

DAIRY REPORTER



Weekly Dairy News for Members of DFMC

26 July 2011

Coles' price cuts not predatory

ACCC says Coles' price cuts consistent with what it expects from a competitive market.

The Australian Competition and Consumer Commission (ACCC) has cleared Coles of engaging in predatory pricing and breaching competition law by selling 2 and 3 litre packs of house-brand milk at a discounted price of \$1 a litre.

The ACCC found Coles' objective had been to increase its market share by taking sales from its supermarket competitors, including Woolworths, and this was consistent with what it expected to find in a competitive market. It also said that the reduction in the price of milk had benefitted consumers and signalled that the marketplace was competitive. It concluded that the major impact of the price cut had been a reduction in the supermarkets' profit margins rather than hurting dairy farmers.

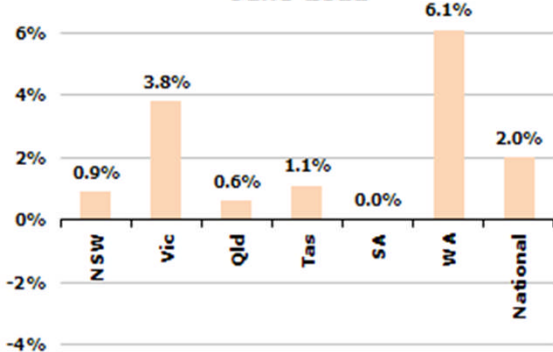
ACCC has stated that it will continue monitoring the dairy industry and grocery sector for signs of anti-competitive behaviour. Unsurprisingly, the ACCC's findings have been welcomed by Coles. However, ADF has remarked that the decision proved Australia's competition laws favour the major retailers.

Australian milk sales

Victoria and WA help national milk sales lift 2% in 2010/11 season.

Dairy Australia reported that the national milk sales in June were 4.2% higher than the same month last year, while the total milk sales in the 2010/11 season were 2% ahead of the previous season. All states have experienced growth in packaged milk sales in the full year to June 2011 period, with the exception of South Australia where the packaged milk sales volumes were at par with that of the previous season of 2009/10.

Packaged milk sales volumes – full year to June 2011



Bega's prospectus hits the streets

Bega Cheese shares expected to begin trading from August 29.

Bega Cheese has released its IPO prospectus for its float and capital raising. Bega plans to raise \$35 million through the issue of 17.5 million shares – about 15% of the company - at \$2-a-share, capitalising the company at \$254.1 million, with farmer shareholders holding the bulk of the company at 85%. Bega will also issue 850,000 free shares to staff under an Employee Loyalty Offer. According to its prospectus, Bega expects to post revenues of \$942 million for 2010-11 and has forecast pro-forma earnings for the year before interest, tax, and depreciation and amortisation of \$53.4 million including the interest in all of Tatura Milk's earnings. The offer is scheduled to close on August 16, with Bega Cheese shares expected to begin trading on the Australian Securities Exchange from August 29.

Headlines

- Australian milk flow up 2% in 2010/11
- Bega's prospectus is released
- Coles' price cuts not predatory: ACCC
- Prices slump at latest GDT auction
- US milk growth slowed again in June

Indicators

Dairy export index	Strong dollar curbs index rise
World dairy prices	Heavy falls in butter and powders prices
Cow prices	Prices increase, continuing a recovery
Grain futures	Wheat futures and local grain prices steady

Freedom Foods lifts stake in A2 Corp

Freedom Foods wants a bigger slice of NZ-based A2 Corp.

Freedom Foods has announced that it wants to exercise an option to lift its stake by 18.7 million shares in the Auckland-based dairy company A2 Corporation Ltd. Freedom had an option to buy the shares at 11c each to boost its stake in A2 Corp. It will be paying \$2.08 million to A2 and will have a total stake of 26.4%, including partly-paid ordinary shares on issue. In 2010, A2 Corp issued Freedom Foods a 25% stake after its shareholders approved a deal to buy the remaining 50% stake in Australia's A2 Dairy Products Pty Ltd that they did not own. The deal gave A2 Corp exclusive rights for the production and sale of A2 milk in Australia and Japan.

Woolworths posts sluggish sales rise

Slowdown in sales rise attributed to the halt in consumer spending.

Woolworths has posted a modest rise in full year sales, helped by the surge in the price of petrol. Full-year sales rose by 4.7% to \$54.1 billion (up 4.1% excluding petrol), in line with expectations, in the middle of challenging trading conditions. Total sales at its food and liquor business – which accounts for 70% of the group sales – was up by 4.3% to \$36.2 billion with comparable sales for the year increasing 3%, as the retailer opened more stores, rolled out a new 2015 store format, offered competitive prices, and focused on fresh food.

But looking closer, comparable same store sales for the 4th quarter of the year rose at a slower rate (adjusted to 3.3%) than the prior quarter (3.9%), which came after a 2.5% lift in price inflation, which means the company's volumes slowed sharply than over the preceding 9 months of the year.



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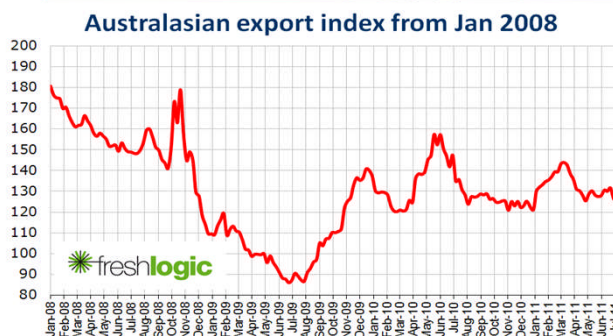


Index of export returns

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.

Dollar, powders and butter pull index south. Butter prices weakened by US\$300/t and powders by US\$200/t each, while cheddar stayed unchanged this week. The strong gain in the \$A further pulled the index of export returns lower. The \$A closed the week nearly 2 cents higher at **\$US1.0831**, as the index of spot returns lost 7 points to **119.9**.

Dairy prices slump at the latest GDT auction. Average dairy product prices posted their biggest decline since early December at Fonterra's online auction last week, signalling that commodity prices are weakening from record highs as global growth slows. The latest *globalDairyTrade* weighted index fell 5.1%, compared to the previous auction held a fortnight ago on July 5. The biggest movement came in AMF, which led the decline at an average of \$4,614/t, down 12.5% compared to the previous auction. It was followed by milk powder concentrate which dropped by 10.2% to \$5,525/t. In comparison, SMP dropped by 5.2% to \$3,488/t and WMP by 4% to \$3,475/t. Cheddar traded for the first time at the gDT auction, achieved an average price of \$4,315/t.

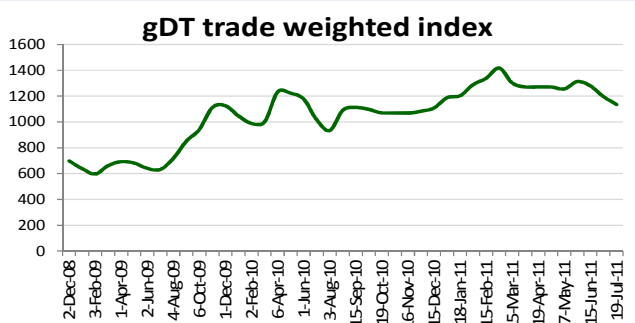


Take note: The index is an indicator of spot trends in gross export returns to the industry based on quoted Australasian export prices, movements in currency and the total milk usage in exports by the Australian industry. It was set at 100 on 1 January 2004.

NZ had a big finish to 2010/11 season

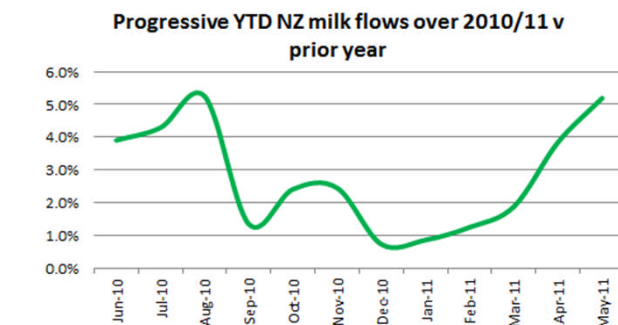
Good finish to 2010/11 season on back of strong late-season milk flows.

According to the official data from DCANZ, NZ milk production rose 5.2% over the full 2010/11 season, compared to the previous season, mainly driven by the strong output in the last two months of the dairy season this year. The progressive rate of increase over the prior year is shown in the chart below. The late season kick came as May production was 44% of the prior year and April was ahead 31%. The flush of milk may be contributing to the worries in the world market about over-supply as the continuity of that growth into 2011/12 will help talk down prices buyers are prepared to commit to.



US Cooperatives to sell on GDT auction. DairyAmerica, a group of four cooperative companies and California's biggest dairy entity, will commence selling its dairy products through Fonterra's globalDairyTrade platform from October 4 this year. DairyAmerica's producers account for about 45% of the skim milk powder produced in the US. DairyAmerica's members include Agri-Mark, California Dairies, O-AT-KA Milk Producers and United Dairywomen of Arizona. The first products to be offered by DairyAmerica will be SMP, in a bid to build up its export business, with other products to be added over time.

USDA: Slowdown in global dairy prices. The latest biannual USDA-FAS report *Dairy: World Markets and Trade* report has predicted a slowdown in global dairy prices over the next six months. World butter prices are expected to dip only slightly and stay above the \$4,000/t level, in the remainder of the year. However, milk powders, particularly WMP is expected to slide to lower price levels, mainly driven by a slowdown in the Chinese WMP imports.



Expert endorses Fonterra's approach

International competition expert says co-op's price structure sound.

Compass Lexecon, an international renowned competition expert, has endorsed the fact that Fonterra's milk pricing formula is fair, as it is based on the costs of a notional competitor using efficient processing facilities instead of its own manufacturing costs. It also stated that there has been a significant increase in competition and expansion of NZ dairy processing since Fonterra was formed, with more efficient plant commissioned by both Fonterra and competitors. Fonterra had commissioned Compass Lexecon to assess the competitive environment for dairy processing in NZ and review the co-op's methodology used for calculating its farmgate milk price paid to farmer-shareholders.

UK Dairy Supply Chain Margins 2011

Key insights of the UK dairy industry from DairyCo's new margins report.

According to the latest DairyCo's Dairy Supply Chains Margins report, at the retail level, retail gross margins for the liquid milk were maintained at around 34%, despite a sharp fall in the average milk price. However, with milk and mature Cheddar, retailers experienced a drop in margins as wholesale prices rose on back of strong commodity markets and limited supply, while retail prices remained stable. Retail margins fell from 51% in 2009/10 to 47% in 2010/11 for mild Cheddar and from 52% to 49% for mature Cheddar. Farmgate prices for liquid milk increased by 5% in 2010/11 compared to the previous year, but increased input costs nullified the increase in income. For processors, gross margins fell for liquid milk, but increased for both mild and mature Cheddar.

US milk output growth eases in June

Rising feed prices and temperature slow milk output growth in June.

According to the USDA figures, US milk production during June totalled 7.49 billion litres, a gain of 1.1% on the corresponding month in 2010. However, this is the slowest rate of growth seen in the US over the past 15 months. The number of cows in June 2011 was 9.21 million, an increase of 10,000 more than the previous month and 81,000 more than June 2010.

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