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9 September 2011

Senator David Bushby
Chairman
Senate Standing Committee on Economics
Parliament House
Canberra ACT 2600

Dear Senator

I have enclosed Coles' supplementary submission to the 2011 Senate Standing Committee inquiry into the impacts of supermarket price decisions on the dairy industry.

We appreciate the opportunity to provide a further detailed submission on the issues before the Committee and in particular to provide evidence on recent developments in the dairy industry since the Committee issued its interim reports in May 2011 and address claims about lower farm gate prices as a result of lower retail milk prices that have been made in supplementary submissions.

We would be pleased to provide any further material or respond to any questions arising from our supplementary submission so that the Committee can finalise its report on this Inquiry.

Yours sincerely

Ian McLeod
Managing Director

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Supplementary Submission to the Senate Standing Committee on Economics Inquiry into the impact of supermarket price decisions on the dairy industry

9 September 2011

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1. Background

In our written submission of 11 March 2011, and in oral evidence to the Committee on 29 March 2011, Coles confirmed that our retail milk price reductions were part of an overarching strategy to build customer understanding of Coles' value proposition and customer trust.

We estimate that Australian consumers have now saved approximately $175 million in grocery bills as a result of lower milk prices initiated by Coles and followed by our competitors in late January 2011.

At the same time, we advised the Committee that Coles did not intend to sell, and was not selling retail milk at a price below the commercial cost of acquiring it from milk processors. We also restated our commitment to absorb the cost of the retail milk price reductions and outlined steps we had taken to mitigate the risk of the reductions being passed down the supply chain including increased commercial contract payments to milk processors and the inclusion of rise and fall clauses in those contracts.

We made it clear at the time and since that we were not reducing milk prices in order to harm competitors nor were we raising prices on other products to offset price reductions on our private label milk range.

We can confirm that Coles has reduced prices by more than 10 percent on over 6,000 products over the last 12 months. There have been some price increases on fresh produce as a result of Cyclone Yasi in Queensland and the east coast floods earlier this year and higher input costs for manufacturers of branded grocery products but there has still been net grocery price deflation in our stores over the last 12 months because of Coles' investment in lower prices.

Evidence is available to the Committee by Government agencies which support Coles' submissions on the impact of lower retail milk prices. In particular, the Commonwealth Treasury and the ACCC gave evidence to the Committee that Coles' actions had not had any causative effect on farm gate prices in the short term and were not considered likely to damage the long term sustainability of the dairy industry.

More recently, on 22 July 2011, the ACCC announced that it considered there was no evidence that Coles had acted in breach of the *Competition and Consumer Act 2010 and* noted that the major impact of the January milk price reduction seems to have been a reduction in the supermarkets' profit margins on house brand milk for the benefit of consumers.

In its second interim report of May 2011, the Committee noted the benefits to consumers from sustained lower prices and concluded it was too early to draw final conclusions about the impacts on the dairy industry.

Some of the supplementary submissions to the Committee since May 2011 continue to express unsubstantiated concerns about the future impact of lower retail milk prices for the dairy industry. The 'worst case' scenarios outlined in these supplementary submissions is not supported by actual movements of branded milk prices nor farm gate prices.

Since the Committee's interim reports, conditions for the dairy industry as a whole have improved, with steady to rising farm gate prices by all milk processors so far for the FY12 season. Predictions of imminent and severe reductions in farm gate prices as a direct result of the Coles retail milk price reductions in January 2011 have simply not occurred.

Where genuine concerns arise about the future sustainability of the dairy industry, they seem to have more to do with broader issues facing the sector including industry policy and food security rather than competition policy concerns per se.

Coles notes that the biggest issue affecting confidence of dairy farmers in NSW and Queensland in recent months is not retail milk pricing but the change in private label supply contracts between milk processors by one of our competitors.

This confirms Coles' previous submissions, and advice from industry research and independent experts, that a range of factors affecting supply and demand for dairy products will impact the longer term sustainability of the dairy industry.

In this environment, two initiatives that may provide greater confidence to dairy farmers include increased transparency of farm gate pricing by milk processors and an improved ability for dairy farmers to collectively negotiate with milk processors.

Coles notes the final ACCC decision of 4 August 2011 to allow dairy farmers associated with Australian Dairy Farmers Limited to continue to collectively bargain with milk processors for a further 10 years. This is a positive development that tackles competition policy issues directly affecting dairy farmers.

Coles remains committed to developing sustainable long term relationships with our suppliers including milk processors and their dairy farmer members. The new contracts that Coles has signed with Harvey Fresh for private label fresh drinking milk in Western Australia and Bega Cheese for all of our private label cheese which was formerly imported from New Zealand highlights our commitment to building a sustainable Australian dairy industry.

A new case study about Coles support for local Gippsland artisan cheese producer Jindi attached to this supplementary submission highlights Coles' commitment to growing our business with local diary producers and replace imports with Australian made products where-ever possible. This and other recent announcements demonstrate Coles' commitment, as part of the Wesfarmers Group, to Australian agri-business and individual farmers.

2. Developments in the dairy industry since May 2011

Since the Committee issued its second interim report in May 2011 there have been a number of encouraging developments relevant to the Committee's consideration of milk pricing in the dairy industry, including the following:

1. Announcements by milk processors of steady or higher farm gate milk prices for 2012

The announcement of steady to higher farm gate prices by various dairy processing companies in both domestic and export markets for the 2012 financial year and positive outlook statements for the dairy industry generally. Copies of comments or announcements by Fonterra on 12 May and 14 July about higher farm gate prices, Murray Goulburn on 29 June and 6 July about solid farm gate returns, National Foods on 27 July maintaining last year's farm gate prices, the Warrnambool Cheese & Butter Factory on 5 August about increased contracts volumes and higher farm gate prices in Victoria and South Australia and the Dairy Farmers Milk Cooperative on 1 August on higher tier one and tier two farm gate prices in Southern, Central NSW, Southern Queensland and FNQ are at Attachment **[1]**.

2. Dairy Australia forecasts improved operating conditions for the dairy industry

The annual 2011 Dairy Australia Situation and Outlook report issued in June 2011 also examines the impact of a range of factors that underpin long term farm gate prices and returns. The report concludes that 'operating conditions for most in the Australian dairy industry have improved dramatically in 2011.' The report also notes that surplus production capacity is a key driver of farm gate returns in domestic fresh drinking milk markets. A copy of the report is at Attachment **[2]**.

3. Independent research concludes Coles' milk pricing is having a minimal impact on farm gate prices

The release of a report by an independent expert on dairy product markets, Steve Spencer of Fresh Logic in July. This report stated that the impact of lower retail milk prices on dairy processing margins had been minimal and that other factors were having a much bigger impact in northern dairy markets, including changes in another supermarket's private label milk contracts from one processor to another. A copy of the Fresh Logic presentation is at Attachment **[3]**.

4. Evidence that a change in Woolworths private label milk contracts is causing recent concern in the NSW dairy industry

The negotiation of new contractual arrangements between Dairy Farmers Milk Cooperative and National Foods and Parmalat over private label milk contracts that highlights the impact of other supply chain developments on milk supply and farm gate pricing. Copies of the announcements are at Attachment **[4]**.

5. Announcements of Coles support for the local dairy industry in Western Australia, NSW and Victoria

Coles has been working to establish new dairy contracts with locally-owned dairy groups in domestic markets. Most recently this is illustrated by the new contract Coles has entered into with Harvey Fresh in Western Australia. This contract not only ensured volume commitments for Harvey Fresh suppliers but provided a significant farm gate price increase for 26 former Challenge Dairy suppliers. Coles is also looking at transferring contracts for value added dairy products from export markets to domestic dairy markets that will increase demand for milk in those markets, including Norco Foods in New South Wales and Brownes Dairy in Western Australia. Copies of the announcements are at Attachment **[5]**.

6. A new Coles five year contract with Bega Cheese that will ensure 100 percent of Coles brand cheese will be Australian made

Coles awarded a new private label contract to local Australian producer, Bega Cheese for 9,000 tonnes of packaged cheese that were previously imported from New Zealand. Bega Cheese will now produce a total of 19,000 tonnes of Coles brand cheese which will require an additional 70 million litres of milk from dairy producers in southern NSW and Victoria. This contract will add an additional $30 million directly into the Australian dairy industry. Copies of the announcements by Coles, Bega Cheese and Federal and State Agriculture Ministers about the announcement on 7 September 2011 are at Attachment **[6]**.

7. ACCC support for collective bargaining by dairy farmers with milk processors

The final ACCC decision on 4 August 2011 to allow dairy farmers associated with Australian Dairy Farmers Limited to continue to collectively bargain with milk processors for a further 10 years. This decision applies to 500 dairy farmers. The ACCC indicated that it will continue to monitor conduct within the dairy industry and grocery sector for signs of anti-competitive behaviour. A copy of the final ACCC decision is at attachment **[7].**

8. ACCC findings that Coles did not engage in predatory pricing and did not breach the law

On 22 July 2011, the ACCC announced that it considered there was no evidence that Coles had acted in breach of the *Competition and Consumer Act 2010* (a copy of the ACCC announcement is Attachment **[8]**.

9. Coles continues it's Down Down milk pricing but restates willingness to pass on higher farm gate prices in payments to milk processors

On 25 July 2011, Coles released a statement which, among other things, indicated that Coles was committed to maintaining its milk prices at the current level of $1 a litre for the foreseeable future to help customers combat rising living costs and that the company was committed to keeping brand milk prices down for as long as possible (see Attachment **[9]**).

10. A Rabobank survey that shows dairy farmers are the most confident in the rural sector

The latest Rabobank survey of rural confidence issued on 5 September 2011 found that dairy producers had the highest confidence levels within the rural sector, with 39 per cent of producers expecting conditions to improve. A Rabobank media release on 5 September is at Attachment **[10]**.

11. Coles support for local artisan cheese producer Jindi Cheese

A new case study about artisan cheese producer Jindi in Gippsland highlights Coles' commitment to growing our business with local dairy producers and replace imports with Australian made products where-ever possible. A copy of the case study is at Attachment **[11]**.

3. New claims in supplementary submissions to the Committee

Coles believes that new claims about the impact of Coles' retail milk price reductions on farm gate prices are unsubstantiated.

The claims made in various supplementary submissions about lower farm gate prices as a direct result of Coles' retail milk price reductions in January appear to be based on relatively high level analysis that does not take into account a range of other factors affecting farm gate prices including milk supply and changes in milk processor contracts.

One report claims that the Western Australian dairy industry will suffer a $25 million per annum reduction in earnings as a result of a dairy industry supply chain squeeze caused by Coles' retail milk price reductions. The report does not appear to have taken into account the fact that Coles fully absorbed the January 2011 retail milk price reductions and that Coles has negotiated a higher commercial price under the terms of its new private label supply contract with Harvey Fresh in July 2011.

The analysis also does not appear to take into account a range of other supply and demand factors affecting the dairy industry in Western Australia, such as the collapse of the former Challenge Dairy which resulted in surplus milk on the local market and moves prior to January 2011 away from branded to private label products as consumers looked to save on grocery bills in the face of rising living costs. The recent Coles contract with Harvey Fresh has also resulted in higher farm gate prices being paid to the majority of Western Australian dairy farmers who formerly supplied Challenge Dairy.

Similarly, reports that Queensland dairy farmers supplying Parmalat under the so-called Paul's Daily Access Scheme (PDA) have suffered as a direct result of Coles' retail milk price reductions do not take into account other factors affecting the Queensland dairy industry.

The report fails to take into account any changes to payments to dairy farmer suppliers as a result of volume or quality changes that may have occurred as a result of Cyclone Yasi and the Queensland floods which affected dairy production in 2011.

The Committee should note that Coles private label milk contracts in Queensland are with Lion (formerly National Foods) and Fonterra, not Parmalat, so we do not have direct insight into contract payments to Parmalat by its supermarket customers. Dairy Australia confirm that Parmalat provides the highest farm gate prices in Queensland as a result of long standing agreements to its dairy farmer suppliers.

As previously discussed with the Committee, Coles fully funded lower retail milk prices and substantially increased contract payments to its major milk processors in Queensland in January 2011. The payments to our milk processor suppliers were sufficient to offset any impact on their margins from the expected shift from branded to private label milk. As a result, there should not have been any impact on farm gate returns as a direct result of Coles' pricing initiatives.

Coles' position is supported by the fact that farm gate prices offered to dairy farmers in southern Queensland and far north Queensland have been broadly steady or increased for the FY12 season (see Attachment **1**).

Other claims that current farm gate price negotiations between Parmalat and dairy farmers in NSW will result in lower farm gate prices are based on hearsay and have no relevance whatsoever to Coles retail milk price reductions in January 2011. At the time of writing this submission, final farm gate price negotiations between Parmalat and dairy farmers in NSW and Queensland had yet to be concluded, and in any case, they will be driven by recent changes in a competitor private label milk contract, <u>not Coles' milk price reductions</u>.

The Adwatch survey by independent dairy industry consultants, Fresh Logic, did not detect any branded milk price promotional activity in the period after the Coles retail milk price reductions, and we are not aware of any material branded price reductions that would justify the worst case scenarios forecast in recent reports.

4. ACCC Inquiry into milk price discounting

The ACCC has concluded that there is no evidence to support claims that Coles are likely to be in breach of S46 of the Competition and Consumer Act.

The Committee has received submissions in which it was claimed that Coles was likely to be in breach of s46 of the *Competition and Consumer Act 2010* as its January milk price reductions were below cost and implemented for an anti-competitive purpose. Further, it has been suggested that Coles intended to later increase its milk prices so as to recoup any profits foregone as a result of the January milk price reductions. No evidence was put forward in support of these submissions.

In its evidence before the Committee, the ACCC confirmed that it had been investigating and was continuing to investigate competition law issues which may arise from the Coles' January milk price reductions. The ACCC indicated that it was conducting industry-wide inquiries and was obtaining evidence from retailers, processors and the dairy farming industry.

On 22 July 2011, the ACCC announced that it considered there was no evidence that Coles had acted in breach of the *Competition and Consumer Act 2010* (a copy of the ACCC announcement is Attachment **[8]**.

The ACCC noted that the major impact of the January milk price reduction seems to have been a reduction in the supermarkets' profit margins on house brand milk for the benefit of consumers.

The ACCC concluded that there was no breach of s46 (1) or s46 (1AA). The ACCC said:

"It is important to note that anti-competitive purpose is the key factor here. Price cutting, or underselling competitors, does not necessarily constitute predatory pricing. Businesses often legitimately reduce their prices, and this is good for consumers and for competition in markets....

ACCC enquiries have revealed evidence that Coles' purpose in reducing the price of its house brand milk was to increase its market share by taking sales from its supermarket competitors including Woolworths. This is consistent with what the ACCC would expect to find in a competitive market...

The ACCC's enquiries show that there is a significant variation between respective costs of supply and operating margins amongst supermarket operators.... However on the evidence we have gathered over the last six months it seems most milk processors pay the same farm gate price to dairy farmers irrespective of whether it is intended to be sold as branded or house brand milk. "

Contrary to continued claims made in some supplementary submissions of below cost selling and predatory pricing , the ACCC made it clear that it had concluded that there was no predatory pricing case against Coles under s46(1) and that there was no breach whatsoever of any competition laws in connection with Coles' January milk price reductions.

Importantly, the ACCC had in its possession the necessary evidence to assess whether any representations made by Coles in connection with the January milk price reductions could amount to false or misleading conduct under the *Competition and Consumer Act 2010*.

5. An extremely competitive grocery market

In January 2008, the ACCC was asked by the Assistant-Treasurer and Minister for Competition Policy and Consumer Affairs to inquire into the competitiveness of retail prices for groceries. In its report of 5 August 2008, the ACCC concluded that the retail grocery market was workably competitive, though broad based price competition was not a strong feature of the market.

Since the 2008 ACCC report, price competition in the grocery market has now become 'extremely' competitive. For example, under our 'Down Down' program, which commenced in July 2010, Coles cut the prices of some 6,000 grocery products by an average of 10 per cent. Other competitors have followed Coles pricing reduction, providing Australian consumers with significant savings on weekly grocery bills.

In his decision in the Metcash case on 25 August 2011, His Honour Justice Emmett of the Federal Court of Australia stated that:

"The grocery industry in Australia is a highly competitive industry characterised by high volumes and low margins. The operators of self-supplying supermarket chains are extremely disciplined and endeavour to standardise their offerings at any one time. Nevertheless those offerings are not static, but shift as the chain operators explore market opportunities and develop new strategies. On the other hand, the products offered by independent retailers exhibit greater diversity than those of the chains in areas such as, for instance, size and location. Independent retailers may choose, or be forced, to rely upon factors other than price to attract customers. "

He also said:

"It is reasonable to conclude that the scale and intensity of retail competition is extreme and is increasing. Volume is the key to success for the major supermarket chains, independent retailers and Metcash alike. "

Emmett noted that competitors, as rivals, continuously seek to gain advantage in the marketplace and that such behaviour enhances efficiency for the benefit of consumers.

In a speech to the Law Council of Australia Competition and Consumer workshop on 27 August 2011, the Parliamentary Secretary to the Treasurer, The Hon. David Bradbury MP, also made the following comments:

"The Government considers that the principles underpinning the competition law framework that has emerged over the past four decades have served Australia well. The nature of competition law, involving the delicate balancing act between the interests of consumers, producers and suppliers, necessarily means that we are continually challenged to assess and reassess whether our legal framework has the balance right. At the heart of competition law in Australia has been the pursuit of consumer welfare, but as Justice French observed in 2004, since the enactment of the Trade Practices Act, there have been ongoing pressures to broaden or diversify that general [consumer welfare] objective in favour of the protection of particular classes of competitors....

There has also been ongoing pressure to qualify or limit the application of the Act with respect to particular sectors of the economy."

Indeed, the consumer welfare objective is best pursued by creating a regulatory framework where participants can compete freely and vigorously. In balancing the competing interests of the participants within a market, the competition framework should never put consumer welfare behind the interests of a particular competitor.

The Parliamentary Secretary to the Treasurer also referred to the so-called 'price wars' between Coles and Woolworths:

"The focus of this debate has been less upon whether competition has been occurring – as I think we can all see it has been occurring in a very aggressive way – and has been more focussed upon the extent to which competition laws should be concerned with the impacts of such aggressive competition upon certain competitors and producers.

To the extent that these debates remain focussed upon consumer welfare, rather than the protection of competitors and producers, this is a legitimate competition law debate. However, one might also question whether some of the objectives being sought by some interests in this debate might be more appropriately pursued under the banner of industry policy rather than through the amendment of our competition laws.

For my part, I find it novel to be fielding complaints that prices of certain staples are too low rather than too high. This is novel given the widespread concern across the community about the cost of living and the pressures being placed on household budgets.

At a time when there are such concerns over the cost of living, it is competition that has provided people with new choices, has delivered a more diverse range of products at lower prices, and which has effectively raised consumers' incomes and allowed them to purchase other goods and services or even increase their savings."

6. Long term dairy industry sustainability

On 25 July 2011, Coles released a statement which, among other things, indicated that Coles was committed to maintaining its milk prices at the current level of $1 a litre for the foreseeable future to help customers combat rising living costs and that the company was committed to keeping brand milk prices down for as long as possible (see Attachment **[9]**).

It is important to note that Coles remains committed to accepting justified cost increases from milk processing companies as a result of higher farm gate prices as part of our annual price reviews under agreed rise and fall clauses.

In these circumstances, future movements in farm gate prices will continue to be driven by the terms of contractual arrangements between processors and dairy farmers, supply and demand fluctuations, input costs, export prices, climatic issues and other industry factors.

The latest Rabobank survey of rural confidence issued on 5 September 2011 found that dairy producers had the highest confidence levels within the rural sector, with 39 per cent of producers expecting conditions to improve.

A media release by Rabobank on 5 September is at Attachment **[10]**. The release said:

> "Inside the farm gate, from a production point of view, things are shaping up for an overall good season," the Rabobank report said. "Generally speaking, with the exception of some pockets, seasonal conditions across Australia are good or average. There has been enough rain to maintain the prospects for winter crops and for pasture growth for graziers, although many areas will need further average rainfall in spring to guarantee a decent harvest.
>
> "That said, farmers are not only affected by what is happening in their paddocks, but also what's happening in the local and international economy. The survey highlights farmer concerns and uncertainty around issues including the proposed carbon tax, the suspension of live cattle exports to Indonesia and the impact of coal seam gas exploration and mining on agriculture."

The Rabobank survey reinforces Coles' view that many of the underlying issues raised in the course of this inquiry are more relevant to other areas of public policy such as industry policy and food security rather than competition policy.

Coles' remains committed to developing sustainable long term relationships with our suppliers including milk processors and dairy farmers. The recent Harvey Fresh contract that Coles' has signed for private label fresh drinking milk in Western Australia and Bega Cheese for all of our private label cheese which was formerly imported from New Zealand highlights our commitment to building a sustainable Australian dairy industry.

A new case study of Coles' support for artisan cheese producer Jindi in Gippsland highlights Coles' commitment to growing our business with local dairy producers and replace imports with Australian made products where-ever possible. A copy of the case study is at Attachment **[11]**. The Jindi Cheese, Bega Cheese, Norco and Harvey Fresh initiatives demonstrate Coles' commitment, as part of the Wesfarmers Group, to Australian agri-businesses and individual farmers.

Attachments to Coles' Supplementary Submission to the Senate Standing Committee on Economics Inquiry into the impact of supermarket price decisions on the dairy industry

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Attachment 1 – Announcements by milk processors about higher farm gate milk prices

“This milk price increase represents an additional $17million for Fonterra’s Victorian and Tasmanian suppliers and will be paid on 15 June 2011” – Fonterra, 12 May 2011

“This is the second highest farm gate price ever paid by Murray Goulburn to its dairy farmer supplier and we are pleased to be forecasting a similar price for the coming year.” – Murray Goulburn, 29 June 2011

“WCB considered current stable market conditions were likely to continue throughout the first half of FY2012.” – Warrnambool Cheese & Butter, 21 June 2011

“Our view of the global market is that it will pretty much hold. Prices look quite sound – but the big risk area is the Australian dollar, demand from the world (markets) seems to be very stable at the moment and the prices are very good.” – Lion, 27 July 2011

“The base price for NSW would be 47 cents a litre, which would rise to about 51c/litre with additional payments, while Queensland suppliers would receive about 0.5c/litre more for tier one milk” – Lion, 27 July 2011

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MEDIA RELEASE

12 May 2011

Fonterra announces opening milk price for 2011/12 season

Fonterra has announced its opening 2011/12 milk prices in Victoria and Tasmania at $4.65 per kilogram (kg) of milk solids.

Heather Stacy, Fonterra's General Manager Milk Supply, says this is the third highest opening price Fonterra has ever delivered.

"We are announcing early what we believe to be a sensible opening price, to give farmers 'line of sight' as they set their farm budgets for the coming season," she says.

"Fonterra's pricing for next season reflects our assessment of the current business conditions on global and domestic commodity markets as well as the current position of the Australian dollar."

As well as the strong opening price for 2011/12, Fonterra will be implementing a further milk price increase to eligible suppliers for milk supplied in the 2010/11 season of 8 cents per kg of fat and 20 cents per kg of protein. Fonterra's average annual price is now around $5.45 per kg of milk solids.

"This milk price increase represents an additional $17 million for Fonterra's Victorian and Tasmanian suppliers and will be paid on 15 June 2011," says Ms Stacy.

"We'll conduct our final price review after we've closed the 2010/11 season and the final elements of our trading year are locked down.

"I am confident that with the extra milk produced this year, and the ongoing demand for high quality dairy products internationally, we will finish in a strong position."

ENDS

For further information contact:
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About Fonterra

Fonterra is a global leader in dairy nutrition – the preferred supplier of dairy ingredients to many of the world's leading food companies. Fonterra is also a market leader with our own consumer dairy brands in Australia/New Zealand, Asia/Africa, Middle East and Latin America. The farmer-owned New Zealand co-operative is the largest processor of milk in the world, producing more than two million tonnes of dairy ingredients, value added dairy ingredients, specialty ingredients and consumer products every year. Drawing on generations of dairy expertise, Fonterra is one of the largest investors in dairy based research and innovation in the world. Our 16,000 staff work across the dairy spectrum from advising farmers on sustainable farming and milk production, to ensuring we live up to exacting quality standards and delivering every day on our customer promise in more than 100 markets around the world.

MEDIA RELEASE

14 July 2011

Fonterra delivers second highest closing price ever with $31 million payment

Fonterra today announced its second highest closing price ever for the 2010/11 season, confirming a large final farmgate milk price increase (or 'step-up') of 15 cents per kilogram of fat and 38 cents per kilogram of protein for Fonterra suppliers in Victoria and Tasmania.

This brings Fonterra's average milk price for the 2010/11 season to $5.70 per kilogram of milk solids (inclusive of incentives, net of volume charge).

"These payments will deliver an extra $31 million to the pockets of Fonterra suppliers. We are very pleased to continue our track record of delivering a consistently strong farmgate milk price, backed by the comprehensive range of value-added on-farm services and benefits we provide for our suppliers," said Heather Stacy, General Manager Milk Supply, Fonterra Australia.

The milk price increases will apply to all milk received from current Victorian and Tasmanian suppliers in the 12 month period to 30 June 2011 and will be paid on 15 August.

"The market is in a position of relative equilibrium which has supported fairly steady whole milk powder prices overall during the past 12 months. Generally, we have seen whole milk powder trading between $3,500 and $4,000 per tonne which provides a consistent base for us to work from," Ms Stacy said.

"Globally, milk production is forecast to increase over the coming year but we continue to see strong demand for dairy products, and milk powders in particular, across the Middle East, South East Asia and China, so we expect these balanced market conditions to continue."

Ms Stacy also announced a new growth incentive payment program, called Boo$t, designed to support Fonterra suppliers in Victoria and Tasmania who are actively growing milk volumes.

"Encouraging growth while maintaining a strong focus on quality is essential to our ability to meet strong projected demand into the future. Boo$t is an innovative way to support our suppliers who are growing milk volumes and we are pleased to be able to strengthen the broad range of incentive payments we offer with this new incentive," she said.

Fonterra has also completed its first scheduled pricing review for the 2011/12 season, and has confirmed a milk price increase of 12 cents per kilogram of fat and 30 cents per kilogram of protein. This payment will be backdated to 1 July 2011 and will be paid to current Fonterra suppliers in Victoria and Tasmania on 15 August.

“Our average annual price for the 2011/12 season is now in the order of $4.85 per kg of milk solids. While the general global dairy outlook is positive, there are other factors which are placing pressure on farm inputs, such as the continued high Australian dollar,” said Ms Stacy.

“We remain committed to passing on improvements in market conditions in our farmgate prices to our suppliers.”

ENDS

For further information contact:
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About Fonterra

Fonterra is a global leader in dairy nutrition – the preferred supplier of dairy ingredients to many of the world’s leading food companies. Fonterra is also a market leader with our own consumer dairy brands in Australia/New Zealand, Asia/Africa, Middle East and Latin America.

The farmer-owned New Zealand co-operative is the largest processor of milk in the world, producing more than two million tonnes of dairy ingredients, value added dairy ingredients, specialty ingredients and consumer products every year. Drawing on generations of dairy expertise, Fonterra is one of the largest investors in dairy based research and innovation in the world. Our 16,000 staff work across the dairy spectrum from advising farmers on sustainable farming and milk production, to ensuring we live up to exacting quality standards and delivering every day on our customer promise in more than 100 markets around the world.

Press Release

29 June 2011

Murray Goulburn Co-Operative forecasts solid farmgate returns as it releases opening prices to its dairy farmer supplier-shareholders

Australia's farmer-owned dairy company - Murray Goulburn Co-Operative today released its 2011/12 opening milk price circular to its dairy farmer supplier-shareholders.

In the circular Managing Director Stephen O'Rourke informed supplier-shareholders that the opening price equated to a weighted average of $4.90 per kilogram of milk solids.

"In addition, our current market forecast for the year ahead suggests a final milk price in the weighted average range of $5.30 to $5.50 per kilogram milk solids and we will update this forecast on a regular basis throughout the year," Mr O'Rourke said.

"If the market conditions allow us to meet this forecast we are committed to delivering this return via step-ups in milk price throughout the coming year."

Mr O'Rourke said that forecasting FY12 farmgate returns involved balancing the risks to the international dairy market and the Australian dollar.

"International dairy prices remain in a historically high range as does the Australian dollar. Obviously these factors can change based on the key factors in the world economy and this can affect returns to Australian farmers.

"Accordingly we have taken a careful forward view to make our forecast for the full year. We will keep our supplier-shareholders as up-to-date as possible in regards to market changes," Mr O'Rourke said.

In regards to finalising the FY11 farmgate returns Mr O'Rourke indicated a final step up would be announced in the coming weeks.

"We are in the process of finalising our accounts and we will then announce our final step-up for FY11. I am pleased to say that we will comfortably exceed the top range of our forecast weighted average price which was $5.50 per kilograms of milk solids.

"This is the second highest farmgate price ever paid by Murray Goulburn to its dairy farmer suppliers and we are pleased to be forecasting a similar price for the coming year."

Ends

Established in 1950, Murray Goulburn Co-Operative (MGC) is Australia's 100% farmer-owned dairy company. MGC is Australia's largest exporter of dairy foods and its flagship Devondale brand is sold nationally and is a market leader in key categories.

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MURRAY GOULBURN

Press Release

6 July 2011

Murray Goulburn Co-Operative (MG) announces final step-up in farmgate milk price for 2010/11 season

Australia's farmer-owned dairy company - Murray Goulburn today advised the co-operative's dairy farmer - shareholders of a final increase in the farmgate milk price paid for last season's milk supply.

In his letter to suppliers Managing Director Mr Stephen O'Rourke advised of a price increase of $0.30/kg protein and $0.12/kg butterfat for milk supplied across the 2010/11 season. This takes Murray Goulburn's final available weighted average farmgate price for the year to $5.65 per kilogram of milk solids.

Mr O'Rourke said this final 2010/11 milk price represented the second highest ever paid by the company.

"We are pleased to have delivered this solid farmgate price to our dairy farmer / shareholders and we hope this contributes to improved confidence in the farm sector," Mr O'Rourke said.

Last week Murray Goulburn announced an opening price for 2011/12 that equated to a weighted average of $4.90 per kilogram of milk solids – up on last year's opening price of $4.75.

In addition the company announced that current market forecast for the year ahead suggests a final milk price in the weighted average range of $5.30 to $5.50 per kilogram milk solids to be updated throughout the season.

Ends

Established in 1950, Murray Goulburn Co-Operative (MG) is Australia's 100% farmer-owned dairy company. MG is Australia's largest exporter of dairy foods and its flagship Devondale brand is sold nationally and is a market leader in key categories.

MGC Contact:

Robert Poole
General Manager Industry and Government Affairs
Tel: 03 9385 6747
Mob: 0408 057 073

Embargoed Media Release 3pm 21 June 2011

WARRNAMBOOL CHEESE AND BUTTER ANNOUNCES

MILK PRICE INCREASE, NEW PAYMENT CHOICES

Warrnambool Cheese and Butter (WCB) today announced an opening milk price for the new season, a new milk supplier payment structure and an increase in milk prices offered for the 2010/11 season.

The opening milk price for 2011/12 will be 36.5 cents per litre or $4.90 per kilogram (milk solids equivalent) on an average basis across the 12 months. This is a 4 per cent increase from last year's opening average price of 35.0 cents per litre.

WCB will also offer suppliers a new payment structure with a choice of two supply options – a seasonal supply option or a flat supply option, whichever best suits their business – the new payment structure also features improved farm cash flow by offering incentives earlier and putting more cash into the hands of suppliers when they need it.

Uniquely, WCB's suppliers are provided with a safety net which guarantees the highest payment option at the year's end.

This year's milk price increase for 2010/11 season takes the year-to-date milk price for suppliers to 41.8 cents per litre (on an average basis across the 12 months) This payment is retrospective and applies to milk supplied from 1 July 2010. WCB intend to review the milk price again once year end processes are completed.

WCB CEO David Lord said: "WCB understands the importance of delivering a strong, competitive price for its suppliers and solid returns for their milk over the longer term.

"We are seeking additional milk supply and welcome the opportunity to sit down with interested suppliers to discuss our new package.

"This is also a signal that WCB is looking forward and implementing its growth strategy based on strong demand for WCB products and a stabilised trading environment.

"The new payment arrangements have been adopted following a full review of WCB's milk payment structure.

"These arrangements give suppliers real choice, flexibility and improved cash flow and we believe it mitigates the risk to suppliers of changes to their business circumstances throughout the year.

Mr Lord said, "WCB considered current stable market conditions were likely to continue throughout the first half of FY 2012.

“The outlook beyond this remains less certain and WCB maintains a cautious approach to the second half of the year.

“Recent times have shown that markets are volatile and can move very quickly in a positive or negative direction - volatility which can impact the industry and milk prices paid.

Mr Lord said, “Any movement in the Australian dollar against the US currency would also impact future returns.”

Suppliers will receive an information pack in the next few days outlining payment options and farm income estimates and should contact the WCB field services team if they have any queries.

Media inquiries: Richard Lange 0457 811 717

[ends]

MEDIA MONITORS

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Warrnambool Standard
14-Jul-2011
Page: 1
On The Land
Market: Warrnambool VIC
Circulation: 12998
Type: Regional
Size: 554.56 sq.cms
MTWTFS-

Plant expands to meet demand for WCB's milk

RISING SUNGOLD

By **STEVE HYNES**

WARRNAMBOOL Cheese and Butter has started a $3.5 million expansion of its Sungold milk facility to meet growing production demands.

Production capacity at the Allansford plant will increase from 40 million to 60 million litres per year when expansion works are completed in October.

The 50 per cent increased capacity is required to meet growing orders for Sungold milk and to accommodate new contracts now being negotiated.

General manager of operations Richard Wallace said the expansion would create five to 10 new jobs at the plant.

The expansion works include upgrading the processing capacity, increasing coolroom space, extra packaging capacity and utility service upgrades.

Demand for Sungold milk has grown, despite the price war between major supermarkets, which has seen homebrand milk selling for $1 per litre.

The increased demand has mainly come from the independent IGA supermarkets, which have moved to Sungold products in increasing numbers.

WCB's general manager of retail, Bill Slater, said the milk price war had little effect on Sungold sales.

"It hit us for about a week and then bounced back.

"People tried the homebrands and most came back."

After the initial impact, Mr Slater said the price war by the major supermarkets had actually helped Sungold sales, as IGA outlets reacted against the cost cutting.

"They can't compete directly with $1 a litre. They rely on selling a quality product to maintain sales." The increase in sales through IGA outlets more than compensated for sales lost in the major supermarkets.

Mr Slater said sales through Coles and Woolworths were still strong despite the cut-price competition.

"Sungold milk sits on the shelf beside the $1-a-litre homebrands, but a lot of people still choose Sungold because they want a quality product," Mr Slater said.

More than 100 supermarkets throughout Victoria now sell Sungold milk, as well as many hundreds of corner stores.

It also has an expanding market in Sydney.

Mick Daly, IGA national board chairman and owner of supermarkets at Koroit, Portland and Heywood, agreed that many of the the group's supermarkets had moved to Sungold products.

"I think people realise $1-a-litre milk is inferior, and that it has to be by its price," he said.

"Quality has to be our point of difference and Sungold sits well with IGA for that reason.

"I would rather sell a good quality product at a reasonable price than an inferior product at a rock-bottom price — the consumer is not getting done over and the farmer, processor and the retailer all get a fair go."

Sungold milk products currently account for about 5 per cent of WCB's 900 million litre-milk collection.

shynes@standard.fairfax.com.au

Production supervisor Garry Brian monitors milk packaging at the Sungold plant, now undergoing expansion. 110707SH12 Picture: STEVE HYNES

Ref: 108566124

MEDIA MONITORS

back

Portland Observer
29-Jul-2011
Page: 25
General News
Market: Portland VIC
Circulation: 3616
Type: Regional
Size: 353.66 sq.cms
M-W-F--

South-west farmers not losing in milk war

WHILE the Australian Dairy Farmers Association has rallied against supermarket decisions to sell $1 per litre milk, local dairy farmers say it's a good thing.

Two Tyrendarra diary farmers this week said the price cut was helpful to consumers yet had no impact on their income.

On January 26, the decision by Coles to sell milk for $1 per has divided consumers and industry members alike.

The debate over such low pricing and its potential impact on the dairy industry almost reached boiling point until the Australian Competition and Consumer Commission announced an industry wide enquiry into the dairy market and specifically Coles milk pricing in relation to the Competition and Consumer Act 2010.

Last Friday the ACCC released the results of their enquiry saying the Coles has in no way breached the Act and that if anything, their decision to price milk was not only good for consumers but for competition markets according to ACCC Chairman Graeme Samuel.

"The major impact of the reduction in milk prices since January seems to have been a reduction in the supermarkets' profit margins on house brand milk.

"These price reductions have benefited consumers who purchase house brand milk," he said.

ADF vice president Adrian Drury described the ACCC as a toothless chihuahua after hearing of their decision.

Mr Drury believes the price of $1 per litre is unsustainable and that while the price is in place it will eliminate smaller competitors in the consumer market.

"It is clear that small retailers and vendors have suffered and lost business as a result of the discounting war started by Coles and that farmers have been directly impacted.

"There are over 20,000 products in Coles stores and we believe Coles has been using milk as a loss leader to draw in customers while fleecing them on other products," Mr Drury said.

But the opinion that matters most – the farmer – says the lower cost will have little effect on farmers in the South West region who supply their product to Fonterra and Murray Goulburn.

Rob Mather, dairy farmer of Tyrendarra says the decision made by Coles to cut milk prices will have little affect on farmers in the south-west.

"Only 12 per cent of our milk goes to the white milk market – most of our product goes into dehydrated milk, so we won't be affected," he said.

Tyrendarra dairy farmer Lynn Knowles says since the supermarket's decision to slash milk prices, more people could enjoy their product and they are still making the same earnings.

Coles managing director Ian McLeod agrees that more people are consuming milk since the cut was made.

"Increased milk consumption over the last six months, well above long term trends, shows that both our customers and the dairy industry are winning as a result of our Down Down milk pricing initiative," he said.

THE cut in the price of house brand milk means more people are consuming milk, and it appears that the price cut has had no affect on the incomes of south-west dairy farmers. FILE PICTURE

Adelaide Advertiser
05-Aug-2011
Page: 31
General News
Market: Adelaide
Circulation: 188117
Type: Capital City Daily
Size: 177.47 sq.cms
MTWTFS-

100m litres extra from our dairies

BUSINESS REPORTER
VALERINA CHANGARATHIL

SOUTH Australian dairy farmers have received a boost to confidence with major customer Warrnambool Cheese & Butter Factory calling for an extra 100 million litres of milk at better prices to feed its growth plans.

In an open letter to dairy farmers, Australia's oldest surviving dairy processor detailed its growth plans, including upgrades to its plants in Victoria and SA, and offered a higher price, including bonuses.

The company currently uses 900 million litres of milk a year – sourced from 600 dairy farms across South Australia and Victoria.

WCB marketing head Richard Lange said the company would need the extra 100 million litres of milk over the next two years to cater to increased demand for its products – and new customers.

"We are investing close to $10.3 million in new capability across facilities – Allansford milk powder plant and Sungold milk plant in Victoria and our Mt Gambier operations," he said.

"It also means a stronger commitment by us and an opportunity for local dairy farmers to supply that extra milk."

WCB managing director David Lord has offered farmers an opening price of 36.5 cents a litre – compared with last year's opening price of 35c – or $4.90 a kilogram of milk solids equivalent on average across 12 months.

"We have been listening to dairy farmers and have put together a payment package that we believe makes a sound business case for all WCB suppliers," Mr Lord said.

The news is likely to bring some relief to SA dairy farmers facing the impact of the Coles-Woolworths price war, the carbon tax, drought and the global financial crisis.

SA Dairy Farmers' Association president David Basham said WCB's initiative was "the kind of long-term good news the industry needs".

"The opening price offered is a good indication prices may get better through the year," he said. "It's a bright light at the end of the tunnel."

Close to 1500 tonnes of cheese per year is processed at the Mil Lel packaging, cutting and shredding facility that employs less than 20 staff.

After the investment, production will be upgraded to 4000 tonnes a year, leading to more local jobs. The Mt Gambier cheese factory will be expanded from boutique facility to a significant part of operations.


Lion moves to ease nerves

Weekly Times
27-Jul-2011
Page: 97
General News
By: Simone Smith
Market: Melbourne
Circulation: 70500
Type: Rural
Size: 166.87 sq.cms
Frequency: --W----

MILK PRICE

Lion moves to ease nerves

By SIMONE SMITH

ONE domestic processor has moved to allay fears the supermarket price war will impact farm-gate prices this season.

Lion, formerly National Foods, will release its southern opening price of $5.87 a kilogram of milk solids this week.

The price for Queensland and NSW suppliers will "hold" from last year, according to Lion general manager of milk supply Murray Jeffrey.

Mr Jeffrey said the base price for NSW would be 47 cents a litre, which would rise to about 51c/litre with additional payments, while Queensland suppliers would receive about 0.5c/litre more for tier-one milk.

He said Lion wanted to ensure suppliers and Dairy Farmers Milk Co-operative members didn't lose confidence in the supplying the domestic market.

"We wanted to go out with a strong price given all the domestic pricing issues with the $1 Coles milk," he said.

"We have taken the position that we will hold our prices and slightly increase in south east Queensland when the marketplace is telling we should go the other way."

The amount of milk paid on the tier-one price — the higher farm-gate price available for suppliers — for NSW farmers will be known in four to six weeks after negotiations with Parmalat.

Lion lost the Woolworths milk supply contract to Parmalat for that state and while it hopes Parmalat will source the milk from it at the tier-one price, this is not known yet.

Mr Jeffrey said if this did not happen the amount of milk that would be bought for the tier-one price in NSW could drop about 100 million litres.

Further south, the price for Tasmania, Victoria and South Australia could fluctuate in-line with the export market price.

"Our view of the global market is that it will pretty much hold," Mr Jeffrey said.

"Prices look quite good — sound — but the big risk area is the Australian dollar, like everyone else.

"Demand from the world (markets) seems to be pretty stable at the moment and the prices are pretty good."

Western Victoria, south east and central South Australia suppliers will be offered one-year contracts to supply Lion before the expected sale of two South Australian processing plants.

Mr Jeffrey hoped that despite the proposed sale, the contracted milk in these regions would remain with Lion and he was also "pretty confident" producers would stay on and supply the buyer of the sites after this season.

Industry talk has suggested Victorian company United Dairy Power is a possible buyer of the sites, although there has been no confirmation.

In March, Lion confirmed the sale of the two South Australian sites would mean its milk requirement for the state would drop from 280 million litres to 100 million.

Dairy Farmers Milk Cooperative
ARBN: 108 690 384

Dairy Farmers Milk Cooperative
PO Box 72
Lidcombe NSW 1825
Tel: 02 8732 5206
Fax: 02 8732 5055
Mob: 0458 487 228

1 August 2011

Dear DFMC Supplier,

NORTHERN REGION (SEQ) ANNOUNCED MILK PRICES 2011/12

On behalf of the Board I am pleased to announce Dairy Farmers Milk Co-operative's (DFMC) opening milk pricing for the new season commencing 1st July 2011 coupled with the DFMC Milk Policies.

This announced base milk pricing is for all Northern (SEQ) Region Suppliers.

Our announced Tier One (T1) base milk price is a weighted average of 47.34 cents per litre at the reference litre of 3.95% Butter Fat and 3.15% Protein ($6.69 per kilogram milk solids equivalent). This price is an increase of +0.5 cpl on last financial year base milk price.

Suppliers achieve increments above the announced base milk price from the DFMC incentive payments. Last year the regional average incentives paid was approximately 6.0 cpl above the base price.

All milk supplied from the 1st of July will be paid at the announced monthly base price (plus incentives).

Suppliers on 30th month legacy contracts and VP & FP contracts that end on the 30th June 2011 will be required, with the assistance of the Regional Managers, to choose and enter into the VP or FP contract option.

Suppliers on existing VP and FP contracts that extends beyond 30th June 2011 will be entitled to "Roll Over" their current contracts onto either of the contract options in order to take advantage of the Guarantee Minimum.

30 MONTH (LEGACY) SUPPLIERS

Suppliers on the 30 month legacy contract with an Initial Term ending 30th June 2011, will placed from the 1st of July, on a FP contract along with the FP flat milk payment model until the 30th September to allow DFMC to finalise contract signing of all suppliers. From the 1st of October the Milk Co-operative will then be in a position to place everyone onto their chosen contract terms and Announced Based Milk price.

If the 30 month legacy contract suppliers subsequently decide to enter into a VP Contract, the following will occur:

- Your Allocation and Tier 1 & Tier 2 Base Milk Price will revert to the Variable allocation model and will be re-calculated and backdated to the 1st of July taking into account the final determination of the regional AFD
    - Please note that the region must first be in excess of the Regional AFD before Tier 2 Base Milk Prices may be imposed on an individual supplier exceeding their individual allocation

- The Milk Co-operative will set-off any amounts payable by you to the Milk Co-operative against any amount payable by the Milk Co-operative to you on your next milk statement for any monies owing

RECALCULATION OF MILK PAYS FROM THE 1ST OCTOBER

When all contracts have been signed in the 90 day period (to 30th Sept) there will be an adjustment, in the October milk statement, to the interim payment for July and August This is because total contract signing is a determinant of the regional AFD which determines Tier 1 and Tier 2 volumes

The Milk Co-operative will set-off any amounts payable by you to the Milk Co-operative against any amount payable by the Milk Co-operative to you on your next milk statement for any monies owing.

DFMC MILK PAYMENT SCHEDULE

The following table (1) details our announced base milk price for all milk purchased within your monthly allocation as T1 milk for financial year 2011/12

Table 1: Announced T1 Base Milk Price

Announced T1 Milk Base Price						
Month	Variable Monthly Volume, Variable Monthly Price			Flat Monthly Volume, Flat Monthly Price		
	Cents per Litre	**Fat $/kg**	**Protein $/kg**	**Cents per Litre**	**Fat $/kg**	**Protein $/kg**
Jul-11	48.76	4.13	10.30	47.50	4.02	10.04
Aug-11	47.84	4.05	10.11	47.50	4.02	10.04
Sep-11	44.64	3.78	9.43	47.50	4.02	10.04
Oct-11	44.64	3.78	9.43	47.50	4.02	10.04
Nov-11	44.64	3.78	9.43	47.50	4.02	10.04
Dec-11	46.76	3.96	9.88	47.50	4.02	10.04
Jan-12	47.74	4.04	10.09	47.50	4.02	10.04
Feb-12	47.84	4.05	10.11	47.50	4.02	10.04
Mar-12	49.63	4.20	10.49	47.50	4.02	10.04
Apr-12	49.63	4.20	10.49	47.50	4.02	10.04
May-12	48.92	4.14	10.34	47.50	4.02	10.04
Jun-12	48.92	4.14	10.34	47.50	4.02	10.04
WT/Price	**47.34**					

With regard to the above table (1) you should note the following:

1. The announced T1 base milk price for a month is the base price for milk purchased as T1 milk
2. In addition to the announced base milk prices detailed above, DFMC suppliers will receive a payment above the base milk price for Contract Consideration, location Incentive (where applicable), Productivity Incentive & Milk Quality Incentive
3. Milk supplied above your monthly allocation may attract a T2 milk price (see Table 2 for T2 milk price)
4. DFMC Contract Consideration, Quality Incentive Payments and Gate Charges applicable to your region will not change from that of 2010/11
5. The Productivity Incentive which previously started at 1,000 Kg Milk Solids per month with a payment rate of .01 will now start at 4,000 Kg Milk Solids per month with a payment rate commencing at .04 cpl (please see DFMC Milk Policy Document for further information)
6. Suppliers who are located outside the 200km circle will cease to receive the +0.5 cpl location incentive (See DFMC Milk Policy Document for further information)

The following table (2) details our announced T2 milk prices.

Table 2: Announced T2 Base Milk Price

Month	Announced T2 Milk Base Price		
	Cents per Litre	**Fat $/kg**	**Protein $/kg**
Jul-11	35.00	2.96	7.40
Aug-11	35.00	2.96	7.40
Sep-11	35.00	2.96	7.40
Oct-11	35.00	2.96	7.40
Nov-11	35.00	2.96	7.40
Dec-11	35.00	2.96	7.40
Jan-12	35.00	2.96	7.40
Feb-12	35.00	2.96	7.40
Mar-12	35.00	2.96	7.40
Apr-12	35.00	2.96	7.40
May-12	35.00	2.96	7.40
Jun-12	35.00	2.96	7.40
WT/Price	**35.00**		

With regard to the above table (2), T2 milk prices will be paid for milk supplied in excess of the contracted monthly volumes. However you should note the following:

1. The monthly T2 payments are applied to an individual supplier's milk only when the regional milk pool exceeds the monthly regional and after the Pro-rata rule is applied (See Pro-rata rule for additional information).

2. A flat price contract supplier (FP) has 10% headroom above the monthly contracted volumes before T2 might come into effect.

3. These prices are base prices only, additional incentive payments will be made for Productivity, Quality and Location.

4. Note that Contract Consideration will not be paid on T2 milk.

REGIONAL ANTICIPATED FULL DEMAND (AFD)

The Milk Co-operative will have all suppliers on either a Flat or Variable allocation, however the Region as a whole will only have one Regional AFD i.e. the sum of all suppliers individual monthly AFD's will be the Regional AFD for that month.

PRO-RATA RULES (may come into play on a monthly payment basis when the regional AFD has been exceeded)

The Pro-Rata rule is to ensure that DFMC suppliers are paid Tier 1 for the milk that Lion (formally called National Foods) needs within a region on a monthly basis. If the total milk supplied for the month exceeds regional monthly AFD it might appear that all excess regional milk is Tier 2, however some farmers may not have supplied their contracted volumes.

Guaranteed Minimum

You should also be aware that the following Guarantee Minimum Base Milk Prices (please refer to the Milk Supply Contracts for details) are available to suppliers who enter into a 1 or 2 year supply contract. These are as follows:

- 2011/12 financial year – 47.50 cents per litre
- 2012/13 financial year – 45.00 cents per litre
- 2013/14 financial year – 45.00 cents per litre

Please note that if you have any questions or concerns regarding the above options available to you, please do not hesitate to contact your Regional Manager Mal Maroske on 0418 634 702 or via email mal.maroske@dfmc.org.au or discuss with your local Director.

DFMC is committed to providing our members a milk price and policies that are competitive with market forces within your region. We will continue to monitor milk pricing paid to our suppliers along with the competitive market that influences the price paid to farmers.

Yours Sincerely on behalf of the DFMC Board

Ian Zandstra
Chairman
Dairy Farmers Milk Co-operative

Dairy Farmers Milk Cooperative

ARBN: 108 690 384

Dairy Farmers Milk Cooperative

PO Box 72
Lidcombe NSW 1825

Tel: 02 8732 5206
Fax: 02 8732 5055
Mob: 0458 487 228

1 August 2011

Dear DFMC Supplier,

FAR NORTH QUEENSLAND REGION (FNQ) ANNOUNCED MILK PRICES 2011/12

On behalf of the Board I am pleased to announce Dairy Farmers Milk Co-operative's (DFMC) opening milk pricing for the new season commencing 1st July 2011 coupled with the DFMC Milk Policies.

This announced base milk pricing is for all Far North Queensland Region Suppliers.

Our announced Tier One (T1) base milk price is a weighted average of 48.00 cents per litre at the reference litre of 3.95% Butter Fat and 3.15% Protein ($6.76 per kilogram milk solids equivalent). This price is an increase of +1.0Cpl on last financial year base milk price.

Suppliers achieve increments above the announced base milk price from the DFMC incentive payments. Last year the regional average incentives paid was approximately 4.0 cpl above the base price.

All milk supplied from the 1st of July will be paid at the announced monthly base price (plus incentives).

Suppliers on 30th month legacy contracts and VP & FP contracts that end on the 30th June 2011 will be required, with the assistance of the Regional Managers, to choose and enter into the VP or FP contract option.

Suppliers on existing VP and FP contracts that extends beyond 30th June 2011 will be entitled to "Roll Over" their current contracts onto either of the contract options in order to take advantage of the Guarantee Minimum.

30 MONTH (LEGACY) SUPPLIERS

Suppliers on the 30 month legacy contract with an Initial Term ending 30th June 2011, will placed from the 1st of July, on a FP contract along with the FP flat milk payment model until the 30th September to allow DFMC to finalise contract signing of all suppliers. From the 1st of October the Milk Co-operative will then be in a position to place everyone onto their chosen contract terms and Announced Based Milk price.

If the 30 month legacy contract suppliers subsequently decide to enter into a VP Contract, the following will occur:

- Your Allocation and Tier 1 & Tier 2 Base Milk Price will revert to the Variable allocation model and will be re-calculated and backdated to the 1st of July taking into account the final determination of the regional AFD
    - Please note that the region must first be in excess of the Regional AFD before Tier 2 Base Milk Prices may be imposed on an individual supplier exceeding their individual allocation

- The Milk Co-operative will set-off any amounts payable by you to the Milk Co-operative against any amount payable by the Milk Co-operative to you on your next milk statement for any monies owing

RECALCULATION OF MILK PAYS FROM THE 1ST OCTOBER

When all contracts have been signed in the 90 day period (to 30th Sept) there will be an adjustment, in the October milk statement, to the interim payment for July and August This is because total contract signing is a determinant of the regional AFD which determines Tier 1 and Tier 2 volumes.

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DFMC MILK PAYMENT SCHEDULE

The following table (1) details our announced base milk price for all milk purchased within your monthly allocation as T1 milk for financial year 2011/12

Table 1: Announced T1 Base Milk Price

Announced T1 Milk Base Price						
Month	Variable Monthly Volume, Variable Monthly Price			Flat Monthly Volume, Flat Monthly Price		
	Cents per Litre	Fat $/kg	Protein $/kg	Cents per Litre	Fat $/kg	Protein $/kg
Jul-11	46.99	3.97	9.94	48.03	4.06	10.16
Aug-11	46.99	3.97	9.94	48.03	4.06	10.16
Sep-11	46.99	3.97	9.94	48.03	4.06	10.16
Oct-11	46.99	3.97	9.94	48.03	4.06	10.16
Nov-11	46.99	3.97	9.94	48.03	4.06	10.16
Dec-11	46.99	3.97	9.94	48.03	4.06	10.16
Jan-12	49.06	4.15	10.37	48.03	4.06	10.16
Feb-12	49.06	4.15	10.37	48.03	4.06	10.16
Mar-12	49.06	4.15	10.37	48.03	4.06	10.16
Apr-12	49.06	4.15	10.37	48.03	4.06	10.16
May-12	49.06	4.15	10.37	48.03	4.06	10.16
Jun-12	49.06	4.15	10.37	48.03	4.06	10.16
WT/Price	**48.00**					

With regard to the above table (1) you should note the following:

1. The announced T1 base milk price for a month is the base price for milk purchased as T1 milk
2. In addition to the announced base milk prices detailed above, DFMC suppliers will receive a payment above the base milk price for Contract Consideration, location Incentive (where applicable), Productivity Incentive & Milk Quality Incentive
3. Milk supplied above your monthly allocation may attract a T2 milk price (see Table 2 for T2 milk price)
4. DFMC Contract Consideration, Location, Quality Incentive Payments and Gate Charges applicable to your region will not change from that of 2010/11
5. The Productivity Incentive which previously started at 1,000 Kg Milk Solids per month with a payment rate of .01 will now start at 4,000 Kg Milk Solids per month with a payment rate commencing at .04 cpl (please see DFMC Milk Policy Document for further information)

The following table (2) details our announced T2 milk prices.

Table 2: Announced T2 Base Milk Price

Month	Announced T2 Milk Base Price		
	Cents per Litre	**Fat $/kg**	**Protein $/kg**
Jul-10	33.21	2.81	7.02
Aug-10	33.21	2.81	7.02
Sep-10	33.21	2.81	7.02
Oct-10	33.21	2.81	7.02
Nov-10	33.21	2.81	7.02
Dec-10	33.21	2.81	7.02
Jan-11	33.21	2.81	7.02
Feb-11	33.21	2.81	7.02
Mar-11	33.21	2.81	7.02
Apr-11	33.21	2.81	7.02
May-11	33.21	2.81	7.02
Jun-11	33.21	2.81	7.02
WT/Price	**33.21**		

With regard to the above table (2), T2 milk prices will be paid for milk supplied in excess of the contracted monthly volumes. However you should note the following:

1. The monthly T2 payments are applied to an individual supplier's milk only when the regional milk pool exceeds the monthly regional and after the Pro-rata rule is applied (See Pro-rata rule for additional information).

2. A flat price contract supplier (FP) has 10% headroom above the monthly contracted volumes before T2 might come into effect.

3. These prices are base prices only, additional incentive payments will be made for Productivity, Quality and Location.

4. Note that Contract Consideration will not be paid on T2 milk.

REGIONAL ANTICIPATED FULL DEMAND (AFD)

The Milk Co-operative will have all suppliers on either a Flat or Variable allocation, however the Region as a whole will only have one Regional AFD i.e. the sum of all suppliers individual monthly AFD's will be the Regional AFD for that month.

PRO-RATA RULES (may come into play on a monthly payment basis when the regional AFD has been exceeded)

The Pro-Rata rule is to ensure that DFMC suppliers are paid Tier 1 for the milk that Lion (formally called National Foods) needs within a region on a monthly basis. If the total milk supplied for the month exceeds regional monthly AFD it might appear that all excess regional milk is Tier 2, however some farmers may not have supplied their contracted volumes.

Guaranteed Minimum

You should also be aware that the following Guarantee Minimum Base Milk Prices (please refer to the Milk Supply Contracts for details) are available to suppliers who enter into a 1 or 2 year supply contract. These are as follows:

- 2011/12 financial year – 48.00 cents per litre
- 2012/13 financial year – 46.00 cents per litre
- 2013/14 financial year – 45.00 cents per litre

Please note that if you have any questions or concerns regarding the above options available to you, please do not hesitate to contact your Regional Manager Mal Maroske on 0418 634 702 or via email mal.maroske@dfmc.org.au or discuss with your local Director.

DFMC is committed to providing our members a milk price and policies that are competitive with market forces within your region. We will continue to monitor milk pricing paid to our suppliers along with the competitive market that influences the price paid to farmers.

Yours Sincerely on behalf of the DFMC Board

Ian Zandstra
Chairman
Dairy Farmers Milk Co-operative

Dairy Farmers milk co-operative

Dairy Farmers Milk Cooperative

ARBN: 108 690 384

Dairy Farmers Milk Cooperative

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Lidcombe NSW 1825

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1 August 2011

Dear DFMC Supplier,

CENTRAL NSW REGION ANNOUNCED MILK PRICES 2011/12

On behalf of the Board I am pleased to announce Dairy Farmers Milk Co-operative's (DFMC) opening milk pricing for the new season commencing 1st July 2011 coupled with the DFMC Milk Policies.

This announced base milk pricing is for all Central Regions Suppliers (NSW).

Our announced Tier One (T1) base milk price is a weighted average of 47.00 cents per litre at the reference litre of 3.95% Butter Fat and 3.15% Protein ($6.65 per kilogram milk solids equivalent). This price unchanged from last financial year.

Suppliers achieve increments above the announced base milk price from the DFMC incentive payments. Last year the regional average incentives paid was approximately 5.0cpl above the base price.

All milk supplied from the 1st of July will be paid at the announced monthly base price (plus incentives).

Suppliers whose old 30th month contract and VP & FP contracts that end on the 30th June 2011 will be required, with the assistance of the Regional Managers, to choose and enter into the VP or FP contract option.

Suppliers on existing VP and FP contracts that extends beyond 30th June 2011 will be entitled to "Roll Over" their current contracts onto either of the contract options in order to take advantage of the Guarantee Minimum.

30 MONTH (LEGACY) SUPPLIERS

Additionally, for suppliers on the old 30 month contract with an Initial Term ending 30th June 2011, from the 1st of July you will placed on a FP contract along with the FP flat milk payment model until the 30th September to allow DFMC to finalise contract signing of all suppliers. From the 1st of October the Milk Co-operative will then be in a position to place everyone onto their correct contract terms and Announced Based Milk price.

If the 30 month contract suppliers subsequently decide to enter into a VP Contract, the following will occur:

- Your Allocation and Tier 1 & Tier 2 Base Milk Price will revert to the Variable allocation model and will be re-calculated and backdated to the 1st of July taking into account the final determination of the regional AFD
    - Please note that the region must first be in excess of the Regional AFD before Tier 2 Base Milk Prices may be imposed on an individual supplier exceeding their individual allocation

- The Milk Co-operative will set-off any amounts payable by you to the Milk Co-operative against any amount payable by the Milk Co-operative to you on your next milk statement for any monies owing

RECALCULATION OF MILK PAYS FROM THE 1ST OCTOBER

For 30 Months suppliers who remain on the FP contract and for existing FP and VP contracted suppliers, from the 1st October after the all the contracts have been signed in the 90 day period, there will be an adjustment to the interim payment for July and August due to variations as follows:

1. Potentially different pricing to the finally agreed Announced Base Milk price
2. Final determination of the regional AFD which determines Tier 1 and Tier 2 volumes

The Milk Co-operative will set-off any amounts payable by you to the Milk Co-operative against any amount payable by the Milk Co-operative to you on your next milk statement for any monies owing.

DFMC MILK PAYMENT SCHEDULE

The following table (1) details our announced base milk price for all milk purchased within your monthly allocation as T1 milk for financial year 2011/12

Table 1: Announced T1 Base Milk Price

Announced T1 Milk Base Price						
Month	Variable Monthly Volume, Variable Monthly Price			Flat Monthly Volume, Flat Monthly Price		
	Cents per Litre	Fat $/kg	Protein $/kg	Cents per Litre	Fat $/kg	Protein $/kg
Jul-11	47.63	4.02	10.08	47.18	3.98	9.98
Aug-11	46.76	3.95	9.89	47.18	3.98	9.98
Sep-11	44.76	3.78	9.47	47.18	3.98	9.98
Oct-11	43.64	3.68	9.24	47.18	3.98	9.98
Nov-11	43.64	3.68	9.24	47.18	3.98	9.98
Dec-11	44.66	3.77	9.45	47.18	3.98	9.98
Jan-12	45.53	3.84	9.64	47.18	3.98	9.98
Feb-12	47.06	3.97	9.96	47.18	3.98	9.98
Mar-12	50.37	4.25	10.66	47.18	3.98	9.98
Apr-12	51.28	4.33	10.85	47.18	3.98	9.98
May-12	51.28	4.33	10.85	47.18	3.98	9.98
Jun-12	49.55	4.18	10.49	47.18	3.98	9.98
WT/Price	**47.00**					

With regard to the above table (1) you should note the following:

1. The announced T1 base milk price for a month is the base price for milk purchased as T1 milk
2. In addition to the announced base milk prices detailed above, DFMC suppliers will receive a payment above the base milk price for Contract Consideration, location Incentive (where applicable), Productivity Incentive & Milk Quality Incentive
3. Milk supplied above your monthly allocation may attract a T2 milk price (see Table 2 for T2 milk price)
4. DFMC Contract Consideration, Quality Incentive Payments and Gate Charges applicable to your region will not change from that of 2010/11
5. The Productivity Incentive which previously started at 1,000 Kg Milk Solids per month with a payment rate of .01 will now start at 4,000 Kg Milk Solids per month with a payment rate commencing at .04 cpl (please see DFMC Milk Policy Document for further information)
6. Suppliers who are located 200+ Km's 'Distance to market' will cease to receive the +.05Cpl location incentive (See DFMC Milk Policy Document for further information)

The following table (2) details our announced T2 milk prices.

Table 2: Announced T2 Base Milk Price

Month	Announced T2 Milk Base Price		
	Cents per Litre	**Fat $/kg**	**Protein $/kg**
Jul-11	47.54	4.02	10.05
Aug-11	46.66	3.95	9.86
Sep-11	22.03	1.86	4.66
Oct-11	22.03	1.86	4.66
Nov-11	22.03	1.86	4.66
Dec-11	22.03	1.86	4.66
Jan-12	23.86	2.02	5.04
Feb-12	24.94	2.11	5.27
Mar-12	50.27	4.25	10.63
Apr-12	51.19	4.33	10.82
May-12	51.19	4.33	10.82
Jun-12	49.46	4.18	10.46
WT/Price	**35.49**		

With regard to the above table (2), T2 milk prices will be paid for milk supplied in excess of the contracted monthly volumes. However you should note the following:

1. The monthly T2 payments are applied to an individual supplier's milk only when the regional milk pool exceeds the monthly regional and after the Pro-rata rule is applied (See Pro-rata rule for additional information).

2. A flat price contract supplier (FP) has 10% headroom above the monthly contracted volumes before T2 might come into effect.

3. These prices are base prices only, additional incentive payments will be made for Productivity, Quality and Location.

4. Note that Contract Consideration will not be paid on T2 milk.

5. The flat payment option is not offered on T2 milk.

REGIONAL ANTICIPATED FULL DEMAND (AFD)

The Milk Co-operative will have all suppliers on either a Flat or Variable allocation, however the Region as a whole will only have one Regional AFD i.e. the sum of all suppliers individual monthly AFD's will be the Regional AFD for that month.

PRO-RATA RULES (may come into play on a monthly payment basis when the regional AFD has been exceeded)

The Pro-Rata rule is to ensure that DFMC suppliers are paid Tier 1 for the milk that Lion (formally called National Foods) needs within a region on a monthly basis. If the total milk supplied for the month exceeds regional monthly AFD it might appear that all excess regional milk is Tier 2, however some farmers may not have supplied their contracted volumes.

Guaranteed Minimum

You should also be aware that the following Guarantee Minimum Base Milk Prices (please refer to the Milk Supply Contracts for details) are available to suppliers who enter into a 1 or 2 year supply contract. These are as follows:

- 2011/12 financial year – 47 cents per litre
- 2012/13 financial year – 45 cents per litre
- 2013/14 financial year – 45 cents per litre

Please note that if you have any questions or concerns regarding the above options available to you, please do not hesitate to contact your Regional Manager Helen Whitelaw on **0429 061 280** or via email helen.whitelaw@dfmc.org.au or discuss with your local Director.

DFMC is committed to providing our members a milk price and policies that are competitive with market forces within your region. We will continue to monitor milk pricing paid to our suppliers along with the competitive market that influences the price paid to farmers.

Yours Sincerely on behalf of the DFMC Board

Ian Zandstra
Chairman
Dairy Farmers Milk Co-operative

Attachment 2 – Dairy Australia Situation and Outlook report points to positive future

“Operating conditions for most in the Australian dairy industry have improved dramatically in 2010/11.”

“While farm gate prices remain stable for many producers, the changes in supply of sizeable supermarket private label milk contracts are increasingly disruptive for processors and suppliers alike. Increased exposure for many producers to lower milk prices for a portion of their milk supply – reflecting supplies of milk in Southern Queensland, NSW and Western Australia that are in excess of processor requirements.”

Dairy Australia

Dairy 2011
Situation and Outlook

Contents

This report has been prepared for the Australian Dairy Industry to provide participants and stakeholders with a comprehensive and objective assessment of the industry's position and outlook, as a resource to the dairy industry for information and planning purposes. The work has been funded by Dairy Australia.

The report has been written by Dairy Australia's Strategic Analysis team with assistance from Freshlogic. The project has benefited from the input from dairy farmers, management of Australia's major dairy companies, and Dairy Australia management.

The project group wishes to acknowledge the valuable assistance and co-operation of industry participants who were consulted in the preparation of this project package, including company management, farm consultants and advisers as well as participants in the 2011 National Dairy Farmer Survey.

Executive Summary

Purpose of this report

- The Situation & Outlook report provides a clear, timely picture of what is happening in the Australian dairy industry and expectations for the future. The report is produced by Dairy Australia, with support from industry organizations – an example of collective industry activity.
- As well as informing farmers, the report aims to provide factual insights into dairy for banks, governments, regional communities, and suppliers of products and services to the dairy industry.
- The Situation & Outlook report is part of ongoing activity to build a comprehensive knowledge base on the Australian dairy industry, its operating environment and the factors affecting its future.
- The dynamic and highly-integrated operating environment for this industry underlines the need for all industry participants to have access to timely, credible intelligence on which to base decisions.
- Dairy Australia augments this major annual report with regular quarterly Situation & Outlook updates on the key drivers of industry profitability.

The industry in 2011 – a platform for growth?

- Operating conditions for most in the Australian dairy industry have improved dramatically in 2010/11. However, differences in price signals and demand outlooks highlight significant regional variances.
- In 2011, the industry's position has continued to improve. Global economic recovery and strong regional growth has underpinned steady demand expansion in key markets, while lower-than expected international supplies saw dairy commodity prices rise sharply in US dollar terms through 2010 and into early 2011.
- While the benefits of higher commodity prices for Australian exporters have been constrained by the strong Australian dollar, farmgate prices for southern producers have improved strongly in the 2010/11 season.
- Improved milk prices, combined with low grain prices and generally favourable seasonal conditions have provided southern farmers with the best production conditions for more than a decade. In some regions, the excessively wet conditions have actually curtailed feed production and herd productivity.
- While cashflows have generally improved, this has merely enabled many producers to restore their financial positions following the shocks of the previous two seasons, and the finance sector is also now generally operating with much tighter controls on debt exposures.
- Milk prices in southern regions will finish the 2010/11 season close to an average of $5.50/kg milk solids. Based on current indications, it is expected that milk prices in these regions over the full 2011/12 season will be close to these levels. Opening prices announced by manufacturers should be stronger than the previous season's openings, when there was less certainty about the strength in the recovery of world prices.
- The 2011/12 opening farmgate milk price announcements will again be important signals for farmers assessing short-term actions regarding their dairy herd size and composition and their longer term confidence in the industry.
- The outlook for indicative southern farmgate milk prices, based on current commodity price and exchange rate expectations is for an opening price range of $4.60 to $4.90 per kgMS up from $4.40 to $4.60 per kgMS in 2010. This implies a full year average price range between $5.10 and $5.50 per kgMS – similar to the current season.
- International dairy market fundamentals support this price outlook – however, the wider global economic situation remains a threat to the stable market.
- The low growth outlook resulting from the uncertainty facing many producers and a slow build in milking cow numbers will sustain the intense competition for southern milk supplies, due to increasing export demand, the need to fill factories, improve efficiencies and support future expansion plans.
- In northern states, the lingering effects of record rainfall and widespread destructive flooding in most regions of Queensland and northern NSW will affect the recovery in herd production and feed supplies for a proportion of producers.
- While farmgate prices remain stable for many producers, the changes in supply of sizeable supermarket private label milk contracts are increasingly disruptive for processors and suppliers alike. Increased exposure for many producers to lower milk prices for a portion of their milk supply – reflecting supplies of milk in southern Queensland, NSW and Western Australia that are in excess of processor requirements.
- This adds to margin pressures being experienced due to the lack of wholesale price improvements in the retail market. As a result, processors are building in sharper signals which will limit further growth in new supply contracts.

Executive Summary

- While the external operating conditions for most farmers are positive, overall confidence levels are generally unchanged. There are distinct regional differences, with Victorian regions more positive about the industry's future and northern and Western Australian farmers increasingly pessimistic. The recent volatility associated with the industry sustains caution in the outlook for many farmers who are seeking a platform of reliable returns before investing further in herd and infrastructure expansion for a longer term future.
- Given the strong global demand for dairy products, current conditions offer significant opportunities. There are many examples of producers that continue to adapt and galvanise their production systems and grow their businesses to take advantage of the current situation.

Australian market

- The Australian economy continues to outperform most in the developed world with GDP growth estimated at 4.25% for 2011/12. However, this healthy growth rate reflects a two-speed economy – with the mining and resources sector continuing to drive the currency higher and the unemployment rate lower. For other sectors such as the dairy industry, the competition for skilled labour and the impacts on international competitiveness are the less positive side-effects of this concentrated mining boom.
- Although unemployment is low and interest rates are on hold, Australian consumers remain cautious, saving in preference to spending and seeking out value. Rising household fixed costs such as mortgage, utility and insurance costs, and now petrol prices are limiting discretionary spending. As a result, eating out is losing some 'share of stomach' to take-home retailers.
- The major supermarkets have supported this trend by ramping up their private label offerings for "every day" purchases at discounted prices. As a staple, milk has been a key product in this strategy, with price cuts announced at the end of January particularly impacting the higher-margin modified milk category. While still too early to assess the impact of the change, it seems there has been a switch toward private label and an increase in supermarket share of milk sales.
- While the initial cuts to private label margins have been absorbed by the major retailers, the dairy industry has raised concerns about the long term impact on the profitability of the fresh milk supply chain if the discounting continues.
- The Australian market has represented a safe haven for the dairy industry in recent years, in contrast to the more volatile international market. However, with increasing pressure on margins, manufacturers will be carefully assessing the relative returns and opportunities for growth represented by the domestic and export markets.

World market

- The international dairy market has enjoyed a strong price recovery in 2010/11 with the combination of good demand from the developing markets led by China and Russia, while product supply has been limited due to shortfalls from southern hemisphere exporters.
- The general weakness of the US currency has contributed to higher commodity prices, supporting import demand by making dairy products more affordable in most local currencies.
- Product prices peaked in early 2011 at levels below those reached in 2008, retreating due to buyer resistance with the expectation of better product availability from the European production peak and uncertainty surrounding the impact of Middle East unrest and Japan disasters.
- The market now appears to be consolidating at relatively high levels, with far less price volatility than has been experienced in the past three years. The uptake of futures products has been slow, but the market has become more accustomed to the price signals generated by *global*DairyTrade's more frequent auction events.
- There has been limited substitution of lower priced vegetable oils and proteins, despite the sustained higher dairy products prices. Rising oil prices have contributed to increased volatility in vegetable oil markets, decreasing the attractiveness of these alternatives. It seems premium products that are utilising dairy-based ingredients are less likely to be substituted as consumers have shown a strong preference and willingness to pay for these quality products.

World supply

- World milk supply has improved in 2010/11 after the effects of price shocks in Europe and the US curtailed output. EU milk output has been well ahead of the prior year, with stronger growth in the past six months, while US monthly total milk flows have been more than 2% above the prior year since the middle of 2010. Despite improved consumer demand in both regions, export availability has also increased.
- New Zealand milk production growth is expected to finish the 2010/11 season 3% higher than the prior year, below expectations, due to early drought conditions affecting the North Island. Production is expected to continue at the

longer term average of 2 to 3% in 2011/12 as farmers respond to stronger milk payouts.

- South American production has rebounded strongly since late 2010, however available export volumes are limited somewhat by stronger demand within the continent. Brazil is now a net importer of dairy products, while Argentina's strong growth is to a large extent a recovery from the effects of poor weather. Their participation in international trade will be heavily dependent on whether or not the government re-imposes export taxes in an effort to curb domestic food inflation.

The farm sector in 2011

- The Australian dairy industry faces very different circumstances regionally and in terms of market exposures. The southern industry is enjoying arguably the most favourable conditions for a decade, with good export demand growth, competition for suppliers and favourable seasonal conditions. There appears to be a platform for returning to growth with farms re-starting in Northern Victoria, and manufacturers actively encouraging increased output.
- In Queensland, much of New South Wales and Western Australia the industry is geared toward domestic fresh milk supply – a stable market but with limited growth prospects. The uncertainty created by ongoing plant rationalisation and the changeover in increasingly sizeable private label supply contracts for processors is undermining the confidence of farmers in the region and providing limited opportunities for growth into the future.
- The polarization of conditions facing dairy producers around the regions remains a strong feature of the farm sector in 2011, although the differences are virtually all due to the nature and security of milk pricing and supply arrangements. With the exception of Western Australia, all regions will in 2011/12 benefit from wet conditions and plentiful feed supplies at affordable costs.
- Southern regions have enjoyed abundant rainfall that has filled water storages servicing irrigation regions. In some areas this has created production difficulties due to water-logged pastures and herd health problems, limiting growth in output for the current season.
- Nevertheless conditions heading into the 2011/12 season are highly favourable, with a good home-grown feedbase, guaranteed access to irrigation water, cows in good condition and continuing export market demand. In general, confidence levels were slightly higher in southern regions compared to this time in 2010, with producer intentions to increase herds by 2-3% over peak herd numbers in 2010/11 and stronger investment intentions.
- Sentiment is far less positive in northern states and Western Australia with the perceived threats to the sustainability of farmgate prices in 2011/12.
- Nationally, ABARES estimates indicate average farm cash incomes in the current 2010/11 season of $100,000 – up nearly 30% on last year's $77,300 – and around 9% up on the ten-year average of $91,000. The percentage of farms with a negative cash income has fallen slightly from 24% to 22%.
- Average farm business profits are projected to lift from a loss of $1,400 last year to a marginal $5,000 profit. Meanwhile, the percentage of farms with a farm business loss has also fallen slightly from 59% to 55%.

Milk production outlook

- Milk production in 2010/11 will post a marginal gain of less than 1% over the prior year to provide close to 9.1 billion litres. Production in northern regions has been constrained by flooding and cyclones in early 2011. In southern regions feed quality and cow numbers have been the major constraints on production growth.
- The outlook for 2011/12 is for a gain of 1 to 2% based on herd growth intentions, and the likely positive margins for southern producers over feed costs. Southern regions should post strongest growth, while some further contraction can be expected in northern regions in response to differential milk prices available.
- However, there may be some further upside in this forecast, should seasonal conditions continue to be favourable in most regions.
- Looking further ahead, three year production intentions from the 2011 survey showed a decline in the medium-term growth expectations compared with the 2010 survey. Based on these expectations and assuming reasonable seasonal conditions and prices, milk production could range between 9.2 and 9.5 billion litres by 2013/14.
- While sustained milk prices and favourable climate for the majority of producers provides potential for stronger growth into the medium term, there are challenges to expansion. The policy settings around continued access to water, the impact of any carbon pricing schemes on competitiveness and the ability of the industry to attract, develop and retain people will be important drivers of the industry's future sustainability and development.

Executive Summary

Is this a platform for future industry growth?

Current industry operating conditions are arguably the best for a decade.
However, are they sufficient to see the industry return to growth?

Production & resource inputs

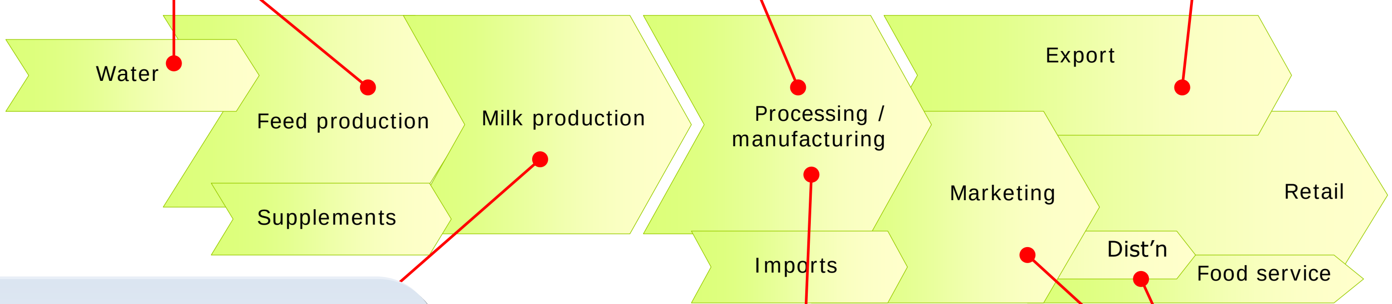
- Plentiful feed grain supplies but international prices rising
- High water allocations and carryover supplies mean short term security for irrigators but medium term policy concerns remain
- Limited supplies of milking cows and replacement heifers

Product manufacturers

- Limited product available – export commitments filled
- Strong competition for milk supplies –more alternative pricing options to attract and retain farmers
- Increased scope for external capital – Bega listing and WCBF shareholder cap removed

Exporters

- Slow supply response tightened international market
- Russian import recovery and strong demand growth for China
- Weak US currency supporting commodity prices and affordability
- Inconsistent participation of several major players (US, Russia, China)



The Australian dairy industry value chain

Milk production

- A "two speed industry" – seasonal conditions and market outlook
- Wet conditions across eastern Australia but drought in WA
- Pricing signals steady for southern farmers and demand for milk supplies
- Retail price cuts and company rationalisations undermining confidence in domestic regions

Fresh dairy processors

- Balancing stable market requirements & pricing with varying milk values
- Pressure on domestic processor and manufacturer margins
- Mismatch of supply and market demand in northern regions exacerbated with plant closures and private label contract changes

Domestic marketers

- Tightened household spending
- Low food price inflation
- Strong price-based retail competition
- Uniform pricing in a national grocery market
- Retailer private label contractual approaches

Executive Summary

Fig E.1 - Drivers of the industry's future

The scenarios for the future size and structure of the Australian Dairy Industry in the medium to long term will be shaped by a number of major primary drivers of change over time. The ultimate outcomes will be based on how well the Australian dairy industry responds to such future opportunities and risks affecting the industry's competitiveness and sustainability. Outcomes are also determined by how well the sectors of the value chain align and respond, affecting its capacity to adopt, innovate and differentiate.

Primary drivers… **…have direct and indirect effects on…** **…future scenarios for the industry:**

Primary drivers…	…have direct and indirect effects on…
Changing global economics	• Developing economies driving economic recovery and food demand • Challenges to competitiveness of agricultural production in first world countries • Transition to low-carbon economy • Costs of competing products influenced by biofuel demand • Volatility of commodity markets in tight supply
Climate variability	• Adaptability & sustainability of proven production systems • Increased complexity and need for long term resilience of business • Increased competition for irrigation water • Volatility of feed input supply and costs • Uncertainty of policy settings affecting resource access and emissions
Advancing technologies	• Need for accelerated adoption of new technologies to address production challenges • Requirements for different skill sets • Functionality of both dairy and its competing products • Consumer acceptance of technology platforms
Changing trade and social policies	• High priority placed on food security • Greater concern for environmental impact • Varied societal empathy for farm sector • Potential competition from emerging low-cost exporters • Weakened appetite for unilateral trade reform - impacts of bilateral agreements on competitiveness • Development of technical and ethical trade barriers
Consumer and community demands	• Consciousness for enjoyment, wellness and healthy eating • Concern for ethics in food production systems • Compliance demands on farm and processing enterprises • Acceptance of GM use in production inputs • Food's role in enabling social equity

…future scenarios for the industry:

Future opportunities:

- Global dairy demand outpacing supply
- Changing economics for competing food ingredients
- Flexible and adaptable production systems
- Adopting technology for productivity gains
- Widening scope for product functionality
- Understanding and managing volatility
- Transformational advances in plant & animal technologies

Areas of industry risk:

- Vulnerable production systems
- Inability to compete for skilled people
- Producers operating on volatile production margins
- Reduced relevance as a reliable dairy exporter
- Threats to dairy's ethical proposition
- Poor understanding of impacts and emissions of dairy
- Increased accountability without effective measurement
- Moving too far from competitive production base

Overview

What drives the returns to the industry?

- The Australian domestic market's share of total industry milk production will remain around 55% in 2010/11, leaving the export share at around 45% for a third consecutive year.
- In 2010/11 the product split from expected total milk production of 9.0 – 9.1 billion litres is estimated per the chart on the right.
- However the product mix varies significantly between regions across Australia's industry.
- The Australian industry is also open to imports of dairy products, with imported product contributing an estimated 25% of domestic cheese consumption and 23% of domestic butter consumption in 2009/10.
- New Zealand is the major source of imports – contributing 78% of total cheese imports and 91% of butter imports. These figures have remained fairly consistent – although the US is gaining share in cheese imports in recent times.
- The majority of wholesale prices (which represent the use of about 75% of milk produced by the industry) in the domestic retail, foodservice and industrial dairy products markets are directly influenced by prevailing international prices and world market conditions – although local retail prices do not reflect the short-term volatility of export commodity prices.
- Due to the transparency of world market prices, the open market for dairy imports, and the structure and practices of the retail grocery sector, there is no effective sustainable premium over time for sales into the domestic market compared to export returns, when all costs are considered.
- As a result, farm gate prices - particularly in the regions of Victoria and Tasmania where the majority of milk is used in the manufacture of dairy products - are closely aligned to returns from exported products.
- Returns for drinking milk and fresh dairy products are less directly affected by returns for traded commodities; however, the extent of this influence varies from region to region, depending on the balance of supply and demand.

Fig E.2 Australian industry market mix since 1990

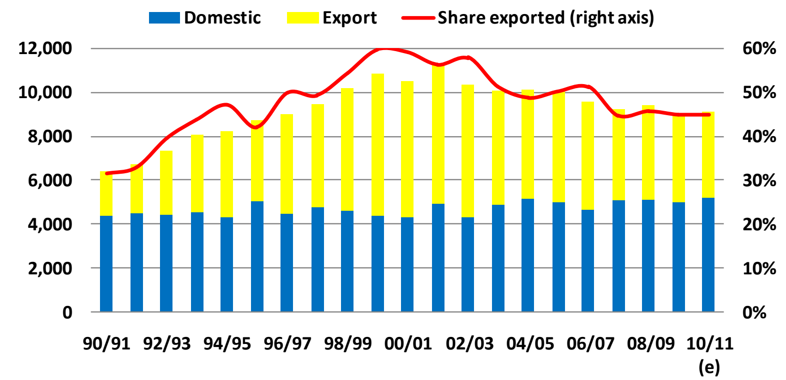
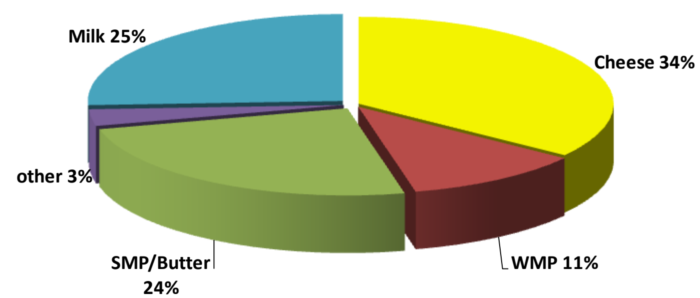


Fig E.3 Australian industry product mix - 2009/10



Glossary of terms

AACS	Australian Association of Convenience Stores
ABARES	Australian Bureau of Agricultural and Resource Economics and Sciences
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ASEAN	Association of South East Asian Nations (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam)
BRIC	Member countries Brazil, Russia, India, China
CAP	EU's Common Agricultural Policy
CDIA	China Dairy Industry Association
CWT	Cooperatives Working Together
DA	Dairy Australia
DEIP	Dairy Export Incentive Program
DFMC	Dairy Farmers Milk Co- operative
Doha Round	The round of WTO negotiations that commenced in 2001
EU	European Union
FAO	Food & Agricultural Organisation of the United Nations
FAPRI	Food & Agricultural Policy Research Institute
FNQ	Far North Queensland
FTA	Free Trade Agreement
GCC	Gulf Cooperation Council (Saudi Arabia, Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates)
GDP	Gross domestic product
gDT	Global Dairy Trade online auction platform
GFC	Global Financial Crisis
GHG	Greenhouse gas

Gipps	Gippsland
IDFA	International Dairy Foods Association
Intervention	A process whereby a government buys products from the market to reduce commercial availability
Mercosur	A trade alliance between a number of South American countries including Brazil, Argentina and Uruguay
NatFoods	National Foods
MENA	Middle East and North Africa
MD	Murray Dairy region incorporating northern Victoria and the NSW Riverina
NDFS	National Dairy Farmers Survey conducted as part of the preparation of this study
NSW	Central and Southern NSW (including the Hunter Valley)
NZ	New Zealand
NZX	New Zealand stock exchange
OPEC	Organisation of Petroleum Exporting Countries
PACER	Pacific Agreement on Closer Economic Relations
PSA	Private Storage Aid
QSR	Quick Service Restaurant e.g. McDonalds, KFC
RBA	Reserve Bank of Australia
SA	Central South Australia and Murraylands
SEQ	South East Queensland and Northern NSW
TRQ	Tariff Rate Quota
UNFCCC	United Nations Framework Convention on Climate Change
US	United States
WA	Western Australia
WCB	Warrnambool Cheese & Butter Factory

Dairy Australia
Your Levy at Work

Chapter 1

The international dairy market

Current market developments

A tight world market

- The world market for dairy products in the last quarter of the 2010/11 production season appears to be stabilising and consolidating at relatively high levels compared to the previous season. The fundamentals in the global dairy market remain tight, with supply limitations and sustained demand for commodity ingredients.
- Milk powder markets are unsettled with a mixed outlook. After a strong run that saw traded short-term supply prices exceed US$4,900/tonne, WMP has quickly lost value, struggling to hold ground in light of falling prices on *global*DairyTrade. Higher prices have heightened expectations of a supply response and buyer resistance at prices beyond US$4,500/tonne.
- Despite relatively low trading stocks, there has been far less volatility in prices for dairy commodities in the 2010/11 season.
- SMP prices posted more modest gains, nearing $US4,100/tonne in short-term *g*DT trades. Australian exports face stiff competition from EU exporters as Europe's seasonal production peaks, however EU offer-price discounts are being moderated by a strengthening Euro.
- Southern Hemisphere supplies of butterfat are extremely limited and prices remain high. Northern Hemisphere supplies are rebuilding, although surplus product availability from Europe is likely to be absorbed by Russia.
- Cheese markets remain steady, with firm pricing for product from all origins. The US is becoming a major player in global cheese markets. Demand for lactose and whey by-products has outstripped supply and prices for lactose and whey powder remain firm. Lactose is being increasingly used in standardisation, while much more whey powder is being used in feed than previously.
- Price gains since January have impacted the affordability of dairy products for importers. However, levels are well below the previous 2008 peak. More recently the currencies of most markets have appreciated against the US dollar reducing the cost of imported products for local buyers.
- While volatility has been relatively subdued in 2010/11, dairy market volatility risk remains from the following sources:
  - Wider economic uncertainty due to the sustained pressures on US and European economies, and the ongoing requirement for China to quell inflation
  - The sensitivity of developing world demand to price and income changes

Fig 1.1 - Spot commodity prices

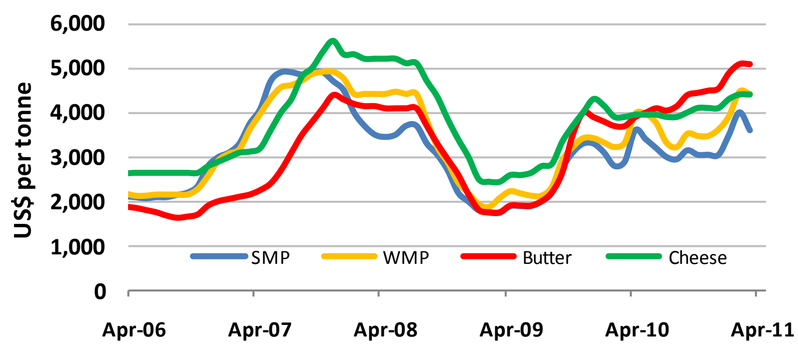
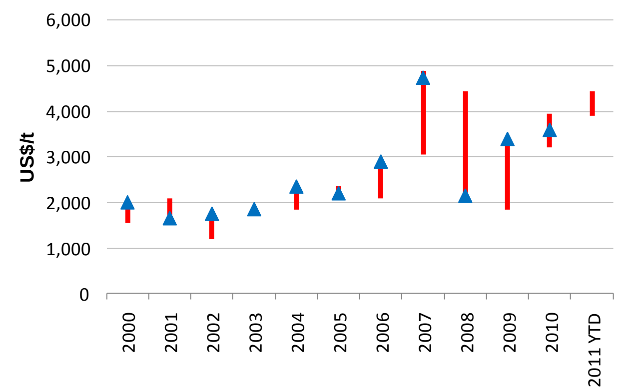


Fig 1.2 – Volatility in WMP prices



- The influence of climatic variability on milk supply and – less directly – on feed grain costs
- The potential disruptions to trade from regional political unrest which has affected North African and Middle Eastern countries
- The ongoing influence of market participants potentially that come in and out of markets, with or without intervention – such as the US, Latin America, and Russia

Current market developments

- The growing influence and spread in application of new ways of interacting (such as the *g*DT, although more frequent events and market familiarity have moderated this impact)
- The sustained shorter periods of buyer commitment than were historically seen

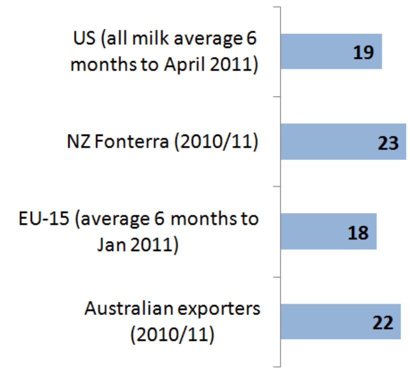
China and Russia are key drivers of demand

- Stronger import demand in the past year from China and Russia has provided a platform for the tight world market conditions.
- China's whole milk powder imports were significantly higher in 2010, climbing to 325,000t, while the total value of dairy products imported by China in 2010 was estimated at US$3.0bn, up 61% from the prior year.
- While the industry is working to improve product quality, it is hard to see them reducing import dependence significantly, although the rate of growth in imports may be reduced.
- The worst drought on record has severely affected Russian milk production over the last year, firstly due to a lack of feed availability, followed by high cow cull rates. After being largely absent from the market post-global financial crisis, Russian demand for imported dairy products recovered in 2010, with large increases in cheese, SMP and butter imports.
- While consumption volumes in Russia are relatively static, increasing prosperity and population is driving overall market growth.

Supply response?

- In the second half of 2010, stronger milk supply accelerated in the northern hemisphere as a response to higher milk prices. This was offset by lower than expected production from New Zealand.
- US milk production continues to increase despite high feed prices, while rising domestic commercial use and exports are maintaining dairy demand and prices.
- US milk production during the March quarter was up 2.3% on the prior year, while for each of the previous nine months has managed to grow milk production at 2% or better than the same time in the prior year. The main downside risk to US production in the short-term is high grain prices, which continue to rise, on the back of strong biofuel and export demand for corn.
- EU milk production is also rising, driven by stronger milk prices. While a further 1% increase in production quota from 1 April may provide some scope for increased output, key constraints will be feed, fertiliser and fuel cost increases.

Fig 1.3 – Changes in average farmgate milk prices (% v corresponding prior year period)

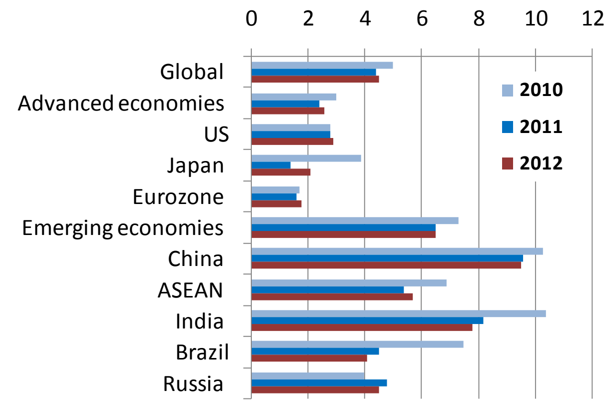


Global economic settings

Global economic situation

- Dairy demand from developing markets is highly sensitive to economic growth and incomes. The economic outlook – for these countries in particular is therefore of strong interest to the Australian dairy industry.
- The global economic recovery continues, led by emerging markets, but is likely to remain uneven for the foreseeable future due to a number of major threats – which include:
    - The potential for oil prices to surge further due to supply disruptions caused by political instability in the Middle East and North Africa;
    - Overheating asset markets in emerging economies;
    - EU sovereign debt issues and banking sector instability;
    - Inflation in emerging markets due to high food prices; and
    - Continuing high unemployment and patchy recovery in the US economy.
- Financial markets remain risky and anxious, and while they are in better condition than 12 months ago, they remain highly reactive to major events.
- The expansionary monetary policies adopted by the world's major economies during the financial crisis have increased global liquidity, causing large capital inflows of capital into emerging markets. This has led to inflated asset values and pressure from "imported" inflation.
- The fact that most advanced markets are at least in positive territory, and the more risk-sensitive emerging markets as a whole are not significantly impacted, is indicative of the ongoing global recovery – although uncertainty remains.
- Large government deficits, limited financial market reforms, relatively weak export sales and stagnant real estate markets are stifling growth in the advanced economies such as the EU and US.
- Japan is struggling to recover following a massive earthquake and tsunami, while trying to resolve the dangerous situation in a damaged nuclear power plant.
- Developing countries' expansive monetary and fiscal policies have also pushed up inflation and fiscal deficits. Soaring commodity prices and robust asset markets across Asia and, in particular China, represent a risk to steady growth in these regions.

Fig 1.4- Year on year changes in GDP (%)



Source:IMF World Economic Outlook April 2011

- The BRIC economies (Brazil, Russia, India and China) play a pivotal role in global growth and their increasing affluence will expand dairy demand. India and China will continue to act as the engine for Asian regional growth despite inflationary concerns.
- China is entering a new phase in its development – with a structural shift from an export and investment-led economy to one driven by domestic consumption. China appears to be moderating somewhat in response to more restrictive financial policies, but 9% growth is expected for the year.
- India will likely register 8% growth again this year. The Brazilian economy, on the other hand, is expected to slow to 4.5%, as compared with last year's 7.5%.

Rising oil prices

- Rising oil prices are a threat to a steady improvement in global economic growth.
- If the world oil price settles around $US110 a barrel then global growth would be reduced marginally. However a sustained lift in prices would negatively affect world economic growth.
- With unrest across the Middle East and North African (MENA) region toppling governments in Egypt and Tunisia and threatening governments around the key oil producer, Saudi Arabia, the price of oil has surged in recent months.

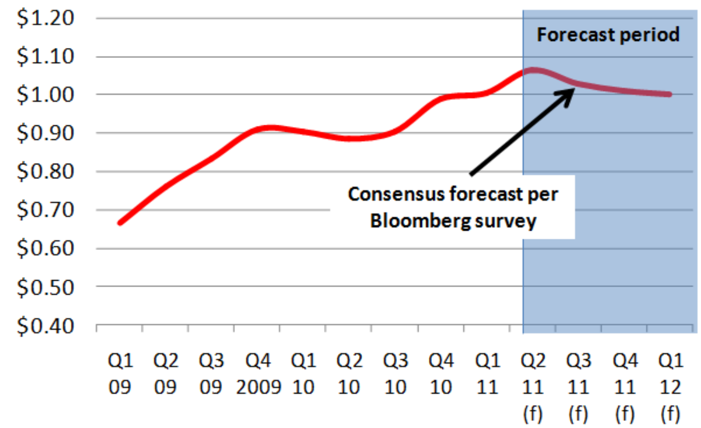
Global economic settings

- Should events in the MENA and/or stronger global demand region lead to a major oil supply shock, sending the price of oil up to US$150 or higher, the negative economic effects would likely be severe.
- Global private consumption would suffer as real incomes are eroded by higher living costs, dragging many advanced economies back into recession. At the same time, inflation would rise, increasing existing pressures in emerging markets
- Much of Asia is vulnerable, reflecting the heavy reliance of most countries in the region on imported oil and its more intensive oil use. Australia is less vulnerable as it is a net energy exporter.
- Rising oil prices benefit Saudi Arabia, Iran, Venezuela and other OPEC members, as well as Russia and Mexico. Higher oil prices will result in increased revenues and a bigger national budget, allowing these countries to increase their foreign exchange reserves.

Currency movements

- The Australian dollar is now trading at its highest level since March 1982. The AUD has proven resilient against geopolitical shocks, and the ongoing financial system risks in Europe.
- Factors driving the rising value of the AUD include:
    - US economic weakness and the comparative strength of the Australian economy;
    - Rising commodity prices;
    - The appeal of the AUD as a "risk play" on the strength of Chinese import demand; and
    - The differential between Australia's relatively high interest rates and the sustained low official interest rates in the US, which attracts foreign investment.
- Once the US Federal Reserve begins lifting its interest rate, the $A's yield will fall in comparison to the greenback, making it less attractive to investors.
- By the end of the calendar year the four major Australian banks have a forecast range for the Australian dollar of 101-104 US cents. A Bloomberg survey of 40 financial institutions forecasts the AUD to trade between US$0.82 and US$1.12.

Fig 1.5- Australian vs. US dollar

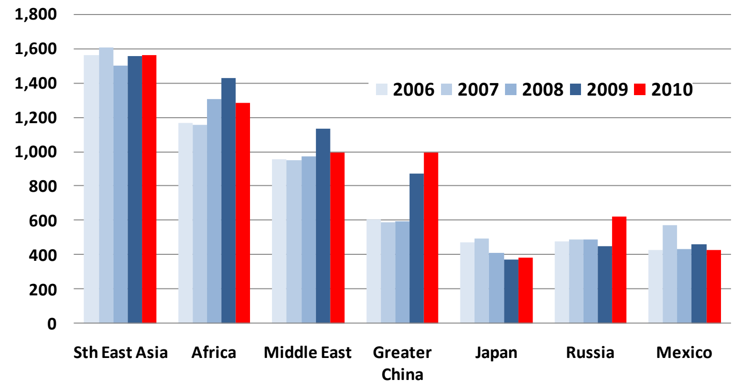


Global market outlook

Demand factors

- Demand for dairy products from developing markets has remained robust, despite rising commodity prices. Demand from the world's three largest dairy importers, China, Russia and Mexico appears as if it will be steady for the next 12 months.
- Chinese milk production in 2010 was up 1.5% on the previous year to around 36bn litres. Domestic production of dairy products has also grown with liquid milk production up 11% and local milk powder production up 10%, but those domestic supplies have not kept pace with demand.
- The strong preference for imported products – especially infant formula products – to service higher nutritional requirements of increasingly affluent consumers is causing significant change in Chinese supply chains. Further challenges face the sector following the 2008 melamine contamination crisis, as Chinese authorities have taken a hard line on cleaning up the domestic production sector by imposing a number of strict testing requirements and regulations.
- A significant percentage of small Chinese dairy processors have been forced to close in April 2011 due to licence regulations designed to achieve China's food safety objectives. These measures have generally affected low-value, low-quality producers and are expected to result in higher concentration of processors with increased diversification.
- Increased costs associated with processing will add to the pressures on the viability of many low cost, low quality processors. The impact is likely to see around 20-30% of current processers unable to comply and forced out of the industry, with their place and processing volumes will be taken up by larger processors.
- The net effect of these significant changes within the Chinese industry is likely to see strong ongoing demand for imported dairy ingredients, provided the country can sustain levels of economic growth at or near current levels, while managing the risks associated with rising food inflation.
- Dairy consumption remains stable within the US and Europe. Steadily improving consumer spending is increasing domestic product demand, although recovery in the US food service sector to date has been patchy.
- The longer term impact of recent earthquakes and tsunami in the Tohoku region of Japan is still unclear but the short-term impact on dairy production will see an increase in import demand.

Fig 1.6 – Major importer by volume ('000 tonnes)



- Unrest in the Middle East is not having a major impact on overall dairy consumption. Many nations in the region are maintaining import demand despite higher prices to ensure the local population has ready access to dairy protein.

Mitigating volatility

- Following a relatively stable period for commodity pricing over the last six months, the widespread adoption of risk management tools such as futures and options products for globally traded dairy ingredients has been slow but steady.
- There has been far less volatility in key products such as WMP during 2010 and 2011 to date.
- From 19 July, cheddar cheese will be offered for sale on *g*DT. However the cheese being offered requires further processing and is only suitable for industrial buyers.
- Fonterra will also start selling Milk Protein Concentrate (MPC70) and rennet casein on *g*DT from May 17, 2011.
- There has been a steady increase in the use of risk management tools, with globalDairyTrade (*g*DT) gaining the greatest usage and visibility. Trade on the *g*DT platform now accounts for around 25% of Fonterra dairy product sales.
- The increased frequency of *g*DT auction events, and the increasing familiarity of the platform has mitigated the more negative effects on market dynamics.

Global market outlook

- The introduction of cheddar cheese increases the number of products offered on gDT to seven. However the cheese being offered requires further processing and is only suitable for industrial buyers.
- There has been little development in the way of new players and for many futures exchanges, market activity has been underwhelming. While the market remains in tight supply, further development will remain slow.
- NZX WMP futures would appear to be the most successful product to date in that there has been reasonable open interest and volumes of contracts settled on the platform.
- A number of users are still watching closely, waiting for the markets to develop further and additional liquidity to build, making the futures products more useful.

Fig 1.7- *global*DairyTrade product offers

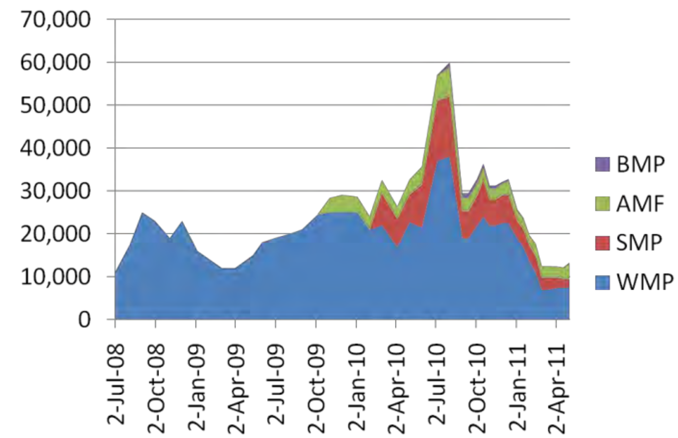
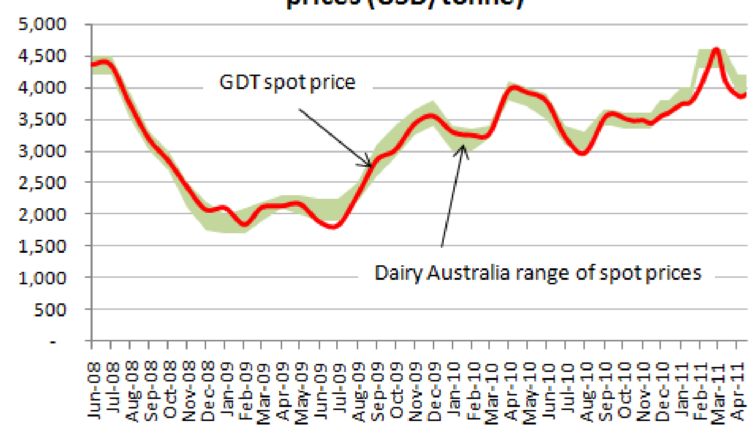
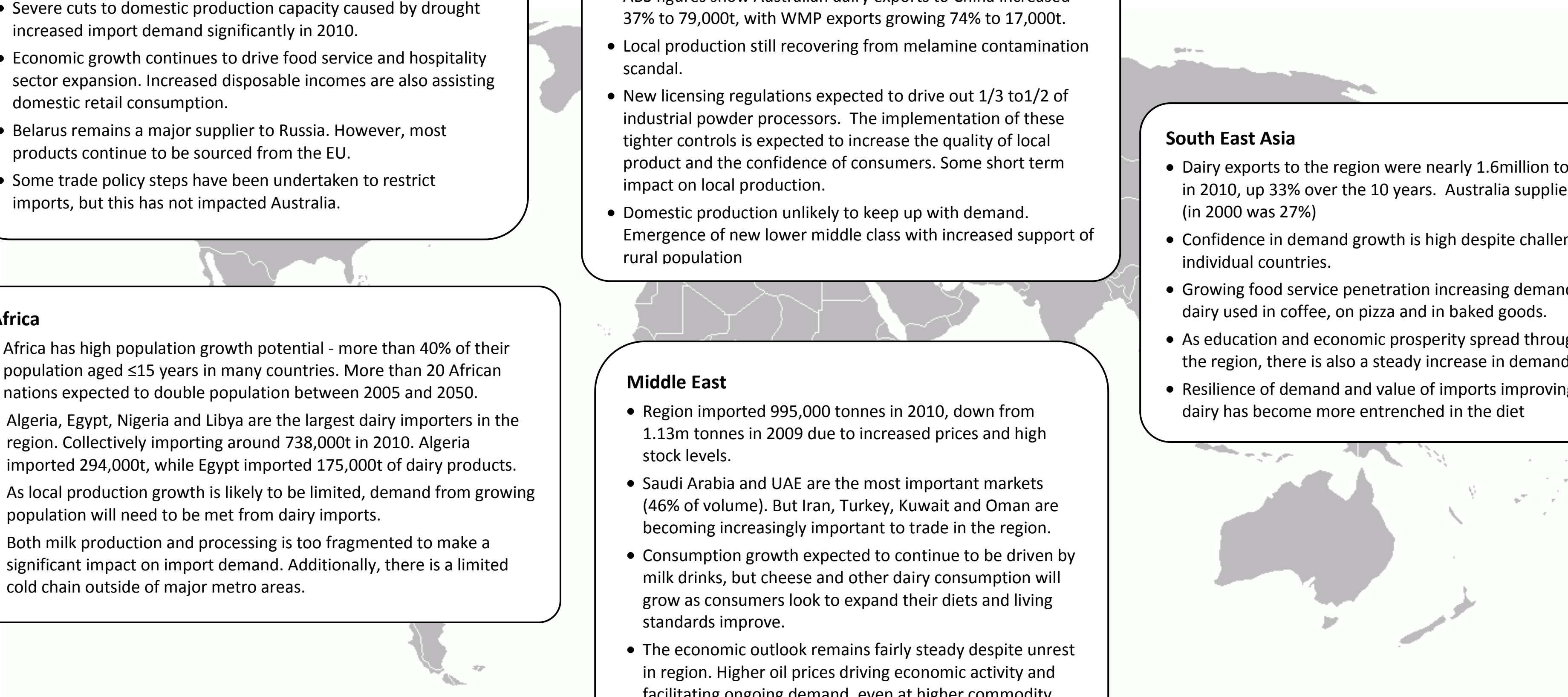


Fig 1.8 - *global*DairyTrade prices vs. Australian export prices (USD/tonne)



Global market outlook

Fig 1.9 - Demand regions at a glance



Russia

- Dairy exports to Russia increased 38% to 620,000t in 2010. Cheese is the largest product category; increasing 21% to 287,000t with EU the major supplier.
- Severe cuts to domestic production capacity caused by drought increased import demand significantly in 2010.
- Economic growth continues to drive food service and hospitality sector expansion. Increased disposable incomes are also assisting domestic retail consumption.
- Belarus remains a major supplier to Russia. However, most products continue to be sourced from the EU.
- Some trade policy steps have been undertaken to restrict imports, but this has not impacted Australia.

China

- According to China Dairy Industry Association (CDIA) Chinese dairy imports increased 20% in 2010 to 904,000t, milk powder imports jumped 67% to 414,000t, and cheese imports increased 35% to 23,000t.
- ABS figures show Australian dairy exports to China increased 37% to 79,000t, with WMP exports growing 74% to 17,000t.
- Local production still recovering from melamine contamination scandal.
- New licensing regulations expected to drive out 1/3 to1/2 of industrial powder processors. The implementation of these tighter controls is expected to increase the quality of local product and the confidence of consumers. Some short term impact on local production.
- Domestic production unlikely to keep up with demand. Emergence of new lower middle class with increased support of rural population

South East Asia

- Dairy exports to the region were nearly 1.6million tonnes in 2010, up 33% over the 10 years. Australia supplied 14% (in 2000 was 27%)
- Confidence in demand growth is high despite challenges in individual countries.
- Growing food service penetration increasing demand for dairy used in coffee, on pizza and in baked goods.
- As education and economic prosperity spread throughout the region, there is also a steady increase in demand.
- Resilience of demand and value of imports improving as dairy has become more entrenched in the diet

Africa

- Africa has high population growth potential - more than 40% of their population aged ≤15 years in many countries. More than 20 African nations expected to double population between 2005 and 2050.
- Algeria, Egypt, Nigeria and Libya are the largest dairy importers in the region. Collectively importing around 738,000t in 2010. Algeria imported 294,000t, while Egypt imported 175,000t of dairy products.
- As local production growth is likely to be limited, demand from growing population will need to be met from dairy imports.
- Both milk production and processing is too fragmented to make a significant impact on import demand. Additionally, there is a limited cold chain outside of major metro areas.

Middle East

- Region imported 995,000 tonnes in 2010, down from 1.13m tonnes in 2009 due to increased prices and high stock levels.
- Saudi Arabia and UAE are the most important markets (46% of volume). But Iran, Turkey, Kuwait and Oman are becoming increasingly important to trade in the region.
- Consumption growth expected to continue to be driven by milk drinks, but cheese and other dairy consumption will grow as consumers look to expand their diets and living standards improve.
- The economic outlook remains fairly steady despite unrest in region. Higher oil prices driving economic activity and facilitating ongoing demand, even at higher commodity prices.

Global market outlook

Supply factors

- Global milk production is forecast to grow by 2% in 2011. As economic conditions for dairying improve around the world, so will production intentions, yet there is likely to be a lagged impact on the world dairy market.
- Relief from 'supply-side pressure' will most likely come from robust growth in milk output from Europe and the US, as they enter peak production, and perhaps, to a lesser degree, from Argentina.
- In Europe, favourable weather conditions, stronger demand, higher milk prices and quota expansion provided the incentive and capacity to expand.
- However, high feed costs in the US and EU are squeezing farmer margins and will likely constrain growth expectations.
- If northern hemisphere producers respond to higher milk prices by adding cows to the herd, this influx of higher production has the potential to over-supply local markets if demand does not keep pace. Sharp increases in corn and soybean prices have raised production costs for dairy farmers which could stifle production growth, and some producers have indicated they intend to rebuild equity rather than expand production this year.

Fig 1.10 - Incremental change in milk production (year-on-year, millions of litres)

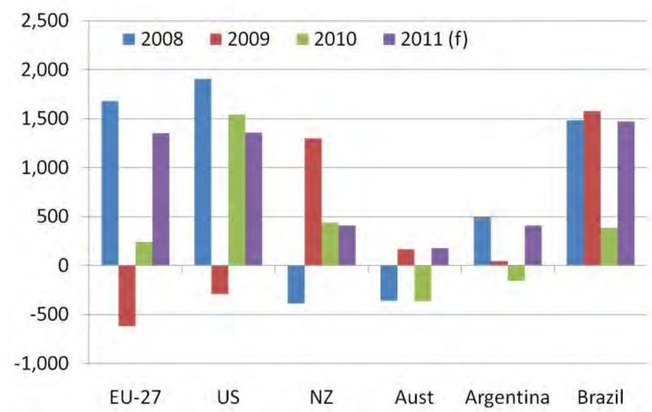
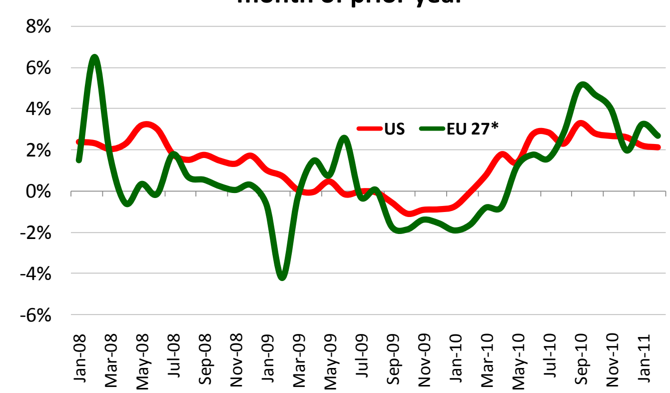
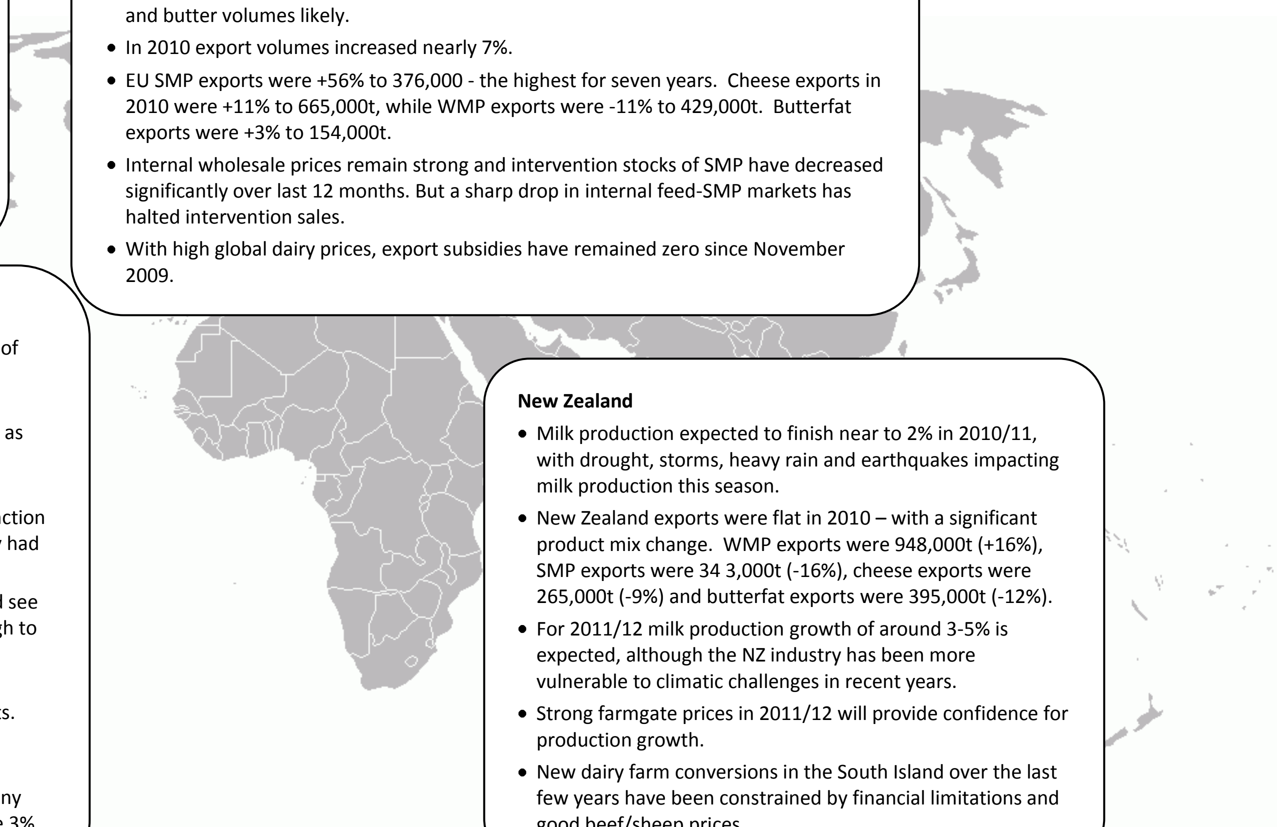


Fig 1.11 - EU and US milk supply % changes on same month of prior year



Global market outlook

Fig 1.12 - Competitors at a glance



US

- US milk production increased 1.9% in 2010 to 87.5 billion litres. Current forecasts suggest US milk production will increase 1.6% in 2011.
- US exports of most dairy commodities grew in 2010. SMP exports were up 41% to 350,000t, cheese exports were up 42% to 154,000t, lactose exports were up 14% to 250,000t and butter exports up 80% to 52,000t
- Economic recovery has been assisting domestic consumption of dairy ingredients, particularly in food service and retail sectors.
- Cheese production remains firm, however butter stocks are at low levels for this time of the season.
- No DEIP activity since late 2009 but CWT program remains in operation

European Union

- Good weather conditions, robust demand and strong milk prices encouraged EU27 milk production growth of 1.2% in 2010.
- Despite increased milk production, the EU27 still closed 2010 an estimated 6% below overall milk production quota volumes.
- EU milk output is forecast to rise slightly in 2010-11 with growth of around 1.5-2.0%. Growth is currently running at 3.3% but is expected to slow given rising feed costs.
- Cheese production is absorbing most of the surplus milk – with little increase in SMP and butter volumes likely.
- In 2010 export volumes increased nearly 7%.
- EU SMP exports were +56% to 376,000 - the highest for seven years. Cheese exports in 2010 were +11% to 665,000t, while WMP exports were -11% to 429,000t. Butterfat exports were +3% to 154,000t.
- Internal wholesale prices remain strong and intervention stocks of SMP have decreased significantly over last 12 months. But a sharp drop in internal feed-SMP markets has halted intervention sales.
- With high global dairy prices, export subsidies have remained zero since November 2009.

South America

- Collectively the South American countries exported 83,000t of WMP beyond the local region. This was down -33% on the previous year and back to 2008 volumes.
- Trade within South America is expected to continue to grow as domestic consumption – particularly in Brazil – grows. The Chilean domestic market also remains strong.
- Argentina has had ideal weather conditions, which in conjunction with strong farmgate prices has offset the difficult start they had to the season.
- Assuming a normal summer and stable feed costs, we should see strong growth in Argentina's milk production, feeding through to double-digit growth in export volumes.
- While Brazilian milk production for 2010 was up 1.3%, solid internal demand will keep Brazil largely out of export markets. Brazil's milk production is forecast to rise 4.5% in 2011
- Uruguay production is up around 12% for Q1, but minimal product is making the global market as Brazil is purchasing any exportable surplus. Uruguayan production is forecast to rise 3% for 2011.

New Zealand

- Milk production expected to finish near to 2% in 2010/11, with drought, storms, heavy rain and earthquakes impacting milk production this season.
- New Zealand exports were flat in 2010 – with a significant product mix change. WMP exports were 948,000t (+16%), SMP exports were 34 3,000t (-16%), cheese exports were 265,000t (-9%) and butterfat exports were 395,000t (-12%).
- For 2011/12 milk production growth of around 3-5% is expected, although the NZ industry has been more vulnerable to climatic challenges in recent years.
- Strong farmgate prices in 2011/12 will provide confidence for production growth.
- New dairy farm conversions in the South Island over the last few years have been constrained by financial limitations and good beef/sheep prices.

Global market outlook

Competitor products

- Dairy substitution in ingredient applications will continue to be perceived as a threat for the dairy franchise. Price volatility and generally higher dairy prices encourage substitution and reformulation from some ingredient buyers.
- During the last commodity price boom, substitutes were able to take some market share from dairy, which has been difficult to get back. Added to the pressure on the dairy franchise is market volatility which appears at times to be more severe than for alternative commodities.
- An assessment of South East Asia demand by Dairy Australia suggested that this is perhaps not as big an issue this time around.
- Reformulation was more common in markets less focused on genuine dairy taste. Where consumers have clear preferences, QSRs have developed two menus - a quality offering including dairy ingredients, and a value offering (perhaps using analogue cheese and vegetable - dairy fat blends).
- However, most reformulation has already taken place - following record prices in 2007. Also at present, there is less pressure to substitute because competing fats and proteins are also in short supply and prices are increasing.
- Food product labeling is part of managing consumers' perceptions – by making it very clear where non-dairy ingredients are used can encourage consumers to prefer dairy products, by allowing them to differentiate between dairy and non-dairy variants.
- Higher oil prices increase the demand for competitor products due to their use in ethanol production which becomes more viable. With higher demand, increasingly frequent production disruptions due to climatic events, and generally lower inventories, prices for competitor products are also increasingly volatile.

Vegetable oil

- Global oil seed markets are very tight and strong demand has eroded stockpiles over recent months. World consumption of the 10 major oil seeds is expected to outstrip supply by around 2 million tonnes in 2010/11.
- The first half of 2010/11 saw demand for palm oil exceed supply, leading to a rise in average prices of 50-60% above last year. The palm oil shortage caused a boost in world demand for seed oils, prompting steep increases in world exports of soya oil, sunflower oil and rapeseed oil in Oct-March 2010/11.

Fig 1.13 - Butterfat price premium vs palm oil (US$ per kg fat)

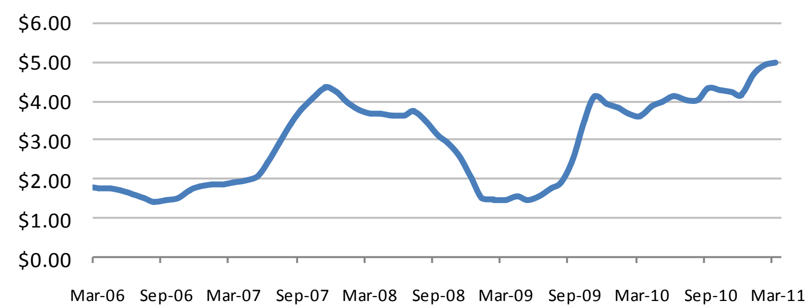
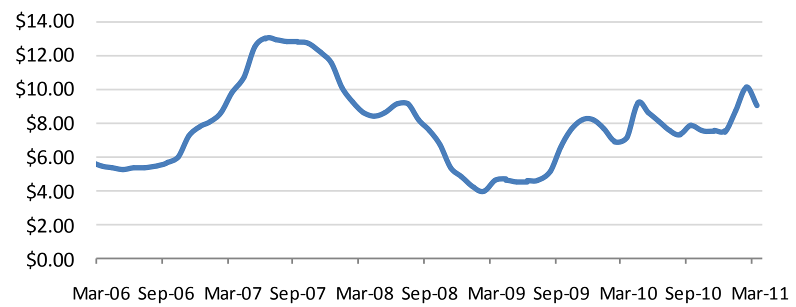


Fig 1.14 - Dairy protein price premium vs soy meal (US$/kg protein)



- Palm oil production is recovering, while large South American soya oil production has increased export supply. With the shortage over, vegetable oil prices have fallen significantly.

Soy

- South American soybean production has been stronger than expected, despite possible damage to the late-sown soybeans in Argentina, caused by dry conditions in March and early April.
- US soybean plantings will decline this spring, with South American soybean supplies sufficient to supply the market until early 2012.
- Prices of soybeans and vegetable oils have been dampened by the temporary weakness in demand from the two major importers, China and India.

Global market outlook

Long term outlook

- The Australian dairy industry has well- established customer relationships in developing market regions that will lead global dairy demand growth into the future.
- Global demand is likely to continue to rise in the long term with growing awareness of milk's nutritional value and functional diversity, and the improvement of living standards in developing economies.
- The outlook chart on the right describes a scenario for future trade in dairy products into the long-term. In this scenario, the apparent gap in future world milk supply to meet projected demand, has been based on detailed demand and supply assumptions using the latest available information and outlook projections from FAPRI, relevant to major dairy producers and importing countries.
- This outlook takes account of the trade in the world market in 2010, and reflects the following key assumptions:
    - Projected growth in milk production and export availability for a number of the major producers and exporters
    - The EU Commission's outlook for slow growth in milk production, dairy product manufacture and consumption
    - Assumed growth in production in Australia of 1% per annum and New Zealand of 2.5% per annum
    - Rapid expansion of Chinese production and consumer demand
- While the world market balance supports firm prices into the medium to long term, this scenario is highly sensitive to a number of factors as shown in the chart on the right. The most influential impacts are:
    - Expansion of Chinese milk production and manufacturing output; and strength in consumer demand
    - EU's trade balance, affected by the adjustment in milk supply after production quotas are removed in 2015
    - US trade balance, especially affecting available exports of skim milk powder
    - Growth in New Zealand milk production

Fig 1.15 - Change in export volumes 2010 to 2020 (million litres milk equivalent)

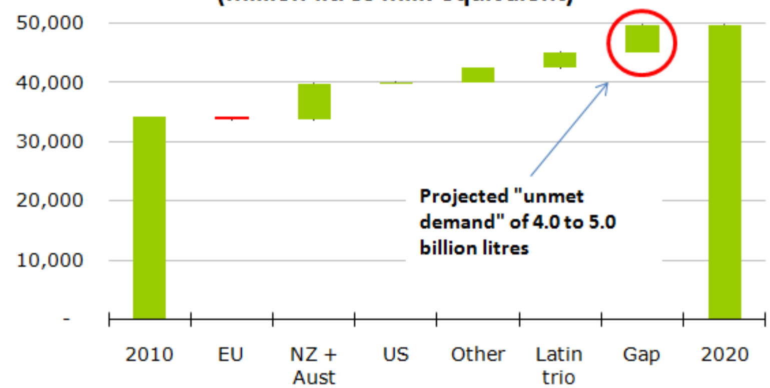
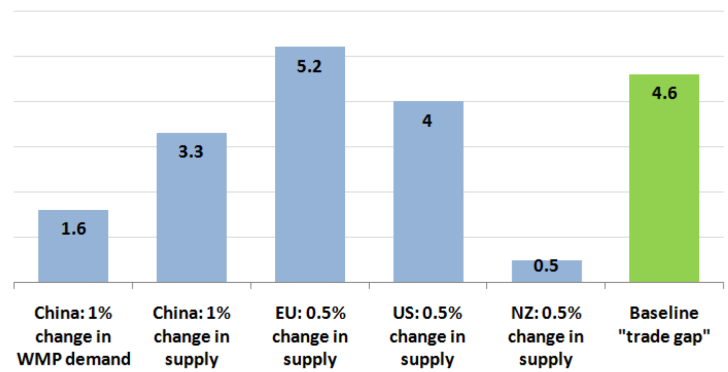


Fig 1.16 – Sensitivity of the 2020 "trade gap" in billions of litres to changes in annual demand or supply growth



- This gap implies that there are opportunities for existing and new suppliers to increase their participation in a growing world market. With growth in supply lagging the expansion of demand, firm pressure on commodity prices will be maintained.
- However, the tight balance and sensitivity of the outlook to small changes in key production and market region variables lends itself to ongoing price volatility.

Policy drivers

Intervention policies

- A tight balance in the global marketplace, firmer prices and severe budgetary pressures within the EU and US, will combine to limit the use of government intervention tools in the foreseeable future.
- Tight demand and prices have seen butter and SMP intervention stocks being run down. Currently butter is only being held currently in Private Storage Aid (PSA) and there is only around 52,000 tonnes of SMP available for sale – well down from the 280,000 tonnes available at the same time last year.
- Export subsidies have not been used in the EU since 2009 and given the small gap between EU and world prices at present, they are likely to be kept at zero in the near future.

European Union

- Discussion on the future of the CAP after 2013 intensified in 2010, and the debate will continue through 2011/12. The Commission issued a report on the situation in November 2010, which sets out options for the future CAP framework.
- There is a parallel debate over the future of the EU's budget (including the CAP budget). The budgetary process and the EU budget post-2013 – including the size of the CAP budget - are under review. The Commission suggests that the CAP needs an overhaul with reform options to include a shift from direct payments and market mechanisms to environmental and climate change objectives. The preferred options should be followed, after consultation, by legislative proposals mid-2011.
- The 'Milk Package' legislative proposals – designed to address perceived problems in dairy markets which were particularly acute in 2008/09 – are under discussion in the Council and European Parliament. The 'Milk Package' addresses the recommendations of 2010's 'High Level Group' affecting:
    - contractual relations between milk producers and milk processors;
    - collective bargaining power of producers;
    - the role of producer/inter-branch organisations in the dairy sector;
    - transparency in the dairy supply chain.
- Previously agreed CAP reforms continue to be implemented such as the yearly increases in milk production quota, before removal on March 31, 2015.

United States

- The US industry and government continues to debate future policy options for regulation of pricing and other farm support.
- National Milk Producers Federation continues to promote Foundation For The Future (FFTF) as the most viable and progressive policy option for the dairy title in the 2012 Farm Bill which applies from 1st October 2012.
- The FFTF package would eliminate the Dairy Price Support Program, rationalise the regulated pricing structure, introduce a form of margin insurance and mandate milk supply management if farm profitability dropped below benchmark levels. The package is running into resistance from within the farm sector due to varying regional priorities.
- The processing sector through IDFA opposes the supply management component of the FFTF and has an alternative proposal to manage price volatility through risk management tools.
- A possible outcome is elimination of the Dairy Price Support Program, a form of margin insurance to be legislated and retention of the counter-cyclical Milk Income Loss Contract (MILC) program.
- Pressure will be applied to reduce 2012 Farm Bill spending if the US government is to address the country's massive budget deficit, although the debate is yet to begin in earnest. The current five year farm bill will expire on 30th September 2012.
- A levy or check-off on the milk solid equivalent of imports will be instituted from 1st August 2011, at a rate of assessment of US$0.0124/kilogram of milk solids. The levy was initially scheduled to apply from 2002 though implementation has been delayed as a result of opposition from industry associations and companies representing the interests of exporters to the USA and importers of these dairy products.

Policy drivers

Directions for trade policy

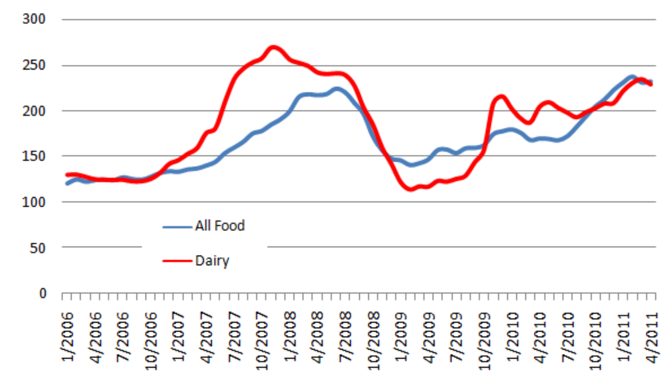
- While negotiations on trade policy reform have continued on a range of fronts over the past year, it is unlikely that current world market settings will be significantly influenced by major policy reforms in the short term.
- The long running WTO Doha Round took on a renewed focus in early 2011,with negotiations restarting in Geneva aimed at securing a final agreement on agriculture, manufactured goods and trade in services by late 2011. However, at the end of April, the negotiations appear to have stalled again with negotiators determining that major gaps exist between the positions of key players and that these gaps are unbridgeable in the short term (particularly in the area of manufactured product trade).
- Major governments such as the US remain publicly committed to seeking a successful conclusion to the Round, but others such as Brazil have publicly rated the chance of successfully resolving the current differences in the near term as being low. This suggests Doha may be postponed once again. Any delay would see the WTO talks overlap with major economy electoral cycles- raising a real question about how and when the Round can move to a successful conclusion.
- For Australia this means that some key WTO objectives such as the elimination of export subsidies remain unmet. However, in the current market condition, there appears to be minimal risk of countries such as the EU and US applying export subsidies in the coming year.
- 2011 has seen a continued push by many countries for regional and bilateral trade preferential access agreements. The Australian dairy industry has long argued that the simultaneous pursuit of market access reform in the WTO and separate free trade agreements can be complementary and market reinforcing (e.g. the successful conclusion of an FTA with ASEAN in 2009 which will help reinforce Australia's competitive position in a key regional market in coming years).
- While there has been some public debate about the benefits/costs of pursuing bilateral trade agreements e.g. Productivity Commission review of late 2010) in April 2011the Australian government recommitted itself to press ahead with trade-related economic reform, irrespective of the approach adopted by other countries.
- The government see these agreements are important in ensuring that Australian firms have an ongoing opportunity to compete on equal terms in major export markets. Australia is currently engaging in trade negotiations with over 25 countries, with varying degrees of progress.
    - Negotiations with Korea came close to conclusion in early 2011 but have been put on hold by the major Foot and Mouth outbreak in that country. These negotiations will hopefully be able to reach a conclusion in late 2011.
    - Japan was actively pursuing an FTA with Australia in early 2011, but this has also been put on hold while the Japanese government concentrates on restoring domestic stability to their economy in the wake of the March tsunami. However, the Prime Ministers of both countries recently reaffirmed their desire that such talks should recommence as soon as practically possible.
    - Negotiations on a Trans Pacific Partnership (which covers nine countries including the US, Peru, NZ and Vietnam are proceeding. A major milestone for assessing progress in these talks will be the negotiations scheduled for Honolulu in November 2011
    - Negotiations have commenced with Indonesia on a broad economic partnership agreement.
    - Similarly India has recently agreed to start free-trade negotiations with Australia, following on from its decision to start similar talks with New Zealand. These two decisions may signal a more open market approach by India to dairy trade in coming years.
    - By contrast, negotiations with other major trade partners such as China and the Gulf Cooperation Council are struggling to move forward. The apparent obstacles to progress in these negotiations are not related to dairy or even the broader trade in processed food products. However, the lack of progress in these talks does pose a challenge for Australian dairy exporters given that their relative competitiveness in these markets is being eroded by preferential access entitlements on offer to overseas competitors (such as New Zealand in the case of dairy sales to China)
- The challenge posed to Australian trade by third party agreements also extends to other regions. The US is likely to finally ratify its FTA agreement with Korea some time in 2011 (the EU has already done so). The EU also is aggressively pursuing bilateral deals with a range of North and Latin American partners (Canada, Mercosur, Peru) and others in Asia (such as India). In many of these arrangements the EU is pressing to extend the coverage of its internal regulatory arrangements

for Geographic Indicators moves which could compromise the future export marketing of a range of Australian cheeses. As a result, the Australian government is working, either directly or in partnership with other dairy exporter countries to address and reduce this risk.

Food security and affordability

- Food security has escalated as a priority for many developing world countries given the steady rise in food commodity prices in 2010 and early 2011.
- No effective mechanisms exist for a long term co-ordinated planning or international co-operation to manage food security.
- These issues are likely to become more important in the future as growing populations place an increased strain on the natural resources required to feed them. The impacts of climate change and increasing variability are likely to lead to shortages and increasing price volatility.
- Governments will be under increasing pressure to guarantee food supplies that are safe and affordable, possibly elevating the risk of a return to protectionist policies that limit trade. However further liberalization of trade may be a more effective means of securing food supplies for many countries.
- Given its population and influence on world commodity trade, the situation facing China's future food security is a matter of major concern, and has a large influence on the tightening world food and livestock feed markets. This is due to the combined effects of:
    - the reduction in good quality arable land due to the rapid expansion of its urban population in coastal areas;
    - reduced availability of underground and surface water;
    - the greater influence of climate change causing year-to-year fluctuations in grain supply;
    - increasing volumes of grain being consumed in biofuel production
- The Chinese government will find it increasingly difficult to continue to fulfil its traditional target of 95% self-sufficiency in basic foodstuffs. Much greater engagement in international grain markets will be required to meet grain requirements for food and livestock feed. This trend towards China's role as a major player in world cereal markets will put extreme pressure on international food security.
- The increased demand for feed grain use in biofuel production is affecting available food use of supplies of corn and vegetable oils.
- During the 2007/08 food crisis, policy responses were adopted by a large number of countries – mostly developing countries that were most exposed to price volatility. They were mainly ad hoc in nature. There is a similar risk of further such actions in 2011.
- Actions regarding food security are being felt in other ways. Rising costs of basic food items have been cited as contributing to the uprisings across the Middle East and North Africa in 2011, which have impacted trade.

Fig 1.17 – FAO's food commodity price index 2006 to 2011



- A number of countries have already adopted measures to improve supplies of affordable nutritious food commodities to their consumers and insulate themselves from price volatility, which have significantly influenced trade. Examples of these include:
    - India's ban on exports of certain vegetables, milk powder and casein and cuts in tariffs on milk and butter.
    - Russia's ban on grain exports which will prevail until September 2011, coupled with laws to support pre-crop financing.

Policy drivers

Australian Food Plan

- On 3 August 2010 the Australian Government committed to developing a national food plan encompassing Australia's food supply chain. The plan is expected to have a broad scope, including issues such as food security, productivity and efficiency, sustainability, health and nutrition and general economic policy relating to the food sector. An issues paper is planned for release in the next few months.
- The government intends that the national food plan will better integrate overall food policy by looking at the supply chain from paddock to plate, including opportunities and risks to the long term sustainability of food production.
- A National Food Policy Working Group has been established as the conduit between the food industry and government to foster a better understanding of the industry's priorities and challenges across the supply chain.

Greenhouse gases

- The Australian Government has announced an intention to implement its carbon emissions reduction policy, with a carbon tax as an interim step towards an eventual emissions trading scheme.
- A carbon price mechanism is proposed to commence with a fixed price on carbon in July 2012 before converting to a cap-and-trade emissions trading scheme. The "fixed price phase" may be between three and five years, with the carbon price increasing annually at a pre-determined rate.
- A carbon price mechanism would have broad coverage of emissions sources will have an impact on the dairy supply chain, affecting energy and road transport costs, including:
  - the stationary energy sector
  - transport
  - industrial processes
- Emissions from agriculture would be excluded from coverage under the carbon pricing mechanism, but this will be reviewed as the details of a cap and trade system are negotiated. Options to provide economic value to activities which store or reduce carbon in the land sector could potentially include the use of credits in the carbon price mechanism or alternative funding arrangements for the primary production sector.
- Details of proposed compensation to mitigate the effects of higher costs on households and businesses have not been released.
- The carbon tax proposal has created significant political and business community debate, and while the proposal has won support of minority parties, passage of legislation to give effect to the proposal is not assured. Opposition to the proposal includes the potential harm to international competitiveness should major trading partners fail to implement compatible measures.

International agreement

- There has been limited progress towards multilateral agreement to emissions reduction policies.
- The Cancun agreement in 2010 provided a broad framework for governments to work towards setting targets for the reduction in emissions, yet without compelling them to mandatory commitments. The agreement included development of a performance measurement system and the establishment of a fund to help developing countries adapt to low emissions targets. Plans were put in place to create a US$100bn per year fund to protect poorer nations against the worst impacts of climate change, and a mechanism was set up to transfer low carbon technologies to developing countries.
- The negotiations will continue this year, with the seventeenth Conference of the Parties to the United Nations Framework Convention on Climate Change (UNFCCC) and the seventh Meeting of the Parties to the Kyoto Protocol to be held in Durban. Whilst agreement to a legally binding treaty is unlikely to be reached at Durban, key issues on the table are likely to include operationalising the commitments made at Cancun as well as:
  - an explicit long-term global goal for reductions in emissions;
  - a timeframe for the peaking of emissions; and
  - a target concentration of atmospheric GHGs.
- Australia's commitment is to reduce national emissions by 25% from 2000 levels by 2020 if there is a global agreement capable of stabilising levels of greenhouse gases (GHGs) in the atmosphere.
- In the absence of such an agreement, Australia has committed to:
  - reducing emissions by 5% below 2000 levels by 2020; and

Policy drivers

    - by up to 15% below 2000 levels by 2020 if there is a global agreement falling short of the 450 parts per million target but under which major developing economies commit to substantially restrain emissions and advanced economies take on comparable commitments.

- The reference to the reduction targets submitted by developed countries is significant. Whilst those targets are not legally binding, it formalises them within the UNFCCC system. In addition, the decision requires developed countries to submit annual GHG inventories as well as biennial reports on their progress in achieving emissions reductions.
- A large number of countries operate carbon emissions taxes with varying designs and scope. Emissions trading schemes operate with limited effect at present.

Dairy Australia
Your Levy at Work

Chapter 2

The Australian dairy market

Current market conditions

Consumer trends

- The household sector has continued to exhibit considerable caution in both its spending and borrowing behaviour. With recent income growth significantly outstripping consumption growth, the household saving ratio has increased substantially – now at levels of the late-1980s of around 10%.
- Retail sales remain flat as consumers continue to be cautious and value-conscious –displaying a reduced willingness to buy products that are not on sale and generally trading away from premium brands.
- Household debt has also continued to grow at a much slower rate than in recent years, and hence the debt to income ratio has fallen. Housing prices have been largely unchanged over recent quarters, although beginning to slide in early 2011; impacting negatively on households' perceptions of their wealth.
- Various measures of consumer sentiment report weaker confidence affected by rising petrol prices and household utility costs. While households' perceptions about their own financial position were a little below average, their perceptions about employment prospects were still above average. Fears of the potential effect of inflationary pressure on interest rates (and consequently pressures on mortgage repayments) are adding to the caution.
- The majority of consumers are also actively curbing their household expenditure by trying to save on gas and electricity; cutting back on take-away meals, new clothes purchases and out-of-home entertainment; and making the switch to cheaper grocery brands.

Spending on food

- Freshlogic tracks household spending through its Mealpulse research product and it has been showing a continuing value shift in spending by consumers between major channels. Through 2010 there has been a continuing shift in share of spending from "eating out" to supermarkets and this trend appears to have increased late in the year.
- This trend has been supported by Dairy Australia sales data collections which showed non-grocery sales slowing in the fourth quarter of 2010 and remaining sluggish into the first quarter of 2011. However supermarket channel sales have lifted in milk, dairyspreads and yogurt to keep the total categories in positive growth. The cheese category is the exception – with declining volume sales in both channels in the latest quarter.

Fig 2.1 – Comparison of consumer sentiment & variable home loan interest rates

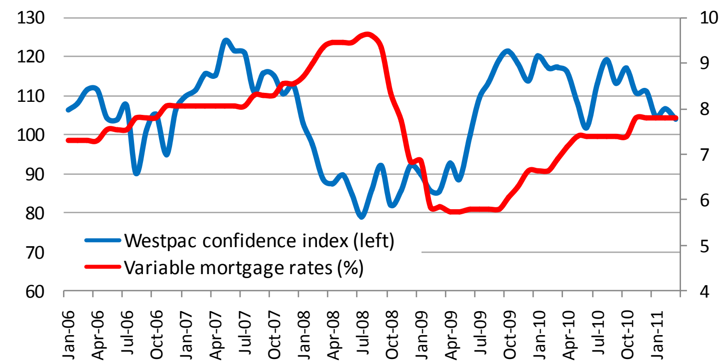
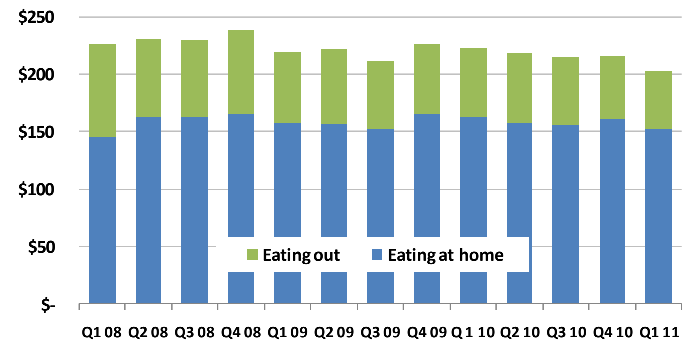


Fig 2.2 – Total food spending – share between eating at home and eating out ($/household per week)



- The escalation of competition in the Australian grocery sector is likely to reinforce consumers' cautious behaviour by focusing consumers' attention ever more squarely on price and the search for 'value'.
- AC Nielsen research estimates that more than 30% of all grocery purchases are now made on promotion.

Current market conditions

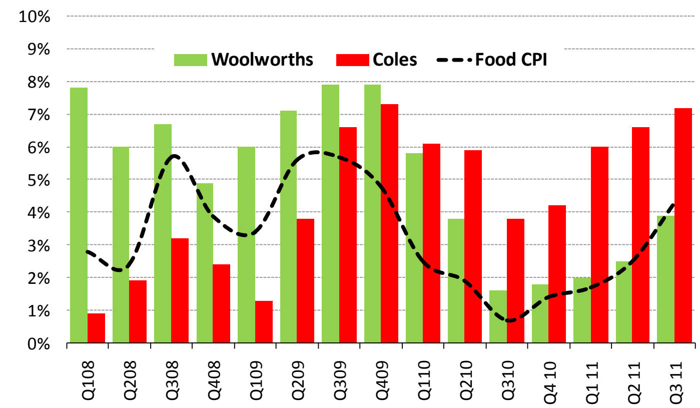
Competition in the retail market

- Intense price-based competition between the two major supermarket chains has been sustained for the past three years, having escalated when consumer sentiment began to decline in 2008 as the global financial crisis became apparent.
- Retailers are responding to weaker consumer sentiment by promoting cheaper products and a value proposition to enable consumers the opportunity to save further on food staples.
- There are a number of grounds on which major retailers compete, and for many years Woolworths maintained the ascendancy with a strong focus of fresh food, while leading in supply chain efficiency and store refurbishment. While Woolworths continues to outperform Coles on a number of retail profitability measures, Coles under new management since mid-2008 has clawed back sales market share.
- The stronger Coles sales performance has brought more customers back into their stores, and has been helped also by Woolworths' sluggish performance of new store openings and refurbishments, providing evidence of saturation in store locations of major supermarkets.
- Published quarterly sales results from the major grocery retailers shows a period of Coles' ascendancy in underlying sales growth – and therefore a gain in grocery market share.
- The Aldi chain has been trading in Australia since 2001, expanding to over 250 stores along the eastern seaboard and securing an estimated 6% market share. It has recently applied for liquor licenses for all of its 102 NSW supermarkets to increase its attractiveness.

Fig 2.3- Comparative retailer performance in the 6 months to December 2010

	Coles	Woolworths
Food & liquor sales growth	+5.9%	+3.5%
Same store sales	**+6.4%**	**+2.2%**
Food price inflation /(deflation)>	(1.7%)	(4.3%)
EBIT margin (EBIT/sales)	**4.1%**	**7.5%**
EBIT growth on LY	+18.3%	+8.1%

Fig 2.4 – Retailer changes in same store sales v food inflation



- US discount warehouse retailer, Costco, will open their second store (in Sydney) in coming months and have announced a third store to open by late-2011 in Canberra.

Promotional activity

- The focus of the promotional campaigns of grocery retailers changed in late 2010 to a focus on deep discounting on staple lines.
- While the volume of promotional discounts has reduced in 2010/11, the depth of discounting has increased, as the major chains battle for the perception of "retailer with the cheapest groceries". This has occurred in a low-inflationary period for food prices, aided to a large extent by the price pressure from the retailers themselves, but also due to lower prices for grains and dairy products.
- Both retailers claim deflation in their overall food prices, taking account of the effects of price promotions.
- Relative retailer profitability suggests Woolworths would be in a much stronger position to see off Coles' retail price discount program into the medium term.

Current market conditions

Dairy category growth

- The domestic share of dairy product use varies significantly – from 97% of drinking milk, 52% of both butter and cheese; to 13% of SMP and 15% of WMP.
- Dairy Australia estimates indicate that domestic per capita consumption for the key dairy categories reached 300 litres in milk equivalents in 2009/10 – with steady per capita consumption rates of milk and cheese; together with a slight lift in yogurt consumption and a marginal fall in butter consumption.
- Although population growth has eased to 1.6%, it remains relatively strong and has offset any easing in per capita consumption rates so that the local market has continued to expand – with milk, cheese and yogurts all increasing volumes over last year.
- Volume growth in milk equivalents in 2009/10 was estimated at around 1%, while wholesale value slipped nearly 3% to an estimated $6.2 billion. This was due to lower commodity prices reflected in non-grocery and industrial prices for the four major consumer categories.

Cheese

- Cheese is the most important product group to the Australian dairy industry.
- Company domestic cheese sales increased by 1% in the 12 months to March 2011 – with a 3% increase in cheddar volumes more than offsetting a 3% contraction on non-cheddar sales.
- The domestic cheese market splits 66% to cheddar – shared 80/20 by natural and processed cheddars – and 34% to non-cheddar cheese types. Stretched curd is the largest non-cheddar cheese type – making up 41% of non-cheddar – followed by fresh cheeses [33%] and hard cheeses [10%]. Mould-ripened cheeses, semi hard and eye cheese each make up around 5-6% of the non-cheddar total.
- Strongest growth came from natural cheddar with growth of 5% over the last twelve months; followed by the much smaller segments of semi hard and eye cheeses which each grew by just under 4%. The remaining cheese types each contracted by around 2-3% over the period.
- Manufacturing capacity for the cheese category is steadily concentrating into the south-east corner of the continent as processors rationalise their factory operations.

Fig 2.5 – Volume growth for Australian sales – year to March 2011

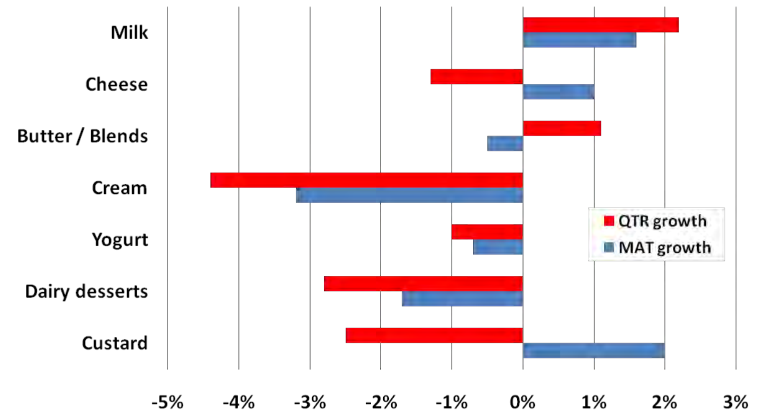
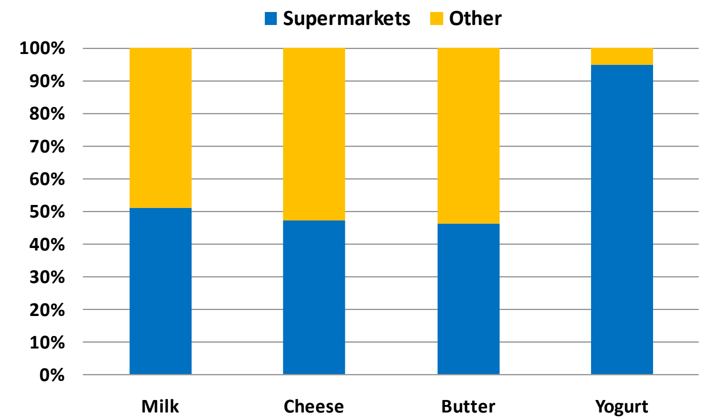


Fig 2.6 – Dairy product sales by channel – 2009/10



Drinking milk

- The drinking milk market slowed in the 12 months to March 2011, but still grew by 1% to reach 2.29 billion litres in the year.
- Regular full cream milk makes up just under half of the market at 49%, with modified milks – including reduced fat, skim and functional milks – making up

Current market conditions

32%. The balance of the market is shared between fresh flavoured milks with 10% and long-life or UHT milks with a 9% share.

- Strongest growth in the 12 months to March 2011 came in fresh flavoured milk - up 4% with modified milk up 4%, UHT milk up 0.9% and full cream milk marginally down.
- The relative importance of drinking milk to regional dairy production sector varies across states.
- The relative importance of the different sales channels varies significantly by type of milk – with full cream, modified and UHT milks highly dependent on the supermarket channel and fresh flavoured milks much more dependent on the petrol and convenience and route trade channels.

Supermarket sales

- The grocery sector of food retail - made up of major full-service supermarket chains and independent grocery stores - is the dominant distribution channel for the domestic food and beverage market.
- Dairy Australia estimates that the supermarket channel accounted for 49% by volume [milk equivalents] and 61% by wholesale value of the total domestic market for the key consumer dairy categories of milk, cheese, dairyspreads and yogurt in 2009/10.
- Supermarket volume shares of the key categories are estimated at 51% for milk, 47% for cheese, 46% for dairyspreads and 95% for yogurt.

Private label v brands

- Private labels – or retailer brands – continue to make gains in the Australian market with the value share of total packaged groceries up to 25% in the last quarter of 2010.
- Consumer perceptions have changed significantly over the last five years, with many consumers now seeing the benefits they offer in terms of value-for-money and as a good quality alternative to name brands.
- These perceptions were reinforced during the recent economic uncertainty when surveyed consumers indicated they would continue to purchase private label products even when the economy improved.

Fig 2.7 – Supermarket volume growth by category – year to March 2011

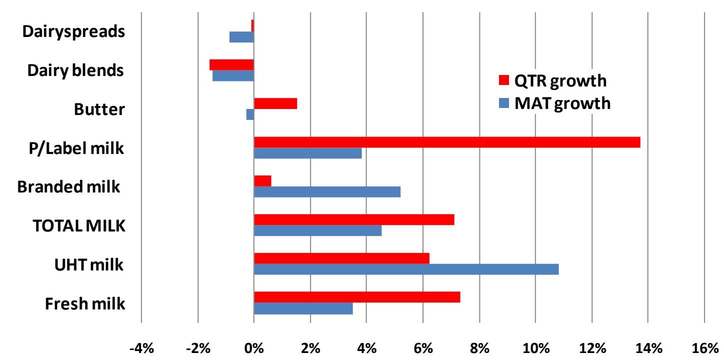
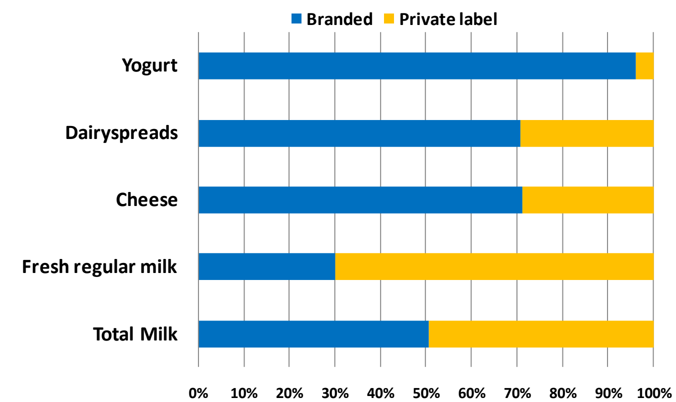


Fig 2.8 – Shares within supermarket dairy category – year to Dec 2010



- Private labels tend to gain significant share in what are termed 'low involvement' product categories – or those where the product offerings are very similar across the range on the market and the consumer decision-making process is relatively simple and straightforward.
- The level of penetration of private labels varies across the dairy product categories – from 50% in total milk – and up to 71% in fresh regular white milk segment - to 30% in cheese, 28% in dairyspreads, and just 6% in the yogurt category.

Current market conditions

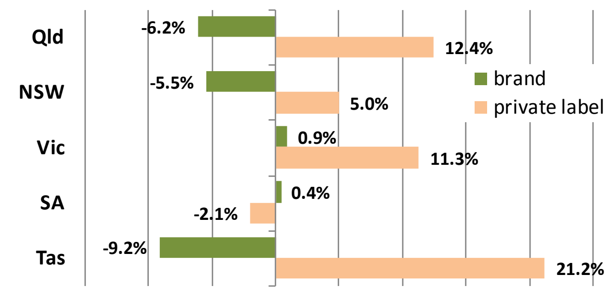
- Within the milk category, the level of penetration of private labels also varies across the various milk categories.
- In the middle of 2010 Woolworths reduced its reliance on a single house-brand milk supplier by splitting up its long-running – since September 2002 – national supply contract with National Foods. It awarded its Queensland supply contract to Parmalat and a contract to supply about 30 stores in southern NSW and the ACT to Murray Goulburn. National Foods retains supply to all other areas of Australia, plus the Coles supply contracts in all states except WA.
- Woolworths also shortened its private label contract periods to one year from its previous three-year contracts – ostensibly to enhance the competitiveness in the milk industry and lessen its dependency on a single house-brand milk supplier. However the move has created significant uncertainty for milk processors and their suppliers.

Supermarket 'milk price wars'

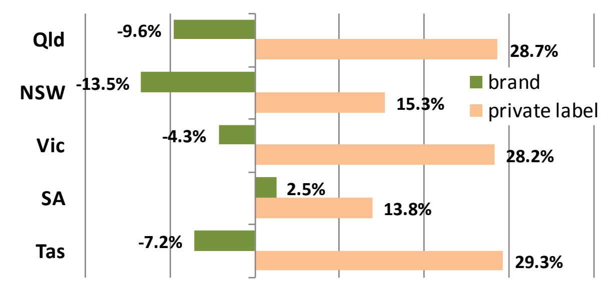
- Both major grocery chains have embarked on new price discounting campaigns in 2011 – Coles launching "Down Down" in January 2011, and Woolworths following with "Price Knockdown". The campaigns are very similar – each focusing on deep price reductions on specific staple items.
- Regular and reduced-fat milk was an early component of the "Down Down" campaign for Coles, which reduced the prices for products across pack sizes to an average of $1 per litre, and removed the Savings brand private label line (the cheaper tier of private label brands) in the process. While the effective discount on private label regular milk prices was around 9%, the reduction in prices for previously higher-priced modified milk products was on average about 23-25 %.
- Woolworths and other retailers have largely matched the discounts. These reductions for Coles and Woolworths have taken an estimated $85 million in annual equivalent terms from retail sales values.
- The retailers differed in their public views as to the length and sustainability of these prices. The industry fears the following impacts:
    - In the short-term, the wider gap between private label and branded products has resulted in a lift in sales of lower-priced products, at the expense of brands, thereby weakening the overall wholesale returns to processors.
    - The shift in sales has occurred not only within the grocery store, but also between convenience and food service outlets and grocery stores. Private label lines at a grocery store have become a cheaper source of milk for cafes who depend on the "route trade" for supplies.
    - If these prices prevail past the middle of 2011, they will not only affect the wholesale prices at which private label lines are packed by processors, but are likely to flow-on into reduced farmgate prices. Indeed, the impact has already been felt by some farmers.

Fig 2.9 – The early impact of milk discounting on brand share volumes

March 2011 fresh white milk sales volumes (change from March 2010)



March 2011 fresh "modified" milk sales volumes (change from March 2010)



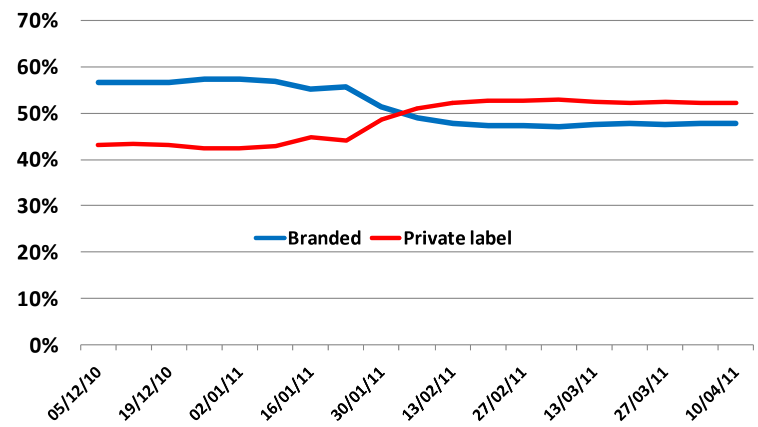
No comparable WA data

Current market conditions

- The longer the milk price war prevails; the more the brand proposition weakens, undermining the viability of marketing and product innovation. Returns from branded products are critical to the mix of returns to processors, which naturally flow-on to affect the affordable values of milk at farmgate.

- Lower overall packaged milk wholesale prices as a result of an increased share of private label sales volumes may result in greater commoditization of the milk sector. If there are permanent changes in product and channel mix, it will force changes in the respective roles and contributions that private label contracts and branded milk products have in processors' business models.
- The impact on average retail sales and, ultimately on wholesale returns has (to the date of this report) varied state-to-state, due to the differences in retail prices, brand and sales channel mix between states. The impacts on wholesale and farmgate returns are potentially greatest in Queensland, where retail prices of branded lines were typically lower and farmgate prices for milk typically higher than in southern states.
- A vocal dairy industry backlash led to a Senate Inquiry being called into the pricing of milk products. The Senate Economic References Committee said in an interim report that their conclusions and recommendations would not be released before October 2011, pending analysis of the duration and impact of the changes to the industry.
- In early-February Coles extended their dairy price reductions into the butter and fresh cream categories.
- Two months of data to March 2011 suggests different effects of the price reductions across the category.
- Despite the significant change in relative prices, there has been no real shift from fresh full cream milk to fresh modified milk at this stage.
- Overall, branded milk has lost around 5% share to private label - from a split of around 50/50 to 45/55. Moving into the segments; fresh regular white brands have lost 3-4% share points and fresh modified white brands have lost significantly more, around 9-10% share points - albeit of a much smaller segment.
- The current pricing trends suggest a reduction in retailer margins of something approaching $65 million over a full year for the two major chains if the current pricing strategy is maintained.
- Neither soy drinks nor UHT milk has lost any share to fresh milk despite all the media attention and the change in price relativities.
- At this stage the data doesn't show any significant discounting in dairy company branded prices – which would represent a greater impact on industry profitability.

Fig 2.10 – Supermarket sales - % share of fresh white modified milk (Dec 2010 to April 2011)



Current market conditions

Food service

- Rising household fixed costs such as servicing the mortgage, utility and insurance costs, and now petrol prices are limiting the amount of discretionary spend; with eating out losing some 'share of stomach' to take home retailers.
- Currently there appears to be a serious disconnect between ABS retail sales data for the components of the foodservice channel – Takeaway Food stores and Cafes and Restaurants – and household tracking of expenditure by Freshlogic.
- While the ABS data suggests growth rates of 6% and 11% respectively, Freshlogic research and industry's own data suggests little or no consistent net growth in these channels during 2010/11. The charts on the right show the monthly changes in sales volumes compared to the same month in the prior year, reflecting the fluctuation in volumes due to buying patterns and limited overall growth over the past year.
- Nevertheless, time and convenience remain important to consumers and lower value purchases of prepared foods to eat at home have significant potential in the current marketplace.
- A recent report by the Australian Association of Convenience Stores highlighted a reduction in customers visiting convenience stores in 2010 – down 10% on 2009 – and petrol only sales increased from 44% to 55% over the year.
- Some large Quick-Serve Restaurant chains including McDonalds and Domino's Pizza have reported strong growth in "same store" sales, reporting that the "value meal" appeal and constant refreshing of menu options remain key drivers of increased volumes.
- An increase in online sales has facilitated this quest for value, as consumers can easily shop around and compare value offerings for pizza. Approximately 40% of Pizza Hut sales are now online.
- At current cheese prices there will be some scrutiny of the amount and type used on pizzas. The presence of US manufacturer Leprino has changed the dynamics for QSR supply – linking it more closely with US market trends than previously. An increase in interest rates combined with rising oil prices will maintain pressure on household incomes and the value proposition offered by foodservice meals. In this environment wholesale prices are likely to remain under pressure.

Fig 2.11 – Dairy spreads sales volumes (changes from same month prior year)

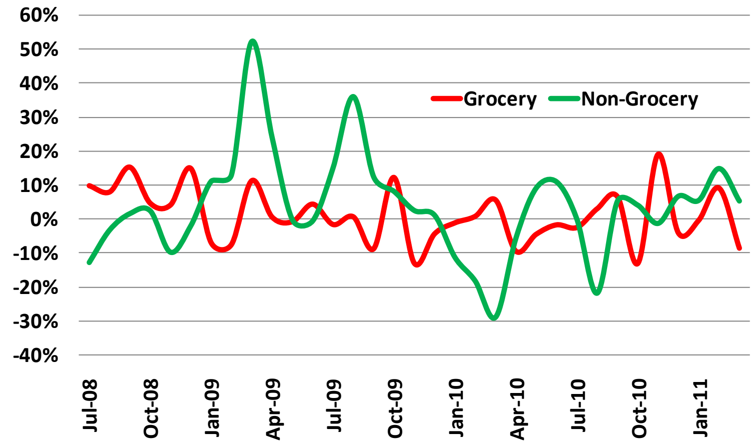
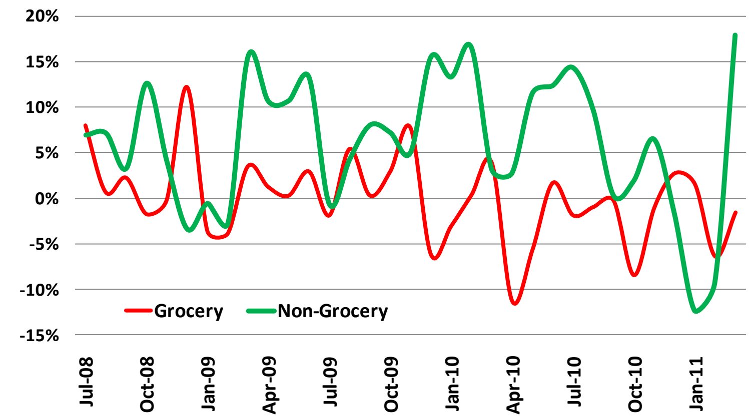


Fig 2.12 – Cheese sales volumes (changes from same month prior year)



Australian market outlook

Overall

- Activity in the Australian economy grew at a solid pace over the second half of 2010. Strong demand for Australian commodities is underpinning growth in national income and a high level of business investment, while growth in household consumption remains relatively subdued.
- However, the multi-speed economy is very evident in business conditions readings; with mining and recreation getting back to normal following the GFC-induced downturn, but a brace of domestically focused industries - retail, wholesale, construction and manufacturing - continuing to struggle.
- The Australian dollar is now at three-decade highs against a weak US dollar, which is causing concerns for export-focused industries within agriculture, manufacturing, education and tourism sectors.
- Expectations for future conditions vary significantly across industries, with confidence highest in the resources sector. In contrast, the strong Australian dollar is weighing on the manufacturing and tourism industries, while subdued consumer spending is weighing on retailing.
- Nevertheless, employment growth continues to be strong and 'official' unemployment measures have moved below 5%. However, consumers are remaining cautious on a number of fronts.
- The RBA's forecast for the Australian economy suggests that the recent widespread floods will have a material effect on the near term profile of GDP. Growth in the December and March quarters will be notably lower than would otherwise have been the case, followed by a strong recovery in the June quarter as coal production picks up and the rebuilding effort gets under way.
- Over late-2009 and across 2010, the RBA gradually removed the monetary stimulus put in place during the global downturn. The official cash rate is currently at 4.75% and, and with interest rate movements by lenders, most loan rates are now a little above their average levels of the past decade or so.
- In view of the overall strength of the local economy and the inflationary pressures from very strong terms of trade, the RBA considers that its mildly restrictive policy stance remains appropriate.

Fig 2.13 - Key economic indicators

	2011/12	Medium-term
Australian economic growth	4.25%	3.5% to 4.0%
RBA official cash rate	5.0% to 5.25%	5.25% to 5.5%
CPI	3.0%	2.5% to 3.0%
Per capita dairy consumption	+1.0%	+1.0%

Challenges for the category

- The overall consumption of dairy products is expected to continue to grow in response to population growth. Underlying any short-term variation in trends in dairy consumption in Australia is the fact that dairy products are available in a range of forms and applications, and are well placed to capitalize on on-going consumer lifestyle trends regardless of the sales channel to the consumer.
- Dairy has four pillars on which to base its continued appeal and presence in the Australian diet – health and nutrition, convenience, taste and indulgence.
- The outlook in the short to medium term is for a continuation of intense retail and wholesale competition in the Australian grocery market.
- While the cautious household sentiment is unlikely to significantly affect the overall volume of dairy products consumed, it may impact on the preference for the channel in which consumers spend their food dollar. It will also be likely to continue to affect the unit value of sales as consumers seek value in their purchases. This will provide continuing support for private label products and price-promoted branded lines through the supermarket channel.
- Pressure applied by retailers as a result of continuing to compete for the mantle of "cheapest for the consumer" will ensure sustained discount campaigns and an increased amount of shelf-space devoted to private label products. Expansion of the presence of Aldi will sustain pressure on the two major retailers to offset the loss in market share to new Aldi stores.
- These factors will threaten growth in the unit value of the dairy category over time, without corresponding investment in innovation, brand support and development.

Australian market outlook

- The challenge for fresh dairy processors and domestic dairy product manufacturers will be to improve brand share of retail sales to overcome the effect of private label sales on average wholesale prices and profit margins. This is especially the case in regions focused only on fresh milk processing.
- A potential increase in ethical requirements of retailers may affect the dairy category in future but to date change in this area has been slow compared to other categories and other countries.
- It is conceivable that retailers however may require product-label information to establish points of difference in response to consumer concerns in relation to "carbon footprints", environmental impact, and animal welfare standards.

Dairy Australia
Your Levy at Work

Chapter 3

The industry value chain

Ownership and consolidation

Industry ownership

- A core challenge for the southern Australian manufacturing sector is sustaining utilisation of factory capacity with the outlook for slow growth at best in milk supply volumes, along with plans for expansion and entry by smaller processors and manufacturers.
- This outlook will also ensure competition for raw milk from producers remains intense.
- Strong competition in the retail market in a price-sensitive economic climate also adds to the pressure for further consolidation of ownership of consumer brands, as well as manufacturing and processing capacity.
- The ownership of the Australian industry continues to change over time, with a growing proportion of the industry beyond the farm gate now owned by public and international interests.

Major changes of ownership

- Major domestic developments that changed the ownership of dairy businesses in the Australian industry over the past 12 months are:
    - **Bega Cheese** took a 15% share in **Warrnambool Cheese & Butter (WCB)** via a share placement – with the two companies aiming to explore a “closer relationship” with the proposed establishment of a strategic management group rather than a merger or takeover.
    - **WCB** also undertook a 1-for-6 rights issue raising funds to reduce net debt and to pursue growth opportunities. The placement and the entitlement offer together raised $37 million.
    - **Bega Cheese** obtained shareholder approval to list on the ASX following a strategic review of the options available for the group’s shareholders to be able to realise the value of their shares. To “ensure existing shareholders retain significant influence on business direction and philosophy”, a shareholder cap of 5% is proposed for the first two years, thereafter lifting to 10% in the following three years – ensuring any takeover would have to be with shareholder approval.
    - **Bega** proposes to fully merge **Tatura Milk Industries** – its 70%-owned subsidiary located in northern Victoria purchased in 2007 – via a scheme of arrangement.
    - Private equity firm **Archer Capital** has purchased Fonterra’s Brownes [WA] dairy business through a company called the **DairyWest Group**.
    - **Challenge Dairy** - one of WA’s four dairy processers went into voluntary administration in late-2010 - leaving farmers chasing payment of $4 million for September and October milk. Challenge has had a long struggle with inadequate processing throughput, the age of its facilities, difficulties in managing operating cash flows in volatile market conditions and an intensely competitive WA market.
    - **Harvey Fresh** purchased **Challenge Dairy** assets for an undisclosed price. Harvey Fresh bought certain land, buildings, plant and equipment at Challenge’s Boyanup and Capel sites.
- There is ongoing interest in the ownership of **WCB**, in view of the fact that the 15% limit on individual shareholder ownership will lift in mid-May 2011. WCB now has two large dairy groups with significant shareholdings – Bega Cheese holding 15% and Murray Goulburn 10%.
- **Murray Goulburn** withdrew a merger proposal with WCB - but retained their 10% stake in the company. MG advised the ACCC in early-June 2010 that it did not intend to progress the proposed merger at this time and would withdraw its application for clearance – which it appeared was unlikely to be granted by the ACCC.

National Foods

- The company continued to rationalise its processing capacity around Australia striving for synergies from the integration of Dairy Farmers and Lactos businesses in recent years.
- National Foods has expressed the need to significantly improve its performance by focusing on higher value branded products and quitting unprofitable business units, and its dissatisfaction at the returns available from fresh milk processing. Parent company Kirin Holdings announced a significant write-down of its investment carrying value in Lion Nathan National Foods in December 2010.
- The performance of the group will come under further pressure with the sustained deep-discounting of private label milk products in supermarkets.
- The company recently announced the results of the review of its cheese business, which will result in:
    - Closure of four small cheese plants in Tasmania and Victoria;

  - Increased investment of $120 million in the Burnie cheese plant – consolidating Tasmanian specialty cheese-making operations;
  - Closure of processing facilities in NSW; and
  - Sale of cheese plants at Murray Bridge and Jervois in South Australia.

- The operation at Allansford, adjacent to the WCB plant was not subject of the review, and there has been no further statement as to any potential revisiting of the joint venture between National Foods and WCB that was scrapped in 2009. There was also no change to the operations at Malanda in Far North Queensland, although the future of that site will depend upon the available milk supplies from contracted producers in that region.
- In August 2010 **National Foods and WCB** renewed their long-term cheese supply arrangement by five years. WCB will continue to supply to NatFoods with about 20,000 tonnes per annum of bulk cheddar varieties from its Allansford plant and delivered to NatFoods' cut and wrap facility on the same site. The companies failed to achieve a restructure of their relationship into a joint venture in 2009 after the turbulence in milk prices caused by the GFC hit WCB's earnings and therefore access to funding.
- The former Dairy Farmers' Hexham plant has been sold to cheese-maker **Brancourts** who will initially use the site to manufacture cottage cheese.

New entrants

- **Murray Goulburn** made a further move into the domestic market when it announced in May 2010 that the company will operate joint-venture with French food company **Danone** – to manufacture, market and sell yoghurt and other fresh dairy products in Australia under the Danone brand from 2011. While the JV will be a stand-alone company, MG will provide operational support during the establishment phase of the business at MG's Kiewa site in north-east Victoria.
- New Zealand's **A2 Corporation** has announced plans to establish its own milk processing plant in south-west Sydney, at a cost of $7.5 million, to foster the growth of its local subsidiary A2 Dairy Products Australia. The project will be funded by a mix of debt and equity, and is planned for operation by the fourth quarter of 2011.
- **Aussie Farmers Dairy** – a subsidiary of the home delivery company **Aussie Farmers Direct** - has started producing bottled milk at its Camperdown plant in early-2011 – after completing commissioning and quality trials. The plant is the former Bonlac factory. Aussie Farmers Direct is one of Australia's fastest growing businesses with about 200 franchisees now signed up.

Potential future foreign interest

- The tightening of supply and demand and increased volatility in the international dairy market has in recent years encouraged a number of international dairy companies to investigate potential acquisition targets engaged in product manufacturer and milk production in low-cost dairy production regions.
- This ongoing interest from foreign groups in purchasing dairy assets is driven by:
  - Increasing concerns for food supply security, especially from Chinese and other Asian dairy processors. Companies such as Bright Foods have been especially active, yet few transactions have been completed.
  - The availability of assets for purchase within the Australian industry
  - The existence of a number of acquisitive groups that are seeking a diversification of their geographic dependence on certain regions.
- The scope for Australian dairy manufacturers to be targets of these acquirers is limited, despite the fact that there exist a number of diverse businesses within the Australian industry. The removal of shareholding limits applicable to WCB, and the floating of Bega Cheese on the share market may add to that interest, although limitations apply to any significant acquisition in the latter for a period of five years.
- The perceived constraints on milk production growth in southern regions are a deterrent for potential buyers seeking secure access to a growing export-competitive supply base. Recent prominence given to the poor returns from domestic milk markets may act as a deterrent for any new entrants to that sector.

Further market changes

- Further developments in the management of private label brand supply by major grocery retailers (including independents and Aldi) may have a significant influence on the medium-term outcomes of consolidation in the milk processing sector.
- Faced with two dominant processors, retailers may seek to reduce their sourcing risk and improve flexibility by seeking alternative supply arrangements –

Ownership and consolidation

including regional private label packing contracts, or even direct farm supply using toll processing.

- Changes of this nature would have implications for processor facilities and milk sourcing, and could create some uncertainty for milk producers regarding their market access.

Company structures

- Farmer-owned dairy manufacturing businesses, including co-operatives, engaged in the dairy industry in Europe, the US, New Zealand and Australia face common challenges.
- These include:
  - Accessing sufficient equity capital for investment in processing assets, product innovation and marketing to remain competitive with publicly owned brand marketers.
  - Redemption risk - regarding the potential drain on shareholders capital as a result of the exit of dairy farmers from the industry or their loss as suppliers to competitors.
  - The desire for flexibility in dealings with supplier-members regarding differentiation in milk payment systems.

What is forcing change?

- The dynamic nature of the world dairy industry is driving the boards of major farmer-owned businesses to assess ownership options. The principal drivers are:
  - The gradual deregulation of and removal of supports from dairy markets in the EU which is forcing dairy companies to evaluate more competitive milk supply sources.
  - Greater volatility in dairy markets flowing back to the farm sector and putting pressure on traditional small-scale farmers to exit.
  - Stronger price-based competition between retailers in developed economies, reducing available dairy margins.
  - Greater competition between dairy companies at the farm gate.
  - Smaller numbers of larger, more business-savvy farmers funding capital requirements and seeking to maximize returns for their investment, either through milk price or other mechanisms.

Fonterra restructure

- The changes being implemented by Fonterra have ongoing relevance to Australia's dairy industry, given the exposure of both to returns from commodity manufacturing. The objectives of the restructure are to remove redemption risk; ensure the preservation of farmer control of the co-operative; and provide a structure to facilitate greater access to farmers' capital for their own farm business requirements.
- In the Fonterra restructure, there are three stages of change, the first two of which were passed in 2009/10:
  - Strengthening the share structure, to allow farmers to hold shares up to 120% of their milk production (compared to the former limit of 100%).
  - Restricting the value of company shares to reflect the fact that they will not be freely traded in the market.
  - Allowing the trading of shares between supplier-shareholders – which is to be put to a vote in 2011. A successful result appears likely based on current reaction within the industry.
- Fonterra have already implemented a change in transparency of its financial performance, unbundling payments to farmers and reporting profits on a fully commercial basis.

Farmgate market

How farm gate milk prices are set

- While more than half of national milk production is processed into products sold on the domestic market, the returns available from dairy products sold in domestic markets such as cheese and butter are governed by export market benchmarks. As a result, the returns to more than 70% of milk production are set by world markets.
- Despite the fact that milk collections by co-operatives have reduced in recent years due to ownership changes and reduced milk flows in regions where cooperatives operate, the traditional co-operative model – operated by Murray Goulburn - plays a critical role in setting the farm gate value of milk in southern states, with which other milk buyers compete.

Farm gate prices in 2010/11

- A summary of milk prices paid across the regions of the industry is set out on page 45. Milk prices in southern regions opened significantly higher in 2010/11 due to improvements in the international market.
- While the benefit of the international market recovery for Australian exporters and farmers has been constrained by the stronger Australian dollar, farmgate prices for southern producers have improved in the 2010/11 season, and are expected to close the season in the vicinity of $5.40 to $5.50 per kgMS.
- Milk prices in NSW and Queensland have been lower than those in the prior year for some producers. However, there is variation between dairy companies depending on the timing of contract periods and their relative exposure to oversupply of milk and product mix.
- Supply contracts have been renewed at lower prices, while sustainability incentives in continuing agreements have been reduced. In the case of contracts offered by National Foods, the portions of volumes attracting “tier 1” prices have been lowered, at varying degrees depending on the region, and with variation between milk supplied through the Dairy Farmers Milk Cooperative (DFMC) and directly from individual farm suppliers. These changes have significantly widened the variation in farmgate prices available.

Sustained competition for milk

- In southern Australia, there has been sustained supply competition between dairy companies driven by strong demand from export markets. Sustaining optimum milk throughput in plants remains a priority to ensure better fixed overhead recoveries.
- Fresh milk processors operating in southern regions are also seeking greater certainty of supply, through increased direct supply to their plants.

Fig 3.1 – Utilisation of milk by state – 2009/10

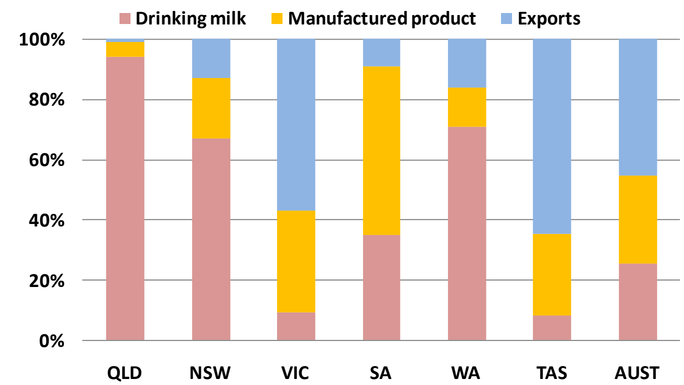
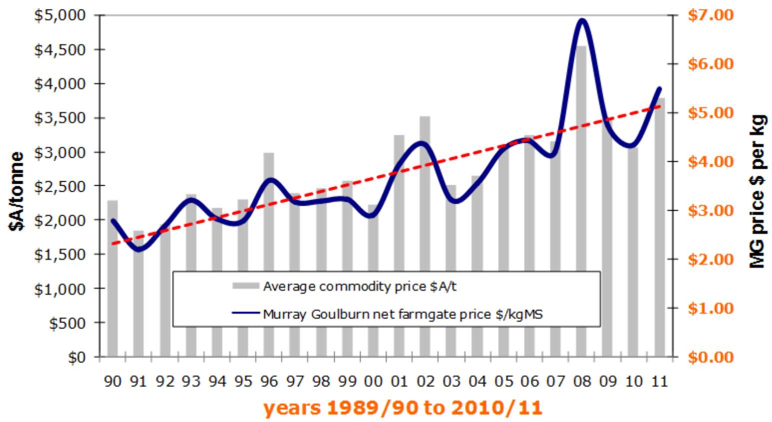


Fig 3.2 – Average export returns and Murray Goulburn milk prices (1990 to 2011)



Farmgate market

- As in the two prior seasons, the outlook for 2011/12 again involves two different scenarios. Southern exporting manufactures looking to increase intake to meet persistent export demand, while domestic milk processors in fresh milk regions are focusing on closely matching demand with secure year round regional supplies, while mitigating the impact of lower fresh milk processing returns.

Forecast milk prices in 2011/12

Southern regions

- The 2011/12 opening farmgate milk price announcements will again be important signals for farmers assessing short-term decisions and their longer term future in the industry. Good seasonal conditions and relatively low feed costs provide an environment rarely experienced in the past decade.
- While uncertainty remains, particularly around currency, opening prices are forecast to be at least at levels of opening prices in 2010/11. Opening prices are expected in the range of $4.60 to $4.90 kgMS, while full year prices are forecast to reach $5.10 to $5.50 kgMS.
- This outlook is based on the following assumptions:
    - Dairy product prices realising the spot price levels in early 2011, which sees all major commodities trading in the range $US3,800 to $US5,100/tonne
    - The AUD valued between 100 and 105 US cents
- Dairy market fundamentals support this price outlook through 2011/12, however currency movements pose a significant risk to the full year outlook.

Northern regions

- Prices remain under downward pressure in Queensland and NSW regions as regional milk flows exceed fresh market demand requirements. In addition, intense retail competition has reduced processing margins.
- The influence of base-level farmgate prices available to Parmalat suppliers may mitigate the extent to which prices are reduced by other companies in 2011/12. These arrangements were largely struck in 2007/08 when seasonal conditions threatened the ongoing adequacy of local milk flows, and southern milk prices were higher than those expected in 2011/12. A large percentage of Parmalat's Queensland milk supply is contracted at firm prices until the end of the 2012 calendar year.

Fig 3.3 - Summary of the structure of milk supply arrangements offered by major dairy companies

	Milk volume direct supply 2010/11 (billion litres)	Step-up payments	Optional pricing structures	Full-year pricing or option	Use of individual contracts	Productivity incentive	Share deductions	Growth incentive
Murray Goulburn	2.8	Y	Y	Y		Y	Y	
Fonterra	1.7	Y	Y	Y		Y		Y
National Foods	1.6			Y	Y	Y		
(DFMC)	(0.9)		Y	Y	Y	Y		
Parmalat	0.5		Y	Y	Y	Y		
WCB	0.8	Y	Y	Y	Y	Y		
Bega Group	0.5	Y	Y	Y		Y	Y	Y
UDP	0.2	Y		Y	Y	Y		

Notes:

1. Contracts are used by WCB for a portion of its supply base
2. National Foods refers to direct milk supply agreements. Milk supplied by DFMC, which offers separate milk pricing and incentive structures to the direct milk supply contracts offered by the company itself.
3. Fonterra offers a range of options to suppliers which include the use of full-year prices.

- In National Foods the loss of private label packaging arrangements and the closure of marginal processing sites has altered that company's milk requirements, which has lowered "tier 1" contract volumes offered to its suppliers.

Changes in pricing arrangements

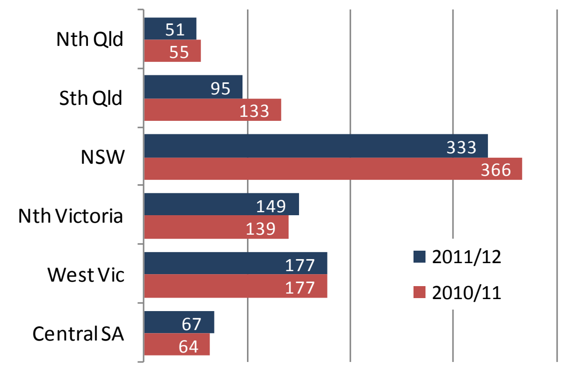
Murray Goulburn

- Murray Goulburn introduced two pricing options as variations to their traditional arrangements at the start of the 2010/11 season. These included new variants to provide suppliers with more choices that may better suit their chosen production system:
    - A "domestic market" supply arrangement with flatter pricing which required a commitment to a flat seasonal ratio that earns a post-season bonus.
    - A "seasonal" payment system that increased the price offered in spring but reduced second half incentives, and also requires a full year commitment.
- These options to a large extent mirror offers of several other major milk buyers, and more closely aligned to the plant and market requirements of the company.

NatFoods and DFMC

- Milk cooperative DFMC provides a substantial portion of National Foods regional milk requirements in mainland eastern seaboard states, alongside direct supply contracts with individual suppliers (some of which are negotiated through collective bargaining groups) and third party bulk milk supply arrangements. In 2010, National Foods and DFMC implemented agreements featuring two-tiered milk pricing and supply.
- Tier 1 milk prices are paid on milk supply volumes representing an allocation of the milk requirements (anticipated full demand or AFD) of the regional National Foods operations. Volumes in excess of this attract Tier 2 prices.
- NatFoods has offered reduced AFDs in 2011/12 (shown in Fig 3.4) across all regions to align with lower market demand, which has included the effects of changes in private label milk contracts and rationalisation of operations in NSW and Victoria. These suppliers are further exposed to potential adjustment in AFD volumes should the company lose the Woolworths contract in NSW.
- This will have the effect of reducing the proportion of milk volumes that attract Tier 1 prices, but the impact will vary region-to-region. The effect on individual suppliers of a portion of their milk production achieving a lower marginal milk price will also vary significantly.
- The two-tier pricing system sends a clear signal as to the size and value of the available market accessible by the processor. The potential flow-on impacts on the structure and level of farmgate prices from the movement of retail private label contracts between processors has affected farmer confidence in northern regions and may threaten the stability of milk production.
- Parmalat has foreshadowed it will apply similar supply management and pricing principles for its northern suppliers when existing contracts expire in 2012 and will consolidate the current differentiated supply pools into one.

Fig 3.4 – DFMC AFD's for 2011/12

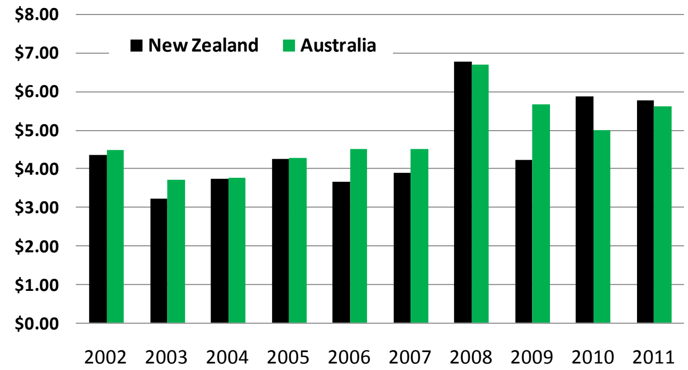


Farmgate market

NZ price outlook

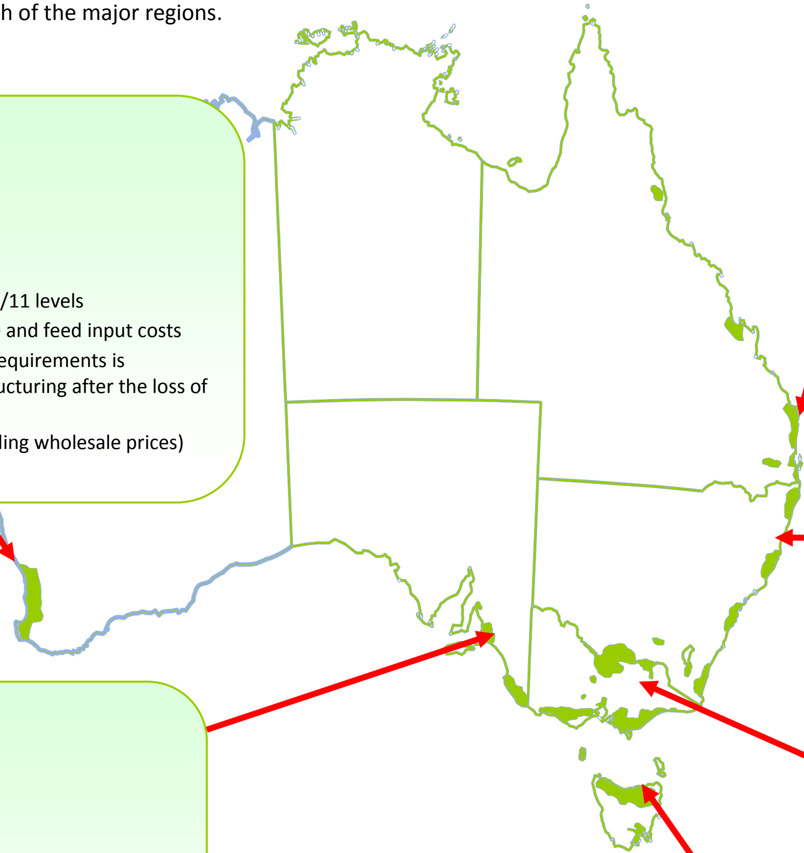
- Fonterra have announced an estimated full-year milk payout for the 2010/11 production season of NZ$7.50 per kg MS – up 23% on last season's final payment of NZ$6.10 kg MS. From a "distributable profit" of 40 – 50 cents, the target dividend range is currently 25 – 30 cents – with the balance being retained within the co-operative.
- In 2010/11 Fonterra will also make a separate profit distribution which is forecast to be 25 to 30 NZ cents per share from a distributable profit of 40 to 50 NZ cents per share.
- Fonterra is currently suggesting to its suppliers that the 2011/12 payout will be similar to the final 2010/11 amount, which would put the payout in the range of expectations contained in this report for Australian companies.
- Prices between Australia and New Zealand are different year-to-year because of:
  - Product mix between major commodity products and co-products
  - Market mix between domestic and export markets
  - Management of currency exposures
  - The different business models operated by dairy companies
  - Different profit retention practices by dairy companies
  - The different treatment of protein measures in quoted milk prices
  - The extent of competition in each market

Fig 3.5 – Aust v NZ farmgate milk prices in nominal $A/kg milk solids



Farmgate market

This map reflects the varying farm gate market prices and dynamics affecting milk supply and competition in each of the major regions.



Queensland and North NSW

Farm gate prices

- 2010/11: 52-60cpl
- 2011/12: reduction for suppliers exposed to changing processor liquid milk market.
- Most supplying Parmalat are locked into agreements until 2012/13

Key dynamics

- Milk supply expected to improve 1-2% in 2011/12, recovering from the effects of January 2011 floods
- The region has been over-supplying local milk market needs in past year, which may change after the effects of flood

Western Australia

Farm gate prices

- 2010/11: 38-42cpl
- 2011/12: reduction of 1-3 cpl

Key dynamics

- Milk supply expected to remain close to 2010/11 levels
- Volumes of production dependent on climate and feed input costs
- Milk production above domestic processing requirements is pressuring returns, especially in view of restructuring after the loss of Challenge
- Weaker milk product margins (affected by falling wholesale prices) threaten milk value

Central NSW

Farm gate prices

- 2010/11: 45-53cpl, for majority of producers
- 2011/12: 45-51cpl with 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

South Australia

Farm gate prices

- 2010/11: $5.40 – 5.50/kgMS (40-41cpl)
- 2011/12: close to 2010/11 levels

Key dynamics

- Milk supply expected to increase by 1% to 2% in 2011/12
- Slow supply growth in Western Victoria and export market demand will ensure sustained farmgate competition
- Volumes dependent on regional climate, water allocations and feed input costs

Tasmania

Farm gate prices

- 2010/11: $5.40 – 5.50/kgMS (40-41cpl)
- 2011/12: close to 2010/11 levels

Key dynamics

- Milk supply expected to increase by 3% to 5% in 2011/12
- Volumes dependent on seasonal conditions and feed input costs
- Spring peak processing capacity would be tested by a strong start to the 2011/12 season

Victorian regions

Farm gate prices

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

Key dynamics

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

Dairy Australia
Your Levy at Work

Chapter 4

The production sector

Production trends

The production sector in 2010/11

- Diverse market and production conditions characterise the dairying regions that comprise the national industry.
- In the spring and summer of 2010, good rains and improving market conditions have seen a general improvement in operating conditions. Milk production is forecast to reach close to **9.1 billion litres in 2010/11 – up nearly 1%** on 2009/10 output.
- Milk production in 2010/11 has been affected by a number of factors. In **southern regions** higher milk prices; good rainfall and irrigation allocations; abundant feed grains and fodder at reasonable prices have provided a platform for better operating margins. Production growth has however been limited by constraints on herd numbers, excessive wet conditions and flooding in some regions. In addition, cash flows have remained tight with increased forage harvesting spend and a general increase in operating costs.
- Floods in the Murray Dairy region caused losses in milk production of approximately 150 million litres and adversely affected herd health. Conversely, good pasture conditions in Gippsland and Tasmania supported strong growth in output.
- Where seasonal conditions have been favourable there has been a shift toward pasture feeding particularly in the Murray Dairy and far north Queensland regions. However feed quality issues have limited the ability of farmers to reduce grain feeding significantly.
- In **northern states**, full year production was affected by high rainfall and significant flooding in late 2010 and early 2011. It is estimated that Queensland production will be reduced by about 40 million litres or 8% of production. Northern NSW was affected to a lesser extent.
- In Western Australia rainfall has been low for much of 2010/11; however milk production is likely to finish close to the previous season.

Limitations on herd expansion

- National Dairy Farmer Survey results reveal an increasing trend to maintain production at current levels which could impact future volumes.

Fig 4.1 - Monthly national milk production

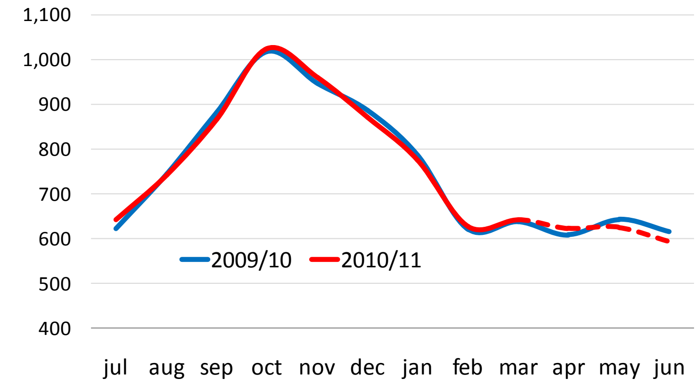
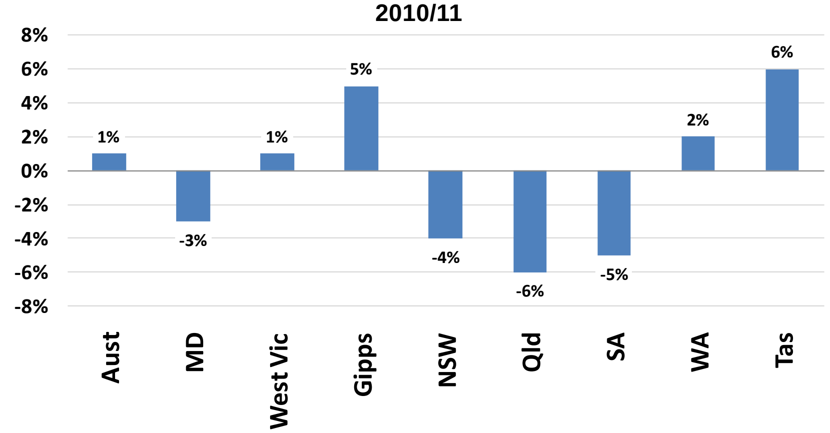


Fig 4.2 - Changes in regional milk production expected 2010/11



- While recent floods, cyclones and drought have had a negative impact on production for 12% of farms nationally, production has been lost on 48% of Queensland farms due to bad weather.
- The Northern NSW/ south-east Queensland region was most severely affected, and flooding resulted in 50% of respondents losing production. Moreover, 15% expect to incur further losses next year. On average, Queensland dairy farmers expect their herd's 2010/11 milk production will be around 9% lower than pre-flood expectations.

Production trends

- In the Murray Dairy region, 20% of respondents lost production due to flooding and 10% predict ongoing losses.
- Of even more significance is the willingness and ability of farmers to push their systems and finances in order to ramp up production. After so many difficult years, there is no doubt that many farmers find themselves emotionally and physically stretched. Their ability to capitalise on the current combination of market and seasonal conditions will be affected by their attitude to the future in the industry.

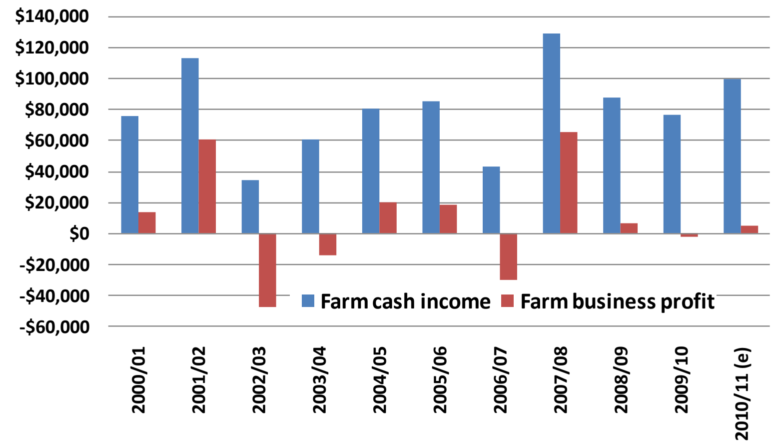
Profitability

- The ABARES 2011 Farm Survey reports that improved pasture growth and increased availability of irrigation water – meaning reduced expenditure on purchased fodder and water – plus higher milk prices will increase dairy farm incomes in southern regions this season. Northern regions will likely see a fall in incomes due to lower milk prices.
- Nationally, average farm cash incomes in the current 2010/11 season are projected at $100,000 – up nearly 30% on last year's $77,300 – and around 9% up on the ten-year average of $91,000. The percentage of farms with a negative cash income has fallen slightly from 24% to 22%.
- Average farm business profitability is projected to lift from a loss of $1,400 last year to a marginal $5,000 profit. Meanwhile, the percentage of farms with a farm business loss has also fallen slightly by 4% to 55%.
- Results vary region to region. The strongest farm income and profitability was recorded in South Australia, with Central NSW and Western Australia also performing well. South Queensland and Western Victoria performed worst.
- Further analysis of ABARES farm survey data indicates that farmers who are positive about the industry's future and planning to grow production in three years' time are – on average – larger and more profitable than farmers who are negative about the industry's future. Indeed, farm cash income was 4 times higher in positive farmers compared to those with a more negative industry outlook.

Financial position

- The ABARES survey reports that average farm debt fell marginally this season – down to an estimated $664,000 per farm.

Fig 4.3 - ABARE farm performance survey - to 2010/11



- Interest payments are the second largest expense item for dairy farmers – representing an estimated 13% of average of dairy farm cash costs in 2010/11 according to ABARES – up from 11% last season. As a percentage of milk receipts interest payments have increased from 8% to 12% over the last four seasons.
- An on-going financial challenge for local dairy farmers will be managing increasing interest rates. While interest rates have remained 'on hold' for a number of months now, there are widespread expectations that they will resume an upward trend later in 2011 as inflationary pressures build.
- Many dairy farmers only started to see 'free cash flow' late in the 2010/11, as milk price step-ups and higher seasonal prices and incentives have come through from manufacturers.
- Federal Government data on Farm Management Deposits (FMDs) shows that by December around a 13% drawdown of the 30 June balance held by dairy farmers had been drawn down.
- The total value of FMDs of $183 million at December 2010 is down 10% from last year – still adjusting back from the record high of $240 million in June 2009.
- The current season is likely to deliver a considerable increase in funds going into FMDs, especially in the southern regions.

People

Industry confidence

- Confidence as measured by the National Dairy Farmer Survey increased slightly in 2011, with the proportion of dairy farmers feeling fairly to very positive about the future of the industry rising from 65% to 69%. However there was considerable variation between regions.
- Producers in Victorian regions particularly Murray Dairy and Gippsland (up 13 and 15 points respectively) are more confident. As are Tasmania and Bega Valley, while significant declines were recorded in Queensland (down 22 points) and most of NSW. The declining positive sentiment in SA and WA continues.
- Positive attitudes about the industry's future are supported by the belief there will be ongoing export and domestic demand for dairy products and improving milk prices.
- Concerns around recent supermarket milk pricing strategies and perceived low farm gate prices are driving less positive attitudes about the future.

Challenges faced

- Farmers surveyed in the 2011 National Dairy Farmer Survey overwhelmingly nominated farm gate milk price as their major current challenge, with 51% believing it will be their greatest challenge in future. This proportion is the highest recorded in the survey's history.
- The proportion of farmers mentioning weather and climate as the main challenge has fallen to 8% down from 12% in 2010.
- The cost of farming inputs, including fuel, feed, power, and labour was nominated as the main future challenge by 12% of respondents.

Investment on-farm

- The proportion of respondents investing on-farm over recent years has remained relatively stable. Over the last 12 months 63% of respondents made capital purchases for the farm, down slightly from 2009/10.
- The main area of investment continues to be machinery (23% of respondents), followed by tracks and laneways (16%).
- A greater proportion of dairy farmers expect to invest on farm in the next 12 months, compared with intentions expressed in the 2010 survey. Nationally 50% intend to invest on farm during 2011/12, 11 points higher than the 2010 survey.

Fig 4.4 - Attitude to the future of the national industry

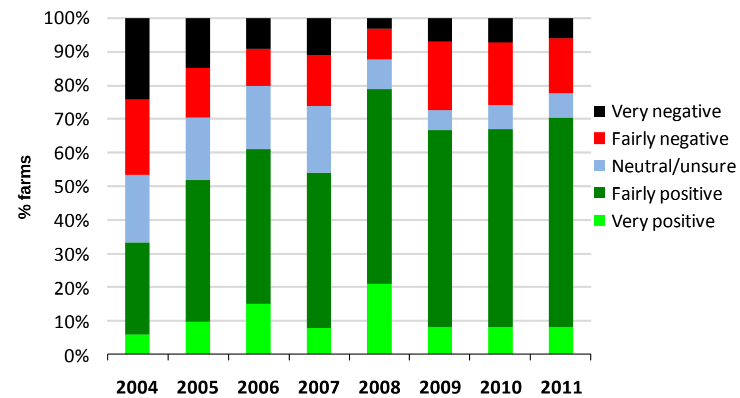
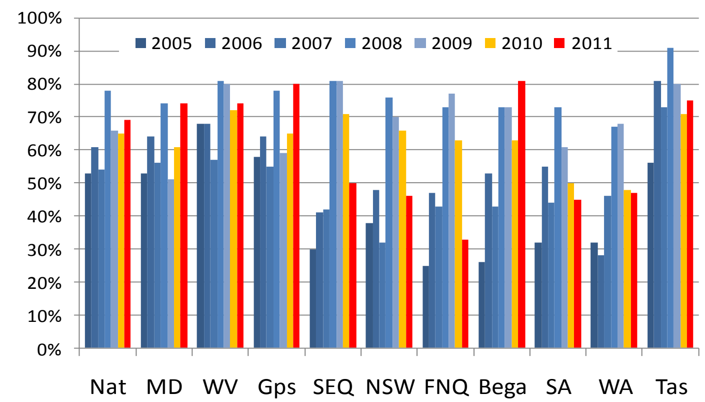


Fig 4.5 - Positive attitude to the industry by region (% farms)



- Much of the investment appears to be repairs to damaged infrastructure, with tracks and laneway the biggest category (18% of respondents), followed by irrigation plant (10%), fencing and machinery (both 9%).
- Investment intentions were strongest in Victorian regions and NSW, but weaker in SA, WA and far north Queensland – where any intended investment was focused on tracks and shedding in the aftermath of Cyclone Yasi.

People

People in dairying

- At an on-going fundamental level, the skills and capability of farm owners and managers is critical to the sustainability and development of the dairy industry.
- The 2011 NDFS results indicate that farm management and labour structures continue to change over time. The number of dairy farms operated by a single person only, or with a partner only has been falling steadily from 43% in 2007 to 29% in 2011.
- At the national level, some 64% of farms operate with paid roles. All regions showed an increase in the percentage of farms with paid roles. It should also be noted that 16% of dairy farms operate with unpaid roles; with this figure as high as 27% in FNQ. Extrapolating from the survey results, it is estimated the industry now employs approximately 12,100 people in paid roles.
- In line with last year's survey, some 18% of farms are planning to recruit staff in the coming season – with just 2% potentially laying off staff.
- 10% of farms with paid roles employ a trainee or an apprentice - with training participation highest in southern central NSW at 17%, South Australia and Western Australia, both at 15%. The lowest rates of training are in far north Queensland at 3% and Gippsland at 7%.
- In terms of perceived future challenges for the dairy industry, 11% mentioned labour as a challenge (marginally down from 12% last year) – although only 4% saw labour as their main future challenge. Specific issues associated with labour and people are availability 9%, succession/young people dairying 6%, cost of labour 4% and quality of labour 2%.
- Labour is anticipated to be the most challenging in the Bega region with quality issues; followed by Tasmania and the three Victorian regions with labour availability issues.
- Interestingly, labour issues were rated lowest in both Queensland and Western Australia where one may have thought that availability could have been a major issue due to the strongly growing and high paying mining industries in both those states.

Fig 4.6 - Main challenge faced in the future (% farms)

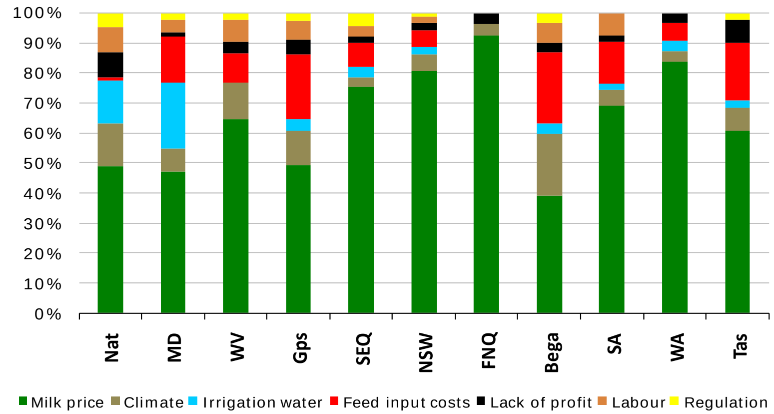
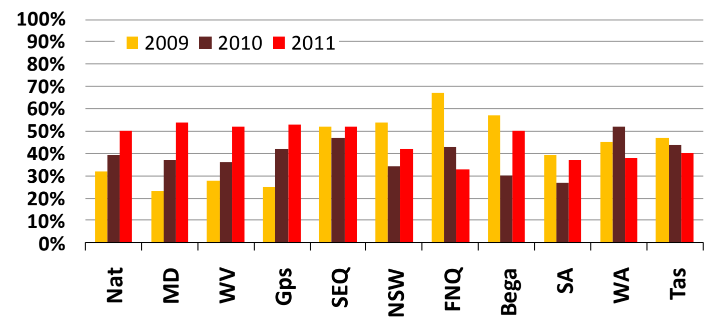


Fig 4.7 - % farms intending to invest in next 12 months (comparing 2009 and 2010 Surveys)



Production outlook

2010/11 production outlook

- The settings for the 2011/12 season are mostly positive. Favourable autumn conditions in most dairying regions, combined with plentiful food supplies and the prospect of stable milk returns for most producers are all positives for milk production.
- On the negative side, farmers are still dealing with the effects of floods on herd condition and feed supplies in some regions. Recent floods, cyclones and drought have resulted in 3% of dairy farmers nationally predicting smaller herd sizes in 2011/12 than would have occurred had the weather been more favourable. This translates to around 7,300 fewer cows milked next year (nationally) as a result of inclement weather.
- The Dairy Australia forecast for milk production in 2011/12 is for a modest increase to **9.3 billion litres,** based on the views of each of the major dairy companies across Australia and corroborated by analysis of the outcomes of the NDFS.
- However, if the favourable seasonal conditions are maintained and the expected forecasts for steady milk prices for southern regions is realised with a strong encouragement through opening prices, there could be some upside to this forecast.

Herd numbers

- As the national herd has contracted over the past decade, increasing volumes of live cattle exports have represented a greater proportion of the herd. When combined with farmers' apparent reluctance to invest in herd rebuilding in times of volatility in milk prices and incomes, it is increasingly difficult for the industry to increase cow numbers.
- Over the next 12 months, given favourable seasonal conditions, 38% of respondents to the NDFS expect to calve more cows than during 2010/11, compared with 25% predicting a reduced number.
- Changes in the national dairy herd based on survey responses suggests that the number of cows milked at the peak in the 2011/12 season may be 2-3% more than that in the 2010/11 season.
- The projected changes in herd numbers varies considerably region-to-region.

Fig 4.8 – projected changes in herd numbers to 2011/12

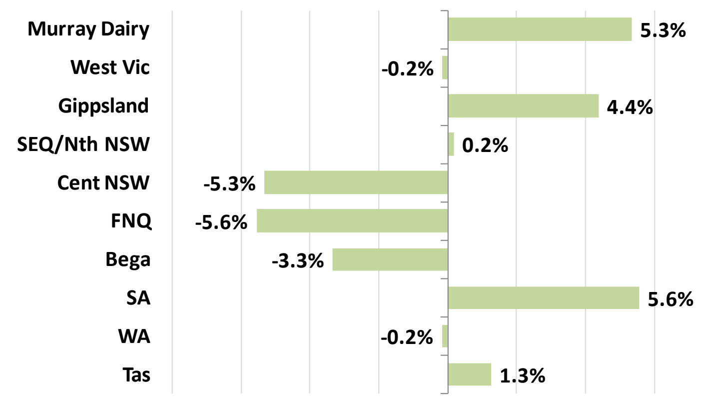
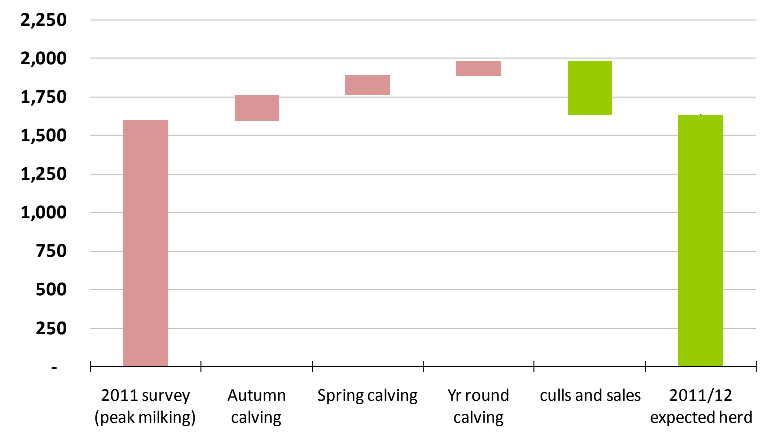


Fig 4.9 - Herd movements 2010/11 to 2011/12 ('000 milking cows)



- The national analysis combines regional estimates of heifer replacement rates, sales and cows milked with the national estimate of cows in milk and dry at 30 June, as published by the Australian Bureau of Statistics.

Production outlook

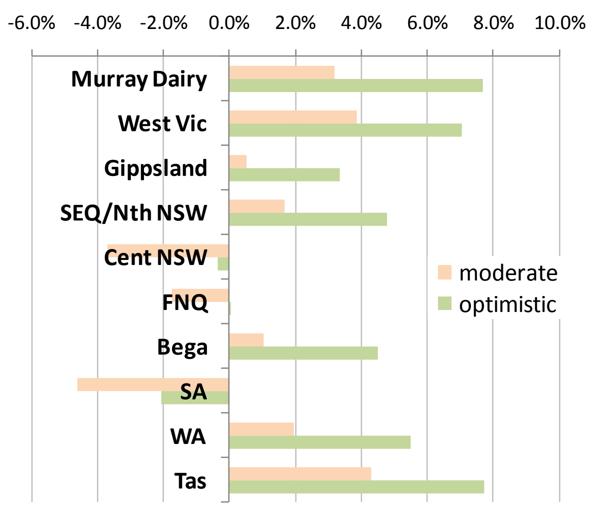
Medium term outlook

- The increasingly complex challenges facing the adaptation of production systems to climatic uncertainty and volatile market conditions, policy uncertainty with respect to carbon and water, and the difficulty for many in sourcing skilled labour and managing expansion affects the overall production outlook.
- Assuming a return to reasonable seasonal conditions, three year intentions from this year's survey indicate a scenario for milk production in 2013/14 of **between 9.2 and 9.5 billion litres**.
- This outlook reflects a reduction in the proportion of survey respondents intending to produce more milk in three years' time. The strong improvement in irrigation water availability and cost underpins stronger growth intentions in the Murray Dairy region.
- Despite good seasonal conditions and indicative milk prices however, the complexity and uncertainty of the operating environment has contributed to a higher proportion of producers in Western Victoria, Tasmania and Gippsland indicate no change in output in 3 years. Uncertainty regarding the stability of market access and pricing for Queensland and NSW producers has affected individual farm growth intentions.
- This page provides some possible scenarios for medium term Australian regional milk production based on indicators of future intentions that have been provided in the 2011 NDFS. Surveys provide indicators of intention and sentiment towards future farm production, rather than an aggregation of firm commitments. The scenarios provided show the difference in outlook between moderate and optimistic outlook views, based on the demonstrated performance of producers who intend to grow their business over the coming three years.
- The 44% intending to keep production at current levels, this is the largest proportion of farmers planning to keep production static in three years time recorded in the seven years of the survey.
- While the 2011 survey indicates a fairly conservative outlook for milk production growth, sustained milk prices and favourable seasonal conditions could see production increase further over the next three years.

Fig 4.10 – Scenarios for medium term Australian milk production

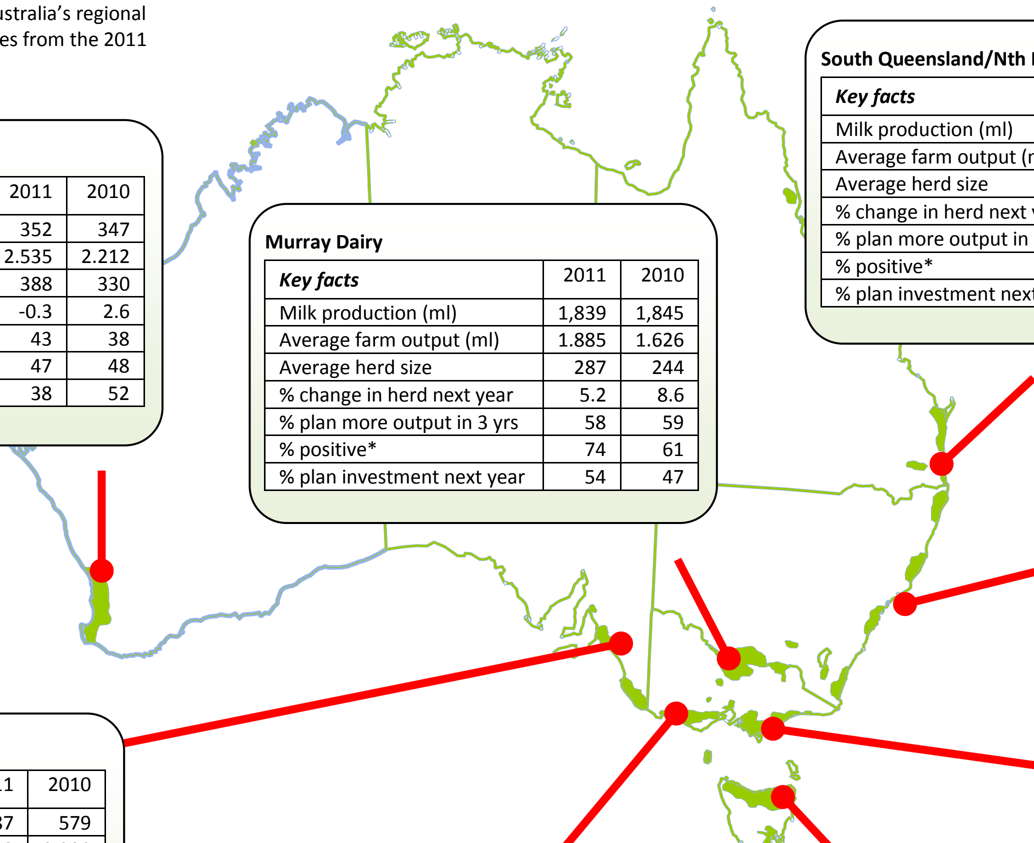
Segments of the production sector	Details	Range of outcomes 2013/14 (billion litres)
Growing	51% of milk production growing by 4-6%, representing production on farms that expect to have higher production in 3 years	5.1 to 5.4
Static	44% of production is on farms that expect similar production in 3 years	4.0
Declining	2% of production is on farms that expect lower production in 3 years	0.1
Leaving	3% exiting within 3 years	-
	Total 2013/14	9.2 to 9.5

Fig 4.11 – Milk production 2010/11 to 2013/14



Key regions at a glance

This page includes data from Dairy Australia's regional forecast milk production and outcomes from the 2011 and 2010 NDFS.



Western Australia

Key facts	2011	2010
Milk production (ml)	352	347
Average farm output (ml)	2.535	2.212
Average herd size	388	330
% change in herd next year	-0.3	2.6
% plan more output in 3 yrs	43	38
% positive*	47	48
% plan investment next year	38	52

Murray Dairy

Key facts	2011	2010
Milk production (ml)	1,839	1,845
Average farm output (ml)	1.885	1.626
Average herd size	287	244
% change in herd next year	5.2	8.6
% plan more output in 3 yrs	58	59
% positive*	74	61
% plan investment next year	54	47

South Queensland/Nth NSW

Key facts	2011	2010
Milk production (ml)	606	606
Average farm output (ml)	1.005	0.966
Average herd size	177	191
% change in herd next year	-1.7	0.5
% plan more output in 3 yrs	44	43
% positive*	50	71
% plan investment next year	52	47

Central Southern NSW

Key facts	2011	2010
Milk production (ml)	720	704
Average farm output (ml)	1.260	1.416
Average herd size	205	214
% change in herd next year	-5.4	-4.7
% plan more output in 3 yrs	44	34
% positive*	46	66
% plan investment next year	42	34

South Australia

Key facts	2011	2010
Milk production (ml)	587	579
Average farm output (ml)	2.233	2.290
Average herd size	288	293
% change in herd next year	3.8	10.3
% plan more output in 3 yrs	50	37
% positive*	45	50
% plan investment next year	37	27

Western Victoria

Key facts	2011	2010
Milk production (ml)	2,119	2,108
Average farm output (ml)	1.828	1.760
Average herd size	300	281
% change in herd next year	0.3	0.1
% plan more output in 3 yrs	42	51
% positive*	74	72
% plan investment next year	52	36

Tasmania

Key facts	2011	2010
Milk production (ml)	747	717
Average farm output (ml)	2.117	1.585
Average herd size	370	322
% change in herd next year	1.1	-0.4
% plan more output in 3 yrs	47	54
% positive*	75	71
% plan investment next year	40	44

Gippsland

Key facts	2011	2010
Milk production (ml)	2,281	2,155
Average farm output (ml)	1.595	1.541
Average herd size	267	264
% change in herd next year	4.5	2.7
% plan more output in 3 yrs	42	50
% positive*	80	65
% plan investment next year	53	42

*% of respondents positive about the future of the national industry

Dairy Australia
Your Levy at Work

Chapter 5

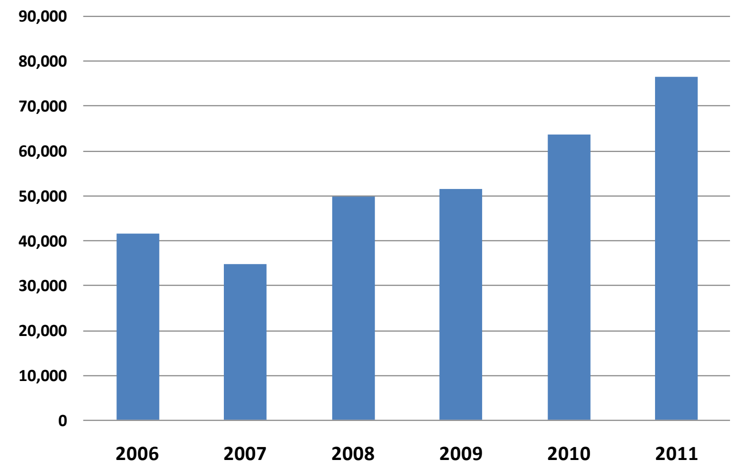
Production inputs and resources

Cow and heifer markets

Cow and heifer trade

- Dairy heifer export data available for the twelve months to February 2011 indicates that the total number of animals exported increased strongly by 21% over the previous 12 months. The 76,600 head of exported cattle were valued at some $A 151 million. With the national herd at approx 1.6 million cows, live export heifers now account for about 5% of milking cows - a record high level.
- China was the largest market for heifers over the last twelve months with 66% (up from 60%); Russia with 15% (2%); and Middle Eastern countries with 6% (7%). Indonesia's share has fallen from 25% last year to 1% this year, reflecting changes to the country's import regime.
- Tightening Chinese Government regulations are increasing the costs of and the access to the country's heifer business, which could reduce exports later in 2011.
- Nevertheless, this trade is likely to be picked up by strong demand in other markets such as Mexico, Indonesia, Turkey and more recently Korea and Taiwan where large numbers of the local dairy herds have been culled due to a severe foot and mouth disease outbreak.
- According to the 2011 NDFS, the proportion of heifers sold for export slipped slightly to 4.1% in 2010/11 from 4.4% last year. While Victoria is the largest source of export dairy heifers in absolute numbers, the proportion is traditionally highest in Western Australia. In a drought-affected WA this season, the proportion of heifers sold for export jumped from 6% last year to 26% this year – with 57% of farms selling export heifers compared to 15% of farms nationally. Heifer exports have been a valuable source of income for many dairy farmers in difficult times.
- Cull cow sales volumes were up 8% in the six months to March 2011, influenced by floods in early 2011 and farmers looking to cash in on high beef prices. This follows a fall of 24% in the previous six months to September 2010, which reflected the positive seasonal conditions and price outlook coming into the 2010/11 season.
- Overall for the 12 months to March 2011 cull cow volumes were 13% below the previous year and the lowest in seven years of available data.
- Results from the 2011 NDFS suggest 15% of the milking herd was culled – the same level as in the 2010 survey – and ranged from lows of 13% in Tasmania and 14% in Victoria, up to a high of 25% in South Australia.

Fig 5.1 – Live dairy cattle exports (12 months to February each year)



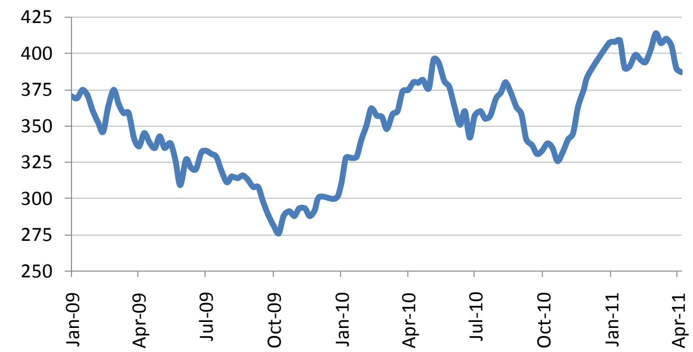
- The prospects of continuing firm milk prices, plentiful feed supplies, good soil moisture, plentiful water in storages and positive indications for water allocations have maintained competition for autumn-calvers in recent months. Export demand has also added to this pressure on prices. Average prices are difficult to ascertain, but it would appear that current prices are around $1,500 to $2,000 again this year.
- The 2011 NDFS results suggest less than 1% of heifers were sold domestically – well down from 1.9% last year – as farmers retained more cattle to take advantage of firm milk prices.

Cow and heifer markets

Beef market

- The decade long drought in south-eastern Australian, which led to a decline in the beef herd over the last five years, has ended with record breaking rains over the past season. Pasture conditions on the east coast are generally excellent with deep soil moisture and plentiful feed.
- Global beef demand is growing and local restocker demand will keep beef cattle prices strong.
- A second year of inland Queensland flooding has resulted in considerable disruption to the industry in many regions, but stock losses appear to have been low as a portion of the national herd.
- Meat & Livestock Australia (MLA) are forecasting a period of expansion of the Australian cattle herd.
- In view of the much improved conditions, ABARES is also forecasting a gradually increasing herd size over coming years, combined with a moderate increase in Australian beef exports – with growth impacted by import restrictions put in place by Indonesia on both beef and live cattle from Australia.
- Consequently, the much improved pasture conditions, despite slightly higher beef prices, are expected to reduce the demand for feed grains from the feed lot sector – at least in the next season or two.
- The US market for manufacturing beef has been firm through most of 2010/11 due to shortages in the US beef herd and a reduction in dairy culls. The returns in AUD have been lower than what may have been possible due to the weakness of the US dollar.

Fig 5.2 – US 90CL "cull cow" prices in Aus cents/kg

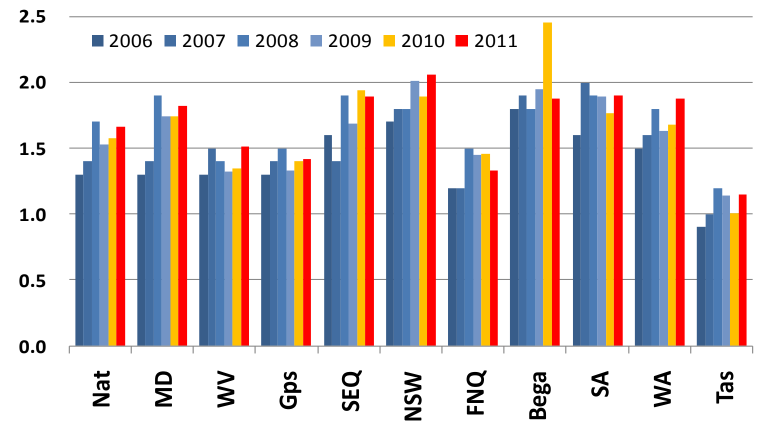


Outlook for feed inputs

Feed usage

- Purchased feed is the largest single cost item for dairy farmers – representing an estimated 28% of average of dairy farm cash costs in 2010/11 according to ABARES analysis – falling from 30% last season and over 35% the prior season. This figure has reduced due to better seasonal conditions across the southern dairying regions and the fall in feedgrain prices.
- According to the NDFS, about 95% of Australia's dairy herd of 1.6 million milking cows consumed an average 1.66 tonnes of grain, mixes and /or concentrates in 2010/11 for a total feed grain requirement of around 2.5 million tonnes. Despite better pasture and forage conditions, national average usage per cow was up slightly on last year's 1.58 tonnes.
- Further analysis of NDFS findings shows that the proportion of farms feeding more than 1.5 tonnes of grain increased in 2011, taking advantage of lower grain prices for much of the year. At the other end of the spectrum, in a number of regions, farms with low feeding levels took the opportunity to increase their pasture intake, leaving the overall average slightly higher.
- In an environment of volatile grain prices during the second half of 2010 and into 2011, 85% of dairy farmers have purchased grain 'as required' – unchanged from last year – with no change in the proportion buying on forward contract at 15%.
- There is a continuing trend for farmers to buy grain from feed mills (up 5% to 50%); and away from feed merchants (down 3% to 31%) and direct from growers (down 2% to 21%). Better seasonal conditions meant that a lower proportion of farmers purchased hay and silage this season – down from 61% to 53%. Conversely, the trend to purchase hay and silage direct from growers for those who bought in fodder, is up from 72% to 78%.
- Analysis of the current season indicates a 'milk price to feed grain price ratio' improving from 1.50 to 1.60 for feed wheat (the best figures in five years); but slipping from 2.00 to 1.80 for barley.
- This ratio improves significantly over the current season as higher second half milk prices take effect – lifting from 1.30 for feed wheat during the first six months to an estimated 1.85 for the current six months. Similarly, barley has lifted from 1.55 to an estimated 2.00 over the season.

Fig 5.3 - Average grain usage per cow per annum (tonnes)



Global feedgrains market

- World prices for grains and oilseeds increased substantially in 2010 and into 2011, primarily due to production shortfalls in some of the major exporting countries. Lower production combined with strong demand has also resulted in a general drawdown of global grain and oilseed stocks, particularly for corn, which is the main feed grain used in the world.
- ABARES is forecasting that grain and oilseed producers will respond to current high prices by increasing production next season and this will put downward pressure on world prices in 2011/12.
- World wheat production is forecast to increase by 4%. World coarse grains and oilseeds production is forecast to increase by 6% and 5% - to 1.1 billion tonnes and 467 million tonnes respectively.
- World consumption of wheat is forecast to increase by 2% to 670 million tonnes in 2011/12. An important contributor to this rise is increased demand for feed wheat, as intensive livestock producers seek alternatives to corn because of increasing corn prices. Food consumption of wheat is forecast to rise in line with population growth.
- The International Grains Council is forecasting a rise in wheat output of some 4% in 2011/12, to 673 million tonnes, so that world supply and demand are

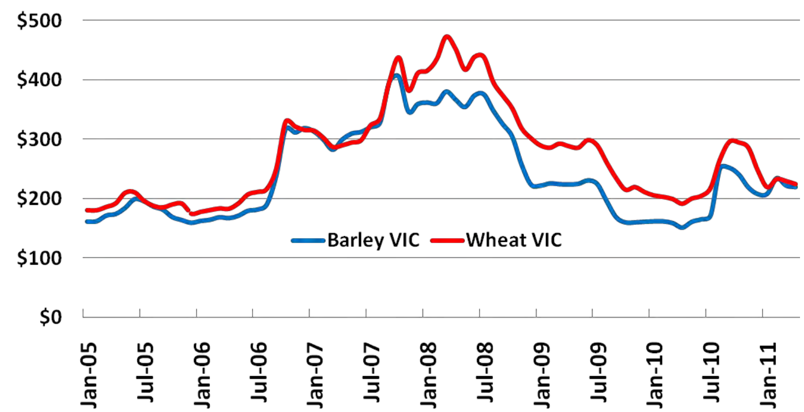
projected to be broadly balanced. Surpluses in the major exporters are expected to be adequate to meet a forecast upturn in 2011/12 imports; assisted by some recovery in the Black Sea region and by ample old crop stocks in other countries, notably the US and Australia.

- The April-May period is critical for global grain crops as unfolding weather conditions will determine the size of the 2011 northern hemisphere harvest and the area of southern hemisphere plantings - with resulting implications for stock levels and prices.
- Geopolitical events are adding to increased price volatility – together with a return of fund manager speculation as food commodity prices increase. Political unrest in North Africa and the Middle East is leading to significant demand as a hedge against rising food prices and concerns about food security issues. Some countries have also removed import tariffs so that an influx of imported grain can dampen local prices.
- US wheat futures continue to be supported by increased demand from Middle East and North African countries; tight global stocks and limited availability of quality milling grades; and concerns over the southern US winter crop as it comes out of winter into spring.
- Tight global feed grain stocks are providing price support to feed grade wheat which currently make up a greater than normal proportion of global stocks – with Asian consumers moving from high-priced US corn to Australian-sourced feed wheat and sorghum.

The influence of biofuels

- Conflict in the Middle East is also pushing oil prices higher. As oil rises, corn follows as ethanol crush margins are increased. With 40% of US corn now being consumed by the local ethanol industry, biofuel demand will be a major influence of corn prices in the future. Corn is the biggest crop in the world, and it dictates the direction of wheat and oilseeds prices.
- A wild card in the corn demand picture, however, is whether US Congress will extend ethanol subsidies at the end of 2011. If they don't, then ethanol margins could turn negative and significantly reduce corn demand, thus easing supply issues.
- Global industrial use of vegetable oils (primarily biodiesel) has increased markedly as a result of government policy in EU countries, Argentina, Brazil, Malaysia and the United States. In 2010/11, around 33 million tonnes of vegetable oils were for industrial use, compared with just 9 million tonnes a decade ago. The industrial use of vegetable oils is expected to continue to rise because of biodiesel mandates in these countries.

Fig 5.4 – Victorian grain price trends - $/tonne



Australian market

- ABARES' February 2011 Crop report found that the excessive rainfall from November 2010 to January 2011 significantly lowered the quality of the harvested crop and resulted in the loss of some crops because of flooding and fungal disease.
- Nevertheless, reports are that yields were at, or near, record highs in the eastern states. Conversely, while the Western Australian cropping zones had their driest year on record, the yields achieved were higher than earlier expectations.
- The national wheat crop is estimated to have been up 20% to 26.3 million tonnes (which is 42% up on the five-year average); while the barley crop is expected to be 18% larger at 9.3 million tonnes (27% up on the five-year average). Consequently total winter crop production for 2010/11 is estimated to be around 42.1 million tonnes, 19% higher than last season.
- Most reports suggest that around half of the wheat harvested this season was down-graded to livestock feed-grade – with increased exports going to meet

Outlook for feed inputs

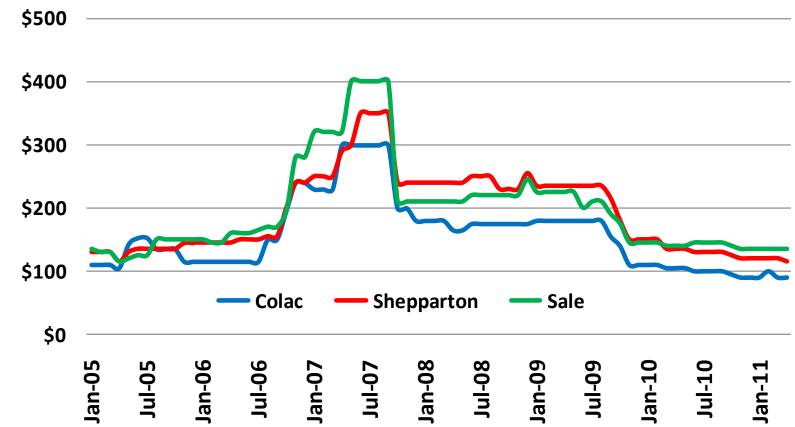
growing demand from the livestock sector in east Asia in line with increased demand in that region.

- According to ABARES favourable prices and a high soil moisture profile in many eastern grain growing regions to result in a 3% increase in the area planted to wheat in 2011/12. However, with a forecast decrease in yields from last season's record highs, the wheat crop is forecast to decline to 24.3 million tonnes in 2011/12. Barley volumes are forecast at around 8.8 million tonnes.
- Australian Crop Forecasters [ACF] are currently forecasting a 4% increase in area planted to wheat in 2011/12, and combined with a 12% decline from record average yields, to deliver a total wheat crop of 24.9 million tonnes - with downside risk coming from the persistent dry weather in WA. The barley crop is forecast at 8.1 million tonnes.
- Rabobank's early forecast for the 2011/12 Australian wheat crop is currently at 25.2 million tonnes, while NAB's early forecast is for 24.75 million tonnes.
- The risk of continuing poor soil moisture conditions – for a second consecutive year - in Western Australia is rising and could limit high quality wheat from Australia; while the continuing wet conditions on the east coast could delay winter plantings.
- Local prices are not following US futures at the present time – for a number of reasons. Local feed grain stocks at very high levels as many domestic traders having bought sufficient tonnage for their needs. Local demand has been limited due to plentiful pasture for both dairy and beef producers. In addition, local logistics are stretched with export terminals at full capacity, while the high Australian dollar masking overseas price movements and keeping local prices relatively stable.

Fodder

- At least a third of Australia has received rainfall in the top 10% of records available and the majority of Victoria experienced its highest summer rainfall on record.
- Consequently, the abundance of pasture feed and low prices for water is inhibiting the demand for hay - particularly in south-eastern Australia. Many farmers are already sowing annual ryegrasses and within six weeks will have more grazing options. There are reports that some farmers were already making autumn hay in March.

Fig 5.5 – Victorian pasture hay price trends - $/tonne



- A lacklustre hay market is having a negative effect on the acreages sown with the intention of cutting as a hay crop. Most hay producers intend to sow 15-30% less hay than last year.
- Many dairy farmers have not required access to the silage and hay stored from spring as yet. However, those that have are reporting lower than average quality with low protein levels this year, as persistent spring rains made curing difficult.

Medium term outlook

- Growth in the biofuel sector will continue to be a key driver of demand for grains and oilseeds, and land-use choices by producers – particularly in the US, the EU and China. The future direction of Government policies and support for biofuel production and the transition to 2nd generation biofuel technologies will be critical to the rate of growth in demand for plant-based inputs to fuel production.
- The growth in world demand for food and the unreliability of seasonal conditions in key production countries will increasingly put pressure on grain supplies and ensure market volatility continues.
- China's rapidly expanding urban demand for nutritious foods and the pressures on arable land availability will combine to increase that country's influence on

Outlook for feed inputs

global food and feed grain markets. The decisions made by China as to how it satisfies national food security across a mix of potential food and feed grain sources will influence market prices in most related commodities given the sheer size of its potential future requirements.

- In Australia, the improved prospects for livestock sectors other than dairy that consume feed grain (with higher prices for wool, lambs, feedlot beef) may trade-off with grain growing in the wheat/sheep belt of eastern Australia in coming seasons.

Fertiliser

- Fertiliser cost is a significant cost item for dairy farmers – representing an estimated 7.6% of average of dairy farm cash costs in 2010/11 according to ABARE analysis – lifting from 7.0% last season and 6.8% the prior season.
- The Middle East crisis has had surprisingly little impact on fertiliser markets with urea prices in particular quite weak – although the on-going uncertainty remains a wildcard.
- International fertiliser markets started to move upwards in April; with the strongest increases in phosphate and potassium markets. Nitrogen was trending down through to the end of March, but has now turned around and is following the other components up.
- Price increases are reported to be a short term rally due to current supply tightness. However, increased supply out of China in the third quarter of 2011 is expected to hold prices steady.
- The counter view is that on-going strength of international oil prices will most likely see nitrogen prices rise – driven by the associated natural gas and ammonia prices.
- Domestic fertiliser markets were slow during the first quarter of 2011 from lower applications of fertiliser due to the generally wet conditions and floods in the eastern states. Consequently, stocks were reportedly high and needed to be cleared.
- In AUD terms, international nitrogen prices have fallen more than 10% since January and the other major components have pretty much held their ground. The dairy mix index has come back to the same level as October / November 2010. At the end of April it was just 16% above the 2006 benchmark.
- With no sign of a fall in the AUD in the short term, and projections of weaker international prices in the second half of 2011, expectations are for on-going stability of fertiliser prices.

Fig 5.6 Indicative Australian fertiliser prices ($A/tonne)

	Dec 10	Mar 11	June11 (f)
Urea	$540	$540	*$500 - $550*
DAP	$777	$770	*$750 - $800*
Single super	$330	$325	*$300 - $350*

Source: X-cheque

- However, both Rabobank and the NAB expect fertiliser prices to firm over the second half of the year; with high prices for agricultural commodities likely to encourage fertiliser use over the coming year – due to larger areas being planted and farmers increasing application rates to maximise yields.

Outlook for feed inputs

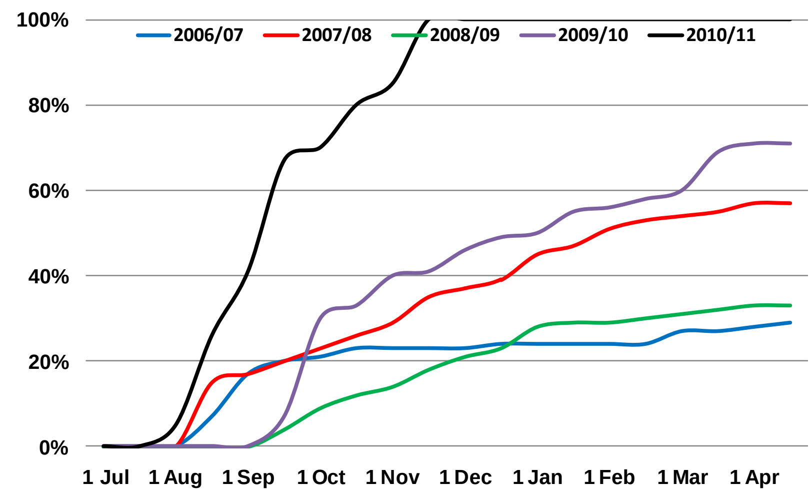
Water Availability in southern regions

- One of the strongest La Niña events on record has led to the Murray-Darling Basin water storages having their wettest year on record and increasing from 26% of capacity in December2009 to over 80% in December2010.
- As early as the end of November 2010, Goulburn-Murray Water (G-MW) had announced sufficient allocation increases across the Goulburn and the Murray system, together with allocations for the smaller systems, such that all the northern Victorian irrigation water systems had a 100% allocation for high-reliability water shares for the first time since 2001/02.
- The consistent rainfall throughout the season means that storage volumes are very high for this time of the year. However, deliveries are at record low levels. Consequently, there is an expectation that large volumes of water held in storage will be carried over into the 2011/12 season in all systems.
- Water storage levels in the Goulburn-Murray system in northern Victoria have greatly improved this season. Combining this situation with low water usage, and high levels of carryover water, there is probably at least two years of irrigation water availability in northern Victoria and southern NSW providing more certainty on this input for many years.
- Water trading volumes for the March quarter were down 66% on last year. By late March prices had dropped to just $5 /ML – compared to $145 /ML at this time last year, and a peak of $1,050/ML in October 2007.
- G-MW has released its first outlook for 2011/12 seasonal allocations. Assuming average rainfall and inflows, the initial outlook is to deliver a 36% allocation on the Goulburn and an 18% allocation on the Murray on 1 July 2011 – the first 1July allocation in over a decade.
- The early outlook for mid-October 2011 is for 92% allocation on the Goulburn system and 53% on the Murray system - rising to 100% on all systems by mid-February 2012.

Rainfall outlook

- The national outlook for rainfall over the quarter to July shows a moderate to strong shift in the odds favouring a wetter than normal season over eastern Australia. The outlook is for average rainfall elsewhere across Australia.

Fig 5.7 – Goulburn Murray Water allocations % of High Reliability Water Shares



- The La Niña event in the Pacific Ocean continues to weaken after reaching peak intensity in early-January. All available climate models suggest further weakening of the La Niña is likely through the southern hemisphere autumn, with a return to neutral conditions by winter 2011.
- However, the Southern Oscillation Index (SOI) remains strongly positive at the end of April and has been consistently positive since April 2010. A positive SOI is historically correlated with wetter conditions in the eastern states.

Water policy developments

Murray Darling Basin

- The draft Murray Darling Basin Plan is expected to be released in mid-2011. The Federal Government intends to approve the final Basin Plan in early 2012 following a 16-week community consultation phase and negotiation with the Basin State Governments.
- The Basin Plan is intended to:
    - Set and enforce sustainable diversion limits (SDLs) on surface and groundwater use.

Outlook for feed inputs

- Set Basin-wide environmental, water quality and salinity objectives.
- Develop efficient water trading regimes.
- Improve water security for all users.

- The States are expected to implement the SDLs in their next State Water Resource Plans, which are expected to be aligned to come into effect in 2019.
- The final Plan could have far-reaching implications for dairying in the Murray Darling Basin, depending on how much water now available for production is reduced to meet the SDLs.
- In October 2010, the Murray Darling Basin Authority (MDBA) released the 'Guide to the proposed Basin Plan'. It proposed reducing current surface diversions by 3000 to 4000 billion litres of water. This translated to an average 27-37% reduction, and up to 45% in some river valleys.
- For irrigated dairy in northern Victoria and southern NSW, this would mean a permanent 'drought', as the volume of water allocated to use and trade in average years would be much the same as during the worst of the drought between 2006 and 2010. This could prevent milk production recovering to pre-drought levels and contribute to regional factory closures and job losses.
- The Guide was widely criticised for its narrow scientific justification and inadequate socio-economic analysis. The regional and political backlash has prompted more in-depth analysis by the MDBA and a parliamentary committee to inform the draft Basin Plan, including how the SDLs are calculated.
- The Federal Government has promised that no licensed water entitlements will be compulsorily acquired or reduced to achieve the SDLs. Rather, buybacks will remain voluntary. This will protect the reliability and security of water supply for individual licence holders, but buybacks inevitably still mean a smaller overall pool for consumption. As of 31 March 2011, more than 966 billion litres of water entitlements had been purchased and removed from production.
- The dairy industry is actively engaged with State and Federal Governments and the MDBA to develop a better Plan for the Basin. It is seeking:
  - Greater investment in on- and off-farm irrigation upgrades to save water for the environment without undermining productive potential.
  - Investment in environmental works and measures to reduce the water volumes needed to achieve improved environmental outcomes in key sites.
  - SDLs to take account of previous efforts to increase environmental flows and outcomes through programs such as the 500-billion-litre Living Murray Initiative.
  - Buybacks as a last resort, strategically integrated with infrastructure investment to avoid the 'Swiss cheese' effect undermining the overall viability of irrigation districts.
  - A comprehensive Plan for the Basin integrating regional development, industry growth, water availability and funding programs across all relevant State and Federal agencies.

Other catchment developments

- Water policy reforms affecting dairy outside the Basin include South Australia's Water Allocation Plans for the Mount Lofty Ranges and the south-east, and Victoria's Sustainable Water Strategies.
- SA's Water Allocation Plans will set limits on surface runoff and watercourse diversions, and groundwater extraction. Water use will be licensed and regulated on the basis of these limits.
- On the Fleurieu Peninsula in the Mount Lofty Ranges, dairy farms' water access may be substantially reduced, ostensibly to protect endangered swamps; the industry is seeking an independent review of the scientific basis for the proposed 10% diversion limit. In the south-east, the degree to which timber plantations must account for their water use will determine water availability for dairy.
- In south-west Victoria and Gippsland, dairy industry growth is constrained by the availability of water for new entrants. Policy solutions through the Sustainable Water Strategies include the conversion of 15-year licences to licences-in-perpetuity, to encourage long-term investment; and facilitating freeing up unused water through trade in catchments where licences are underutilised.
- In April the Federal government endorsed Tasmania's largest irrigation development project under the Environmental Protection and Biodiversity Conservation Act. The $88 million Midland Irrigation Scheme has the potential to provide water for 500 farms, and could provide a significant platform for growth in the State's dairy industry.

Attachment 3 – Fresh Logic presentation on northern dairy industry confirms a range of factors are affecting farm gate prices

“Changes in contract access mean certain volumes of milk are unprofitable – Tier 2 pricing is the signal.”

“National Foods loss of (Woolworths) private label (contract) in NSW – equals a 2 cents per litre change, a 2 cents shift in the Australian dollar – equals 1.25 cents per litre change - the impact of shift in private label volumes – equals 1 cent per litre change.”

Northern dairy industry

2011 situation & outlook

Steve Spencer

Freshlogic

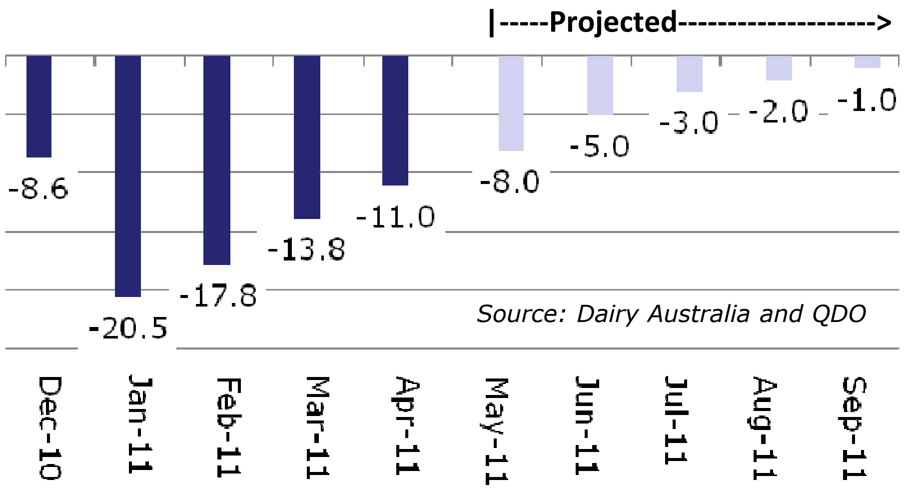
Headlines in the outlook

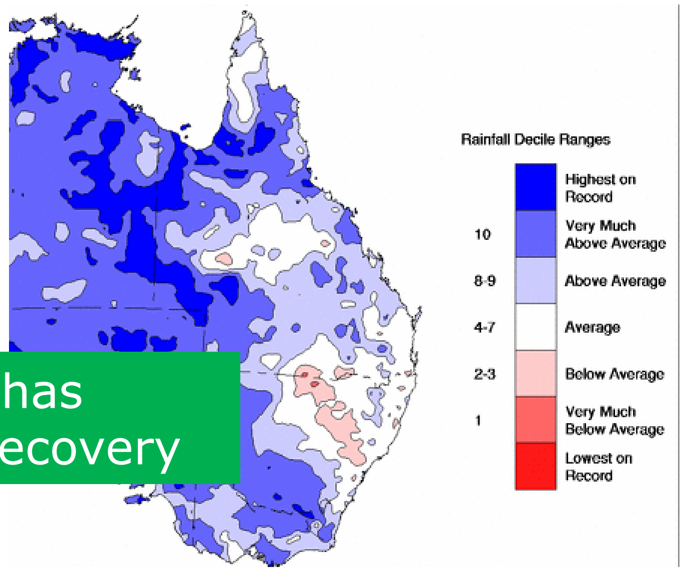
- Supply:demand balance has tightened
  - Weaker margins for producers has curbed output
  - Losses due to severe impact of floods
- Local fresh milk demand is sluggish but better
- Intense retailer competition has reduced fresh milk returns & dislocated stability
  - Switching private label suppliers
  - 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

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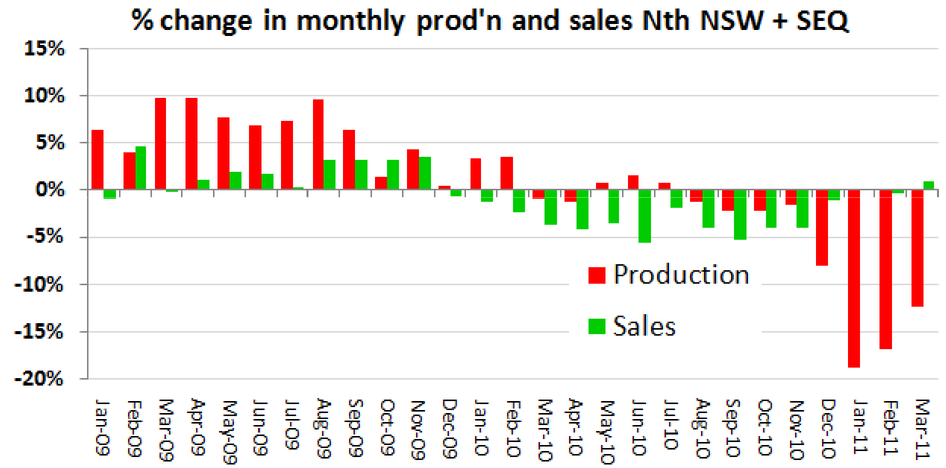
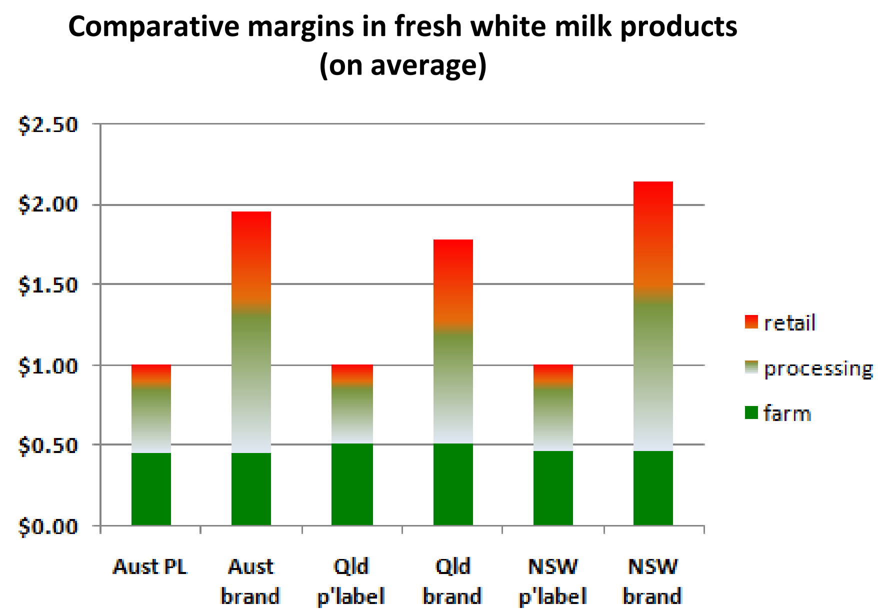
Regional market has weakened

- 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





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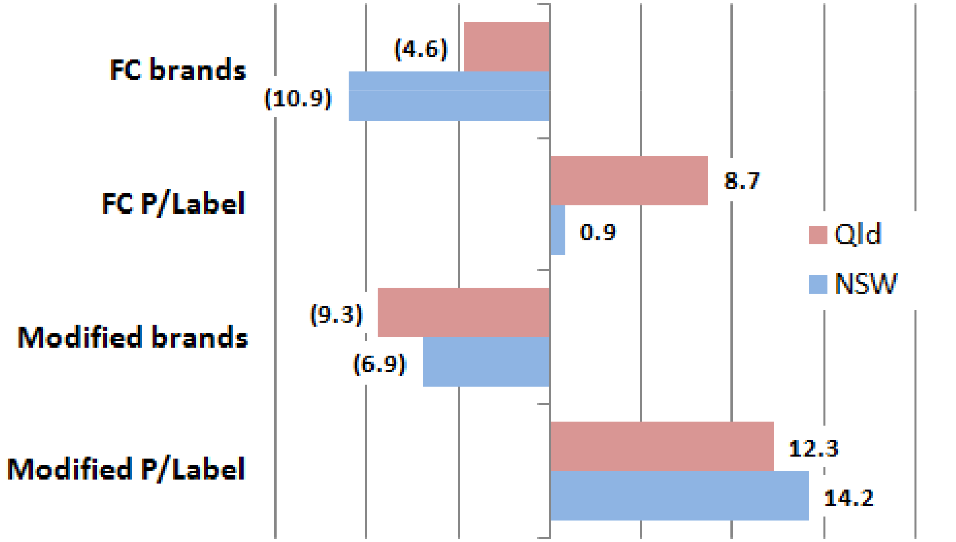
Milk discounting

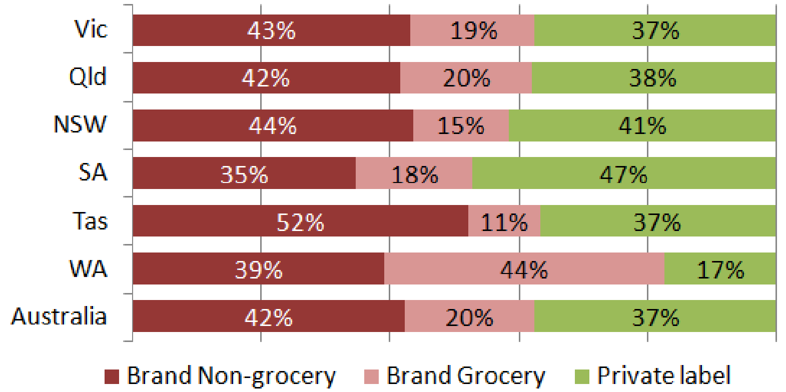
- Risks
  - Higher % of sales of lower-priced products
    - shift in sales within the grocery store
    - from convenience and food service outlets to grocery stores
  - Weakens overall wholesale returns to processors
  - A flow-on to farmers in reduced farmgate prices.
  - Weakens brands in fresh white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

Estimated annualised effect in milk sales (mill litres)



Source: Freshlogic using Dairy Australia data

Share of channel sales (last 12 months)



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Milk discounting

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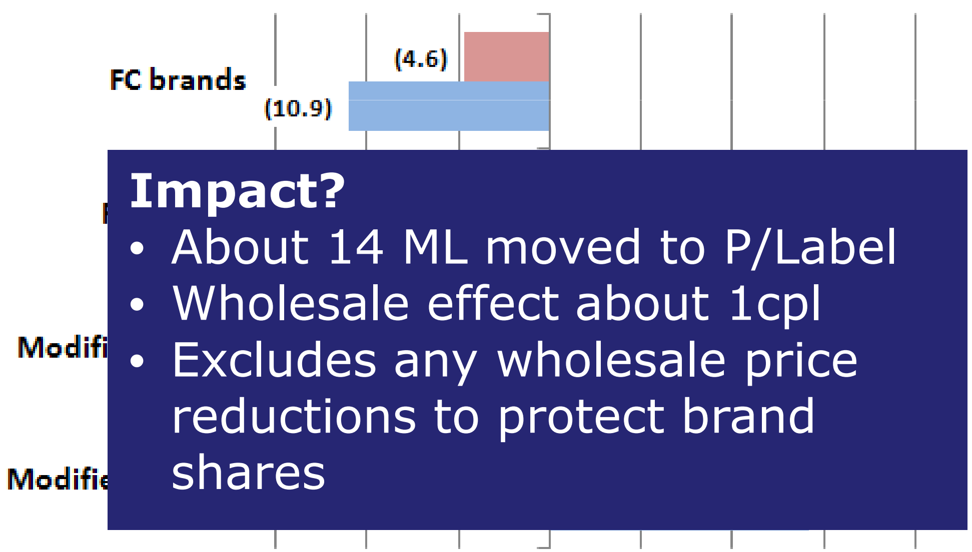
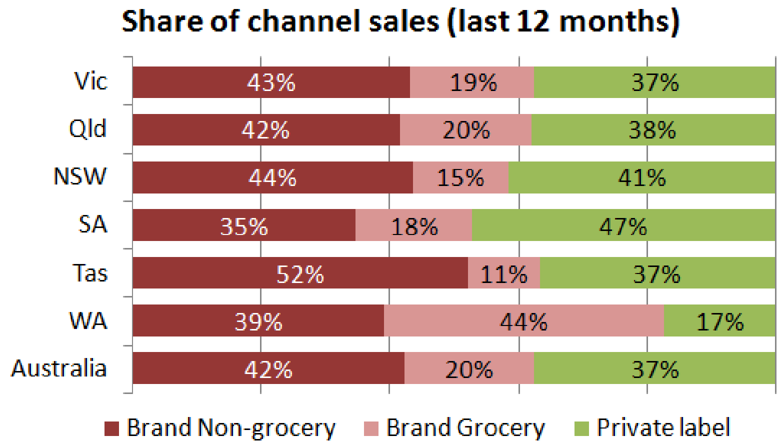


Impact?
- About 14 ML moved to P/Label
- Wholesale effect about 1cpl
- Excludes any wholesale price reductions to protect brand shares



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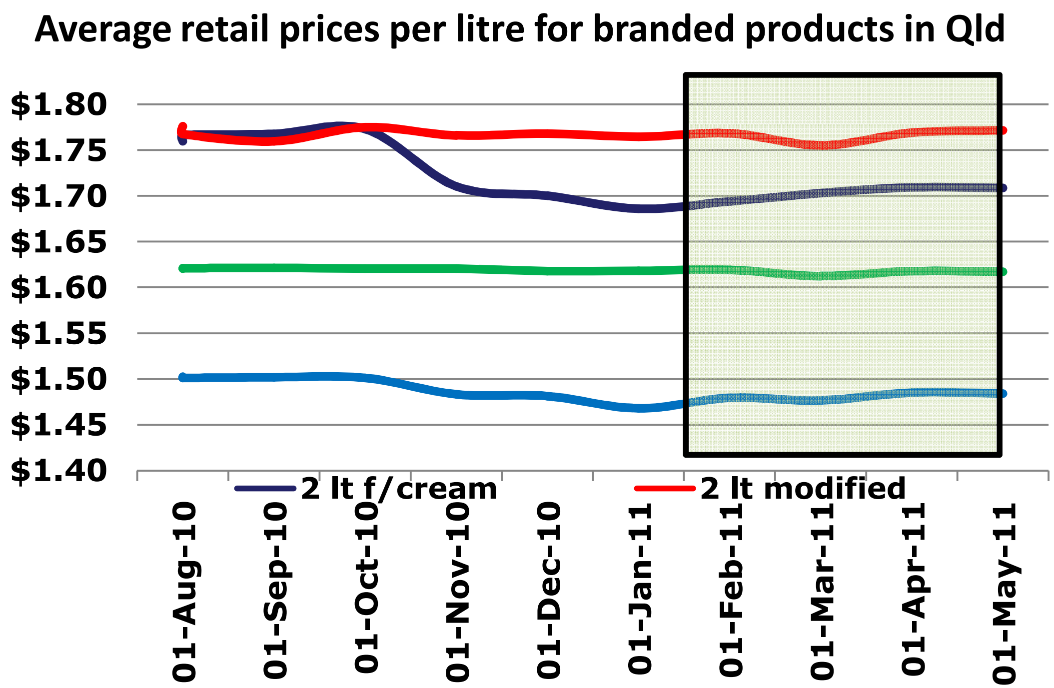
Retail price movements (grocery)



Source: Dairy Australia

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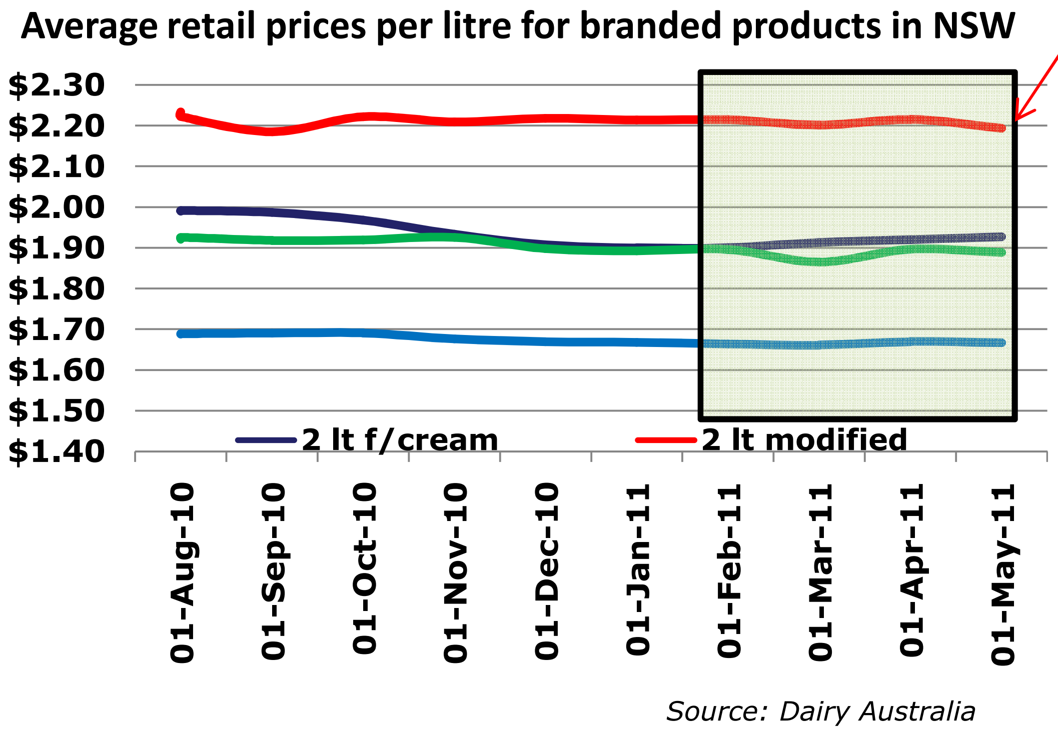
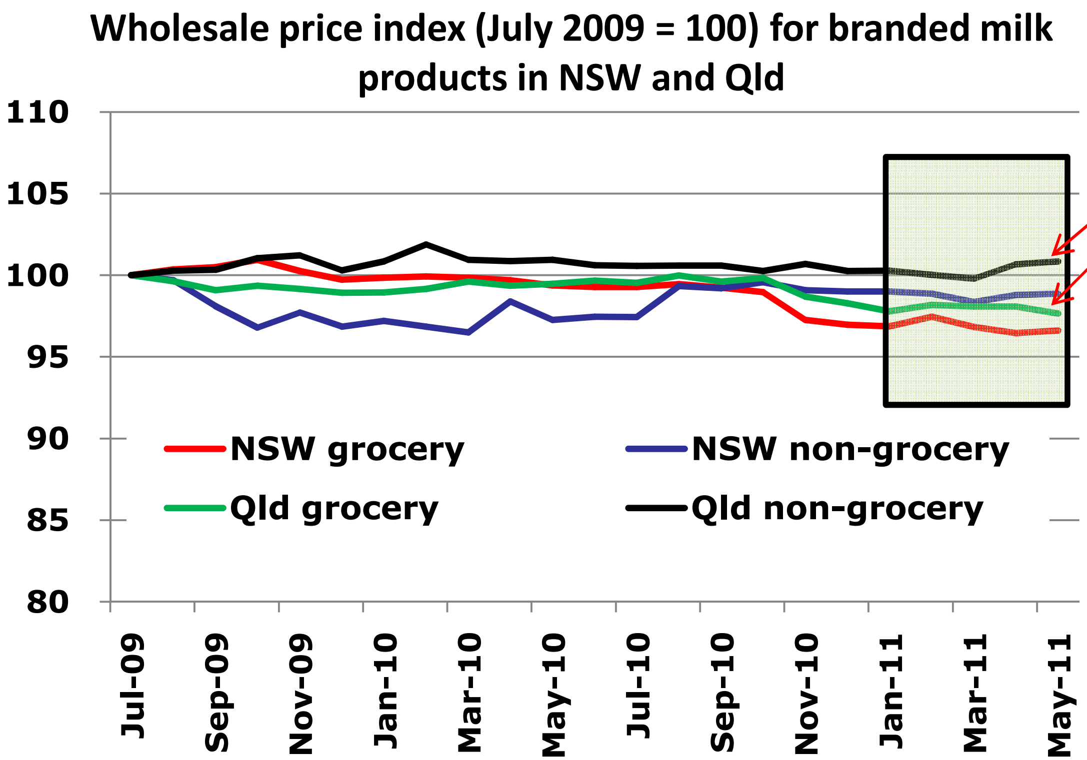
Retail price movements (grocery)



2 and 3 litre modified products are back to pre-discount levels, full cream milk prices have risen slightly since Australia day

Wholesale price movements



Source: Dairy Australia

Qld grocery lost 1pt which was offset by a gain in non-grocery of the same amount (which is a much larger channel for brands)

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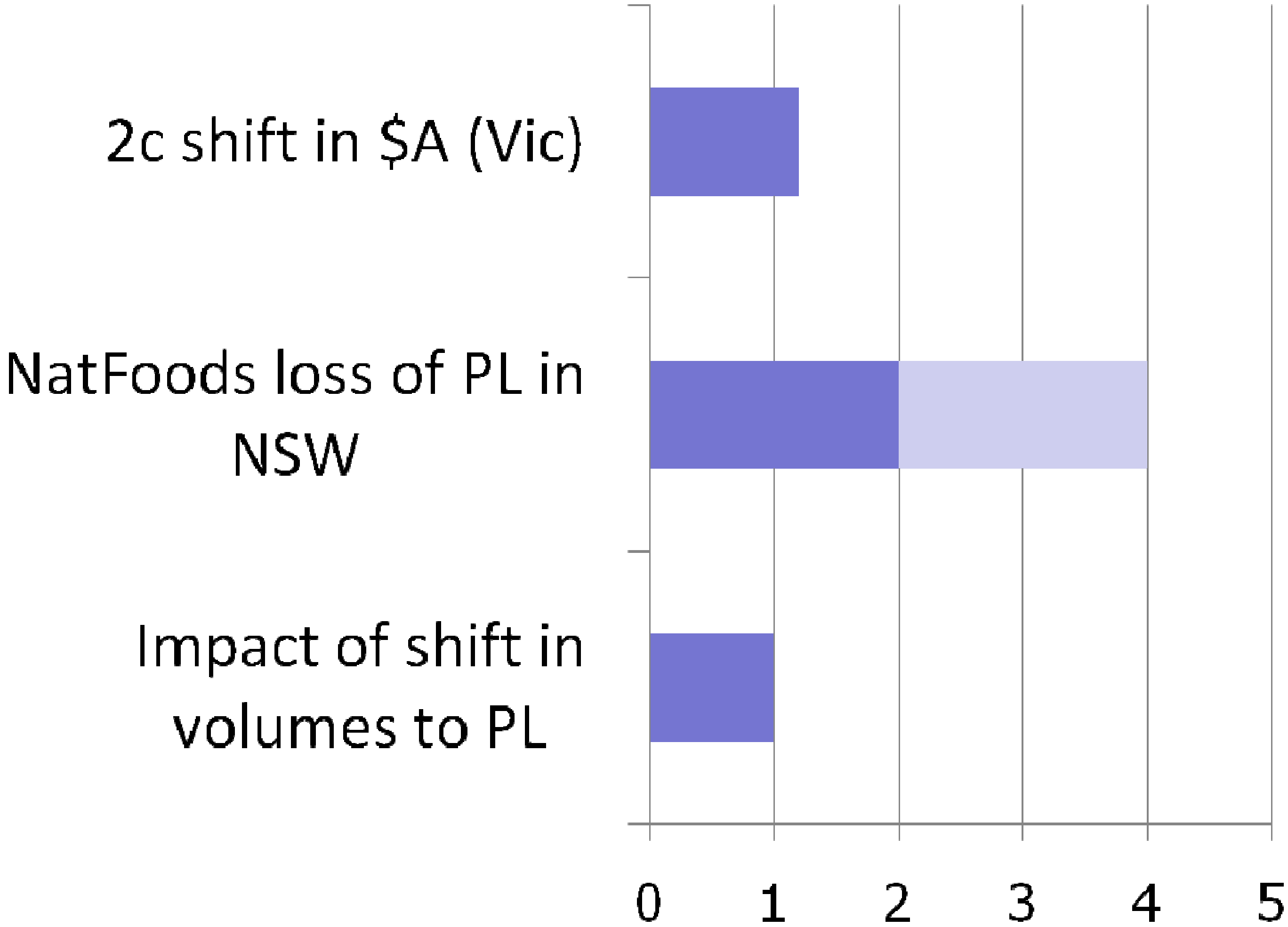
Other pricing information

- Freshlogic tracks retail promotional activity through Adwatch, which logs all food product content in a database for analysis
- A “line” of promotion is counted as an occurrence each week in each state
- Since Australia Day, in Qld, Pauls and NatFoods products have been specialled in catalogues on just 3 occasions
- Dairy Australia advises that any specialling activity is captured in the level of scan data they purchase

Milk discounting in context



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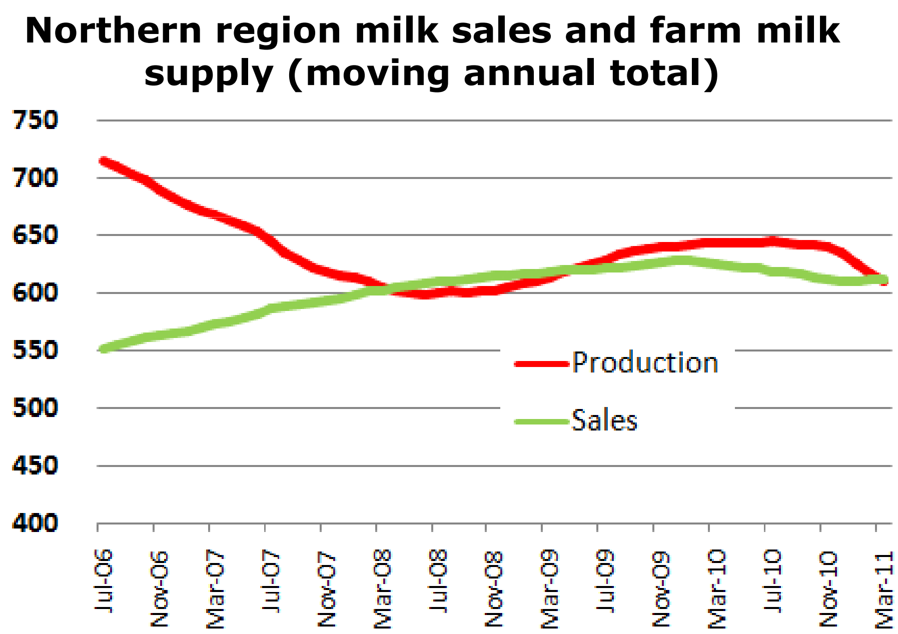
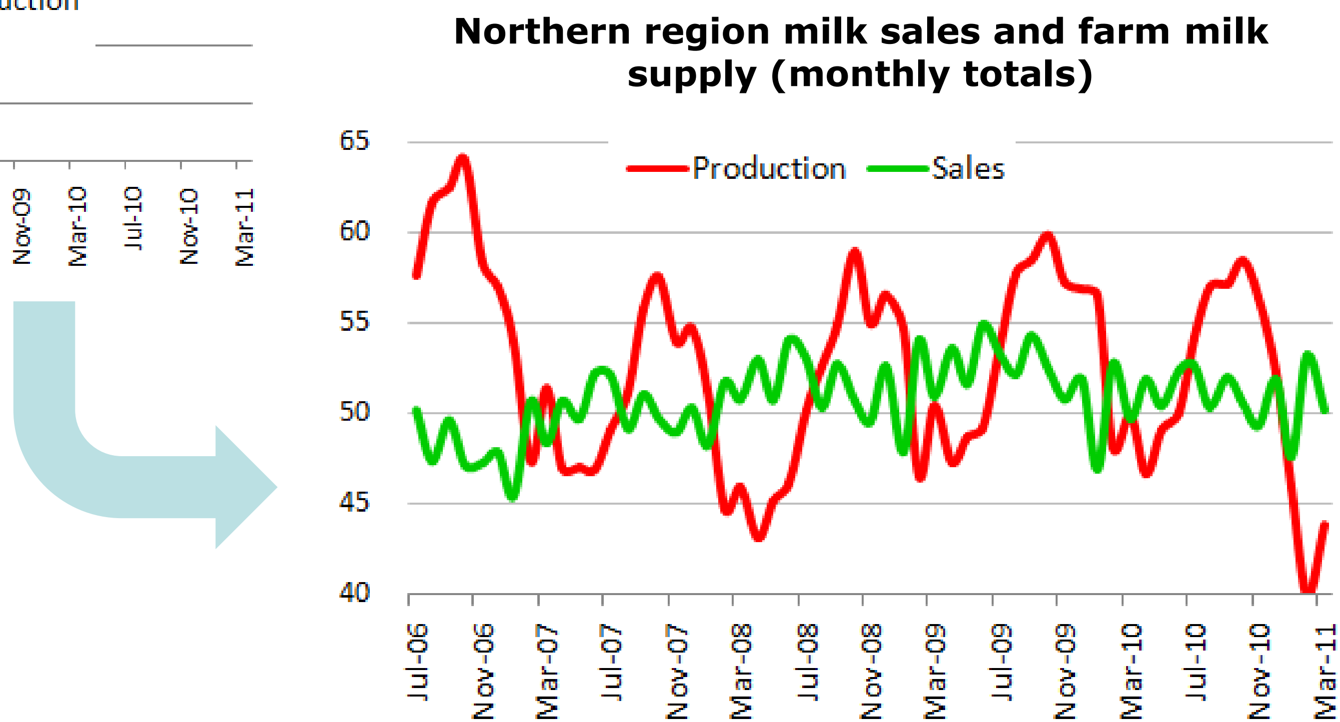
Demand v supply



Real picture?

- Fresh sales only
- Buffer for daily milk flow management



Source: Dairy Australia

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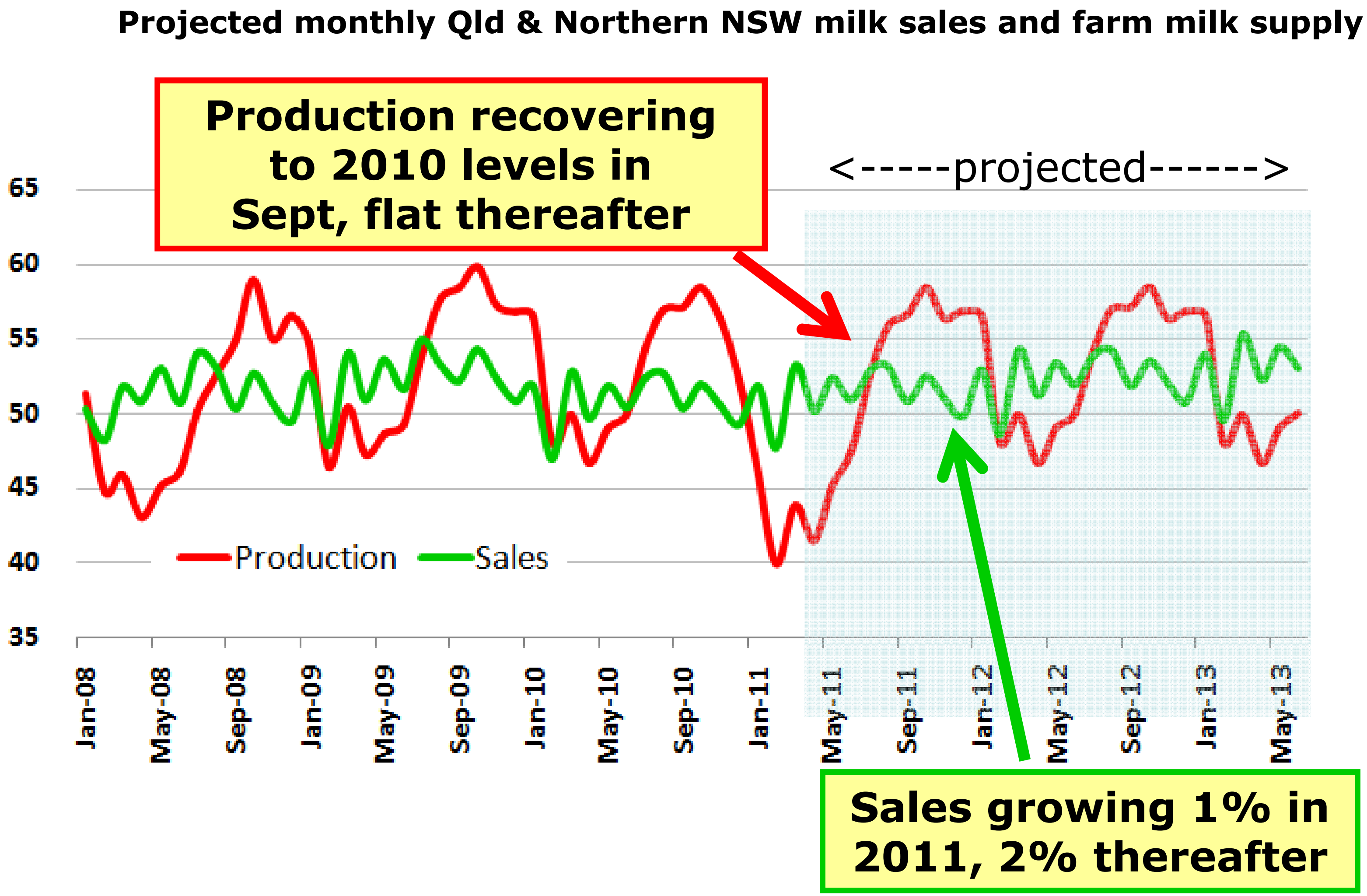
Projected regional demand v supply



Note: Fresh milk sales +2.3% last quarter

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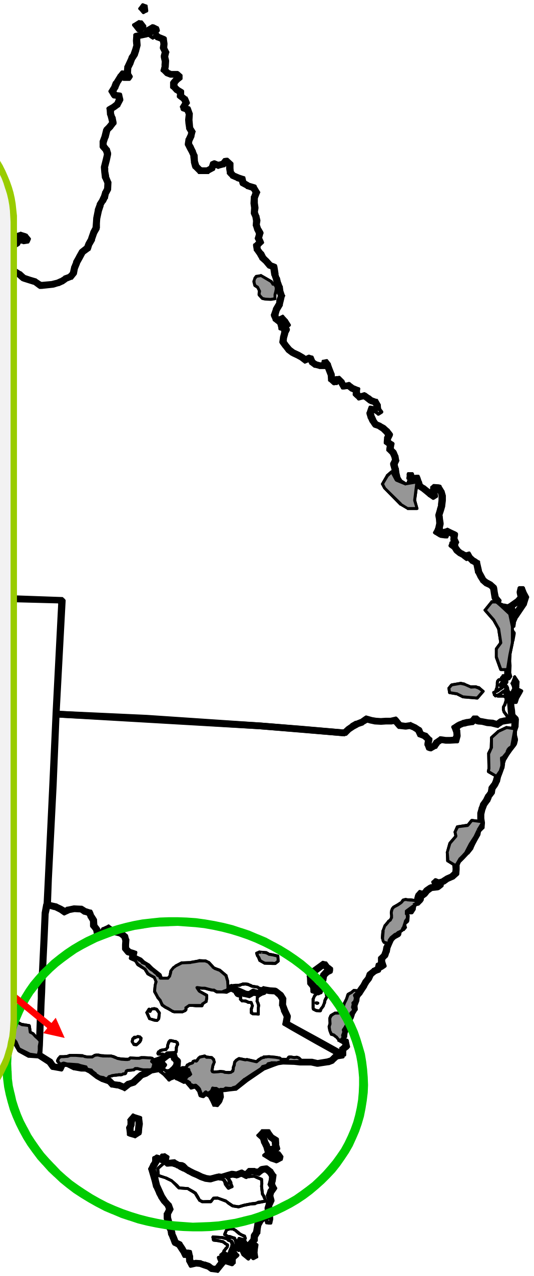
Farmgate market



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

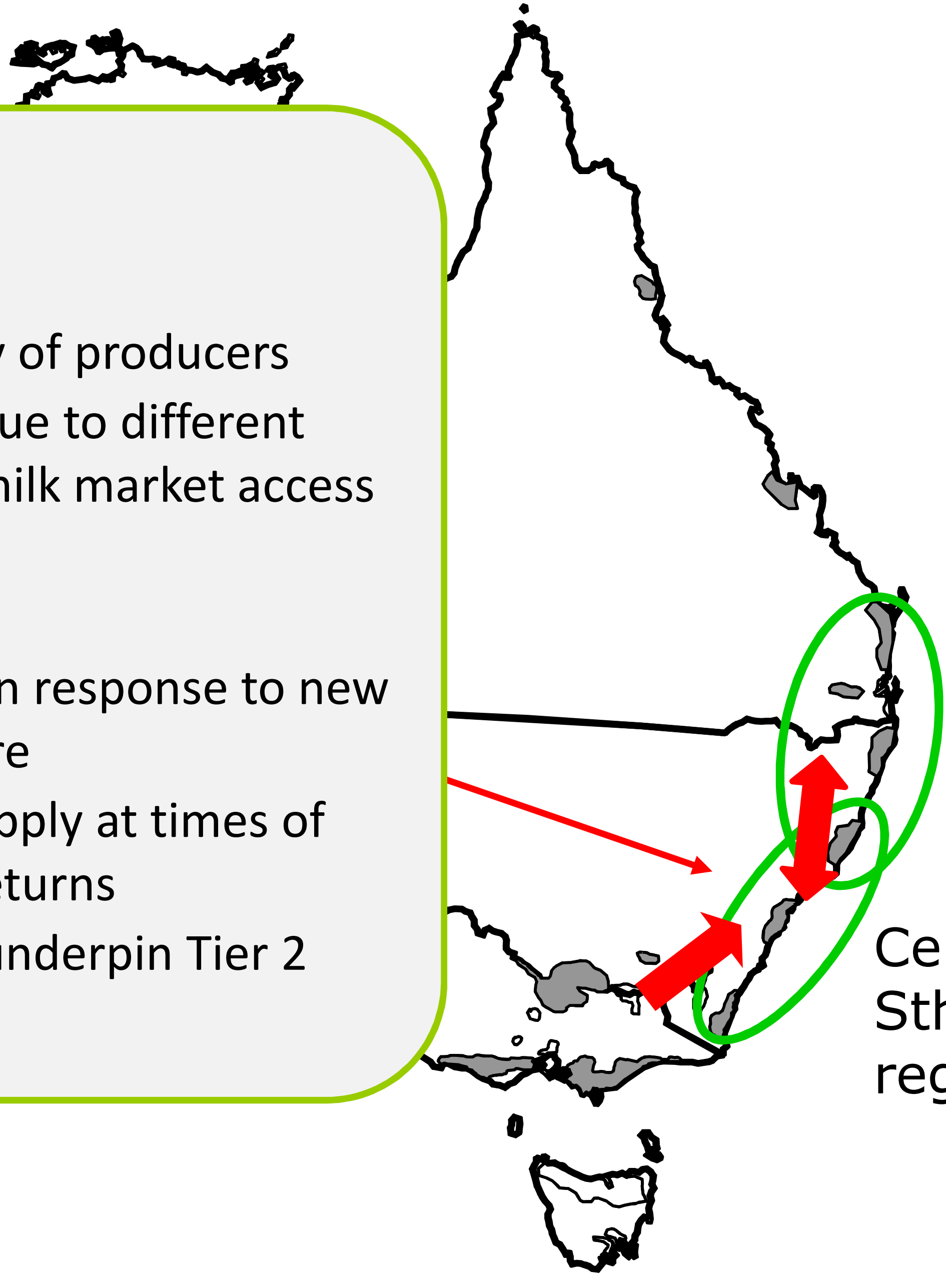
Central NSW

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

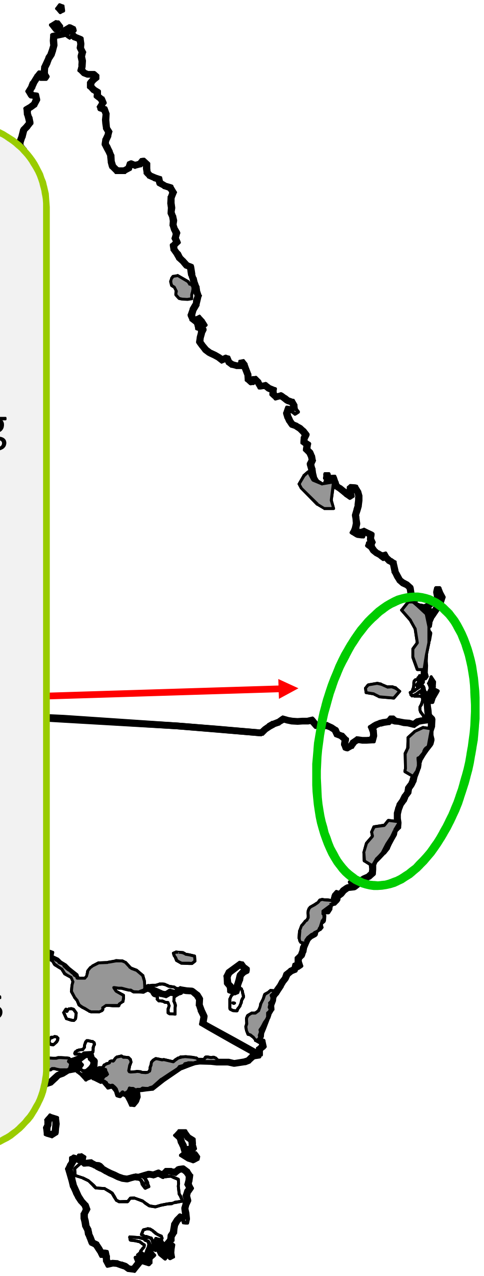
South Queensland and North NSW

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.



Farmgate market

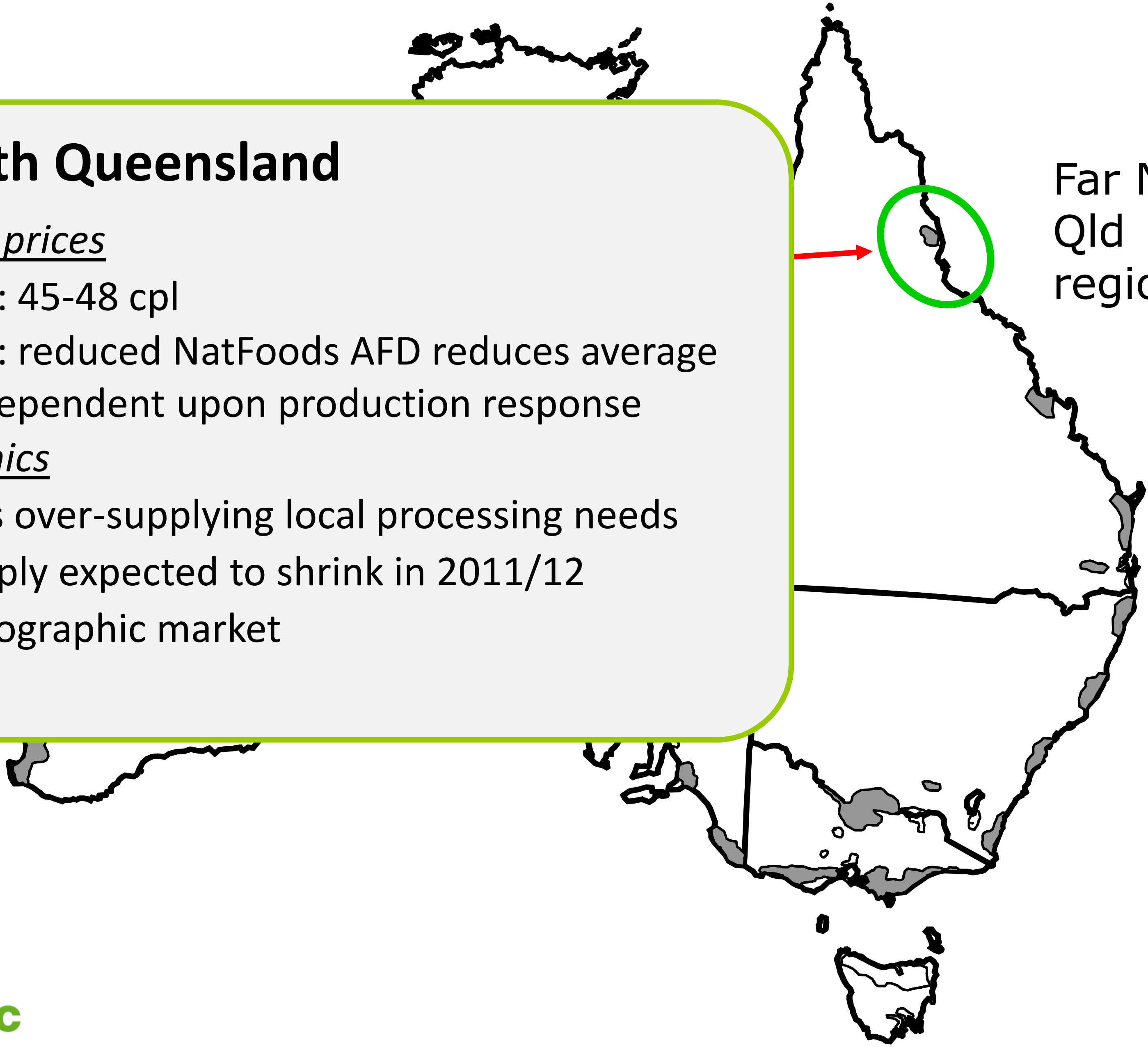
Far North Queensland

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



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	•2-tier pricing •Tier 1 contract volumes •Tier 2 benchmarked off southern prices
Parmalat PDA	•3-tiered pricing •Volumes shift based on actual sales (brand v PL) •Farmers manage their own exposure (buy/sell PDA access)
Parmalat POPS	•Pricing based on milk solids
Norco	•Contract volumes for supply "baseload" •Seasonal manufacturing price over peak periods

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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?

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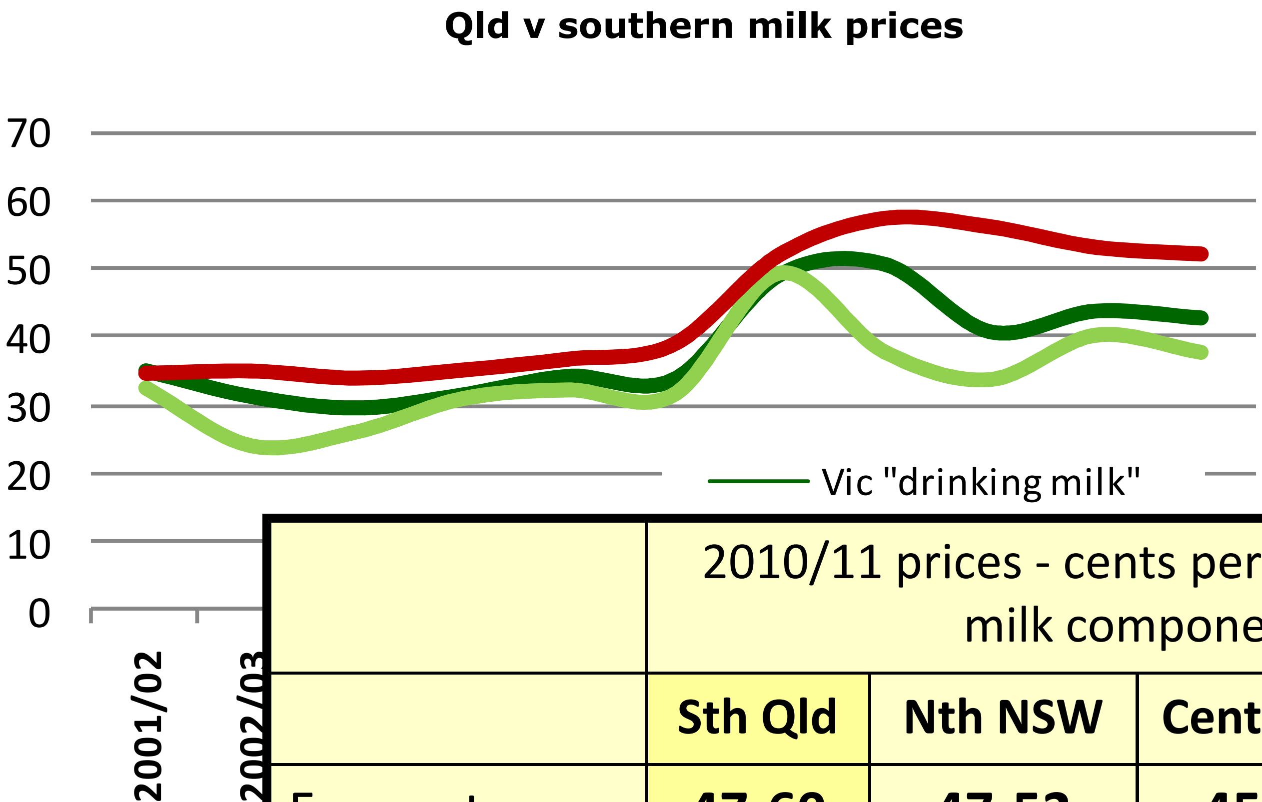
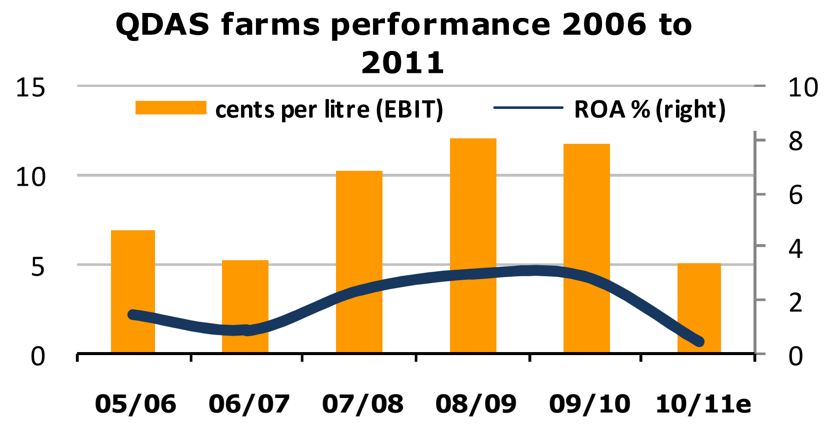
Farmgate prices

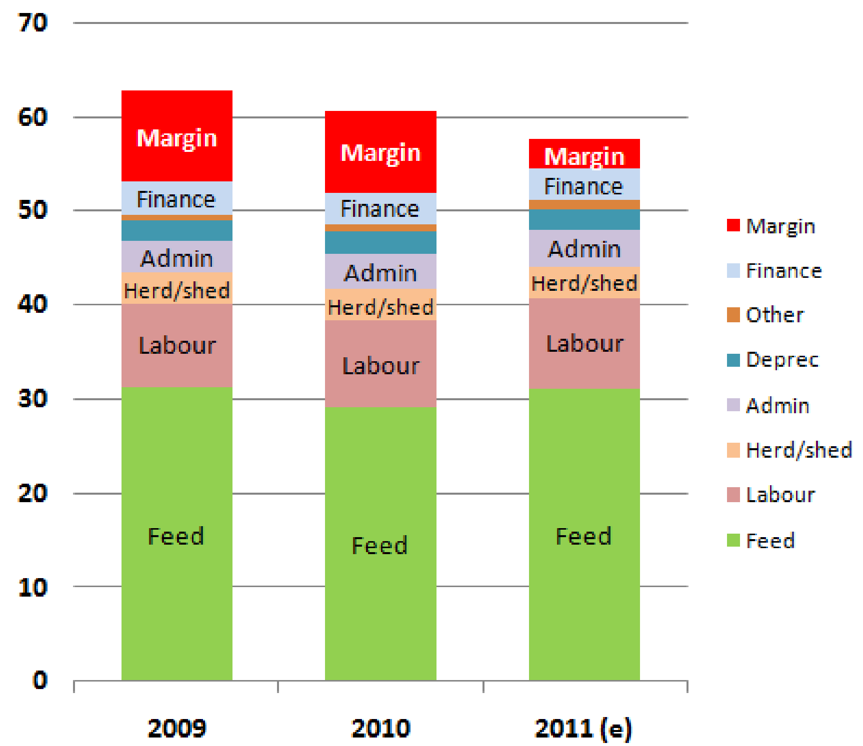


	2010/11 prices - cents per litre at average milk components			
	Sth Qld	**Nth NSW**	**Cent NSW**	**Nth Vic**
Farmgate	**47-60**	**47-52**	**45-50**	**42-44**
Freight	**3-4**	**5-6**	**10**	**17-20**
Landed cost	**50-64**	**52-58**	**54-59**	**59-64**

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





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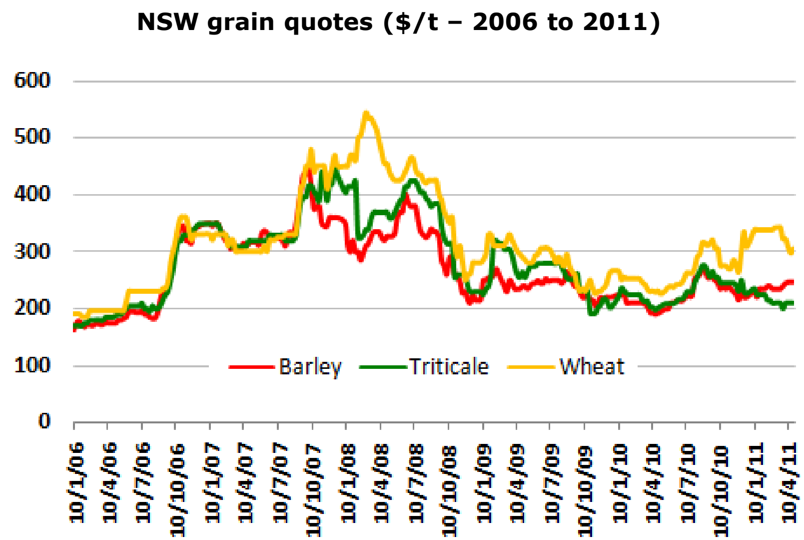
Feed market outlook

Short-term

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

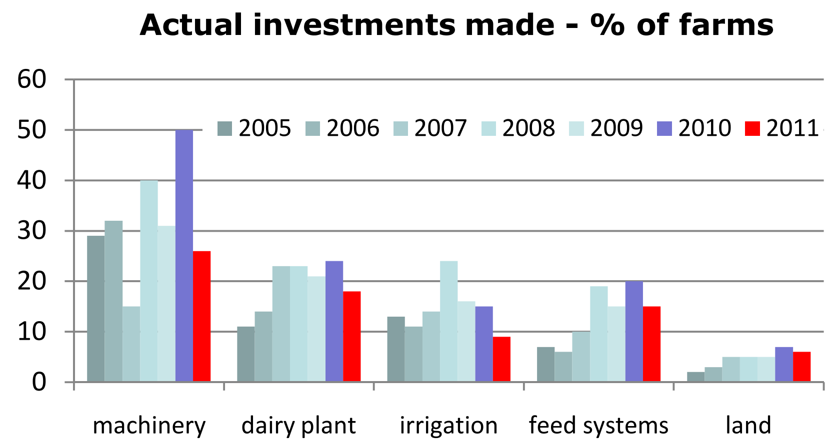


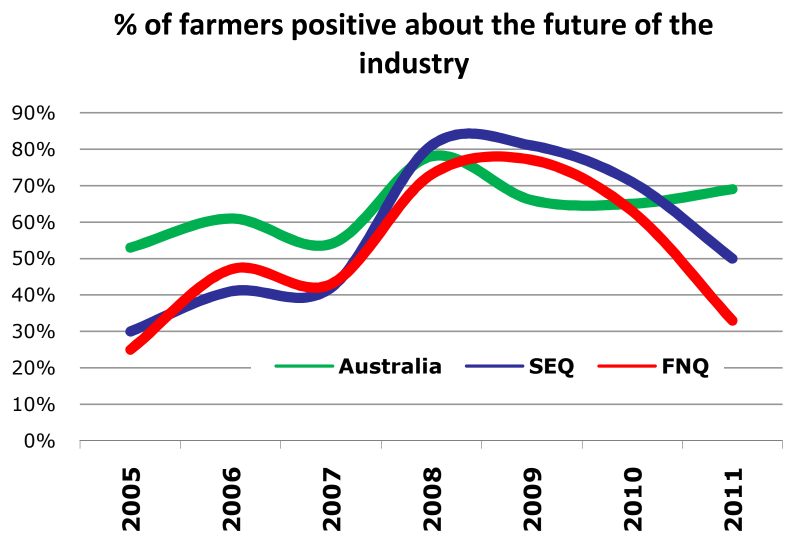
Medium term

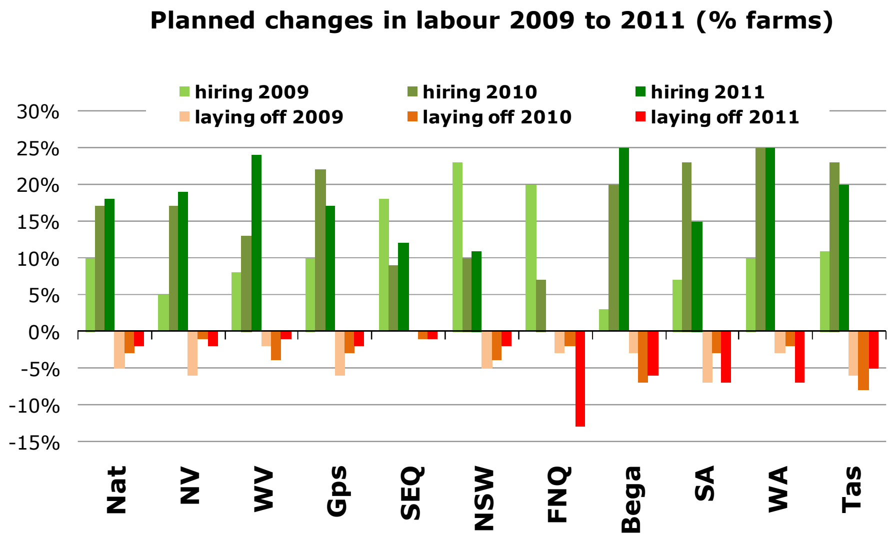
- Volatility increasing
  - More frequent global shocks
  - Skinny inventories
- Supply & demand to tighten
  - Sustained food/feed demand
  - Protein demand in developing world
  - US/EU commitments to biofuels demand will grow
  - China's priorities on food security

Investment

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







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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

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Attachment 4 – DFMC concern about impact of change in Woolworths' private label contracts in NSW and Queensland

"Woolworths' decision to award the future contract to Parmalat was of concern to DFMC as a high percentage of the milk produced by DFMC members is currently utilised by National Foods to supply Woolworths' private label milk products." – DFMC, 14 June 2011

"DFMC has serious concerns that Parmalat's decision to abandon the co-operative based supply and pricing arrangements will resort in a reduction in farmer revenue in NSW." – DFMC, 1 August 2011

"We believe Parmalat's move is a negative development that could potentially undermine the farm gate value of market milk in NSW and will create uncertainty in the industry around the right contract terms and price for milk supplied to the local market." – DFMC, 1 August 2011

"Dairy Farmers Milk Co-operative (DFMC) is increasingly concerned the viability of the New South Wales (NSW) dairy industry is under threat, based on Parmalat's approach to securing raw milk to fulfil the Woolworths private label milk contracts." DFMC, 1 August 2011

Dairy Farmers Milk Cooperative

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Lidcombe NSW 1825

Tel: 02 8732 5206
Fax: 02 8732 5055

MEDIA RELEASE

12 April 2011

Dairy Farmers and National Foods reach 2011/12 supply agreement

Today, Dairy Farmer Milk Co-operative (DFMC) announced it had reached an agreement with National Foods on milk supply volumes for the upcoming 2011/12 season.

DFMC Chairman, Ian Zandstra, welcomed the finalisation of the deal, under which National Foods will purchase around 900 million litres of milk from DFMC member dairy farms across Queensland, New South Wales, Victoria and South Australia in 2011/12.

"This purchasing commitment by National Foods provides some much needed certainty to dairy farmers and is a positive development for an industry still coming to terms with the impact of the aggressive milk price discounting by Coles Supermarkets," said Mr Zandstra.

"National Foods is operating in a challenging market and reflecting this environment the contract negotiations were tough at times. However, we are pleased we have been able to work constructively with National Foods to achieve a mutually beneficial commercial outcome.

"Since the sale of the Dairy Farmers business in 2008, the partnership between DFMC and National Foods has delivered real value for our members. With this agreement, our members are again well placed to receive a highly competitive farmgate return for their milk."

Under the agreement, National Foods' has committed to purchase around 870 million litres of contracted milk (plus or minus a 10 per cent variance) from DFMC members nationally at a 'tier one' milk price. This commitment is subject to certain conditions including the status of supermarket private label contracts in some states.

"We are particularly pleased National Foods has delivered on their commitments to farmers in South Australia and Victoria as part of the recent announcement on the restructuring of their cheese business.

"DFMC members in central South Australia, Mt Gambier and western Victoria can be assured National Foods will buy the same volume of milk from them in 2011/12 as they did this season."

DFMC's contracted milk volume commitments vary by region. DFMC is currently working through the numbers to develop milk supply volumes tailored to the production profile of each of its 780 supplier farms.

"We will be conducting meetings across all our supply regions and we are looking forward to going through the figures and the commercial rationale for them in detail with our members," said Mr. Zandstra.

ENDS

For more information contact:

Ian Zandstra
Chairman DFMC
0400 100 852

James Molan
Royce Communications
03 8628 9314

Dairy Farmers Milk Co-operative (DFMC) represents 1,820 members from 780 dairy farms in New South Wales, Victoria, Queensland and South Australia. DFMC is a true farmer Co-operative that for more than a century has worked to maximise the value of the milk produced by its members. Collectively, DFMC members produce over one billion litres of milk per annum and DFMC is the largest single supplier to the Australian fresh dairy market.

Dairy Farmers Milk Cooperative

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MEDIA RELEASE

14 June 2011

Woolworths contract announcement impacts New South Wales dairy farmers

Recently, Dairy Farmers Milk Co-operative (DFMC) became aware of the results of the tender for the Woolworths Private Label milk supply contract. National Foods, who are supplied by DFMC, retained the Woolworths Private Label contract in Victoria and South Australia however they have been unsuccessful in securing the contract in New South Wales (NSW).

DFMC Chairman, Ian Zandstra, said the Woolworths decision to award the future contract to Parmalat was of concern to DFMC as a high percentage of the milk produced by DFMC members is currently utilised by National Foods to supply Woolworths' private label milk products.

DFMC recently negotiated with National Foods for contracted milk needs in NSW for 2011/12 of 333 million litres, but this was dependent on National Foods securing the Woolworths private label contract.

"DFMC farmer suppliers in NSW currently produce over 370 million litres of white milk per annum. This announcement now means DFMC suppliers have a secure home for only 268 million litres and we are now reliant on the two processors, National Foods and Parmalat, coming together to ensure the milk needed to fulfil the Woolworths contract is acquired from within NSW," said Mr Zandstra.

"Parmalat does not have the supply volume in NSW to service this contract and we look forward to working with them to ensure the viability of DFMC farmers and to support a sustainable national dairy industry.

"For DFMC suppliers in NSW, we are not in a position to inform them what their individual contract volumes are for the 2011/12 season until National Foods and Parmalat come together to negotiate terms for the possible transfer of milk volumes to Parmalat to meet the Woolworths contract.

"We have enjoyed some constructive preliminary discussions with Parmalat and we are confident DFMC milk will find its way into Parmalat processing facilities. The last thing the dairy industry wants to see is a situation where Woolworths' milk products in NSW are supplied by milk sourced from outside of the state when we know that there is sufficient milk in NSW to fulfil the contract.

"The farming community has seen recently with the growth of supermarket private label milk and the unsustainable retail pricing of milk at $1 per litre how they are exposed to retailer activity and decisions," said Mr Zandstra.

"There is great concern among dairy farmers that this switching of retailer contracts will lead to a major reduction in farmer contracts, as happened in Queensland recently. Such an outcome would be very detrimental to the dairy industry and would also create alarm among NSW consumers who we know want to continue to be able to buy milk produced by local farmers."

DFMC represents 1,820 farmer members from 780 dairy farms that produce one billion litres of milk per annum. Since the sale of the Dairy Farmers business to National Foods in 2008, DFMC has supplied its milk to National Foods.

“We will do everything possible to work with all parties associated with the Woolworths contract to ensure that our NSW suppliers, who produce 370 million litres of milk per annum, get the best commercial deal and stay relevant and viable in the dairy industry,” said Mr Zandstra.

“On behalf of our members we have had discussions with Woolworths, National Foods and Parmalat about these supply arrangements and we are sure wise heads will prevail to ensure we have a home for all of our milk associated with the private label contract.”

For more information contact:

Greg Griffith	*Ian Zandstra*
Executive Officer	*Chairman*
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greg.griffith@dfmc.org.au	*ian.zandstra@dfmc.org.au*

Dairy Farmers Milk Co-operative (DFMC) represents 1,820 members from 780 dairy farms in New South Wales, Victoria, Queensland and South Australia. DFMC is a true farmer Co-operative that for more than a century has worked to maximise the value of the milk produced by its members. Collectively, DFMC members produce over one billion litres of milk per annum and DFMC is the largest single supplier to the Australian fresh dairy market.

Dairy Farmers Milk Cooperative

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MEDIA RELEASE

1 August 2011

Changes in Woolworths milk supply arrangements threaten NSW farmgate prices

Today, Dairy Farmers Milk Co-operative has written to its 320 farmer members in New South Wales (NSW) advising them to be careful in assessing any new contract offers to supply Parmalat with milk in order to fill the Woolworths private label contract.

Parmalat recently won the contract to supply Woolworths' house brand milk products in NSW. This contract was previously held by Lion (formerly National Foods), which sourced around 100 million litres of milk from DFMC members in NSW to supply Woolworths.

DFMC Chairman, Mr Ian Zandstra, said the Co-operative had been hopeful Parmalat would come to an agreement with Lion to continue to source milk through DFMC, but the negotiations between Lion and Parmalat had ended in a stalemate.

"We understand Paramalat will now be out in the market trying to convince NSW dairy farmers to supply them directly without the support and assurance of working through a Co-operative," said Mr Zandstra.

"Parmalat's move creates uncertainty in the NSW dairy industry around the right contract terms and price for milk supplied to the local consumer market.

"DFMC's has serious concerns that Parmalat's decision to abandon the Co-operative based supply and pricing arrangements will result in a reduction in farmer revenue in NSW. This risk is heightened by the continuation of the $1 per litre retail price point that is being maintained by the major supermarkets, which is putting downward pressure on processor and farmer returns.

"NSW farmers must realise what the market value is for their high quality milk is in NSW. The current DFMC Tier 1 price is $6.65 per kilogram of milk solids, or 47 cents per litre, with additional incentives worth on average 4 cents per litre. This should be the minimum a NSW farmer should receive from Parmalat.

DFMC represents 320 dairy farmers in NSW who produce over 360 million litres of milk annually. Nationally, DFMC represents 780 dairy farms producing one billion litres of milk per annum. Through its relationship with Lion, DFMC is the largest single supplier to the Australian consumer dairy market.

DFMC Directors and Executive will be holding supplier meetings in NSW in the coming weeks in order to provide members of the Co-operative with a clear understanding of the value of their milk and the options available to them.

"We urge any DFMC member who is approached by Parmalat to first contact their DFMC Regional Manager or local Director to discuss their options prior to making any major supply decision," said Mr Zandstra.

"We will continue to do everything possible to work with all parties associated with the Woolworths contract to ensure our suppliers receive a fair and competitive price for their milk."

For more information contact: James Molan, Royce Communications, 03 8628 9314

Dairy Farmers Milk Co-operative (DFMC) represents 1,820 members from 780 dairy farms in New South Wales, Victoria, Queensland and South Australia. DFMC is a true farmer Co-operative that for more than a century has worked to maximise the value of the milk produced by its members. Collectively, DFMC members produce over one billion litres of milk per annum and DFMC is the largest single supplier to the Australian fresh dairy market.

Dairy Farmers Milk Cooperative

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1 August 2011

Dear DFMC NSW Supplier,

Don't let Parmalat undermine the value of market milk in NSW

As you are aware, the contract to supply Woolworths' house brand products recently shifted from Lion (formerly National Foods) to Parmalat. This contract covers about 110 million litres of raw milk and Lion had previously drawn on significant volumes from Dairy Farmers Milk Co-operative (DFMC) in order to supply Woolworths.

We had been hopeful Parmalat would come to an agreement with Lion to continue to source milk through DFMC. This would have created stability and certainty in the NSW market. However, we have been informed the negotiations between Lion and Parmalat have broken down. We continue to push for these negotiations to recommence but in the meantime we understand Parmalat will now be out in the market trying to convince NSW dairy farmers to supply them directly without the support and assurance of working through a Co-operative. Potentially, Parmalat could also begin drawing on milk supplies in Victoria and bringing it into NSW.

We believe Parmalat's move is a negative development that could potentially undermine the farmgate value of market milk in NSW and will create uncertainty in the industry around the right contract terms and price for milk supplied to the local consumer market.

It is important that our members carefully assess any alternative supply arrangement from Parmalat or anyone else and make an informed decision about their future rather than hasty choice which may not be in their long term interests.

DFMC's position is that any direct supply offer from Parmalat must be at or above DFMC's Tier 1 price, otherwise Parmalat are undermining the value of market milk in NSW. Parmalat could try to take advantage of the fact that since Lion (i.e. National Foods) lost the Woolworths contract, DFMC suppliers in NSW face reduced Tier 1 volumes and their returns reflect a higher proportion of Tier 2 milk. This does not mean the value of DFMC's members' milk has fallen but rather it simply reflects the fact Tier 1 market milk volumes have switched to Parmalat.

All DFMC suppliers should realise what the market value is for their milk in NSW. The recently announced opening DFMC Tier 1 Base Milk Price is 47.00 cpl, (or $6.65 per kilogram milk solids equivalent), plus average incentives of approximately 4.0cpl. This is a competitive and fair price given current market conditions and we believe that our suppliers should not accept anything less from Parmalat.

If Parmalat try to attract new milk for the Woolworths contract at a price below the DFMC Tier 1 Base Milk Price, we believe the company will be exploiting the position DFMC NSW farmers find themselves in through no fault of their own. Indeed, given Coles and Woolworths continue to retain a $1 per litre retail price point the incentive for Parmalat to try and undermine Tier 1 prices is even greater. Farmers must recognise if Parmalat are able to achieve this, we believe it will be to the detriment of the long-term farmgate returns of all NSW dairy farmers.

As another alternative, Parmalat could seek to draw on milk purchased at lower commodity prices in Victoria to supply Woolworths in NSW. If this is Parmalat's intention, it represents a grave risk to the future of the NSW dairy industry and would deprive NSW consumers of milk produced by local farmers. We believe such a move would also signal that Parmalat is an opportunist player in the dairy industry in NSW.

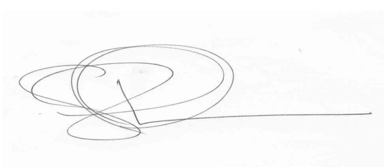
We urge any DFMC member who is approached by Parmalat to first contact their DFMC Regional Manager or local Director to discuss their options prior to making any major supply decision.

Additionally, until DFMC knows the outcome of supplier movement, we are not in a position to provide annual T1 allocations beyond the end of August. All NSW suppliers have been provided T1 allocations for July and August.

It should also be noted that suppliers coming off contract have an additional 90 day period through to the end of September. DFMC will extend this period until such time that annual allocations have been provided.

DFMC local Directors and Executive will be holding supplier meetings in the coming weeks in order to provide a clear understanding as to the options available to our suppliers. We will continue to do everything possible to work with all parties associated with the Woolworths contract to ensure that our suppliers, receive a fair and competitive price for their milk.

Yours sincerely on behalf of the DFMC Board



Greg Griffith
Executive Officer
Dairy Farmer Milk Cooperative.

Dairy Farmers Milk Cooperative

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MEDIA RELEASE

24 August 2011

New South Wales dairy industry under threat

Dairy Farmers Milk Co-operative (DFMC) is increasingly concerned the viability of the New South Wales (NSW) dairy industry is under threat, based on Parmalat's approach to securing raw milk to fulfil the Woolworths private label contract.

Parmalat recently won the contract to supply Woolworths' house brand drinking milk products in NSW. This contract was previously held by Lion (formerly National Foods), which sourced more than 100 million litres of milk from DFMC members in NSW to supply Woolworths.

DFMC's Chairman, Mr Ian Zandstra, said DFMC farmer suppliers in NSW are facing a 30% reduction in milk destined for supermarket shelves but the Co-operative believes this situation could be significantly improved if Parmalat decided to secure the milk they need at a competitive price from the NSW milk pool.

"Parmalat won the Woolworths private label contract two months ago. This comes into effect in September, in under two weeks, yet DFMC believes Parmalat have secured very little milk from NSW suppliers to meet the 110 million litres required annually to supply Woolworths," said Mr Zandstra.

"It is becoming increasingly likely NSW consumers who purchase their milk from Woolworths supermarkets will be drinking milk produced by Victorian dairy farmers.

"By all accounts DFMC's suppliers are likely to experience firsthand the 'knock them down' price campaign by Woolworths, with 30% of all current milk production no longer needed by Lion due to movement of the private label contract from Lion to Parmalat.

"Drinking milk for NSW consumers should come from NSW dairy farmers. It is crazy to think that milk tankers will be passing each other on the Hume Highway if Parmalat decides to source cheaper milk from Victoria in order to make a greater margin on the $1 per litre retail price point that is being maintained by the major supermarkets," said Mr Zandstra.

All NSW DFMC suppliers are under contract to DFMC and have a guarantee of milk off-take for <u>all</u> the milk they produce. In terms of the value of this milk it is a question of how much of it finds its way into drinking milk. DFMC believes drinking milk has a fair market value of 47 cents per litre plus additional incentives of approximately 4.5 cents per litre in NSW this season.

DFMC has 320 dairy farmer members in NSW who produce over 360 million litres of milk annually. Nationally, DFMC represents 780 dairy farmer members producing one billion litres of milk per annum. Through its relationship with Lion, DFMC is the largest single supplier to the Australian consumer dairy market.

"DFMC will be looking to offer all NSW suppliers new trading terms in the coming month once we have a clearer understanding the situation in the NSW market. We recommend NSW milk suppliers consider all of their options, including the 2012 allocation and DFMC contractual terms before deciding how to allocate their future milk supply," said Mr Zandstra.

For more information contact:

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John Stanham
NSW Director
0425 276 171

Dairy Farmers Milk Co-operative (DFMC) *represents 1,820 members from 780 dairy farms in New South Wales, Victoria, Queensland and South Australia. DFMC is a true farmer Co-operative that for more than a century has worked to maximise the value of the milk produced by its members. Collectively, DFMC members produce over one billion litres of milk per annum and DFMC is the largest single supplier to the Australian fresh dairy market.*

Attachment 5 – Coles and Harvey Fresh announce higher West Australian farm gate contract prices and Coles awards additional contract volumes in NSW and Victoria

“Under the new agreement, Harvey Fresh has agreed to increase the farm gate price paid to its 26 former Challenge Dairy suppliers to the standard price for all its suppliers.” – Coles, 28 July 2011

“Harvey Fresh will also look at expanding its supplier base to meet market opportunities arising from the Coles private label contract.” – Coles, 28 July 2011

“Under the new contract arrangement, we will source Coles brand ice-cream from three regional Australian manufacturing companies including Norco in NSW and Dairy Bell and Bulla in Victoria.” Coles, 23 July 2011

coles

MEDIA RELEASE

Thursday 28 July 2011

Harvey Fresh awarded Coles Western Australian milk contract

Harvey Fresh has been awarded Coles' private label milk contract in Western Australia for the next three years.

Harvey Fresh will begin supplying Coles brand milk in Western Australia from October 2011.

Under the new agreement, Harvey Fresh has agreed to increase the farm gate price paid to its 26 former Challenge Dairy suppliers to the standard price for all of its suppliers.

Harvey Fresh will also look at expanding its supplier base to meet the new market opportunities arising from the Coles private label contract.

Coles merchandise director, John Durkan, said he believed the new Coles' Western Australian private label milk contracts would build a more sustainable dairy industry.

"This re-distribution of our dairy business in Western Australia means that more local processors and dairy farmers will benefit from partnerships with Coles," Mr Durkan said.

"We believe that these contracts will build long-term sustainable relationships with dairy processors and farmers in Western Australia.

"Harvey Fresh has advised us that as a result of this new partnership with Coles, they will be able to expand their production facilities and invest in new equipment."

Coles' former private label milk supplier, Brownes Dairy, now owned by private equity firm Archer Capital, will continue to supply Coles with Brownes brand milk.

Coles is working with Brownes Dairy on plans to produce a range of value-added dairy products in Western Australia, including Coles brand cream, yoghurt and sour cream. These products are currently manufactured interstate.

Further information,
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Coles Media Relations
Ph (03) 9829 4354

Harvey Fresh
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Media Release

Thursday July 28, 2011

Harvey Fresh wins Coles private label milk contract

Harvey Fresh is pleased to announce that it has been awarded a contract by Coles to supply Coles private label milk to the retailer's supermarkets and Coles Express stores throughout Western Australia.

The large contract will be supplied from Harvey Fresh's dairy at Harvey in Western Australia's South West and will elevate Harvey Fresh to become the largest supplier of fresh milk to Western Australian consumers.

Harvey Fresh Marketing and Sales Director Kevin Sorgiovanni said the Coles private label contract was an endorsement of the quality of Harvey Fresh's milk and the 71 Western Australian farming families who supply milk to Harvey Fresh.

"Harvey Fresh has a track record of innovation that has enabled the company to increase its product lines, customer base and growth profile," he said.

"The decision by Coles to award its private label supply contract to Harvey Fresh is recognition of that approach and is an important development for our company, our suppliers and WA's South West.

"It provides volume and certainty for Harvey Fresh and dairy farmers suppliers and provides a platform to pursue new market opportunities."

Harvey Fresh will continue to supply Harvey Fresh branded product to all major and many smaller retailers. The new supply contract is in addition to the Harvey Fresh branded milk and Harvey Fresh remains committed to increasing sales volumes of Harvey Fresh branded milk.

"The supply of Harvey Fresh milk to consumers who enjoy its rich and full taste will remain unchanged," Mr Sorgiovanni said.

The three year supply contract starts on October 1, utilising part of the 115 million litres of milk supplied by Harvey Fresh's South West farmers each year. Other dairy products produced by Harvey Fresh include Extra flavoured milk and Harvey Fresh branded, long life milk, yoghurt, custard, cream and cheese.

“Harvey Fresh has recently invested in the expansion of its processing facility and adoption of new technology at its Harvey site to guarantee quality and consistency of product and to reduce processing costs,” Harvey Fresh Finance Director John Scolaro said. “This investment ensures Harvey Fresh has ensured Harvey Fresh compete effectively in domestic and international markets.”

The receipt of the Coles private label supply contract has enabled Harvey Fresh to implement a single milk pricing structure for its farmer suppliers, providing farmgate price increases to farmers who had previously supplied the failed Challenge Dairy Co-operative.

“The increase in the farmgate price paid to former Challenge suppliers is a direct result of being awarded this Coles contract; fulfils our desire to achieve a single milk price schedule for all of our suppliers and was an important component in our discussions with Coles,” Mr Sorgiovanni said.

In addition to fresh milk processing, Harvey Fresh operates the only UHT milk production facility in WA.

It is also the only major processor in Western Australia that buys and crushes oranges, apples, pears and carrots supplied from Western Australian fruit and vegetable growers.

“The new Coles contract is a significant milestone for our company as we continue to grow the Harvey Fresh business and seek new opportunities,” Mr Sorgiovanni said.

The commercial terms of the supply contract are confidential.

Media Contact:
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FD
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About Harvey Fresh

Harvey Fresh is a family owned and operated company. It has built a large domestic and export dairy and fruit juice business from its base at Harvey in South West Western Australia.

In addition to its 71 dairy farmer suppliers, the company employs 260 staff at its dairy and juice operations.

It has more than 300 product lines and sells to retailers throughout Western Australia and Singapore, Hong Kong, Korea, China, India, Thailand and the Philippines.

Harvey Fresh products include Harvey Fresh branded fresh milk, long life milk, yoghurt, custard, cream and cheese plus Extra flavoured milk and Capel Vale cheese.

Harvey Fresh is the only major processor in Western Australia that buys and crushes oranges, apples, pears and carrots supplied from Western Australian fruit and vegetable growers.

The company also owns a number of wine labels, including Joseph River Estate, which was awarded Australia’s most prestigious wine award in 2011, the Jimmy Watson Trophy, for its 2009 Cabernet Sauvignon.

coles

MEDIA RELEASE

Saturday 23 July 2011

Coles offers its customers higher quality ice-cream at Down Down prices

The price of Coles' award-winning Australian-made ice-cream has been cut by up to 48 percent and the former entry level ice-confectionary brand SmartBuy has been withdrawn from sale.

From today, a two litre tub of Coles brand vanilla ice-cream will be cut by 48 percent a tub from $4.19 to $2.19 and a four litre tub of Coles brand vanilla ice-cream will be cut by 42 percent from $7.44 to $4.29 a tub.*

Merchandise Director, John Durkan, said the move by Coles to transform its private label ice-cream range was part of the supermarket's "Quality food costs less" strategy to help Australian consumers.

"We are fully funding the lower retail prices of our higher quality Coles brand ice-cream and replacing the SmartBuy brand so that Australian consumers can have better quality products at lower prices," he said.

"Everyone should have the opportunity to indulge themselves a little each week and Coles is determined that our customers should not have to pay more for the privilege of higher quality ice-cream."

Mr Durkan said Coles had recently retendered its ice-cream contracts to ensure a better regional spread of production amongst local Australian dairy products manufacturers.

"Under the new contract arrangements, we will source Coles brand ice-cream from three regional Australian manufacturing companies including Norco in New South Wales and Dairy Bell and Bulla in Victoria.

"Norco, which has already won awards for private label products supplied to Coles, will get additional volume contracts worth approximately two million litres a year.

"Dairy Bell will also produce Coles brand vanilla ice-cream in Victoria and Bulla will continue to supply a range of ice-cream products including Coles brand Neopolitan ice-cream and ice cream cones from its Colac factory in Victoria."

Further information
Jim Cooper
Coles' Media Manager
0438 588 619

Footnote: * Coles' brand ice-cream products are priced on a nationally uniform basis.

Attachment 6 – Coles and Bega Cheese announce new five year contract that will increase demand for 70 million litres of Australian milk

“This contract is great news for both Bega and the Australian dairy industry, and further underlines Coles’ commitment to develop long term, mutually beneficial partnerships with Australian rural producers.” – Coles, 7 September 2011

“This means Bega Cheese will be sourcing an extra 70 million litres of Australian milk, representing $30 million of additional milk to be purchased.” – Bega, 6 September 2011

“This announcement will see increased employment in Bega and Victoria but it is good news for rural Australia as a whole. This is an important shift on the way one of our leading supermarkets is sourcing their product.” – Federal Agriculture Minister, Joe Ludwig, 7 September 2011

MEDIA RELEASE

Wednesday 7 September 2011

Coles brand cheese goes 100% Aussie-made with new Bega partnership

As part of its "Australian First" sourcing initiative, Coles has awarded its entire housebrand cheese business to iconic Australian dairy processor, Bega Cheese Limited.

The new five year contract means that the 50 per cent of Coles brand cheese currently sourced from New Zealand, over 9,000 tonnes, will now be produced in Australia each year.

This means Bega Cheese will be sourcing an extra 70 million litres of Australian milk – or 3500 milk tanker loads.

Coles Merchandise Director John Durkan said Coles wanted to enter a partnership that saw all its Coles brand cheese made in Australia.

"Coles was very keen to partner with an Australian dairy industry processor who could produce all of our cheese locally, and not rely on imported product," Mr Durkan said.

"I'm very pleased that Bega will now be producing 19,000 tonnes of great quality Coles cheese each year.

"This contract is great news for both Bega and the Australian dairy industry, and further underlines Coles' commitment to develop long-term, mutually beneficial partnerships with Australian rural producers."

Bega Cheese CEO Aidan Coleman said that the contract was a growth opportunity for the company, and would inject an extra $30 million directly into the Australian dairy industry.

"This new contract with Coles means we will be sourcing additional milk from our 400 dairy farmers across New South Wales and Victoria," Mr Coleman said.

"We'll also approach up to 70 farmers who don't currently supply Bega and invite them to become part of our milk network.

"And Coles have asked us to give them a high quality product, so we'll be looking for high quality, premium milk."

Mr Coleman said the Coles contract would generate added investment and jobs in the dairy industry.

"Bega plans to upgrade their Coburg plant in Melbourne to meet the contract requirements, which will also create 30 new roles across the company."

Bega will begin producing Coles brand cheese from February 2012.

Further information,
Jim Cooper, Coles Media Relations
Ph (03) 9829 4354

MEDIA RELEASE

Bega Cheese Secures Landmark Cheese Deal with Coles

Iconic Australian dairy processor Bega Cheese Limited has struck a landmark deal to supply the entire range of house brand cheese to all Coles supermarkets.

The new, five-year arrangement, further evidences Bega Cheese's ability to create strong relationships with key business partners.

Bega Cheese CEO Aidan Coleman said that the contract was a growth opportunity for the company. This means Bega Cheese will be sourcing an extra 70 million litres of Australian milk, representing $30 million of additional milk to be purchased.

"This new contract with Coles means that we will be sourcing additional milk from our 400 dairy farmers across New South Wales and Victoria," Mr Coleman said.

"We will also be intending to take on around another 70 farmers to become part of our high quality milk network".

Mr Coleman said the Coles contract would generate added investment and jobs in the dairy industry, and drive innovation.

"Bega Cheese plans to expand their Coburg plant in Melbourne to meet the contract requirements, which will also create 30 new roles across the company".

Coles Merchandise Director John Durkan said Coles, as part of its "Australian First" sourcing initiative, wanted to enter a partnership that saw all its Coles brand cheese made in Australia.

"Coles was very keen to partner with an Australian dairy industry processor who could produce all of our cheese locally, and not rely on imported product," Mr Durkan said.

"I'm very pleased that Bega Cheese will now be producing 19,000 tonnes of great quality Coles cheese each year".

"This contract is great news for both Bega Cheese and the Australian dairy industry, and further underlines Coles' commitment to develop long-term, mutually beneficial partnerships with Australian rural producers."

Bega Cheese will begin producing Coles brand cheese from February 2012.

September 6, 2011

For further information please contact:

Aidan Coleman
Chief Executive Officer
Bega Cheese
02 6491 7720

Senator the Hon. Joe Ludwig

Minister for Agriculture, Fisheries and Forestry
Senator for Queensland

The Hon. Dr Mike Kelly AM MP

Parliamentary Secretary for Agriculture, Fisheries and Forestry
Member for Eden-Monaro

MEDIA RELEASE

7 SEPTEMBER 2011

Minister welcomes boost for the dairy industry

Minister for Agriculture, Fisheries and Forestry, Senator Joe Ludwig, has welcomed today's announcement by Bega Cheese and Coles supermarkets that 100 per cent of Coles-branded cheese will be Australian sourced as a significant boost for local industry.

Minister Ludwig and Parliamentary Secretary for Agriculture, Fisheries and Forestry, Dr Mike Kelly, travelled to Bega today for the announcement that Bega Cheese will produce all Coles branded cheese from November this year.

"As a result of this partnership, Bega Cheese will be sourcing an extra 70 million litres of Australian milk and that's great news for the dairy industry," he said.

"Until now, half of this cheese has been produced in New Zealand. I applaud Coles for this move – it's great to see that more Australian product will be available on supermarket shelves.

"I am sure Australian consumers will be equally pleased to be able to purchase a product that supports Australian farmers and industry, with flow-on affects to rural communities."

Minister Ludwig said the announcement was testament to the dairy industry's ability to embrace change and adapt to new conditions, which had helped make it one of Australia's key agricultural industries, worth $3.45 billion at the farmgate.

Parliamentary Secretary and Member for Eden Monaro, Dr Mike Kelly, said it was good news for rural Australia, but especially for those in his home electorate.

"This is great news for Bega and the south coast," Dr Kelly said.

"This announcement will see increased employment in Bega and in Victoria but is good news for rural Australia as a whole

"This is an important shift in the way one of our leading supermarkets is sourcing their product.

"It will benefit many people, including dairy farmers, their families, rural communities and the workers at Bega Cheese."

Media contact: Melissa Patch 0418 734 413 or Katana Smith 0459 813 574 (Minister Ludwig)
Elyse Gatt 0459 810 654 (Dr Kelly)

Attachment 7 – ACCC extends collective bargaining for dairy farmers

"This is an important example of how the ACCC can assist small businesses, particularly those in the agricultural sector, to achieve better outcomes in their negotiations with processors." – ACCC, 4 August 2011

Australian Competition & Consumer Commission

NEWS RELEASE

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ACCC EXTENDS DAIRY FARMER COLLECTIVE BARGAINING ARRANGEMENTS

The Australian Competition and Consumer Commission has extended the exemption allowing dairy farmers to collectively bargain with processors for a further 10 years.

Australian Dairy Farmers Ltd was first granted authorisation by the ACCC in 2002. Since that time dairy farmers have formed 18 collective bargaining groups. These groups represent about 500 farming families.

"This is an important example of how the ACCC can assist small businesses, particularly those in the agricultural sector, to achieve better outcomes in their negotiations with processors," ACCC chairman Rod Sims said.

This is the second time the ACCC has undertaken a comprehensive review of the ADF arrangements. It is clear from submissions received that collective bargaining by dairy farmers is both supported and well understood by the industry.

The ACCC considers collective bargaining by dairy farmers has the potential to deliver better access to information and resources as well as improved input into contract negotiations. Collective bargaining does this by providing an effective mechanism through which productive contractual discussions can be achieved.

Collective bargaining can also reduce the transaction costs associated with negotiating supply arrangements for both dairy farmers and processors.

The ACCC may authorise collective bargaining arrangements when it is satisfied that the public benefit from the conduct outweighs any public detriment.

Authorisation provides immunity from court action for conduct that might otherwise raise concerns under the competition provisions of the *Competition and Consumer Act 2010*.

Alternatively, small businesses can obtain immunity from legal action under the Act for such arrangements by lodging a collective bargaining notification.

The ACCC's determination on the ADF's application will be available from the ACCC website, www.accc.gov.au/AuthorisationsRegister and by following the links to this matter.

Media inquiries
Mr Duncan Harrod, media unit, (02) 6243 1108 or 0408 995 408
General inquiries
Infocentre: 1300 302 502
NR 136/11
4 August 2011

Attachment 8 – ACCC confirms Coles' milk pricing is not predatory pricing

"The major impact of the reduction in milk prices since January seems to have been a reduction in supermarkets profit margins on house brand milk. These price reductions have benefited consumers who purchase house brand milk." – ACCC, 22 July 2011

Australian Competition & Consumer Commission

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NEWS RELEASE

ACCC: COLES DISCOUNTING OF HOUSE BRAND MILK IS NOT PREDATORY PRICING

The Australian Competition and Consumer Commission announced today that it considers there is no evidence that Coles has acted in breach of the *Competition and Consumer Act 2010 (CCA)*.

“The major impact of the reduction in milk prices since January seems to have been a reduction in the supermarkets’ profit margins on house brand milk. These price reductions have benefited consumers who purchase house brand milk”, ACCC Chairman Graeme Samuel said.

The ACCC has been conducting industry wide enquiries with dairy market participants including industry associations, milk processors, supermarkets and independent retailers to assess whether Coles is or has been in breach of the two predatory pricing provisions of the *CCA*.

Section 46(1) prohibits businesses that have substantial market power from taking advantage of that power for the purpose of (a) eliminating or substantially damaging a competitor, (b) preventing the entry of a person into a market and/or (c) deterring or preventing a person from engaging in competitive conduct in a market.

And section 46(1AA) prohibits businesses with a substantial share of a market, from selling goods or services for a sustained period at a price below the relevant cost of supply. As with s46(1), to breach this provision there must be evidence that a business acted with an anti-competitive purpose.

“It is important to note that anti-competitive purpose is the key factor here. Price cutting, or underselling competitors, does not necessarily constitute predatory pricing. Businesses often legitimately reduce their prices, and this is good for consumers and for competition in markets”, Mr Samuel said.

ACCC enquiries have revealed evidence that Coles’ purpose in reducing the price of its house brand milk was to increase its market share by taking sales from its supermarket competitors including Woolworths. This is consistent with what the ACCC would expect to find in a competitive market.

After Coles price reductions, Woolworths and other supermarket retailers have also reduced prices for house brand milk.

The ACCC’s enquiries show that there is a significant variation between respective costs of supply and operating margins among supermarket operators.

“As to the relationship between dairy farmers and milk processors, it is the case that some processors pay some farmers a lower farm gate price for milk sold as supermarket house brand milk. However on the evidence we've gathered over the last 6 months it seems most milk processors pay the same farm gate price to dairy farmers irrespective of whether it is intended to be sold as branded or house brand milk."

"On that front, the ACCC has recently issued a draft decision proposing to allow dairy farmers associated with Australian Dairy Farmers Ltd to continue to collectively bargain with milk processors for a further 10 years. This strengthens the position for farmers when negotiating with processors over milk prices", Mr Samuel said.

The ACCC will continue to monitor conduct within the dairy industry and grocery sector for signs of anti-competitive behaviour.

The ACCC does not usually comment on individual matters that it may or may not be investigating. However, given the substantial publicity generated by this issue, the ACCC considers it appropriate to provide these general comments on its findings.

Media inquiries

Mr Graeme Samuel, chairman,   (03) 9290 1812 or pager/mobile 0408 335 555

Mr Duncan Harrod, media unit, (02) 6243 1108 or 0408 995 408

General inquiries

Infocentre: 1300 302 502

NR 129/11

22 July 2011

Attachment 9 – Coles extends Down Down retail milk pricing

"Increased milk consumption over the last six months, well above long term trends, shows that both out customers and the diary industry are winning as a result of our Down Down milk pricing initiative." – Coles, 25 July 2011

coles

MEDIA RELEASE

Monday 25 July 2011

Coles brand milk prices to stay Down Down

Coles is committed to keeping its milk prices at the current level of $1 a litre* for the foreseeable future to help our customers combat rising living costs, Managing Director, Ian McLeod has announced.

Mr McLeod said Coles would continue to fund lower retail milk prices to ensure that customers and dairy farmers were winners from the Down Down milk price reductions announced on 26 January 2011.

“I told the Senate Committee earlier this year that Coles brand milk prices would stay Down Down for at least six months - ***if not longer*** - and given the positive customer response, we are committed to keeping prices down for as long as possible,” he said.

“Increased milk consumption over the last six months, well above long term trends, shows that both our customers and the dairy industry are winning as a result of our Down Down milk pricing initiative.”

Mr McLeod welcomed last week’s announcement by the Australian Competition and Consumer Commission (ACCC) that Coles ‘Down Down’ milk prices were consistent with a competitive market and had benefitted consumers.

“Coles fully cooperated with the ACCC review and I am pleased that the competition policy umpire has published the results of its detailed industry review on this matter,” he said.

“We have always said we are committed to reducing prices for Australian consumers as well as supporting Australian farmers. We are therefore re-assured that farm gate milk prices are increasing for most dairy farmers and domestic milk consumption is up.

“Coles also continues to award new contracts to local dairy processors that will generate new opportunities for dairy farmers in domestic dairy markets. Just a couple of days ago, Coles awarded Norco Foods, an Australian dairy cooperative with 165 dairy farmer suppliers on the north coast of NSW, with new ice-cream contracts worth an additional 2 million litres a year.”

For further information:
Jim Cooper
Coles Media Manager
03-9829 4354
0438 588 619

*Footnote: Coles brand milk pricing as follows:
One litre: $1.25
Two litres: $2
Three litres: $3

Attachment 10 – Rabobank survey shows dairy farmers most confident of all in rural sector about the future

“Dairy producers reported the highest confidence with 39 percent expecting conditions to improve.” – Rabobank, 5 September 2011

Media Release
September 5, 2011

Concerns 'outside farm gate' shake Australian rural confidence

Results at a glance:

- *Rural confidence has fallen into negative territory – with more farmers expecting conditions to worsen than improve*
- *Fall comes despite generally positive seasonal conditions and commodity price outlook.*
- *Global economic uncertainty and concerns about public policy issues were major contributors to farmer pessimism*
- *Beef producers the least confident sector in the nation*

Australian rural confidence has slid to its lowest level in more than two years, with global economic uncertainty and concerns about public policy impacting on farmer sentiment.

The latest quarterly Rabobank Rural Confidence Survey found Australian farmer sentiment has dipped into negative territory – with more farmers expecting conditions to worsen than improve in the next 12 months.

A comprehensive monitor of outlook and sentiment in Australian rural industries, the Rabobank Rural Confidence Survey questions approximately 1200 farmers across a wide range of commodities and geographical areas throughout Australia on a quarterly basis.

The latest survey – completed approximately a month ago – found 35 per cent of farmers expected conditions to worsen in the coming year, a significant increase from the 12 per cent with that view in the previous quarter. Only 18 per cent of farmers expected the agricultural economy to improve (down from 42 per cent previously), while 42 per cent expected conditions to stay the same.

Rabobank general manager Rural Australia Peter Knoblanche said the fall in farmer confidence appears to have been influenced more heavily by factors "outside, rather than inside, the farm gate". Global market volatility and concerns about public policy issues were shown to have had the main dampening effect on farmer confidence this quarter.

"Inside the farm-gate, from a production point of view, things are shaping up for an overall good season," Mr Knoblanche said.

"Generally speaking, with the exception of some pockets, seasonal conditions across Australia are good or average. There has been enough rain to maintain the prospects for winter crops and for pasture growth for graziers, although many areas will need further average rainfall in spring to guarantee a decent harvest.

"That said, farmers are not only affected by what is happening in their paddocks, but also what's happening in the local and international economy."

Mr Knoblanche said while the Australian economy and agricultural fundamentals remained strong, it appeared some of the global turmoil, which was occurring at the time of the survey, had rubbed off on farmer sentiment.

Concern about government intervention and policies, including the threat to live exports, was also nominated as a major driver of farmer pessimism in the survey. Of those primary producers who expected conditions to worsen over the next 12 months, 45 per cent identified government intervention policies as a major contributing factor, while threat to live exports specifically was also top of mind for 25 per cent.

“The survey highlighted farmer concerns and uncertainty around issues including the proposed carbon tax, the suspension of live cattle exports to Indonesia and the impact of coal seam gas exploration and mining on agriculture,” Mr Knoblanche said.

The majority of farmers surveyed (52 per cent) viewed coal seam gas exploration as a threat to agriculture. This figure was higher in states where coal seam gas exploration or mining was occurring – with 62 per cent of New South Wales farmers and 71 per cent of Queensland farmers having this view. Overall, seven per cent of farmers surveyed believed coal seam gas exploration represents an opportunity to agriculture while 40 per cent were undecided.

“Threat to live export was also top of mind for farmers, particularly cattle and sheep farmers at the time of the survey – however the two private member bills to ban live export have since failed to win support from the government or opposition,” Mr Knoblanche said.

Of those farmers surveyed who expected conditions to improve over the next 12 months, 52 per cent cited rising commodity prices as the major driver and 46 per cent nominated favourable seasonal conditions.

Mr Knoblanche said commodity prices remained high, although prices had eased in the past month for most commodities including wheat, beef, sheep and dairy. “The high Australian dollar is also beginning to take the edge off returns for producers,” he said.

Farm business performance, income and investment intentions

In terms of farmers’ expectation of their own operations, the Rabobank survey found a fall in sentiment – 31 per cent of those surveyed expected to see improved performance in their business over the next 12 months, down from 53 per cent last quarter. While 44 per cent of farmers expected the performance of their business to remain the same, 21 per cent expected performance to worsen.

Overall, 34 per cent of respondents expected to have higher incomes over the next 12 months, although the number of producers expecting lower gross farm incomes increased to 22 per cent, compared to 10 per cent last survey.

The reduction in income expectations follows a generally favourable second quarter for gross farm income this year. A total of 49 per cent of Australian producers surveyed reported higher gross farm incomes, compared to the same period the previous year.

Farmers' investment intentions also declined this quarter. A total of 87 per cent intended to maintain or increase the level of investment in their business, down from 95 per cent last quarter.

States

In line with the national trend, all states recorded weaker sentiment compared to the previous quarter. In NSW, Victoria, Queensland and South Australia, farmer confidence is in 'the red' – with more farmers expecting conditions to worsen rather than improve. Although Western Australian and Tasmanian farmer sentiment is still in positive territory – with more expecting conditions to improve rather than worsen – confidence is still comparatively low.

Mr Knoblanche said generally farmers across most of Australia had received average to good rainfall in the winter season. "Graziers in Queensland and New South Wales are enjoying very good pasture conditions and across Western Australia conditions in the grain belt have also improved," he said. "However, market dynamics as well as concerns about intervention and policies are working against farmer sentiment."

Queensland farmers recorded the lowest confidence levels in the survey. "This is mainly driven by cattle farmers in the state," Mr Knoblanche said. "The suspension of live trade export to Indonesia has shaken confidence in cattle farmers in the north, although the lifting of ban has been a welcome development for producers."

Tasmanian farmers were found to be the most confident this survey, despite confidence also declining in this state. "Seasonally conditions are sound, although heavy winter rainfall in the state has delayed the planting of some crops. Despite this, the state is well positioned for the spring emergence," Mr Knoblanche said.

Sectors

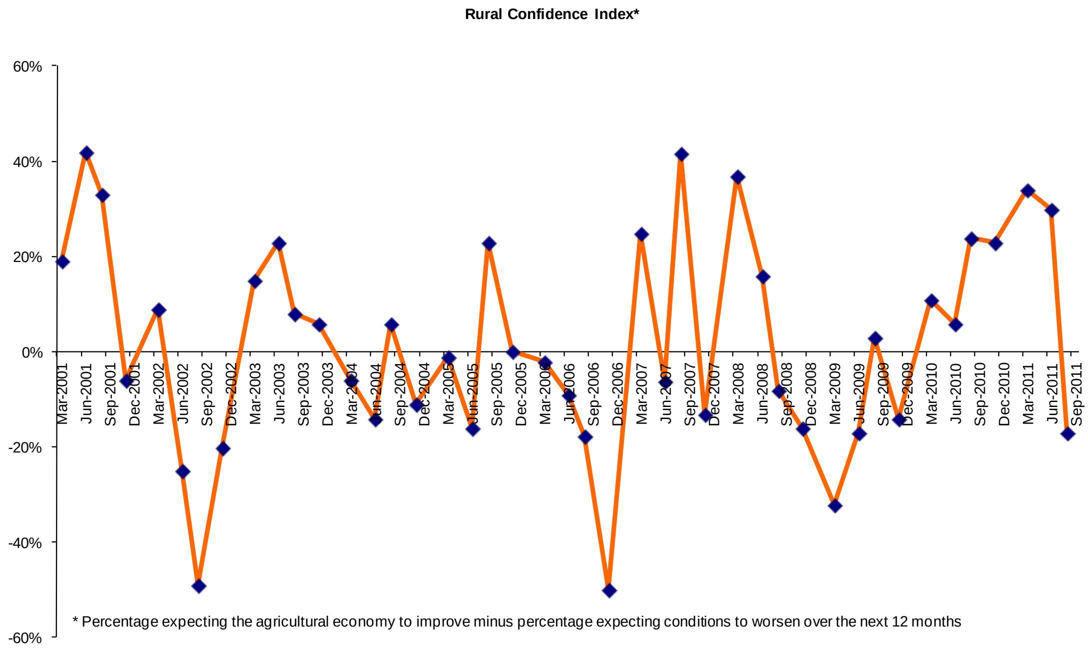
The decline in confidence was reflected across all sectors.

Cattle farmers reported the lowest confidence, with only eight per cent expecting conditions to improve in the next 12 months.

Mr Knoblanche said beef producers in all states reported a dramatic decline in confidence in the survey, not just northern producers directly impacted by the Indonesian live export ban. "This is due in part to global markets, with Australia's key market of Japan still subdued in the wake of the earthquake earlier in the year," he said. "Consumer confidence is also likely to impact on global beef demand with continued concerns that the US and EU could move into recession. In addition, suspension of live trade to Indonesia also indirectly affected cattle producers in the southern states, with confidence impacted by concerns there would be an influx of northern cattle on to the market."

Dairy producers reported the highest confidence with 39 per cent expecting conditions to improve.

Mr Knoblanche said an expectation of favourable commodity prices and seasonal conditions had kept dairy producers positive. "Good seasonal conditions continue to assist a strong finish to the milk production year. Most processors have announced opening milk prices for southern producers with prices slightly above where they were at last year," he said.



The most robust study of its type in Australia, the Rabobank Rural Confidence Survey has been conducted since 2000 by an independent research organisation interviewing an average of 1200 farmers throughout the country each quarter. The next results are scheduled for release in December 2011.

<ends>

Rabobank Australia is a part of the international Rabobank Group, the world's leading specialist in food and agribusiness banking. Rabobank has more than 110 years' experience providing customised banking and finance solutions to businesses involved in all aspects of food and agribusiness. Rabobank is structured as a cooperative and operates in 48 countries, servicing the needs of approximately 10 million clients worldwide through a network of close to 1600 offices and branches. Rabobank Australia is one of the country's leading rural lenders and a significant provider of business and corporate banking and financial services to the Australian food and agribusiness sector. The bank has 61 branches throughout Australia.

To arrange an interview with Rabobank general manager Rural Australia Peter Knoblanche, or for more information on Rabobank's Rural Confidence Survey, please contact:

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Attachment 11 – Jindi Cheese to expand production as a result of Coles' contract

"To supply the new Reserve range (of artisan cheese) in more than 170 of Coles' high-profile stores is a big motivation for us. Should the Reserve range be a success (which we are sure it will be) it will mean a big incremental shift in volume." – Jindi Cheese, 9 September 2011

Jindi Cheese

AT A GLANCE

2.1
THE BEST CHEESE REQUIRES THE BEST MILK
Jindi Cheese's European knowhow is backed by using the best quality, locally-sourced milk from Gippsland dairy farms.

2.2
BORN IN FRANCE, MADE IN AUSTRALIA
The French background of Jindi's head cheese maker Franck Beaurain is complemented by a strong team of passionate Gippsland locals.

2.3
Q&A WITH FRANCK BEAURAIN
The success of the new Jindi Reserve range, developed with Coles, will lead to a big incremental shift in volume - starting with an expected initial supply of 2,100kg of cheese.

Gippsland milk, European knowhow

Based in the rolling hills of Australia's dairy farming heartland in Gippsland, Jindi Cheese celebrates the time-honoured traditional method of cheese making – one that values the benefits of patience, allowing for natural ageing to occur.

Proudly Australian made and owned Jindi Cheese is the largest, private, locally-owned specialty cheese manufacturer in Victoria. It uses only the highest quality cows' milk produced by local cows that feed on the lush, rich pasture of West Gippsland – so the milk doesn't travel far before it is transformed into authentic, hand-made cheese.

Jindi's Head Cheesemaker, Franck Beaurain and his cheese making team of passionate locals are currently creating a special Jindi Reserve range which on release will be exclusive to Coles. The range – which includes a Cremeux, Washed Rind and Estate Blue – is a response to the shortage of ripe and ready to eat local cheeses on supermarket shelves.

"Most cheese you see in stores today is released before it is mature and in optimum condition," says Franck.

"In Australia our cheese culture is still very young. Few people understand the benefit of maturing cheese for optimum flavour and often eat cheese before it has reached its full potential."

Franck says that while there are many elements to producing top quality cheese, the traditional method of ripening that is so often the missing link. To add complexity to cheese and to make it something special cheese has to be allowed to age.

"Hopefully the introduction of the Reserve range in Coles supermarkets will help to further develop Australian palettes and increase the demand for artisan cheese."

Thirty years ago, Australians' appetite for cheese barely extended beyond cheddar. Over time cheeses such as brie and camembert became popular (despite most consumers not being able to differentiate between the two), and Franck hopes this will soon be expanded further

High quality

At the top of their craft

There is little doubt that Jindi Cheese and the Reserve range is at the top of their craft.

In August, the Jindi Reserve 1kg Brie was awarded the best Brie/ Camembert of the Royal Melbourne Show Fine Food Award 2011 and was the only gold medal received in these two categories.

The high quality of Jindi's cheese in in a large part borne from its passionate employees. During peak times this represents about seventy locals (including eight cheese makers), all of whom appreciate local regional produce made from cows who feed on the rich pasture of the West Gippsland valley.

(continued page 2)

From left: Shane Adamiak, Coles' Cheese Specialist Fiona Goniak and Franck Beaurain

MEET JINDI'S CHEESE MAKERS

Franck "with a 'c'" Beaurain was born in Normandy, France, but Australia has adopted him to make a cheese that can stand alongside the very best in the world.

Franck's native France really knows how to make good cheese and his team have the advantage of using the very best Gippsland milk to make the highest quality cheese.

He has been described as a 'cheese freak'. He lives for cheese and meticulously practices the art of fine-tuning his craft.

Franck's right-hand man, **Shane Adamiak** is a local with a dozen years of cheese making experience and controls the quality of the Jindi Reserve range.

JINDI CHEESE BY THE NUMBERS

70

The number of local Gippslanders employed by Jindi Cheese during peak production.

8

The number of expert cheese makers employed by Jindi

2,000

The number tonnes of cheese Jindi aims to produce in a year.

5

The number of different cheeses available in Coles' Jindi Reserve range - Cremeux, Camembert, 1kg Brie, Washed Rind and Estate Blue.

As head cheese maker, Franck makes sure that every decision made during the process does not compromise the quality of the Reserve range and enforces two non-negotiable rules:

Rule 1 : Only the best quality cheese will be selected for the Reserve range – it cannot be too salty, too dry, too strong or too mild.

Rule 2 : The cheese will not be released when it is too young – it has to be just right.

The Jindi Reserve range will be found in specialty cheese shops being developed as an extension to Coles' delis.

While the locally sourced and made Jindi Reserve range will be a step up from the gourmet cheese range found in the dairy aisle, but will be more reasonable priced compared to the imported cheese of a similar or lesser standard found in specialty foodstores.

In short, it is a local addition to a high-end cheese range, until now dominated by expensive imports.

Investment and innovation

Investing in excellence

A recent addition to the company's property on Old Telegraph Road in Jindivick is a brand new factory, which according to Franck, has already impressed a host of cheese manufacturing experts from France.

The new factory will help Jindi meet its aim of supplying 2,000 tonnes of cheese per year. However, Franck maintains that it is 'quality' and not 'quantity' that will continue to drive the focus of Jindi Cheese.

"As well as physical investment in the factory, we've also invested a lot in our processes and moulds so we can epand our range even further."

While they plan for growth, Franck says Jindi will remain a size that allows for a smaller, more flexible management than some of their big name counterparts.

"The size of Jindi is perfect," says Franck. "It is functional and allows us to make cheese they way we want to make it – we don't simplify things for the sake of efficiencies."

(continued page 3)

A perfect example of this is their use of the same cultures that are used in the cheese making process in France.

"A lot of companies that are producing cheaper camemberts will only use one culture," says Franck.

"Here at Jindi, for the high-end quality of the Reserve range camembert, we are using eight cultures."

"It is another demonstration of how we can make the same quality of cheese here in Gippsland, as they do in France.

"It is no longer true that European cheeses are better than what we can make here in Australia."

Coles Cheese Specialist, Fiona Goniak, agrees.

"Franck and Shane have worked in collaboration with Coles to produce a beautiful and delectable gourmet range of recognised, quality cheeses for Coles Deli Cheese Shop customers.

"From the discussions and conception of the new range and working with Franck at Jindi through to seeing the packaged products and finally tasting this fine range of cheeses brings immense professional and personal satisfaction.

Q&A

with Jindi Cheese's Franck Beaurain

Does your relationship with Coles help provide further insights into the needs of consumers?

Definitely.

Coles has identified a need for top-quality cheeses in their supermarkets.

The requirement from their customers is that these cheeses are more flavoursome and comparable to the top-quality cheese product coming out of Europe.

How is Coles helping Jindi Cheese in its commitment to produce cheese of the highest quality?

The establishment of new concept cheese sales at Coles place a priority on high-quality, specialty cheeses based on traditional recipes.

The new Jindi reserve range has been perfectly developed to meet this trend.

How important is Coles' commitment in growing and developing the Jindi Cheese business?

It is very important.

To supply the new Reserve range in more than 170 of Coles' high-profile stores is a big motivation for us. Should the Reserve range be a success (which we are sure it will be) it will mean a big incremental shift in volume.

Does Coles' commitment also help Jindi Cheese continue to be at the forefront of new products?

Absolutely.

Along with Fiona Goniak from Coles, we are currently working on a range of products to develop and extended variety of cheeses over the coming years.

On product types and innovation, how are you trying to provide Coles with a point of difference?

No problems there.

The Jindi Reserve range is different from other Jindi products. With the Reserve range, we've given the utmost priority to texture and flavour.

The results are almost undistinguishable from imported European products, other than that they are made right here in Australia using high-quality, local Gippsland milk.