

DAIRY REPORTER

War of words escalates

Both sides dig in...this won't go away for a while

The extent of coverage and vitriol over the discounting of private label milk prices would suggest this is the biggest single issue facing the Australian industry at present, which is frustrating many in the southern industry who will be barely affected by the changes. The arguments between Coles and the dairy farm organisations continued to consume significant energies and create confusion about the potential effects of the reduction in packaged milk prices on the Australian dairy industry. Coles Managing Director Ian McLeod got heckles further raised with a column in the Financial Review which sought to present Coles Supermarkets' recent cut in retail drinking milk prices as a move aimed at protecting the interests of both Australian consumers and local dairy farmers.

Coles continued to hold the line that farm gate prices for milk are underpinned by global milk prices and that it expects rising global prices will flow through to all Australian farmers - which prompted further press releases from ADF pointing out that for a number of dairying regions, (i.e. Queensland, Northern NSW and Western Australia), retail sales of drinking milk are the key market and farm gate price drivers, and where farmgate prices have fallen in the 2010/11 season.

Meanwhile Woolworths have cleverly managed to match the milk price reductions to a large extent (many stores have been carrying two-tiered pricing of private label lines with \$2.29/2 litres on Woolworths Daily Milk and \$2/2 litres on the generic house brand), while appearing as the white knight for the farm sector donating \$1million dollars to the Queensland industry flood relief fund from milk sales. The retailer remains "in favour" by continuing to claim the price reductions as unsustainable. Aldi meanwhile carries its milk prices well below the level offered by the big two.

The issue will stay in headlines for a while yet. Submissions to the urgent Senate Economics Committee review into the supermarket pricing decisions, which is due to report by 15 April, were due 28 February.

Parmalat prices to show effects

Prices altered as volumes shift from brands to private label.

The prices paid under Pauls PDA milk supply agreements in Queensland - which is one of two milk pricing regimes used in the region by Parmalat - will be adjusted in the next milk pay cheque to reflect the shift of milk volumes from brands to private label. This flies in the face of Coles' "no impact on farmers" claim.

The mechanism in PDA contracts, which directly links farmgate prices to the mix of sales between the milk products, will pay PDA suppliers about 14c per litre less for the assessed share of milk which has moved to the cheaper retail product.

Coles relents in WA

The retailer takes steps to spare WA farmers from facing the brunt of milk price war.

Coles says it will pay a 5c/litre price increase to the WA milk processor Peters & Brownes to ensure farmers are not affected by recent cuts to its retail milk prices. Coles announced last month it was cutting the price of its milk to \$1 a litre, as part of an escalating price war with competitor Woolworths. Industry reaction to the increase has been critical - with the claim that this proves a link back to the farmgate. The rise wouldn't be necessary if the "no impact" claim had merit, said ADF's response.



Headlines

- Milk price war stays in headlines
- Coles offers more in WA
- Fonterra lifts payout for NZ farmers
- Middle East turmoil threatens stability
- India sees potential supply gap

Indicators

Dairy export index	Index unchanged despite \$A moving higher
World dairy prices	Small lift in Cheddar, others steady
Australian cull cow prices in the US	Minor drop in US prices, values staying firm
Grain futures	Sharp fall in US wheat prices and local grains

WCB boosts half year earnings

WCB's improved result helps slash debt by \$60m.

Warrnambool Cheese has announced an half year profit after tax of \$36.4m, with EBITDA up to \$61.1m, a \$40m increase on the prior year. Total milk intake for the half year was down 2.9% to 506 million litres, on the same period in 2009, due to an excessively wet spring and summer. The company said it expects the majority of the lower milk intake volume to be recovered in the second half of the year as favourable soil and pasture conditions should result in a prolonged milk production season taking the total intake close to 900 million litres. WCB booked a 36% rise in the average selling value of export commodities. The proceeds from a rights issue and operating cashflows allowed the company to reduce debt by \$60m, reducing gearing from 50% at 30 June 2010 to 19% at 31 December.

Gloss is off Woolworths results

Woolies profit momentum stalls as Coles strategy shows results.

Woolworths Ltd posted its slowest growth in half-year profits since 1999, hurt by a slump at discounter Big W, and warned the trading environment could remain subdued over the second half. Woolworths has recorded a 6% increase in net profit after tax to \$1.16 billion, with revenue up 4.2% to \$28.42 billion, although the company admits trading conditions remain "challenging". The company has amended its full year profit guidance, saying growth is expected to be between 5-8% due to the impact of floods and New Zealand earthquakes.

But most of the focus is on the biggest division of the largest retailer, which remains far more profitable than its nemesis Coles. Coles supermarket and liquor unit has in the last 6 months done better than its bigger rival, posting a 5.9% gain in sales and an 18.3% rise in EBIT compared with a 3.5% gain in sales and an 8.1% EBIT rise at Woolies' same division.

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DAIRY REPORTER

Weekly Dairy News for Members of DFMC

Index of export returns

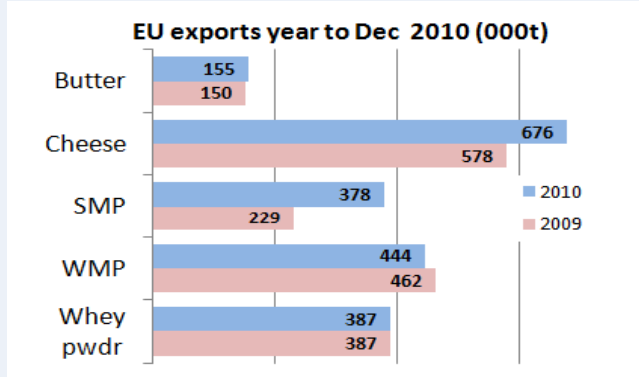
Freshlogic tracks an index of the \$A value of spot returns from dairy exports as an indicator of the potential impact on southern milk prices.

Little change as currency and spot prices steady.

Spot prices were little changed this week but for a small rise in the price of cheddar. The \$A closed slightly higher at \$US1.018, while the index was unchanged at 139.4.

NZ powder exports bank on China. New Zealand's whole milk powder sales leapt 16% in 2010 to 947,400 tonnes, as China took around a third of all export shipments, well ahead of Venezuela and Sri Lanka. WMP was New Zealand's dominant dairy export, and last year was worth \$4.3bn. SMP export tonnages fell 16% as the priority went away from the butter-SMP process towards meeting China's whole milk powder hunger with the poor state of the local milk supply systems.

Higher EU exports in 2010. EU exports for the 2010 calendar year were ahead of 2009 in total tonnage but it was a mixed bag with strong gains in cheese and SMP volumes while WMP retreated and butter was on a par. EU's butter exports have to be taken into perspective with a drop in imports by more than 20,000t, and the significant reduction in intervention stocks.



Carbon tax declared – price awaited

Controversial carbon tax finds its way back to Labor policy.

The Gillard government (with support of the Green Party) have pledged to legislate this year for a "fair" carbon price to be imposed from mid-2012, leaving themselves six months to sort out complex and controversial details. The model proposes an initial carbon tax rising at an agreed annual rate before moving to an emissions trading scheme with a market-determined price sometime between 2015 and 2017. The government has declared agriculture will be excluded from the scheme (for now). The government has set the initial carbon price; how various sectors of the economy will be affected; nor how compensation will be applied. All details of the new carbon price will be negotiated through the multi-party climate committee, which includes Labor, the Greens, and two independents that provided it with a majority after the 2010 elections.

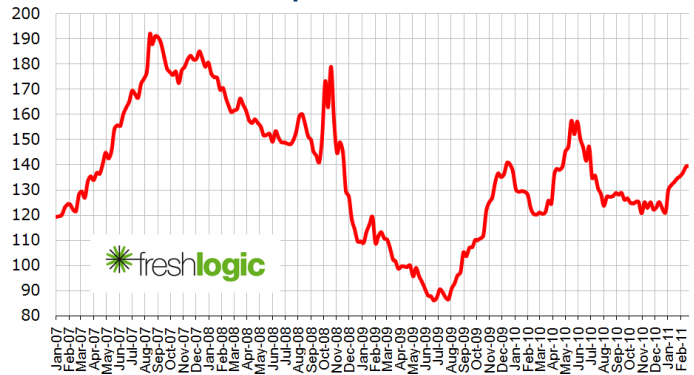
Christchurch earthquake repercussions

Dairy co-operatives step up to help earthquake-hit city.

The Christchurch earthquake could see the New Zealand economy take a hit of up to 1% of GDP. Rural Canterbury appeared to have largely escaped the impact of the earthquake leaving Fonterra and Federated Farmers to play a leading role in supplying food, water supplies and accommodation for displaced people in the week following the devastating earthquake. Fonterra donated \$1 million dollars to the Red Cross Christchurch Earthquake Appeal and launched a Fonterra Earthquake Relief Fund for its 10,500 farmer-shareholders and 16,000 staff to make personal donations, matched dollar for dollar. It also delivered UHT milk, bottled water and many tankers of fresh water to school sites around Christchurch.



Australasian export index from Jan 2007



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.

Middle East turmoil hits oil and grain

Grain futures tumble amid ongoing Middle East unrest.

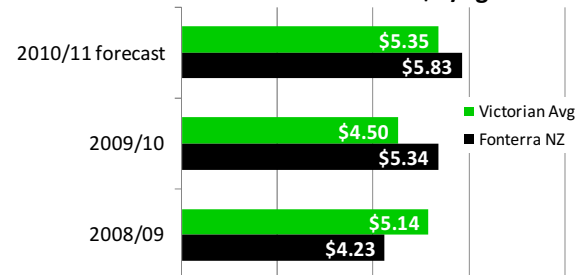
Wheat prices have dropped almost 16% since hitting a 29-month on February 9, due to the potential disruption to grain trade. North Africa and the Middle East are expected to purchase approximately 39.4 million metric tons of wheat in the 2010-11 season, or 32% of world purchases.

Fonterra lifts payout

Fonterra rewards NZ farmers as global prices lift.

Dairy giant Fonterra has boosted its forecast payout to farmers to record levels as international prices keep rising. The farmers co-operative yesterday raised its forecast payout for this season by 60c to \$7.90-\$8 per kg of milksolids before retentions. With milk production expected to be broadly in line with last season an \$8 payout could be worth about \$10.3 billion. Chairman Sir Henry van der Heyden said the increased forecast milk price reflected strengthening international dairy prices during recent months. The forecast payout incorporated a milk price of \$7.50 per kg of milksolids and a distributable profit of 40-50c, with fully share-backed farmers expected to get \$7.75-\$7.80 after retentions by the co-operative. Chief executive Andrew Ferrier said higher dairy market prices appeared to be driven by a combination of strong demand from China and other Asian markets, and tight international supply due to adverse weather conditions in many parts of the world.

The milk returns scoreboard in \$A/kgms



India sees a massive potential supply gap

Growing demand-supply gap could spike a looming milk crisis in India.

The Indian government's annual economic survey has warned that the country could become a serious milk importer by 2022 if local production doesn't keep pace with demand. The government said its target for the current fiscal year was 116.2 billion litres. A survey for 2011 sees India's milk production is rising by about 3.5 billion litres a year, while demand is growing by an estimated 6.0 billion litres. To keep pace with demand, it must grow production by about 5.5% per annum.

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