Explanatory Memorandum

Mackay Sugar Limited ACN 057 463 671

INTRODUCTION

This Explanatory Memorandum is to be read with the Notice of Annual General Meeting issued by Mackay Sugar Limited. It deals with the following resolution which will be put forward for the consideration of shareholders at the Annual General Meeting convened for 9 December 2009. The Explanatory Memorandum should be read in its entirety. If shareholders are in doubt as to how they should vote on the resolution to be proposed they should seek advice from their professional advisors.

SHAREHOLDER APPROVAL

The Board of Directors is seeking the support of a two-thirds majority of shareholders to authorise it to proceed with the implementation of the Cogeneration Project as outlined in this Explanatory Memorandum.

RESOLUTION

To approve the implementation of the Cogeneration Project having regard to the information contained in and subject to Board approval on terms set out in the Explanatory Memorandum which forms part of this Notice of Annual General Meeting.

The resolution has been proposed by the Board of Directors and the Directors unanimously recommend the Cogeneration Project to shareholders and request your vote in favour of the resolution.

OVERVIEW

The Board gave a commitment to shareholders following the conversion of the Co-operative to Mackay Sugar Limited (MSL), that it would seek your approval for the first large diversification project undertaken by MSL. As part of that commitment the Directors are now seeking the approval of shareholders to proceed with the Cogeneration Project.

The Company has been investigating a number of diversification opportunities for several years with a particular focus on the Cogeneration Project. Since the Federal Government passed legislation on renewable energy targets which requires Australian electricity retailers to source 20% of their power from renewable energy resources by the year 2020, the Cogeneration Project planning has progressed to its final stages.

The Project will involve the construction of a cogeneration plant at the Racecourse sugar factory to supply steam and electricity to the factory and the annexed sugar refinery. It will also supply surplus power into the North Queensland electricity grid. With the exception of the Ergon Energy interconnection, the plant will be solely owned by Mackay Sugar Limited (MSL) and all net income will be retained by MSL.

The Cogeneration Project is dependent on finalisation of a secure Power Purchase Agreement (PPA). A PPA has been negotiated with Ergon Energy and is subject to final approval by the Ergon Energy Board on 5 December 2009. A network connection Agreement is also being negotiated with Ergon Energy.

During the construction and subsequent operation of the Cogeneration Project the Company's sugar milling business will continue as usual for growers and harvesting contractors. The construction and operation of the plant is not expected to affect milling operations and indeed the installation of modern equipment will provide improved plant reliability at the Racecourse factory.

THE PROJECT

The Cogeneration Project is based on the high efficiency utilisation of our bagasse resource (up to 2.0 million tonne per year fibrous residue from cane milling) which is currently incinerated in low efficiency boilers to supply steam and electricity to our three sugar factories and Australia's largest white sugar refinery (Refinery). This Project is the culmination of several years of engineering design, optimisation and planning, and will deliver approximately 200,000 MWh of reliable electricity into the North Queensland electricity grid every year. This represents approximately 30% of the Mackay District's electricity consumption.

It is proposed to engage A E & E Australia Pty Ltd to design, deliver and construct the major components of the power plant at the Racecourse sugar factory. Negotiations with A E & E Australia Pty Ltd are well advanced and are expected to be completed by the end of 2009. The major components include:-

- 150 tonne/hour high pressure boiler;
- 36 MW condensing/extraction steam turbine generator;
- 70 tonnes per hour condenser, cooling tower and pumps;
- coal plant and moving fuel grate; and
- new 11kV switchgear and 66 kV export transformer

Auxiliary plant will be constructed in accordance with a number of smaller contracts.

The major Cogeneration plant contract with A E & E Australia Pty Ltd contains clauses which are designed to provide cash compensation from the contractor to MSL in the event that the contract is not completed on time, or if the plant outputs do not meet performance guarantees.

Any possible delays or late completion of the Cogeneration Project will not impact the start of a crushing season, or the non-crush operation of the Refinery. The existing No 2 boiler is being retained to supply energy if required.

Construction contracts are expected to be awarded in early 2010 and the site will be cleared of redundant plant and equipment by June 2011. The boiler, steam turbine generator and auxiliary plant construction will begin in July 2011 for completion by December 2012. Electricity generation is due to commence in early 2013. Project management will be undertaken by the experienced MSL Project Team.

The Cogeneration Project is essentially an expansion of electricity generation activities which MSL's factories have been successfully undertaking for many years. Whilst the technology of the Cogeneration Project is well established, there are operational features which make it a strong proposal from both a risk management and economic perspective.
The features include:-

- 50 weeks per year operation - allowing two weeks per year for maintenance of critical plant;
- supply of electricity and steam to the Refinery for the full year;
- bagasse will be supplied by three factories, not just the Racecourse factory with large stockpiles at two sites.
- coal will initially be used as a supplementary fuel for 14 weeks of the non-crushing season;
- longer term plans to store more bagasse and totally eliminate coal (100% renewable energy);
- high steam conditions resulting in increased operating efficiencies.

PROJECT CAPITAL COST AND FUNDING

The estimated capital cost of the Cogeneration Project is expected to be not more than $120 million. The ability to utilise existing plant and infrastructure at the Racecourse factory and the year round operation of the Refinery were the major factors involved in the decision to locate the project at Racecourse and this will provide considerable savings in capital and operating costs.

The Board expects to fund the Project from three sources:

- $33 million funded from the business;

- On 14 June 2009, the Honourable Stephen Robertson MP, Minister for Natural Resources Mines and Energy and Minister for Trade, announced a $9 million grant from the State of Queensland acting through the Department of Employment, Economic Development and Innovation Office of Clean Energy; and

- The balance from two financiers, namely Rabobank and National Australia Bank.

Rabobank and National Australia Bank will also fund guarantees as may be required under the various contracts and a contingency facility.

It is anticipated that the borrowing levels will peak in June 2013. Once the plant is operational, the revenues from the Cogeneration Project are expected to meet the operating costs, debt and interest servicing commitments without contribution from the raw sugar milling business. On current projections, the Cogeneration Project could repay the debt to be raised from the banks by the end of 2018, which coincides with the expiry of the PPA.

The Project will be constructed under a number of firm, lump sum contracts. The scope of work has been carefully defined in order to limit contract variations, and appropriate contingencies have been allowed in the capital budget.

In addition, as the lump sum contracts are quoted in Australian Dollars, there will be no currency exposure to MSL from the time of contract award, expected in January 2010, until project completion.

The financial modelling for the Cogeneration Project has been developed using various scenarios. Even in the worst case scenario, when for example the crop is projected to be at a minimum, and the sugar price drops to low levels, and the implementation of the Cogeneration Project is delayed for a year, the Company will still be able to fund the debt servicing requirements and continue with the Project until completion.

In addition, the Board is giving consideration to a capital raising to strengthen the Company's balance sheet and finances which includes both the core business and Cogeneration Project.

PROJECT REVENUE

The major source of revenue from the Cogeneration Project will be derived from electricity sales to the grid and the sale of renewable energy certificates (REC's) which are the subject of a six year Power Purchase Agreement with Ergon Energy.

The Power Purchase Agreement for the first six years will cap Project revenue, however the revenue is calculated to cover the repayment of capital and interest on the borrowings.

OTHER PROJECT CONSIDERATIONS

The Cogeneration Project does not require any land purchase or rezoning approval as its operation falls within the limits of the current use of the Racecourse site and has conditional Local Authority and DERM approval. It replaces older plant with modern, high efficiency plant.

Funds generated in the core (milling) business will continue to be used to fund capital requirements for the core business of the Company. It is estimated that the expenditure required will continue at levels similar to previous years. As an indication of the current budgeted level of expenditure, the capital budget approved for 2010 for "stay-in-business" capital expenditure is $4.5 million, plus another $1.2 million carried forward from 2009.

To protect the core business, the Company has entered into further long term raw sugar hedging contracts to secure the "miller pricing" for future years, and will continue to do so up to a level of 66% of the Company's share of the estimated raw sugar make per year.

Both crop and cane fibre levels affect the amount of fuel available for steam and electricity generation from the Project, however only approximately 20% of MSL's current production of bagasse will be consumed in the cogeneration plant. By careful management of surplus bagasse from all of the MSL factories, and with the availability of supplementary coal, the outputs from the cogeneration plant are unlikely to be significantly affected even in lower crop years. The Project remains sustainable in a season that the Company has to rely on coal to make up for a shortage of bagasse fuel.

The Cogeneration plant would increase Racecourse factory's water consumption by about 25%. A study is currently underway to evaluate lower cost sources of surface water for the Racecourse site including the milling and refining operations and cogeneration.

Once completed the cogeneration facility will operate within the Company's existing licence and permit conditions and is not likely to present any additional environmental issues.

STRATEGIC CONSIDERATIONS

The Cogeneration Project will be a critical income diversification step for Mackay Sugar, and importantly it will lay the energy foundation for other diversification projects at the Racecourse mill site. For example, if in the future a 60ML ethanol plant was developed it could derive its production steam and electricity from Cogeneration.

The Cogeneration Project offers the advantage of utilising existing resources from MSL's core business activities with a resultant income stream to the Company (and so its shareholders). This will assist in reducing the impact of fluctuating raw sugar prices. Put simply, the same crop of sugar cane should be able to generate increased profits. Significantly, the Project will produce green energy and has been designed to meet the Federal Government's current and expected future legislative requirements.

DIRECTORS' RECOMMENDATION

The Directors unanimously recommend the Cogeneration Project to shareholders and request your vote in favour of the resolution.

Shareholders will be provided with the opportunity to raise queries and matters of concern at the meeting.

The Board strongly recommends and asks you to support the resolution to enable the Board to commence the Cogeneration project.

We recommend it to you for the following reasons:-

- **It is based on an industry we know well - growing sugar cane.**
- **It will require a new high pressure boiler and larger generating set and is therefore using technology our staff are currently operating. It is not new technology.**
- **The revenue is derived in Australia in Australian dollars and is not subject to exchange rate fluctuations like the sugar price.**
- **The income per unit of electricity and REC produced is guaranteed by a Power Purchase Agreement for the first six years.**
- **On completion of construction it will not require contributions from the raw sugar milling business.**
- **On completion of capital repayments expected to be 2018 it will have low operating costs and provide strong cash flows for the business.**
- **It will diversify our income base into "green" renewable energy which has the potential for good growth – provides an efficient energy source for future diversification opportunities.**

	Definitions
Cogeneration Project	the Company's development and construction of an electricity cogeneration plant at the Racecourse sugar factory for the subsequent sale or use of electricity.
Company or MSL	means Mackay Sugar Limited ACN 057 463 671.
DERM	means the Department of Environment and Resource Management
Directors	means the Directors of the Company