

Bonlac Supply Company



Farmers representing farmers

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12 October 2018

Dear << Salutation >>,

I am writing to update you on the outcome of the 2017/18 milk price benchmark discussions between Bonlac Supply Company (BSC) and Fonterra, which looked at whether all requirements under the Milk Supply Agency Agreement (MSAA) have been met.

By way of background, the MSAA between Fonterra and BSC includes a 'benchmarking' clause that requires Fonterra to pay an average milk price for the season that is no less than the 'Volume Leading Milk Processor' (VLMP) in Victoria. This calculation is based on the average milk price paid to all Fonterra suppliers, excluding those on fresh milk contracts.

For the 2017/18 season, the VLMP as at 30 June was Saputo Dairy Australia Pty Ltd (Saputo) – which for the purposes of the agreement, is made up of Murray Goulburn (MG) for the 10 months to 1 May 2018 when Saputo assumed ownership of all assets and liabilities of MG, and then the combined MG and Warrnambool Cheese & Butter (WCB) for the last two months.

After the end of each season, the BSC Board undertakes a review, alongside Fonterra, of the final milk price paid by both Fonterra and the VLMP to ensure that the benchmark obligations under the MSAA have been met.

A challenge with determining the 2017/18 season benchmark price is that no formal end of season price from Saputo or MG for the merged entity is publicly available. Historically there has always been a final formal published price from the VLMP and disclosed as part of its audited annual report.

Therefore, BSC has worked with Fonterra to determine a comparable benchmark figure by applying the VLMP pricing model (as per both MG and WCB's handbook payments) against the milk collected from and paid to each Fonterra supplier. This same process is undertaken each year to determine and reconcile the final average price, even when the publicly noted final milk price has been disclosed.

In summary, the outcome of the benchmark review is as follows:

Please note that this is not an exact science as a number of components of the VLMP are not publicly available, however the process is consistent with prior years and is well established.

For simplicity, we have excluded the 40c payments by both Fonterra and MG (*) from the numbers below:

Final Fonterra Market Quoted Price	\$5.68	
Final Fonterra best quality milk price	\$5.68	(Fonterra suppliers' volume x Fonterra pricing system) Total volume supplied
+/- quality related premiums/penalties	-\$0.05	
Final Fonterra average quality milk price (kgMS)	\$5.63	
VLMP Market Quoted Price May 2018 (**)	\$5.68	
Final VLMP best quality milk price	\$5.57	(Fonterra suppliers' volume x MG/WCB pricing system) Total volume supplied
+/- quality related premiums/penalties	-\$0.130	
Final VLP average quality milk price (kgMS)	\$5.44	

In conclusion, we can confirm that we believe Fonterra has met its obligations for the 2017/18 season – exceeding its obligation by a minimum of 8c, and up to 19c – and that there are no additional payments required to be made for the 2017/18 season, or any previous season.

In addition, one topic which has been the subject of discussion is whether the additional 40c/kgMS payment made by Fonterra, which was subsequently 'matched' by MG, was payable in addition to the benchmark obligations under the MSAA. We understand that some of our farmers are of the view that the 40c/kgMS payment should have been paid in addition to the benchmark milk price.

We have thoroughly tested this proposition, and assessed if any further payments are required by Fonterra under the MSAA. BSC has sought and received independent legal advice. We have focussed on Fonterra's benchmark obligations, and whether the 40c should be paid over and above the benchmark.

We have concluded that Fonterra has met its obligation to pay not less than the benchmark price for the 2017/18 season and BSC does not have grounds to require Fonterra to make any additional payments. We understand that you will be disappointed with the outcome. We appreciate your patience while we have worked through this process.

The MSAA will end in 2019 and BSC is continuing to work with Fonterra to ensure that there is a strong representation model established for future years. We will also continue to work with Fonterra to get back to one simple milk price free from loyalty or bonus payments, which aligns with industry calling out for transparent and simplified pricing structures.

Yours sincerely,



Tony Marwood - Chairman
Bonlac Supply Company

* As part of the benchmark review, we were required to consider the additional 40c payments per kgMS made by Fonterra (to all suppliers) and the 40c payment by MG (to only eligible suppliers, and sourced from the sale proceeds, thus reducing the capital return to all MG supplier shareholders). No such payment was made to Saputo's farmers who supplied WCB for the 2017/18 season.

For simplicity, we agreed with Fonterra to exclude this 40c from the calculations noted above for the purposes of this review. This decision was on the basis that when looking at this 40c payment in isolation, it was clear that all Fonterra Suppliers were either equal to or ahead of the VLMP (MG suppliers) for the first 10 months of the 2017/18 season, and were clearly ahead of the VLMP (merged MG / WCB) for the last 2 months.

** Note that this headline price was the publicly announced price by the VLMP (applicable to both MG and WCB) ahead of the end of the season (May 2018).

The analysis completed by Fonterra cannot fully reconcile how this price was achieved for the full season. The Fonterra analysis returns a final best quality price from the VLMP of \$5.57, which is 11c below this last available publicly announced price. We have concluded that the final end of season headline VLMP 'best quality' headline price falls somewhere between the calculated \$5.57 and quoted \$5.68.