Discussion Paper 04:
Murray Goulburn July-December 2014 Financial Results

1 Minor decline in sales revenue (0.7%)

Sales Revenue ($ million)	2014	2013	Change	%
Sales Revenue	1,330.1	1,339.3	- 9.2	- 0.7

- Sales revenue is down only 0.7% but most of July-December 2014 sales were contracted during April-June before the collapse of international prices during July-December 2014.
- Holding sales revenue January-June 2015 will be a challenge as international prices are still well down on the previous financial year.

2 Milk intake (+129.9 million litres)

Milk Intake Jul-Dec (million litres)	2014	2013	Change	%
Milk intake	2,039.9	1,910.0	129.9	6.8

- The 129.9 million litres (+6.8%) milk increase against a 2.6% increase in Australia's milk production was helped by the inclusion of milk from the Victorian and NSW's milk plants for first time.

3 Competitive milk price

- MG's average milk price of $6.00 per kg milk solids (44 cents per litre) has underpinned the Australian market but at the expense of profit, increased borrowings and reduced equity of the business.

4 Profit sacrificed to support milk price (-$63.5 million)

Profit (million)	2014	2013	2012
Before tax	13.6	77.1	53.8
Tax	- 0.6	- 16.3	- 2.1
Profit after tax	**12.9**	**60.8**	**51.7**
Profit	**-47.9**	**9.1**	
	-78.8%	**0.9%**	

- 2014 sales revenue is similar to 2013 but the pre-tax profit is down $63.5 million (after tax $47.9 million).
- The $6.00 per kg milk solids price is at the expense of prudent profit retention.
- Moving profit into the milk price is good for farmers but not for potential investors in the Unit Trust ASX listing.

5 MG is forecasting 2014/15 a similar profit to 2013/14 ($29.3 million)

Profit (million)	2014/15	2013/14
July-December	12.9	60.8
January - June	16.4	- 31.5
Profit	**29.3**	**29.3**

- To meet 2014/15 forecast MG must find $16.4 million after tax profit during January-June 2015.
- Another big challenge as dairy companies including MG normally make most of their profit in the first half of the season and profit reduces during the second half.

6 Increasing costs

Costs ($ million)	Interim Financial Report For Half Year Ending 31 December 2014		Interim Financial Report For Half Year Ending 31 December 2013	
	2014	2013	2013	2012
Distribution	82.0	71.6	61.2	61.6
Marketing expenses	41.5	47.7	23.0	12.3
Administration expenses	28.9	25.9	52.0	45.1
Finance costs	14.3	15.4	14.5	13.5
Other unspecified expenses	9.0	14.5	15.4	6.2
Total	**175.6**	**175.2**	**166.1**	**138.7**
Cost increases	**0.4**	**9.1**	**27.4**	

- The December 2014 interim report shows a $9.1 million increase in 2013 costs as a correction between reports.
- The adjustment reduces the 2014 cost increase from $9.5 million down to a minor $400,000 increase.
- The 2014 interim accounts also reports administration costs 2013 decreased 50% from $52 million down to $25.9 million by redistributing 2013 administration costs into marketing and distribution.
- The redistribution hides increasing administration costs and makes it impossible to establish increases since the new management took over in 2011/12.
- The changes were made without any explanation or qualification suggests the figures have been manipulated to improve the July-December 2014 report ahead of the proposed $500 million unit trust capital raise via ASX.

7 The Financial Statements still fails to show the claimed $100 million cost reductions ("driving down costs")

Costs Changes ($ million)	Total	Jul-Dec 2014	2013/14	2012/13
Distribution	**15.4**	10.4	9.2	-4.1
Marketing expenses	**44.3**	-6.2	19.8	30.7
Administration expenses	**-5.6**	3.0	8.6	-17.1
Finance costs	**0.4**	-1.1	-0.9	2.4
Other unspecified expenses	**-26.1**	-5.5	11.8	-32.4
Total	**28.3**	**0.4**	**48.5**	**-20.6**

- In 2011/12 farmers were promised $100 million cost savings in the first year (by the end of 2012/13).
- Since 2011/12 costs have actually increased $28.3 million.
- Cost savings of $100 million cannot be seen in any of the audited financial statements since 2011/12.
- Farmers want to know exactly where in any of the financial statements over the last three and a half years is the claimed $100 million cost savings?

8 Record stock holdings at the end of December 2014 (+117.3 million)

Inventories ($ million)	2014	2013	2012
July-December	633.5	516.2	471.7
Increase	**117.3**	**44.5**	
	22.7%	**9.4%**	

- Record end of December stocks suggests difficulty selling or gambling on selling later at higher returns.

9 Increased borrowings July-December 2014 (+$169.6 million)

Borrowings (million)	2014	2013	2012
Current liabilities	394.0	330.2	242.1
Non current liabilities	376.7	271.0	353.7
Total	**770.8**	**601.2**	**595.9**
Increase	**169.6**	**5.3**	
	28.2%	**0.9%**	

- Increasing borrowings to cover increased spending and costs.
- The July-December financial accounts do not report the off balance sheet debt.
- Assets have been sold and leasing costs 2013/14 increased to $359.5 million from only $53.2 million in the previous year.
- It was a massive $306.3 million (576%) increase in leasing commitments made in just one year. (See discussion paper 3.)
- Even the over budgeted $160 million two new milk processing plants are not adding to equity as they were also leased (kept off the balance sheet).
- See: www.commbank.com.au/content/dam/commbank/theme/corporate/change-the-game/docs/Devondale-Murray-Goulburn.pdf

10 The dangerous trend of negative operating cash flow short falls continue ($120.5 million).

Capital Expenditure (millions)	2014	2013	2012
Net cash flow from operating activities	-120.5	- 64.9	- 50.5
Negative	**- 55.6**	**- 14.4**	
	85.7%	**25.8%**	

- The "Weekly Times" on MG's last November's AGM reported management's assurance to shareholders the $69 million negative cash flow in 2013/14 financial year was temporary and "since been corrected".
- The July-December 2014 financial statement confirms it has not "been corrected" in fact it increased to $120.5 million.
- The operating cash flow shortfalls have also increased each year since 2011 and almost doubled in 2014.
- MG has moved from the past practice of financing expansion from a positive cash flow, to financing debt by borrowings to cover negative cash flows.
- MG is spending faster than it earns is a real concern to farmers.

11 Diminishing equity

Equity (million)	2014	2013	2012
Total assets	1,989.1	1,933.6	1,755.8
Total equity	726.7	786.6	761.1
Reducing	**36.5%**	**40.7%**	**43.3%**

- Increased expenditure, selling assets for lease back, expansion through new leases and borrowing to cover operating cash shortfalls have all contributed to reducing shareholders equity.
- 40% equity is generally regarded as minimum desirable in a company.
- The $500 million listing will enable management to claim strengthening the balance sheet and improving equity when it represents debt financed by paying dividends.
- The banks are pushing for the $500 million capital raise as it moves some of their increasing risk back on to farmers and investors.

12 Conclusion

- The current milk price is subsidised by sacrificing profit at the expense of retaining a prudent profit level.
- There is a deliberate attempt to pump up the current milk price ahead of the $500 million capital raise.
- The $500 million is needed to plug debt and meet spending commitments.
- The ASX listing will incur some ongoing costs (and more corporate effort) just to keep the investment trust listed.
- Investors expect a higher return than MG's normal sources of finance including for taking the risk in shares with no voting rights or say in the way MG is managed.
- **Financing debt and dividends can only be funded by lower milk prices to farmers**.
- Lower milk prices by MG means lower milk prices for all farmers.
- Good news for Fonterra (NZ), WCB (Canadian) Lion (Japanese), Parmalat (French), Bega (ASX listed company) competing against a lower benchmark and will easily secure milk to fill their production capacities at the expense of MG.
- Unfortunately, there are dollar signs in the eyes of humble innocent farmers who believe that management will keep their milk prices high and see dollars for their shares.
- The reality is management is borrowing farmers' money and by the time it's all spent, management will have received their bonus payments and moved on.
- The directors who approved everything, including downsizing the number of farmer directors, will have retired.
- Who will be left to be accountable?
- No one!
- It may take a couple of years to unravel at MG, but the warning bells are ringing loudly.

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).