

Northern dairy industry 2011 situation & outlook

Steve Spencer
Freshlogic

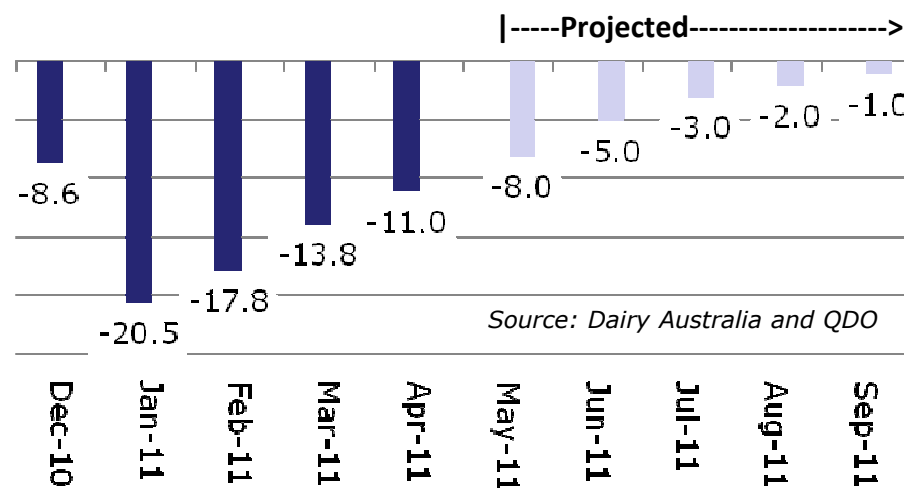
Headlines in the outlook

- Supply:demand balance has tightened
 - Weaker margins for producers has curbed output
 - Losses due to severe impact of floods
- Local fresh milk demand is sluggish but better
- Intense retailer competition has reduced fresh milk returns & dislocated stability
 - Switching private label suppliers
 - Deep discounting of private label
- Farm sentiment is damaged
- Weather remains a key variable

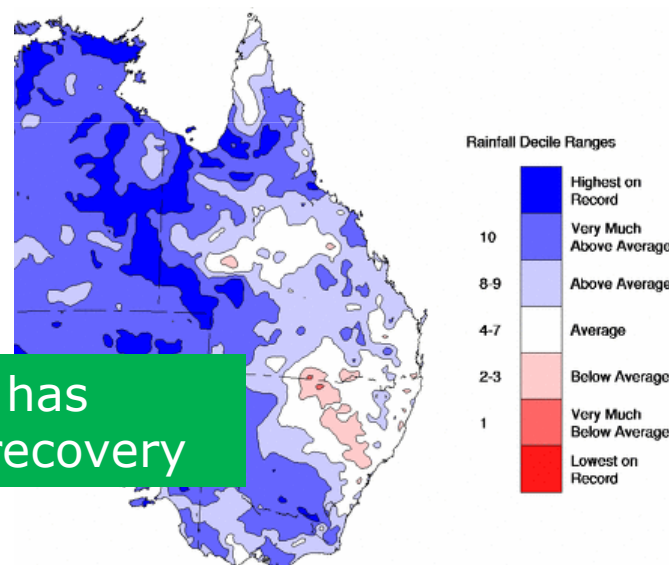
Flood impacts

- Immediate effects disrupted production & collections
- A range of on-going impacts
 - Damaged farm infrastructure and assets
 - Lost of livestock
 - Slow recovery in feed production - gaps in fodder supplies
 - A decline in milk quality and milking volumes - cow condition and herd health
- Ongoing wet conditions

% change in monthly production due to flood impacts

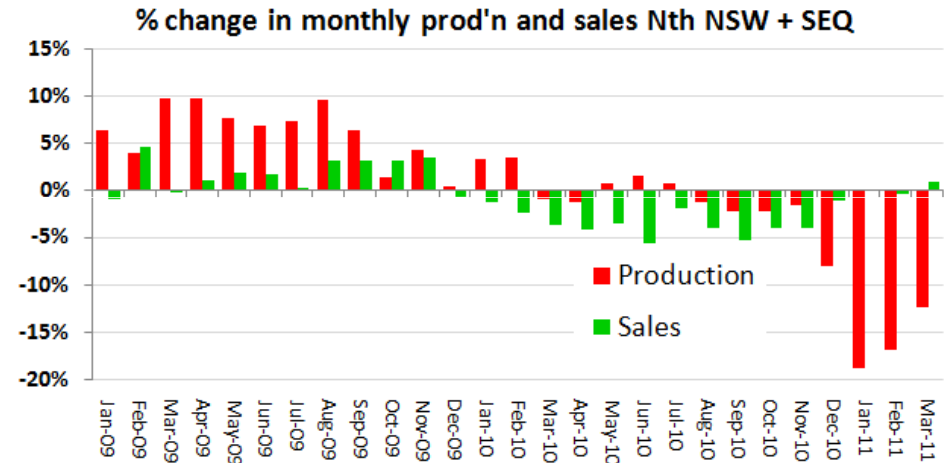


Rainfall since floods has slowed operational recovery



Regional market has weakened

- Retail market remains weak
 - Consumer still cautious
 - Promotions pushed hard
- Low-inflation environment
- Total regional milk sales recovering
 - Brands taking share back
 - UHT losing share
- Regional prices remain lower than southern states



Comparative margins in fresh white milk products
(on average)



Milk discounting

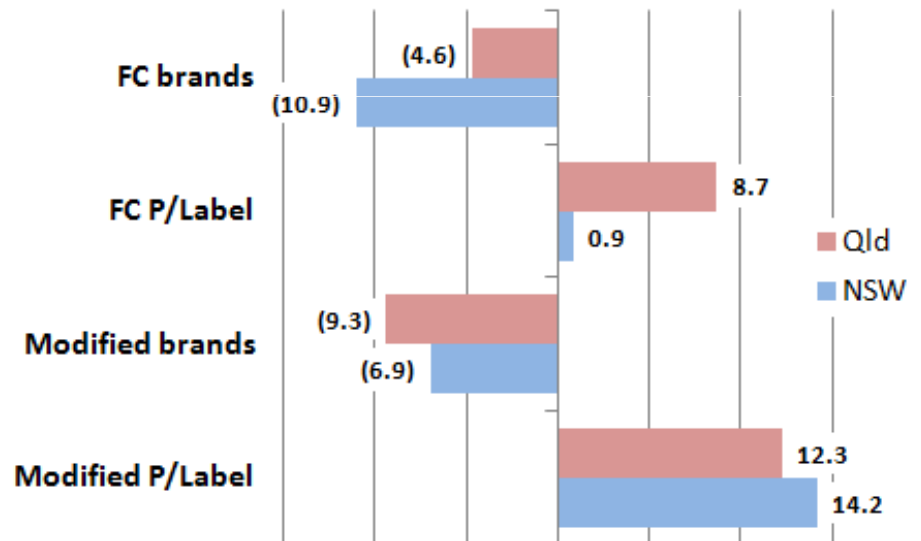
- Risks

- Higher % of sales of lower-priced products
 - shift in sales within the grocery store
 - from convenience and food service outlets to grocery stores
- Weakens overall wholesale returns to processors
- A flow-on to farmers in reduced farmgate prices.
- Weakens brands in fresh white milk – threatens viability of marketing and product innovation.

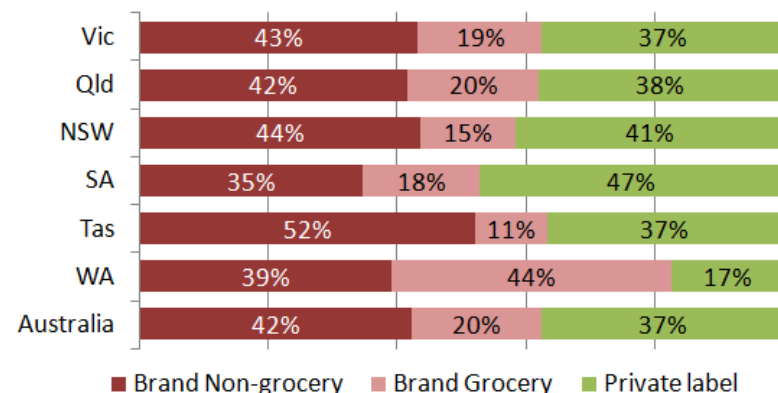
- Impact to date?

- Change in milk pricing model?

Estimated annualised effect in milk sales (mill litres)



Share of channel sales (last 12 months)



Milk discounting

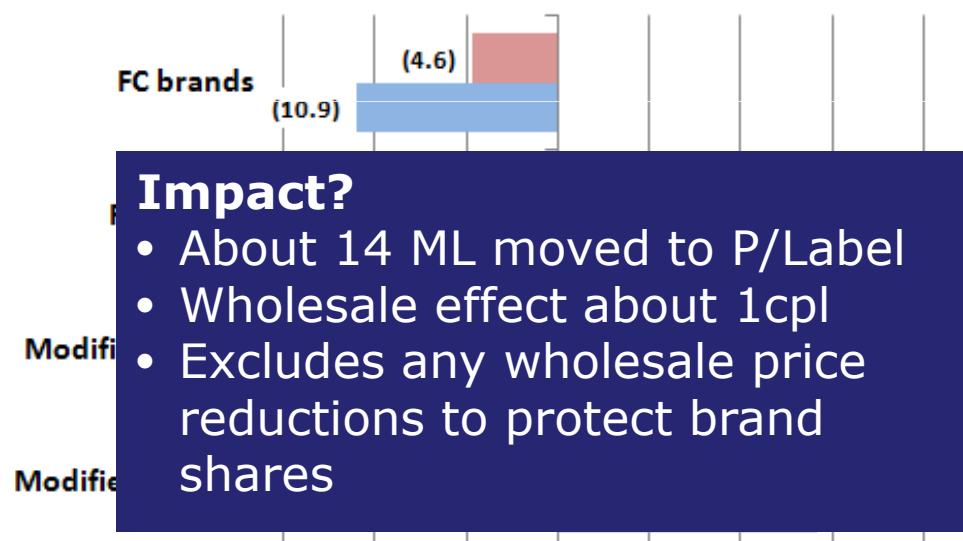
- Risks

- Higher % of sales of lower-priced products
 - shift in sales within the grocery store
 - from convenience and food service outlets to grocery stores
- Weakens overall wholesale returns to processors
- A flow-on to farmers in reduced farmgate prices.
- Weakens brands in fresh white milk – threatens viability of marketing and product innovation.

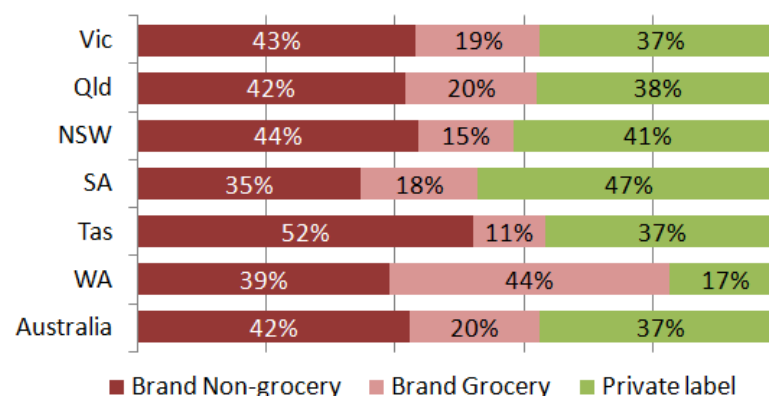
- Impact to date?

- Change in milk pricing model?

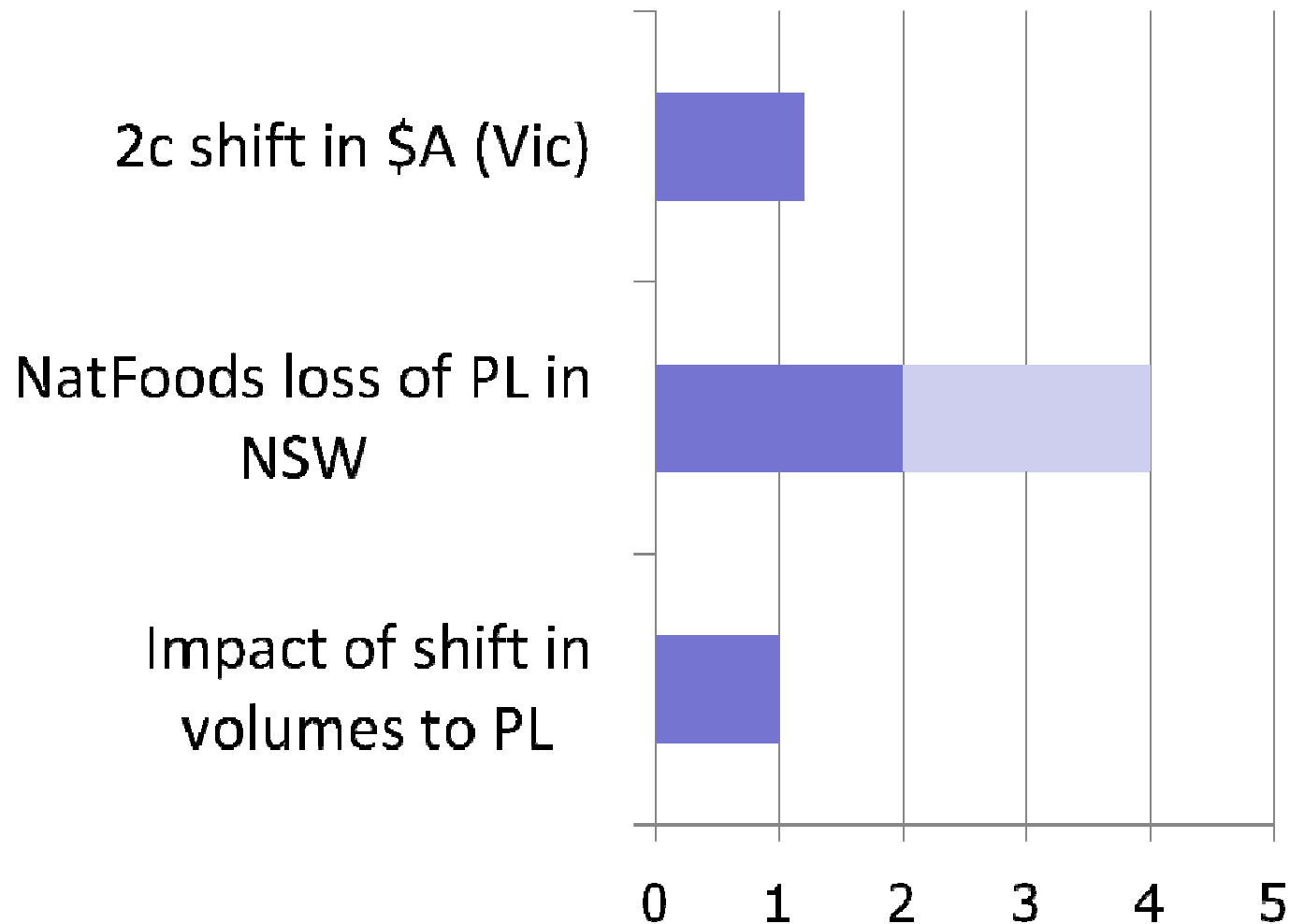
Estimated annualised effect in milk sales (mill litres)



Share of channel sales (last 12 months)

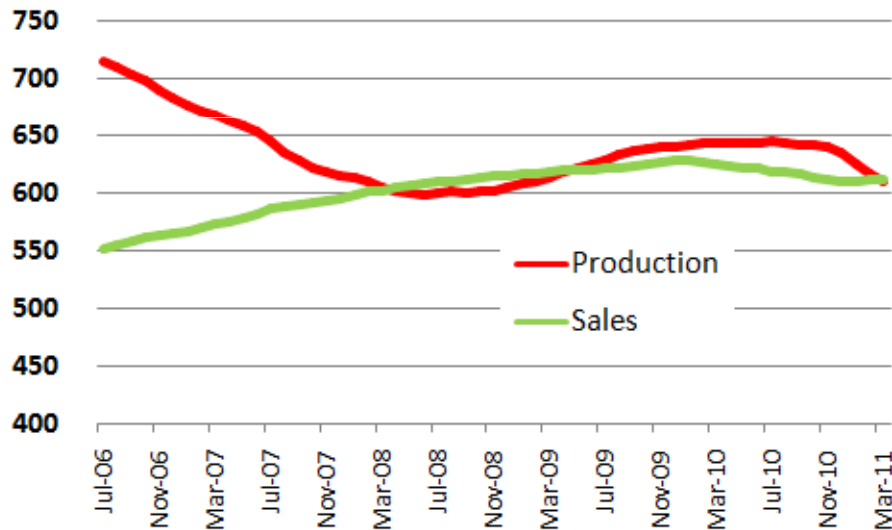


Milk discounting



Demand v supply

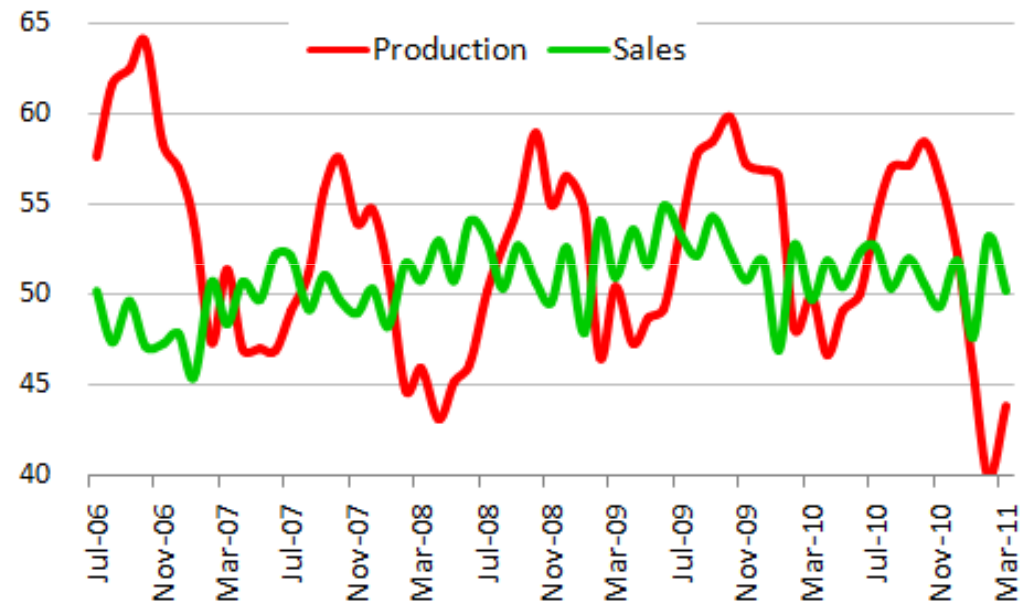
Northern region milk sales and farm milk supply (moving annual total)



Real picture?

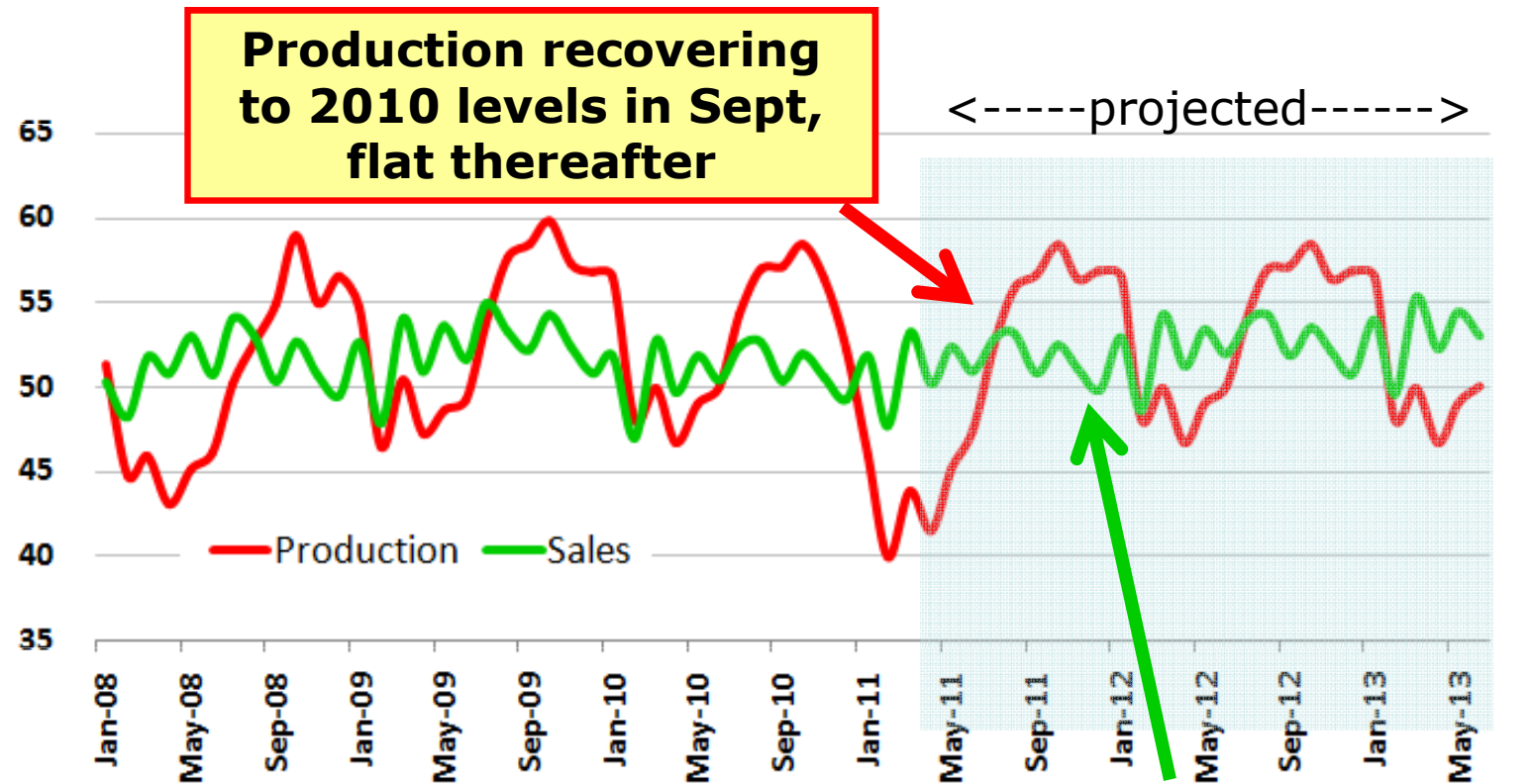
- Fresh sales only
- Buffer for daily milk flow management

Northern region milk sales and farm milk supply (monthly totals)



Projected regional demand v supply

Projected monthly Qld & Northern NSW milk sales and farm milk supply



Sales growing 1% in 2011, 2% thereafter

Note: Fresh milk sales +2.3% last quarter

Farmgate market

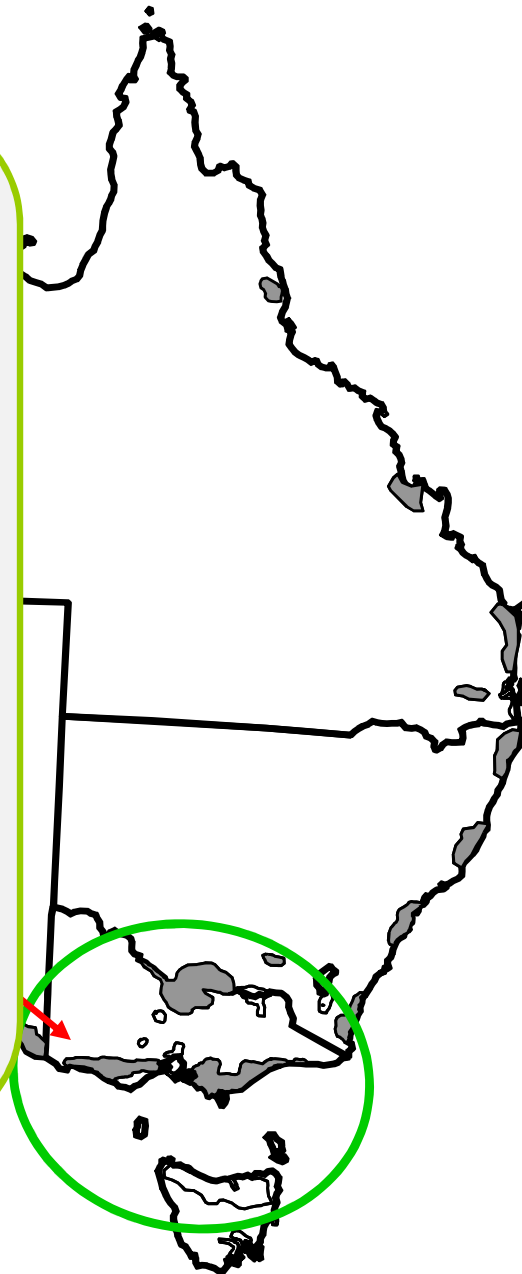
Southern regions

Farm gate prices

- 2010/11: \$5.40 – 5.50/kgMS (40-41cpl)
- 2011/12: close to 2010/11 levels, range lowered
- Higher payments (by 3-4 cpl) for suppliers to fresh processor prices

Key dynamics

- Milk supply to increase by 2-4% in 2011/12
- Volumes dependent on regional climates in Western Victoria and Gippsland; increased cow numbers; and feed input costs
- Slow supply growth and market demand will ensure sustained farmgate competition



Farmgate market

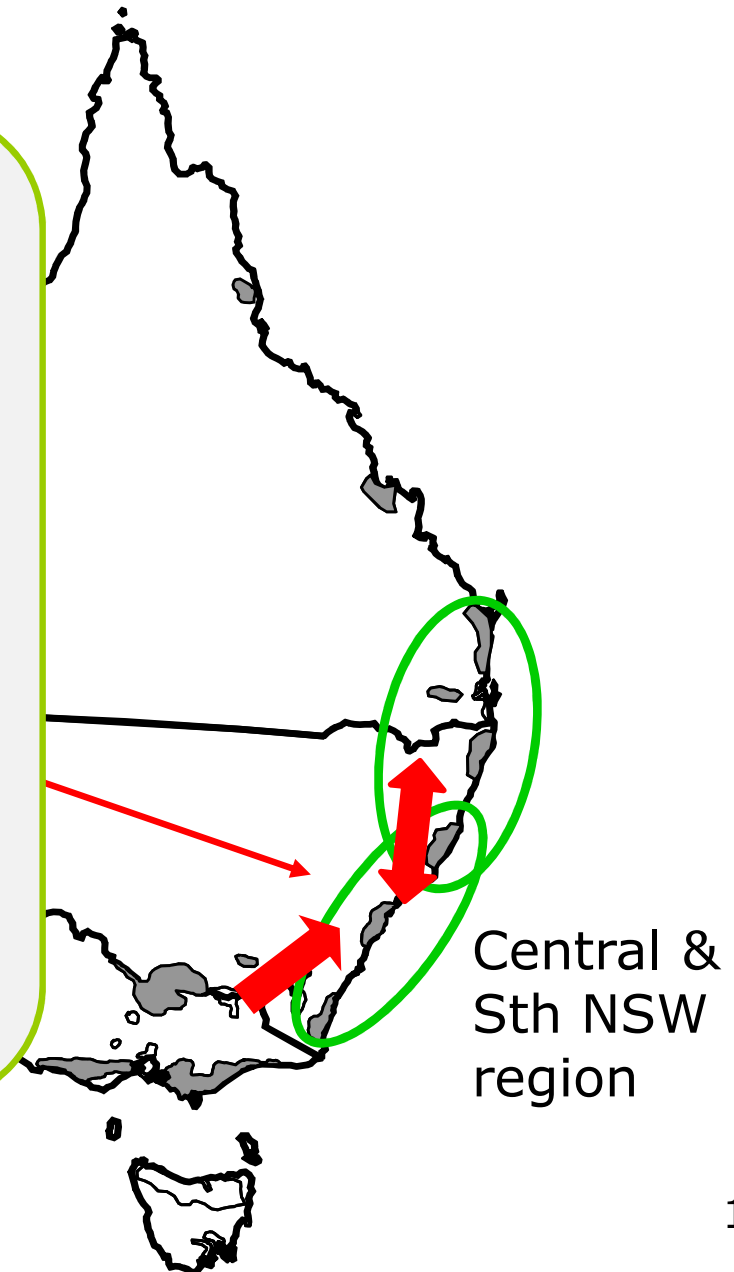
Central NSW

Farm gate prices

- 2010/11: 45-53cpl, for majority of producers
- 2011/12: 45-51cpl - variation due to different exposure to changes in liquid milk market access (affecting % of Tier 2 prices)

Key dynamics

- Milk supply is likely to decline in response to new milk supply agreement structure
- Increasing influence of over-supply at times of the year affecting milk value/returns
- Firm southern milk prices will underpin Tier 2 milk prices



Farmgate market

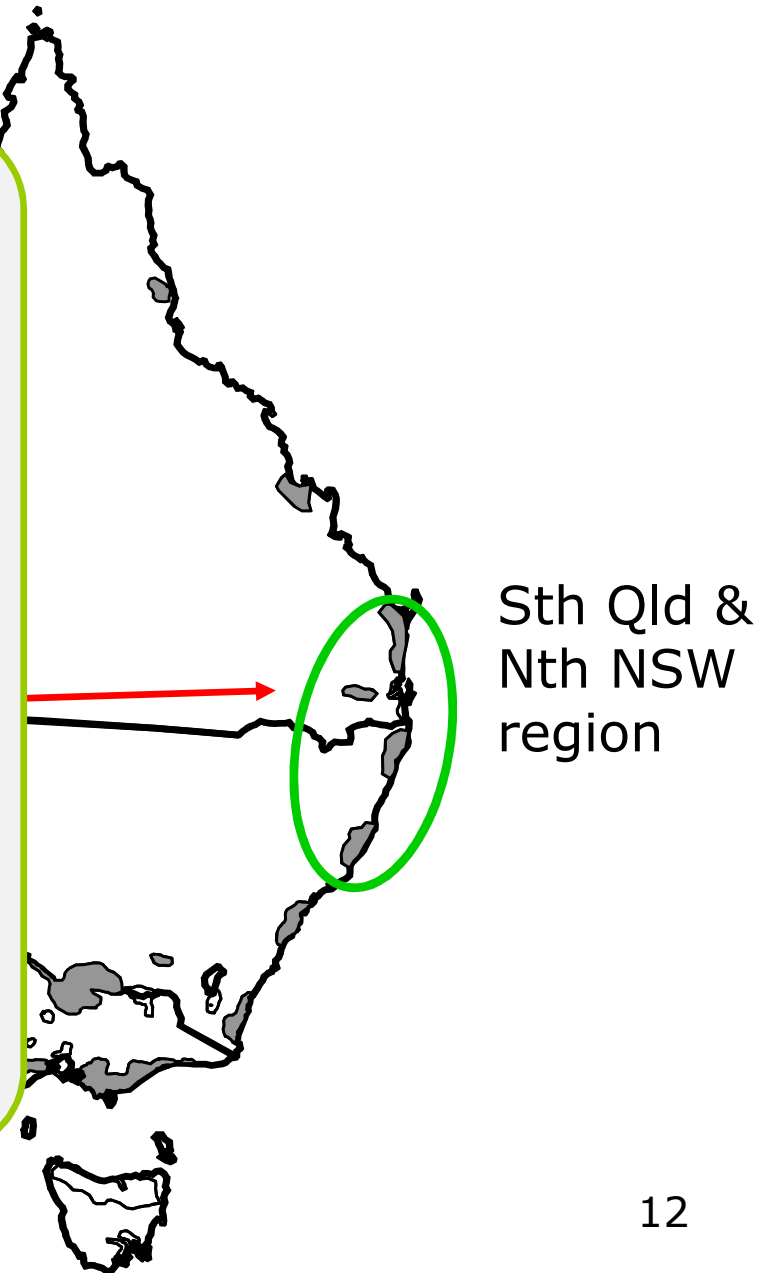
South Queensland and North NSW

Farm gate prices

- 2010/11: 47-60cpl
- 2011/12: reduction for suppliers exposed to changing processor liquid milk market and losses of market share of processors branded milk sales.
- Most supplying Parmalat are locked into agreements until 2012/13

Key dynamics

- Region had an excess of supply to local milk market.
- This changes due to the effects of flood.
- Improvement in milk supply for 2011/12 subject to the recovery rate from the effects of natural disasters and perceived scope for production margins.



Sth Qld &
Nth NSW
region

Farmgate market

Far North Queensland

Farm gate prices

- 2010/11: 45-48 cpl
- 2011/12: reduced NatFoods AFD reduces average prices, dependent upon production response

Key dynamics

- Region is over-supplying local processing needs
- Milk supply expected to shrink in 2011/12
- Large geographic market

Far North
Qld
region

Supply management

- Various approaches - 2-tier pricing now commonplace
- Tier 1 reflects balance between
 - production costs and
 - capacity to pay on fresh white milk margins
- Tier 2 reflects alternate returns (including haulage south)
- Reflect processor exposure to supply:demand balance

| Buyer | Approach |
|---------------|--|
| NatFoods | <ul style="list-style-type: none">•2-tier pricing•Tier 1 contract volumes•Tier 2 benchmarked off southern prices |
| Parmalat PDA | <ul style="list-style-type: none">•3-tiered pricing•Volumes shift based on actual sales (brand v PL)•Farmers manage their own exposure (buy/sell PDA access) |
| Parmalat POPS | <ul style="list-style-type: none">•Pricing based on milk solids |
| Norco | <ul style="list-style-type: none">•Contract volumes for supply “baseload”•Seasonal manufacturing price over peak periods |

Issues with milk supply arrangements

Market drivers

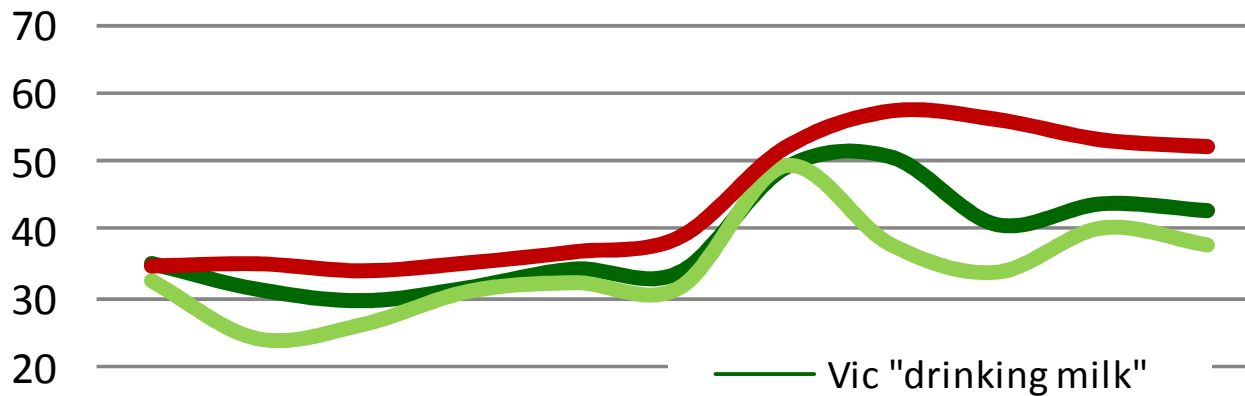
- Fresh milk product demand
- Supply chain returns
 - Much lower than in south
 - Higher input costs
- Changes in contract access means certain volumes of milk are unprofitable
 - Tier 2 pricing is the signal
- Alternate supply/ingredient options

Farm requirements

- High-cost, year-round production systems
- Sustainable cashflow requirements of producers
- Certainty for farm planning timeframes?

Farmgate prices

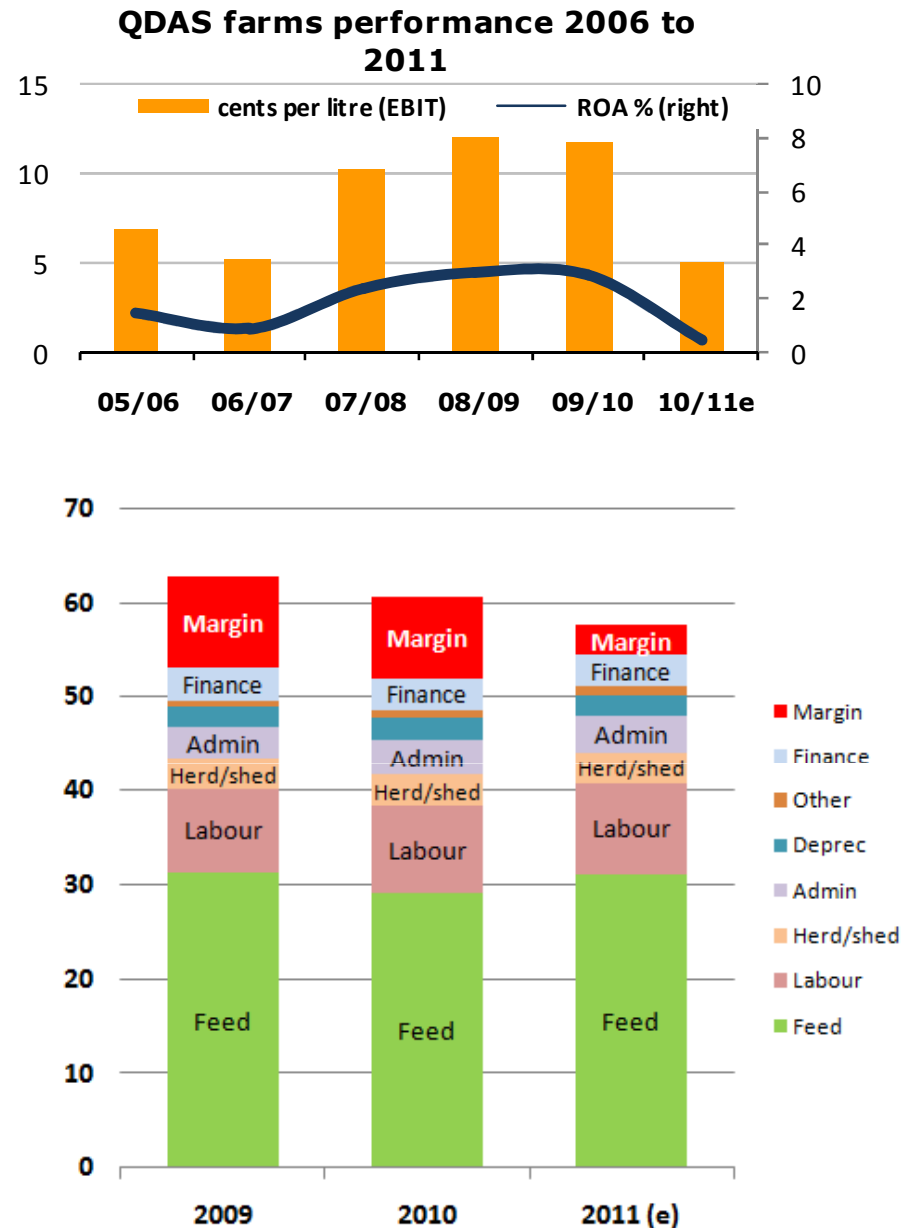
Qld v southern milk prices



| | 2010/11 prices - cents per litre at average milk components | | | |
|-------------|---|---------|----------|---------|
| | Sth Qld | Nth NSW | Cent NSW | Nth Vic |
| Farmgate | 47-60 | 47-52 | 45-50 | 42-44 |
| Freight | 3-4 | 5-6 | 10 | 17-20 |
| Landed cost | 50-64 | 52-58 | 54-59 | 59-64 |

Dairy farm profits & cashflow

- Strong improvement in profitability & cashflow 2008 to 2010
- 2010/11 was much leaner
 - Milk prices a little lower
 - Feed costs higher – potentially understates costs of flood adjustment



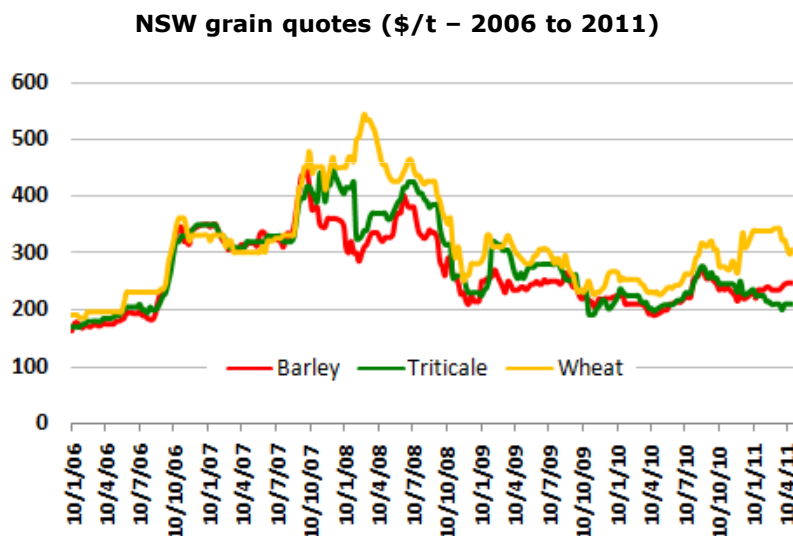
Feed market outlook

Short-term

- Grains market relatively stable
 - Oversupplied local markets
 - High \$A affecting export benchmarks
 - Weaker beef feedlot demand
- Fertiliser prices building

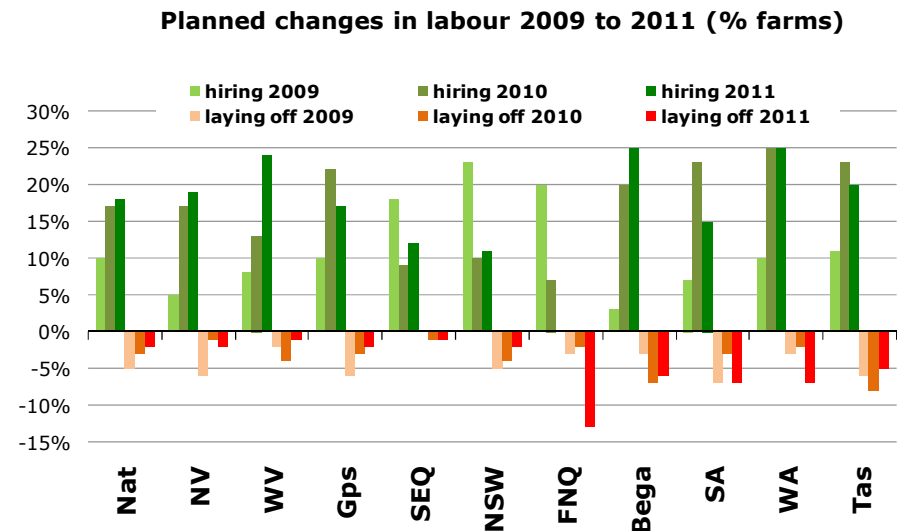
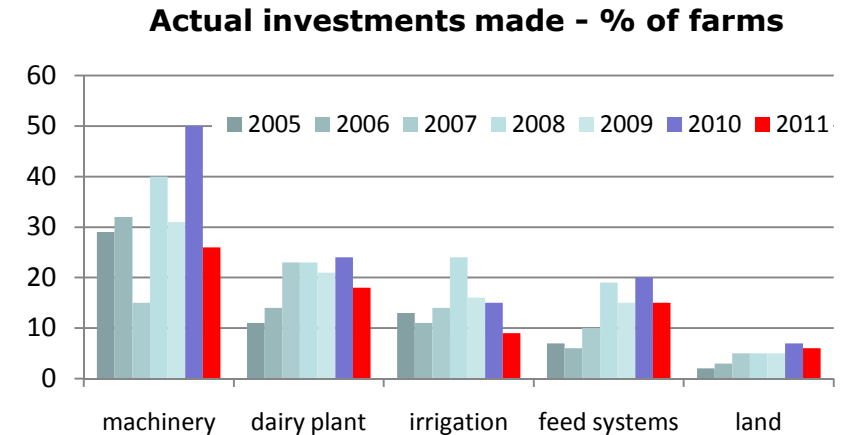
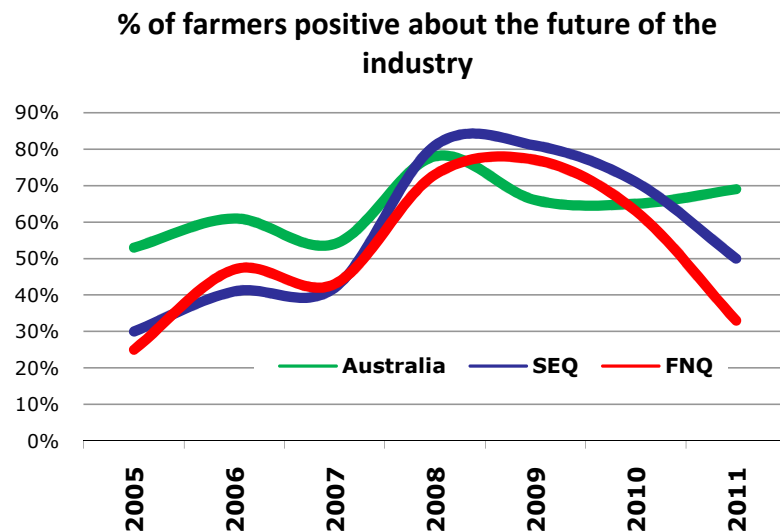
Medium term

- Volatility increasing
 - More frequent global shocks
 - Skinny inventories
- Supply & demand to tighten
 - Sustained food/feed demand
 - Protein demand in developing world
 - US/EU commitments to biofuels demand will grow
 - China's priorities on food security



Investment

- Confidence is well down
- Reduction in farm investment
- Limited infrastructure expansion
 - Maintaining output on existing farms
- Small lift in labour hiring



Stability of the regional outlook?

Positives

- Increasing regional population driving higher demand in future
- Low feed costs
- Clear market signals

Uncertainty?

- Weakened regional sentiment
- Weather remains a major influence on feed access & cost
- Water access/security
 - Regional & MDB plans
- Future impact of emissions policies?

Negatives

- Pressure on farm margins
 - Lower milk prices
 - Rising cost base (labour, energy)
- Dislocation thru shifting short-term P/label contract periods
- Sustainability
 - Farm size, intensity, skills
- Low % of planning and succession planning
- Low application of risk management
 - Storage, fwd coverage