



12 October 2016

Senator Chris Ketter
Chair
Senate Economics References Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Australian Dairy Farmers Limited
Level 2, Swann House
22 William Street
Melbourne Victoria 3000

Phone +61 3 8621 4200
Fax +61 3 8621 4280

www.australiandairyfarmers.com.au

ABN 76 060 549 653

Dear Chair,

Submission by Australian Dairy Farmers (ADF) to the Senate Economics References Committee Inquiry into the Dairy Industry

Australian Dairy Farmers (ADF) is the national advocacy body representing dairy farmers across the six dairying states. Our mission is to improve the profitability and sustainability of dairy farmers in Australia.

Industry Background

Australian dairy is a \$13 billion farm, manufacturing and export industry. Australia's 6,128 dairy farmers produce approximately 9.5 billion litres of milk a year.

More than 100,000 Australians rely on dairy for their livelihoods, including vets, scientists, mechanics, financial advisers and feed suppliers, while 39,000 Australians are directly employed on farms and in dairy processing. Approximately 98% of Australian dairy farms are family-owned businesses.

Our quality and safety processes are among the best in the world and Australian dairy makes a vital contribution to the national economy. With a farm gate value alone of \$4.7 billion, dairy enriches regional Australian communities across Australia.

We are the fourth largest exporter in the world, accounting for 7% of global trade. Around 65% of Australian dairy product is sold on the domestic market, with the remainder exported. Australian dairy exports go to more than 100 countries and are worth around \$2.8 billion a year. More than 125 Australian companies export dairy products.

Major export markets include China, Japan, Singapore, Malaysia and Indonesia.

Dairy farmers have had a tough past season and it is pleasing to note that the outlook for dairy in the future is more positive with a rebalancing of supply and demand fundamentals globally taking place.

Below is a short summary that provides a global context for supply and demand at a high level.

Global - Demand and Supply Overview

Global dairy supply

- Milk production is now falling in year-on-year terms across three of the world's four largest exporting regions. Large stockpiles and the potential for resurgent growth pose some risks, but overall the market is finally seeing supply settings conducive to higher prices.
- Milk production in Europe finally dipped below year-ago levels in June, down around 2% compared to June 2015. Despite only a modest slowdown in production, European supplies have tightened noticeably for a number of commodities, pushing prices higher. Be it through market or policy pressures, European milk production is expected to continue to

slow, from the current year-to-date increase of 3.5% across the 28 member states, to a full year figure of 1.3%.

- Farmers in the United States have benefited from a relatively robust domestic market combined with falling feed prices in recent months. Milk production expanded by 1.4% in July, driven almost entirely by increases in per-cow production. The USDA's calculated farm margins have risen to their highest point (US\$8.59/cwt) since the start of 2016. This level is considered to support an expansion in production, which the USDA forecasts will amount to almost 2% over the full 2016 year.
- After two difficult seasons, New Zealand's farmers are reportedly much more optimistic as 2016/17 proceeds, buoyed largely by an improving price outlook. So far, milk production for 2016/17 is down almost 2% for the season to August. Much will depend on weather conditions, which have improved from mid-August after below-average winter pasture growth.

Global dairy demand

- In terms of global dairy demand, the volume of dairy products traded over the past twelve months to June 2016 fell by 2%, with a recovery in demand from Greater China only partially offsetting declines in other major importing markets. Overall volumes to Southeast Asian countries (ASEAN) declined, while exports volumes to the Middle East and Japan also fell. The value of global exports fell by 19%, with falls across all major markets, reflecting the lower global prices for key dairy commodities.
- Total Dairy exports to Greater China (PRC, Macau and Hong Kong) grew by 19.6% in volume terms over the 12 months to June 2016, while the value of exports declined by 0.5% to \$US 7.2 billion.
- Australian export volumes to Greater China grew by 34%, from around 128,000 tonnes to 172,000 while the \$USD value Australian of exports increased by almost 70% year-on-year, from \$US314 million in 2014/15 to \$US533 million in 2015/16.
- This exceptionally large growth in the value of Australian dairy trade with China reflects the changing composition of Australian exports- towards higher value categories such as liquid milk and infant formula.
- Falls in global prices combined with a strong appreciation of the Yen has seen the affordability of dairy imports improve significantly for Japanese consumers over the last 12 months. However, despite this, global dairy exports to Japan fell by 1.2% in volume over the course of 2015/16.
- Overall growth in the Southeast Asian region slowed, with import 2015/16 volumes falling 1% year-on-year, whilst the USD value fell 27%. Dairy export volumes to the Middle East also decreased slightly in 2015/16, falling 3%.
- Russian embargoes remain in place on dairy imports from United States, European Union, Australia, Canada and Norway. With the EU voting to retain its own sanctions on Russia for at least another six months, these embargoes will likely remain in place for the foreseeable future.

Dairy farmers and processors have reason to believe the market fundamentals are improving with recent data on global dairy prices showing positive trends that look as if they may continue.

Analysts are predicting further rises in the global milk price which suggests that the worst might be behind the industry and there may be some stability returning to the global milk supply. This will hopefully occur through the rebalancing of supply and demand mentioned above due to cut backs in EU production, intervention buying of SMP (skim milk powder) in Europe and increased buying in China.

Although these increases are not sufficient at this stage to return to sustainable prices it is pleasing to see that prices are on the rise and the global market may be improving in the long term.

Dairy farmers have a limited capacity to manage the market price so it is important to always focus on what can be managed, remain aware of industry risks and maintain a low cost production system so the industry is in a better position to weather any storms.

While the dairy industry has been under intense pressure, we are also an industry that has the know-how and resilience to overcome adversity and thrive in the long term.

ADF, together with our state members, is continuing to fight for farmers. Even though we won't be able to solve all of the issues farmers are facing, we are working to relieve some of the pressures to create change to ensure that an unfair share of the risk in the value chain is not taken by the farmer and that recent events in the industry don't happen again.

We are working closely with the Australian Dairy Industry Council (ADIC) to constructively and cooperatively resolve issues across the value chain, and where possible, presenting solutions to Government and regulators.

ADF and the ADIC hope to achieve implementation of mutually acceptable and beneficial contract clauses through negotiations between farmers and processors and be able to provide the Inquiry and Government with industry developed and shared solutions.

With this approach in mind ADF convened a meeting between dairy farmers and processors on 27 September 2016 to begin the process of improving the contractual arrangements with farmers and balance risk along the supply chain.

The workshop followed the Deputy Prime Minister and Minister for Agriculture and Water Resources, Barnaby Joyce's August 2016 Dairy Symposium, where key industry stakeholders committed to working cooperatively to find solutions to issues faced by dairy farmers, processors and the industry generally.

The industry has long recognised that it is important that farmers and processors work together collaboratively to address both domestic and international challenges to the profitability of the industry.

The workshop was a constructive first step for dairy farmers and processors working together on contract and transparency issues.

The importance of working cooperatively to find solutions to issues faced by dairy farmers and the industry was emphasised.

Dairy farmers and processors discussed an ADF draft discussion paper outlining a set of principles which industry could consider in working together to develop a Code of Best Practice on Contractual Relationships.

Processors and dairy farmers engaged in a constructive discussion of the points raised in the draft discussion paper whilst being mindful of the specific needs of different industry players and regional differences.

The discussion took place in the context of four overarching principles acknowledging:

1. The changing nature of the dairy industry, e.g. increasing global volatility;
2. The different Australian operating environments, e.g. domestic vs export;
3. The need for fair and reasonable negotiation to take place between farmers and processors on contracts and supply agreements and the need to assist farmers to negotiate; and
4. The importance of transparency in both market signals, pricing and forecasts and supplier agreements and contracts.

Two key outcomes from the workshop were:

- Agreed importance of transparency and prescribing the mechanisms for pricing in the proposed draft Code and importance of allowing flexibility.
- Agreed no retrospectivity regarding pricing and pricing mechanisms.

The two outcomes above are a small selection of the outcomes from what was a very constructive workshop.

Dairy farmers and processors agreed to form a small working party of processor and farmer nominees to further progress the issues raised with a view to developing a draft code of conduct for further consideration by the wider group.

The processor and farmer meeting was also attended by Mick Keogh, the Australian Competition and Consumer Commission (ACCC) Agricultural Counsellor and Craig Latham, Deputy, Australian Small Business and Family Enterprise Ombudsman.

Mr Keogh provided background on unfair contracts and other issues, including the ACCC market study into the dairy industry, which will commence soon and is discussed further briefly below.

ADF understands there are currently investigations into Murray Goulburn and Fonterra by the ACCC and a separate investigation by the Australian Securities and Investments Commission (ASIC).

ADF respects the roles of both these organisations and the important part they play in competition and corporate regulation.

Given the importance and sensitive nature of these investigations ADF is unable to comment further apart from stating that all ADIC members, including Murray Goulburn, other processors and dairy farmers, are cooperating fully with both the ACCC and ASIC.

ADF is also aware of at least one class action against Murray Goulburn and a number of current and former directors that has been lodged in the Supreme Court of Victoria on behalf of unitholders in Murray Goulburn.

This action is going through the court process and thus ADF is unable to comment on it.

ADF is aware that the ACCC will be undertaking a market study into the dairy industry at the direction of the Treasurer.

ADF understands the market study will be finalised in 2017 with an issues paper released, a request for submissions issued, regional hearings, and a draft report released.

The dairy industry market study will provide an opportunity for the concerns of stakeholders to be examined by the appropriate regulator, potentially lead to policy recommendations and potential enforcement issues being identified. ADF and the ADIC expect that the market study will also identify positive aspects of the industry and what is working well.

ADF and ADIC engagement in the study will be integral to its outcomes and recommendations being adopted by the whole of the dairy industry value chain and ADF looks forward to working with the ACCC and the Government on the dairy industry market study.

We operate in a global environment that is increasingly volatile. The dairy industry is examining ways to help manage this volatility.

It is important to acknowledge that whilst the Australian dairy industry is an industry that has been under intense pressure, it is also an industry that has the know-how and resilience to overcome adversity and thrive in the long term.

Collaboration is the key to get us where we need to be. Our industry relies on all the elements to operate effectively. Farmers need processors and vice versa – so the solutions require all stakeholders to come together to ensure a positive future.

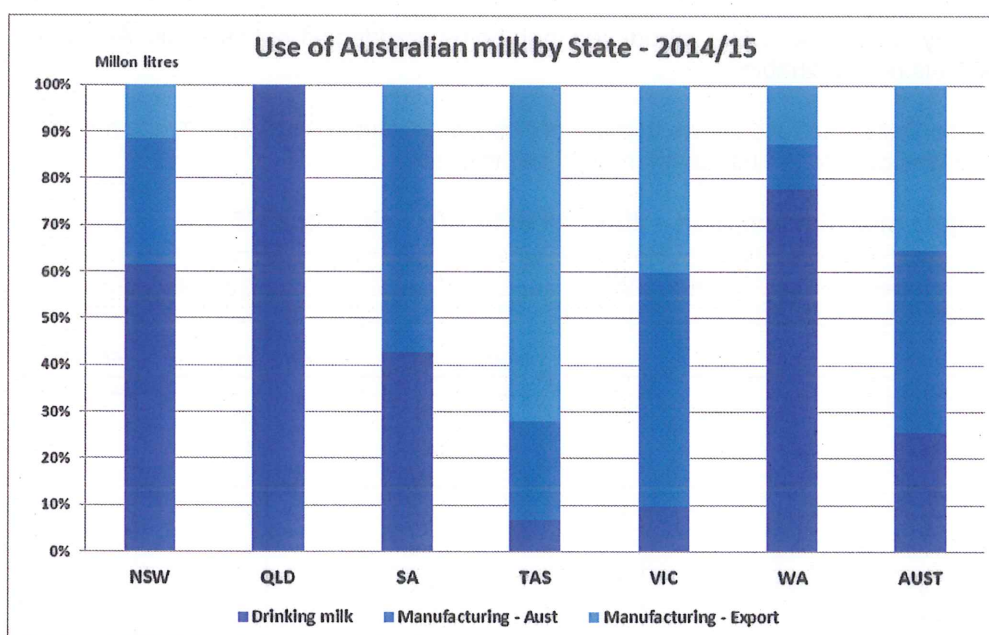
The recent farmer and processor workshop and the subsequent actions and changes that will flow from that meeting are the first step in ensuring a fairer, mutually beneficial and more transparent system for all.

There has been significant ongoing discussion since 2011 regarding \$1 per litre milk and the impact this marketing strategy has on farmers.

There are key differences in the use of Australian milk by state, for example in Queensland, almost 100% of milk produced is used as drinking milk. In Victoria, about 10% of the milk is used as drinking milk with the rest being manufactured into products for local consumption and export.

The table below shows the use of Australian milk by state and highlights the regional differences in the way the milk is used.

Dairy product mix by state – drinking milk vs manufacturing milk

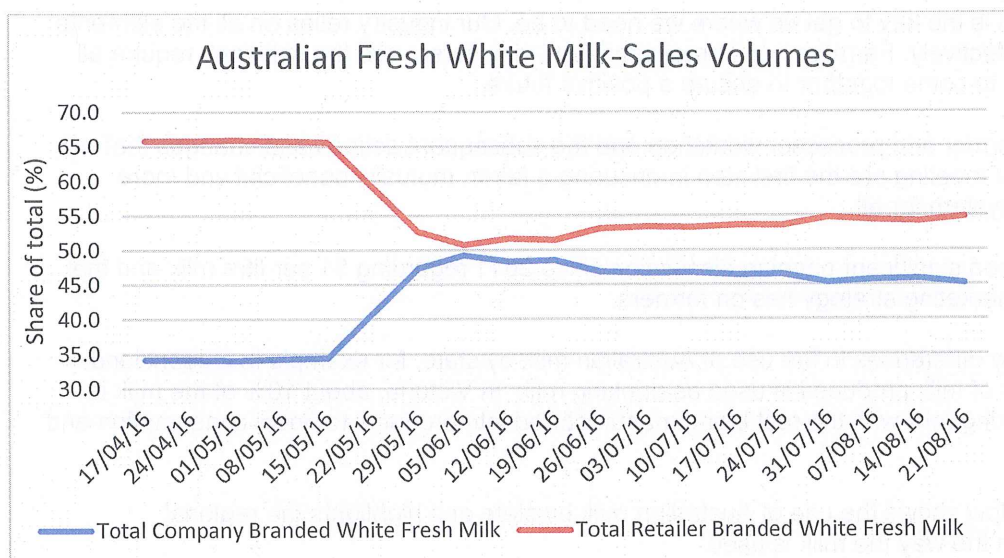


Recent developments in supermarket liquid milk consumption

Research commissioned by Dairy Australia in June 2016, confirms that consumers share concerns about the fairness of liquid milk prices and the inherent value of milk. Some key themes to emerge were:

1. The price of milk is too low (Around 70% agree that milk should cost more than \$1 a litre, and that it should cost more than a bottle of water);
2. Farmers are struggling and the future of the industry is uncertain (Around 90% agreed that farmers are struggling because of low prices); and
3. Farmers aren't being treated fairly, particularly by supermarkets (74% felt that supermarkets were not treating farmers fairly).

These consumer attitudes have also been borne out of the very sudden and large shift in consumer behaviour following the price step down in April 2016, with consumers switching to branded milk in favour of private label milk, as shown below.



Per capita \$1 per litre milk – S&O

Since Australia Day 2011, when Coles introduced their home branded \$1 per litre milk, ADF and others have said it is unsustainable.

Recent analysis by Dairy Australia shows that the per capita consumption of fresh white milk is now lower than it was prior to the introduction of \$1 per litre milk.

Table 1: Per capita milk consumption – litres, 1990 to YTD February 2016

YR. TO JUNE	FULL CREAM	REDUCED FAT	LOW FAT	FLAVOURED	UHT	OTHER	MILK TOTAL		FRESH WHITE		FLAVOURED		UHT	
1990	73.9	14.4	4.6	6.6	2.4	0.3	102.2	CAGR%	93.2	CAGR%	6.6	CAGR %	2.4	CAGR%
1991	72.0	16.2	4.7	6.6	2.8	0.3	102.5		93.2		6.6		2.8	
1992	70.3	17.7	5.2	6.6	3.1	0.3	103.2		93.6		6.6		3.1	
1993	68.6	18.6	5.5	7.0	2.8	0.5	103.1		93.3		7.0		2.8	
1994	68.1	18.6	5.9	7.6	3.4	0.7	104.1		93.2		7.6		3.4	
1995	68.0	18.5	6.2	8.0	4.3	0.8	105.9		93.6		8.0		4.3	
1996	66.0	18.5	6.3	8.1	5.2	1.1	105.1		91.8		8.1		5.2	
1997	63.5	19.2	6.6	8.7	5.7	1.1	104.7		90.3		8.7		5.7	
1998	60.8	19.4	7.0	8.8	6.6	1.0	103.7		88.2		8.8		6.6	
1999	59.4	19.1	7.5	9.0	7.0	1.1	103.2		87.2		9.0		7.0	
2000	58.1	18.7	7.6	9.1	8.7	0.0	102.2	0.00%	84.4	<0.95%>	9.1	3.91%	8.7	26.77%
2001	57.1	21.7	5.0	8.6	8.6		101.0		83.8		8.6		8.6	
2002	55.4	22.4	5.4	8.8	7.2		99.3		83.3		8.8		7.2	
2003	53.8	22.3	6.2	8.9	7.8		99.0		82.4		8.9		7.8	
2004	53.3	23.0	6.3	9.6	7.7		99.9		82.5		9.6		7.7	
2005	53.0	24.2	6.1	9.9	7.7		101.0		83.4		9.9		7.7	
2006	53.8	24.0	6.1	9.9	7.7		101.5		83.9		9.9		7.7	
2007	53.7	25.7	6.0	10.4	8.8		104.5		85.4		10.4		8.8	
2008	53.2	26.3	5.8	10.1	8.7		104.1		85.3		10.1		8.7	
2009	52.9	26.6	5.5	9.8	9.1		103.8		84.9		9.8		9.1	
2010	51.8	27.1	5.4	9.9	9.7		103.8	0.16%	84.3	<0.02%>	9.9	0.79%	9.7	1.17%
2011	51.4	28.5	4.9	10.3	9.4		104.5		84.8		10.3		9.4	
2012	51.6	30.1	4.6	10.5	9.2		106.0		86.3		10.5		9.2	
2013	51.2	30.1	4.4	10.4	10.6		106.7		85.7		10.4		10.6	

2014	51.2	29.6	4.0	10.3	10.7	105.9		84.9		10.3		10.7	
2015	52.6	27.9	3.7	10.2	10.9	105.3	0.29%	84.2	<0.01%>	10.2	0.66%	10.9	2.53%

[*Estimated on YTD Feb16 trends]
CAGR = Compound annual growth rate
Source: IRI - Aztec, Dairy Australia Analysis

This data clearly demonstrates that \$1 per litre milk has failed to deliver on Coles' claim that their marketing strategy has increased dairy consumption. Their strategy has failed to increase milk consumption, has seen millions of dollars taken out of the value chain and has severely impacted many dairy farmers.

It is time for Coles to raise the price of \$1 per litre milk to a sustainable level. This will ensure a fair price for everyone along the supply chain.

Conclusion

While we are an industry that has been under intense pressure, we are also an industry that has the know-how and resilience to overcome adversity and thrive in the long term.

ADF, together with our state members, are continuing to fight for farmers. Even though we won't be able to solve all of the issues farmers are facing, we are working to relieve some of the pressures to create change to ensure that an unfair share of the risk in the value chain is not taken by the farmer and that recent events in the industry don't happen again.

Collaboration is the key to get us where we need to be. Our industry relies on all the elements to operate effectively. Farmers need processors and processors need big business – so the solutions require all of us to come together to ensure a positive future.

While we work towards for solutions to these issues we must remember that we are a resilient industry with a long, sustainable future ahead and our profitability depends greatly on cooperation across the value chain and the continued support of the Australian public, which we are always thankful for.

If you require any further information or wish to discuss these matters, please do not hesitate to contact me

Yours sincerely,

John McQueen
Interim ADF Chief Executive Officer