

DAIRY REPORTER

Weekly Dairy News for Members of DFMC



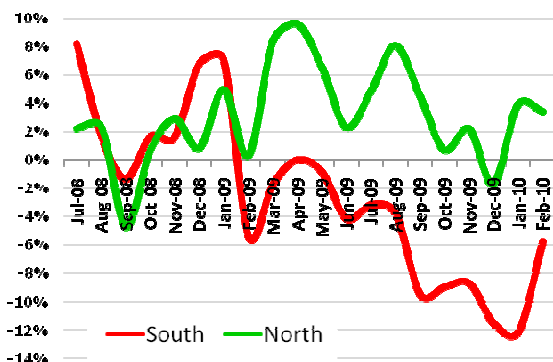
13 April 2010

Milk production turns the corner

Rate of decline in milk production slows, following expectations of higher milk prices, a better season, and improving margins.

The expectation of higher milk prices in 2010/11, a better season and the improving margins in the latter part of the southern production season has seen a slowing in the rate of decline in milk production for February, with Western Victorian and Gippsland showing a strong rebound from the previous months, posting their best performance (compared to 2008/09) since August. Season-to-date production in southern states was 8.4% down by the end of February, only slightly better however than the YTD record in January.

Total southern state and northern state milk production since mid-2008 compared with prior year



Pricing outlook better but changes ahead

National Foods won't be the only one changing milk price structures in the near future.

As changes in the 2010/11 milk price levels and structures remain in negotiation between NatFoods and DFMC, other changes are being proposed for the new production year as the level of competition between milk processors and manufacturers slips into a higher gear.

With the stronger export product prices expected to remain better than current levels in 2010/11 due to supply shortages and healthy demand, full year milk prices in southern Australia are likely to get into the range \$5.00 to \$5.30/kg milk solids (38-40cpl in simple speak). The strength of competition will even bring changes to some of the most traditional approaches in future.

Murray Goulburn has been telling suppliers and influencers that it will be offering three payment options in the new season, being:

1. A traditional payment system
2. A "domestic market" supply arrangement with "flatter pricing" but which will require a commitment to a flat seasonal ratio that will earn a post-season bonus
3. A seasonal payment system that will increase the price offered in spring but reduce 2nd half incentives.

MG will also offer a growth incentive based on multiple year performance by suppliers. At this stage details are sketchy and will only be detailed as late as the usual June price announcement.

Note: Your Chairman's Letter this month will outline the principles of DFMC's 2010/11 pricing.

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Headlines

- Fonterra's GDT result stuns market
- Pricing changes ahead
- NatFoods puts more \$\$ into North Qld
- Fonterra's share-trading unveiled
- Rabo: EU could upset dairy price stability

Indicators

Dairy export index	11pt rise with surge in spot prices
World dairy prices	All products improved, powders lifting more than 20%
Australian cull cow prices in the US	Prices still rising in US market
Grain futures	US and Australian futures prices steadied

Freedom & A2 Corp in talks

Freedom & A2 Corp enter talks on a "merger of equals".

The small but expanding Australian functional foods group, Freedom Nutritional Products, and technology & marketing company A2 Corp have announced that they have entered into talks for a "merger of equals", which would see a combined entity remain listed on the ASX. FNP markets A2 milk in Australia and has a range of other functional food lines. According to the companies, the largest shareholder in A2 Corp, Mountain Road Investments, has granted FNP a right of first refusal for up to 15 per cent of the shares issued in A2C. The companies have also signed a deal that they will enter into a 3-week period of exclusive discussions, during which they will undertake due diligence and negotiate the terms of the merger proposal.

NatFoods invests more in Malanda

National Foods calls to the faithful and will invest another \$5.5 million in its Malanda facilities.

Following its \$1.2 million investment over the last eight months and the news that it intends to discourage growth in milk supply in the region, National Foods has announced plans to invest a further \$5.5 million in its Malanda milk processing plant on the Atherton Tablelands. The investment is aimed to upgrade systems and facilities and also plans to install a new bottle filling production line this year.

According to the National Foods Managing Director Andrew Reeves, the investment represents a tangible vote of confidence in Malanda and the region. He said, "National Foods is committed to Malanda and the dairy industry in Far North Queensland... We employ 73 people here and our milk comes from 68 farms, all within 50 kilometres of our plant."



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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.

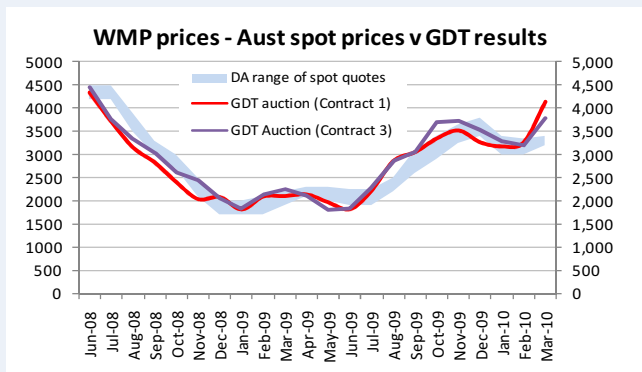
Price leap lifts index sharply

The sharp increases in spot price quotes this week after the surge posted in the Fonterra's GDT auction has also lifted the \$A value of export returns. The index bolted more than 11pts to **136.2**, offset slightly by another strong rise over the week in the \$A of 1.4c to **US93.3c**.

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.



GDT result stuns market.

Results from Fonterra's globalDairyTrade online auction last week surprised the market with their strength posting an average price increase for Whole Milk Powder (WMP) of 21%. The average price reported across all contracts and contract periods for WMP was US\$3,969/T FAS, US\$688/t higher than the March event. But there was a stronger spread in the contract prices this month as average prices ranged from US\$3,755/t to US\$4,230/t. This was not the biggest spread between short-term delivery (2 months) and later-term delivery (4-6 months) on offer, but it provided the biggest gap since the auction system started where a later-term contract was lower than the short-term price.

Expectations that stronger milk flows from southern Australia as a result of higher 2010/11 milk prices may give be giving traders some caution with product deliveries in the latter part of 2010. The prices lifted sharply above the range of spot prices reported by Dairy Australia a week earlier, and was also well ahead of prices collected by both the USDA and NZX's Agrifax.

Prices for Anhydrous Milk Fat (AMF) across all contracts and contract periods averaged US\$4,827/t, 22% higher than the March event. Skim Milk Powder (SMP) posted the biggest lift in trades, with the average price achieved across all contracts and contract periods was US\$3,672/t, up 25.5% above than the March event.

Rabo: EU may yet upset price stability

Europe's spring flush might yet mean further gyrations in export returns.

According to Rabobank's well-timed report, which was released ahead of one of the most volatile positive leaps in the auction market barometer, the key commodities in USD prices have fallen 10% to 15% in the first two months of the year before establishing in the first half of March and this "recent market correction has brought pricing back into a more comfortable range". However, Rabobank states that in Europe, there exists a potential for a strong increase in production called a "spring flush" as cattle head back into pastures. The subdued European demand could lead international markets to be hit with a wave of surplus EU dairy supplies". This state combined with the risk of a weakening Euro could make EU exports more competitive.

Fonterra share trading proposal unveiled

Fonterra's share trading proposal gives farmers the freedom to either trading shares among themselves or leave it to the Co-op to do it for them, helping stop redemption risk.

Fonterra has unveiled a share trading proposal that will allow farmer shareholders to buy and sell shares among other Fonterra farmers on any business day, when it suits their cash flows. If they choose, farmer shareholders would be able to buy and sell shares among themselves at a market price throughout the year on any business day, using an online system or by using a toll-free telephone number. Members could leave it to the Co-operative to buy and sell shares on their behalf at the end of the season. This would say Fonterra overcome redemption risk – money washing in and out of the Co-operative as farmer shareholders purchase or redeem Fonterra shares through the Co-operative at the end of the season.

Fonterra Chairman, Sir Henry van der Heyden said the co-operative has managed redemption risk reasonably well so far but it may not work as well in the future. "For example, there is the risk of strongly capitalised or subsidised offshore investors entering New Zealand and paying unsustainably high prices for milk to get a foothold. In such an event, Fonterra could face considerable redemptions – putting our balance sheet under potentially significant financial stress."

Glanbia Co-op offers €420 million

A price has been set in an interesting deal for the Irish co-op.

Glanbia Co-op's initial offer, with a pension deficit at a price more than the expected €70 million, is above the €280 million ceiling suggested by analysts, indicating a net valuation of the plc's Irish assets of up to €350 million, which could prove controversial with farmer shareholders if analysts suggest these are being over-valued.

Colour-changing test detects melamine

The game may be up for Chinese cheats with a new quicker test for the presence of melamine.

Researchers at the University of Miami have developed the melamine-tainted milk detection test, which separates the casein-based component in the milk before adding the nanoparticles to the solution. The team of researchers said, "When melamine is present, the colour of the solution changes from red to blue within seconds and can be measured both by visual inspection and spectrophotometry." The work represents a significant step towards the rapid detection of melamine, which addresses a critical health risk and credibility issue for the Chinese industry.

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