

# DAIRY REPORTER

Weekly Dairy News for Members of DFMC



20 July 2010

## Fonterra reviews prices

*As promised, Fonterra undertakes first bimonthly price review, despite some shaky market movements.*

Fonterra has implemented its first Australian farmgate milk pricing review for the 2010/11 season, and as a result has announced a milk price increase for Victorian and Tasmanian suppliers of 24c/kg fat and 60c/kg protein for the 2010/11 season - back dated to 1 July 2010. This review is the first under the new structure whereby the company will review prices bimonthly throughout the season based on market conditions and business performance.

The company says this price increase, combined with our Seasonal Ratio Payment (SRP) and new SRP Plus incentives, takes Fonterra's current average forecast price to \$4.83/kg milksolids.

The July milk price review took into account the fact that, since setting its opening farmgate price in May, global prices for most dairy commodities have stayed above the US\$3,000 per tonne but nonetheless remain volatile. The Australian dollar exchange rate has also helped, having fallen from its highs of around US93 cents in May to around US83 cents in early July.

## NatFoods' farmgate prices gain high profile

*The NatFoods-offered milk prices in Southern Queensland receive an airing.*

Southern Queensland has become a new flashpoint for NatFoods, as the relationship between company and a collective bargaining group was aggravated last week when the current contract offer to Progressive Dairies was published in the Queensland Country Life. QCL quoted the offer as comprising Tier 1 price of 46.19cpl and Tier 2 price of 30cpl, and this has since been widely reported in other media.

Progressive claimed the top tier price compared with 56.25cpl in the 2009/10 year (and preceding year), and that its members faced a fall of around 20% in prices taking account of the percentage of milk that would attract the top tier price.

The state dairy farmer advocate QDO has injected itself into the issue, challenging the sustainability of the prices, and publicly asking NatFoods for a justification for dropping Tier 1 prices by 10cpl, when none of its milk will end up in private label containers after the expiration of the Woolworths contract in September this year. Again, the cost of production has been brought into the debate, this time based on the results of the regional farm accounting system (QDAS) which reports an average cost for the participants of close to 53cpl.



*Hopes squashed as doors close to NQ deal.*

The Atherton Tableland dairy industry claims it remains in limbo as negotiations between Parmalat and National Foods broke down, meaning that FNQ milk is not likely to be used in private label containers sold in the local market region.

Late in the week, Parmalat closed the doors on a co-packing arrangement with National Foods that could have seen far northern milk stay in Woolworths' bottles. Parmalat said it will now truck packaged milk north from a plant in Rockhampton. Parmalat said the asking price from National Foods was simply too high and Parmalat is now closed to further negotiations.

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## Headlines

- New milk price flare-up for NatFoods
- Fonterra lifts Australian milk prices
- Bright to take control of NZ's Synlait
- Tetra positive about the outlook
- Olam bids for the rest of NZFSU

Indicators	
Dairy export index	Index steady with slight weakening in \$A
World dairy prices	WMP loses ground while others remain steady
Australian cull cow prices in the US	Prices increase, reverse last week's sharp decrease
Grain futures	Increases in US wheat and local grains futures

## Two NZ takeovers announced

*Takeover bid for NZFSU...*

Singapore's Olam International has launched a takeover bid for dairy farm developer NZ Farming Systems Uruguay (NZFSU), offering to buy the 81.55% of shares it does not already own for NZ\$109.6 million (or 55c a share). PGG Wrightson said it had entered into a lock-up agreement with Olam for its 28.1million shares, or 11.5 percent stake in NZFSU.

Olam - a global integrated supply chain manager of agricultural products and food ingredients - acquired an initial 14.35% tranche in NZFSU in September last year and subsequent purchase of a further 4.1 percent from the receivers of Rural Portfolio Investments in May. NZFSU shares climbed as high as \$2 in mid-2008 but then fell quickly to bottom at 35c nine months later. NZFSU has struggled to meet its forecasts of farm development in South America based on NZ systems.... due mostly to a lack of rain!

*... while Bright aims to take control of Synlait.*

Chinese food company Bright Dairy & Food Co announced it planned to buy a controlling stake in Synlait Milk Ltd, to ensure it had a stable supply of "quality" milk. Bright Dairy will pay NZ\$82 million for a 51% stake in Synlait Milk. Synlait posted a net loss of NZ\$5.11 million for the nine months to the end of April, and said it will use the money to repay bank loans and build a second plant. The deal, subject to regulatory and shareholder approvals, comes amid renewed concerns about the quality of Chinese milk.

Synlait Milk said a key element of the value-added export strategy would be it producing high quality infant and whole milk powders for Chinese consumers, which would be helped by Bright Dairy's dominant presence in this growth sector. Synlait Milk's chief executive John Penno said today that work has already begun on building a second large scale milk powder processing production plant capable of producing high specification formulated milk powders alongside its existing facility at Dunsandel, near Christchurch.

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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.**

### **Index steadies.**

Export spot prices for powder were fairly stable this week as movements in prices and currency offset each other. Spot WMP prices lost ground by US\$100 while the \$A weakened to US\$86.9c and the index settled at 135.7.

### **EU milk flows stay below last year.**

European Union milk deliveries to dairy plants were 0.8% lower in April compared to 2009 levels. Milk deliveries have been running below prior year levels since last September, with the largest year-on-year percentage decreases to date occurring in October and January, when each saw production at 1.9% lower compared to the corresponding month in the previous year.

### **US exports surging.**

US dairy exports more than doubled to reach the highest monthly total since May 2008, according to trade data released by the USDA. The increase pushed January to May 2010 export sales to US\$1.384bn, a rise of 62% compared with the same period in 2009, but behind the pace of 2008 sales. In the first five months of the year, US exports equated to 11.4 percent of the total milk solids produced in the United States. On a product basis, exports were equivalent to 34 percent of the SMP produced in the US, 66 percent of whey proteins, just 3.3 percent of cheese and 6.1 percent of butter. SMP exports have rocketed 37%, while whey protein exports are up 36% over the year to date period.

## EU ministers heading towards agreement

### **EU member states finally trod the path of consensus.**

EU member states were moving towards agreement on the priority areas for dairy sector reforms after the work of the HLG, including the need for a true 'package' of coherent, overlapping measures, based on the outcomes of a Farm Council debate in Brussels in the past week.

The recommendation on **contracts** merely calls however for a voluntary system of formal contracts. While useless without other measures, pro-deregulators - including the UK, the Netherlands and Sweden - were keen to ensure that contracts must remain not only voluntary but also "flexible" to take into account the way dairy sector relationships function in different member states. The 2<sup>nd</sup> issue on **collective bargaining** is more serious, calling for a change in competition law to allow producer organisations constituted by dairy farmers to negotiate contract terms with a dairy company, including price, jointly for some or all of its members' production. The third issue questions whether **IPOs** could be given more freedom in the dairy sector without amending EU legislation. Again, a number of states have declared opposition to allowing farmer organisations to "meddle in the dairy market".

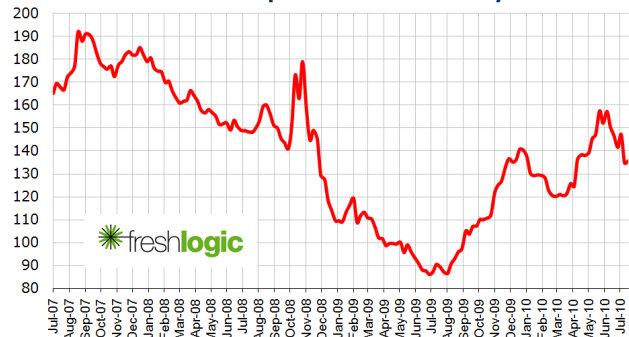
## Yum sees mixed results

### **Yum announces patchy results – sales boost, though margins slip.**

Global fast food operator Yum Brands, has reported patchy results from its units in the US and China. Yum has more than 3,500 outlets in mainland China and is its largest foreign restaurant operator. The China division which includes mainland China, Thailand and Taiwan contributed 35% of group profits, but will run into some tougher conditions as rising labour costs are expected to cut into margins in the 2<sup>nd</sup> half of the year. Sales at established restaurants in China rose 4% percent during the quarter to June 2010, in line with expectations. Overall sales at U.S. restaurants open at least one year posted flat sales. That result included an 8 percent same-store sales rise at Pizza Hut and a 1 percent gain at Taco Bell, offset by a 7 percent decline at KFC.



## 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.

## Tetra lifts its outlook

### **Tetra ups forward outlook on changing demographics and social changes.**

Tetra Pak has lifted its growth forecast for the global liquid dairy market to 2.4 per cent CAGR for the next 2 years, a slight lift from its last update 6 months ago. The latest update of its Tetra Pak Dairy Index has underlined the importance of demographics and social changes in driving up demand across the globe. Tetra Pak expects consumption of ambient liquid dairy products to grow at a CAGR of 5.4 per cent from 2009 to 2012.

Tetra sees big potential for growth that companies are exploiting with new types of products at the low-end of the value spectrum, citing dairy formula products in Mexico and small packs of less than 125ml in Indonesia as examples of how firms are reaching lower income groups in emerging markets. It says that in developed markets, the challenge is not to reach out to entirely new consumers but to follow social changes to ensure that products are in line with the latest consumer trends, including adapting to an ageing population, and offering products that help older consumers reduce cholesterol and protect themselves from osteoporosis.

### **... and remains very positive about Brazil.**

Tetra is especially positive about Brazil, where it has a 95% share of UHT milk packaging, seeing consolidation driving creation of several new groups as positive, as they will take better care of processing, quality, and brands, and will have capacity to invest in new technologies. In 2009 Tetra Pak sold 10 billion packaging units in all market segments across Brazil.

## DEIP subsidies announced, but no use yet

### **The US export assistance scheme is formally refreshed, but market conditions, and rate of growth of US supply will dictate its use**

The US Department of Agriculture (USDA) has announced new allocations under the *Dairy Export Incentive Program* (DEIP) for the period July 2010-June 2011. DEIP allocations of 68 201 metric tonnes of non-fat dry milk, 21 097t of butterfat and 3 030t of various cheeses may be made available through Invitations for Offers. These allocations correspond to total WTO limits for this year's DEIP. Because of current international and domestic market conditions, Invitations for Offers will not immediately be made available. USDA said it would continue to monitor market conditions closely to determine when invitations on these allocations may be issued.

Under DEIP, USDA pays cash bonuses to exporters, allowing them to sell certain dairy products at prices lower than the exporter's costs of acquiring them. The major objective is to develop export markets for dairy products where US products are not competitive.

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