

11 November 2013

The Manager – Companies

ASX Limited Company Announcements

For release to market

UPDATE ON THE DAIRY FARM PROJECT

APA Financial Services Limited (APA or the Company) has previously advised shareholders of a proposal to aggregate and operate dairy farms in Victoria (Proposal) subject to shareholder approval and re-compliance by the Company with Chapters 1 and 2 of the ASX Listing Rules.

This announcement is to provide an update to the market about the status of the Proposal.

Since the announcement by the APA board of its interest in Australian Dairy in late 2012 with the intention of using the company as an ASX listed vehicle to progressively become a major Australian **Producer of Milk**, there have been a number of significant positive market events in the industry.

These relate to the **Processing of Milk** sector of the Australian Dairy Industry which has reinforced the initial views of the board in deciding to fully review the opportunity. A summary of these events is as follows:

- **Fonterra float:** World's largest dairy exporter floated on NSX with strong international participation and continued market support;
- **Synlait float** a second NZ processor and farm owner/operator floated successfully on NSZ. Currently weighing international bids for its dairy farms assets;
- **Victoria's Bega Cheese** announced a takeover offer for competitor **Warrnambool Cheese and Butter** takeover bid, rapidly bringing additional stronger bids from Australian and international parties including **Murray Goulburn**, Canada's largest milk producer **Saputo Group**, plus **Fonterra** and Japan's **Kirin group**

In particular, the competitive takeover action underway by most of Australia's export oriented **Processors**, and two major international market participants, has underlined the global significance of the interest in Australian Dairy.

The significant positive aspect of the recent activity is that Milk Processors need Milk Producers and compete strongly for fresh milk supply. Unlike other milk producing and exporting countries, Australian Milk Processors have minimal investment on the Milk Production side of the supply chain. APA Directors see this as the opportunity, strongly supported by growing global demand, which according to international forecasts is unlikely to be able to be supplied fully over several decades.

Background

In November 2012 the directors advised the ASX that APA had entered into a heads of agreement, which subsequently expired, with companies associated with NZ based Dairy Farm Investments (Management) Ltd to acquire, manage and operate a planned

aggregation of Australian dairy farms. This envisaged using an unlisted property trust structure to be established to acquire Victorian dairy farms to be operated by APA in conjunction with Dairy Farm Investments (Management) Ltd.

The business strategy was to progressively increase the number of farms under ownership, lease or management to optimise the financial returns of investors through the following broad outcomes:

- (a) obtaining premium farm gate prices currently paid by processors to farmers who produce high annual volumes of milk;
- (b) generating cost savings from efficiencies in both operating and overhead costs through shared farm management and combined purchasing power; and
- (c) increasing volume and quality production through application of sound agronomy, pasture management, genetic improvement and breeding techniques and the capacity for livestock mobility between properties for seasonal location advantages.*

Progressively increasing scale in terms of numbers of farms and milk production volumes provides **the Producer** with significant sales and price leverage from supplying milk to **Processors** which compete to fulfill existing factory capacity or meet rapidly growing global demand for milk products. Forecast demand globally over the next several decades substantially exceeds forecast supply growth, particularly from growing wealth populations in Asia.

In February 2013 the **Dairy Farm Investments Trust** was established as the intended property holding entity with Trustees Australia Limited, an associate of APA director Michael Hackett as the trustee. The Dairy Farm Investments Trust completed the purchase of its first farm in June 2013 and has contracted to acquire the adjoining farm owned by NZ company Dairy Farm Investments (Brucknell) Limited. The contract is subject to several conditions precedent including a successful capital raising in APA and re-compliance by APA with Chapters 1 and 2 of the ASX Listing Rules.

Stapled Security

During the intervening period, the Company and DFI Management Pty Ltd reviewed the project structure and formed the view that, for at least the first stage of the Dairy Farm Aggregation Project, the most appropriate structure is a single listed entity or security which includes all business activities and common investor interests.

It has been agreed to combine the property and operating assets, including livestock into a **single ASX listed security**, while also retaining separate entities to hold the real property assets (**Dairy Farm Investments Trust**) and to operate and manage the farms and own the livestock (**DFI Operations Pty Ltd**, 100% subsidiary of APA).

The structure agreed provides a **single listed stapled security** comprising a property trust and an operating company which have their respective securities stapled together for the purpose of ASX listing. Therefore the proposed ASX listed security comprises one share in APA (renamed as Dairy Farm Investments Limited; ASX code reserved: DFI) and one unit in the Dairy Farm Investments Trust. This is similar to stapled securities of some listed property groups. The documentation of this structure is advanced and APA will be providing material for ASX review shortly.

The Directors believe a DFI Stapled Security for the Dairy Aggregation Project provides benefits in being able to pool all revenues and costs of both property and operational entities into the single listed group.

It retains considerable flexibility in the early stages of building scale in numbers of farms while also minimizing future transaction costs in the event that the greater capital growth requirements of the property entity in the longer term make a future “un-stapling” of the entities, a more efficient structure for different investor profiles.

New Aggregation Agreement

A revised agreement regarding the change of activity to include dairy farm ownership and operation between APA as the farms operator, Trustees Australia limited as the trustee and future responsible entity of the Dairy Farm Investments Trust, and the Farm Manager, DFI Management Pty Ltd was executed by APA recently in November 2013.

The agreement, which provides for the restructure of APA’s existing capital is subject to several conditions precedent customary for a transaction of this nature including raising significant additional capital, which will require the approval of a special general meeting of APA’s existing shareholders on a date to be confirmed in the near future by notice of meeting.

If the proposals to be put to that meeting are approved and the project proceeds, APA’s future activities will focus on **Production of Milk**. This will represent a significant change in the activities of APA, which will require the ASX listing of APA’s shares to be suspended from trading until APA raises the necessary capital and re-complies with Chapters 1 and 2 of the ASX Listing Rules.

Note that these matters are not on the agenda of the Company’s upcoming Annual General Meeting scheduled for 27 November 2013. A separate General meeting is intended to be convened once the Notice of Meeting and offer documents are complete and negotiations with brokers and investors are finalized. The directors are not currently in a position to provide an accurate timetable given the proximity of the Christmas holidays and their potential impact on timing. APA will provide an update as soon as possible.

The directors believe that the Dairy Aggregation Project has realistic potential to gain shareholder and market support for the capital raising necessary to undertake the project and to return the restructured group to a profitable and cash flow positive listed group with sound prospects for growth.

Notwithstanding this view by the directors, shareholders and potential investors should wait until they receive and have read the detailed notice of the upcoming special general meeting and the associated prospectus for the capital raising, before forming a view themselves about the merits of the project.

For any further enquiries regarding this announcement please contact the writer.

APA FINANCIAL SERVICES LIMITED

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