

MARKET UPDATE

Monthly Market Summary for Members of DFMC



August 2010

Milk output down 3.9% in 2009/10

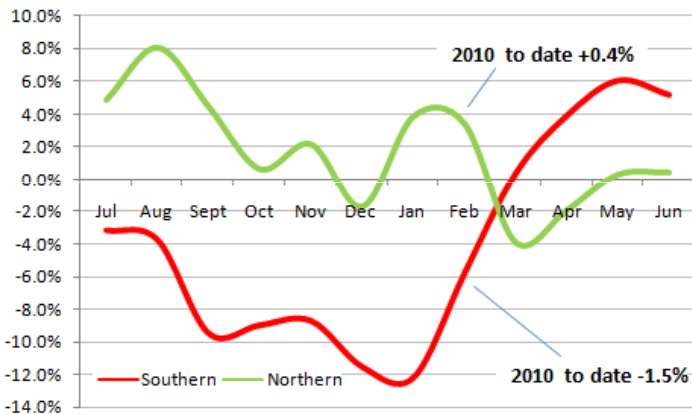
A strong finish keeps the loss of volume under 4%.

Official full-year milk production numbers were released by Dairy Australia showing total output for the year was 9.023 bn litres, down 3.9% on the previous year. The result was a partial turnaround from the result 7 months into the year when volumes trailed 2008/09 by 6.5%, but the better season, lower supplementary feed costs and increased optimism about 2010/11 prices lifted output – the last quarter has been 4% higher than in 2009. June output was up 4.6% - in southern regions up 5.2%.

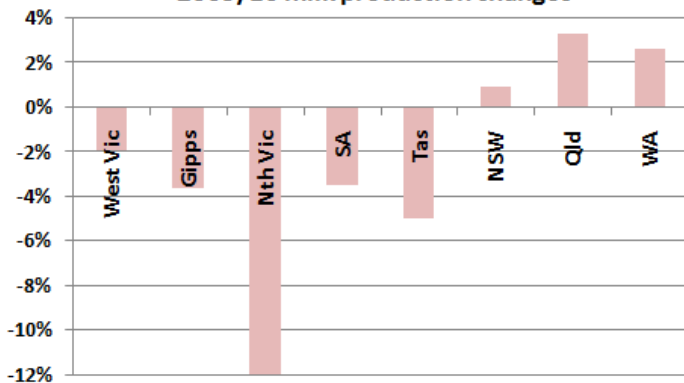
Western Victoria was the largest production region in 2009/10, with 2.07bn litres or 23% of the total. Northern Victoria finally finished 12% lower at 1.67bn and now speaks for 18.6% of the total. 5 years ago, the north posted 25.3% of the national total with 2.57bn litres.

Year on year changes show the recovery in southern regions continues as the best season in a decade rolls on.

Australian milk production - changes in southern v northern output in 2009/10



2009/10 milk production changes



Milk sales up 2.3% in DFMC regions

Full year sales strongest in NSW.

Australian milk sales were up 2.3 per cent in the full 2009/10 year, which matched the total increase in the packaged milk sales in regions supplied by DFMC milk. 28% of the total increase in milk sales came from UHT products, which curbed the overall gains in fresh product to just 1.6% over the full year. NSW posted the best gains in packaged milk sales at 3.9%, Victoria 2.2%, SA 1.3% and Queensland limped to 0.6%. Worryingly for the northern state, the last 4 months have seen sales in reverse, down 0.8% compared with the same period in 2009.

Important market indicators

Dairy export index	The index has fallen to 127pts, down about 14% on the last month, as the market weakens
World dairy prices	Powder prices have fallen sharply again in the past month, WMP losing the most (US\$350/t) and SMP off US\$150/t.
Australian dollar	The \$A has been volatile in the past month, affected by a host of factors from tax policy, Chinese economic prospects, the financial crisis in Europe... and the election result
Grain futures	Grain prices in US have increased sharply due to fears of a shortage of global wheat. This has quickly flowed on to feed grain prices with commodities up around \$100/t
Cow prices for cull exports to the US	The US market for Aussie cull cows has improved with supply problems lifting US\$ prices. The stronger \$A hasn't helped push these into \$A prices in the past month

No dairy CPI

June food CPI rose slightly by 1.4% after the tiny increase in the March quarter. After 3 quarters in deflation, the ABS said dairy CPI crept back to a neutral position for the 12 months to June 2010, with mil at 0.1%, cheese still in negative territory at 1.1% - offsetting small gains in ice-cream and other products. The trend is turning as consumer confidence improves the scope for stronger price rises.

Food and Dairy annual CPI over last 10 quarters (red = most recent)



Coles gaining on Woolies

Latest sales data says Coles is well on the way back

Woolworths Ltd posted a 5.1% increase in annual sales for its Australian food and liquor business in 2009/10. The division posted a 3.3% increase in comparable store sales over the full year, constrained by continued low food inflation of 1.1%, with deflation in produce and perishables. During the fourth quarter, comparable store sales were up 1.8%, **Meanwhile Coles** posted a sales increase of 4.3% over the full year. The group sustained a better same-store sales performance against its larger rival, with the 4th quarter like-for-like increase rising to 4.2%, making this the third quarter in row that it has outperformed Woolworths.

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World dairy market returns

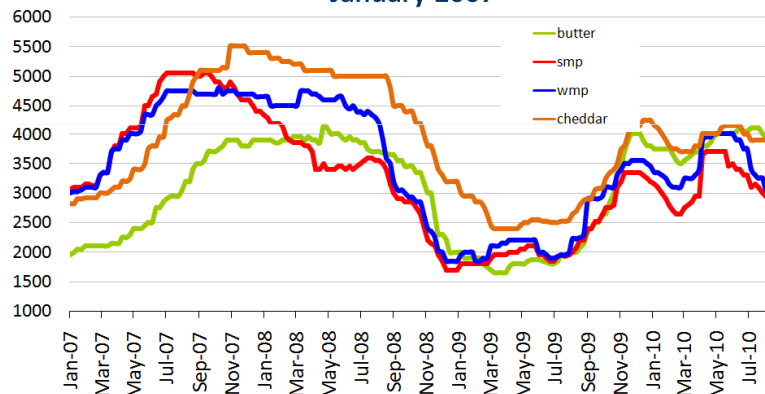
Slides in export indicator continues

At the time of this report the index of Australian export returns had lost about 20 points over the last month in net terms, with weaker spot prices and a slightly stronger \$A. Spot prices have continued to fall as the fears of over-supply stalk the world market, with increased output of Australia, NZ, US and signs of recovery in Europe give dairy product buyers the excuse to be less committal about buying larger quantities for longer periods. The \$A remains volatile and has seen larger swings from week to week as a variety of issues affect the \$A itself and the US currency.

Prices weaken further in August GDT auction

Export spot prices have weakened in the past month, with the latest GDT auction set to spark a further retreat in prices for more than just whole milk powder (see below) The average price for WMP shed 7.7% on average in the GDT auction event in early August, as did SMP and butter, but the prices for longer contracts did not weaken as far, and there was even a gain in the 6-month price for WMP, giving signs that the market is plateauing. Fonterra reported that the trade weighted index covering the basket of products fell 8%.

NZ export quotes in \$US/tonne - weekly since January 2007



Spot prices for powder down to US\$3,000/t, cheese holding

As the chart above indicates, milk powder prices have fallen over the past month to around US\$3,000/t, while butter and cheese prices have remained relatively steady. Butter stocks are relatively short everywhere, with prices within the EU hitting US\$4,800/t and has hit US\$4,200/t in the US, affected by a little more milk production than expected. Cheese prices remain close to US\$4,000 a tonne which will keep southern milk values for DFMC milk stable while those prices hold. US cheese prices are still on the way up and have moved above US\$3,500 for the first time in 2010.

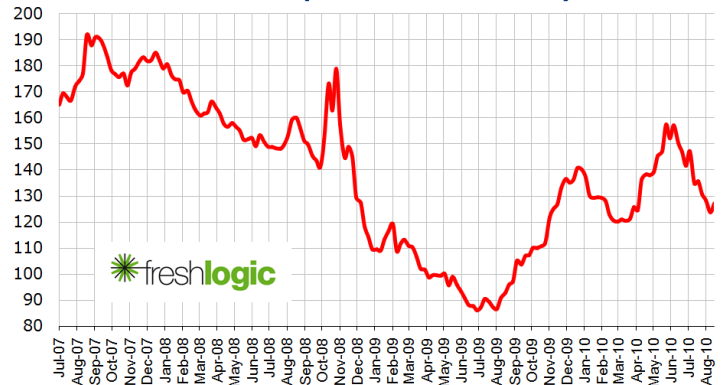
Grain markets suddenly change

World grain markets have shot up in the past few weeks, driven by a shortage of supply of Russian exports onto the world market, while the USDA has forecast an overall lowering of world grain supply by 2.3% in 2010/11.

Prices have eased recently after peaking in early August, but there is a lot of uncertainty affecting the outlook. Barley and sorghum futures have quickly risen in value – barley by more than \$100/t in a few weeks.

The rising feed costs will start to have an effect on world dairy prices if these prices hold, but analysts working in the grain market think the price spike may have been a little panicky. The outlook for east coast feed grain supply is fairly strong based on crop growing intentions and the recent rainfall that will only further improve sub-surface moisture.

Australasian export index from July 2007



Take note: The index is an indicator of spot trends in gross export returns to the industry based on quoted Australasian export prices, movements in currency and the total milk usage in exports by the Australian industry. It was set at 100 on 1 January 2004.

Source: Freshlogic

Another potential scare for Chinese

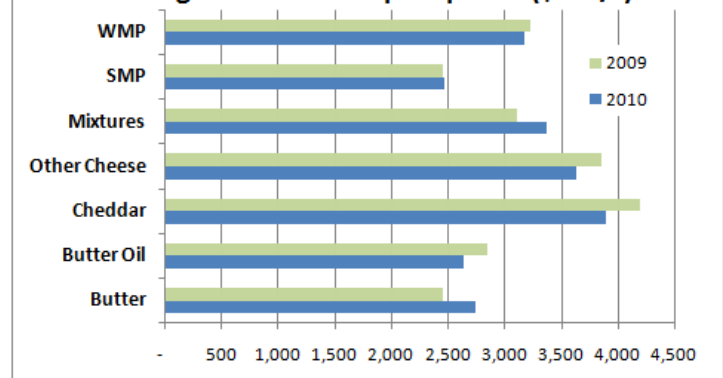
Just when the melamine scandal was becoming a thing of the past, a new problem emerges...this might be one to watch!

China's Health Ministry has ordered food safety authorities to investigate hormone imbalances in infants allegedly caused by being fed a formula drink, after tests were carried out on samples of milk powder made by Synutra International Inc. It is claimed that the formula had led to infant girls developing breasts. Synutra said in a statement that it is "completely confident that our products are safe and our quality levels are industry-leading. We do not add hormones to our products and we have invested heavily in research, quality control, formulations and ingredients." The company said it is working closely with the authorities "to test product samples to prove that these claims are false. We expect that the results of these tests should be made public soon".

Fonterra has confirmed that it is one of several suppliers of whole milk powder to Chinese company Synutra International, which is being investigated following accusations that premature breast development in small girls may be linked its formulas.

There is a ban on the use of hormonal growth promotants in dairy cows in New Zealand which the Food Safety Authority says that is backed by tight legislative and monitoring controls. Meanwhile Fonterra's chief executive, Andrew Ferrier says he is "100 per cent positive" it can protect its reputation in food-scare-prone China in future. He believed Synutra had drawn New Zealand dairy product into the debate to give Chinese consumers confidence, not because it blamed it as the product source.

Average Australian export prices (\$ US/t)



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