MG offers a short term incentive plan for the Executive and a long term incentive plan for the Managing Director. The performance of the Executive and the Managing Director is measured against a set of key performance indicators. Details of these performance measures are described in pages 42-47 of MG's 2013 Annual Report at **RAP3**.

61. In the case of MG's senior executives, apart from the Managing Director, 25% of their remuneration comprises a short term incentive that is only paid if the milk price budget set by the Board at the beginning of each year is achieved. If the milk price budget is achieved, three other factors (namely, safety performance, internal audit performance and individual key performance indicators) determine the level of short term incentive that is paid.
62. In the case of Murray Goulburn's Managing Director, 40% of the Managing Director's at risk remuneration comprises a short term incentive that is only paid if the milk price budget set by the Board at the beginning of each year is achieved. If the milk price budget is achieved, three other factors (namely, safety performance, internal audit performance and individual key performance indicators) determine the level of short term incentive that is paid. 60% of the Managing Director's at risk remuneration comprises a long term incentive, which is paid having regard to implied milk price growth and return on capital employed on an equally weighted basis.
63. The long term incentive plan has the express objective to focus the Managing Director on delivering an optimal return to supplier shareholders through an increase in underlying milk prices, while also making sure that there are sufficient funds available for reinvestment back into the business.
64. MG's emphasis on an increase in the milk price as a critical performance measure is in contrast to the approach taken by similar dairy processors. The remuneration packages for MG and three comparator companies, being Saputo, Bega and Warrnambool Cheese and Butter Factory Company Holdings Ltd (**WCB**) reveal that MG is the only one which rewards its Managing Director for an increase in the milk price. Instead those companies place emphasis on an increase in earnings. The long term incentives for the Chief Executive Officer of WCB are set out at pages 30 - 33 of the 2013 WCB Annual Report which is attached as **RAP6**. The long term incentives for the Chief Executive Officer of Bega are set out at pages 19 – 23 of the 2013 Bega Annual Report which is attached as **RAP8**. The long term incentives for the Chief Executive Officer of Saputo are set out at pages 23 – 39 of a Saputo Management Proxy Circular dated 5 June 2013 which is attached as **RAP7**.
65. The most critical performance measure is attaining a milk price budget set by the Board at the beginning of each year. This requirement is a 'gateway' to the short term incentive. If the milk price budget is not achieved, no short term incentive will be paid. The milk price budget is set by the Board at the beginning of the financial

year. The performance incentive requires both the attainment of a Board set milk price within the budget and the payment of dividends out of profit, not retained earnings.

66. In the 2013 financial year the final milk price of \$4.97 per kilogram of milk solids outperformed the milk price budget by 1.4 per cent. I discuss the way in which MG sets the milk price in section 6.3 of this statement.

3.9 Pricing model

67. MG adopts pricing models that largely offer the same price per kilogram of milk solids to suppliers in all regions from which MG acquires milk, other than the New South Wales / Sydney region. This price is structured and supplemented by a series of incentive payments that are designed to encourage business practices that result in a more efficient supply of milk and increase returns to all shareholders. For example, flatter milk supply, more efficient milk collection systems, high quality milk supply and growth of milk supply. I discuss MG's pricing structure in further detail below at paragraphs 158 to 161 and Section 6.3.4. MG does not offer an incentive or charge a penalty to suppliers unless this can be justified via a commercial cost or benefit or adds directly to the milk price of all suppliers.
68. A principal reason for MG adopting this pricing structure is so that it can share as fairly as possible between supplier shareholders the benefits of a varied product portfolio irrespective of the location of its plants. By applying a single price across the Southeast Australian region, the volatility of prices to farmers in different regions is reduced. This is because supplier payments are not tied to the price of the products processed in the plants located in their region, but are the function of the full basket of products sold by MG across all its regions. For example cheese is made in Northern Victoria, milk powders in Western Victoria and retail products in Gippsland. In future, daily pasteurised milk will be processed in Sydney and Melbourne. MG suppliers share in the returns of this basket of products via the farmgate price and dividends.
69. The return to suppliers under MG's pricing models will depend on a number of factors including the protein and butterfat content of their milk and quality of their milk. For example :
- (a) suppliers are paid according to the butterfat and the protein content of their milk. MG values the protein content in milk as approximately twice the value of butterfat content based on an assessment of what protein

and fat return from the market place. The cost of handling milk volume is also charged in the system. This ensures that the value of milk supplied by each supplier is in line with its protein, fat and volume;

- (b) MG pays a different price for different grades of milk. The announced base price (discussed in paragraph 180 to 187 below) is paid for Premium 1 milk only. Premium 2 and Base Quality milk receive discounted prices. Suppliers with better quality product therefore receive a higher price than suppliers with lower quality milk;
- (c) MG offers a Flat Milk Incentive. This is explained more fully below at paragraph 206 to 207. This provides an incentive to suppliers to supply part of their milk in the off-peak months of July, August, February, March, April, May and June when the company's product mix provides higher returns and the benefits of factory utilisation are higher.

4 MG Relationship with supplier shareholders

4.1 Supplier Relations Committee

70. Each of the Supplier Directors are members of the Supplier Relations Committee. I am the member of the Executive responsible to the Supplier Relations Committee. The committee has been established, amongst other things, to:

- (a) review and monitor MG's relationship with suppliers;
- (b) provide advice and guidance for management with regard to the Company's communication strategy with suppliers including the communication of regular updates of major company developments and the process for addressing any questions or complaints from suppliers;
- (c) review the standard terms and conditions for the supply of milk to MG and make recommendations to the Board as appropriate;
- (d) review parameters for the variation by management of the standard terms and conditions for the supply of milk to MG and make recommendations to the Board regarding any variations; and
- (e) review any proposed amendments to Company policies or procedures that could affect the MG's relationship with its suppliers.

A copy of the Supplier Relations Committee Charter is attached at **RAP9**.

71. The committee does not set the milk price which is determined by the Board with input from management.
72. In 2012, the Supplier Relations Committee undertook a comprehensive review of milk payments to its suppliers using external consultants. The review involved a farmer survey (with responses received from 580 farmers), 16 meetings with farmers held across the supplier regions and consultation with numerous industry advisers.
73. The purpose of the review was to seek to:
 - (a) address complexities in the existing payment arrangements;
 - (b) ensure a pricing system based on fairness; and
 - (c) maximise the return to all farmers.
74. The survey resulted in a recommendation by the Supplier Relations Committee to change the milk price structure incorporating:
 - (a) as far as possible, a single base price for all suppliers;
 - (b) the base price still to incorporate a seasonal component with a higher base payment in the off-peak which recognised higher costs of off-peak production, and reduced the need for MG to invest in further peak capacity;
 - (c) a "flattening" of the price curve to shift milk payments from the off-peak to the peak season by reducing the differential to +20%; and
 - (d) a change in the fat:protein price ratio from 1:2.5 to 1:2.2 to recognise the higher value of protein content in milk .

The key elements of the recommendation are set out in a paper to the Supplier Relations Committee attached as Confidential Annexure **RAP10** .

75. The proposed changes to the milk price structure have been implemented for the 2013/2014 season.
76. I believe that the new payment system has resulted in a fairer and simpler payment system with a number of additional benefits for suppliers, including the following:

- (a) it delivers a slightly higher base payment to all suppliers;
 - (b) it reduces the risk of one supplier group being paid more at the unreasonable expense of the other; for example suppliers with higher protein content receiving the same as suppliers with higher butterfat content;
 - (c) it maintains the incentive for flatter supply; and
 - (d) it provides incentives for larger, more efficient suppliers.
77. In my discussions with suppliers, including through the consultative groups with whom I meet (as discussed below), there has been an overall positive reaction to the new payment system. If MG acquired and merged with WCB, the new payment system would continue to apply to the merged entity.

4.2 Consultation and access to management

78. MG consults regularly with its suppliers through a consultative group, comprising 30 farmers appointed from each of the three supplier regions, 10 farmers from each region. I ask for expressions of interest from suppliers to join the group and then appoint the group with a view to obtaining a representative sample of farmers by reference to farm size, age and gender. The consultative group reports to me.
79. I meet with the consultative group three or four times a year but members of the group have access to me at all times. MG's Chairman, Philip Tracy, usually attends the consultative group meetings. Members of the consultative group also speak to me on a regular basis between meetings and I am aware that they also speak to other members of the Executive, including the Managing Director, Gary Helou.
80. From time to time I also hold a teleconference with the consultative group to advise of any significant events affecting MG. For example I held a teleconference to brief them about the landmark 10 year milk supply agreement with Coles announced in early 2013.
81. The consultative group does not have any decision making powers, rather its purpose is to provide a forum for suppliers to discuss all matters relevant to the dairy industry with MG. This has included aspects of the relationship between MG and suppliers, matters of concern affecting the dairy industry, the price of milk and how MG might provide assistance to suppliers where required. The consultative group

helps build the relationship between suppliers and MG and provides access between senior management and suppliers.

82. The consultative group provides MG and me with valuable feedback on the relationship with suppliers and any problems emerging with that relationship and how these might be addressed. I also use the group to test various initiatives which MG is considering. The consultative group also provides me with valuable insight into the current state of the dairy industry, the financial position of suppliers and with ideas about how to deliver MG's operational objective of increasing the farmgate milk price.
83. Since 2011 MG has operated the Supplier Development Programme . This is an education based nine day programme with three sessions per year. The programme allows suppliers to learn about all aspects of MG's business including raw milk purchases, transport, manufacture, banking, MG stores, human resources and marketing. The programme also provides members with access to members of the Executive and their senior managers.
84. The Supplier Development Programme is very popular. Applications to the programme are usually double the number of available places. Suppliers have told me that they particularly welcome the access to executives which the programme provides.
85. Survey feedback from participants records that the programme helps build respect and understanding between MG and its suppliers.

4.3 Services available to supplier shareholders

86. As a co-operative, MG provides a range of services for its members, particularly suppliers, a number of which are described below.

MG Trading stores

87. MG operates 21 rural stores and four fertiliser depots throughout the three supplier regions through its subsidiary company MG Trading Pty Ltd (**MG Trading stores**). In the financial year ended 30 June 2013 revenues for MG Trading stores were approximately \$200 million and are anticipated to be [REDACTED] in the 2014 financial year. As set out above, I have responsibility for MG Trading stores.
88. MG Trading stores sells a full range of rural merchandise particularly focusing on the 100 key lines of products required by dairy farmers. These products are then

sold at a competitive price to dairy farmers with free on farm delivery and 35 and 40 day current accounts, subject to conditions. This is designed to assist with the reduction of input costs for MG suppliers.

89. MG Trading stores are open to all farmers but MG shareholders (including supplier shareholders) receive a three per cent discount on key lines and some exclusive rebates. MG Trading stores provide the following services, amongst others:
- (a) it sells a variety of farm products (including 100 key product lines) which are bought in bulk and sold at competitive prices including fodder, feed, fertiliser, farm chemicals, animal health products and dairy hygiene products;
 - (b) access to expert technical and agronomy advice from MT Trading stores staff; and
 - (c) milking machine sales and servicing in Western Victoria and Gippsland.
90. In 2013, MG Trading stores entered into a three year partnership with Momentum Energy to offer MG suppliers savings on their energy bills. Energy is a key input cost for dairy farmers because of their reliance on machinery including milking machinery and milk storage. Almost half of MG's supplier base participated in the Momentum scheme and I anticipate that over the three year period this arrangement will result in an estimated \$12 million in energy savings for MG suppliers. I estimate that in its first year the programme delivered approximately \$3.75 million in savings to participating farmers.

Next Generation package

91. MG's 'Next Generation package' is designed to assist suppliers in establishing their business, developing their workforce and maintaining a sustainable business.
92. The Next Generation Dairy Rebate offers an investment rebate for young farmers, farming families who wish to grow their business and for new entrants to the dairy industry. A copy of a flyer explaining the Next Generation Dairy Rebate is attached as **RAP11**.
93. The Next Generation Dairy Rebate is available to suppliers investing more than \$100,000 with the aim of increasing milk production from the applicant's farm. The rebate is conditional on a commitment by the applicant to supply milk to MG.

94. Eligible suppliers may apply for an investment rebate to assist in the purchase of dairy land, permanent water or a dairy herd. The investment rebate will vary depending on the size of the investment and the anticipated milk production which the investment will return.
95. Suppliers face difficulty attracting and retaining employees. MG has appointed an experienced employment adviser (Susan Denny) to assist MG suppliers to attract and retain employees, including sourcing reliable workers internationally. Ms Denny is also a registered migration agent. A copy of a flyer explaining this service is attached as **RAP12**.
96. As part of the Next Generation package MG offers opportunities through its "MG Partnerships" programme to farmers wanting to enter the dairy industry or expand current production. MG has access to equity funding to assist this programme. Suppliers can identify investment opportunities, such as buying a new farm. If the project is sustainable an investor will acquire the farm, which is then leased back to the supplier. This programme allows farmers who would not otherwise be able to enter the industry or expand production because of capital constraints, to do so. A copy of a flyer explaining the MG Partnerships programme is attached as **RAP13**. MG is currently considering applications to this programme which could result in an increase of milk supply to MG of approximately [REDACTED] million litres per annum.

Food safety and Field Services

97. MG also offers a free food safety programme (**MG Milkcare**) to its shareholder suppliers which provides one day courses on dairy food safety and helps dairy farmers meet legislative requirements. The MG Milkcare programme also provides follow up field services, with the Field Services team visiting individual farms to provide additional support to dairy farmers on food safety where required.
98. MG employs Field Service Officers who are located through the supplier regions, including in south-western Victoria. The Field Service Officers provide a service to suppliers where requested including:
- (a) assistance with farm budgeting and dairy food safety;
 - (b) farm audits every two years to assist dairy farmers to monitor their dairy food safety and compliance with legislative requirements; and

- (c) the provision of budgetary and analysis tools including feed planning, income expenses budgeting and 'what if' modelling for farms considering changes to production systems or farms planning growth.

MG Trading Finance

99. MG also provides its supplier shareholders with a variety of loans at competitive rates through its MG Trading Finance and Supplier Finance programmes. Loans have flexible terms, no fees and can include interest subsidised loans. Loans include:
- (a) advances on milk income;
 - (b) finance for working capital;
 - (c) seasonal operations loans which provide short term finance through MG Trading stores to permit the bulk purchase of items such as feed; and
 - (d) MG equipment loans which provide medium term finance to purchase equipment from MG Trading stores for equipment, such as feed systems, milking plants and machines and wash systems.
100. Finance facilities can be obtained at MG Trading store outlets. MG has access to finance from Westpac and also uses some of its own reserves. MG Trading finance's loan book is approximately [REDACTED] at present. In the last financial year it was approximately [REDACTED]

5 The acquisition of raw milk

5.1 Overview

101. The dairy industry is Australia's third largest agricultural industry worth over \$4 billion per annum, according to a report by PricewaterhouseCoopers for Dairy Australia, a copy of which is attached at **RAP14**. The Dairy Australia Outlook Report for 2013 reports that in the 2013 financial year, Australia's estimated milk production fell by 1.4% relative to the previous financial year. A copy of the Dairy 2013 Situation and Outlook Report by Dairy Australia is attached at **RAP15**. Dairy Australia is the national services body for the dairy industry, funded by a levy paid by farmers based on milk production as well as funding from the Federal Government, state governments, universities and dairy support organisations. Dairy Australia publishes a number of papers regarding the dairy industry each year.

102. In my role, from time to time I cause MG staff to undertake analysis of aspects of the dairy industry and also commission reports from external consultants, often with input from MG data. In 2013 I commissioned a confidential report on milk sourcing by the dairy industry from Freshagenda, specialist consultants and analysts in the food industry. The report states that in the 2014 financial year Australia will produce approximately 9.4 billion litres of raw milk. The report also states that in the 2013 financial year around [REDACTED] [REDACTED] was produced in the region encompassing Victoria, South Australia and the Riverina in southern New South Wales, with the remainder [REDACTED] [REDACTED] produced in Tasmania, central and northern New South Wales, Queensland and Western Australia. A copy of the report is contained in the file "Freshagenda report" at Confidential Exhibit **RAP16**.
103. The Australian dairy industry has changed significantly over the past ten years:
- (a) there has been a reduction of almost 20% in Australia's milk production. In the 2002 financial year, Australia produced approximately 11.27 billion litres of milk according to page 18 of a 2013 report by Dairy Australia titled "Australian Dairy Industry in Focus 2012", a copy of which is attached at **RAP17**. This can be contrasted with the estimate above that in 2014 Australia will produce approximately 9.4 billion litres of raw milk;
 - (b) the number of Australian dairy farms has almost halved. The number of dairy farms in 2001 was 11,839 and the number of dairy farms in 2012 was 6,770 (page 14 of Attachment **RAP17**);
 - (c) the number of dairy cows in Australia has reduced by around a quarter. In 2001, there were approximately 2.17 million dairy cows and in 2012 there were 1.63 million dairy cows (page 15 of Attachment **RAP17**); and
 - (d) land used for dairy in Victoria has declined by [REDACTED] [REDACTED] [REDACTED] This information is contained in a report prepared by Boston Consulting Group for MG, an extract of which is attached at Confidential Annexure **RAP18**). Land used for dairy in Australia has also declined over the past 10 years, from approximately 2.8 million hectares in 2002 to approximately 1.6 million hectares in 2012. I have determined this from an AGSURF report that shows the average farm area for each of 2002 and 2012, a copy of which is at **RAP19A**, and a Dairy Australia report that shows the number of

registered dairy farms in 2002 and 2012, a copy of which is attached at **RAP19B**.

104. A report on the Australian dairy industry, prepared by the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) is contained in the file "ABARES dairy report" attached at **RAP20**.
105. Dairy Australia reports that for the past three years the raw milk price in Victoria and South Australia has ranged between 38 cents per litre and 48 cents per litre (an equivalent of approximately \$5.00 per kilogram milk solids and \$5.80 per kilogram milk solids). An extract of Dairy Australia's website that contains this information is attached at **RAP21**.
106. This decline in the Australian dairy industry, from my knowledge, is due to a number of factors, including:
- (a) urban growth which has meant that areas previously occupied for dairy farming could be more profitably used for alternate purposes;
 - (b) poor seasonal conditions, notably drought, in key dairy areas;
 - (c) volatility in dairy milk prices and high farm debt levels;
 - (d) rationalisation in milk production in states such as Queensland and NSW post deregulation; and
 - (e) relatively lower returns due to inefficiencies in the post farmgate sector with over capacity and under-investment. There has been little consolidation in the sector that has been captured as farmgate price.
107. In 2012 MG commissioned a report from The Boston Consulting Group into farmgate milk prices. The report found that there were [REDACTED]
[REDACTED]
[REDACTED] A copy of the relevant pages (pages 41 and 42) from The Boston Consulting Group report is Confidential attachment **RAP22A**.
108. Since 2000, there has been significant change in the post farmgate sector including the loss of control by dairy farmers of previously owned assets,
- (a) In 2001, National Foods entered the specialty cheese and gourmet foods market with the acquisition of the King Island Dairy Company. This

information is contained on the Lion website, an extract of which is at **RAP22B**;

- (b) In 2001, Fonterra acquired a 25% interest in the Australian dairy company Bonlac Foods Limited, which was increased to a 50% interest in 2003, and ultimately 100% in 2006;
- (c) Fonterra has also acquired two other Australian dairy companies, Murrumbidgee Dairy Products and Bonland Dairies. This information is contained at the Fonterra website, an extract of which is at **RAP23**;
- (d) In 2006, National Foods acquired specialty cheese manufacturer Lactos Pty Ltd. This information is contained on the Lion website (Attachment **RAP22B**);
- (e) In 2007, Bega acquired a 70% interest in of Tatura Milk Industries. Following Bega's listing on the Australian Securities Exchange in 2011, Bega merged with Tatura Milk Industries to obtain complete ownership of the company. This information is contained in ASX announcements by Bega and Tatura, a copy of which are attached at **RAP24**;
- (f) In 2007, Japanese company Kirin Holdings Company Limited acquired National Foods from San Miguel Corporation. This information is contained at Attachment **RAP22B**;
- (g) In 2008, National Foods acquired Australian Co-operative Foods Limited, which was trading under the Dairy Farmers brand name, as well as fetta style cheese specialist Hillwood Cheese. This information is contained at Attachment **RAP22B**;
- (h) In 2009, Kirin Holdings Company Limited assumed 100% ownership of Lion Nathan by acquiring the remaining shares in Lion Nathan that it did not already own. In the same year, Lion Nathan and National Foods were merged to form Lion Nathan National Foods, which changed its name to Lion in 2011. This information is contained on the Lion website, extracts of which are at **RAP25**;
- (i) In 2009, Japanese company ITOCHU Corporation and ITOCHU Australia Ltd (based in New South Wales) acquired a 45% stake in BFA Holdings Pty Ltd, the 100% holding company of Australian dairy manufacturer

Burra Foods Pty Ltd. This information is contained at the ITOCHU website, extracts of which are at **RAP26**; and

- (j) French company Lactalis Group entered the Australian market, acquiring Lemnos, a manufacturer of premium quality Mediterranean style cheeses and dairy products in 2010, and Jindi Cheese in 2012. It also acquired an 83.3% stake in Italian dairy company Parmalat Finanziaria SpA in 2011, the holding company of Parmalat Australia Pty Limited. This information is contained at Lactalis' website and in a joint media release by Lactalis, Menora and Jindi, copies of which are attached at **RAP27**.

109. Industry consolidation has continued in the 2013 financial year, albeit on a smaller scale. For example,

- (a) Nestlé acquired Pfizer Nutrition, an infant formula manufacturer;
- (b) Pacific Equity Partners acquired Nestlé's Peters Ice Cream business;
- (c) Brownes acquired Casa Dairy Products, a specialty European style cheese, yoghurt and buttermilk manufacturer; and
- (d) Brownes acquired Ravenhill Dairy's brand, processing assets and exclusive milk supply.

Information about these acquisitions from the 2013 financial year is contained at page 38 of the Dairy 2013 Situation and Outlook report by Dairy Australia (Attachment **RAP15**).

110. Neither MG nor WCB has acquired another Australian dairy processor in the last five years. In 2006 MG purchased Classic Foods, a packer of UHT foods and drinks, in Tasmania.

5.2 The Dairy Companies

111. All dairy manufacturers located in Victoria must be licensed with Dairy Food Safety Victoria (**DFSV**). This is a requirement of the *Dairy Act 2000* (Vic), as stated on website of DFSV a copy of which is attached at **RAP28**. A dairy manufacturer may be someone who collects milk ex-farm or who packs and processes dairy products or both. A dairy manufacturer who collects milk ex-farm but sells it to another dairy manufacturer for processing is sometimes called a dairy broker. Two dairy brokers are United Dairy Power (**UDP**) and Australian Consolidated Milk (**ACM**) which I

discuss further below. Dairy brokers therefore compete with dairy processors for the acquisition of raw milk (without the need to purchase processing assets).

112. In the 2013 financial year MG acquired approximately 3 billion litres of raw milk from farmers across Australia (see page 23 of MG's 2013 Annual Report, which is **RAP3**), making it the largest acquirer of raw milk in Australia. MG also process approximately 180 million litres in Tasmania via its Edith Creek site (milk procured from a third party) and its joint venture Tasmanian Dairy Products.
113. The majority of MG's milk is acquired from the region encompassing Adelaide in the west, Victoria (western Victoria, Gippsland and northern Victoria), and the Riverina of southern New South Wales (**S/E Australia**). A map identifying the regions from which MG procures milk is set out at page 4 of the Dairying with Devondale brochure attached at **RAP29**. Of MG's milk procurement from S/E Australia, about a third of the milk procured comes from the west region (SA and west Victoria), a third from the north region (north Victoria and Riverina) and a third from the east region (Gippsland) of S/E Australia. MG's exports represent 48% of its sales volume (page 3of the 2013 MG Annual Report (Attachment **RAP3**)).
114. MG collects approximately [REDACTED] litres of milk from South Australia, of which approximately [REDACTED] litres is from south-east South Australia and the remaining [REDACTED] litres is from the Adelaide region (including Barossa mid north, Adelaide Hills, the Murray River flats, and Fleurieu Peninsula).
115. MG and WCB both have farms supplying milk to each of them that are located in S/E Australia. More specifically, both MG and WCB have suppliers in South Australia and Western Victoria. The areas in which MG and WCB's milk procurement overlaps is shown in the map attached at **RAP30**. The map also shows the areas from which other dairy companies/processors procure their milk.
116. MG's major competitor dairy manufacturers in S/E Australia are:
 - (a) Fonterra;
 - (b) WCB;
 - (c) Lion;
 - (d) Bega;
 - (e) UDP; and

(f) Parmalat.

I discuss each of these competitors in more detail below based on my understanding of the publicly available material in relation to each of them.

117. Fonterra, the largest processor of milk in the world, is a co-operatively owned company of approximately 11,000 members based in New Zealand, according to p 24 of an IBIS World report attached at **RAP31**. In Australia Fonterra operates through a subsidiary company, Fonterra Australia. Fonterra Australia dairy suppliers are not required to be shareholders of Fonterra to supply it milk.
118. According to Fonterra's website, Fonterra acquires approximately 1.8 billion litres of milk annually from 1400 Australian farmers. This represents about 20% of Australia's raw milk supply. This makes Fonterra Australia's second largest acquirer of raw milk. Fonterra also has a strong relationship with Bonlac Supply Company which has historically supplied a large proportion of Fonterra's milk.
119. Fonterra has eight processing plants in the region that comprises northern Victoria and the Riverina in southern New South Wales. Fonterra also has two plants in Western Victoria (one has recently closed in 2013 at Cororooke). Fonterra's Australia operation is much more retail and domestic focussed than its New Zealand parent, although it does export from Australia, particularly in the infant nutrition category. Information about Fonterra's Australian milk procurement, plants and exports is contained on Fonterra's website. Relevant extracts from Fonterra's website are attached at **RAP32**.
120. WCB is Australia's third largest acquirer of raw milk, acquiring approximately 890 million litres in the 2013 financial year, according to the 2013 WCB Annual Report (Attachment **RAP6**). This represents about 9.5% of Australia's raw milk supply and just half the volume of raw milk acquired by Fonterra. WCB has two plants at Allansford in Victoria and at Mil-Lel in South Australia, the latter of which is a cheese cutting and processing plant. According to WCB's website, its exports represent 50% of total sales volume. Relevant extracts from WCB's websites are attached at **RAP33**. According to an ASX release dated 9 October 2013, WCB's milk procurement is expected to fall to approximately 800 million litres in FY14. A copy of the ASX release is attached at **RAP34**.
121. Lion (previously Lion Nathan National Foods - Japanese company Kirin Holdings acquired 100% of Lion Nathan and merged the company with National Foods) is an Australian beverage company that acquires approximately 1 billion litres of raw milk

from 750 farmers annually. This is described on Lion's website, relevant extracts from which are attached at **RAP35**.

122. Lion acquires milk directly from farmers and a large proportion of its milk is acquired from DFMC. According to its website, DFMC is owned by approximately 600 farmer suppliers, and supplies all its raw milk to Lion under a milk supply agreement. The milk supply agreement guarantees Lion will acquire milk from DFMC farmers until June 2019. This information is contained in a letter from DFMC's Chairman to its suppliers dated 3 October 2013, a copy of which is attached at **RAP37**. The document attached as **RAP36** records that the Australian Competition and Consumer Commission has authorised the agreement until 2023. DFMC is Australia's fourth largest acquirer of raw milk ex-farm and acquires milk from farmers all over the eastern coast of Australia, from South Australia, Victoria, New South Wales, and southern and northern Queensland. The report which is Confidential Exhibit **RAP16** states that in the 2013 financial year DFMC acquired approximately [REDACTED] litres of raw milk across Australia. This is likely to fall further in the 2014 financial year as MG and Parmalat grow market share at the expense of Lion and DFMC. [REDACTED]
[REDACTED]
[REDACTED]
123. Bega purchased 641 million litres of raw milk in the 2013 financial year across all regions in Victoria, and New South Wales. This amounts to approximately 7% of Australia's raw milk supply. Bega has three plants in Victoria and two plants in Bega in southern New South Wales. This information is contained in the 2013 Bega Annual Report (Attachment **RAP8**). Bega's exports comprise about 20% of its overall production, according to Bega's website, an extract of which is at **RAP38**.
124. United Dairy Power is a private company. It acquired approximately 200 million litres of raw milk from Australian farmers in the 2011 financial year, according to the Department of Environment and Primary Industries website, an extract of which is attached at **RAP39**. The report which is Confidential Exhibit **RAP16** states that UDP acquired around [REDACTED] litres of raw milk across S/E Australia in the 2013 financial year [REDACTED] UDP has two plants, both in South Australia. I believe, based on my knowledge of the dairy industry, that UDP primarily on-sells milk to other processes (i.e. dairy broking) and only entered primary processing in 2012.

125. Parmalat Australia is a subsidiary of the Italian based Parmalat Group (itself controlled by the French based Lactalis Group) with eight manufacturing plants across Australia, two of which are in Victoria and one in South Australia. In the 2011 financial year Parmalat acquired approximately 430 million litres of raw milk from Australian farmers, according to page 26 of an IBIS World report attached at **RAP40**. The report which is Confidential Exhibit **RAP16** states that in the 2013 financial year Parmalat acquired [REDACTED] litres from Australian farmers, [REDACTED].
126. Other dairy processors operating in Victoria and South Australia are Bulla Dairy, Burra Foods and Longwarry Food Park. ACM is a private Australian dairy company operates predominantly as a milk broker. In 2008 ACM developed manufacturing capabilities. ACM supplies pasteurised milk, cream and milk powders as well as raw milk. It has approximately 50 suppliers who in the 2012 financial year supplied over 100 million litres of milk to ACM. This information is contained at ACM's website, extracts of which are attached at **RAP41**.
127. The table below summarises the raw milk volumes acquired by each dairy company/processor for the 2013 financial year in the S/E Australia region. As discussed earlier, all of DFMC's milk is supplied to Lion. The figures next to Lion below represent milk that Lion acquired directly from farmers and do not include milk that DFMC farmers supplied to Lion.

[Confidential:

Acquirer	S/E Australia	
	(ML)	(%)
MG	[REDACTED]	
Fonterra		
WCB		
Bega		
DFMC / Lion		
UDP		

Acquirer	S/E Australia	
	(ML)	(%)
Parmalat		
Other		
]		

This table is based on the report which is Confidential Exhibit **RAP16**.

128. There is no substitute for raw milk as the input ingredient for MG's dairy products or the dairy products of its competitors.

5.3 The Dairy Farmers

5.3.1 MG's suppliers

129. As noted above, MG has approximately 2,500 Australian dairy farmer supplier members across South Australia, Victoria, and New South Wales. Approximately 95% of MG's suppliers are from South Australia and Victoria with approximately 115 suppliers only recently added in the central and northern New South Wales (since 1 September 2013). Those farmers are broadly equally distributed across the milk producing areas in S/E Australia - around a third are located in South Australia / West Victoria, a third are located in Gippsland, and a third are located in northern Victoria / the Riverina. A map showing the dairy regions in which MG's farmers are located is attached at **RAP30**. MG also processes milk in Tasmania but this is acquired via its joint venture, Tasmanian Dairy products.
130. Most of MG's dairy farmer suppliers (approximately 90%) supply to MG on a non-fixed term basis. This means that (other than for suppliers in the New South Wales – Sydney region, discussed at Section 6.4.1 below) if the supplier wants to cease supply to MG it can do so without penalty and without any minimum period of notice to MG.
131. Details of a cross section of 10 suppliers to MG and 11 suppliers to WCB are listed in Confidential Annexure **RAP42**.

5.3.2 Competition for suppliers

132. As noted earlier in my statement, over the past 10 years raw milk production in Australia has been declining. Simultaneously, Australia's per capita consumption for

dairy products has been steadily increasing, as shown in the graph at page 24 of the Dairy Australia report "Australian Dairy Industry in Focus 2012" (Attachment **RAP17**). To the best of my knowledge and belief a number of dairy processors have excess capacity as a result of investments that were undertaken at times when raw milk supply was higher. Together, these circumstances have resulted in a shift of milk away from lower returning export processing towards domestic requirements such as drinking milk.

133. Competition for raw milk can be seen in movements by suppliers between dairy processors. While competition is intense during periods of falling milk supply, my experience is it takes effect only on the margins. A net movement to or from MG of zero to 200 million litres in a given year is usual. This represents zero to 6% of MG's volumes. If the movement occurs away from MG then this will reduce overall milk prices that MG offers in S/E Australia due to a fall in MG's efficiency (for example, plant utilisation and transportation costs). Based on my observation, in S/E Australia other dairy manufacturers tend to follow MG's prices. As a result, lower milk prices offered by MG usually means lower milk prices offered by other dairy companies/processors. Conversely, higher milk prices offered by MG usually means higher milk prices offered by competitor dairy manufacturers.
134. From my observation there are three main reasons why MG's suppliers tend to remain as suppliers to MG:
- (a) MG's suppliers are members of the company and continue to supply because they support the principle of a co-operative and recognise the role it plays in benchmarking pricing.
 - (b) generally MG's price tends to be near that of other processors (for example, Fonterra, Bega, Lion and WCB) and where lower, the price differential is relatively small;
 - (c) provided the price differential between processors is not too great, dairy farmers tend to be loyal to the processors to whom they, or their family have historically supplied milk.
135. During the financial crisis in 2008/2009, MG gained approximately 140 farmers from WCB. This unusually high level of milk supply gains in a financial year, and from a single competitor, was a result of the way in which WCB managed the milk price in that year. WCB did not adequately anticipate the effects of the crisis on demand for its products.

136. WCB's opening price for the financial year ending 2009 was similar to that paid by MG. In December 2008, MG announced that effective from February 2009, it would reduce the price it was paying farmers. This price reduction was effective for the remaining five months of the season. WCB also reduced its price in February but by less than MG. As market conditions worsened, in about April 2009 WCB further reduced its price to a level much lower than that then being paid by MG. As a consequence a number of WCB suppliers transferred supply to MG, threatening WCB's raw milk supply. I believe that this movement of suppliers occurred because the price being paid to MG's suppliers was higher than that of WCB. WCB was able to make changes in financials and plans to reverse its price reduction and most WCB suppliers returned to WCB. Page 8 of WCB's 2009 Annual Report provides some background to these events and is attached as **RAP43**.
137. In the 2013 financial year, MG lost around [REDACTED] litres (approximately [REDACTED] of its total milk procurement) of raw milk to competitor processors and gained around [REDACTED] litres (approximately [REDACTED] of total milk procurement) of raw milk from competitor processors. A summary of MG's raw milk gains and losses from and to competitor processors in the 2013 financial year is the file "2013 Supplier Movements" attached at Confidential Exhibit **RAP16**.
138. MG tracks the loss and gain of its suppliers on a monthly basis. I present this information to the Board as part of the Shareholder Relations Report, which I am responsible for overseeing. By way of example, a copy of a Shareholder Relations Report for May 2013 is Confidential Annexure **RAP45**. [REDACTED]
[REDACTED]
[REDACTED] Information about MG's gains and losses for the 2011 and 2012 financial years is contained in the files "2011 Supplier Movements" and "2012 Supplier Movements" respectively, which is Confidential Exhibit **RAP16**.

5.4 Geography of milk supply

5.4.1 Milk producing regions in Australia

139. The Freshagenda report at Confidential Exhibit **RAP16** shows that in the 2013 financial year approximately [REDACTED] per cent of Australia's milk came from raw milk supplied by farmers from S/E Australia. Most of the remainder of Australia's milk is supplied from the regions north of Wagga Wagga through to Sydney (**central NSW**) and around Taree in northern New South Wales, and from

Tasmania. Relatively small quantities of milk are also produced in Western Australia and southern Queensland, with a small amount produced in far north Queensland (FNQ). This is explained in the table below. [Confidential:

Region	% share milk supply
S/E Australia (including Tasmania)	82%
Central and northern NSW	9%
South Queensland	4%
WA	4%
FNQ	1%
Total	100%

]

140. A summary of dairy milk production by state in Australia for the last 16 years is available on Dairy Australia's website, a copy of which is attached at **RAP46**.
141. Almost all major dairy companies/processors collect milk from dairy suppliers in S/E Australia, while slightly less than half collect milk from central and northern New South Wales. Only one major processor currently collects milk from FNQ. The table below shows my knowledge of the location of dairy farmers who supply to each of the major milk processors. This information is also graphically represented in a map, a copy of which is attached at **RAP30**.

Processor	Location of dairy supplier								
	S/E Aus				central & nth NSW	Tas	sth Qld	FNQ	WA
	West Vic	North Vic / Riverina	Gippsland	SA					
MG	✓	✓	✓	✓	✓ ¹	✓ ²			
WCB	✓			✓					
Fonterra	✓	✓	✓	✓		✓			
Bega	✓	✓			✓				
Parmalat	✓	✓	✓	✓	✓		✓	✓	
Lion / DFMC	✓	✓	✓	✓	✓	✓	✓	✓	✓
Longwarry			✓						
Burra			✓						
UDP	✓	✓	✓	✓					
ACM		✓							
Brownes									✓
Norco					✓		✓		

142. Milk supplied from the areas shown in the table above may be processed at a plant in the area in which it is supplied, or it may be transported to a different area for processing (see section 5.4.2). Milk from a farm in a particular area may not be processed by the processor with whom the supplier has a supply agreement. Instead, it may be processed by a competitor processor under a “milk swap” arrangement or otherwise sold to that competitor (see section 5.4.3). As milk is transported and swapped between the areas loosely identified in the above table, a processor does not need to have a processing plant in the same area as the farm from which milk is supplied.

5.4.2 Transportation of milk for processing

143. Raw milk can be, and often is, transported from one region to another for processing. This occurs predominantly so that milk can be processed in a way that maximises the value of the end product mix. For example, MG may transport milk

¹ MG offered to receive milk supply in this region in June 2013.

² MG has a joint venture (Tasmanian Dairy Products) with Mitsubishi Corporation and a number of Tasmanian investors.

from its Koroit plant to its Rochester or Cobram plants if value will at that time be maximised by converting the milk to cheese instead of milk powder. Transfer from one region to another may also occur if the quantity of milk supplied in one area is too great to be processed by MG's plant in that area or if MG sells milk to another processor with a plant in another region.

144. A map that shows the regions between which MG transports its milk for processing is the file "Map of MG milk movements" attached at Confidential Exhibit **RAP16**.

145. Examples where milk is transported by MG between regions include:[**Confidential**:

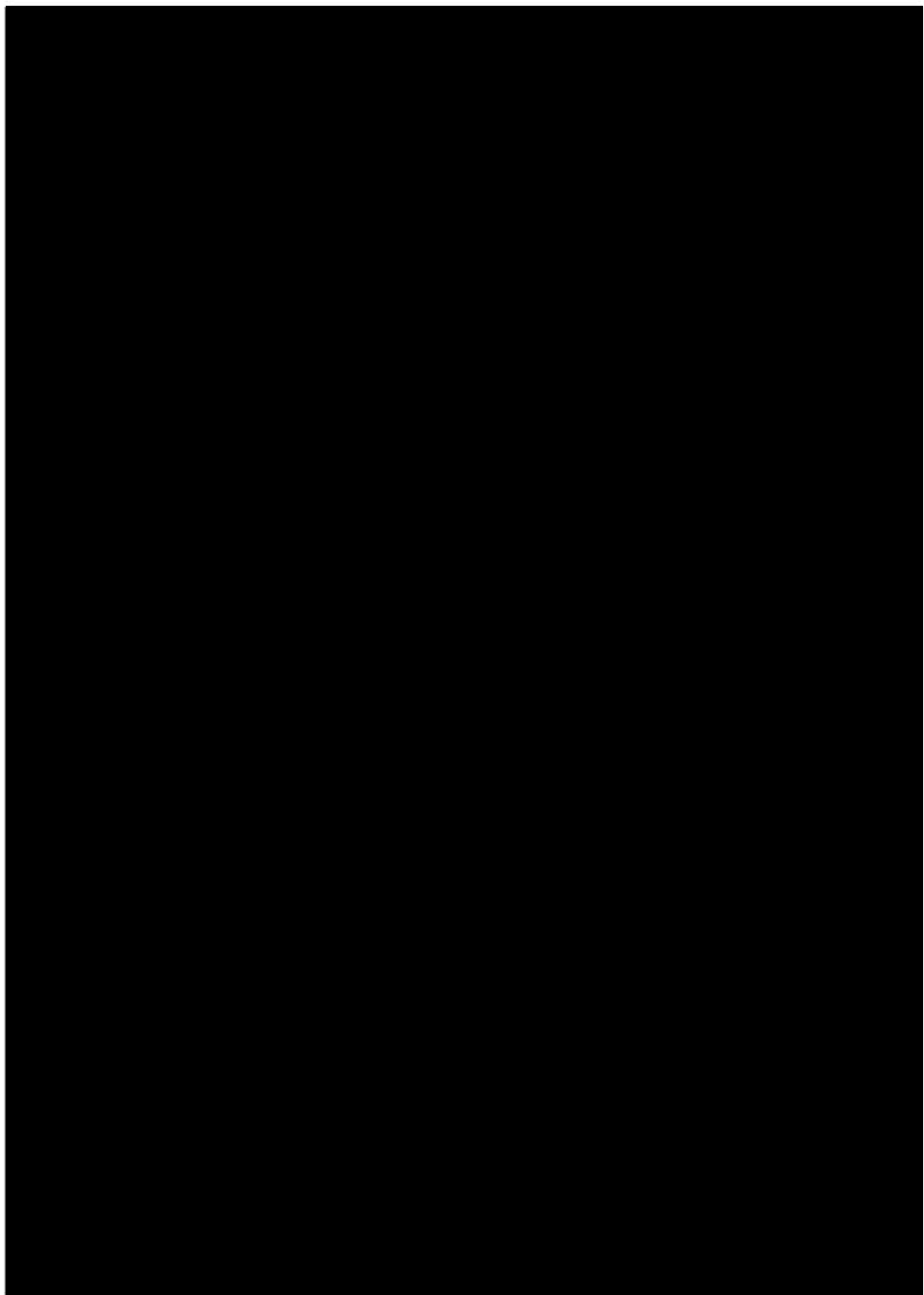
(a)

(b)

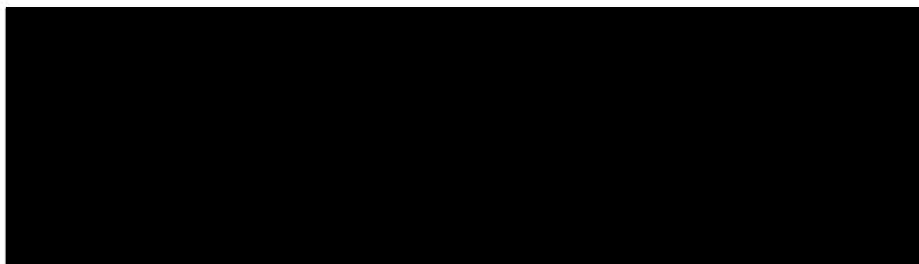
(c)

(d)

(e)















RMP



146. Raw milk is perishable and MG does not transport raw milk internationally. I am not aware that any other Australian dairy producer does so. MG's export sales of long life milk is growing and we expect sales to continue to grow into markets such as China.

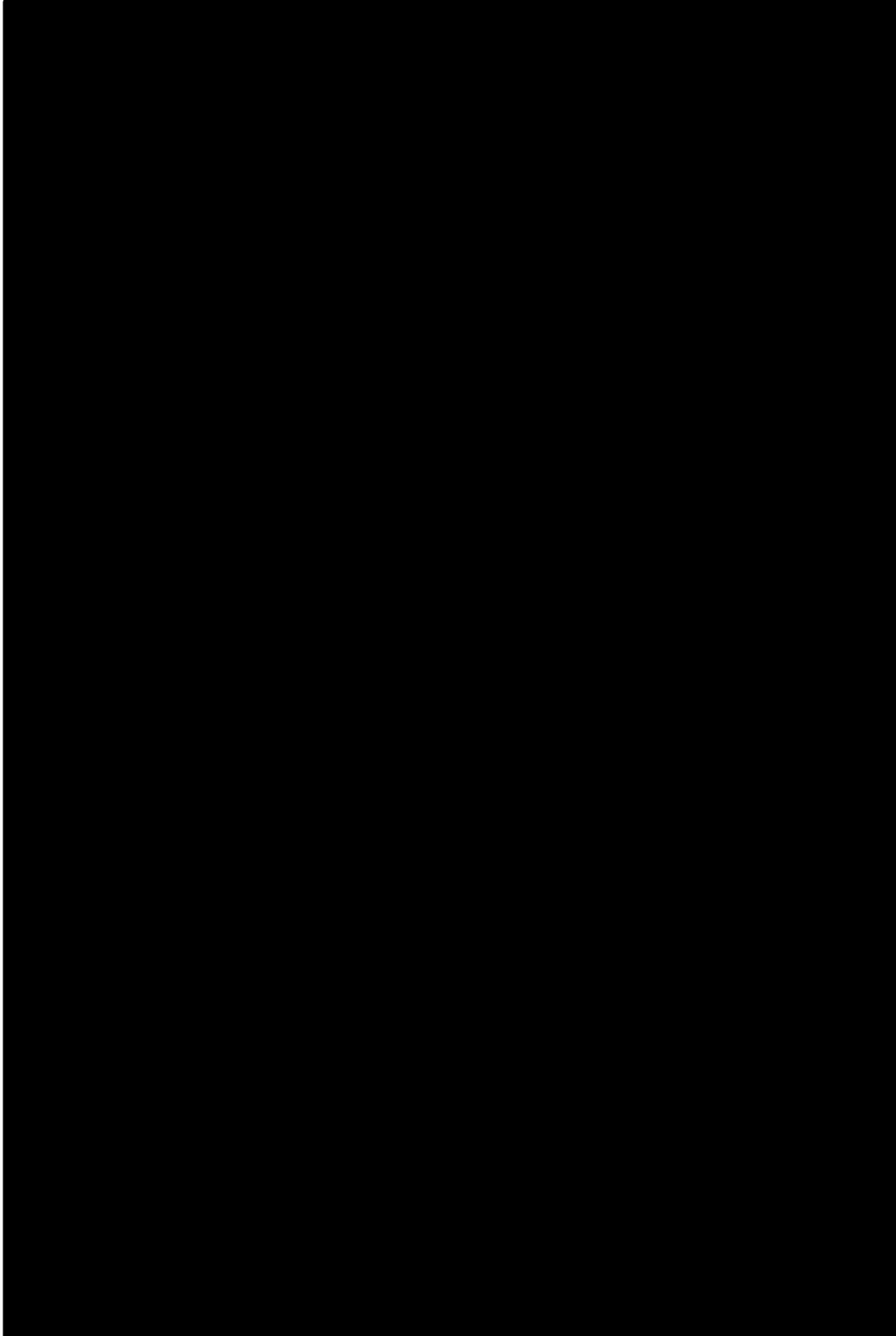
5.4.3 Milk swaps and commercial sales

147. I am responsible for overseeing MG's inter-regional milk swap and commercial sales. Milk swaps and commercial sales (being buy/sell arrangements) are used to minimise costs of milk handling and balance milk requirements across the season. Raw milk is often directed towards commodity processing in the peak of the season and towards drinking milks in the lower milk supply months and milk swaps and commercial sales are used to assist with this.
148. It is common industry practice for one processor (Processor A) to acquire raw milk from an area in which it has less processing capacity and supply it to a local processor in that area (Processor B), in return for Processor B supplying it with milk from Processor B's suppliers in regions where Processor A has greater processing capacity. This exchange is known as a "milk swap". Because MG works with most major dairy companies in the milk swap and commercial sales area I am aware of a large number of milk swaps and commercial sales of those companies.
149. For example, 


150. MG also enters into commercial sales with other dairy processors. The difference between a swap and a commercial sales is that a swap is an agreement for the delivery of a similar volume of milk by each processor that is party to the swap, whereas a commercial sales involves in the one transaction a unilateral sale of raw milk by one processor to another processor. In the case of a swap arrangement, there is usually no transfer of funds (unless the swap is uneven), whereas in a commercial sales the acquirer will pay the seller an agreed amount for the sale milk.

151. Some of the swaps and commercial sales by MG to other processors, notably Lion and Parmalat, are used by them in processing daily pasteurised drinking milk. Those processors value a flat milk supply, with a large portion contracted, and MG provides a flexible smaller portion to match production demand. MG does not sell milk to another dairy processor unless the arrangement is profitable for MG at that time. MG usually obtains a fair margin on the sale because the other dairy processor requires the milk that MG can supply and MG needs to cover opportunity cost, being benefits available from using the milk for another purpose.
152. Occasionally another processor's forecast milk supply may drop unexpectedly (such as when there are poor seasonal conditions). Such an event can increase demand such that a processor of daily pasteurised drinking milk urgently needs to meet the shortfall. In such circumstances, MG negotiates to supply milk on different terms. In doing so, MG reduces the risk of other dairy processors approaching MG's suppliers directly and MG losing suppliers.
153. MG enters into milk exchanges (swap arrangements or commercial sales) with the following dairy companies: **[Confidential]**:
- (a) 
 - (b) 
 - (c) 
 - (d) 
 - (e) 
 - (f) 
 - (g) 
 - (h) 
154. In S/E Australia, MG enters into milk exchanges under which it supplies (receives) raw milk to (from) dairy processors operating in western Victoria and South Australia, northern Victoria and Gippsland.
155. MG forecasts that for the 2014 financial year the total volume of milk that it will sell to other dairy processors either under swap arrangements or commercial sales will be approximately  litres. The total volume of milk that MG

will buy from other dairy processors will be approximately [REDACTED] [REDACTED] litres.

- 156. The table below sets out my and my department's estimates of the volume of milk that MG will exchange with other dairy processors for the 2014 financial year.



RAP

6 Raw milk prices

6.1 Milk Price Review

157. In 2012, the Shareholder Relations team lead a review of MG's milk pricing structure. I was responsible for executive oversight of this review. The review involved intensive consultation with farmer suppliers, including 16 workshops and a farm survey. This is discussed more fully in paragraphs 72 to 76 of my statement above. Following the review MG adopted a new pricing structure in 2013.

6.2 Overview of MG's Milk Payment System

158. Approximately 90% of MG's raw milk is acquired under the standard terms of its Milk Payment System. The remainder of MG's raw milk is procured through arrangements that are variations to standard terms that are deemed to provide overall revenue benefits to MG. For example [REDACTED]

[REDACTED] The terms of any special arrangements (which I discuss below in section 6.4) are largely consistent with the standard milk supply terms.

159. The Milk Payment System is the payment structure that applies to farmers located in S/E Australia who supply milk to Murray Goulburn. A copy of the brochure provided to farmer suppliers which describes the Milk Payment System is attached at **RAP47**. That payment structure is governed by the General Milk Payment Terms, which comprise the Standard Milk Payment Terms and the Flat Milk Incentive Election Form. A copy of the Standard Milk Payment Terms and the Flat Milk Incentive Election Form are attached at **RAP48**.
160. As set out above, MG has just completed a thorough review of its pricing system and is not contemplating changing this pricing structure in any significant manner should MG's acquisition of WCB proceed. If the acquisition does proceed, former WCB suppliers will have access to the same pricing system as MG suppliers. MG's and WCB's payment systems are very similar in any case. As far as I am aware, WCB applies one pricing system for all its suppliers in S/E Australia.
161. Under the Milk Payment System, MG offers farmers a single milk payment structure – a base price that varies according to the quality of milk supplied and which increases incrementally during the year (see also sections 6.3.1to 6.3.3of this statement).These are complemented by a series of incentives designed to

encourage year-round and efficient milk supply (section 6.3.4). Farmers who supply milk to MG under the General Milk Payment Terms must not supply milk to any other processors whilst they are supplying milk to MG (clause 3.2 of the Standard Milk Terms).

162. The price paid by MG for raw milk together with dividend payments represents approximately 45 to 50 per cent of total revenue.

6.3 How does MG set milk prices?

163. Each financial year, the Managing Director, Gary Helou, and the Chief Financial Officer, David Noonan, as representatives of the Executive Team, present to the Board the forecast budget and recommend, by reference to the forecast budget, the price suppliers should be paid for raw milk in the coming financial year. In broad terms, the amount that MG can pay to farmers for their raw milk is MG's forecast revenue less costs less an amount that is allocated to shareholders to be paid as dividends. It is MG's objective to maximise the farmgate price within this process.
164. The forecast prices of processed dairy goods (both in the domestic Australian market and in MG's export markets), the exchange rate, and MG's costs are therefore the key variables affecting the price MG pays to farmers for raw milk.
165. A copy of the budget presentation to the Board for the 2014 financial year is Confidential Annexure **RAP49**.
166. The raw milk price paid to farmers comprises the following elements:
- (a) an opening base price usually approximately 93% of the budgeted full-year price;
 - (b) periodic increases or step-ups to the base price during the year as the budget becomes more certain via completed sales; and
 - (c) incentive payments and charges designed to reward and incentivise suppliers.

For S/E Australia MG offers the same pricing structure, including the same available base price, step-ups and incentive payments and charges. The timing of periodic increases to the base price is also uniform across S/E Australia. I discuss below how MG calculates the amount for each of these elements and how that amount is communicated to farmers.

6.3.1 *Single base price*

167. MG offers to farmers located in S/E Australia a single base price per kilogram of fat and protein supplied. In this section I describe how MG determines the amount of the base milk price and how it communicates this information to farmers.

Calculating the amount of the base milk price

168. To calculate the price that MG can pay its suppliers under the General Milk Payment Terms in a given financial year, MG adopts the following steps:

(a)

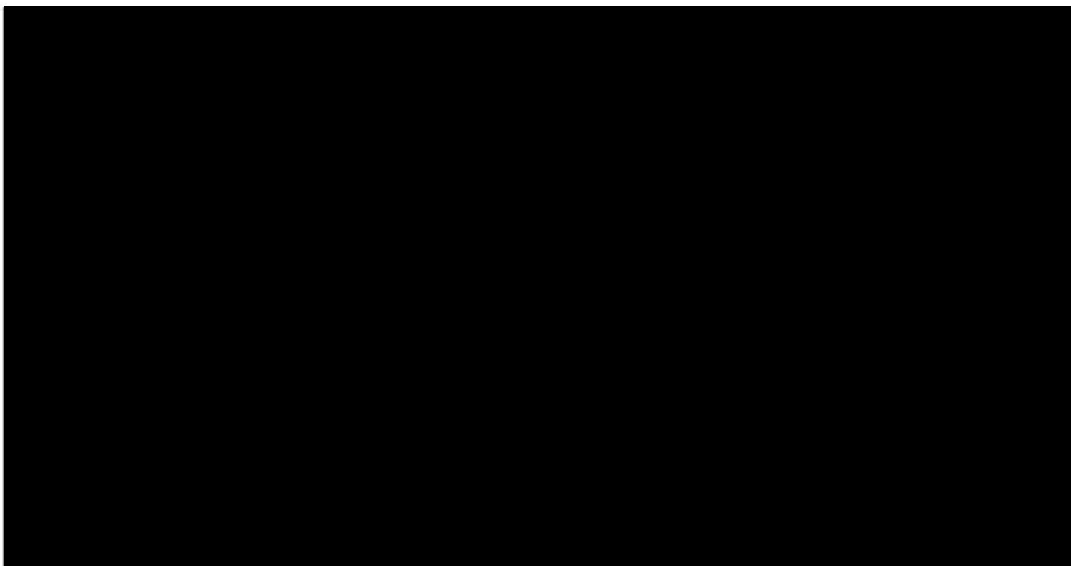
(b)

(c)

169.

170.

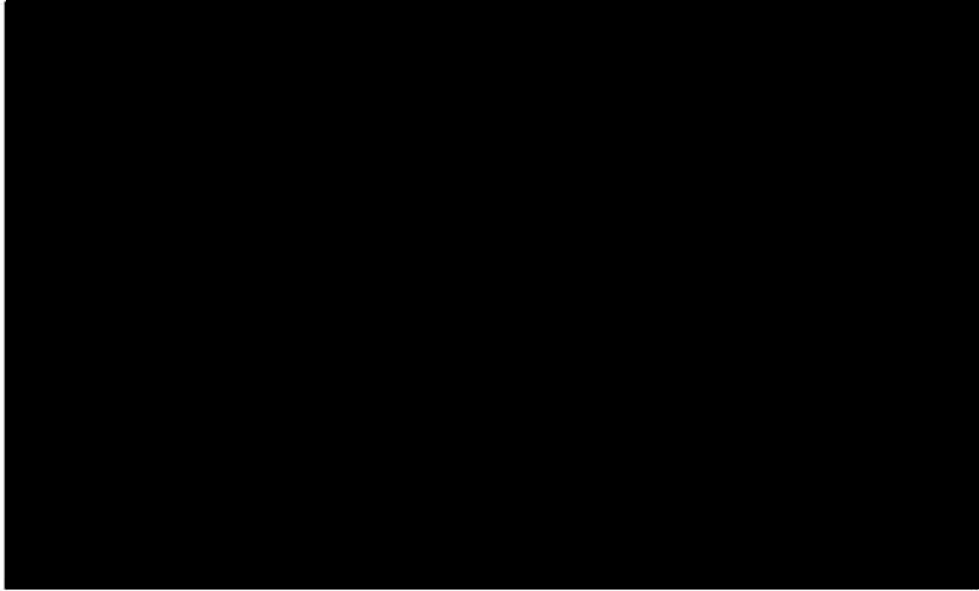
171.



172. The precise way in which the total available for base price payments is divided among farmers (i.e. how MG distributes the amount available for milk payments) is determined by the Milk Payment System. As noted above in paragraph 166, the Milk Payment System includes a base price component and incentive payments, the latter of which I discuss in more detail below at section 6.3.4. The Budget Milk Price is therefore an average price that MG considers it will be able to offer farmers in that financial year for milk supplied to MG. Individual farmers may receive more or less than the Budget Milk Price (even if the budget forecast remains unchanged) due to the individual characteristics of their farming operations, including milk quality.

173. Because the amount available for milk payments (as referred to above in paragraph 168(c)(c)) will change depending on expectations about the exchange rate and the commodities market, MG also conducts a sensitivity analysis with reference to the exchange rate and the commodities market. The Budget Milk Price is the price available based on MG's best estimate of the Australian dollar exchange rate against the US dollar and the expected value of a bundle of dairy products, that make up MG's production mix. By way of example, the table below shows how MG's Budget Milk Price for 2014 varies according to different assumptions about the exchange rate for the Australian dollar and the commodities market (price per kilogram of milk solids):³


³ Confidential.

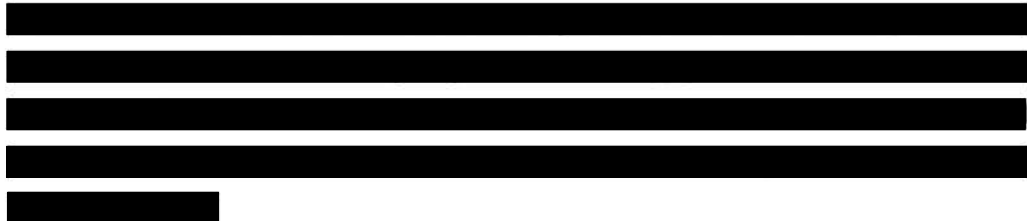


174.



175. Having determined the Budget Milk Price, MG then determines a price range that farmers can expect to receive for their milk over the coming year (the **Forecast Full-Year Price Range**). This range is determined by reference to the sensitivity analysis above and includes in its range the Budget Milk Price.

176. A separate pricing system applies to farms in central and northern New South Wales, which supply to MG under the Sydney-NSW Milk Supply Terms, a copy of which are attached at **RAP50**. 



177. Factors that influence MG's prices in central and northern New South Wales are:

- (a) the pricing of other dairy companies in central and northern New South Wales (for example, Parmalat and Lion);
 - (b) retail contract requirements;
 - (c) commercial sale margins and opportunities; and
 - (d) the freight cost involved in transporting milk from Cobram to New South Wales.
178. MG's operations in respect of milk acquired under the Sydney-NSW Milk Supply Terms are different to those in S/E Australia, in two main respects:
- (a) MG requires flatter raw milk supply; and
 - (b) MG sells a single dairy product, being daily pasteurised milk.
179. The pricing system in central and northern New South Wales is discussed in further detail below in section 6.4.1.

Base price announcement to farmers

180. At the start of the financial year, MG issues an "Opening Price Circular" to its farmer suppliers that explains:
- (a) the base price for raw milk that will be paid to farmers for each month of that year (which does not include step-ups, or incentives and charges, discussed in sections 6.3.3 and 6.3.4 respectively); and
 - (b) the Forecast Full-Year Price Range.
181. The base prices announced in the Opening Price Circular are typically between 90% to 96% of the Budget Milk Price.
182. For the 2014 financial year the opening base price was \$5.47 per kilogram of milk solids (the effective price was \$5.60 per kilogram milk solids due to the offer of a special pre-paid step-up, which I discuss in more detail below in paragraph 195) and the Forecast Full-Year Price Range was \$5.80 to \$6.00 per kilogram of milk solids. A copy of the 2014 Opening Price Circular is attached at **RAP51**.
183. The base price is expressed in dollars per kilogram of milk solids (a commonly used combination of all factors expressed as one number) as well as dollars per kilogram of butterfat and dollars per kilogram of protein. Typically, one kilogram of milk solids

equals 0.6 kilograms of butterfat plus 0.4 kilograms of protein. The price that MG offers for milk protein is 2.2 times the price for butterfat.

184. The following example based on MG's actual opening base price for the 2013 financial year, shows how the price per kilogram of milk solids is calculated by reference to the price per kilogram of butterfat and protein:

- in June 2013, MG's opening base price for July was \$3.78 per kilogram of fat and \$8.33 per kilogram of protein;
- on average, per 100L of milk there are approximately 4.2 kg of butterfat and 3.2 kg of protein. By way of example therefore, the price per kilogram of milk solids / base price can be calculated as follows:

	Fat	Protein	Total
Kilograms per 100L milk	4.1	3.3	7.4
Price per kg MS	\$3.78	\$8.33	
Value per 100L milk	\$15.50 ⁴	\$27.49 ⁵	\$42.99
Value per L milk	\$0.16 ⁶	\$0.27 ⁷	\$0.43
Price per kg MS (base price)			\$5.81⁸

185. The base price varies across the year to reflect the seasonality of milk supply and to encourage milk supply in the off-season months. The peak season for milk supply is in the months of September to December. Therefore, the base price per kilogram of milk solids will be relatively higher for the months of July, August, February, March, April, May and June, to encourage flatter-supply of milk year long. Flatter milk supply is important in securing the milk input required year-round to produce high-

⁴ The number of kilograms of fat per 100L of milk multiplied by the per kilogram price of fat (4.1 x 3.78).

⁵ The number of kilograms of protein per 100L of milk multiplied by the per kilogram price of protein (3.3 x 8.33).

⁶ The value of fat per 100L of milk divided by 100 (15.50 / 100).

⁷ The value of protein per 100L of milk divided by 100 (27.49 / 100).

⁸ The price of \$5.81 per kilogram of milk solids is calculated by adding the value of fat per kilogram of milk solids to the value of protein per kilogram of milk solids. The value of fat per kilogram of milk solids is calculated by first determining how many kilograms of fat there are in one kilogram of milk solids (4.1/7.4) and multiplying that figure by the price per kilogram of fat (\$3.78). Similarly, the value of protein is calculated by determining how many kilograms of protein there are in one kilogram of milk solids (3.3/7.4) and multiplying that figure by the price per kilogram of protein (\$8.33). The price per kilogram of milk solids can therefore be expressed as: (4.1/7.4) x 3.78 + (3.3/7.4) x 8.33 = \$5.81.

end-value products like creamed cheese, certain cheeses (like mozzarella), UHT milk, and milk powder and to maximise the fixed cost recovery from milk processing assets.

186. By way of example, the opening base prices for each month of 2014 financial year, as reported in the Opening Price Circular are set out below:

Month	Butterfat kg MS	Protein kg MS
July	\$3.78	\$8.33
August	\$3.41	\$7.52
September	\$3.29	\$7.25
October	\$3.29	\$7.25
November	\$3.29	\$7.25
December	\$3.29	\$7.25
January	\$3.49	\$7.68
February	\$3.59	\$7.92
March	\$3.63	\$8.00
April	\$3.78	\$8.33
May	\$3.86	\$8.49
June	\$3.93	\$8.66

187. As noted above, the opening base price is typically between 90% to 96% of the Full-year Budget Milk Price. The Budget Milk Price is not offered in full at the beginning of the year due to the risk that the forecasted budget will not materialise if there are adverse market changes or changes in the Australian dollar. Instead, as the year progresses and MG gains confidence in the forecast budget, MG will raise the available base price by a series of "step-ups" (section 6.3.3).

6.3.2 What happens if the forecast budget changes?

188. If, during the year, the forecast budget increases (for example if the Australian dollar depreciates, exports improve, or the commodities market strengthens) MG may revise upward its Forecast Full-Year Price Range. Alternatively it may increase dividends, or allocate the funds to retained earnings if profitable investment opportunities have been identified.

189. By way of example, before the beginning of the 2014 season, MG increased the previously announced opening prices by \$0.09 per kilogram of fat and \$0.19 per kilogram of milk solids. MG increased the opening price due to a depreciation in the value and forecast value of the Australian dollar, which had the effect of increasing MG's forecast budget.
190. MG rarely revises down the Forecast Full-Year Price Range because farmers are likely to have made investment decisions at the beginning of the year based on their expected cash-flow for the year. MG did revise down its Forecast Full-Year Price Range (as did many other dairy companies) in 2008/09 during the global financial crisis.

6.3.3 *How do step-ups work?*

191. As noted earlier in this statement, at the beginning of the season MG offers between 90 to 96% of its Budget Milk Price. During the year the base price approaches the Budget Milk Price, through a number of periodic increases to the base price, called "step-ups". As MG's trading position becomes clearer, and MG becomes more confident that the Budget Milk Price can be achieved, MG will determine the "step ups" it can pay, if any. The new base price that applies from the time of the announced step-up is the old base price plus the amount of the step-up.
192. The amount of each step-up (including consideration of whether a step-up should be made at all) is determined by reference to:
- (a) delivered sales as the year progresses;
 - (b) updated expectations about the foreign exchange;
 - (c) updated expectations about the commodities market; and
 - (d) any other assumptions underlying the initial budget estimate (for example revised milk intake volumes, revised operating costs etc).
193. By way of example, a copy of a memorandum by Managing Director Gary Helou to the Board, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
194. A step-up operates retrospectively in the sense that when it is announced farmers are paid the amount of the step-up (the difference between the new base price and

the old base price) over the volume of milk solids they have supplied up to that point in time. Suppliers are not entitled to this retrospective payment unless they are a current supplier to MG at the time the payment is made.

195. At the beginning of the 2014 season, MG offered a special pre-paid step up which provided farmers with the option to receive the value of the step-up for their forecast milk supply for the coming season.⁹ Details of this pre-paid step-up for the 2014 financial year are contained in the Opening Price Circular. The pre-paid step-up provided cash up front to support farm business recovery following a difficult season.
196. The timing of MG's step-ups each year is not predetermined. In determining the timing of step-ups, MG takes into account completed sales volumes and prices, updates in the commodities and currency market outlook, farmer hardship / cash-flow needs) and MG's pricing position relative to its competitors at that point in time. MG's decision to offer the special pre-paid step-up at the beginning of the 2014 season was influenced by farmer hardship and cash-flow needs. Usually there are around three step ups per year, but there could be none if market conditions are worse than expected.
197. MG usually leads milk pricing in terms of opening price and timing of step-ups. It is not impossible that if a competitor had already stepped-up its milk price, MG may consider stepping-up earlier than otherwise to avoid the risk of farmers moving to competitor processors. In that way, MG's pricing position relevant to its competitors can influence how much risk it is willing to take on in terms of timing. Stepping up earlier risks market conditions changing and not meeting forecast budget, whereas waiting reduces the magnitude of exposure from unsold product value varying with market fluctuations.
198. The table below shows point-in time milk prices offered by MG, WCB, Fonterra and Bega for the 2013 financial year..

	2012						2013						
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul(b)
MG	4.50	4.63	4.63	4.76	4.76	4.76	4.76	4.89	4.89	4.89	4.89	4.89	4.96

⁹ Farmers' forecast milk supply is based on actual milk supply for the previous financial year.

WCB	4.48	4.48	4.48	4.61	4.61	4.61	4.71	4.71	4.81	4.81	4.81	4.90	4.90
Fonterra(a)	4.50	4.50	4.50	4.63	4.63	4.63	4.63	4.76	4.76	4.76	4.76	4.83	4.83
Bega	4.50	4.50	4.50	4.76	4.76	4.76	4.89	4.89	5.02	5.02	5.09	5.09	5.09

199. I note the following in relation to the table above:

- (a) Fonterra did not announce an opening price but announced a closing price of \$4.70 - \$5.00. The table assumes that Fonterra matched its competitors and opened at \$4.50; and
- (b) the July price is the announced closing price.

200. The amount MG has available for milk payments and dividends is determined by the budget and MG's ultimate financial performance. MG's milk pricing is not impacted in a meaningful way by the price paid by other dairy companies/processors.

201. For example, MG does not step-up its milk price unless it considers that its forecast budget allows it to do so. MG does not make losses in order to match a the price paid by other dairy companies/processors. MG would only consider trading losses to support farmgate price in extreme cases if it considered that there was an extreme risk of its raw milk base significantly depleting due to farm business losses for example in extreme droughts or market downturns.

202. The table below shows MG's opening price, step-ups and closing price for the past five years.

	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013
Opening Price	5.12	5.51	3.55	4.83	4.94	4.50
Step-ups	1.64	-0.72 ¹⁰	0.87	0.81	0.50	0.46
Closing price	6.76	4.79	4.42	5.64	5.44	4.96

6.3.4 Incentive structures

203. The available base price is impacted by a series of incentive payments and charges. It does this to encourage efficient, flatter and growing milk supply, and to promote

¹⁰ I explain the reasons for the reduction in MG's base milk price earlier in paragraphs 135 and 136.

fairness in milk payments by tying the price that each farmer receives for its milk to its value (not just in terms of quality, but in handling cost minimisation).

204. The incentives MG offers are designed to encourage:
- (a) flatter milk supply year round;
 - (b) increases in milk supply (vis-à-vis previous years) and improved factory efficiencies and market security;
 - (c) high quality milk; and
 - (d) low collection and handling costs.
205. MG has the following six incentives structures – four of which involve extra payments for high quality flatter milk whose supply volume has grown over time, and two of which involve extra charges for inefficiency in handling.

Flat Milk Incentive

206. The Flat Milk Incentive (**FMI**) rewards milk supply in the off-peak period. Unlike the variation in the base milk price that applies across all farmers, farmers must elect before 31 August each year to participate in the FMI for that year. Farmers who elect to participate in the FMI receive an addition to the base milk price per kilogram fat and protein, if the total milk solids the farmer supplies over the off-peak period is more than 40% of the total milk solids the farmer supplies over the entire season. The FMI does not apply under the NSW-Sydney Milk Payment Terms, but a similarly motivated incentive scheme that rewards off-peak supply, called the "Seasonal Incentive" (**SI**), does apply. FMI payments are back-paid at the end of the year.
207. Conversely, if a supplier participates in the FMI and the total milk solids the farmer supplies over the off-peak period is less than 40% of the total milk solids the farmer supplies over the entire season there will be a reduction to the base milk price per kilogram fat and protein received by that supplier.

Growth Incentive

208. The Growth Incentive (**GI**) is designed to encourage farmers to increase supply of milk solids in subsequent financial years. The GI applies automatically to all farmers if the kilograms of fat or protein supplied in a year is more than the average supply of each for the previous two years. For example, for a GI of \$0.33 per kilogram butterfat and \$0.72 per kilogram of protein, average supply of each of butterfat and

protein of 100kg over the previous two years, and 200kg in the current year, the GI incentive payment is a total of \$105 (comprising $0.33 \times 100 = \$33$ for butterfat, and $0.72 \times 100 = \$72$ for protein). GI payments are back-paid at the end of the year.

Productivity Incentive

209. The Productivity Incentive (PI) encourages lower handling costs on a per kilogram milk solids basis by rewarding farmers whose farms supply relatively high volumes of fat and protein. Handling costs are lower per kilogram milk solids for large farms because test costs and collection costs are dispersed over a higher number of kilogram milk solids. PI payments are back-paid on a monthly basis.

Milk quality system

210. The base price available applies to Premium 1 milk. If milk supplied is lower than Premium 1 (Premium 2 or Base Quality) the base price per kilogram of butterfat and per kilogram of protein is less.
211. Secondly, MG reduces the base price per kilogram solids where a farmer's milk tests positive for inhibitory substances. The magnitude of the discount depends on the number of repeat positive tests in the previous 12 months.

Volume charge

212. MG charges fees in accordance with the efficiency of milk collection on each farm. The volume charge is calculated on a cents per litre of milk supplied. Volume charges are determined daily and adjusted in the monthly milk payment.

Collection charge

213. Collection charges vary according to frequency of collections and encourage farmers to invest in greater vat capacity. For example, farms that only require pick-ups every-second day are charged on a 'skip-a-day' basis, and farms that require more than one pickup in 24 hours are charged an increased fee for the subsequent pick-ups. The collection charge is a fixed fee per collection that is designed to recover costs. Collection charges are determined and levied daily.

6.4 Fixed-term arrangements with milk suppliers

214. MG has three fixed-term supply arrangements with farmers:
- (a) 12 month contracts for farmers supplying milk to MG in central and northern New South Wales with rollover provisions and notice periods.

These are recent arrangements following MG's expansion into the Sydney-region market;

(b)

(c)

For the reasons that I explain in the next section, the NSW-Sydney region is different from S/E Australia in terms of pricing structure.

6.4.1 *New South Wales Milk Payment System*

215. In 2013 MG offered for the first time the opportunity for farmers located in central and northern New South Wales to supply raw milk to MG. The terms under which farmers in central and northern New South Wales supply milk to MG are governed by the NSW-Sydney Milk Payment Terms (Attachment **RAP50**).
216. The NSW-Sydney Milk Payment Terms are different from the General Milk Payment Terms (which I discussed earlier in section 6.2). This difference is due to differences between the New South Wales dairy market and the S/E Australia and Tasmania dairy market. New South Wales dairy processors are predominantly supplying a single end product to their customers, being daily pasteurised milk. Because demand for daily pasteurised milk is relatively flat across the year and milk is highly perishable, the supply of daily pasteurised milk also needs to be fairly flat. As a consequence, dairy processors in New South Wales require certainty in the volume of milk procured throughout the year. By comparison, in S/E Australia, where raw milk is used to produce a mix of dairy products, processors can re-allocate raw milk supply to different products in order to ensure they meet their contractual obligations for the supply of daily pasteurised milk.
217. The two major dairy processors in New South Wales are Parmalat and Lion (supplied by DFMC). Both Parmalat and Lion/DFMC offer price structures to their farmer suppliers that reflect their need for certainty and stability in the volume of milk supply year round. As a new entrant to the market, MG has needed to offer competitive prices to dairy farmers in central and northern New South Wales to encourage them to supply milk to MG in line with the requirements of flatter milk supply in NSW.

218. As raw milk may be transported from northern Victoria to satisfy demand in central New South Wales, I would expect the market price in New South Wales to be capped at a price near the market price of milk in S/E Australia plus transport costs to Sydney. If the price were more than this, it would be more profitable for dairy processors to transport milk from Victoria rather than acquire raw milk from dairy farmers in central and northern New South Wales.
219. MG will use the milk it acquires from farmers in central and northern New South Wales to supply from July 2014 and for the next 10 years, pasteurised milk to Coles for its private label milk (**Coles contract**). [REDACTED]
[REDACTED]
[REDACTED]
- (a) [REDACTED]
(b) [REDACTED]
(c) [REDACTED]
220. [REDACTED]
[REDACTED] Consequently, MG requires certain and flatter volumes of raw milk supply from its farmers and the NSW-Sydney Milk Payment Terms (Attachment **RAP50**) are designed to produce that form of supply. The product that New South Wales dairy farmers must therefore supply to dairy processors is quite a different product from that which dairy farmers located in S/E Australia and Tasmania are required to supply to MG.
221. In general, the differences between the General Milk Payment Terms and the NSW-Sydney Milk Payment Terms are:
- (a) farmers who supply milk to MG under the NSW-Sydney Milk Payment Terms agree to commit to a minimum monthly milk allocation for 12 months, whilst under the General Milk Payment Terms farmers may supply any volume of milk to MG;
- (b) farmers who supply milk to MG under the NSW-Sydney Milk Payment Terms must do so for a term of 12 months or provide 90 days' written notice if it wishes to cease to supply MG within the 12 month term (clause 18.1 of Attachment **RAP50**). Under the General Milk Payment Terms there is usually no fixed-term contract and no minimum notice period is

required if a farmer wishes to cease supplying milk to MG (clause 17.1(2) of Attachment **RAP48**);

- (c) the penalties for below grade milk are slightly higher than under the General Milk Payment Terms;
- (d) the incentive payments are structured in a way that encourages the supply of flatter year round milk of above base quality, more so than do the incentive structures under the General Milk Payment Terms; and
- (e) volume charges are region specific. This is done to maintain proportionality between the cost incurred by MG and the charge imposed on farmers, given the greater variation in transport distances for milk collected in central and northern New South Wales than from farms in S/E Australia and Tasmania.

222. A copy of the brochure provided to farmer suppliers in central and northern New South Wales that describes the New South Wales Milk Payment System is attached at **RAP53**.

6.4.2 [Redacted]

223. [Redacted]

6.4.3 [Redacted]

224. [Redacted]

6.5 Other processor pricing

6.5.1 Other processor price structures

RAP

225. In my experience, I have observed broadly three regions in Australia for the acquisition of raw milk:

- (a) S/E Australia and Tasmania;
- (b) South east Queensland, central and northern New South Wales and FNQ; and
- (c) Western Australia.

226. I have observed that prices for raw milk vary between regions, but much less so within a region. For example, in S/E Australia I have observed that dairy prices are comparable between western Victoria / South Australia, northern Victoria / Riverina, and Gippsland. To the extent that there are differences in prices between regions, this is due to variations in farm productivity and milk quality rather than different price structures. To put it another way, in the Southeast dairy region (S/E Australia and Tasmania) where most of Australia's milk is produced, the major dairy companies offer the same pricing structures in all of the regions.

227. Furthermore, based on my knowledge, and observation of:

- (a) other dairy processors' supply contracts; and
- (b) the timing of announcements of opening prices and step-ups,

I believe that other dairy manufacturers always benchmark their pricing against MG, including Lion which requires a flatter milk supply and Fonterra which has a more seasonal milk supply curve.

Fonterra, WCB, Burra, Longwarry and Bega

228. The pricing structure for Fonterra, WCB, Burra, Longwarry and Bega is similar to that of MG. Each offer an opening base price which is augmented during the year by a series of step-ups. Incentive payments and charges operate in addition to the base price and are designed to encourage off-peak milk supply (customised to the peak season of each region), increased production, quality milk and efficient handling. Most dairy manufacturers offer payment options similar to that of MG.

229. As I describe later in section 6.5.3, Fonterra receives milk from Bonlac Supply Company Limited on the condition that Fonterra match the price offered by Victoria's leading processor, which is MG. .

Other processors

230. Pricing structures for other major processors, such as Parmalat, UDP and Lion, is private and not known.

Other services offered by dairy companies

231. WCB offers to its suppliers the following services that assist with cash-flow:
- (a) a flat cash flow option which enables eligible suppliers to receive a flatter milk price year round. The monthly price is based on the estimated average price for the entire year. To be eligible suppliers must have a flat supply ratio (proportion of milk solids supplied in the off season relative to the year) that averaged in excess of 45% for the previous two years;
 - (b) a ten-day payment option under which suppliers can elect to receive milk proceeds in three instalments over the month; and
 - (c) interest-free advances for the purchase of feed and fertiliser. WCB offers up to \$145 per cow milked in the current season. The option is available to suppliers who are not eligible to take up the flat cash flow option. Suppliers must pay for the advance in full within 12 months.

6.5.2 *Effect of other processors' pricing on Murray Goulbourn's pricing*

232. Pricing analysis of the price paid by other dairy processors who operate in the same regions as MG is provided to the Board in the following contexts:
- (a) as general market information; and
 - (b) in monthly Shareholder Relations Reports.
233. If MG observes that its competitors are pricing above its current base price, the Executive may recommend to the Board that it:
- (a) change the date on which it had planned to make its next step-up (see also section 6.3.3. This would always be subject to the budget position);
 - (b) consider whether MG is operating as efficiently as it can, and if not, what it can do to improve operations; and
 - (c) consider whether its forecast market analysis is correct.

234. As noted earlier, MG does not increase its base price because it observes that other dairy processors are outpricing it.
235. MG's pricing structure is designed to provide incentives that serve both its domestic and international purposes for its raw milk procurement. In order to ensure that MG's price structure is attractive to different farm types that serve its product mix, MG does take into account the types of farms that competitor processors design their pricing structures to suit. For example, Parmalat and Lion focus on pasteurised milk that requires year round flatter supply, whereas WCB and Burra structure prices to support their export-focussed businesses. MG aims to serve both types of end purposes and therefore aims for a middle ground. This goal is supported by the returns generated from the business and this reflects in a set of justifiable market signals via the pricing system. Because its farmers are also its shareholders, MG aims to maximise the entire value chain – meaning that its pricing structure aims not only to support a value maximising product mix but also to support farmers' most efficient farming operations.

6.5.3 Effect of Murray Goulburn's pricing on other processors' pricing

236. As discussed above, based on my observation, the milk price that is offered by dairy processors who acquire milk in the same regions as MG tends to follow the price that MG offers its suppliers.
237. By way of example, I am aware from my discussions within the dairy industry that Fonterra has entered into a supply arrangement with Bonlac whereby Bonlac agrees to supply raw supply raw milk to Fonterra at prices matching "Victoria's leading milk processor". As noted earlier in paragraph 127, MG is the leading milk processor (in terms of volume of raw milk acquired) in S/E Australia. An article published in The Age online dated 5 August 2005 reported that: "Fonterra will pay a price as high as Murray Goulburn, Victoria's leading milk processor and Bonlac's chief rival. A copy of this article is attached at **RAP54**."
238. I am also aware that DFMC has an arrangement with Lion under which Lion provides a price guarantee to DFMC farmers that is linked to MG's milk price. In November 2013, DFMC sent a letter to its Southern Suppliers announcing that it had stepped up the base milk price by 5 cents per litre which enabled it to keep ahead of the MG guarantee premium. The letter indicates that Lion has agreed to pay to DFMC farmers a premium on the MG milk price which varies in size according to the level of MG's milk price. A copy of a letter from DFMC to its Southern Suppliers is attached at **RAP55**.

239. A Bloomberg article dated 7 June 2005 reporting on Fonterra's acquisition of Bonlac reported the former chief executive of Australian Dairyfarmers as saying that "Most Australian dairy companies have found it fairly hard to compete with Murray Goulburn and match the higher prices it pays its suppliers". A copy of this article is attached at **RAP56**.¹¹

7 The position if MG acquires WCB

7.1 The proposed structure

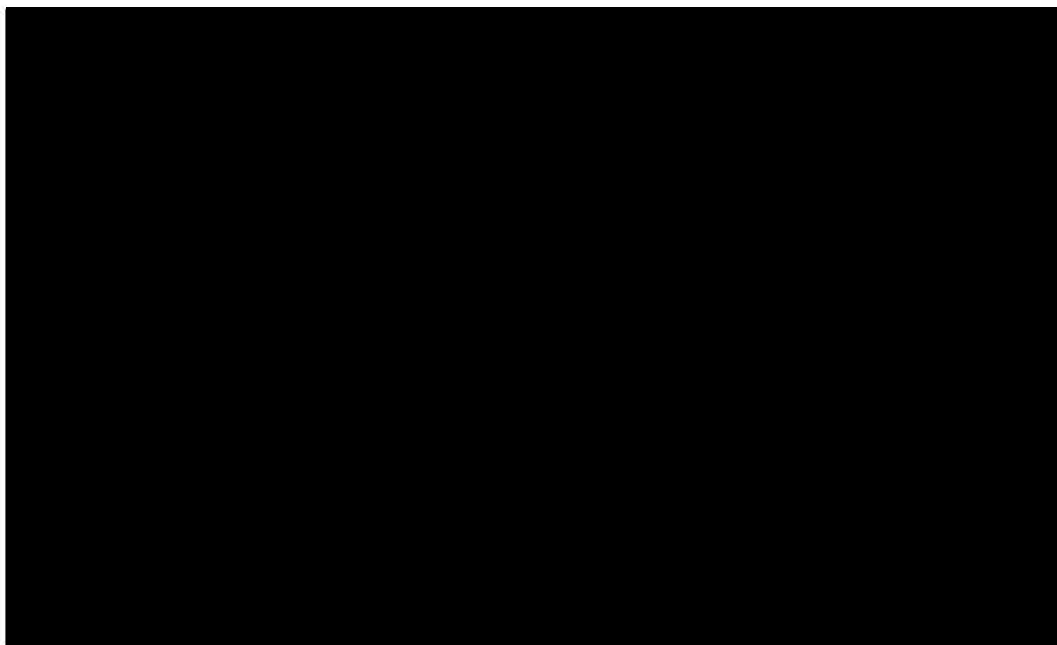
240. If MG acquires 100 per cent ownership of WCB it intends to merge the two businesses. The merged entity will also operate in accordance with co-operative principles and have similar objectives to those of MG. The merged entity will retain the operational objective to significantly increase the farmgate milk price.
241. It is proposed that the merged entity will over time offer the same conditions and incentives to suppliers as MG does. For example, suppliers to WCB who wish to supply milk to the merged entity would be required to acquire a minimum number of shares in the merged entity. As a consequence, current suppliers to MG will retain the same rights, influence and interest in the merged entity as they currently have and former WCB suppliers will acquire those rights, influence and interest in the merged entity.
242. As set out above, MG does not intend to make any significant changes to the milk payment system as a consequence of the acquisition of WCB.
243. If MG acquires more than 51 per cent, but less than 100 per cent of WCB, WCB will operate as a subsidiary of MG. In that event WCB suppliers who continue to supply milk for WCB's operations will be required to do so through MG. They will therefore become a supplier to MG and subject to the same conditions, including the need to acquire shares in MG. Details of MG's initial and revised takeover offer for WCB are contained in MG's ASX announcement dated 18 October 2013, a copy of which is attached at **RAP57** and MG's ASX announcement dated 13 November 2013, a copy of which is attached at **RAP58**.

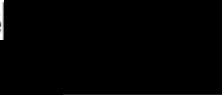
7.2 Impact of the acquisition

244. 

¹¹ <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a9Ddk0YuBdsM>.

DM



245. The increase in milk price will be received by all suppliers to the merged entity, including potentially all 500 current suppliers to WCB. In total this will affect approximately 3,000 suppliers.
246. The co-operative principles on which the MG/WCB merged entity will operate also ensure that the increased earnings of the merged entity from growth opportunities, including exports, will ultimately benefit suppliers through further sustained and increased farmgate prices and dividends.
247. From my experience in the dairy industry, the increased milk price  will likely be spent by suppliers in the regional areas where they operate, providing a benefit to the economies of those regions. A report to Dairy Australia prepared as a background paper for the Lower Murray-Darling Basin Inquiry in 2009, sets out on page 46 of that report the significant contribution which dairy farming makes to the Murray-Darling Basin. In particular the report states that *"Dairy farms in the region have direct and indirect contributions to the region's economy through a number of channels. Dairy farms directly purchase inputs, such as supplementary feed, fertiliser and fuel, and services including veterinarians, farm management consultants, nutritionists and contractors, Dairy farmers also contribute to underpinning a number of markets in the region, particularly land and water"*. In my experience this statement is applicable to other regions in S/E Australia in which dairy farms operate. Page 47 of the Dairy Australia report further states that *"The dairy farm sector has a large multiplier effect including indirect employment in trade,*

services, transport and other agriculture". A copy of the report is attached as **RAP59.**]

248. Dairy Australia notes this effect in an overview of the dairy industry on its website where it states that *"Dairy is also one of Australia's leading rural industries in terms of adding value through downstream processing. Much of this processing occurs close to farming areas, thereby generating economic activity in country regions"*. A copy of the relevant extract from the Dairy Australia website is attached as **RAP60.**
249. The merged entity will continue to seek to persuade suppliers to supply milk to it in the same areas as other dairy processors seek to obtain milk, including Fonterra, Bega, Lion, DFMC, Parmalat and UDP. The increased milk price paid by the merged entity to its suppliers will act as an incentive to other dairy processors to match the price (if higher than that paid to their suppliers) in order to maintain their supplier base which will result in an increase in farmgate milk prices throughout S/E Australia.
250. From my knowledge and experience of the dairy industry, I believe that if milk prices rise above \$5.30 per kilogram of milk solids and stabilise at that higher level, this will permit and lead to investment in efficient production techniques, larger herds and new or expanded dairy farms which will in turn result in increased production. There was strong growth in production in Australia in the 1990s when prices were relatively stable. This is apparent from Figure 6 (page 11) of a paper published by Dairy Australia called "Australian Dairy Industry in Focus 2012" (Attachment **RAP17**). Figure 6 reveals that milk production in Australia increased from just over six billion litres in 1989/90 to approximately 11 billion litres in 1999/2000 which equates to an annual growth rate of approximately 6.25 per cent. Figure 4 (page 9) shows that Factory Paid Milk Prices in the 1990 to 2000 period were relatively stable at about 30 cents per litre (approximately \$3.50 per kilogram milk solids). After taking into account CPI, I calculate that prices paid in the 1990s were the equivalent of more than \$6.00 per kilogram milk solids in 2013 dollars. Based on what occurred in Australia in the 1990s, I believe that similar growth in milk production could occur if milk prices continued to grow and stabilised at a higher level. Although milk prices will always fluctuate to some extent, I believe that a benefit of the proposed acquisition of and merger with WCB is that there will be a permanent increase in the price of milk for MG and WCB suppliers of approximately [REDACTED] [REDACTED] as referred to in paragraph 244.

8 The position if MG does not acquire WCB

251. At the time of making this statement I believe that there are a number of possible outcomes if MG does not acquire WCB:
- (a) The bid by Saputo and Bega may not proceed and the position may remain the same;
 - (b) Saputo may acquire WCB; or
 - (c) Bega may acquire WCB.
252. I consider below how each of these outcomes may affect the prices paid to suppliers for raw milk.
253. If WCB is not acquired by any party this will not affect the approach taken by MG to the price it pays its suppliers. However, none of the synergies of an MG / WCB combination referred to above will be captured and farmgate prices paid by MG will therefore be lower in this case than if MG was successful in acquiring WCB
254. If Saputo acquires WCB, Saputo will effectively replace WCB. It does not have any existing business in South East Australia that it will need to merge with WCB. Again this will not affect the approach taken by MG to the price it pays its suppliers. However, none of the synergies of an MG/WCB combination referred to above will be captured and farmgate prices paid by MG will therefore be lower in this case than if MG was successful in acquiring WCB.
255. If Bega acquires WCB, it will not affect the approach that MG takes in paying its suppliers. However, none of the synergies of an MG / WCB combination referred to above will be captured and farmgate prices paid by MG will therefore be lower in this case than if MG was successful in acquiring WCB.
256. If:
- (a) no party acquires WCB; or
 - (b) Bega or Saputo acquire WCB,
- MG will continue to seek to persuade the suppliers to WCB or the Saputo/WCB or Bega/WCB entities to supply milk to MG by becoming a supplier/shareholder of MG. If the suppliers to WCB or the Saputo/WCB or Bega/WCB entities choose to supply MG, MG will obtain savings in the form of fixed-cost recovery, which all

else equal, will enable MG to pass on higher milk prices to its suppliers, including the suppliers it has acquired from WCB or the Saputo/WCB or Bega/WCB entities. For example, milk acquired from current WCB suppliers in South Australia / western Victoria could be processed in MG's plants with excess capacity (such as Koroit) or in the Laverton plant that MG is currently building.

257. If MG does not acquire WCB, the estimated increases in the price paid to MG suppliers as a result of increased exports and synergies and efficiencies (see paragraphs 244 to 246 of this statement), may not occur or may take longer to achieve. As the milk price paid by MG influences the prices paid by other dairy processors in S/E Australia, including WCB and Bega, this may result in the price paid for milk by MG and its competitors being lower than if MG acquired WCB. Therefore if:

- (a) no party acquires WCB; or
- (b) Bega or Saputo acquire WCB,

this will likely result in lower farmgate prices for milk in S/E Australia.

9 Capital restructure

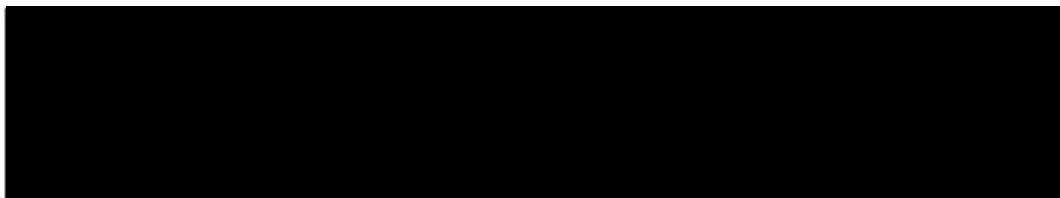
258. MG has undertaken a review of its capital structure to investigate the most effective and efficient capital structure which will permit it to invest in the capacity and capability of existing plant operations and capitalise on growth opportunities, particularly in emerging export markets. A core objective is to increase the return to MG's suppliers by at least \$1.00 per kilogram milk solids (more than \$0.07 per litre) over a five year period from 2012 to 2017. The restructure has been considered by a Board sub-committee which has met regularly during 2013. I am an ex-officio member of the sub-committee and have attended all meetings and have been central in the development of the new structure.

259. The principal objectives of the proposed restructure are to:

- (a) retain the co-operative structure and 100% Australian dairy farmer control of MG;
- (b) underpin MG's goal of an increase in farm-gate returns of \$1 per kg of milk solids (more than seven cents per litre) over a five year period from 2012 to 2017;

- (c) provide MG supplier/shareholders with an observable market price for their MG shares, consequently strengthening farm balance sheets; and
 - (d) provide access to additional sources of capital to meet the co-operative's investment plans and deliver improved returns.
260. The proposed restructure is subject to a comprehensive review process with supplier/shareholders and further development. MG is commencing a round of consultation meetings with its supplier/shareholders in December 2013/January 2014 with a further round in March 2014. Depending on the outcome of those meetings it is presently intended to put the proposed restructure to shareholders at an Extraordinary General Meeting in 2014.
261. It is not proposed that the capital restructure will change the co-operative structure of MG, or any merged entity created from the acquisition of WCB. As set out above, it is proposed that supplier shareholders will still retain control over MG or the merged entity. The co-operative principles on which MG presently operates will therefore not be able to be changed without the approval of supplier shareholders.
262. I believe that the benefits to supplier/shareholders from such a capital restructure will include:
- (a) the capital restructure will place MG in a stronger financial position to pursue growth opportunities, particularly in relation to export of dairy products. Growth opportunities will increase earnings which will in turn lift the return to suppliers;
 - (b) the restructure will assist MG to reduce its debt, also placing it in a stronger financial position; and
- the enhanced value placed on supplier/shareholder shares will provide them with potential access to funding from external lenders to grow their own businesses.
263. A copy of the letter provided to MG shareholders at the Annual General Meeting on 22 November 2013 explaining the proposed restructure is attached as **RAP61**.

264.



(a)

(b)



SIGNED by Robert Arthur Poole

A handwritten signature in blue ink, appearing to read 'R. Poole', is written over a horizontal line.

28 November 2013

Glossary of terms used in this statement

Term	Meaning
ACM	Australian Consolidated Milk.
Adelaide region	the region encompassing the Barossa mid north, Adelaide Hills, the Murray River flats and the Fleurieu Peninsula.
ASX	Australian Securities Exchange.
Bega	Bega Cheese Limited.
Board	the board of directors of MG.
Bonlac	Bonlac Supply Company.
Budget Milk Price	the estimated amount available for milk payments to farmers, divided by the estimated number of kilograms of milk solids.
Coles	Coles Supermarkets Australia Pty Limited.
Coles contract	a contract for MG to supply from July 2014 and for the next 10 years, pasteurised milk to Coles for its private label milk.
Constitution	the current constitution of MG, adopted on 28 November 2012.
CPI	consumer price index.
DFMC	Dairy Farmers Milk Co-operative.
DFSV	Dairy Food Safety Victoria.
EBITDA	earnings before interest, tax, depreciation and amortisation.

FMI	Flat Milk Incentive, described at paragraphs 206 to 207.
FNQ	Far North Queensland.
Fonterra	Fonterra Co-operative Group Limited.
Forecast Full-Year Price Range	the price range that MG determines farmers can expect to receive for their milk over the coming year.
General Milk Payment Terms	the document governing the Milk Payment System, comprising the Standard Milk Payment Terms and the Flat Milk Incentive Election Form.
GI	Growth Incentive, described at paragraph 208.
Kirin Holdings	Kirin Holdings Company Limited.
Longwarry	Longwarry Food Park.
MG	Murray Goulburn Co-operative Co. Limited.
Milk Payment System	the payment structure that applies to farmers located in S/E Australia who supply milk to MG.
Momentum Energy	Momentum Energy Pty Ltd.
Next Generation package	a package offered by MG designed to assist suppliers in establishing their business, developing their workforce and maintaining a sustainable business.
Next Generation Dairy Rebate	an investment rebate offered by MG for young farmers, farming families who wish to grow their business and new entrants to the dairy industry.
Norco	Norco Co-operative Limited.
Northern Region	the region encompassing north Victoria and the Riverina of southern New South Wales.

NSW-Sydney Milk Payment Terms	the pricing terms that apply to MG suppliers in central and northern New South Wales.
NV class shares	non-voting class shares.
Opening Price Circular	a document issued to farmers by MG that explains the base price for raw milk that will be paid to farmers for each month of that year (excluding step-ups, incentives and charges) and the Forecast Full-Year Price Range.
Parmalat	Parmalat Australia Pty Limited.
PI	Productivity Incentive, described at paragraph 209.
S/E Australia	the region encompassing Adelaide, Victoria (western Victoria, Gippsland and northern Victoria) and the Riverina of southern New South Wales.
Saputo	Saputo Inc.
Supplier Directors	directors who have been nominated to the Board by a specific supplier region.
Supplier Relations Committee	a committee established to perform the functions outlined in paragraph 70
UDP	United Dairy Power.
WCB	Warrnambool Cheese and Butter Factory Holdings Limited.
Western Region	the region encompassing South Australia and western Victoria.
Westpac	Westpac Banking Corporation.