Discussion Paper 01:
Murray Goulburn Financial Year 2012/13 Record Borrowing and Escalating Debt

Question 1: Is Murray Goulburn in a better financial position since 2010/11?
Answer: No in fact the situation has deteriorated significantly.
Reason: Borrowings (Annual Reports)

- 30 June 2011 $356 million
- 30 June 2012 $458 million
- 30 June 2013 $530 million

Total increased borrowing over the last two years $174 million.

Current Projects (2012/13 Annual Report):

- $120 million state of the art milk processing plants in Sydney and Melbourne to supply Coles' brand milk (Coles currently retailing at $1.00 per litre).
- $19.1 million UHT facility at Leongatha
- $5 million butter packing line at Koroit
- $5 million cheese cut and wrap facility at Cobram

Capital and leasing commitments 2013/14:

- Capital expenditure $157.5 million up 158% from $61 million, leasing $42.5 million up 20% from $35.4 million (Note 26, Annual Report 2012/13)
- Increased borrowing $174 million (since 2011) plus capital commitment 2013/14 of $157.5 million = $331.5 million (not taking into account increased leasing costs) = **$138,100 per MG farm** (based on 2,400 farms) = record ever level of funding even without WCB.

New commitment: $533 million to buy Warrnambool Cheese & Butter **(additional $222,100 per farm).**

Question 2: How is MG's record increased borrowing going to be funded?
Answer: Mainly bank finance offset mainly by lower milk price

Question 3: Does off loading $500 million to investors reduce debt?
Answer: Yes but it does not improve the cost of borrowing.
Reason: Investors require an incentive to invest based on an expected return on investment above the cost of bank finance.

Key Question 4: The true litmus test: If MG was a business or listed company would the banks fund MG's increased borrowing with $500 million to be offset by capital raised from investors?
Answer: MG's balance sheet does not support it. (Ask your accountant)

Question 5: Then why are the banks, to quote MG so "comfortable about lending $533 million to buy Warrnambool Cheese & Butter"?
Answer: Banks love lending co-operatives money and the more the better.
Reason:

- It is a no risk and only a win situation for banks:
- Bank finance costs can always be recovered from lower milk prices to farmers.
- If the co-op looses competiveness on milk price and farmers leave to competitors then the banks make even more money from compound interest until the co-op is sold leaving little or nothing for the farmer shareholders. **This is exactly what happened Bonlac in 2003**

Question 6: What are other warning signs?
Answer:

- When valuable assets start being sold and leased back to "free up dead capital to invest in the future". (e.g. a good example would be if MG starts selling and leasing back their warehouses and distribution centres.)
- Selling assets to free up working capital and leasing back is exactly what happened to Bonlac during the late 1990's. The Managing Director at the time called it "Investing in the future"

Remember, Bonlac's Board enthusiastically supported the Managing Director's "investing in the future" but excessive debt and crippling interest costs destroyed their ability to compete for milk. Farmers moved to competitors and a great dairy farmer owned co-op, once bigger than Murray Goulburn was lost overseas to Fonterra NZ.

Question 7: Is there a serious danger of seeing a repeat of Bonlac's demise where the banks win and the farmers loose?

Answer: Potentially yes and that is why the above needs to be fully debated as debt can very quickly pass the point of no return.

The recently suggested share value of $3.00 per share could end up being worth nothing. Bonlac farmers never had the opportunity to have this debate before it was too late.

This entry was posted on December 15, 2013 by Barry Crumps.