

# DAIRY REPORTER

Weekly Dairy News for Members of DFMC



1 June 2010

## Consumer sentiment takes a beating

*Higher interest rates with fading government's stimulus dampen consumer sentiment and tighten retail sales.*

The Westpac-Melbourne Institute Consumer Sentiment index has fallen from 116.1 in April to 108 in May, a decline of 7 per cent. Westpac chief economist Bill Evans has stated that consumer sentiment usually drops when interest rates become too high. The latest increase in rates that has pushed the variable mortgage rate to 7.4 per cent from 7.14 per cent is one of the important factors that has led to the drop in the consumer sentiment. With OECD forecasting Australia's interest rate to be one of the highest in the world at 5.7 per cent by 2011, the consumer sentiment is expected to plunge further with time and have a huge impact on the economy.

*Meanwhile*, Woolworths CEO Michael Luscombe reckons the Federal Government's stimulus measures of late 2008 and early 2009, which helped survive the Australian retail sector by reviving consumer confidence and saving jobs at the critical period of the global economic crisis, will be completely "washed out" by November 2010. Luscombe expressed his concerns over the recent slump and downturn in retail sales and sector, which he believes has been triggered by the gradual fading of the stimulus and the rising petrol prices and interest rates, and could lead more retailers to collapse after the recent failure of Clive Peeters. Luscombe said Woolworths is focussing on cost savings and passing savings to shareholders and customers.

## Coles expands new formats

*Coles extends roll-out to gain edge over Woolworths.*

After launching trial stores with new format in every state, which reported double-digit sales growth, Coles has announced its plans to launch more than 50 new format stores by June 2011 and 100 more in the following year. This expansion is part of the second stage of its five-year Coles turnaround program as it tries to take back more ground from Woolworths.

## Vic farmers agree to higher UDV levy

*Higher UDV levy gets farmers' approval.*

In the latest chapter in the riveting saga over the future of dairy farmer advocacy, Victorian dairy farmers have agreed to pay a higher United Dairyfarmers of Victoria (UDV) levy – increased from 0.042c/l to 0.06c/l for the first time in five years – from 1 July 2010. However, the UDV also decided to review the levy annually, which means the next levy increase will be discussed next year, and allowed farmers who have stopped supplying milk to remain as members.

## WCB changes share ownership rules

*Limits on shareholding in the listed company have been raised.*

As scheduled, WCB has altered its share ownership limit, which now enables a single investor to own up to 15 per cent, instead of the previous 10 per cent, of the company's share.

## Westland's payout

*Westland will come close to Fonterra's payout in the current year.*

With the strong rise in world prices, small west coast NZ co-op Westland Milk Products intends to pay its second highest return from milk of more than \$6/kg milk solids to its shareholders. Westland has enjoyed the production conditions this season and expects to close the year with milk intake up 5%, well behind the increase Fonterra expects from its South Island supply base.

## Headlines

- Economy souring, say consumers
- Fonterra announces 2010/11 payout
- Slow start for new futures market
- Fonterra welcomes HK court's decision
- HGL wants greater farmer involvement

Indicators	
Dairy export index	A decrease by 5 pts on prices and slight rise in \$A
World dairy prices	Sharp drop in SMP with others steady
Australian cull cow prices in the US	Market weaker but steady in \$A terms
Grain futures	Decreases in US and local futures prices

## Fonterra payout could get to NZ\$8/kg

*Fonterra announces payout, though warns of market volatility.*

Fonterra has announced a payout forecast for the full 2010/11 season in New Zealand of \$6.90-\$7.10/kg MS. This includes a milk price of \$6.60/kg MS and a Distributable Profit of 30-50c/share. The opening Advance Rate is \$4.30/kgMS.

Fonterra Chairman, Henry van der Heyden, says if prices and the currency stay where they now are for the whole season, a payout of more than \$8 is a possibility. "But, there's significant volatility in the markets – in both commodities and currencies. That means we need to be doing our farm budgets on the forecast and cash flows broadly in line with this season."

## Fonterra welcomes HK court's decision

*Fonterra wins an important case in the shadows of melamine scandal.*

Fonterra has welcomed a Hong Kong court's decision to reject a lawsuit by the parents of four Chinese children who were among thousands made ill two years ago by tainted milk powder. Fonterra was a majority shareholder in one of the companies (Sanlu) at the centre of the scandal, which later went bankrupt due to the consumer backlash against its products.

Hong Kong's Small Claims Tribunal adjudicator Ada Yim ruled last week that the case should be handled by mainland Chinese courts since the plaintiffs are from the mainland and their children were poisoned there. The parents say lawsuits filed in mainland China by them were ignored.

The judge said Fonterra could not be held accountable because, as a minority shareholder, it had no control over the production and distribution of Sanlu milk powder. It had three out of seven seats on the Sanlu board - not enough to influence company policy.

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## Index of export returns

**Freshlogic tracks an index of the \$A value of spot returns from dairy exports as an indicator of the future southern milk prices.**

**SMP loses ground on EU action.**

The only change in spot prices quotes was a drop of \$250/t for SMP – unsurprisingly as the EU's plan to sell by tender some 65,000t out of intervention stores. The index was also pruned by the recovery in the \$A as exchange rate volatility continues. The index lost 5 points to **152.5**, as the \$A closed the week down at **US\$84.6c**.

**New futures trade opens slowly.**

The new international SMP futures and options market – claimed by CME to be the first international dairy risk management tool available – was launched on 24 May but had a very quiet week. The CME site shows no trades for its first week with the quote on short-term futures booked at US\$3100/t, while prices for periods over the rest of the year rising to US\$3200. The products, which are based on a physically delivered contract, have been introduced into a market which has an estimated size of US\$6.7 billion. The SMP futures trading market has delivery points in six locations, including Auckland and Melbourne.

## IMF: EU's debt crisis risk to global growth

**IMF announces lifeline, hopes to revive EU debt-ridden countries.**

The International Monetary Fund has stated its concerns regarding the sovereign debt crisis in EU, which it believes, is the biggest threat to global economic recovery. The managing director of IMF, Dominique Strauss-Kahn, has stated that EU countries have to solve their financial problems as they try to expand their economies. In a bid to restrain the financial problems and reinforce the euro, the IMF along with the EU has announced a US\$1 trillion lifeline for Greece, Portugal, and Spain, and other debt-ridden countries.

## UK study into milk selling arrangements

**UK study reveals unhappy milk producers, bound by lengthy notice periods.**

A recent study undertaken by Defra has investigated the milk selling arrangements in the UK. The report has revealed that a wide range exists in farmgate prices from 20ppl to 40ppl and while producers with choices of milk buyers attained the highest milk price, others with only one buyer attained the lowest. Further, organic producers, on an average, attained a premium of 7.3ppl more than conventional producers. Although the study showed that 30 per cent of the producers are not happy with their milk buyers, one quarter of producers had the option of selling to only one milk buyer and the rest had a choice of two buyers. The farmers in the Less Favoured Areas had the most restricted choice of buyer. Further, the report found that lengthy notice period, such as the 12-month notice period for leaving a contract, also restricted farmers to move buyers.

## Danone's cholesterol reduction



**Danone teams up with cardiovascular experts to develop healthy products.**

Danone Research – a unit of Danone – has formed a \$8 million partnership with Canadian biological science firm Micropharma to develop reduced cholesterol dairy products. This collaboration will bring together the expertise and patented technology in cardiovascular health of Micropharma and the experience, market knowledge and equity financing of Danone Research to develop a new healthy product for the market.

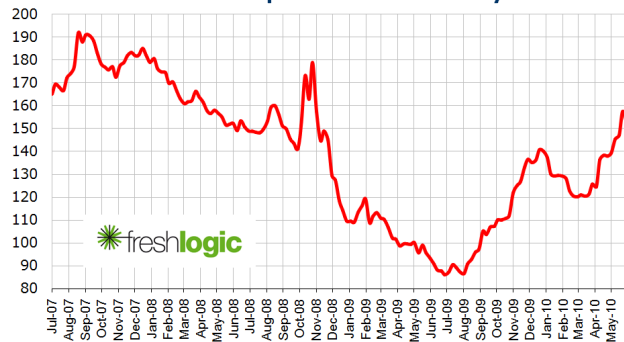
## Mastellone in strife with debts

**Annual losses soaks Argentinean processor in debt.**

Mastellone Hermanos SA – the Argentine partner of Danone – is reportedly ridden with restructured debts of US\$222 million after suffering an annual loss of €54.8 million. It is believed that business consultant Merrill Lynch is helping the Argentine company to find a partner to resolve its situation.



## 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.

## Chinese food "insecurity"

**Burgeoning population mounts serious food problems for China.**

A major investment bank is suggesting that fertiliser could be the safest long term investment bet in China. CLSA Security's Simon Powell told investment managers at a recent forum that China has to feed 20 per cent of the world's population with only 7 per cent of available arable land and fresh water. Given Beijing's resolve to be self sufficient, huge increases in fertiliser use are the only way to bridge the gap between demand and supply. China already uses 30 per cent of all the fertiliser produced in the world even with its per-hectare use much lower than other users. Meanwhile food consumption in China's swelling cities has doubled since 2002. Even in rural China, food consumption has grown more than 14 per cent a year for the last decade. But China's economic growth has come at the cost of food production. Farmland has shrunk by 6% since 1996 and industry has left more than 10% of total arable land contaminated. The effect of declining farmland would be significant rises in crop prices and mounting pressure and incentives for farmers to increase yields. All three forms of artificial fertiliser will be in hot demand but added to the underlying demand will be the bigger structural efforts of Beijing to ensure food security.

## HGL wants greater farmer involvement in milk pricing processes

**HGL wants reform, tips the scale in favour of greater farmer involvement.**

According to the High Level Group (HGL), the EU should establish a detailed framework for milk contracts and amend its competition rules for dairy farmers, which would allow increased farmer involvement in the milk pricing determination process. The HLG urges the Commission to develop a legislative proposal under agricultural law that will enable farmers to "negotiate contract terms, including price, jointly for some or all of its members' production with a dairy, subject to an appropriate size limit." It is expected that the proposals on regulatory changes will be further developed in the coming month by EU Farm Commissioner Dacian Cioloș, based on HLG's conclusions.

## Tenth herd retirement programme to boost US milk prices

**CWT conducts another retirement programme to sustain US milk prices.**

Funded by US dairy co-ops and individual dairy farmers, Cooperatives Working Together (CWT) is conducting its 10<sup>th</sup> herd retirement program, which is hoped to give a further push to the already recovery milk prices in the US. Taking into account the strong beef prices and the relatively low cow and springer prices, CWT will be considering bids up to US\$3.75 hundredweight.

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