

# DAIRY REPORTER



Weekly Dairy News for Members of DFMC

6 September 2011

## Bega profits steady

*Bega flags potential, as post-tax profits exceed prospectus guidance.*

Bega Cheese posted a steady profit before tax for the 12 months ending 30 June 2011, but net profits exceeded the prospectus forecast of \$17.9 million due to a lower-than-expected tax charge. Bega's sales rose by 12% to \$932 million, driven by higher prices for cream cheese and nutritional powders. EBITA was level with last year's result at \$52 million, although the EBITDA margin was lower due to higher input costs for milk, lower margins on contract packing arrangements and transition costs associated with the recent acquisitions at Coburg and Strathmerton. Bega collected 591 million litres of milk and pumped out 186,000 tonnes of dairy products.

At the same time, Bega has flagged plans to continue to grow, on the back of its strong balance-sheet and expanded manufacturing foothold. The company has signed a memorandum of understanding for a new 10-year supply contract with Fonterra and expects to purchase the remaining 30% of Tatura Milk Industries by end of this year.

## ADF: stricter milk supply chain regulation

*ADF spells out strict measures to curb profit-making conduct of businesses.*

In its submission to the Senate Economics References Committee, the peak national dairy farmer organisation Australian Dairy Farmers (ADF) has asked for several measures to improve the scrutiny of the fresh milk supply chain - the establishment of a Supermarket Drinking Milk Commissioner; a Mandatory Supermarket Industry Code of Conduct; and a number of other changes to the Competition and Consumer Act, including a "statutory test of good faith".

ADF articulates the impacts of the price reductions on regional supply chains using a wide range of sources and references and claims that the 1-2cpl assessed impact on wholesale margins is just the beginning of further wholesale price adjustment once branded milk prices are lowered to respond to private label pricing over time.

## Metcash talks down its prospects

*Metcash fears a \$20m hit in the form of costs from its Franklins' takeover.*

Metcash reported solid growth in the past year, with wholesale sales up 6% and comparative store sales up 4.5%. However, it has forecast to deliver low single earnings per share growth - less than 5% - this year, and warns that it may incur initial costs of more than an estimated \$20 million of its \$215 million acquisition of Franklins' proceeds.

Metcash expects Franklins to generate wholesale sales around \$500 million and earnings before interest and tax of \$20-\$30 million a year; however, at the same time, it expects to incur similar costs as it closes Franklins' warehouse and head office and sells the 80 stores to independents over a period of 9 to 12 months.

Goldman Sachs estimates that the deal would boost Metcash's net profit by 1% in the first year and 4% by the third year.

## Aussie farmers most pessimistic in 2 years

*Confidence among farmers takes a hit as economic uncertainty looms.*

The latest quarterly Rabobank Rural Confidence Survey shows that farmers are the most pessimistic in over two years, due to government's policies and global economic uncertainty, with 35% of farmers expecting conditions to worsen in the coming year, compared to 12% in the prior quarter. The survey also found that farmer sentiment had weakened in all states, with Queensland farmers the least confident and Tasmanian farmers the most confident. Cattle farmers were found to be the least confident, and dairy farmers the most confident.

About 1,200 farmers were questioned across Australia for the survey.

## Headlines

- Bega 2011 profits beat prospectus
- Metcash talks down its prospects
- Fonterra confirms 2011/12 payout
- US milk-feed price ratio dips further
- Peak volumes for sale on GDT this week

Indicators	
Dairy export index	Index lifts despite stronger dollar
World dairy prices	Sharp rise in butter prices
US cull cow prices	Prices continue to fall
Grain futures	Wheat futures slide but local grains rise

## Retail sales data

*Surprise gain in retail numbers, as food retailing steps up in July.*

Retail sales released by the Australian Bureau of Statistics (ABS) rose 1.5% in July 2011, compared to July 2010. ABS' data on food sales show that food retailing (most grocery) and Cafes, restaurants and takeaway food services were each up 0.2%.

## Fonterra confirms 2012 payout forecast

*2011/12 forecast payment - an expected decline from 2011 record payout*

Fonterra has kept its forecast payment unchanged for the 2011/12 season, at \$7.15-\$7.25 before retentions, made up of a milk price of \$6.75/kg milk solids. This is an expected decline from the 2011's record payout as global commodity prices ease. The 2011 payout forecast of \$8-\$8.10/kg includes \$7.50/kg milk solids and a Distributable Profit range of 50-60 cents. Fonterra has also finalised its budget for the 2012 financial year, with forecast Distributable Profit range at \$570-\$720 million, which equates to a forecast range of 40-50 cents per share. Dividend payments are expected to be made in accordance with the co-op's dividend policy to pay out 65%-75% of profits.

## Fonterra seeks changes to milk laws

*Fonterra proposes regulatory changes to support domestic market.*

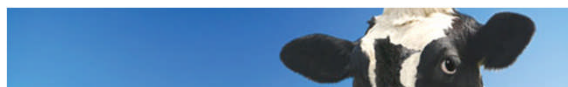
Fonterra has proposed changes to the Raw Milk Regulations in its submission to the Ministry of Agriculture and Fisheries (MAF), which will ensure processors supplying New Zealanders with dairy products get a fair share of regulated milk. The main changes proposed include ensuring processors who supply dairy products to NZ consumers continue to get their share of regulated milk; preserving domestic consumption; and abolishing out-dated rules that are being "gamed" to the advantage of some processors exporting products and profits offshore.

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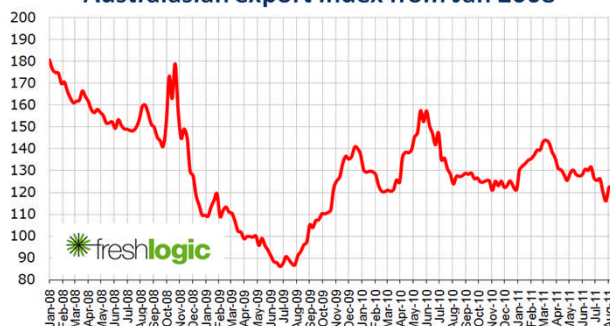
## Index of export returns

**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.**

**Strong prices lift index.** The index of Australia export returns fell this week as the \$A rose this week, despite the \$A gaining strength against the \$US. Butter prices lifted sharply by US\$200/t and WMP rose by \$50/t, while others stayed firm this week. The \$A closed the week slightly stronger against the US dollar at **\$US1.0602**, while the index of spot returns rose by a point to **120.25**.

**Peak volumes of WMP on GDT will test market.** A seasonal high of 25,500 tonnes of WMP across all three contracts will be offered at the upcoming GDT auction this week, followed by SMP at 9,500 tonnes and 1,025 tonnes of BMP. In comparison, a total of 5,300 tonnes of AMF will be available, down 200 tonnes compared to the previous auction held a fortnight ago.

Australasian export index from Jan 2008

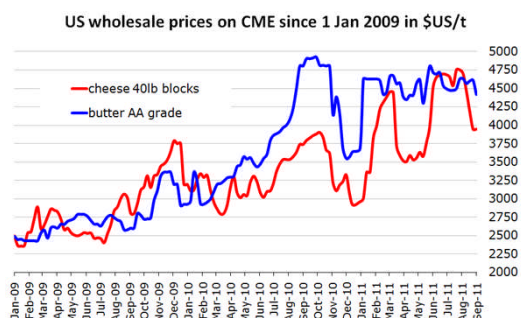


**Take note:** The index is an indicator of spot trends in gross export returns to the industry based on quoted Australasian export prices, movements in currency and the total milk usage in exports by the Australian industry. It was set at 100 on 1 January 2004.

## Wholesale prices will pressure US farmers

**US butter prices dips, on the track of cheese prices trend.**

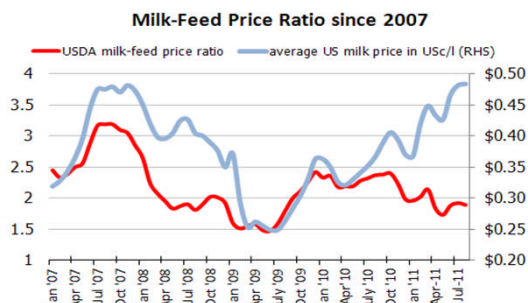
CME spot prices for butter fell, as block cheese steadied in recent trading sessions. Butter prices are now down at \$4,419/t from an earlier high of \$4,600/t two weeks ago. Block cheddar prices have held at \$3,945/t, well down from \$4,750/t two months ago. The falls in prices have, however, filtered through to the USDA surveyed butter prices which last week were tracking at \$4,520/t.



## US milk-feed price ratio dips further

**High feed prices keep the pressure on margins and profitability.**

According to the profitability ratio published by the USDA, dairy farm margins in the US are still poor, despite higher milk prices. The preliminary milk-feed price ratio for August was 1.89, down from 1.92 in July this year and down 20% compared to August 2010 when it stood at 2.36. It hasn't seen 3.0 since late 2007.



## Mengniu reports strong first half

**Profits surged at Mengniu, as dairy demand strengthened in the country.**

China's dairy processor Mengniu reported a good jump in operating profit by 27.6% to CNY789.8m (US\$123.8m) for the first six months to July 2011, compared to the same period last year, on the back of a growing dairy sector in the country. Revenue was up 28.7% at CNY18.58bn (US\$2.91bn).

## Indian dairy demand to attract investment

**Foreign dairy firms eye bigger slices of the Indian dairy industry.**

At a recent conference with international dairy delegates in India, Indian government officials stated that India needs to lift its annual milk production growth from a current 4% to 6% to attain a target production of 180 million tonnes of milk by 2020 simply for its local market needs; however, to attain this target, the country needs to step up its research and development and adopt a much more scientific approach, together with well-co-ordinated efforts by the government.

In response, European and foreign dairying nations expressed their willingness to either establish production facilities or provide technological support to become stakeholders. Considering that India's annual milk production of 125 million tonnes is derived from 17 million small and marginal farmers, French delegate Michele Janezic said that *Danone Ecosystem Trust*, is conducting a survey to devise a model farm approach to help Indian farmers increase output.

Fonterra is also looking to overcoming diplomatic trade barriers to set up a base for its global marketing network in India, while Canada's trade commission has submitted a project that encompasses usage of better genes and breeding techniques for boosting dairy output.

## Nestle plans major investment in Thailand

**Nestle pledges millions to boost production in Thailand.**

US-based Nestle plans to invest more than US\$120m in Thailand over the next two years in order to increase manufacturing of its products, including ice cream and coffee, and meet the growing demand for its products in the country and surrounding region. The investment will support the expansion of the company's existing factories in Thailand, as well as the construction of a new Nestlé quality assurance centre.

In 2010, Nestlé's business in Thailand increased by more than 10% through a combination of domestic sales and the export of Thai-produced products increasing to more than 44 countries across the world.

## NZFSU posts annual loss

**NZFSU nearly doubles revenue but losses for the full year widen as well.**

NZ Farming Systems Uruguay Ltd has suffered a net loss of \$US8.7 million in the 12 months ended June 30, compared to a loss of \$US7.9 million last year, on the back of higher expenses on feed and farm operations. Its move to increase the use of concentrate feeding more than tripled its milking cows cropping and feeding costs to \$US21.1 million. Drought in parts of Uruguay and generally higher feed costs also contributed to the surge in input costs. However, revenue was up 91% to \$US43 million, mainly reflecting an increase in milk sales.

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