



Australian Dairy Farms Group

ASX Code: AHF

27 May 2016

Effects of Farmgate Milk Price Changes and Seasonal changes

Camperdown Dairy acquisition makes AHF resilient to recent farmgate milk price changes in 2017 and thereafter;

Consumers desire to support dairy farmers has seen significantly increased premium milk sales orders from CDC's two major Customers; Woolworths Farmers Own and Aussie Farmers Direct.

FY 2016 is adversely affected and adds to the difficult dry El Nino summer and autumn seasons

AHF strongly supports higher farmgate prices to support farmers

Focus on transition to higher yielding organic and specialty dairy products

Improving seasonal outlook as El Nino recedes

AHF remains in a sound financial and cash position

Australian Dairy Farms Group (AHF or the Group) provides the following update in relation to the potential effects of reduced farmgate milk prices on the Group's activities for the information of investors.

OVERALL

On balance, as a combined dairy farming and dairy processing and retail product manufacturing entity, AHF will be resilient to recent milk price changes in the 2017 financial year and thereafter. As its processed milk products range expands and sales of premium products grow, AHF Group's earnings become more diversified with far less negative exposure to global milk price movements. The fully vertically integrated structure of AHF dairy business significantly reduces milk price commodity risk.

The final pricing outcome of recent changes announced by Fonterra remain under review and negotiation and a further announcement regarding expected 2016 financial results will be made over the coming weeks for investor guidance, when that pricing is settled.

DAIRY FARMS SEGMENT

FY 2016 impacts

In the dairy farming segment of the Group's business, the financial results for 2016 will be materially negatively impacted by the combination of:

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- Reduced farmgate milk price for the final two months of the financial year. The base price received from Fonterra will decrease from \$5.60 per kilogram of milk solids to approximately \$1.95 for the final two months. This will negatively impact farm revenue by approximately \$700,000 from earlier estimates.
- an extended season of above average dry weather resulting from the El Nino influence affecting many parts of Australia and consequent severely reduced on farm grass growth;
- Consequent increased volume purchases of grain and fodder at higher than average prices.

These conditions have been experienced by dairy farmers throughout Victoria who do not have extensive irrigation.

Actions taken to mitigate risk

The Group is at an advanced stage of implementing a range of options for mitigating the Group's exposure to such seasonal conditions. Some of these options have already been implemented, funded and completed as follows:

- installation of irrigation on the Drumborg Farm (Heyward) and extension of water storage capacity in dams on all properties with significant drainage and water flow management systems to better collect and store rainwater and runoff.
- Installation during summer of a Pivot irrigation system to irrigate parts of the Drumborg property has been completed ready for the next spring and summer season.
- extensive improved drainage on all production farms (already completed before recent rains) will also facilitate stronger and faster pasture growth for longer periods, which allows greater opportunities to multiple harvest and store excess growth as silage for the dryer months.
- Exploring options to irrigate parts of the Brucknell farms

These actions, undertaken through the last summer period are expected to have a tangible and permanent positive effect on the production viability and operational costs of the farm operations in years to come, including 2017.

The following page shows some images of the farms on which drainage works have progressively been completed during the last year



Winter 2015 picture of waterlogged Brucknell farm



Winter 2015 waterlogged Brucknell farm before drainage



Autumn 2016 of same Brucknell farm after drainage



Summer 2016 picture with progressive drainage works to final drain - Brucknell farm



Autumn 2016 picture of completed paddock new lanes post early rainfall Drumborg farm

DAIRY PROCESSING SEGMENT – CHANGING CONSUMER TREND INCREASING SALES

The Camperdown Dairy Company Pty Ltd (CDC) acquisition, which was settled on 15 April 2016, **provides a strong in-built buffer to market reductions in the farmgate milk price** for the Group.

In the 2017 financial year, AHF will be a **net buyer of raw milk** to the extent that CDC's capacity to process milk and sell finished milk products exceeds its owned farms' current capacity to produce milk.

CDC also contract processes milk purchased directly from farmgate for a number of customers. In this specific area of the business, CDC and therefore AHF has no exposure to the milk prices paid by the customer and therefore maintains its processing margin.

In this range of products is the Woolworths Farmers Own premium milk range, which is processed and packaged at CDC for Victorian distribution. The Farmers Own full cream milk recently won the Dairy Industry Association of Australia's National award against all other contenders.

In response to recent media about the plight of dairy farmers impacted by the \$1 per litre supermarket price, consumers across Australia have voted with their pockets in the last few weeks.

Many have already significantly swapped their milk choice to reject the \$1 per litre options in favour of brands, which ensure farmers get a fair price. This has emptied supermarket shelves in Victoria of Farmers Own fresh milk, which has been repeatedly sold out.

The result has materially increased the sales and production orders for CDC, which are all premium products and looks, set to continue.



Increased sales are also evident in the Aussie Farmers Direct milk products also processed and packaged by CDC.

If the recently evident move to increase retail pricing of milk is maintained, the increased processing and sales of products with attractive margins will have an immediate positive effect on CDC's bottom line as available capacity is utilised.

Next week will see a record production level from Camperdown increasing confidence in management's sales forecasts in FY 17.

CAPITALISING ON THE FLEXIBILITY OF CDC

CDC has very flexible capability to maintain segregation between different milk types and to process relatively small runs of the different milk types into a variety of products and brands of the same product - such as fresh milk, yoghurt, butter, cream.

This flexibility represents a significant benefit and differentiates the Group from the major processors in the industry, which have large-scale specific product plants that produce a narrow product range and rely on achieving marginal efficiencies on a high volume throughput of relatively price inelastic and low margin products for major retailers.

AHF will concentrate on **high value-added products** focused on **premium domestic and export markets** with "**paddock to plate**" transparency of product from farm to consumer

TRANSITION TO ORGANIC MILK PRODUCTION

AHF has previously advised its intention to strongly focus on the **production and processing of Organic cow's milk** in the acquisition of new farms and to progressively move away from conventional cow's milk on existing farms. The recent price reductions for conventional milk will accelerate this transition.

Demand for organic milk in Australia exceeds supply, particularly in the high value-added products sold domestically and to export markets, and this demand is growing significantly faster than supply is growing.

Demand is also growing strongly in international markets and a number of Australian product manufacturers must rely on imported organic ingredients to meet demand.

While the input costs of producing organic milk are higher than conventional milk - the farmgate price for organic is generally more than double - which creates the potential to deliver significant margins to the Group on an ongoing basis.

Further, **AHF has the capacity and experience**, through CDC, to **manufacture, and wholesale and retail the end-product** in Australia and internationally, and in so doing, **capture premium margins** while **building its own premium brands** and working with other organic participants. This approach forms the basis of the Groups growth strategy in the current reduced-farmgate-milk-price environment.

FAVOURABLE SEASONAL CONDITIONS PREDICTED FOR 2017

El Niño ends as tropical Pacific Ocean returns to neutral (BOM 24/05/2016)

Extract

The tropical Pacific Ocean has returned to a neutral El Niño– Outlooks suggest little chance of returning to El Niño levels, in which case mid-May will mark the end of the 2015–16 El Niño. International climate models indicate the tropical Pacific Ocean will continue to cool, with six of eight models suggesting La Niña is likely to form during the austral winter (June–August). However, individual model outlooks show a large spread between neutral and La Niña scenarios. Typically, during La Niña, winter-spring rainfall is above average over northern, central and eastern Australia.

Follow the link below to BOM for details:

<http://www.bom.gov.au/climate/enso/>

Essentially, this message translates into an expectation of good widespread rainfall including in the south west of Victoria where the Group's farms are located. The welcome commencement of rain, referred to locally as the "Autumn Break" arrived in the last week with good falls on all farms.

A wetter than average winter (June through August) is predicted and this should deliver strong benefits to the AHF farms, after completion of the extensive on-farm work program of drainage and water storage expansion through summer and autumn (December through April).

The work completed is expected to be reflected in significantly stronger pasture growth in winter and spring, as plants cease to become waterlogged throughout winter and grow deeper roots to assist them through the dryer months following. Additionally, damage to pastures by livestock movement should reduce significantly and livestock health and temperament should improve.

STRONG FINANCIAL POSITION

The Group remains in a strong financial position with low debt to assets ratio of sub 30% and cash at bank of \$3.5 million, which will enable AHF to continue to pursue the many growth options currently at various stages with management and board.

Ends

Further Details

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About Australian Dairy Farms Group

Australian Dairy Farms Group (AHF) is Australia's first ASX listed dairy farmer. Its focus is on aggregating high quality dairy farms in Victoria, initially in the South Western region with particular emphasis initially, on the famous Dairy Golden Triangle region of South West Victoria between Warrnambool and Colac south of the Princes Highway to the coast around Port Campbell.

On 29 December 2015, AHF announced to ASX that it had entered into a contract to acquire Camperdown Dairy Company Pty Ltd - ACN 140 640 606 (CDC) – see announcement on <http://www.adfl.com.au/announcements> . This transaction has now settled in accordance with the contract terms and CDC is a wholly owned subsidiary of AHF.

Australian Dairy Farms Group is listed as a stapled security comprising one fully paid share in **Australian Dairy Farms Limited** (the Company) and one fully paid unit in **Australian Dairy Farms Trust** (the Trust). Within the structure, the Company is the operator and manager of the dairy farm properties, which are leased from the Trust as the registered owner.

Camperdown Dairy International Pty Ltd ACN 168 442 206 Clarification for Investors

The company acquired by AHF is Camperdown Dairy Company Pty Ltd - ACN 140 640 606 (CDC), which is not associated with a company with a similar name involved in the dairy industry called Camperdown Dairy International Pty Ltd ACN 168 442 206 or CDIC. There are no common directors or shareholders and the two companies do not have any customer / supplier relationship. The only substantive connection is that the two companies are each lessees of separate but adjoining land parcels at Camperdown owned by the same third party property owner. The directors and personnel of the two companies are on friendly terms as next-door neighbours and cooperate with each other in that context but otherwise have no financial or legal interaction.

Disclaimer

This announcement may include "forward looking statements" within the meaning of securities laws of applicable jurisdictions. These forward-looking statements are not historical facts but are based on AHF's current expectation, estimates and projections about the industry in which it operates, and beliefs and assumptions. Forward Looking Statements may include indications of, and guidance on, future earnings or distributions and financial position and performance and involve known and unknown risks, uncertainties and other factors, many of which are beyond the control of AHF, and its officers, employees, agents, or associates, that may cause actual results to differ materially from any projections and forward-looking statements and the assumptions on which those statements are based. Readers are cautioned not to place undue reliance on forward looking statements and AHF assumes no obligation to update such information.