



18 February 2011

The Hon. Senator Alan Eggleston
Liberal Party Senator for Western Australia
Parliament House
Canberra ACT 2600

Dear Minister

Coles milk price reductions

I am writing to you about Coles' recent decision to reduce the retail price of milk in our supermarkets and attach a *Fact Sheet* that dispels the myths being spread by agri-politicians about the impacts of our initiative on dairy farmers.

A central pillar of Coles' turnaround from day one has been to deliver truly better value to consumers and engender higher levels of customer trust. In the last year, Coles has cut prices on more than 5,000 products including milk to help stretch the weekly pay packet for Australian families.

Over half of all Australian families, including teachers, nurses and fire-fighters, earn less than the average wage. Rising utility bills, rising mortgage payments, higher credit card bills and higher health costs are making it hard for these Australian families to make ends meet.

By reducing grocery prices, Coles has helped turn food inflation from 4-5 per cent a year, to food deflation of around 2 per cent a year. This has saved Australian families about \$1 billion dollars a year on their total grocery bill. As a result, more and more Australians are trusting Coles as a shop that offers real value every day of the year.

Despite claims to the contrary, Coles is not out to hurt dairy farmers by cutting retail milk prices. Our customers want high quality, fresh Australian milk on their tables every day. Coles therefore needs a sustainable Australian dairy industry to meet the needs of our customers. And the more milk we sell, the better it is for Australian dairy farmers.

The simple fact is that Coles does not buy raw milk from the farm gate. We buy processed milk from foreign-owned manufacturing companies from Japan, Italy and across the Tasman that now dominate the Australian food sector. These milk processing companies determine the price they pay to Australian dairy farmers.

To ensure that there would be no flow-on effects for milk processors and dairy farmers from our decision, Coles fully funded the lower retail price from its own profit margin. Coles did not ask milk processors or dairy farmers to help fund the cost of lower retail process. Indeed, Coles increased the price we paid to the major milk processing companies in mid-January.

While retail milk prices are available on shelf every day for everyone to see, there is a lack of transparency about what the multinational milk processing companies pay Australian dairy farmers at the farm gate.

Coles believes there should be greater transparency of farm gate pricing by the multinational milk processing companies so that everyone knows what is really going on. The multinational milk processing companies should not be able to sit between Australian dairy farmers and customers and protect their profit margins.

What needs to be fully appreciated is that the milk price to farmers is determined by the export market which equals half of the 9 billion litres of annual Australian milk production. This market is extremely strong and is allowing farm gate prices to increase, a dynamic which is set to continue.

Murray Goulburn, one of Australia's biggest milk processors and exporters publishes its farm gate price. A copy of a recent press release by Murray Goulburn and its recent farm gate prices is attached. The Murray Goulburn data shows that its farm gate prices have increased by more than 20 per cent in the last year.

The peak milk industry group, Dairy Australia, recently forecast higher global milk demand and higher prices for Australian milk. A copy of their press release is also attached.

Accusations that the price reduction on private label milk will destroy the milk industry is ludicrous. Branded milk still accounts for about 25 per cent of sales and is therefore about five per cent of total milk production.

In a theoretical worst case scenario, milk processors margins would be affected by no more than a few cents per litre. Given Coles has just paid them an equivalent price increase there is absolutely no excuse for processors to squeeze farm gate prices. Processors profit margins are already higher than our own in any event.

In any case, multinational milk processing companies have a range of options to respond to greater competition from private label milk rather than take the easy option of cutting farm gate prices for raw milk.

They could and should follow Coles lead and reduce costs and improve operating efficiencies to fund investments in value, quality and service to their customers and higher returns to their owners.

I would be pleased to discuss this issue with you to ensure a thorough understanding off what we are doing because we strongly believe what we are doing is right for our customers and is right for Australian dairy farmers.

Yours sincerely

Ian McLeod
Managing Director

Coles Milk Pricing Fact Sheet

Reducing the price of Coles brand milk for our customers

As part of our overall strategy of lowering the price of the weekly shopping basket, Coles announced retail price reductions on Coles brand milk products on 26 January.

The price reductions applied to all Coles brand milk products, bringing milk prices down to one dollar a litre on 2 and 3 litre packs.

Coles also removed the previous price premium for lite milk, so the price of full cream milk and lite milk is now exactly the same in all Coles' supermarkets, as we didn't believe it was right for health-conscious customers to be charged a premium.

What does this mean for dairy farmers?

The farm gate price dairy farmers receive is set by the world price because around half of Australian milk products are exported.

The farm gate price is rising because global demand for milk product is rising (see Dairy Australia press release 14 February 2011).

Coles has no direct influence over farm gate prices because Coles buys milk from processing companies, not from dairy farmers.

Coles paid a higher commercial price to these milk processing companies for Coles brand milk in mid-January so they would not have to pass on a lower price to dairy farmers.

Dispelling the myths about Coles brand milk pricing

Myth One: Coles is refusing to meet with dairy farmers about its milk price cut announcement

Coles has discussed the price reductions with milk processors and has met with the peak milk industry organisation, Australian Dairy Farmers, and other farmer organisations.

Myth Two: Coles' retail milk price cut will push down the farm gate price of milk.

The farm gate price dairy farmers receive is set by the world price because most Australian milk products are exported. In any case, Coles buys milk from the major milk processing companies, not direct from the farm gate and Coles paid a higher price to milk processing companies in mid-January. As such, the farm gate price should not be affected by our decision to reduce the retail price.

Myth Three: Coles' actions are anti-competitive

Our intent is to provide lower priced milk for our customers while not adversely affecting our suppliers. Coles increased the price it paid to milk processing companies in mid-January and is fully absorbing the cost of the lower retail price in a lower profit margin. Coles has therefore reduced its own profit margin on milk sales so that it can provide a benefit to its customers.

Myth Four: Coles funded lower milk prices through higher petrol prices at Coles Express.

Coles does not cross subsidise lower grocery prices through higher petrol prices. Pricing of these products is quite separate. Petrol prices have been rising because of higher global oil prices.

Myth Five: Lower Coles brand milk prices will result in lower branded milk prices and hurt farmers.

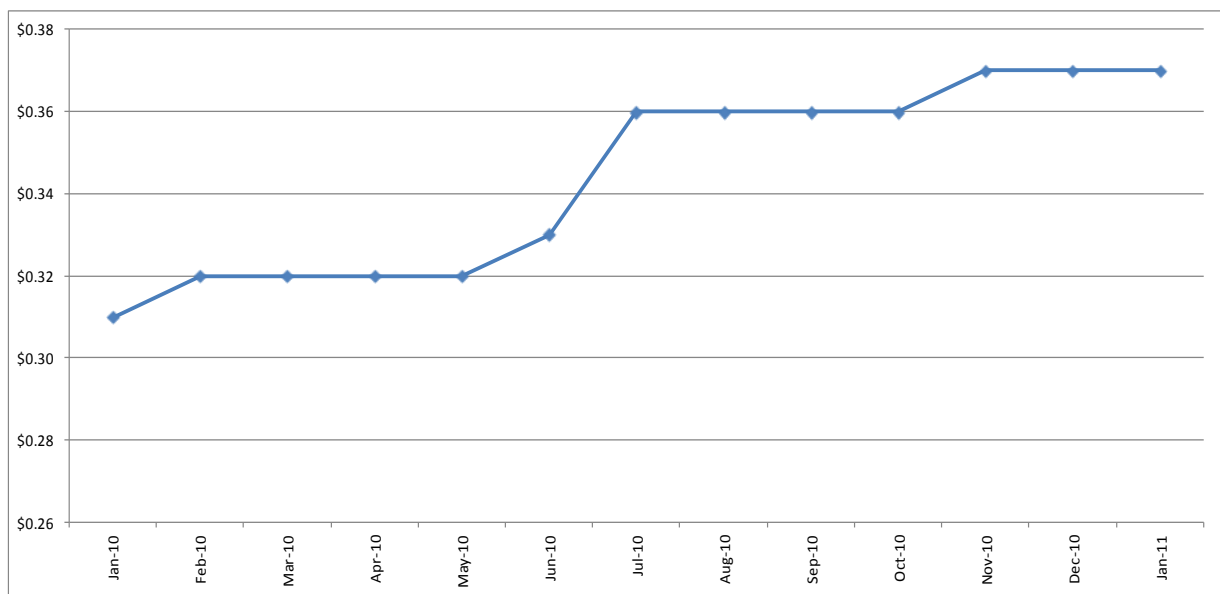
Coles has increased the price we pay the milk processors for Coles brand milk, so they have no reason to reduce farm gate milk prices as a result of the Coles brand retail milk price reduction. Any decision about branded milk prices is a matter for the milk processors.

Myth Six: Lower Coles brand milk prices are part of a plan to replace fresh milk and with long life milk.

Coles' customers want high quality fresh milk at the lowest possible price. To achieve that, Coles' is paying milk processors more for their milk, and fully absorbing lower retail prices. That is a win for the Australian dairy industry and a win for our customers.

What drives farm gate milk prices?

The farm gate price dairy farmers receive is set by the world price because a large proportion most Australian milk products are exported. The farm gate price is rising because global demand for milk product is rising (see Dairy Australia press release 14 February 2011). The following graph shows that benchmark farm gate prices have been increasing.



Source: Dairy industry

Coles purchases most of its private label milk from milk processing companies, not dairy farmers. Coles increased the annual contract prices paid to these processors in mid-January – a week before it reduced the retail price of milk. In other words Coles reduced its own profit margin on milk - not the prices paid to the milk processors.

How much milk does Coles sell?

Coles' milk sales (including modified drinking milks) represent less than 5% of Australia's total milk production.

For more information

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