

DAIRY REPORTER

Weekly Dairy News for Members of DFMC



6 December 2011

MG reports strong financial results

MG booked strong gains for 2010/11.

Positive results continue to highlight Murray Goulburn's recovery from the impact of the GFC three years prior. At last week's AGM, Murray Goulburn posted a \$15.2 million increase in pre-tax profits to \$40 million for 2010/11, up from \$24.8 million the previous year. Sales revenue also improved, up 6% on last year, to \$2.29 billion, with export sales of \$1.17 billion. Despite less than favourable currency conditions, MG has been able to lift milk prices four times over the year, with the final weighted average milk price 27% higher than the previous year.

The company's domestic business – which includes the Devondale brand – also reported strong financial results, with combined domestic net revenue of \$1.12 billion.

Tracy elected as new MG chairman

South Victorian dairy farmer replaces MG's ex-chairman Davies.

Following the AGM, Mr Philip Tracy was elected as the new chairman, replacing outgoing chairman Grant Davies. Mr Tracey has been serving as a director on the Board of MG since 2009 and has a strong background in agriculture and finance. A southern Victorian dairy farmer, Mr Tracey also owns Southern Stockfeeds and an accounting practice, both based in Foster. He has previously held the position of deputy chairman in different organisations, including the Herd Improvement Cooperatives – SGHI, GHI, and Hico. Mr Tracy indicated that he expects to have a strong partnership with the recently appointed managing director, Mr Gary Helou, who has outlined his vision to improve efficiencies within the business and enhance innovation.

NSW Co-op backs Sungrow takeover

NSW's dairy plant approved takeover has an export flavour.

Shareholders of Hastings Co-operative have voted 92% in favour of the sale of the Wauchope dairy factory in NSW to Indian-owned agribusiness, Sungrow Australia. The proposal, made in June, is for \$2.94 million, including plant and equipment, land, and buildings, and stock on hand. Sungrow plans to add Indian products such as ghee, paneer, and lassi to its production line, increase milk production and build a new powdered milk factory. More than 50% of its manufactured dairy products are expected to be exported to the Gulf countries, with the remainder to be sold domestically.

Metcash profits slide in tough market

Metcash lifts full-year forecasts despite slide in profits.

Metcash reported a net profit of \$94.4 million for the six months to 31 October 2011, down 14% - a reflection of the intense retail competition, grocery price deflation, and increasingly 'price' sensitive consumers.

However, when removing \$19.5m in costs associated with the purchase of the 80 Franklins supermarkets which took place earlier this year, and a one-off tax benefit (\$4.9m) related to this period, the bottom line was up \$1.6 million compared to the previous year, to \$116.6 million. While IGA distribution margins were down five basis points, sales from Metcash's IGA distribution business rose 1.7% to \$3.70 billion.

Despite the tough market, Metcash insists it has maintained its share of the supermarket sector, and has increased its full year forecasts, expecting 'low-to-mid' single digit growth in the underlying earnings per share for the full year, higher than its original estimate of 'low' single digit growth.



Headlines

- MG reports strong financial results
- Metcash wins legal stoush with ACCC
- MG joins Fonterra's GDT auction
- Economic outlook threatens spending
- Mengniu products hit retail shelves

| Indicators | |
|--------------------|-------------------------------------------|
| Dairy export index | Index falls as dollar lifts |
| World dairy prices | Powders and cheddar stronger |
| Grain futures | Rise in US wheat futures and local grains |

Federal Court gives all clear to Metcash

Metcash wins legal stoush with ACCC to buy Franklins.

The Federal Court's full bench has ruled against the ACCC's appeal, which attempted to stop the takeover of the Franklins chain by Metcash from parent Pick n Pay Retailers. The decision upheld an earlier primary Federal Court judgment and also requires the ACCC to pay Metcash's legal costs. The ACCC had argued that Metcash's \$215 million Franklins' buy-out in NSW would significantly increase its control within the wholesale independent supermarkets sector, and would likely result in increased prices. The ACCC is reported to be considering the ruling. Metcash welcomed the judgement, which it reports will help increase competition against the national self-supply chains, and is currently seeking expressions of interest for the purchase of the 80 Franklins supermarkets.

Synlait seeks \$70m for majority stake

Canterbury dairy company seeks new investment to expand.

Synlait Ltd is seeking investor capital in return for up to 70% of its wholly owned subsidiary Synlait Farms, in order to undertake productivity improvements, irrigation development, and acquisition of complementary dairy farms. The dairy producer has issued an investment memorandum, and is seeking proposals from potential investors by 20 December. Under the proposed transaction, worth up to \$70 million, Synlait Farms and Synlait Milk would operate independently with different shareholders, but would continue to maintain a strong customer-supplier relationship.

Fonterra: waterway fencing compulsory

Co-op tightens rules on maintaining water quality.

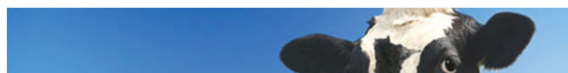
Fonterra has included a new clause in its terms and conditions of milk supply making it mandatory for its 10,500 farmers to fence off waterways within 18 months from the beginning of next season. The move forms part of the Clean Streams Accord, signed by Fonterra and various government bodies eight years ago, in a bid to keep waterways free of effluent. Since its signing, many farmers have already voluntarily fenced off waterways.

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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 potential impact on southern milk prices.

Market firmer with stronger dollar. The index of Australia spot returns slumped this week, as the \$A gained strength against the \$US. Spot prices for powders and cheddar were stronger, while butter stayed steady this week. The \$A closed the week at **\$US1.0244** and the index of spot returns fell by 4 points to **122.9**.

Murray Goulburn joins online trade auction. MG has signed up to offer lactose for delivery on the online trading platform *globalDairyTrade* (GDT) from Trading Event 65 on 3 April 2012, becoming the third major supplier to participate, joining Fonterra and Dairy America. MG will offer fixed-price contracts mainly in the GDT contract periods 2 and 3, and occasionally 4.

MG's decision to join GDT was supported by the increased demand for lactose including use in infant formula and other nutritionals, and the opportunity to add a new product not currently offered. MG expects the move to benefit both shareholders and customers, and potentially reduce volatility and provide greater price transparency for buyers and sellers. The move enhances GDT's role as an international trade platform in a broad range of dairy commodities. GDT's sales to date total more than \$5 billion, with approximately 700,000 metric tonnes of products traded annually. It has about 500 qualified bidders from more than 80 countries.

Safety standards in China under fire

Revised dairy safety standards stir complaints.

China's Ministry of Health has defended the new revisions in the milk safety standards protocol, countering accusations by the country's leading newspaper *People's Daily* that the country's top dairy manufacturers, including Yili, Mengniu, and Bright Foods, had influenced the decision to amend the baseline bacteria count for pasteurised milk, raw milk, and yoghurt in the draft regulations.

Critics state that the standards are the weakest in the world, and were designed to provide dairy producers with greater freedom. However, according to the food safety ministry, the drafting panel of the latest national dairy legislation consists of 70 members, including representatives from the government, academia, and the dairy industry.

Under the new safety standards, the baseline bacteria count in raw milk in China has been raised to 2 million cells per millimetre, four times higher than the amount allowed under previous regulations, and the minimum standard for protein content raised to 2.8% from the proposed 2.9% when the standard was published in March last year.

Worries about new post-2013 milk quotas

Irish dairy farmers anxious over new milk levy proposal.

Irish farmers are concerned that dairy processors, such as Glanbia and Dairygold, might impose penalties for milk supplied beyond contracted volumes, following the end of the EU-wide quota regime ends in 2015.

Unlike the EU quotas – where total milk supply is controlled – quotas imposed by dairy processors seek to control company milk supply to meet their own market needs. While common place elsewhere, they are a relatively new concept in the EU. The penalties, possibly in the form of monthly quotas, would be imposed in peak production months, in order to level production. Ireland's aim to increase milk production by 50% by 2020 will not work if it exacerbates the major seasonality problems that already exist. The quotas imposed would be designed to prevent undue peaks and would assist the industry gets better returns on its investment in processing capacity. The Creamery Milk Suppliers Association (ICMSA) has indicated that the penalties could be significant, and is concerned about the implications for farm planning, and has raised questions over ownership of the current quotas post-2015.

Australasian export index from Jan 2009



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.

EU economic outlook threatens spending

Is the EU economic turmoil spilling over to Australia?

The ongoing weakness in the global economic environment – influenced by Europe's ongoing economic crisis – is starting to weigh on Australia's economic outlook. While growth in emerging economies, including China, continues, more broadly the global recovery remains shaky. If there was a significant deterioration in the Europe or the US, this is likely to have flow-on effects in growth in emerging market economies. At home, the weak international economic outlook has led to a downward revision of Australia's short-term economic and fiscal outlook.

The recently released Mid-Year Economic and Fiscal Outlook incorporates revised GDP growth forecast for 2011-12, now 3.25% for the next two years, down from forecasts of 4% and 3.75% made in May this year. In line with the weaker economic growth, the unemployment forecast has also been lifted from 4.5% to 5.5% by June 2012.

US SMP earnings lift on higher prices

US export earnings lift on back of strong global demand.

Supported by strong global demand, the value of US SMP exports increased by more than 30% in the third quarter of 2011 compared to the same period a year ago. However, while rising prices have lifted the value of SMP sales, the total volume of exports between July and September 2011 (112,560 tonnes) was only slightly higher than the same period last year (109,770 tonnes). The moderate increase in volume may be influenced by the average price over the quarter, which was up 28% to US\$3,536/tonne, compared to the same quarter last year.

Production of SMP – which constitutes the main dairy export commodity of the US – reached 148,700 tonnes in the first nine months of 2011, up 73% compared to the same period last year.

Mengniu dairy products back in market

Mengniu Dairy recovers to put dairy products back on retail shelves.

Mengniu Dairy – a leading dairy product manufacturer in mainland China – has commenced the distribution of its dairy products in Hong Kong after a three-year absence. Currently, two of its conventional products – pure milk and low-fat high-calcium milk – which account for more than 60% of the local UHT milk and dairy product market, are available at more than 80 stores in the Kai Bo Food Supermarket chain, targeting the health-conscious Hong Kong consumers. Hong Kong is considered as key global consumer market, and has very strict quality and safety requirements of dairy products. Since the occurrence of the melamine scandal in 2008, Mengniu has pledged \$100 million to upgrade its milk sources, investing in credible small and midsize ranches, and to manage product quality at every stage of production. In 2010, the group recorded an annual turnover of RMB30 billion.

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