27 October 2016 **ASX announcement**

Murray Goulburn announces completion of Milk Supply Support Package review

- Milk Supply Support Package (MSSP) review complete
- Package amended to improve outcomes for MG suppliers, balancing interests of all stakeholders and the future of MG
- MG announces a one off $81.8 million deviation from the Profit Sharing Mechanism (PSM) ($57.3 million post tax) comprising:
  - A $31.8 million impairment of the MSSP; and
  - $50 million in step-up payments to suppliers
- The step-up payments to suppliers in FY17 will total 2c/litre. This increases MG's forecast FY17 available FMP[1] to $4.95 per kgms.
- FY17 dividend/distribution to be paid as 100 percent of underlying net profit after tax (i.e. excluding impact of deviation) to ensure all investors are treated equally
- FY17 dividend/distribution to be fully franked, franking for FY18 is unlikely with partial franking anticipated for FY19
- Grant Samuel and Associates Pty Limited has provided an independent expert's opinion concluding the deviation is in the overall interests of suppliers (both as suppliers of milk and as shareholders) and unitholders. A summary of their opinion is attached to this announcement.

MSSP amended to assist suppliers

MG today announces that it has completed a review of the MSSP and has made a number of amendments to the MSSP in the interests of all MG stakeholders.

In April 2016 MG implemented the MSSP, which provided a $183 million advance to suppliers in recognition of the size and lateness of the reduction in the FY16 farmgate milk price (FMP). The intention of the program was to support suppliers' cash flow and protect MG's milk supply in the long term, with recoupment of the MSSP to occur over a three year period. However, substantial milk losses in the early part of FY17 have demonstrated that the MSSP was not operating as MG had originally intended and a review of the MSSP was warranted.

In early September 2016 MG announced that it was conducting a review of the MSSP. As part of this review MG examined a range of options with regard to:

- The expected future size of the co-operative's milk pool as Australia's leading milk processor
- Appropriate level of support to MG's vital suppliers
- MG's ability to pay a competitive FMP in the future
- Appropriate debt and gearing levels for the co-operative
- Best use of the co-operative's capital, including any impacts on MG's plans to invest in identified growth projects including the proposed nutritionals and beverages investments
- The overall interests of all stakeholders including supplier/shareholders and unitholders

[1] The Available Southern Milk Region FMP includes the add-back of quality adjustments accrued from the supply of non-premium milk.

As a result, MG has amended the MSSP as follows:

- Suspended MSSP recoupment in FY17 from 1 October 2016 in recognition of climatic conditions and low FY17 FMP (as announced on 20 October 2016)
- The recoupment period for the MSSP has been extended from three years to six years (i.e. to FY22)
- Annual recoupment is reduced to 1c/litre plus interest from 1 July 2017, but this is expected to be offset by cost savings. MG will retain the right to accelerate recoupment in high FMP years.
- Capped recoupment from suppliers, meaning recoupment from individual suppliers will not exceed individual support received in the FY16 year
- A $31.8 million impairment of the MSSP asset reflecting MG's estimate of future recoupment
- Step-up payments in FY17 to suppliers totalling approximately $0.25 per kgms

MG and the Board are of the opinion that these changes will address a number of suppliers' concerns. In addition, MG is confident that operational efforts, in particular the announced cost efficiencies, will ensure the co-operative can deliver a competitive FMP for suppliers. MG confirms the cost efficiency program is proceeding in line with expectations.

Chairman Philip Tracy said "I am pleased to announce the completion of our MSSP review today. We have announced step-ups and an increase to our available FMP forecast. MSSP recoupment will be extended over a greater period, with our cost efficiency program expected to offset the contribution from FY18. The annual MSSP recoupment has essentially been halved, and no supplier will repay more than the support they originally received. This should contribute to confidence for suppliers, particularly given our balance sheet strength has allowed us to undertake these initiatives."

Deviation from PSM

As part of the MSSP review, MG announces a deviation from the PSM of $81.8 million pre-tax ($57.3 million post tax). The two components of this deviation are:

1. Impairment of the MSSP asset of $31.8 million to reflect MG's estimate of future recoupment of MSSP
2. An amount of $50 million to cover the 2c/litre step-up payments to suppliers, as described above. MG believes this will support milk intake this year, given the greater input investment required by suppliers in current conditions.

The combination of these actions represents a deviation from the PSM, and will result in a reduction in MG's net tangible asset base per share/unit of $0.103. The Board, with the unanimous support of the Special Directors, were of the opinion that these actions are in the overall interests of all stakeholders by supporting milk intake in FY17 and the future. As required by the PSM, the decision is supported by an opinion from an independent expert, Grant Samuel and Associates Pty Limited. A summary of that opinion is attached to this announcement.

Chairman Philip Tracy said "We believe the announcement today will improve the MSSP impact for our suppliers. During the review process, the Board and I were very conscious of ensuring a successful future of the co-operative, a very important element of which is our planned investments in nutritional powders and dairy beverages. The announcement today preserves MG's ability to make these investments in the future, whilst maintaining prudent debt levels. We thank our suppliers and investors for their patience as we have worked through this review, and we now look forward to working together to rebuild our great co-operative."

- ENDS -

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About the MG Unit Trust

The MG Unit Trust is a special purpose funding vehicle which provides its unitholders with an economic exposure to the business of Murray Goulburn Co-operative Co. Limited (**Murray Goulburn**). The MG Unit Trust invests in notes and convertible preference shares issued by Murray Goulburn. The Responsible Entity of the MG Unit Trust is MG Responsible Entity Limited, a wholly-owned subsidiary of Murray Goulburn. Unitholders are entitled to receive distributions equivalent to any dividends paid to the ordinary shareholders of Murray Goulburn. Dividends paid on ordinary shares will be determined by Murray Goulburn in accordance with the Profit Sharing Mechanism described in Section 6 of the Product Disclosure Statement dated 29 May 2015. Units do not confer a direct interest in Murray Goulburn.

Murray Goulburn is Australia's largest dairy foods company and one of Australia's largest food and beverage companies with annual turnover of approximately 2.8 billion. Through its co-operative structure, Murray Goulburn has approximately 2,200 supplier shareholders. Murray Goulburn manufactures and markets a full range of dairy and nutritional products such as cheese, milk powder, butter and fat, drinking milk and liquid milk products, nutritionals and value-added products, such as infant formula. Murray Goulburn supplies the grocery, foodservice and ingredients channels domestically and around the world, particularly in Asia, with its flagship Devondale, Liddells and Murray Goulburn Ingredients brands.

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Murray Goulburn Co-operative Co. Limited –
Proposed Amendments to the Milk Supply Support Package

Introduction

The Directors of Murray Goulburn are considering a restructure of the Milk Supply Support Package ("MSSP") and other initiatives aimed at supporting Murray Goulburn suppliers and underpinning ongoing milk supply ("Proposal"). The key elements of the Proposal are as follows:

- no further deductions from milk payments for MSSP recoupments will be made during FY17[1]. MSSP recoupments will commence again in FY18. This initiative has already been announced;
- Murray Goulburn will limit the amount that it recoups under the MSSP from individual suppliers to the amounts advanced to each supplier;
- the MSSP asset will be impaired by $31.8 million, reflecting MG's estimate of future recoupment;
- the balance of the MSSP (an amount after the impairment of approximately $137 million) will be recouped over no more than five years, over the period 1 July 2017 to 30 June 2022, at an intended rate of one cent per litre. The Board will retain the right to recoup MSSP amounts at an accelerated rate in times of high milk price; and
- Murray Goulburn will augment milk payments for the current year by making step up payments to its suppliers of two cents per litre of milk. An initial payment of one cent per litre will be paid as a step up to the FY17 milk price, with the remaining one cent per litre to be paid as a final step up to those suppliers who are actively supplying Murray Goulburn at 30 June 2017. The aggregate cost of these payments is expected to be $50 million and will be funded from debt. If the cost is greater than $50 million, the excess will be paid from the DMP. These payments are expected to equate to approximately $0.25 per kilogram of milk solids ("kgms").

The Proposal will involve deviations from the terms of the Profit Sharing Mechanism Deed (collectively, a "Deviation"). Essentially, these deviations involve exclusion of the $31.8 million impairment from the calculation of the DMP and the payment to suppliers of an amount not exceeding $50 million over and above the amounts that would otherwise be payable for milk price under the Profit Sharing Mechanism.

The Directors of Murray Goulburn have engaged Grant Samuel & Associates Pty Limited ("Grant Samuel") to provide an independent opinion in relation to the Proposal.

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[1] FY17 refers to the financial year ending 30 June 2017. FYXX refers to subsequent financial years ended 30 June 20XX.

Opinion

The MSSP achieved one of its primary objectives, in that it allowed Murray Goulburn to deliver meaningful milk payments to suppliers across the closing months of FY16. However, the commencement of the recoupment of amounts advanced under the MSSP, through deductions from milk payments, has meant that Murray Goulburn has been unable to pay a competitive milk price so far during FY17. The impact on Murray Goulburn's suppliers has been exacerbated by low commodity prices and poor seasonal conditions.

The consequence for Murray Goulburn has been a material loss of milk volume. Murray Goulburn has lost approximately 375 million litres (net) of milk (on an annualised basis) or around 11% of its total milk supply as a result of losing suppliers to competitors and the retirement of suppliers from the industry. Murray Goulburn expects to lose an additional 10% of milk supply in FY17 due to production curtailments by ongoing suppliers, predominantly on account of adverse seasonal conditions. Competition for milk supply has been heightened by the industry wide fall in milk production and the resulting availability of surplus milk processing capacity.

In the absence of some "circuit breaker", Murray Goulburn will continue to be unable to pay a competitive milk price (conceivably through to FY19), which can be expected to result in further losses of milk supply. Fixed manufacturing and corporate costs represent a significant proportion of Murray Goulburn's overall cost structure. Accordingly, any further losses of milk supply will result in a disproportionate reduction in the DMP and put further downward pressure on the milk price. In turn, this is likely to lead to further loss of milk supply. The risk for Murray Goulburn is that the current position deteriorates into a downwards spiral that permanently compromises its milk pool and significantly reduces Murray Goulburn's equity value.

The structure of the MSSP has accentuated the challenges facing Murray Goulburn. Suppliers who leave Murray Goulburn (whether to competitors or through leaving the industry altogether) also leave behind their share of the MSSP. This is a continuing incentive for suppliers to leave Murray Goulburn. It makes it exceedingly difficult for MG to attract new supply, as new suppliers will effectively assume a share of the MSSP.

In this context, it is critical that Murray Goulburn takes prompt and decisive action to demonstrate its ability to pay a competitive milk price, regain supplier confidence and arrest the decline in milk supply.

The combined impact of the suspension of MSSP recoupment for the remainder of FY17 and of the two cents per litre step up payments will be to increase Murray Goulburn's milk price for FY17 by an average of approximately $0.34 per kgms. Based on current milk prices across the industry, the increase will allow Murray Goulburn to at least match the milk price of most (although not all) of its competitors. The ultimate impact of this increase on Murray Goulburn's competitive position will depend in part on competitor response, as well as other external factors. However, it will clearly position Murray Goulburn to pay a competitive milk price for the balance of FY17.

Judgements regarding Murray Goulburn's competitive position for FY18 and subsequent financial years are subject to more uncertainty. The recoupment of the MSSP receivable over six years rather than three years and the $31.8 million MSSP impairment should collectively reduce the impact of MSSP recoupments on the FY18 milk price by around $0.15 per kgms, from $0.32 to $0.17 per kgms. At the same time, Murray Goulburn's continued "cost out" program is expected to generate annual savings of around $55 million, with incremental savings in FY18 of approximately $32-47 million, or around $0.16-23 per kgms. This should largely off-set the competitive disadvantage constituted by the continuing MSSP recoupment (at least to the extent that the savings exceed the savings that competitors are able to achieve). Furthermore, the limiting of MSSP recoupment to amounts originally advanced to suppliers will reduce the incentive for suppliers to leave and make it easier to attract new supply.

Overall, in Grant Samuel's opinion, the Proposal should materially assist Murray Goulburn in paying a competitive milk price and, in turn, arresting Murray Goulburn's ongoing loss of milk supply. The actual impact on milk supply, however, will reflect a variety of factors, including the competitive response of other milk processors, commodity prices, seasonal conditions and other external factors. Murray Goulburn's success in reducing its cost base is likely to be key to its ability to pay a competitive milk price in FY18 and beyond.

Most importantly, the impact of the Proposal on milk supply (in the short term at least) will be based as much on supplier perception as on the reality of Murray Goulburn's competitive position. Accordingly, clear and compelling communication to suppliers will be essential if the Proposal is to successfully deliver its objective of arresting the loss of milk supply.

The $31.8 million impairment of the MSSP and the $50 million of step up payments represent (on one view) a transfer of value from shareholders and Unitholders to suppliers. On a tax-effected basis, the Proposal will result in a reduction in NTA per share and NTA per Unit of approximately $0.10. The $81.8 million of aggregate cost ($57.3 million tax effected) will effectively be funded by an increase in net debt. At current interest rates, the annual interest expense on this additional debt will be of the order of $2.1 million. This $2.1 million cost will be included in the calculation of DMP and so will largely be borne by suppliers. Based on current farmgate milk prices, shareholders and Unitholders will collectively bear less than 5% of this additional interest expense. Accordingly, the effect of the Proposal on dividends to shareholders and distributions to Unitholders should be negligible. Overall, in Grant Samuel's view, the adverse impact of the Proposal on the value of shares and Units should not be material. Almost certainly, any reduction in the value of Murray Goulburn shares and Units will be far less significant than the potential loss of equity value that could result if the ongoing loss of milk supply was to continue.

Murray Goulburn's modelling shows that, notwithstanding that the aggregate $81.8 million cost of the Proposal ($57.3 million on a tax-effected basis) will effectively be debt funded, Murray Goulburn's total debt will remain well within facility limits and Murray Goulburn will continue to comfortably comply with all debt facility covenants. In Grant Samuel's view, the Proposal should be viewed by Unitholders and market participants generally as a broadly appropriate and proportionate response to Murray Goulburn's current position in relation to milk supply.

There are numerous potential alternatives that could incorporate some or all of the elements of the Proposal (a partial impairment of the MSSP, an extended time frame for recoupment and some form of upfront step up payment or other milk price subsidy) to varying degrees and in varying proportions. Grant Samuel is not aware of any such alternative that is clearly superior to the Proposal, having regard to the interests of the different stakeholders in Murray Goulburn. Murray Goulburn has also considered more radical solutions, including an immediate full write off of the MSSP receivable. In Grant Samuel's view the Proposal is on an overall basis superior to such an outcome, having regard to the interests of both suppliers and equity holders, after taking into account factors such as the immediate uplift in milk price, the likely impact on Unit and share values, the effect on Murray Goulburn's gearing and other relevant matters.

Accordingly, in Grant Samuel's opinion:

- **Murray Goulburn's current circumstances warrant deviation from the Profit Sharing Mechanism Deed to protect MG's milk supply and profitability and to support its supplier base; and**

- **The Proposal, including the Deviation, is in the overall interests of Suppliers (both as suppliers of milk and as Shareholders) and Unitholders.**

Other Matters

The Proposal is the responsibility of the Directors of Murray Goulburn. Grant Samuel's role is limited to the expression of the opinion set out in this letter and is expressed purely for the benefit of the Directors of Murray Goulburn in their consideration of the Proposal. Grant Samuel does not accept any responsibility to any other party or for any other purpose.

The impact of the Proposal will depend not only on the terms of the Proposal but also on other factors such as the success with which Murray Goulburn communicates the Proposal to its suppliers and other stakeholders, the competitive response of other industry participants, other external factors (commodity prices, weather, etc), and Murray Goulburn's ability to deliver its planned cost saving initiatives. To the extent that these issues are capable of being managed or controlled, such management and control is the responsibility of the Directors and management of Murray Goulburn and Grant Samuel accepts no responsibility in this regard.

This letter has been prepared without taking into account the objectives, financial situation or needs of individual suppliers, shareholders or Unitholders. It is a matter for individual Unit Holders as to whether to buy, hold or sell units in the Murray Goulburn Unit Trust and for individual shareholders as to whether to increase or reduce their shareholdings in Murray Goulburn. These are investment decisions upon which Grant Samuel does not offer an opinion. Grant Samuel takes no responsibility for any decisions made by Unit holders or shareholders in relation to these investment decisions. Unit Holders and Shareholders should consult their own professional advisers in this regard. Similarly, decisions in relation to the supply of milk to Murray Goulburn are matters for suppliers and potential suppliers. Grant Samuel does not offer any opinion in relation to these decisions and takes no responsibility for any such milk supply decisions.

The opinion is made as at the date of this letter and reflects circumstances and conditions as at that date.

Yours faithfully
GRANT SAMUEL & ASSOCIATES PTY LIMITED