Contents

OCD Valuation Analysis

OpenCountry™

February 2014

TDB ADVISORY

Executive Summary

- Talley's strategy for OCD is to get shareholder value by generating a highly cashflow positive business by:
  1. Having lower costs of capacity (plants) than competitors;
  2. Having lower operating costs per unit of milk than competitors;
  3. Having small but sustainable customer margins above GdT for NZ commodity product.
- Point one above has been achieved and is apparent from the accounts.
- Point two is clouded by OCD building new plants and always building volumes across each plant to full capacity, usually a three year cycle. The current year (2014) is the first year that the accounts will show costs for full plants.
- Point three is also not clear from the accounts. That analysis would need to be done through sales and customer reports.
- We expect that the 2014 FY will show OCD capturing better historical cashflows and expected returns. It is water shed year where, in our opinion, OCD will double EBITDA to circa $75m.

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Executive Summary

- The NZ milk processing sector has an observable and growing level of profitability.
- Fonterra's competitors are growing at a higher pace than the NZ market.
- The highest value commodity returns are currently a WMP mix with Global Dairy Trade prices being set by Chinese demand.
- Investors are paying above book values for processors with committed milk supply and distribution channels into China; this implies growth in margins for those processors with existing milk supply.
- Talley's own 60% of OCD and are currently increasing that to 70% at $1.85 a share ($310m), this is a small discount on our assessed book value of $1.90.
- Our assessment of a DCF value is $2.76 per share.
- If OCD was available for sale it would have a market value of above $3 per share.

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Profitability - Summary

- Fonterra's processing competitors have growing profitability.
- That profitability is trending towards the regulator's expected return of:
  - between 60 - 70c EBITDA per KGMS;
  - WACC on replacement cost of assets of around 8%.
- The continued improvement in profit is a result of:
  - Capacity utilisation improvements as start ups increase volumes of milk supply;
  - Product mix moves towards export WMP;
  - The costs of milk supply becoming more transparent.

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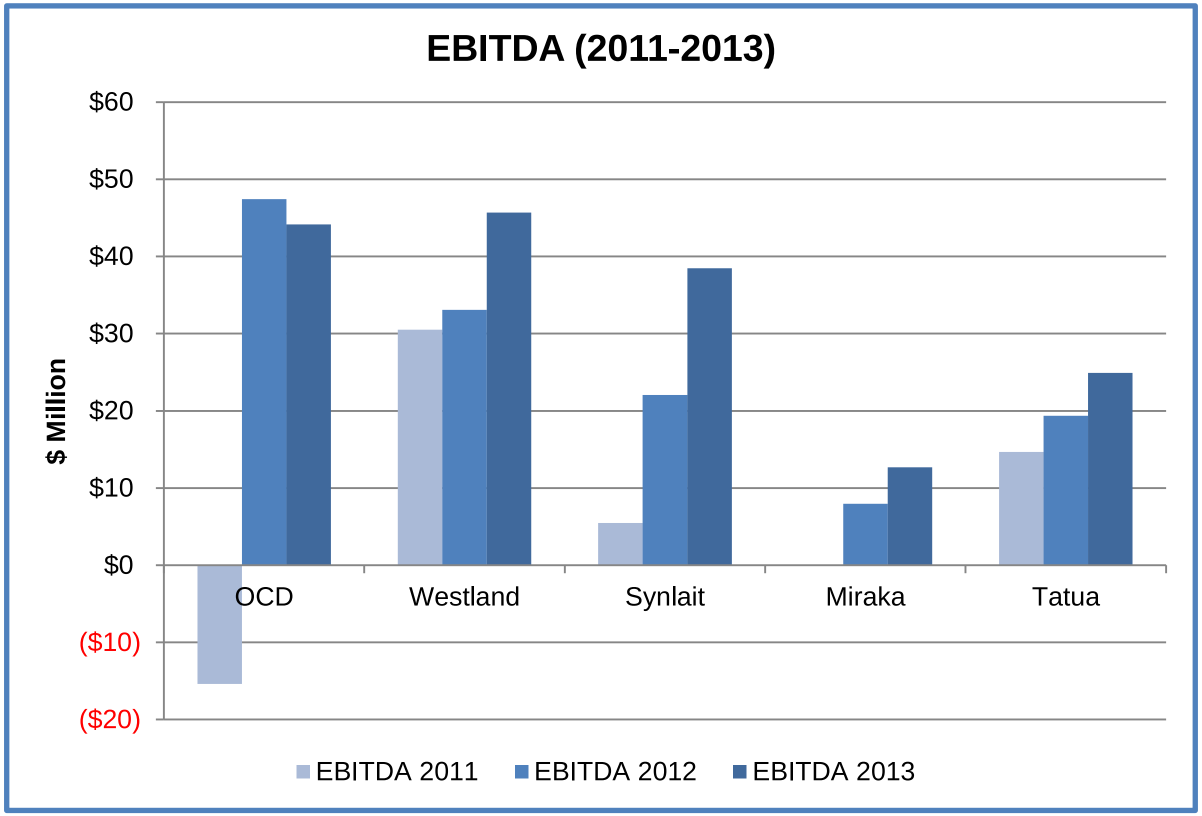
2013 showing growth in EBITDA for NZ competitors to Fonterra…



Source: Annual Accounts
OCD 2013 Financial Year = 14 months to 30 Sept 2013

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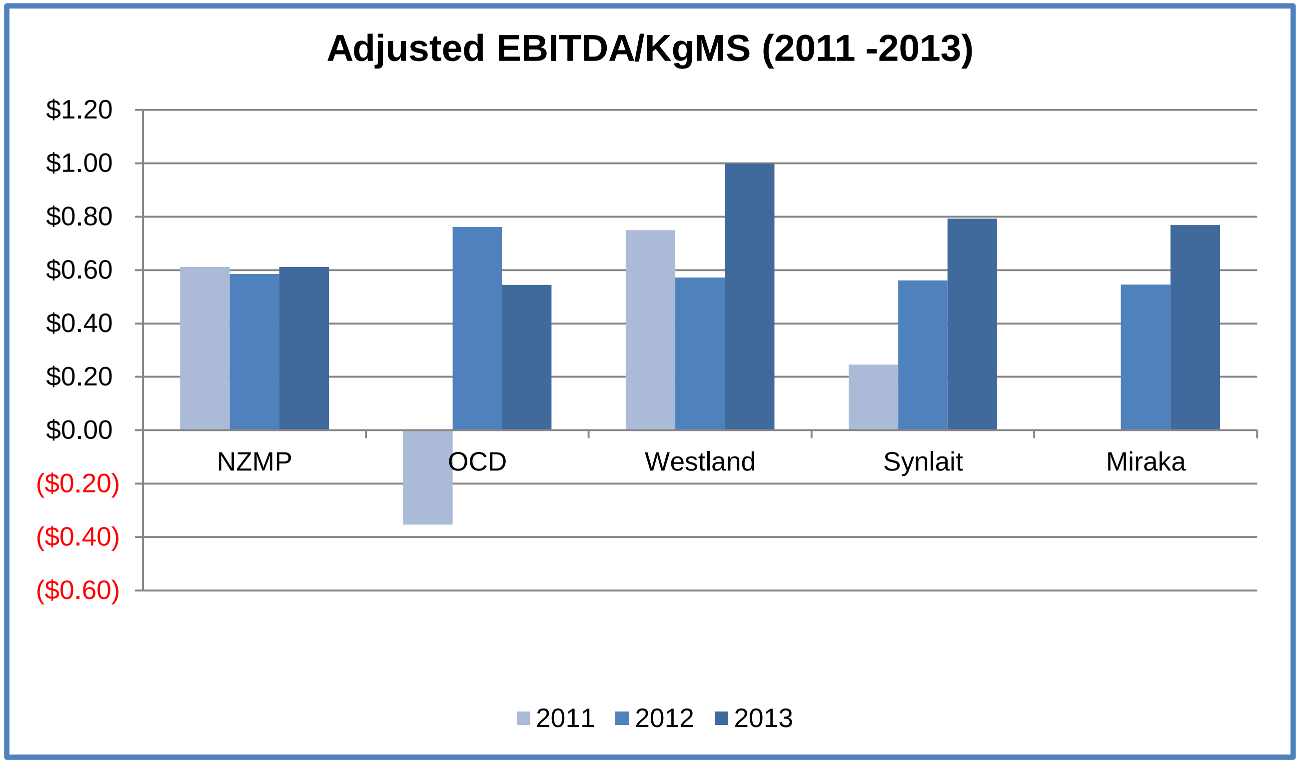
Profits of Fonterra competitors now matching NZMP with EBITDA approx 60c KgMS…



- Tatua has been removed because its adjusted EBITDA return of $2.84 (2013) indicates a level of performance that confirms it cannot be grouped in the same segment as commodity processors.

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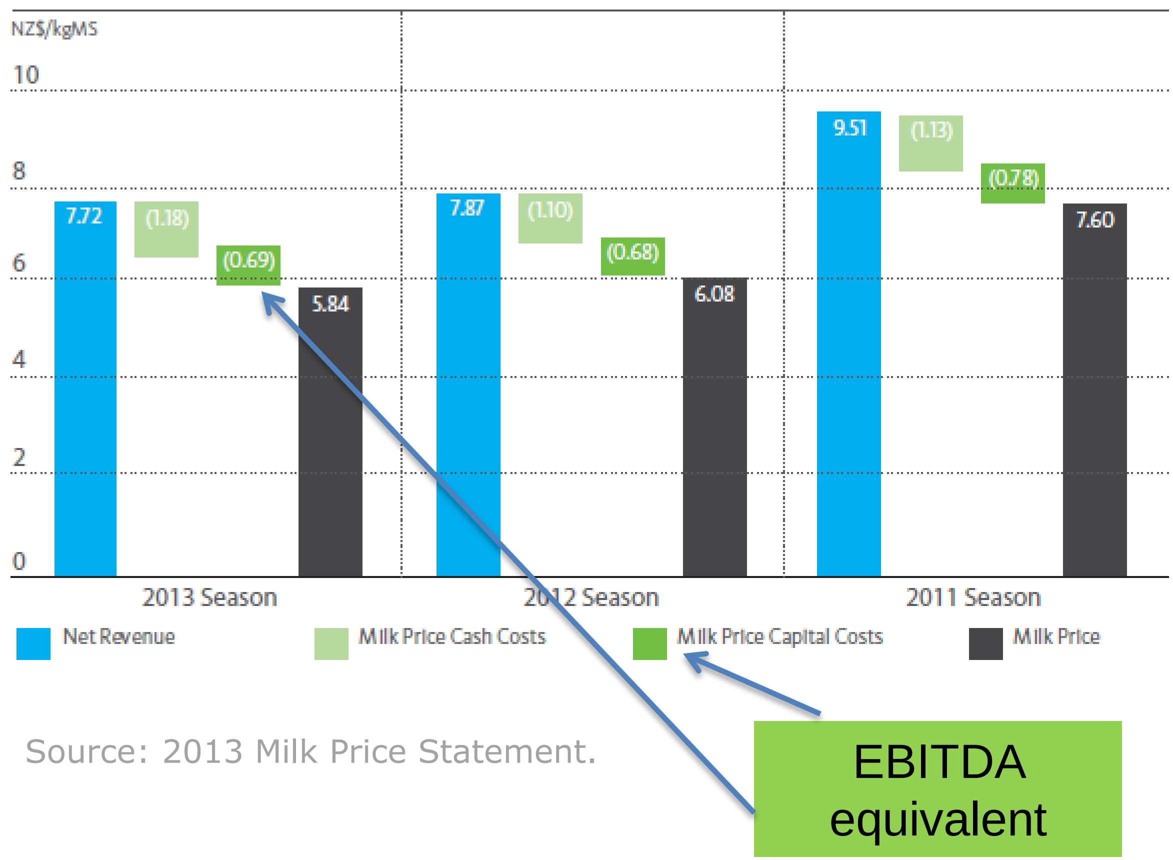
Profits trending towards expected regulatory return, being 69c of EBITDA per KgMS, for 2013…



- Source: 2013 Milk Price Statement.

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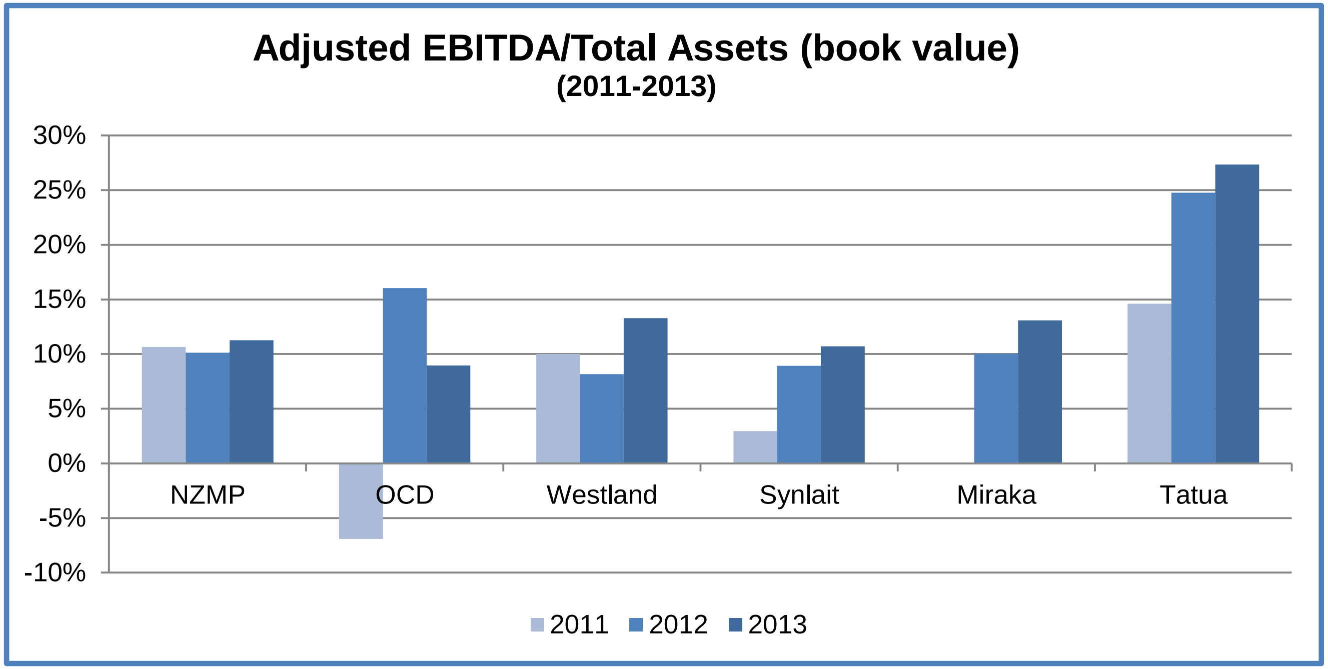
Total EBITDA for NZ processing industry now around $NZ 1 Billion, just over 11% return on total assets…



- In a very fixed-asset-heavy industry we have used EBITDA as the starting point – it indicates cashflow generation once a business is at adequate capacity utilisation.
- We have also used this because of a wide range of depreciation policies and actual Capex spends.
- EBIT/Assets = 6.5%

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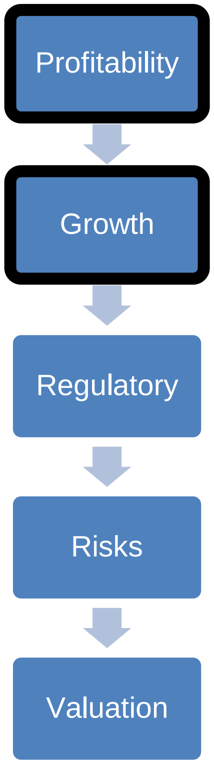

Growth - Summary

- Fonterra’s processing competitors have been growing faster than NZ milk supply growth of about 3% p.a.
- That has resulted in milk processing market share of 89% Fonterra/11% others.
- Fonterra’s competitors through a combination of established customer relationships, profitability, access to capital and currently committed growth in capacity will continue to grow faster than Fonterra.
- Listed market valuations of NZ and Australian processors with established milk supply are materially above book value and replacement costs of assets; this implies growth in gross margins above the regulatory required rates of return.

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NZ Milk Supply Growth….about 3% p.a.

- NZ milk volume growth of 3.5 % p.a. (in last decade):
  - Fonterra 2.6%;
  - Others at 10%.
- Fonterra, dairyNZ, and now analysts' reports on FSF all suggest lower growth in the next decade:
  - National growth of 2 – 3% p.a.;
  - Higher potential growth in Canterbury subject to irrigation infrastructure and environmental law;
  - As the graph shows below 2012 was an extraordinarily high growth year (11%), 2013 (the drought year) then fell by 2%.

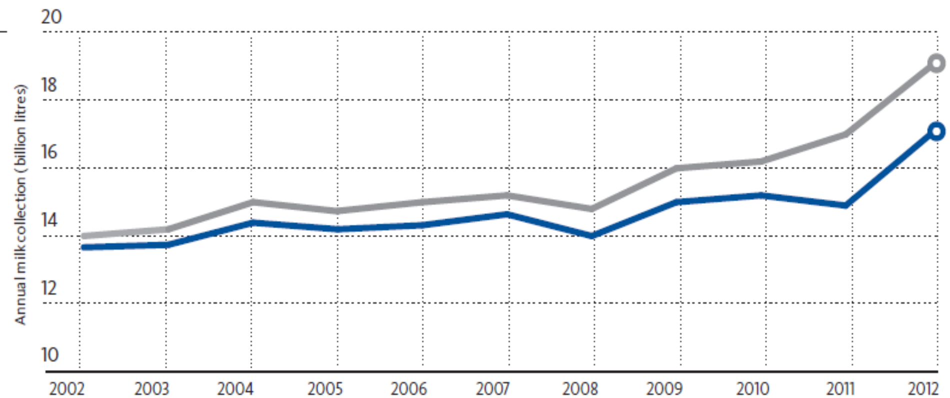
NEW ZEALAND MILK COLLECTION BY SEASON

Source: Fonterra and DairyNZ

New Zealand
- 12 months to May 2012
- Milk collection: 19.1 billion litres
- 11-year growth: 40.6%
- 11-year CAGR:[1] 3.5%

Fonterra
- 12 months to May 2012
- Milk collection: 17.0 billion litres
- 11-year growth: 29.1%
- 11-year CAGR:[1] 2.6%

1 CAGR refers to compound annual growth rate.



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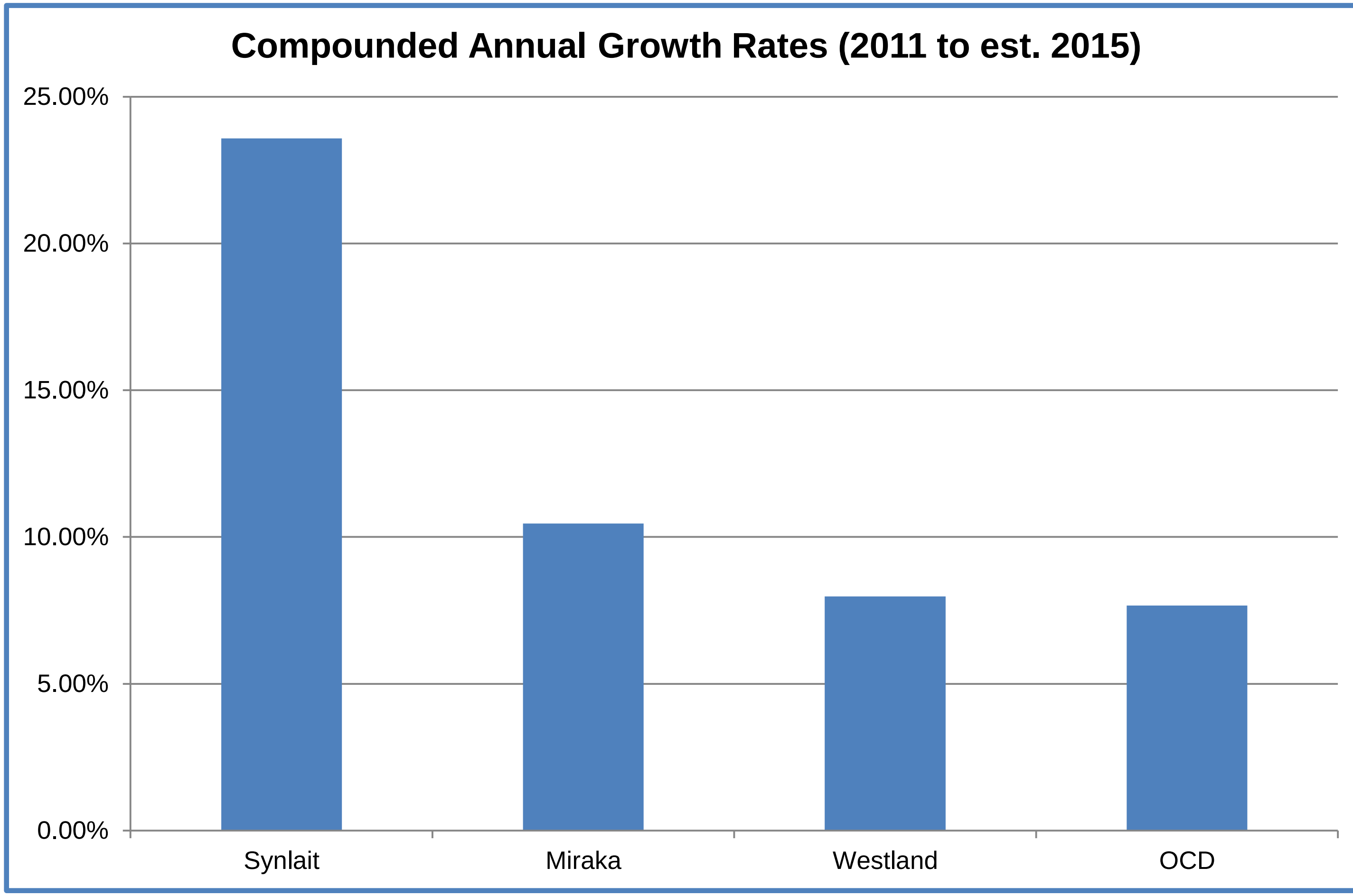
All Fonterra competitors capturing market share through milk growth…



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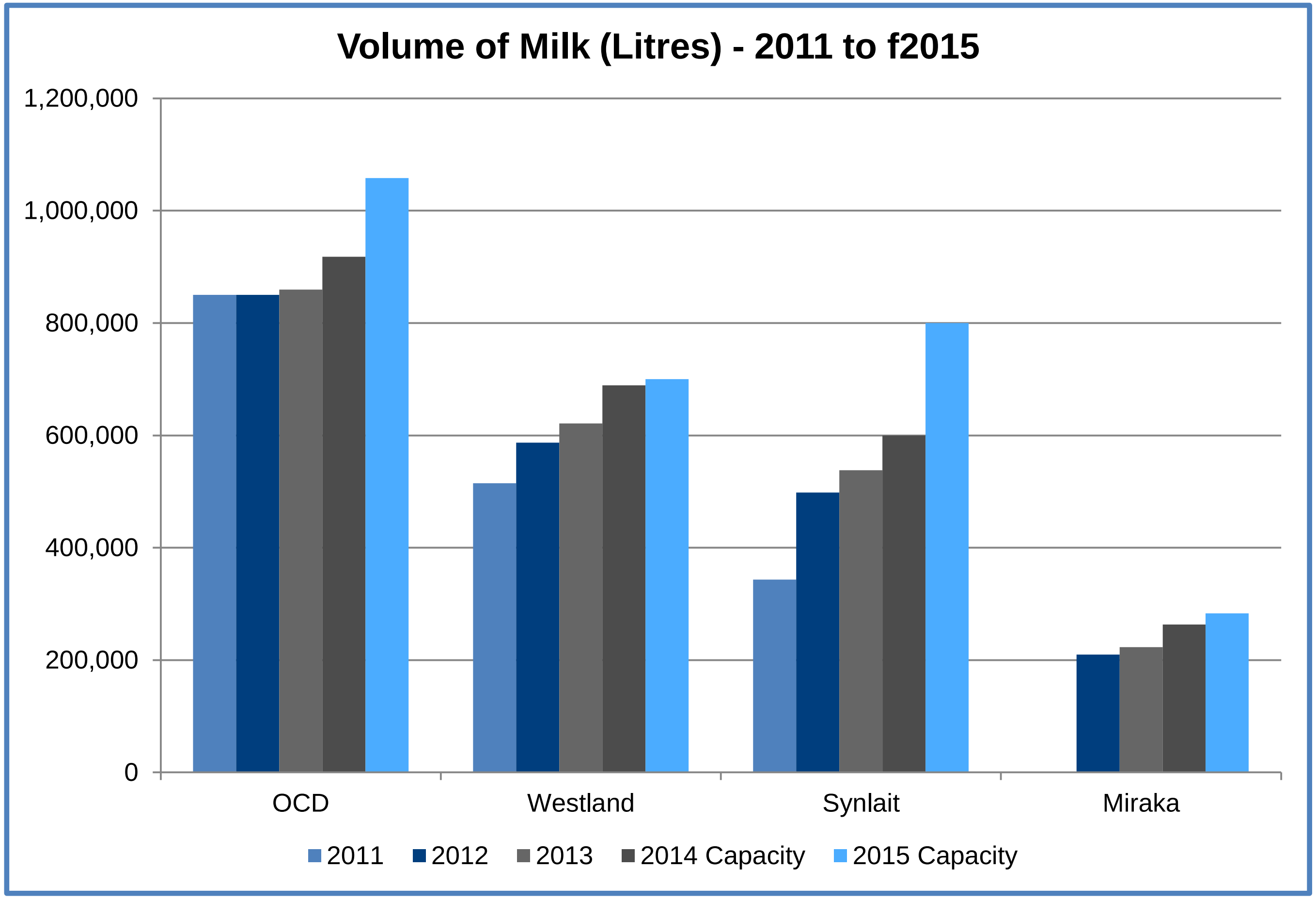
We can expect that growth rates will continue to be higher for Fonterra's competitors than industry growth rates…



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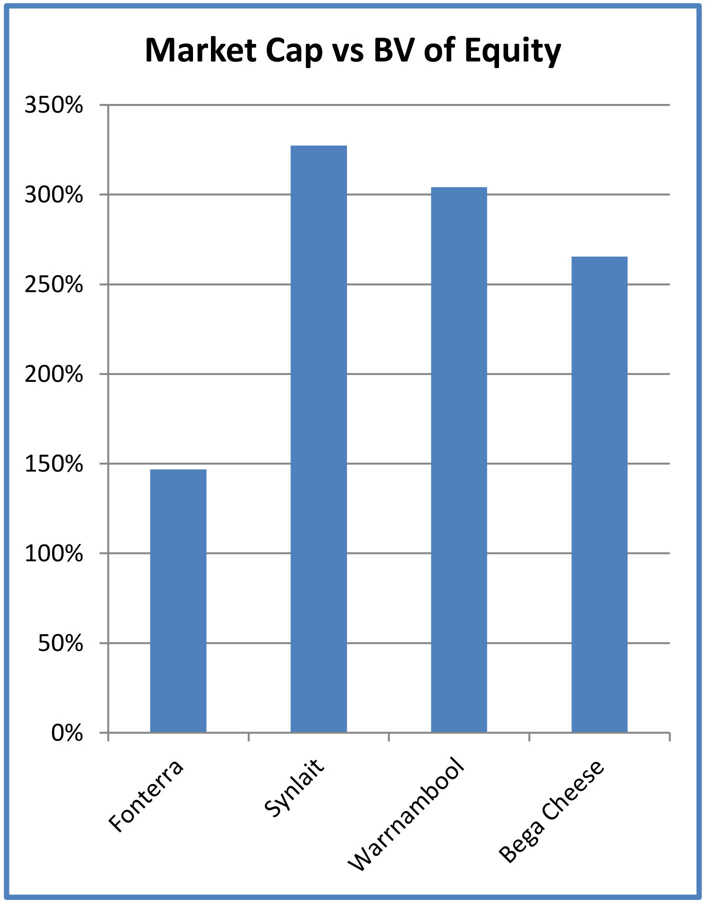
Listed market values of NZ/Aust milk processors imply profit growth - all are materially above book value…



- 2013 NZX Market listings of FSF and Synlait along with market valuations of Warrnambool and Bega Cheese on ASX show market valuations versus book values;
- Material premiums being paid for the equity of these listed processo;
- Reasonable to conclude that a lot of growth in profitability from these processors is being built into market valuations.

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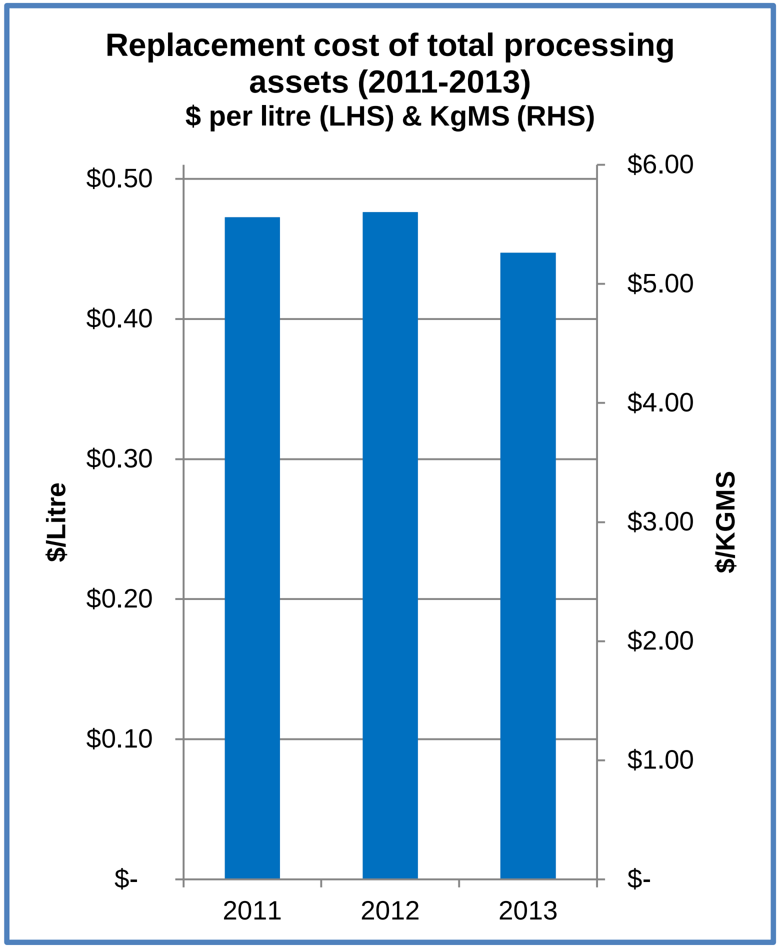
Market valuations are also above replacement costs…. calculated each year within the regulatory methodology related to milk price calculations and currently 43c per litre…



The replacement costs of the assets reflect:

- The fixed assets required from farm gate to the port, to convert each litre of milk into standard commodities for export;
- Working capital to support the production and selling cycle.

The costs can be expressed as per units of milk, either:

- Litres; or
- KGMS.

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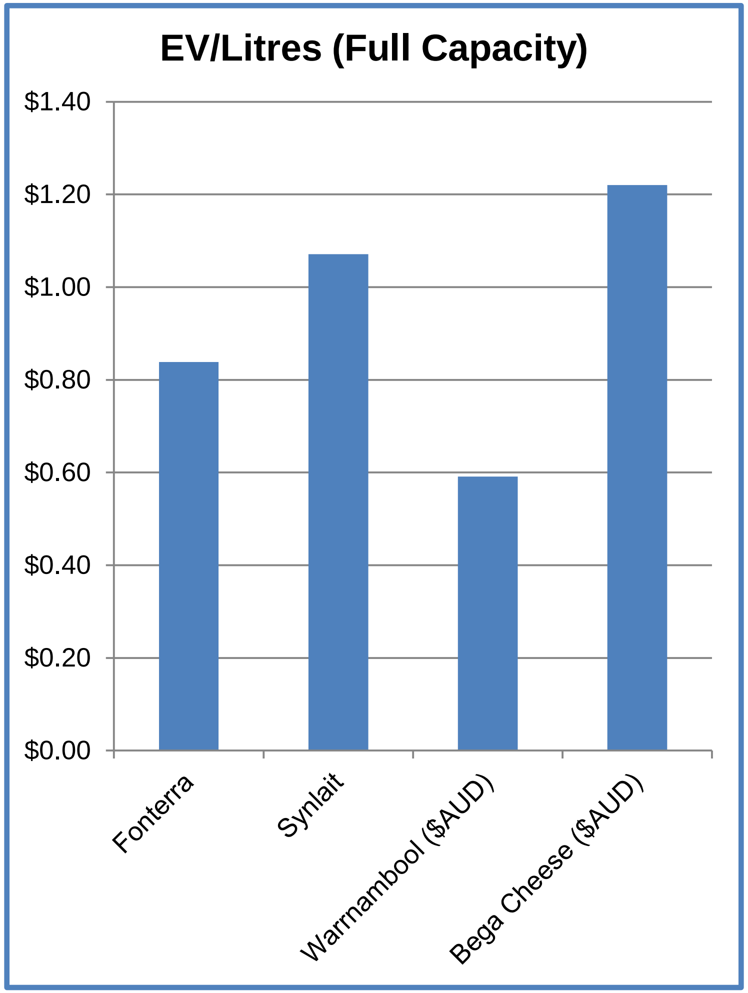
The size of the valuations above the 43 cents replacement costs are material…



- All listed processors are trading at a premium to replacement cost of assets;
- Profit growth is being built into their valuations.

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Large variations of EV/EBIT multiple reflects differing growth prospects…

- Synlait valuation confirms an expectation of continued high growth.
- The recent takeover of Warrnambool also indicates bidders expect higher profits off existing milk supply.

	Listed Dairy Companies			
	Fonterra	**Synlait**	**Warrnambool**	**Bega Cheese**
	FCG.NZX	*SML.NZX*	*WCB.AX*	*BGA.AX*
FYE 2013	*NZD $M*	*NZD $M*	*AUD $M*	*AUD $M*
EBITDA	$1,467	$38	$26	$64
EBIT	$937	$28	$14	$44
Market Capitilisation	$9,906	$537	$492	$695
Net Debt	$4,348	$106	$75	$87
Enterprise Value	$14,254	$643	$567	$782
EV/EBITDA	***10***	***17***	***22***	***12***
EV/EBIT	***15***	***23***	***41***	***18***

- Average EV/EBIT = 24x
- Average EV/EBIT (ex Warranmbool) = 19x

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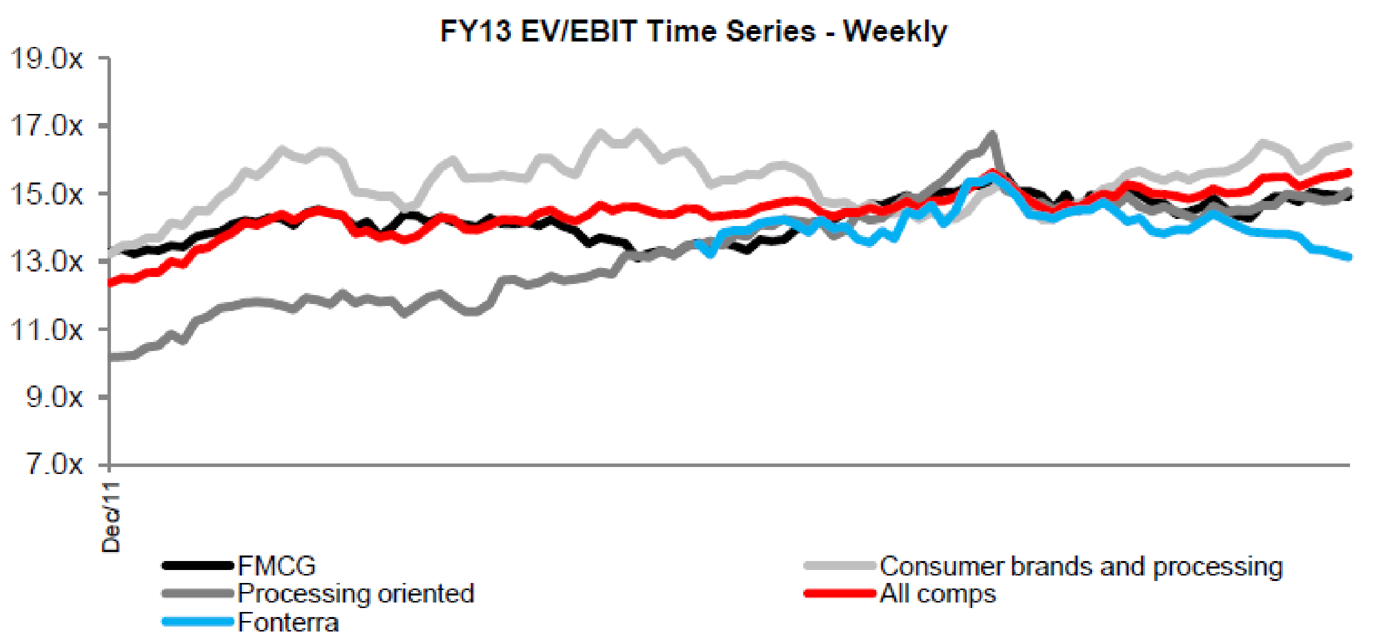
Larger grouping of global milk processing comparables…. suggest EV/EBIT Multiple of 15…

- Average EV/EBIT for global 'processing focused' companies is around 15x (Macquarie Research Dec 2013).

Historic FY13 EV/EBIT for Global Comps



Source: Macquarie Research Dec 13

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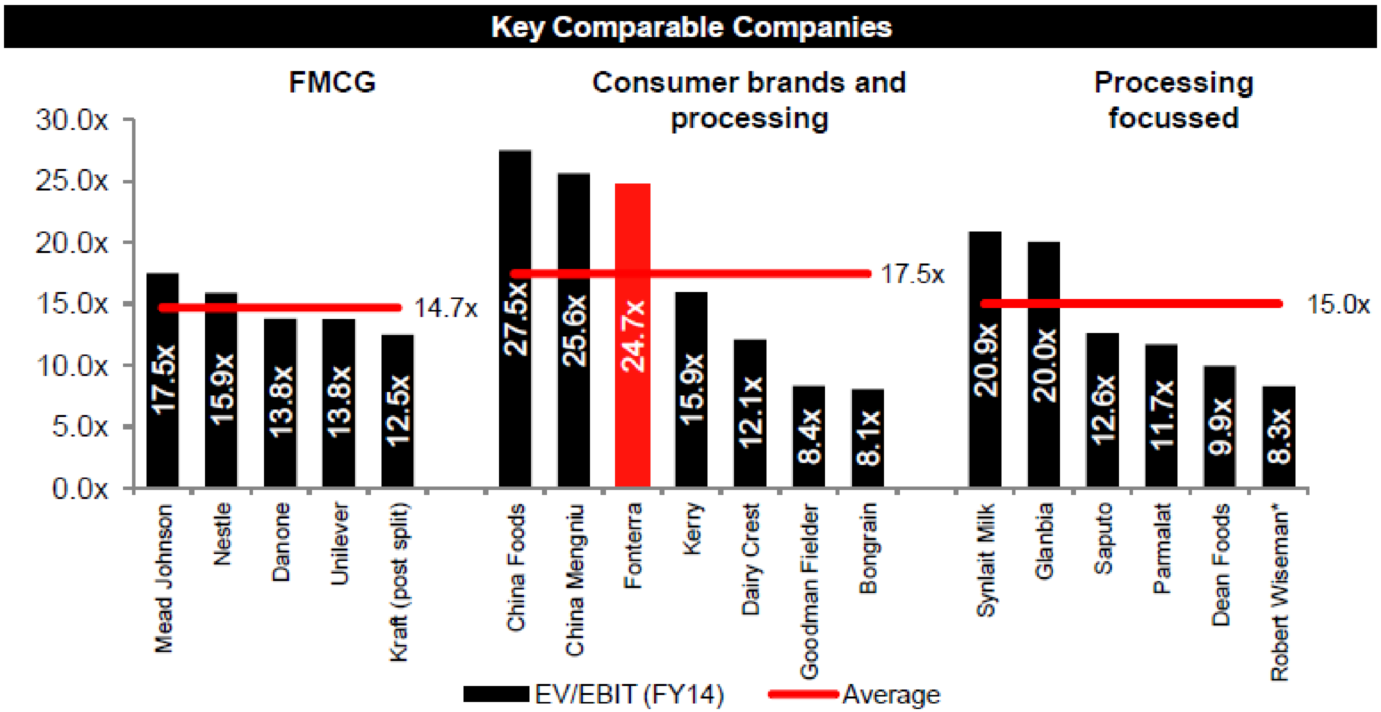
The Synlait multiple of above 20 suggests an expectation that NZ processors will outperform others…



Source: Macquarie Research Dec 13

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Regulatory - Summary

- Dairy Industry Restructuring Act (DIRA) now into second decade.
- Enabling provisions within DIRA have worked to the extent that processors independent of Fonterra have grown to 11% market share.
- Milk pricing is now more transparent and has moved past the start up phase of farmers receiving premiums to take the risk of switching to Fonterra competitors.
- Fonterra’s competitors have also established committed milk supply directly from farmers and are receiving similar returns from export customers for commodity products.
- Changes to Fonterra’s milk supply commitments within DIRA increase the risk for any new start ups.

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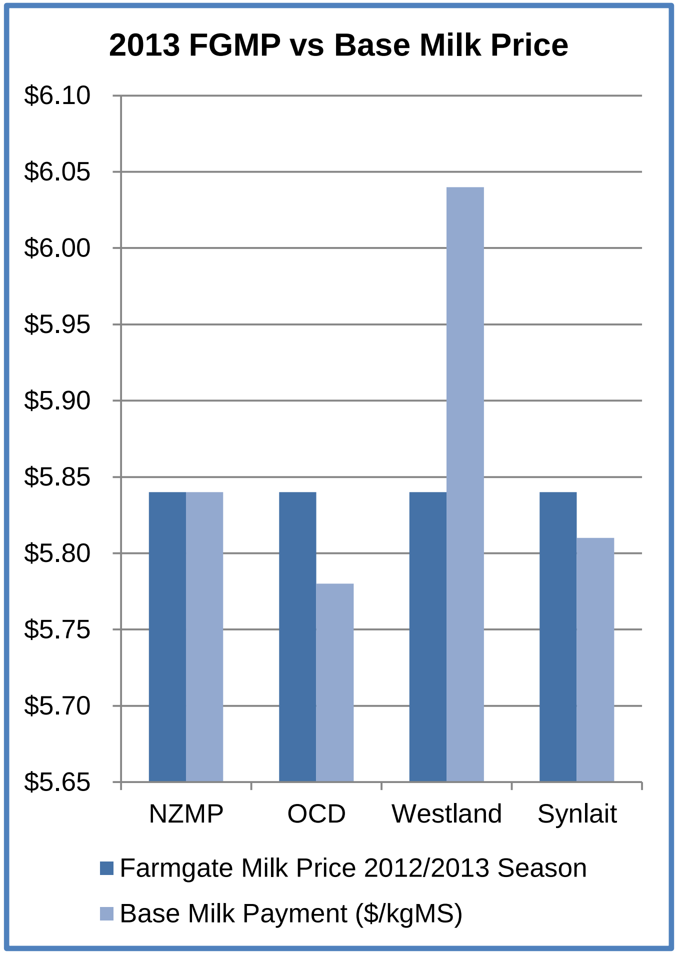
Now past the tenth year of DIRA… cost of milk to secure and then maintain milk supply is established..

- Most processors now paying a similar milk price to the "Farm Gate Milk Price" (FGMP).
- Most new entrants had been paying a premium above the FGMP through their establishment phases:
  - Both OCD and Synlait paid less in 2013.
  - Miraka does not disclose publically but they are understood to be paying a 10c premium above FGMP .
- FGMP is a national milk price. It could be there are regional payment differences for:
  - OCD, 4 plants in three regions.
  - Westland, now competing for milk in Canterbury with Synlait and NZMP.
- Industry payments generally follow NZMP (being the co op subordinated payments system) of advance part payments through the year followed by a final payment three months after year end except for OCD:
  - OCD now pay for the full value of their milk to suppliers on a shorter cycle.
  - This has positive value to farmers in that they receive the cashflow (i.e. the $5.79) from OCD earlier than others in the industry.



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The regulated price of milk (Farm Gate Milk Price) now more transparent…

- Revenue derived from Global Dairy Trade prices for a Whole Milk Powder mix of commodity prices;
- Less:
  - notional costs
  - required rate of return from the processing assets
- = FGMP

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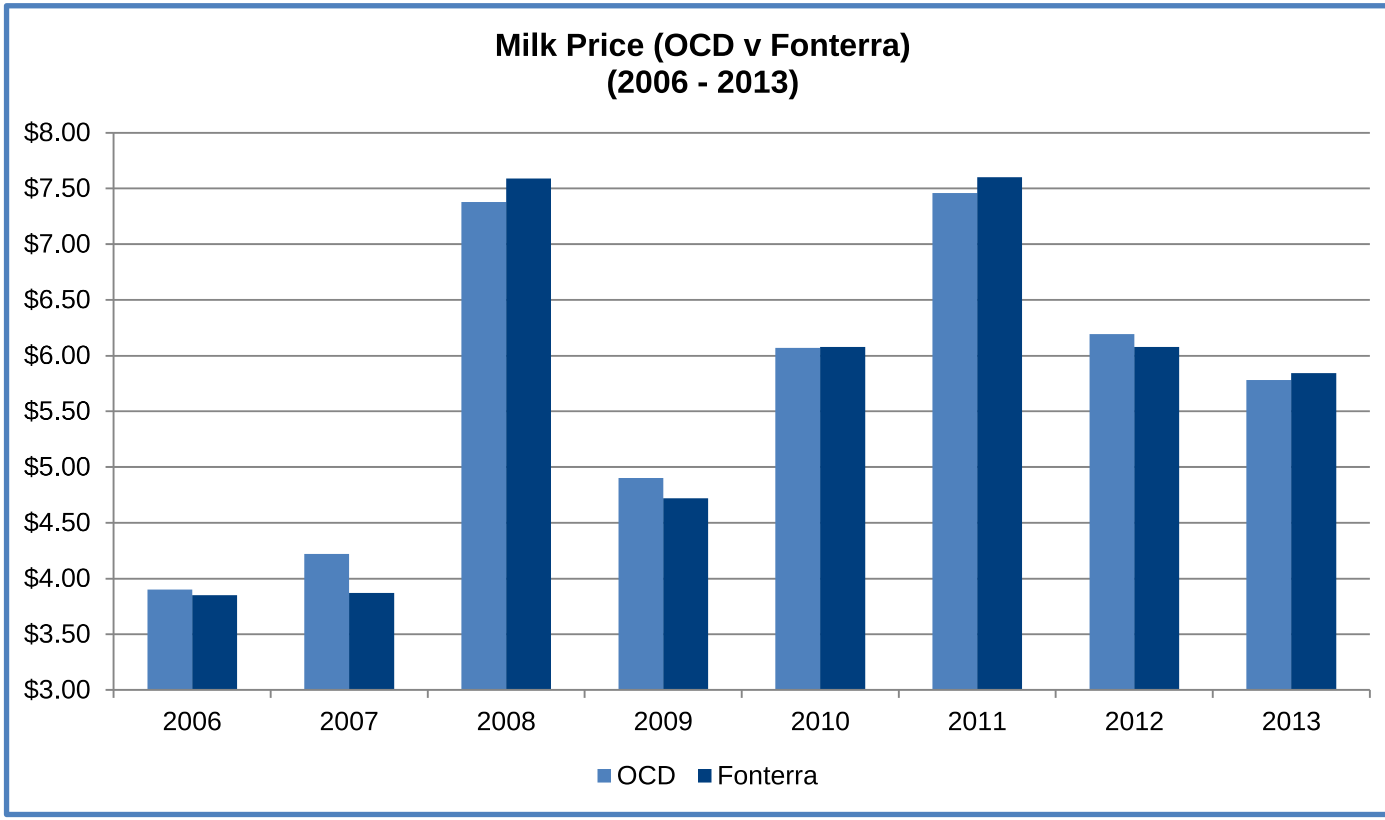
So Fonterra processing competitors have now moved past start up phase when a premium was paid for milk compared with Fonterra



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Fonterra has now shown that they won't always match the FGMP….(Dec 2013 announcement a big surprise and very positive for competitors)

Fonterra is required to consider its Farmgate Milk Price every quarter as a condition of the Dairy Industry Restructuring Act (DIRA).

Following the Board's decisions, today Fonterra is announcing that:

- ***The Farmgate Milk Price will be maintained at its current level of $8.30 per kgMS;***
- ***This is 70 cents per kgMS below the theoretical Farmgate Milk Price of $9.00 per kgMS calculated in accordance with the Milk Price Manual;***

Dec 2013

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…and DIRA milk volumes harder to access for new start ups…

- DIRA changes from 2012:
  - require Fonterra to supply competitors with up to 5% of the national milk pool (about 900m litres where previously it was 700m litres).
  - Restrict any one competitor to 50m litres for a maximum of 3 years (previously the term was indefinite):
    - This will mean OCD, Synlait and Miraka will lose their Fonterra supplied milk in two years.
    - It will mean greater risks for any new independent start ups.

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Risks - Summary

- Fonterra’s competitors are generally through the high risk start-up stage.
- Improvements in financial flexibility as profitability has increased and debt decreased.
- Costs have improved as milk volumes have increased and moved operating costs to competitive levels on a per unit of milk basis with NZMP (Fonterra’s commodity processing business).
- Transparency of milk pricing has improved risk management and moved the product mix towards Whole Milk Powder (WMP).

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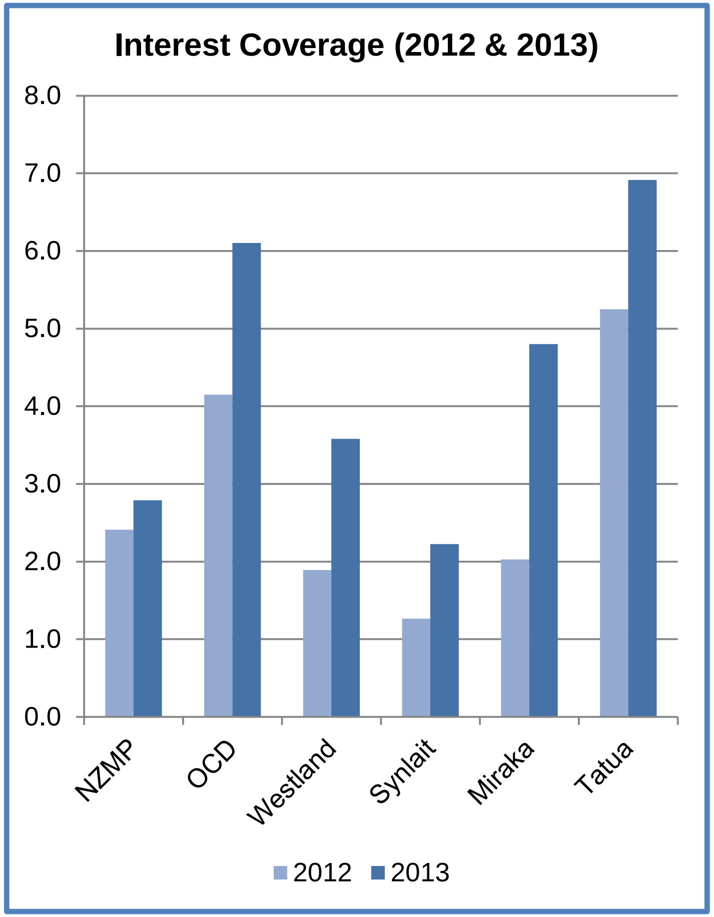
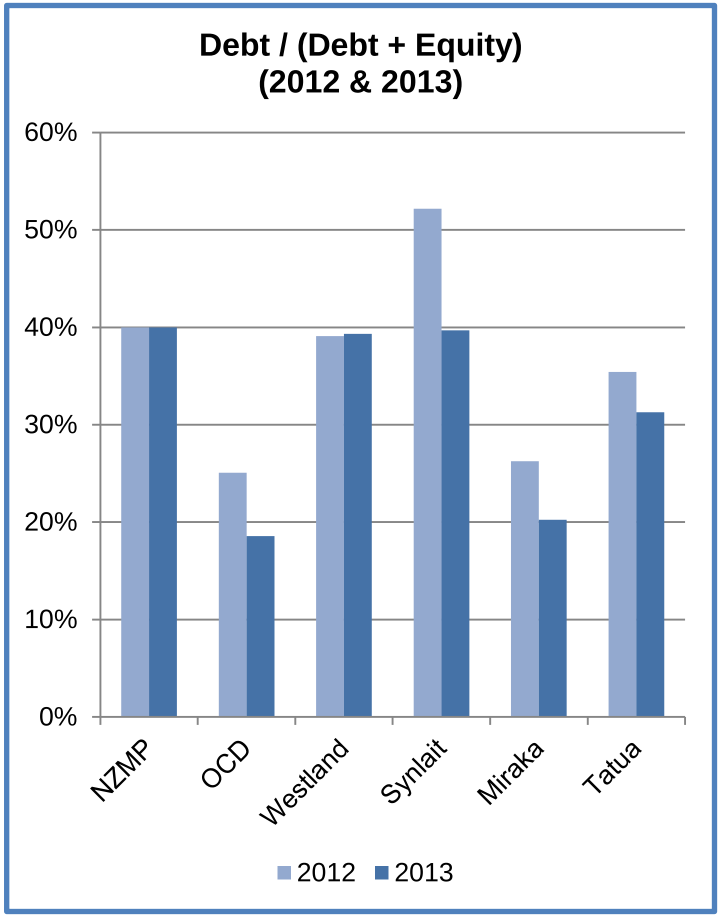
Fonterra competitors now through the high risk start-up stage – good financial flexibility through developed capital structures…





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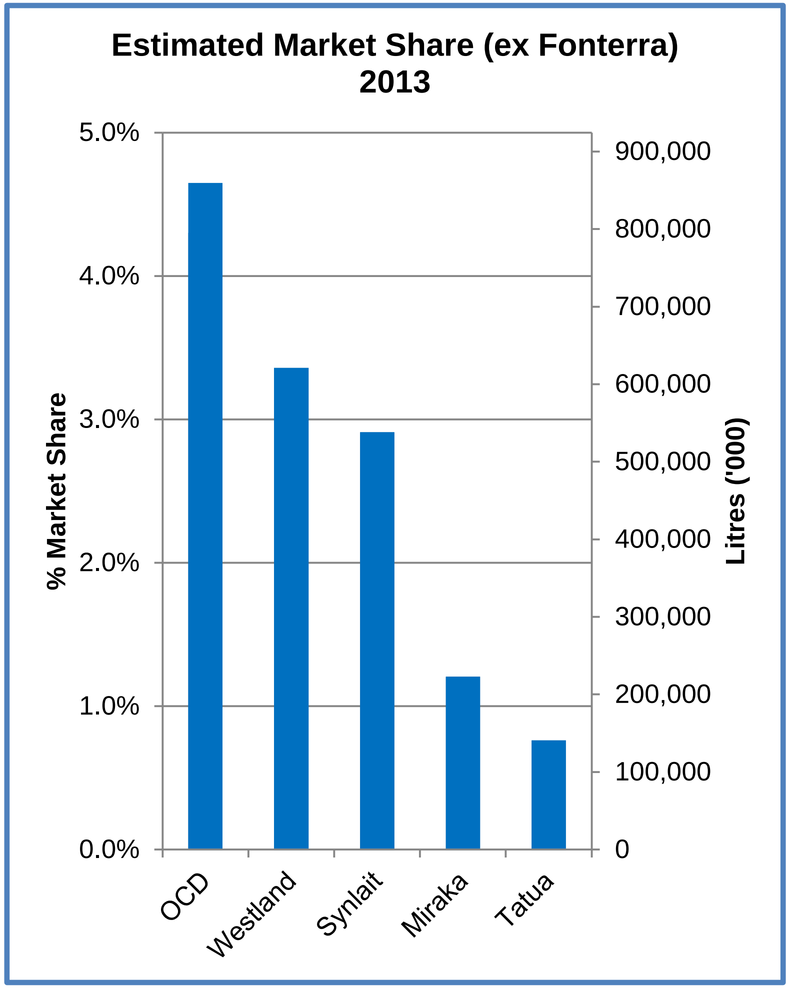
….and milk volumes consistent with competitive operating costs…



- Total milk supply in NZ is approximately 19 billion litres.
- About 11% of that is now being processed by competitors to Fonterra.
- A commodity processor can be competitive (on opex and capex) with plants of about 200m litres.
- Westland and Tatua are long established co-ops with committed milk supply.
- OCD, Synlait and Miraka have direct farmer supply and DIRA milk of 50m litres (see regulatory comments earlier in report).

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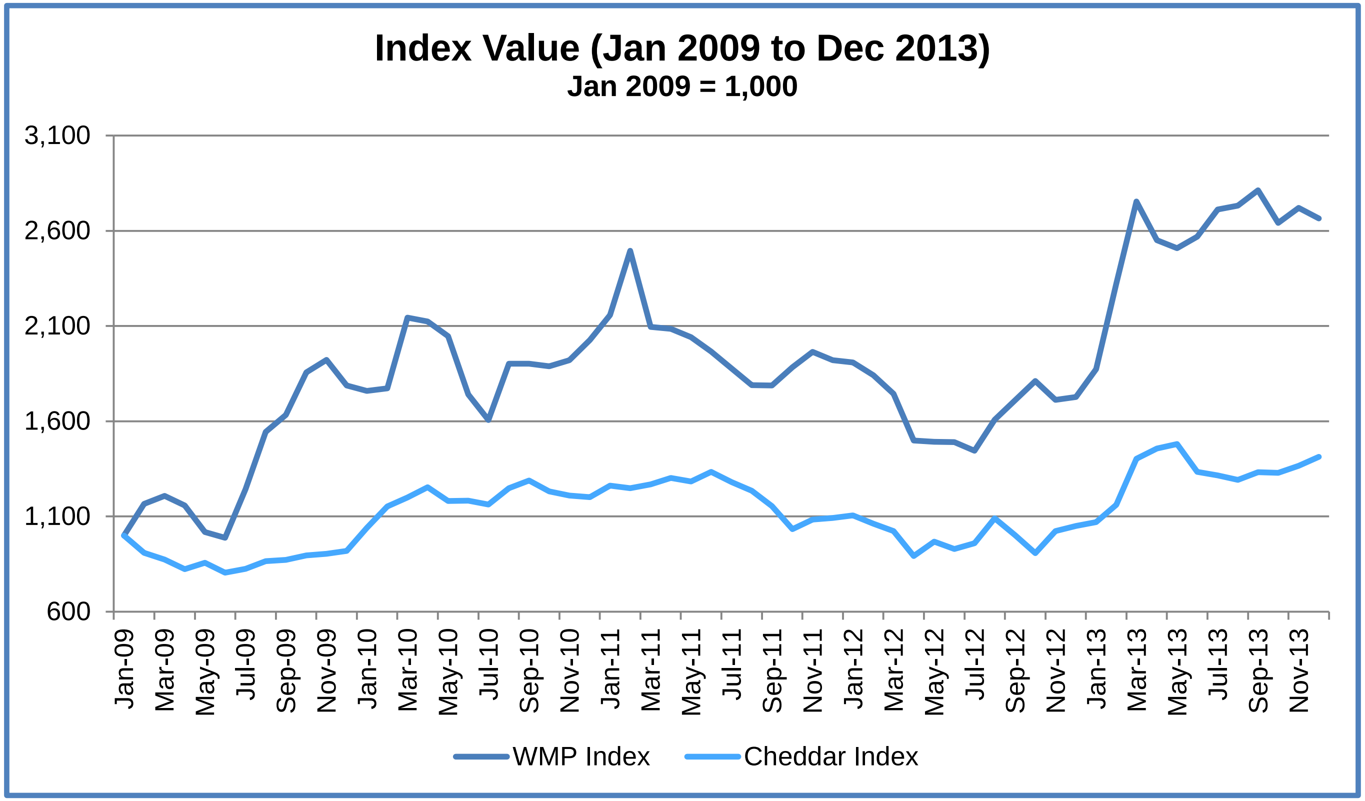
….and product mix is moving towards higher WMP returns…



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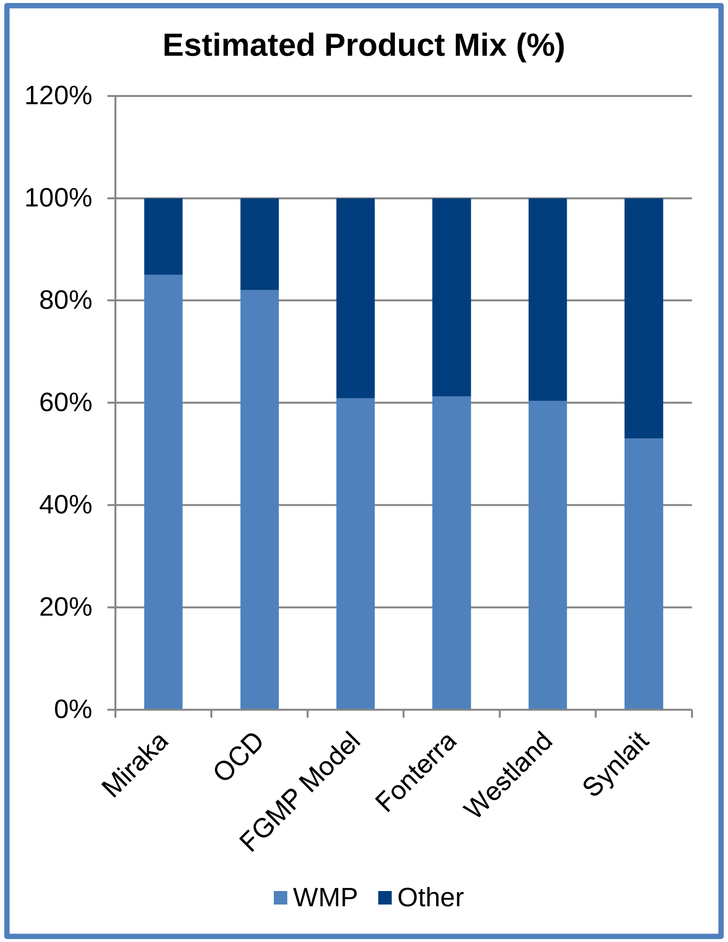
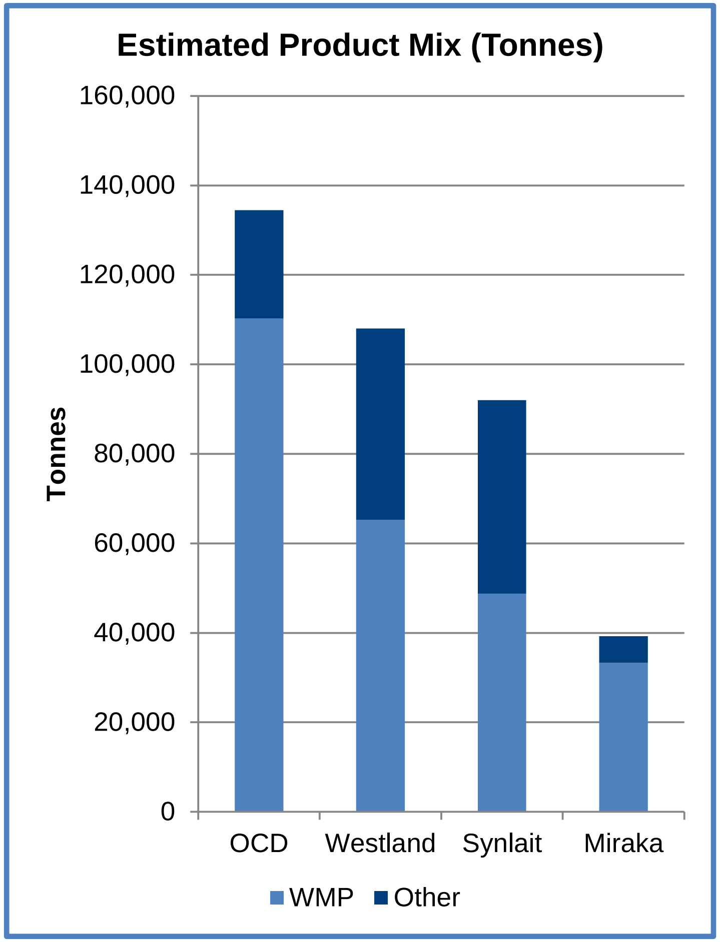
….new capacity of Fonterra's competitors biased to either WMP or higher value ingredient products





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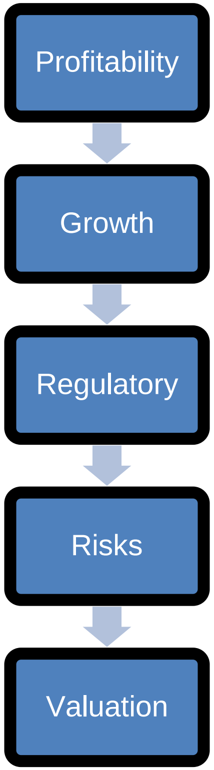

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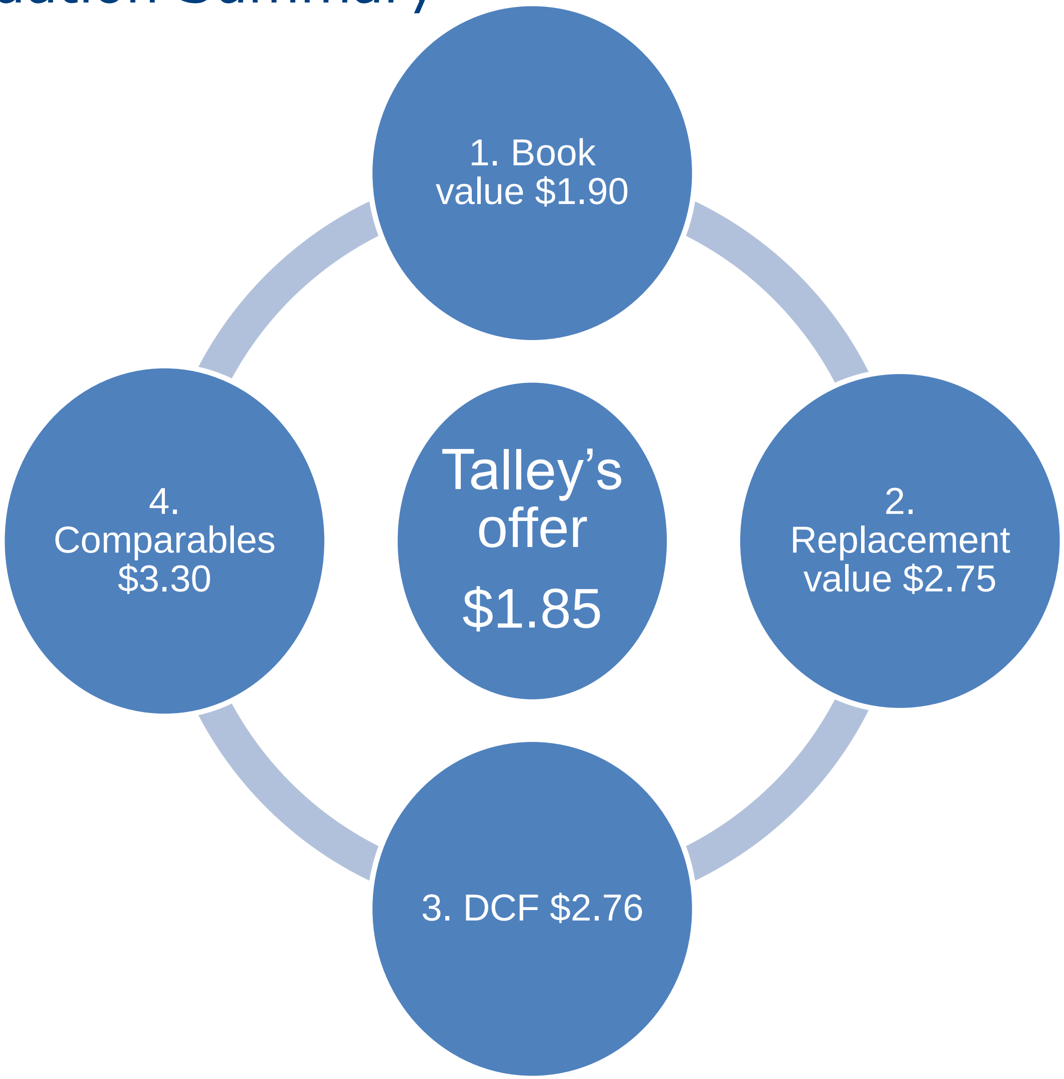

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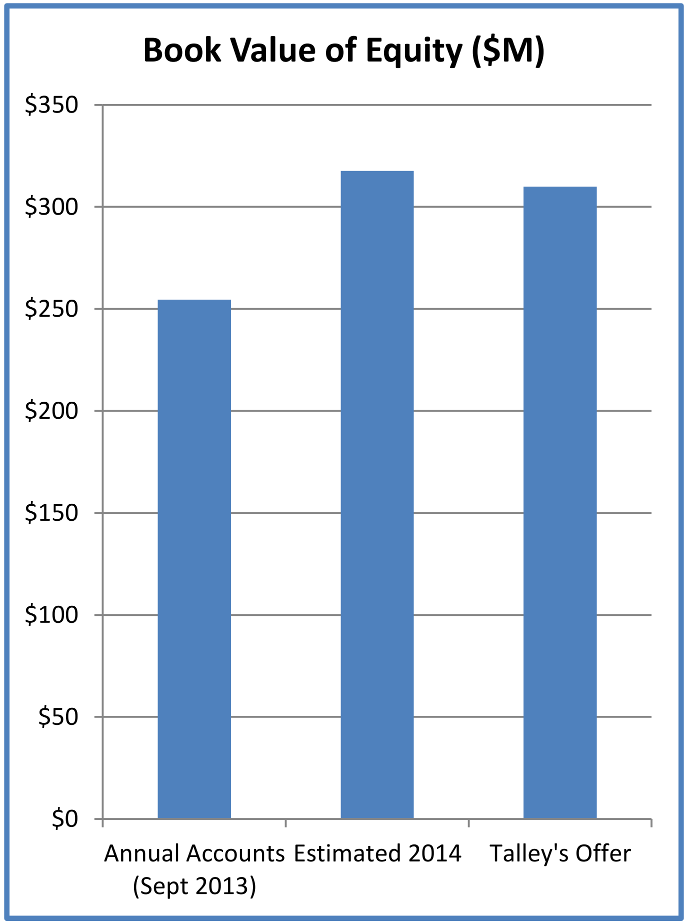
1. Book value $1.90 ($318m)

- Book Value of Equity as at Sept 2013 was $255m. We have adjusted this upward by $63m to $318m.
- We have done this because Talley's offer (if accepted) will be settled in May 2014 (i.e. 9 months from last book valuation) and it is assumed the majority of cash flows are captured within this timeframe.
- The increase of $63m is made up of two components.
  - 1. Normalised cash flow based on 2013 figures of $42m; and
  - 2. Extraordinary cash flow based on an estimated benefit of paying lower than the FGMP.
- See appendix one for further details.

Talley's offer is 22% above book value of equity as at Sept 2013 and 2% below our adjusted book value of equity (est. 2014).



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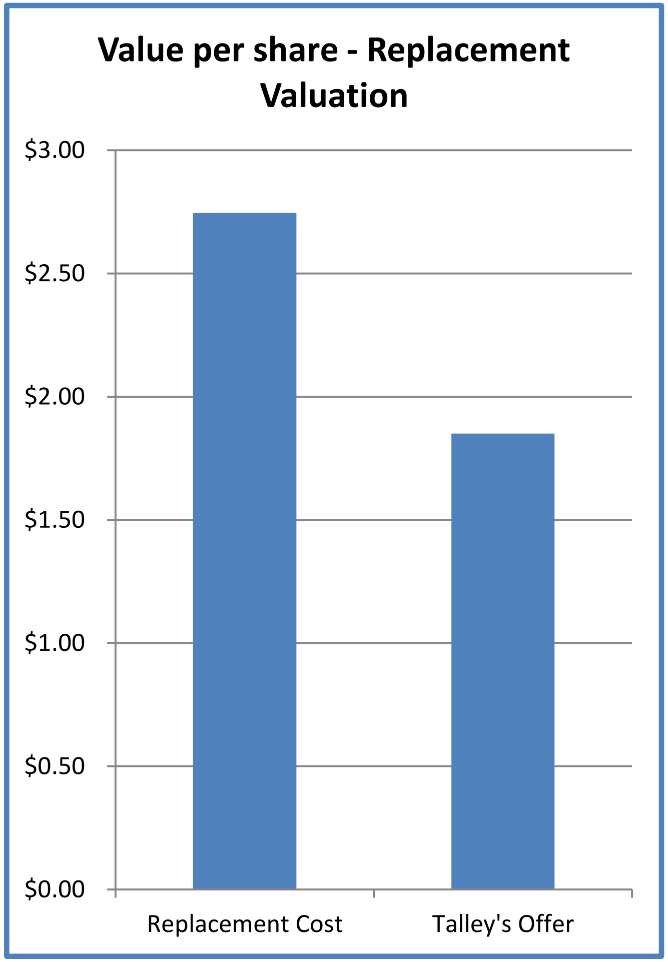
2. Replacement value $2.75 ($460m)

- In the regulatory model for calculating the milk price (FGMP) there is an assessment of the capital costs of the manufacturing and other assets required to manufacture standard commodity products.
- The 2013 regulatory calculation translates into capital costs of 45c a litre.
- The 45c a litre calculation translates into $460m of equity value based off OCD's March 31 2014 milk processing capacity – a per share value of $2.75



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3. DCF value $2.76 ($457m)

OCD DCF Valuation	2013	2014	2015	2016	2017
Litres of Milk	859,568,301	918,008,715	1,138,008,715	1,138,008,715	1,138,008,715
Solids (%)	8.50%	8.50%	8.50%	8.50%	8.50%
Solids (KgMS)	73,063,306	78,030,741	96,730,741	96,730,741	96,730,741
Regulatory Return	-	-	*$ 0.68*	*$ 0.68*	*$ 0.68*
EBITDA	**$ 44,175,000**	**$ 72,161,667**	**$ 65,776,904**	**$ 65,776,904**	**$ 65,776,904**
CASH FLOWS					
Capex Awarua	$ -	$ 57,047,000	$ -	$ -	$ -
Other Capex	$ 26,141,000	$ -	$ 6,000,000	$ 12,000,000	$ 24,182,685
Tax Expense		$ 16,292,267	$ 14,504,533	$ 14,504,533	$ 14,504,533
Cashflows for Valuation		**-$ 1,177,600**	**$ 45,272,371**	**$ 39,272,371**	**$ 27,089,685**

WACC	8.00%		
Terminal Growth Rate	3.00%		
Terminal Value		$ 541,793,710	
Enterprise Value		$ 457,546,487	
Value of tax losses		$ 8,904,000	
Value of surplus properties		$ 15,000,000	
less Debt		$ 18,177,600	
Equity Value		**$ 463,272,887**	**$ 2.76**

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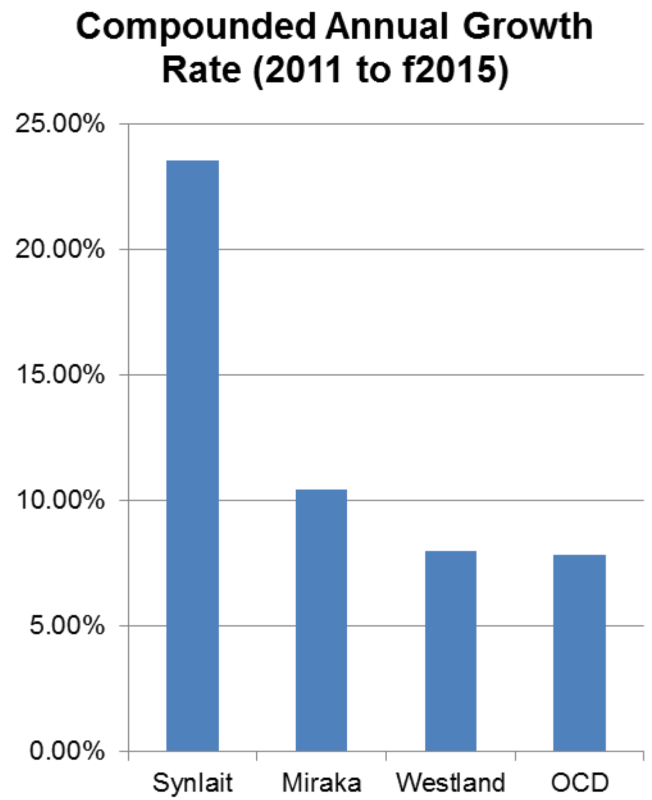
3. DCF value $2.76 – sensitive to our WACC of 8% and growth of 3%

WACC

- OCD has the closest risk profile to NZMP (being the monopoly toll processor with WACC of 7.5%) we conclude this by taking into account:
  - its size;
  - WMP product mix;
  - current capacity utilisation;
  - low reliance on DIRA milk;
  - diversity of locations;
  - "toll processing" change to a shorter payment cycle to farmers

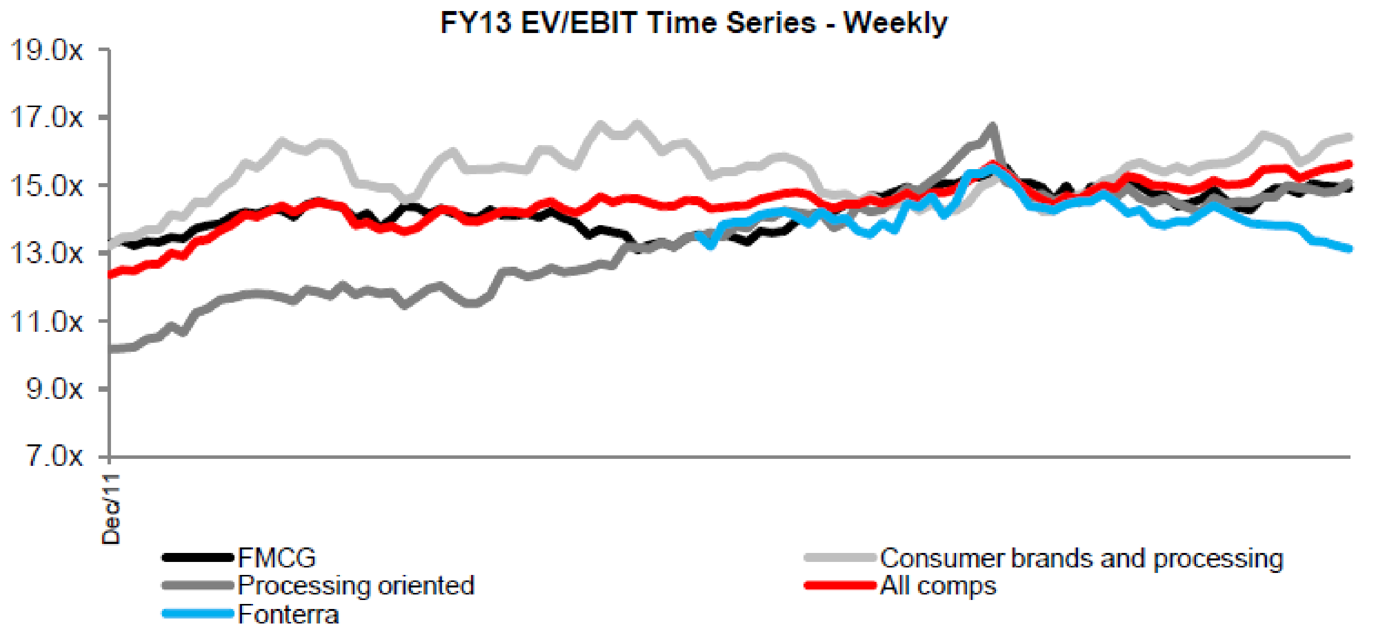
Growth



4. Comparables – EV/EBIT

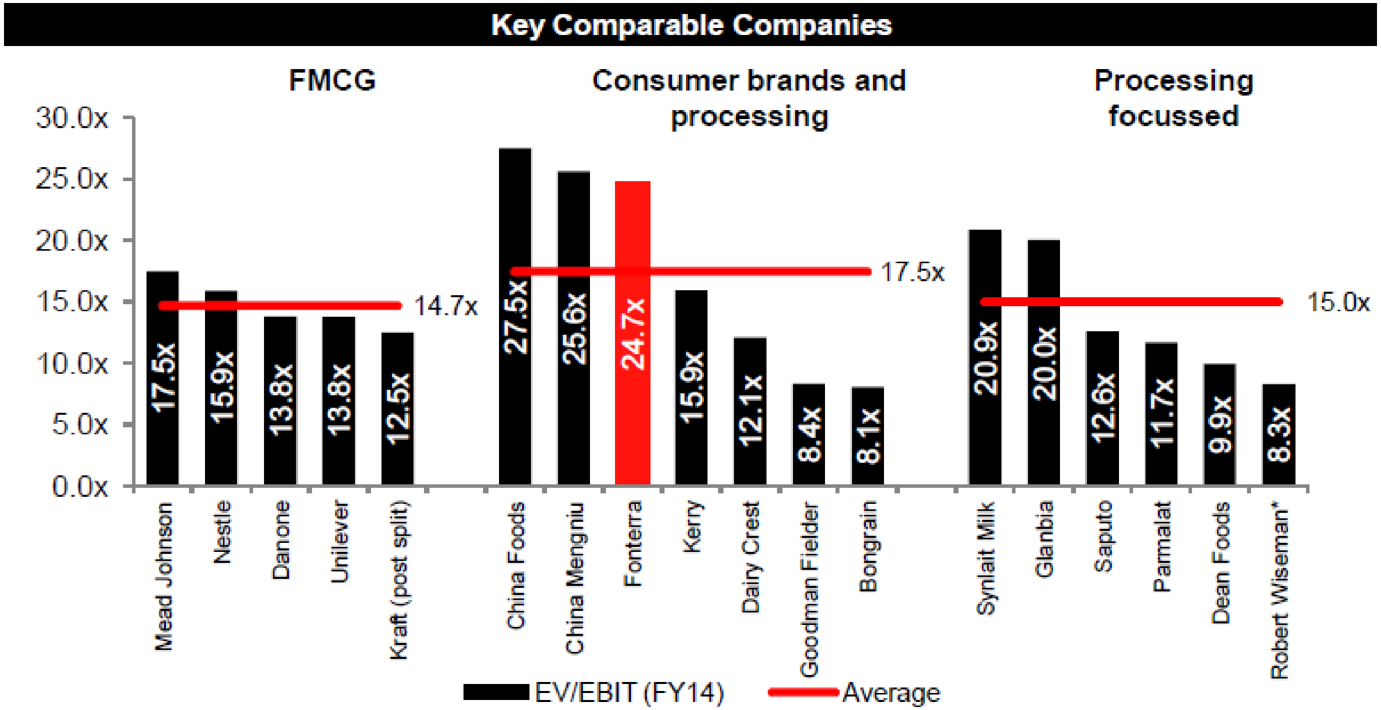
- Average EV/EBIT for global 'processing-focused' companies is around 15x (Macquarie Research Dec 2013).

Historic FY13 EV/EBIT for Global Comps



4. Comparables – EV/EBIT

- Synlait (and more recently Warrnambool) multiples imply Australiasian processors have higher multiples (higher expectations of margin growth)



Source: Macquarie Research Dec 13

4. Comparables – EV/EBIT of 19 = $3.30 per OCD share

- Talleys multiple of 11 compares with 15 for Fonterra and 23 for Synlait.
- An EV/EBIT mid point of 19 would translate into EV of $573m, being a per share equity value of $3.30

	Listed Dairy Companies				Talley's Offer
	Fonterra	**Synlait**	**Warrnambool**	**Bega Cheese**	**OCD**
	FCG.NZX	*SML.NZX*	*WCB.AX*	*BGA.AX*	
FYE 2013	*NZD $M*	*NZD $M*	*AUD $M*	*AUD $M*	*NZD $M*
EBITDA	$1,467	$38	$26	$64	$44
EBIT	$937	$28	$14	$44	$30
Market Capitilisation	$9,906	$537	$492	$695	$310*
Net Debt	$4,348	$106	$75	$87	$20**
Enterprise Value	$14,254	$643	$567	$782	$330
EV/EBITDA	***10***	***17***	***22***	***12***	***7***
EV/EBIT	***15***	***23***	***41***	***18***	***11***

* Market Cap based on Talley's offer of $1.85 per share.

** Net Debt adjusted due to OCD balance date being Sept 2013.

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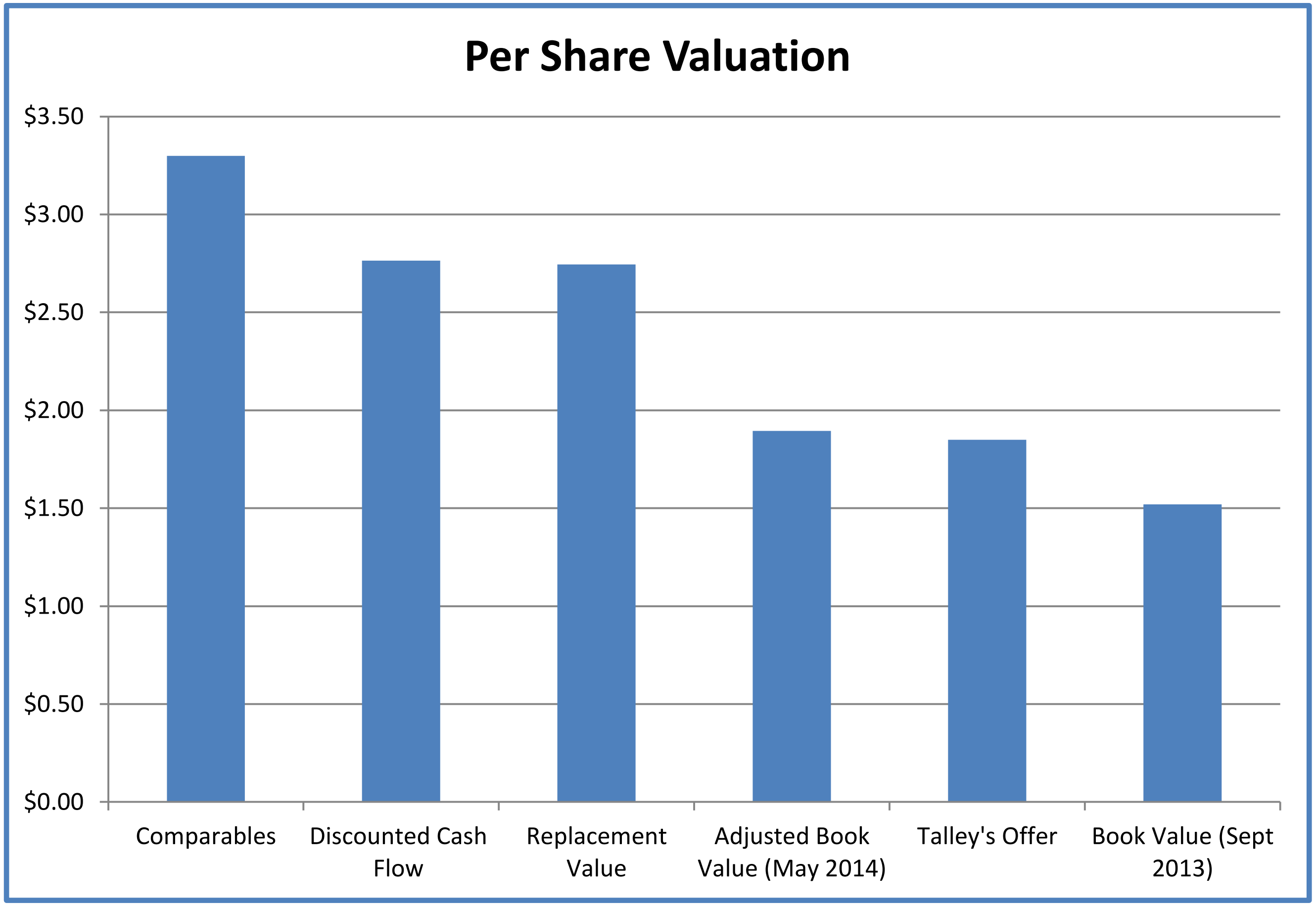
Valuation summary…



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Executive Summary

- The milk processing sector has an observable and growing level of profitability.
- Fonterra's competitors are growing at a higher pace than the NZ market.
- The highest value commodity returns are currently a WMP mix with Global Dairy Trade prices being set by Chinese demand.
- Investors are paying above book values for processors with committed milk supply and distribution channels into China; this implies growth in margins for those processors with existing milk supply
- Talley's own 60% of OCD and are currently increasing that to 70% at $1.85 a share ($310m), this is a small discount on book value.
- Our assessment of a DCF value is $2.76 per share.
- If OCD was available for sale it would have a market value of above $3 per share.

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Appendix One: Adjustment to OCD Book Value

- Book Value of Equity as at Sept 2013 was $255m and Net Debt was $54m.
- Book value of total enterprise = $255m + $54m = $309m.
- Talley's offer ($1.85/share) values OCD equity at $310m with an EV of $364m. This is 22% above the Book Value of OCD.
- However… we need to make an adjustment given we are now in Feb 2014 and Talley's offer (if accepted) will be completed in May 2014, i.e. we need to add another year's free cash flows to EV.

Appendix One: Adjustment to OCD Book Value

- Sept 2013 Book Value of Equity = $255m.
- We add a normalised and extraordinary EBITDA to this BV.
- Normalised EBITDA:
  - We assume that 2013 numbers will be the same for 2014. EBITDA = $44m
- Extraordinary EBITDA:
  - We take two approaches to this:
  - Number One: Synlait Announcement
    - Synlait has recently announced their forecast net profits for the 2014 year will be $13m higher than previously announced.
    - We then take Synlait's capacity of 600 million litres to find the per litre uplift = $0.02 per litre.
    - We apply this $0.02 per litre to OCD's capacity of 920 million litres to give us the estimated increase in cash flow of $19m.

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Appendix One: Adjustment to OCD Book Value

- Number Two: KgMS
  - Fonterra have announced a milk price of $8.30 despite the FGMP calculation deriving the price at $9.00.
  - This $0.70 difference is assumed to go directly to farmers ($0.20) and shareholders ($0.50).
  - Using OCD KgMS of 73m this equates to an extra $37m to shareholders.
- We take the average of the two approaches taken = $28m.

- Estimated Book Value of Equity 2014:
  - Book Value Sept 2013 = $255m
  - Estimated EBITDA = $72m
  - Estimated free cash flows = $6m
  - New assets built = $57m
  - Depreciation = $14m
  - Total Book Value of Equity = $318m


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