Discussion Paper: 03

Murray Goulburn Financial Year 2013/14: Increasing costs, massive increase in debt and uncompetitive milk price raises serious concerns over future survival (another Bonlac)

1. **Revenue up 22.3%**

MG Sales Revenue (millions)	2013/14	2012/13	Difference	%
Sales Revenue	2,916.5	2,385.1	531.4	22.3

- Increase in Sales Revenue was due to record international prices not from good management. (Warrnambool Cheese & Butter also recorded a similar 23% increase in revenue.)
- Record international prices generated record profits and farmgate prices for everyone but Murray Goulburn

2. **Lowest average milk price to farmers**

MG Paid The Lowest Average Milk Price	Per kg milk solids	Per litre	Cents per litre more than MG	$ million per 3,400 million litres
Murray Goulburn	6.81	51.10		
Fonterra (Australia)	6.95	52.15	1.05	35.7
Warrnambool Cheese & Butter	7.00	52.50	1.40	47.6

- MG farmers would have gained an extra $35.7 million if paid Fonterra's price.
- MG farmers would have gained an extra $47.6 million if paid WCB's price.
- MG's milk price is falling behind competitors so how does MG expect to grow their milk intake.

3. **Serious deterioration in profit (underlying profit $2.8 million)**

MG Profit (millions)	2013/14	2012/13	Difference	%
Declared Profit	29.3	34.9	-5.6	-16
Net gain from sale of Integrated Logistics Centre (note 2)	26.5			
Profit without sale of Integrated Logistics Centre	**2.8**	**34.9**	**-32.1**	**-92.1**
Dividend paid on ordinary shares (cents per share)	0.08	0.13	**-0.05**	**-38.5**

- Profit has been boosted through the sale of the Integrated Logistic Centre (ILC).
- MG's underlying profit (without the ILC sale) was only $2.8 million (on a turnover of $2,916.5 million).
- It explains why there was a 38.5% reduction in the farmers' dividend (see point 5).

4. **Investments in Associate Companies into loss (-$12 Million)**

Investments in Associate Companies (millions)	2013/14	2012/13	Difference
Share of profit (loss) of associates after income tax (note 13)	-10.9	0.8	-11.7

- Investments in associated companies (e.g. Intermix, Danone, Progenex, MGM) have gone from a profit into loss.

5. **Underlying Retained Earnings (-$24.3 million on last year)**

Underlying Retained Earnings (million)	2013/14	2012/13	Differenc
Balance at the end of the financial year	**287.1**	**233.9**	**53.2**
Net gain from the ILC sale (note 2)	-26.5		
Before tax net profit from WCB shares (note 11)	-51.0		
Underlying Retained at the end of the financial y	**209.6**	**233.9**	**-24.4**

- The before tax net profit from the WCB shares has been bundled in as part of the $54.1 million transferred from reserves (net of tax) note 24.
- Underlying Retained Earnings of $209.6 million is a significant deterioration when the one-off sales are taken into account.

6. Costs increasing not reducing (+$49 Million)

Costs (million)	2013/14	2012/13	Difference	%
Distribution	152.7	143.5	9.2	6.4
Sell & Marketing expenses	73.7	53.9	19.8	36.8
Administration expenses	58.3	49.7	8.6	17.2
Finance costs	27.2	28.0	-0.8	-2.9
Other unspecified expenses (WCB takeover?)	20.8	9.0	11.8	130.2
Total	**332.7**	**284.2**	**49.3**	**17.4**

- Management is misleading when they say they are "continuously driving down costs".
- It is not in the financial accounts or the milk price where it matters most!

7. Massive increase in off balance sheet debt (+$360 million)

Leasing (million) (note 26)	2013/14	2012/13	Difference	%
Due within 1 year	42.7	10.0	32.7	77.1
Due within 1-5 years	145.5	21.3	124.2	292.5
Due longer than 5 years	148.7	11.2	137.6	324.0
Total	**336.9**	**42.5**	**294.5**	**693.6**
Rental expenses on operating leases (note 3)	**22.6**	**10.7**	**11.9**	**111.0**
Grand Total	**359.5**	**53.2**	**306.3**	**576.1**

- Leasing costs (not shown as part of the balance sheet) has gone from $53 million to $360 million (+$306 million).
- This is actually an increase debt.
- The **"crown jewel asset "** Integrated Logistic Centre was sold for cash and leased back (reportedly for 20 years at a 6.72% yield according to property consultants Urbis).
- There is no provision or options to buy back any of these leased assets at the end of the lease (see note 26).
- They are permanently lost.
- The 80,000 square metre warehouse/distribution centre is now an expensive lease back at an estimated cost of $6.2 million per year (based on the 6.72% yield).

8. No effective attempt to reduce debt (Borrowings up $800,000)

Borrowings (millions)	2013/14	2012/13	Difference
Current liabilities	149.9	205.5	-55.6
Non current liabilities	380.9	324.5	56.4
Total	**530.8**	**530.0**	**0.8**

- There is no evidence of any effective attempt to reduce debt and when off-balance sheet lease debt is included it is actually increasing rapidly to dangerous levels!
- **Borrowing on balance sheet $530.8 million plus off-balance sheet $359.5 million lease liabilities means total debt is now jumped to $890.3 million**!
- Management has been a history of increasing debt (see saveaussiefarmers.com Discussion Paper 01)
- MG is asking farmers to contribute towards another $500 million to spend.
- Whenever was there justification to try and buy WCB for over $550 million using bank loans?
- The proposed funding by banks involves paying interest on loans.
- The financial accounts suggest this was impossible to deliver without a further serious reduction in the farmgate milk price**.**
- Management is misleading to suggest they have already achieved the *"underlying profit by 30-40 cents per kg milk solids"* and "*we are well on the way to achieving $1.00 per kg underlying profit by 2015/16".*
- If underlying profit has increased by 30- 40 cents per kg of milk solids why is MG paying the lowest milk price?
- The financial accounts suggest the underlying profit has deteriorated not improved

9. One off Earnings (77.5 million)

One-off Earnings (million)	Sold	Cost	Net Gain
Sale International Logistic Centre (note 2)	96.4	69.8	26.5
Sale WCB Shares (note 11)	92.9	41.9	51.0
Total	**189.3**	**111.8**	**77.5**

- The $29.5 million profit was only achieved by including in the Profit and Loss the $26.5 million profit from the ICL sale. (The profit from WCB shares was not included in the P&L only in retained earnings - note 11)
- It should also be pointed out that management in the Weekly Times on the 3/9 claimed MG could have paid a higher milk price!
- The financial accounts show a completely different story; in fact it can be argued MG paid too much.
- Remember any increase in milk price would have simply increased debt.

10. Cash Flow From Operating Activities (-$69.0 million)

Capital Expenditure (million)	2013/14	2012/13
Net cash flow from operating activities	-69.0	117.6

- MG historically generates a positive operating cash flow, whether prices are up or down.
- This year MG paid out to suppliers and employees more than it received from customers and entered into dangerous negative cash flow territory by spending more than earnings in the ordinary course of business.

11. Remuneration Report 2014 (Item 6 Annual Report)

- How does the board justify approving managements "Short Term Benefit" $3.9 million bonuses?

12. Committed Capital Expenditure (-$137 million)

Capital Expenditure (millions)	2013/14	2012/13	Difference
Capital Expenditure Commitments due within one year	20.4	157.5	-137

- Contracted capital of $160 milk plants ($40 million above budget) can be seen in the 2012/13 accounts.
- Committed capital for 2014/15 is only $20.4 million.
- Where is the future funding for promised projects? It is not in the financial accounts.
- The level of capital expenditure is significantly greater than depreciation in the accounts therefore it is being funded totally by increasing debt.
- Depreciation is reducing because now everything is leased. Increased leasing will see MG generate less positive cash flow.
- There is no underlying increase in retained earning that could fund capital expenditure.
- The level of capital expenditure is continuing grow.
- MG management is promising (gambling) that increased capital expenditure will generate sufficient profit to cover increased debt and higher farmgate milk prices. If they don't farmers will loose their co-operative.
- There are so many unknown factors including future fluctuations in international price, future interest rates (currently historically low) and future exchange rates.
- There is general assumption international demand for dairy products will continue to exceed supply and will always hold prices up.

13. Press releases:

Murray Goulburn Media Releases

	Date	Media Release	Cost (million)	Leongatha	Edith Creek (Tasmania)	Koroit	Cobram	NSW	Victoria	Time Frame
1	08-Aug-12	MG planning $200 million investment to support growth in higher value dairy food products	200.0	Double capacity to 500 million litres		Increase consumer butter capacity to 20,000 mt	Highly automated cheese cut & wrap			Next 3 years
2	03-Apr-13	MG invests $19.1 million in Leongatha	19.1	Lift UHT capacity to 70 million litres						Dec-13
3	10-Apr-13	Devondale enters daily pasteurised milk market to boost farmer returns	120.0					Budget 120 million (blew out to 160 million)		Jun-14
4	02-Aug-13	Koroit upgrade to meet growing dairy nutrition demand	2.5			50,000 mt Growing Up Milk Powders (GRUMPs) over 5 year agreement with Danone				No date mentioned
5	02-May-14	Devondale Murray Goulburn invests $127 million in new dairy future	127.0		Flexible cup and bottle filling line (cost $14 million)	Infant formula nutritionals (cost $38 million)	Highly automated cheese cut & wrap (cost 74 million)			within 12-18 months (Jul-Dec 15)
7	20-May-14	$91 million investment brings world leading technology to Cobram	91.0				Highly automated cheese cut & wrap (cost 74 million), Optimising capacity for nutritional products (cost $17 million)			within 12-18 months (Jul-Dec 15)
8	23-May-14	$19 million Koroit Investment to boost export capacity	19.0			increase capacity to produce nutritional products				May-15
9	11-Jun-14	MG's $14m Tasmanian Investment support dairy food innovation	14.0		Flexible cup and bottle filling line (cost $14 million)					Mid-15

- There is no significant investment achieved outside of $120 million (sorry $160 million) to supply the Coles' 200-million litre contract at the very bottom end of the Australian market (retailing milk at $1.00 per litre).
- Financial accounts for the last two years highlights a disparity between rhetoric and performance (see Discussion Paper 01 Review of 2012/13).
- There is insufficient profit generated or debt reduction or further assets to sell to fund any of the other major projects often repeatedly announced in "Press Releases" dating back to 2012.
- There is no evidence management can meet a major project on budget or on time. (Milk plants 33% above budget.)
- MG has a mothballed a modern cheese factory at Leitchville with a capacity of 30,000 tonnes.
- MG is unable to keep their powder dryers full at Rochester yet wants to invest in further spare capacity?
- Farmers are being asked to contribute towards the $500 million capital raise to fund projects on a management "promise" it will generate a better farmgate price.
- The "promise" should be measured against the declining competiveness in farmgate milk price and selling assets and shares to prop up profits.
- Farmers have been told their current $1.00 per share is likely to increase to $3.00.
- Share prices are determined by the profitability of a company and the accounts just don't show it.
- Farmers should invest in growing milk production not fund a co-op they already own that sells assets and spend without any regard to profit (Financial Review 8th July 2014 "*The skinny on MG and Coles milk deal*").
- The massive increase in debt and capital raise to increase capacity is based on the fairyland premise that Australia is going to increase milk production over 10% per year to 15 billion litres within five years. (Milk production July 2014 up 1.5%.)

14. Milk Intake

Milk intake (million litres)	2013/14	2012/13	Differenc
MG	3,400	3,200	200
Warakirri Dairy	60		
Mainly from Lion NSW & Victoria (Lion lost Coles'	140		
Net	**3,200**	**3,200**	**200**

MG required an extra 200 million litres to meet the Coles contract starting July 2015. The build up for the 200 million litres was achieved by:

- A secret deal with Warakirri Dairy for 60 million litres contracted at a price well above offered by WCB or Saputo who regarded it as totally unworkable. The milk price was not available to any regular MG suppliers.
- NSW and some Victorian suppliers loosing Lion as a processor had no option but move.
- NSW suppliers have been contracted at $7.20 per kg milk solids (54.2 cents per litre) *see MG 24 July 2014 circular "NSW-Sydney Milk Region*". Who in the chain can make any profit processing, packaging, distributing and retailing milk at $1.00 per litre?
- The total 200 million litres gain will not be going into any value added products in 2014/15. It is required to supply the Coles' 200-million litre contract at the very bottom end of the Australian market.
- *(How much smarter was Fonterra selling a factory they already own to fund their 49% share of a joint venture with a major Chinese infant formula company accessing 80,000 retail stores. It will move 100,000 mt of Fonterra's Australian powder to the very top end of the value added chain.)*
- How does MG expect to grow milk intake when it is falling behind competitors on milk price.

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 to overseas ownership (Fonterra NZ).