# MASTELLONE HERMANOS S.A.
# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
# FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2015

The following discussion and analysis should be read in conjunction with the unaudited consolidated financial statements of Mastellone Hermanos S.A. (the Company) and notes thereto for the three month period ended March 31, 2015.

We are the largest dairy company and the leading processor for fresh dairy products in Argentina, ranking first in market share for fluid milk, butter, cream, and caramelized condensed milk (*dulce de leche*). Our main market is the Argentine retail market. We have been active in the Argentine domestic market for almost 85 years. We also have been exporting dairy products for more than 30 years. Therefore, we are affected by developments in the Argentine dairy sector as well as developments in Argentina's economic and financial situation. Since we have commercial activities in Brazil, we are also affected by developments in its economic and financial condition, although to a lesser extent than in the case of Argentina.

In this report, "$" and "Ps." refer to the currencies of the United States and Argentina, respectively.

## ***Adjusted EBITDA (millions of Pesos)***

| | | | LTM | |
|---|---|---|---|---|
| | **1Q15** | **1Q14** | **March 15** | **March 14** |
| Consolidated net result | -166,3 | -160,3 | -463,7 | -201,2 |
| Income tax | -85,5 | -92,5 | -95,3 | -99,7 |
| Amortization Intangible assets | 3,2 | 10,0 | 19,8 | 26,1 |
| Depreciation | 84,7 | 33,4 | 195,5 | 128,4 |
| Interest expenses | 93,6 | 49,3 | 341,4 | 175,3 |
| Exchange differences | 74,1 | 323,1 | 194,6 | 617,2 |
| Other | | | | -60,4 |
| **Adjusted EBITDA** | **3,8** | **163,0** | **192,3** | **585,7** |

## ***Evolution of Adjusted EBITDA since 2011***

Can be summarized as follows (millions of Ps. or US$):

| Period | Ps. | Ps./US$ | US$ |
|---|---|---|---|
| 1Q11 | 35,3 | 4,054 | 8,7 |
| 2Q11 | 86,7 | 4,110 | 21,1 |
| 3Q11 | 118,7 | 4,205 | 28,2 |
| 4Q11 | 79,8 | 4,304 | 18,5 |
| 1Q12 | 36,3 | 4,379 | 8,3 |
| 2Q12 | 22,7 | 4,527 | 5,0 |
| 3Q12 | 83,0 | 4,697 | 17,7 |
| 4Q12 | 150,9 | 4,918 | 30,7 |

| | | | |
|---|---|---|---|
| 1Q13 | 89,1 | 5,122 | 17,4 |
| 2Q13 | 186,1 | 5,388 | 34,5 |
| 3Q13 | 111,2 | 5,793 | 19,2 |
| 4Q13 | 123,8 | 6,521 | 19,0 |
| 1Q14 | 164,6 | 8,002 | 20,6 |
| 2Q14 | 111,2 | 8,133 | 13,7 |
| 3Q14 | 102,8 | 8,430 | 12,2 |
| 4Q14 | -27,1 | 8,551 | -3,2 |
| 1Q15 | 3.8 | 8,822 | 0.4 |

The cash generation for the first quarter of 2015 was affected mostly due to the contraction in the overall economic activity in Argentina in that period and additionally by some factors impacting in our business and the dairy industry, such as: (i) International prices for milk powder, (ii) availability of raw milk, and (iii) the delay in the recovery of higher costs incurred during 2014 and the first quarter of 2015, not transferred to sales prices yet.

Although international prices for milk powder have shown some signs of recovery, currently they remain in the level of the last quarter of 2014. This volatility has led to a delay in the export´s transactions. Despite this situation, our company has closed export sales by approximately 8,000 tons of milk powder, with shipments starting in March and forecasted to be completed during the second quarter, at prices slightly higher than the current average, although below the minimum desired.

The volumes of raw milk received remain at the prior level, not showing yet clear signs of recovery. That situation has a negative impact on the Company´s results in two ways: (i) reducing the volume of activity for the whole portfolio of products, and (ii) with cost increases resulting from the low supply of raw milk to the market. However, we remain confident to recover, during the rest of the year, the historical levels of raw milk processed.

The increases in our sales prices, needed to compensate higher costs incurred the last year and during the first quarter of 2015, could only been applied in part and approximately by mid-March instead of at the beginning of the quarter.

Finally, consumption in Argentina remains stagnant, affecting our sales volumes during the quarter, on top of seasonal factors, usually negative for such period. We expect a better performance for the rest of the year, with a positive impact on our results.

## ***Outlook***

We estimate that in the next few months domestic demand for our products will improve (due to both seasonal factors and real growth), with a positive impact on our sales, and consequently, on our results.

In the export business, during the upcoming quarter we will complete the shipments for the sales already agreed with our foreign customers, with destinations such as Mexico and Algeria. The volumes to export during the rest of the year will be subject to the availability of raw milk and the evolution of the international price of milk powder.

We will do our best efforts to reverse the negative results of the first quarter. Mastellone Hnos. has basic strengths that remain unaffected by the short-term developments. Based on that, we expect to improve substantially our economic results for the rest of the year. It should be pointed out also that we will continue with actions for further growth in the raw milk intake on a long-term basis, which will undoubtedly, generate sustainable improvements in our economic performance in the medium and long term

## ***Comparison of Results of Operations for the three month period ended March 31, 2015 and 2014.***

***Revenues***. Our revenues are divided as follows:

| | Three month period ended March 30, | | | |
|---|---|---|---|---|
| **(millions of Ps. or %)** | **2015** | **2014** | **Difference** | **%** |
| Products - Argentine Market | 2,818.5 | 2,332.4 | 486.1 | 20.8% |
| Products - Foreign Markets | 165.5 | 190.3 | -24.8 | -13.0% |
| Exports | 99.4 | 180.4 | -81.0 | -44.9% |
| Services | 79.4 | 79.3 | 0.1 | 0.4% |
| **Total** | **3,162.8** | **2,782.4** | **380.4** | **13.7%** |

***Product Sales – Argentina.*** During the three month period ended March 31, 2015, our product sales in the Argentine domestic market increased by Ps.486.1 million, or 20.8%, as compared to the same period of 2014, primarily as a result of (i) a 7.4% decrease in physical volumes sold (expressed in terms of the raw milk used to manufacture the products sold), and (ii) a 28.1% year on year increase in product mix and average prices during the period.

Physical volumes sold decreased mostly due to the suspension of deliveries of fluid milk to the Buenos Aires province and a decreased in sales to retail markets reflecting the contraction in the levels of consumption of the economy.

***Product Sales – Foreign Markets***. During the three month period ended March 31, 2015, sales in the foreign markets (Brazil and Paraguay) decreased Ps. 24.8 million, or 13.0% as compared to the same period of 2014, principally as a result of a 0.4% decrease in sales in Brazil, expressed in Brazilian reais (from BRL 56.1 million in 2014 to Reais 55.9 million in 2015) and the average appreciation of the Argentine peso against Brazilian Reais.

***Exports.*** During the three month period ended March 31, 2015, exports to third parties decreased by Ps.81.0 million, or 44.9% compared to 2014, primarily due to the combined effect of: (i) a 24.3% decrease in exported volumes of powder milk affected by the drop of the international price of the powder milk, (ii) a 43.1% decrease in average export prices for powder milk, and (iv) the depreciation of the Argentine peso.

***Cost of Sales.*** Cost of goods and services sold during the three month period ended March 31, 2015 as compared to the same period of 2014, increased by Ps. 385.0 million, or 19.5%, from Ps. 1,970.6 million to Ps. 2,355.6 million.

The cost of raw materials increased 15.3% from Ps. 1,413.5 in 2014 to Ps. 1,630.2 in 2015 principally due to an increase of 24.1% in the average price paid for the raw milk and a decrease of volumes processed in the period.

, Production costs increased by Ps. 168.3 million or 30.2%, from Ps. 557.1 million in 2014 t o Ps. 725.4 million in 2014, principally due to the following reasons:

- An increase in depreciations of Ps. 48.0 million or 161.1% from Ps. 29.8 in 2014 to Ps. 77.8 in 2015, due to the change of method from cost to revalued cost for the valuation of certain items included in property, plant and equipment;

- An increase in labor cost of Ps. 75.5 million, or 30.1%, from Ps. 251.0 million in 2014 to Ps. 326.5 million in 2015, primarily due to agreements with the union and salary increases granted to non-unionized personnel;

- An increase in fuel, gas and energy expenses of Ps. 8.5 million or 25.1% from Ps. 33.8 million in 2014 to Ps. 42.3 million in 2015.

- An increase in freight costs of Ps. 19.5 million, or 16.8%, from Ps. 116.0 million in 2014 to Ps. 135.5 million in 2015; and

***Selling Expenses***. Selling expenses for the three month period ended March 31, 2015, increased Ps.183.2 million, or 30.9%, as compared with the same period of 2014, from Ps.593.8 million in 2014 to Ps.777.0 million in 2015. Such increase was primarily attributable to:

- Higher transportation costs of Ps.85.1 million, or 27.8%, from Ps.306.1 million in 2014 to Ps.391.2 million in 2015,

- An increase in advertising costs of Ps.12.3 million, or 18.4% (from Ps. 66.8 million in 2014 to Ps.79.1 million in 2015)

- An increase in labor costs of Ps.28.3 million, or 34.0%, from Ps.83.3 million in 2014 to Ps.111.6 million in 2015,

- Higher fees (most of them related with the distribution of our products in Argentina) increased Ps. 47.3 million, or 41.4%, from Ps.114.3 million in 2014 to Ps.161.6 million in 2015.

***General and Administrative Expenses***. During the three month period ended March 31, 2015, General and Administrative Expenses increased by Ps. 23.9 million, or 24.8%, as compared to the same period of 2014, from Ps. 96.5 million to Ps. 120.4 million. Such increase is primarily attributable to:

- An increase in labor costs of Ps.14.1 million, or 30.1%, from Ps. 46.9 million in 2014 to Ps. 61.0 million in 2015; and

- An increase of Ps. 4.7 million, or 18.7%, in taxes (principally the tax on checking accounts), from Ps. 25.2 million in 2014 to Ps. 29.9 million in 2015.

***Investment Income.*** During the three month period ended March 31, 2015, investment income increased by Ps.1.8 million, or 27.3%, (from Ps.6.6 million in 2014 to Ps.8.4 million in 2015, primarily due to an increase in cash balances.

***Finance Cost***. During the three month period ended March 31, 2015, finance cost increased Ps. 44.3 million, or 89.9% as compared to three month period ended March 31, 2014 (from Ps. 49.3 million in 2014 to Ps. 93.6 million in 2015), primarily due to a combined effect of: i) an increase in the exchange rate between the Argentine peso and the U.S. dollar (which can be estimated in 9.7% – based on the average of the exchange rates prevailing during the three month period ended March 31, 2014 and 2015), ii) an increase in the short and long-term financial debt used to fund working capital needs and general corporate purposes , iii) an increase in the principal amount of our long term financial debt primarily due to the net issuance of our Series F Notes and the execution of the exchange, tender and call offer applicable over the prior debt (2015 and 2018 Notes and Tranche A & B loans), and iv) an increase in the finance cost of our long-term debt primarily due to a higher interest rate of our Series F Notes as compared with the interest rate applicable in our prior debt.

***Foreign Exchange Losses***. Losses from exchange differences during the three month period ended March 31, 2015 decreased Ps. 249.0 million, or 77.1%, as compared with the three month period ended March 31, 2014 (from Ps. 323.1 million in 2014 to Ps. 74.1 million in 2015), primarily due to the lower devaluation of the Argentine Peso.

***Other Gains and Losses***. During the three month period ended March 31, 2015, the losses from Other Gains and Losses, increased by Ps. 1.6 million or 228.6% , as compared with the same period of 2014 (from a loss of Ps. 0.7 million in 2014 to loss Ps. 2.3 million in 2015), primarily due to (i) the booked losses derived from results from contingencies of Ps. 2.4 million (from a loss of Ps. 0.4 million in the three month period ended March 31, 2014 to a loss of Ps. 2.8 million in 2015 (ii) a gain from recuperated charges to truck drivers of Ps. 1.1 million (from Ps. 0.3 million in the three month period ended March 31, 2015 to Ps. 1.4 million in 2015.

## *Liquidity and Capital Resources*

### *Sources and Uses of Funds – Three month period ended March 31, 2015 and 2014*

| | **Three month period ended March 31st,** | |
|---|---|---|
| | **2015** | **2014** |
| | **(Millions of pesos)** | |
| **Net Cash used by operating activities** | **-77.7** | **96.9** |
| **Cash from investment activities** | | |
| Purchase of property, plant & equipment | -43.2 | -48.2 |
| Purchase of investment property | -0.7 | |
| Proceeds from net sales of other financial assets | 66.9 | 2.7 |
| Proceeds from sale of subsidiaries | | 6.3 |
| Proceeds from disposal of Property, Plant & Equipment | 1.1 | 1.1 |
| Proceeds from other assets | | 0,8 |
| **Cash generated by (used in) investment activities** | **24.1** | **-37.3** |
| **Cash from financing activities** | | |
| Proceeds from borrowings | 134.7 | 50.6 |
| Repayments of borrowings | -30.7 | -3,0 |
| Interest paid on borrowings | -30.6 | -9.6 |
| **Cash generated by financing activities** | **73.5** | **38.0** |
| Net change in cash and cash equivalents | 19.9 | 97.5 |
| Initial balance | 169.8 | 115,3 |
| **Ending balance** | **189.7** | **212.8** |

During the three month period ended March 31, 2015, net cash from operations decreased Ps.174.6 million, or 180.2%, as compared with the same period of 2014, primarily reflecting the effect of decrease in the EBITDA and an increase of Ps.49.6 million in funds applied to working capital needs, to a great extent due to a higher inventories and a reduction in the payment terms to dairy farmers, in accordance with market conditions, applied since the third quarter of 2014.

Net cash applied to investment activities improved Ps.61.4 million, or 164%, from cash outflows of Ps.37.3 million in 2014 to cash inflows of Ps.24.1 million in 2015, primarily due to the net sale of Government bonds.

Net cash proceeds from financing activities increased during the three month period ended March 31, 2015, Ps.35.5 million, in comparison with the same period of 2014 (from cash inflows of Ps.38.0 million in 2014 to cash inflows of Ps.73.5 million in 2015), primarily due to an increase in short term financial debt destined to finance higher working capital needs and increased interests payments (Ps.21 million more than during 2014).

## ***Financial Debt***

The following summarizes the evolution of our financial debt (expressed in millions of dollars) for the dates therein indicated.

| | 31-Mar-15 | 31-Mar-14 |
|---|---|---|
| Loans and bonds - principal | | |
| Final maturity 2015 | -- | 30.4 |
| Final maturity 2018 | -- | 140.9 |
| Due 2021 | 199.7 | -- |
| Subtotal | 199.7 | 171.3 |
| Short term debt | 65.7 | 54.3 |
| Other long term debt | 1.7 | 4.8 |
| Principal - total | 267.1 | 230.4 |
| Accrued interest | 7.2 | 5.6 |
| Prepaid expenses | -8.2 | -- |
| Total Debt | 266.1 | 236.0 |
| Cash and cash equivalents | -21.5 | -26.6 |
| Net Debt | 244.6 | 209.4 |

## **Change of method from cost to revalued cost for the valuation of certain items included in property, plant and equipment**

It having become evident that using the revaluation method to reflect certain assets included under Property, plant and equipment would improve the quality of the information provided in the financial statements, the Board of Directors approved the change from cost to revalued cost in their book value. For this reason, a specialized firm was hired to provide advice to the Board of Directors on the determination of the revalued amounts of certain items included in this account. The result of their professional work is shown in the following changes in the accounts subject to analysis (amounts in thousands of Argentine pesos, as of December 31, 2014):

| | **Amounts as of December 31, 2014** | | |
|---|---|---|---|
| | **Cost** | **Revalued cost** | **Difference** |
| | | (in thousands of pesos) | |
| Land and buildings | 762,257 | 1,835,761 | 1,073,504 |
| Machinery and equipment | 259,606 | 1,033,129 | 773,523 |
| Laboratory facilities and equipment | 194,246 | 608,796 | 414,550 |
| **Total** | **1,216,109** | **3,477,686** | **2,261,577** |

Consequently, it was resolved that (i) the change from cost to revalued cost in the valuation model for the items of Property, plant and equipment set forth in December 31, 2014, thus establishing a new accounting policy in these matters, (ii) the new amounts would be included in the Company's financial statements as of such date, and (iii) the above revaluation would be approved.

The remaining items included in Mastellone's Property, plant and equipment has been excluded from the change of valuation model because of their own specific features. In effect, in the case of the works in progress, no improvement would be obtained in the information provided to readers of the Company's financial statements if they were revalued at a reasonable cost because these costs were incurred relatively recently. Other excluded assets comprise furniture, fixtures and equipment, vehicles and trays, whose book values are similar or close to their respective fair value, among other reasons on account of their higher turnover. Therefore, we believe that the information provided to readers of our financial statements would not be more relevant if the revalued cost method were applied.

Finally, it should be noted that the effect of the asset revaluation described above is somehow opposed to the loss from exchange differences recorded in recent three month periods as a result of the liabilities used to finance such assets, and largely exceeds the accumulated amounts under such item in the last five years.

**Mastellone Hermanos S.A.**

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