MASTELLONE HERMANOS S.A.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
FOR THE NINE MONTH PERIOD ENDED SEPTEMBER 30, 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 nine month period ended September 30, 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 more than 85 years. We also have been exporting dairy products for more than 30 years. Therefore, we are affected by developments in the international and Argentine dairy sectors 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)

	Nine month period ended		Last 12 months as of	
	September 30, 2015	**September 30, 2014**	**September 30, 2015**	**September 30, 2014**
Consolidated net result	-237.6	-331.4	-363.8	-435.9
Income tax	-153.1	-56.8	-198.6	-61.8
Amortization Intangible assets	9.6	26.5	9.7	42.4
Depreciations	257.1	106.8	294.5	138.7
Interest expenses	278.5	217.8	357.9	234.1
Exchange differences	223.4	415.6	251.4	567.7
Other	0.0	0.0	0.0	-12.5
Adjusted EBITDA	**377.9**	**378.5**	**351.1**	**472.7**

It is to be pointed out that, from the financial point of view, the EBITDA for 2015 has been reduced by a provision of Ps.190.5 million due to an inventories write down to adjust to the applicable market value in the case of exportable products, as a result of lower international prices.

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Cash generation, as measured by the Adjusted EBITDA, improved during the third quarter of 2015 in comparison with the previous quarter. This improvement confirms the positive trend that has begun in the previous quarter. The main factors that impacted in the EBITDA are (i) the reduction in the cost of raw milk in line with current international prices, (ii) the evolution of sales and (iii) our actions to reduce costs.

Comparison of Results of Operations for the nine month period ended September 30, 2015 and 2014.

Revenues:

Our revenues are divided as follows:

	Nine month period ended September 30,			
(Millions of Ps. or %)	**2015**	**2014**	**Difference**	**%**
Products - Argentine Market	9,374.6	7,772.1	1,602.5	20.6%
Products - Foreign Markets	477.6	620.8	-143.2	-23.1%
Exports	309.6	383.5	-73.9	-19.3%
Services	260.8	233.0	27.8	11.9%
Total	**10,422.6**	**9,009.5**	**1,413.1**	**15.7%**

Product Sales – Argentina:

During the nine month period ended September 30, 2015, our product sales in the Argentine domestic market increased by Ps. 1,602.5 million, or 20.6%, as compared to the same period of 2014, primarily as a result of:

- A 3.0% decrease in physical volumes sold (expressed in terms of the raw milk used to manufacture the products sold) to the retail market,
- A 1.2% decrease in physical volumes sold to governmental institutions and other non-retail sales, and
- A 24.8% year on year increase in product mix and average prices during the period.

Product Sales – Foreign Markets:

During the nine month period ended September 30, 2015, sales in the foreign markets (Brazil and Paraguay) decreased Ps. 143.2 million, or 23.1% as compared to the same period of 2014, principally as a result of a 24,6% depreciation of the Brazilian Real versus the Argentine Peso

Exports:

During the nine month period ended September 30, 2015, exports to third parties decreased by Ps.73.9 million, or 19.3% compared to 2014, primarily due to the combined effect of:

- An increase of 32.2% in volumes of powder milk, our main product for export sales

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- A decrease of 45.4% in average sales prices for powder milk, and
- The depreciation of the Argentine peso.

Cost and expenses

Cost of Sales:

Cost of goods and services sold during the nine month period ended September 30, 2015 as compared to the same period of 2014, increased by Ps. 957.3 million, or 15.0%, from Ps. 6,379.3 million to Ps. 7,336.6 million, principally as a result of:

- An increase of production costs of Ps. 617.0 million or 34.5%, from Ps. 1,787.4 million in 2014 to Ps. 2,404.4 million in 2015, principally due to the following reasons:
  - ✓ An increase in labor cost of Ps. 298.3 million, or 36.6%, from Ps. 814.7 million in 2014 to Ps. 1,113.0 million in 2015, primarily due to agreements with the union and salary increases granted to non-unionized personnel.
  - ✓ An increase in depreciation of Ps. 140.7 million or 146.4% from Ps. 96.1 in 2014 to Ps.236.8 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 freight costs of Ps. 43.8 million, or 12.1%, from Ps. 360.8 million in 2014 to Ps. 404.6 million in 2015.
- A write down applied over exportable inventories for Ps. 190.5 million, due to the resulting adjustment to the applicable market value as a result of lower international prices.
- A 3.3% increase in the cost of the raw materials in comparison with the same period of 2014, from Ps. 4,591.9 in 2014 to Ps. 4,741.6 in 2015 principally due to an increase of 8.0% in the average price paid for the raw milk.

Selling Expenses:

Selling expenses for the nine month period ended September 30, 2015, increased Ps.598.9 million, or 30.0%, as compared with the same period of 2014, from Ps. 1,999.1 million in 2014 to Ps. 2,598.0 million in 2015. Such increase was primarily attributable to:

- Higher transportation costs, mostly related with an increase of salaries included in the cost of freights, of Ps.246.6 million or 23.6%, from Ps.1,044.9 million in 2014 to Ps.1,291.5 million in 2015.
- Higher fees (most of them related with the distribution of our products in Argentina) increased Ps. 145.8 million, or 37.5%, from Ps.388.6 million in 2014 to Ps.534.4 million in 2015.
- An increase in labor costs directly related with selling expenses (sales force, marketing areas, etc.) of Ps.120.9 million, or 44.5%, from Ps.271.4 million in 2014 to Ps.392.3 million in 2015.

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- An increase in advertising costs of Ps.54.3 million, or 24.3% (from Ps. 222.8 million in 2014 to Ps.277.0 million in 2015).

General and Administrative Expenses:

During the nine month period ended September 30, 2015, General and Administrative Expenses increased by Ps. 75.0 million, or 22.4%, as compared to the same period of 2014, from Ps. 335.2 million to Ps. 410.2 million. Such increase is primarily attributable to:

- An increase in labor costs of Ps.42.7 million, or 25.0%, from Ps. 170.9 million in 2014 to Ps. 213.6 million in 2015; and

- An increase in taxes (principally the tax on checking accounts), of Ps. 8.8 million, or 10.1%, from Ps. 86.9 million in 2014 to Ps. 95.7 million in 2015.

Investment Income:

During the nine month period ended September 30, 2015, investment income increased by Ps.36.2 million, or 861.7%, (from a loss of Ps.4.2 million in 2014 to a gain of Ps.32.0 million in 2015), primarily due to an increase in cash balances.

Finance Cost:

During the nine month period ended September 30, 2015, finance cost increased Ps. 90.3 million, or 48.0% as compared with the same period ended of 2014 (from Ps. 188.2 million in 2014 to Ps. 278.5 million in 2015), primarily due to a combined effect of:

- An increase in the exchange rate between the Argentine peso and the U.S. dollar (which can be estimated in 10.9% – based on the average of the exchange rates prevailing during the nine month period ended September 30, 2014 and 2015),

- 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),

- 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, and

- The absence in 2015 of a non-recurring loss of Ps.43.9 million, covering expenses related to tue refinancing of our financial debt

Foreign Exchange Losses:

Losses from exchange differences during the nine month period ended September 30, 2015 decreased Ps. 192.2 million, or 46.2%, as compared with the same period of 2014 (from Ps. 415.6 million in 2014 to Ps. 223.4 million in 2015), primarily due to the lower depreciation of the Argentine Peso.

Other Gains and Losses:

During the nine month period ended September 30, 2015, the results from Other Gains and Losses increased by Ps. 6.1 million or 124.5% as compared with the same period of 2014 (from a loss of Ps. 4.9 million in 2014 to a gain of Ps. 1.2 million in 2015), primarily due to reduction in charges from contin-

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gencies of Ps.5.9 million (from a loss of Ps. 7.3 million in the nine month period ended September 30, 2014 to a loss of Ps. 1.4 million in 2015).

Liquidity and Capital Resources

Sources and Uses of Funds – Nine month period ended September 30, 2015 and 2014

	Nine month period ended September 30th, 2015	2014
	(Millions of pesos)	
Net Cash generated by operating activities	**607.6**	**245.8**
Cash flows used in investment activities		
Payments for property, plant & equipment	-125.3	-149.8
Purchase of investment property	-4.4	
Proceeds from (payments for) sale (purchase) of other financial assets	49.2	-8.5
Proceeds from sale of subsidiaries	6.2	6.3
Payments from acquisition of subsidiary company	-13.1	-10.0
Proceeds from disposal of Property, Plant & Equipment	3.1	12.3
Capital contributions to subsidiary sold		-22.3
Proceeds from other assets	0.0	0,9
Cash used in investment activities	**-84.3**	**-171.1**
Cash flow used in financing activities		
Proceeds from issuance of Series F Notes		925.5
Proceeds from borrowings	82.4	347.1
Payment of Notes 2015 & 2018 and Loans Tranches A and B		-695.4
Repayments of borrowings	-241.2	-419.2
Refinancing debt expenses		-43.8
Interest paid on borrowings	-213.3	-118.4
Net cash used in financing activities	**-372.1**	**-4.2**
Net change in cash and cash equivalents	151.1	70.4
Reduction in cash due to discontinued operations		-0.5
Initial balance	169.8	115,3
Ending balance	**320.9**	**185.2**

During the nine month period ended September 30, 2015, net cash from operations increased Ps.361.8 million, or 147.2%, as compared with the same period of 2014, primarily reflecting the effect of an increase of Ps.237.9 million in funds from working capital accounts.

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Funds applied to Investment activities decreased Ps.86.8 million, or 50.7%, from cash outflows of Ps.171.1 million in 2014 to cash outflows of Ps.84.3 million in 2015, primarily due to the proceeds from the sale of securities held by the end of 2014.

Funds applied to financing activities increased during the nine month period ended September 30, 2015, increased Ps.367.9 million, as compared with the same period of 2014 (from cash outflows of Ps.4.2 million in 2014 to cash outflows of Ps.372.1 million in 2015), primarily due to

i) an increase of Ps.316.7 million in net payments of principal (from an increase in debt of Ps. 157.9 million in 2014 to a reduction of Ps.158.8 million in 2015),
ii) an increase in interest payments Ps.95.0 million (from Ps.118.3 million in 2014 to Ps.213.3 million in 2015), and
iii) the absence in 2015 of costs related to the liability management of July 2014

Financial Debt

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

	September 30,	
	2015	**2014**
Series F Note Due 2021	199,7	199,7
Net present value adjustment and issuance expenses	(7,5)	(5,8)
Subtotal	192,2	193,9
Short term debt	35,7	42,0
Other long term debt	0,9	3,2
Principal - total	**228,8**	**239,1**
Accrued interest	7,0	6,9
Total Debt	**235,8**	**246,0**
Cash and cash equivalents	-34,4	-22,2
Net Debt	**201,4**	**223,8**

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

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 as of December 31, 2014		
Cost	**Revalued cost** (in thousands of pesos)	**Difference**

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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.

A new appraisal of the main components of Plant, Property and Equipment will be made for our year-end financial statements

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 quarters 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.

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