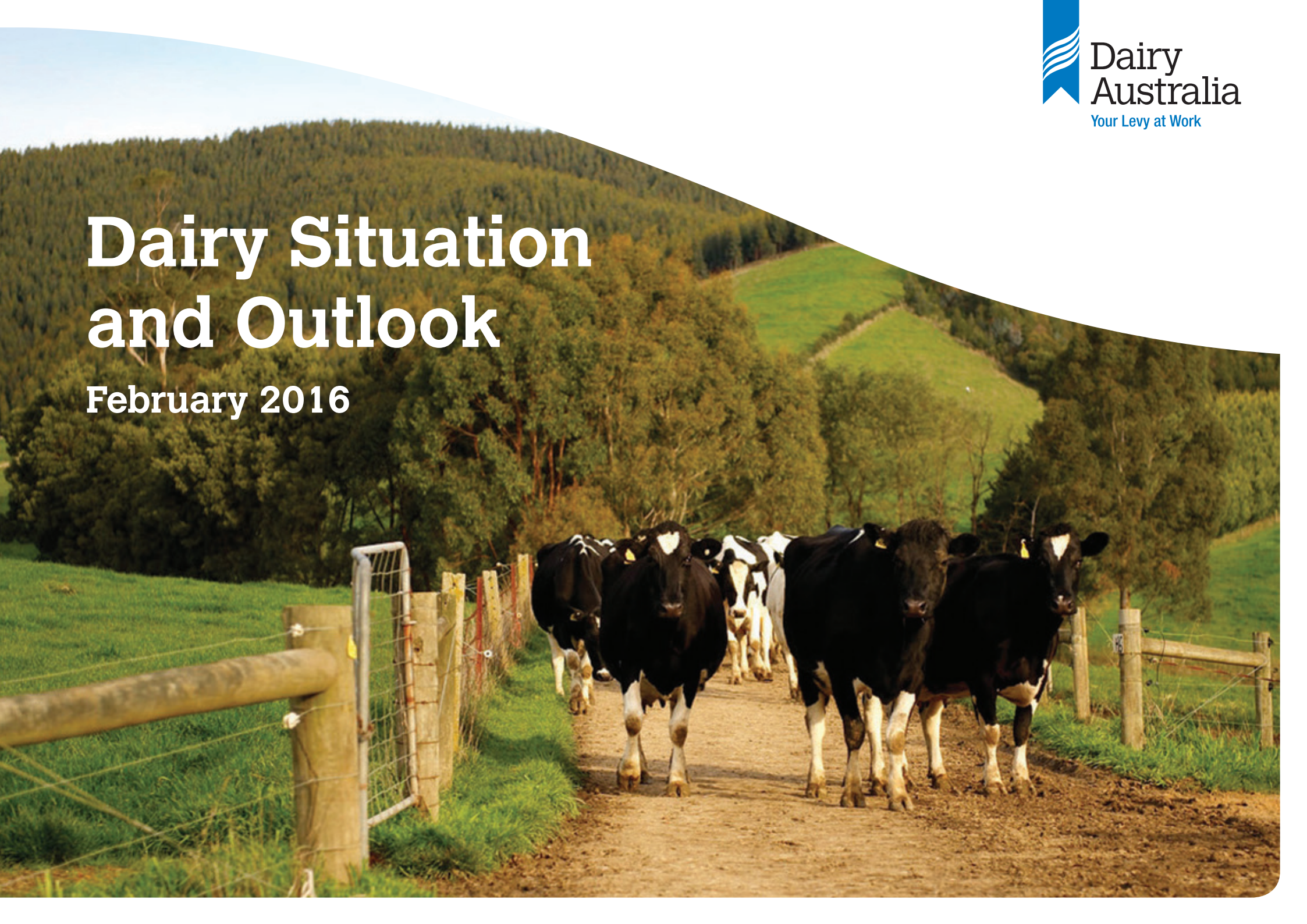


# Dairy Situation and Outlook

February 2016



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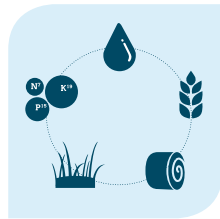
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# Six key drivers of the Australian Dairy Industry

## Inputs



Situation: ▼

Outlook: ■

Input costs continue to add to the margin challenge for many Australian farmers. Irrigation water has been a serious constraint for many this season, while hay is in short supply, and grain prices remain firm. A strong supply and demand situation persists for cull cows.

## Global supply



Situation: ▼

Outlook: ■

A tough international market and challenging weather are driving a southern hemisphere supply response, but northern hemisphere milk production growth continues. The US remains focused on domestic markets, but Europe continues to aggressively in grow export market share.

## Global economy



Situation: ■

Outlook: ■

The IMF has trimmed expectations for 2016 global growth, reflecting slower than anticipated growth in emerging economies. Low oil prices are limiting incomes for energy exporters, but failing to stimulate demand in importing countries to the expected extent.

## Australian market



Situation: ■

Outlook: ■

Supermarket trends remain mixed. Dairy spreads continue to grow strongly, cheese volumes are holding steady, and yoghurt and dairy snack volumes continue to decline. Milk sales grew incrementally, with an ongoing shift toward full fat product.

## Global demand



Situation: ▼

Outlook: ■

Global demand growth continues to largely come from price sensitive countries. While demand from Greater China and Russia remains subdued, Japan continues to see strong growth, as does Southeast Asia.

## Exchange rates



Situation: ▲

Outlook: ■

Australian dairy exporters look likely to continue benefiting from a relatively weak currency into 2016, with the median forecast fluctuating around the 0.68-0.69 AUD/USD mark.

▲ Positive    ■ Neutral    ▼ Negative



# Executive summary

Dairy markets have entered 2016 with an all-too-familiar outlook. Internationally, prices remain depressed, as evidenced by persistent weakness in key pricing indicators. In combination with challenging seasonal conditions and persistently high input costs, this has tightened pressure on Australian farmers' margins, despite the buffering effects of a stable domestic market and a more favourable exchange rate.

However, while southern hemisphere exporters are seeing milk intakes slow substantially, growth in the northern hemisphere continues. In particular, European milk production continues to rise – seemingly impervious to global market influences. With the northern spring flush just around the corner, the global industry is again seeing the prospect of a market recovery pushed back; now into 2017.

Ongoing supply growth from Europe is the prominent factor keeping the market depressed, but prices are ultimately a function of the supply/demand balance, and dairy demand hasn't kept pace. Demand growth tends to be less volatile than that of supply; price volatility is often caused by supply overshooting, then falling short of demand. In recent months, growth in global demand has been relatively small, largely come from price sensitive countries, and been on a slowing trend as inventories have built up. Many Southeast Asian countries continue to stock up on relatively affordable dairy products, while the pace of exports to the Middle East has moderated. Subdued demand from Greater China remains a feature, while on the other hand, global exports to Japan have demonstrated their strongest growth in years. Demand from Russia, hitherto the world's second largest single country dairy market, has plummeted following the embargo on major (western) exporters, now

considered likely to persist until 2018. A number of positive trade policy developments promise to help improve access and competitiveness of Australian exporters into the future, including the completion of Trans Pacific Partnership (TPP) negotiations, and the implementation of the China-Australia Free Trade Agreement (ChAFTA).

The Australian market remains a steady outlet for more than half of the industry's milk. Supermarket sales of the major dairy categories displayed divergent trends over the most recent 12 month period. While both the volume and value of dairy spreads sold continue to grow strongly, milk and cheese sales are steadier, as are sales values for yoghurt and dairy snacks (although volume sales for this category continue to contract).

At farm level, Australian milk production finished December 2015 down 0.2% for the season to date, and down 4.6% for the month. A solid start to the season was followed by slowing growth through spring, thanks to tighter margins and dry conditions across many regions. December was generally hot and dry, whilst January offered little relief – cooler temperatures and rainfall towards the end of the month may provide a reprieve for many farmers. Queensland is seeing the impact of further industry exits, whilst Western Australia's volumes continue to grow (albeit more slowly) as

a result of the high farmgate prices on offer to many farmers.

Elevated grain and hay costs, combined with lower milk prices, have reduced the scope and incentive for farmers to draw on alternative feed sources to maintain or grow production. At the same time, high beef values have encouraged many to cull underperforming cows, with early action by many bringing forward the volume impact. An 'average' autumn could see volumes prove more resilient later in the season, but even a recovery through this period would be too late to offset volumes lost to a slow spring and summer. Dairy Australia's revised milk production forecast for 2015/16 anticipates an overall decrease of between 1% and 2% for the season to June, implying a total volume of between 9.55 and 9.65 billion litres.

Lower milk flows have given Australian processors room to move in adjusting their product mix to optimise returns and help mitigate lower commodity prices, resulting in a reprieve from the milk price 'step down' many feared earlier in the season. Although lower than prior-year levels, southern farmgate prices have been spared the scale of adjustment seen in New Zealand. Farmgate prices are also stable in northern regions, though margins remain under pressure. The perennial focus on production of 'higher value' manufactured products continues

**The skills and strategies many farmers have developed during recent tough years have been evident in the response to the slow tightening of margins and seasonal conditions in 2015/16.**

apace, with a number of new announcements. Infant formula has been a hot topic in recent months, with sales volumes and values growing over 30% for the 12 months to October and manufacturers scrambling to increase capacity. Bega Cheese is establishing a joint venture with supplement maker Blackmores, and Fonterra Australia flagged a strategic agreement with infant formula producer Bellamy's, that will see increased utilisation of Fonterra's Darnum (Gippsland) plant.

Fonterra also plans to build a bigger cheese plant at Stanhope to replace the facility destroyed by fire in 2014, and is selling its Australian yoghurt business to Parmalat – the latest in a string of acquisitions for the latter. Murray Goulburn snatched the five year Coles

private label cheese contract from Bega (with supply commencing 2017), and acquired the remaining shares of Tasmanian Dairy Products (TDP) that were held by Mitsubishi Corporation. A2 Milk (A2M) saw off a takeover threat and subsequently completed a NZ\$40 million (A\$37 million) capital raising, intended to support its expansion efforts in Oceania, China, the US and UK.

Farm investment by corporate entities has continued, with The Van Diemen's Land Company (VDL) sold after years of speculation, ACE Farming adding to its portfolio, and ASX-listed Carbon Conscious unveiling big plans for a WA-based milk production and export business.

The Australian industry continues to evolve and adapt, and the skills and

strategies many farmers have developed during recent tough years have been evident in the response to the slow tightening of margins and seasonal conditions in 2015/16. The weather may have provided a late January/early February reprieve, but the tectonic pressures of European expansion and sluggish demand from key markets look set to limit any recovery in international markets for some time to come. As a result, Australian farmers are likely see pricing remain constrained for the near future. The stability of the domestic market, the trend towards value adding for export, and (with more rain) some input cost relief will all prove valuable as the Australian industry 'plays the long game' in the months ahead.

# Inputs



## Fertiliser

Urea  
(granular Middle East)

226 US\$/t

▼ -7% LY

▼ -40% 5Y

DAP (US Gulf)

338 US\$/t

▼ -4% LY

▼ -24% 5Y

MOP (granular Vancouver)

320 US\$/t

■ 0% LY

▲ +8% 5Y

Price is January 2016 average (to 18/01/2016), compared to the 2015 (LY) and 5-year (5Y) average

Source: Bloomberg

## Water and weather

Northern Victoria

234 \$/ML

▲ +119% LY

1,108,817 ML

▲ +89% 5Y

Murray Irrigation System

233 \$/ML

▲ +108% LY

57,118 ML

▼ -31% 5Y

Price is average YTD FY 2015/16 (to December), and compares to year earlier (LY). Volume of water traded is YTD FY, and compares to the 5-year average (5Y).

Source: Victorian Water Register, Murray Irrigation Ltd

## Cows

Cull cows

405 c/kg

▲ +45% LY

▲ +51% 5Y

89,506 head

▲ +49% LY

▲ +47% 5Y

Dairy cattle exports

86,487 head

▲ -1% LY

▲ +9% 5Y

Price is December 2015 average, compared to year earlier (LY) and 5-year (5Y) averages. Number of head is last 12 months (cull cows to December, dairy cattle exports to October 2015).

Source: NLRS, ABS

## Weather

Australian rainfall was mixed during the last quarter of 2015, ranging from the highest on record in parts of the north, to the lowest on record in other regions, including a large part of Tasmania. While some parts of northern Queensland were lucky enough to receive above average December rainfall, these eased, rather than rectified rainfall deficiencies on a longer timescale. Many areas missed out entirely on the above average falls, and rainfall deficiencies increased slightly in parts of western Victoria. Other areas, such as far southwest Western Australia, and large areas of southeastern Australia, remain rainfall deficient at various timescales.

While a strong El Niño persists, according to the Bureau of Meteorology, climate models indicate that early 2016 will see the weather system deteriorate, with neutral or La Niña conditions likely by the second half of the year. The likelihood of either state occurring is considered to be approximately equal. Around 50% of El Niño events since 1900 have been followed by a neutral year, and 40% by La Niña. Above average rainfall is generally experienced in parts of Australia during the first half of a year when a strong El Niño event breaks down. Extra moisture may also be available for rain systems across the country due to record warm Indian

Ocean sea surface temperatures. Forecasts indicate that the first quarter of 2016 will be wetter than average in southeast Queensland and Tasmania, but drier than average across parts of northern Australia and the southeast mainland.

## Water

Dry conditions, low seasonal water allocations, and less water overall for irrigation use under the Murray-Darling Basin Plan has meant that irrigation water availability and affordability has been a serious production constraint in the Murray Dairy region and on the Murray River in South Australia this season. These conditions are driving increased competition in the temporary market and putting upward pressure on prices; temporary water has traded at more than \$200/ML since July (reaching \$269/ML in the Murray Irrigation System, and \$278/ML in Northern Victoria), compared with a range of \$80/ML to \$128/ML over the same period the year before.

High Reliability Water Share allocations as of 15 January 2016 were 85% in the Goulburn and 96% in the Victorian Murray systems. General Security water share allocations in the NSW Murray system were 19%.

Water market news has included the Murray Goulburn announcement during

October that it would lease high security irrigation water, reportedly at \$125/ML and \$60/ML “plus standard water charges and administration costs” to its northern Victorian and Southern New South Wales Riverina suppliers respectively, for the first year of the agreement. MG’s offer was for a single 50 ML parcel per supplier farm, and demand was reported to have far exceeded supply. Tenders (with a minimum bid size of 30ML) also closed in October for 20 GLs of temporary water from the Goulburn river catchment being sold by The Commonwealth Environmental Water Holder following “detailed consideration of the environmental conditions ... as well as implications for irrigators and their communities.”

## Fertiliser

Global fertilizer markets remain subdued, with low crop values flowing back to reduced willingness from farmers to pay for inputs, and week or volatile domestic currency in several importing nations. Supply of urea continues to outweigh demand. In addition to crop values and currency considerations, there are substantial supplies of warehoused stock, new urea plants are starting up in several countries, and lower energy prices are reducing production costs.

Demand for phosphates has also been relatively soft, although renewed interest is expected from India, Brazil and the US. While an improved export tax environment will likely improve the global competitiveness of Chinese exporters, apparently poor margins are causing some producers to reduce output.

Potash prices remain relatively strong when compared to urea and phosphate markets, but demand may soften this year. Demand from China, a major importer of MOP, may be impacted by currency factors and import taxes. In areas of South and Southeast Asia, currency may also negatively affect demand, as will weather conditions.

## Cows

Cull cow numbers remain significantly elevated, driven by a combination of high prices for manufacturing beef, relatively cheap replacement stock, and continued margin pressures. Sales for the 12 months to December 2015 were 49% higher than the same period year earlier, and 47% above the 5-year average. The December average per kilogram price was 45% higher than prior year.

Dairy cattle exports totaled 86,487 head for the 12 months to October 2015, 1% less than the same period year-earlier, and slightly above average. While China remains the primary destination



for Australian dairy cattle, accounting for 83% of exports over the last 12 months, demand has been impacted by lower domestic milk prices, and the opening of their market to live cattle imports from other origins. Consequently, exports during the 12 months fell 7% compared to year-earlier, from 71,503 to 76,663 head. The majority of the balance of exports went to Vietnam, Malaysia, Sri Lanka and Indonesia. Exports to Pakistan fell substantially, while Russia, previously a significant market, remained out of the market.

## Grain

Global macroeconomic factors and depressed energy markets are putting pressure on commodities in general. Grain markets are no exception, and in particular, low crude oil prices continue to pressure biofuel usage, which accounts for a very large proportion of demand for corn and rapeseed. Adding further downward pressure to global grain prices are record wheat and corn stocks, and recent improvements in crop conditions in Brazil and the Black Sea. As usual, geopolitical factors are also playing a part, with the change of government in Argentina having resulted in reduced wheat export taxes, increasing competition as Argentine exporters win business in major markets such as Egypt, Indonesia and South Korea.

One impact of low prices is that farmers around the world are holding grain back from the market, waiting for selling conditions to improve. Crop conditions in South Africa and India are also putting upward pressure on prices, with South Africa in drought for the second year in a row, and India having experienced poor monsoonal rains. The latest United States Department of Agriculture (USDA) report also estimated US wheat planting at 2 million acres lower than expectations, causing an increase in futures markets as fund managers and speculators sought to reduce short positions.

Back in Australia, continued softening in the AUD is making grain exports more competitive in global terms, and hence putting upward pressure on domestic prices. China is starting to show renewed export interest in Australian barley, which is having the greatest impact in Western and Southern Australia, as the lowest priced markets. Production of feed grain (sorghum and corn) in central Queensland is likely to be negatively impacted by continuing very dry weather, however southern Queensland and much of New South Wales continue to have relatively good growing conditions.

## Hay

Two key factors when looking ahead for the hay market at this time of year are the autumn break, and the availability of stocks to get us there. Hence, in the absence of being able to predict the break, it's useful to look at current demand and estimates of fodder stocks. At the present time there are large variations in the level of demand between the north and south of the country, with a virtual reversal of fortunes from the same time last year: this year the demand is coming from the south, especially from Tasmania and Victoria's dairy regions. At the same time, in much of New South Wales, and areas of Queensland it appears that a good season has put demand for fodder back to average. There are however areas impacted by both drought and fires that will see localised fodder shortages.

The general trend down the East coast of Australia is that there is both interest in and demand for hay, increasing as you progress south. Coupled with low stocks, the general consensus is that fodder prices in most regions are unlikely to decrease before winter. Coastal regions in New South Wales and southern Queensland continue to experience good conditions for pasture production, resulting in low demand for purchased fodder. While the

scale of on farm hay and silage production is difficult to estimate, there is general agreement that demand for purchased fodder into these regions is likely to be well down on average.

In contrast, fodder production in Victoria this season was below average. If the demand we are currently seeing (especially from Gippsland) continues, it is likely that buyers will need to look further afield to source fodder until the Autumn break. Demand for fodder remains strong in Tasmania, a situation that is likely to continue over the coming months. Despite the prices on offer, it appears that not all orders will be met from the 2015 fodder harvest. There are reports of interest in bringing in fodder from the mainland. There appear to be good volumes of hay available in New South Wales and South Australia.

The 2015 cereal hay harvest in Western Australia reportedly produced both good yields and quality, which was good news for the export sector. However, yields for pasture and legume hay (fodder types generally produced for the Western Australia sheep, beef and dairy markets) were not as favourable. The combination of a lower than average pasture hay harvest due to poor growing conditions, and an as yet unknown impact from the recent fires in the region, suggests that fodder may be tight in the domestic sector.

## Grain and hay prices

### Australian dairy regions

#### Grain and hay



The relevant stockfeed wheat available in a region (ASW, AGP, SFW1 or FED1).

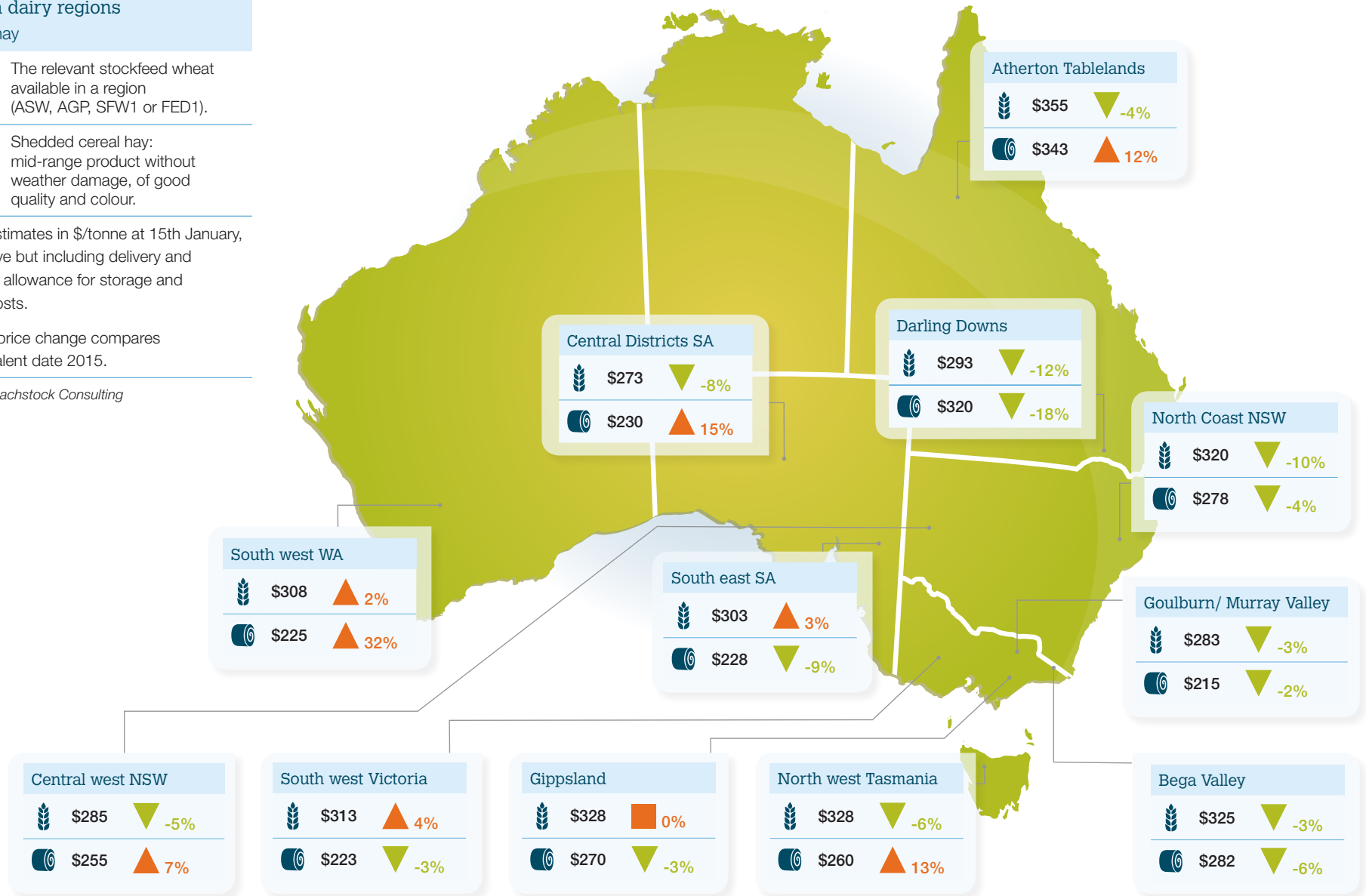


Shedded cereal hay: mid-range product without weather damage, of good quality and colour.

Prices are estimates in \$/tonne at 15th January, GST exclusive but including delivery and (for grain) an allowance for storage and marketing costs.

Percentage price change compares to the equivalent date 2015.

Source: AFIA, Lachstock Consulting



# The Australian market

## Supermarket sales

Supermarket sales of the major dairy categories displayed divergent trends over the most recent 12 month period. While dairy spreads continue to grow strongly, milk and cheese sales are steadier, as are sales values for yoghurt and dairy snacks, although volume sales for this category continue to shrink.

Milk sales volumes remain relatively steady, increasing 0.4% over the 12 months to December, with the majority of extra product sold being UHT. Sales volumes for UHT product rose 2.1% (to a total of 192 million litres), although category value declined 1.1% due to declining per litre pricing, which fell 3.1%, to an average of \$1.31. Within the UHT sub-category, sales of flavoured milk

continue to decline (-11.4%), while sales of “white” (non-flavoured) milk rose 2.7%.

Growth in sales of fresh milk remains considerably slower than UHT, increasing 0.1% in volume terms (to 1,134 million litres), with value declining -0.3% as the price per litre declined by -0.4%, to an average of \$1.58. In contrast to UHT product, sales of fresh flavoured milk continue to grow (+3.4%), while white milk sales declined 0.2%. Convenience is an important purchasing driver, and UHT provides consumers with an on hand supply of milk, particularly the older demographics.

A common trend across both fresh and UHT white milk is the continued move away from reduced or low fat (“modified”) products, toward full cream options. Sales of full cream fresh white milk have increased 5.1%, and modified milk decreased 8.8%, while sales of full cream and modified UHT milk rose and fell 9.8% and 3.6%, respectively. Hence, full cream fresh white milk now represents 49.9% of total white milk sales (by volume), compared to 47.7% a year earlier. Full cream UHT white milk now represents 7.7% of total white milk sales, compared to 7.1% a year earlier.

Nutrition science over recent years has questioned dietary recommendations towards low-fat products. An increasing body of data shows consumption of whole-milk dairy products is associated with reduced risks of heart disease and

reduced body fat, according to Nutrition Scientist Anita Lawerence. The rise of this debate coincides with a continued move to consume fresh white whole milk.

Private label product continues to gain market share in the fresh white milk category, representing 63.4% of sales (up from 61.8% 12 months earlier), on a 2.3% increase in sales volumes (to a total of 648 million litres). There was no change in the average price per litre, which remained steady at \$1.01 (compared to \$1.93 for branded product). In contrast, branded UHT milk continues to grow faster than private label. Sales of branded white UHT milk grew 6.4%, while private label sales shrank 3.3%. The average per litre price for branded and private label white UHT milk was \$1.37 and \$0.97.

The recent rise in popularity of diets such as Paleo, correspond with the rise in a broader range of milk alternatives. Sales of non-dairy milk continue to grow, as does the trend away from soy and grain based products toward nut based alternatives. Over the 12 months to October, category sales grew by 1.5% in volume terms, and 4.8% in value, reflecting a 3.3% increase in the average per litre price as consumers shifted toward higher priced products. The category has seen a similar shift to dairy milk in terms of preferences for fat levels, with full cream product sales increasing 5.6%, and modified product sales falling 1.9%.

Figure 3 Supermarket sales

Milk	Cheese	Dairy spreads	Yoghurts and snacks
Volume (m. litres) <b>1,326</b>	Volume (kt) <b>137</b>	Volume (kt) <b>46</b>	Volume (kt) <b>204</b>
Year-on-year growth <b>+0.4%</b>	Year-on-year growth <b>0.0%</b>	Year-on-year growth <b>+4.7%</b>	Year-on-year growth <b>-3.9%</b>
Retail value (\$ m) <b>2,041</b>	Retail value (\$ m) <b>2,113</b>	Retail value (\$ m) <b>418</b>	Retail value (\$ m) <b>1,426</b>
Year-on-year growth <b>-0.4%</b>	Year-on-year growth <b>0.0%</b>	Year-on-year growth <b>+6.1%</b>	Year-on-year growth <b>+0.1%</b>

Source: IRI

Note: Available data is taken from differing periods; milk and dairy spreads figures from MAT 13/12/2015; cheese, yoghurt and dairy snacks from MAT 04/10/2015.

Dairy spreads (butter and blends) grew 4.7% in volume and 6.1% in value in the 12 months to December 2015, with major contributors being strong sales growth in butter, and increased average pricing for blends. Representing 53.6% of dairy spreads sales (by volume), butter continues to demonstrate the strongest growth in the category, with sales volumes increasing 7.5%, to a total of 21 million tonnes. The average price for butter fell -0.3% (to \$8.39/kg), resulting in category value growth lagging behind volume growth, at 6.4%. While the majority of butter sold is salted, sales of unsalted butter are growing more rapidly: salted butter sales increased 7.5%, but unsalted butter sales by 11.6% over the same 12 month period. Sales of butter blends increased 1.6% in volume terms, and 5.6% in value, with a 2.1% increase in the average unit price (to \$9.83/kg).

Cheese sales volumes remained steady for the 12 months to October 2015. While smooth or cream cheeses declined 6.4%, and sliced cheese 1.8%, block and snacking cheese sales turned around from recent trends to increase slightly (+0.7% and 3.7%, respectively). Specialty or entertaining type cheeses posted strong double-digit growth (+16.4%), while sales of deli cheese grew slightly (+1.7%).

Unit pricing increased across all cheese varieties (with the exception of smooth or cream cheeses), with the average per

kilogram price rising 2.5% (to \$15.37/kg). The average chilled cheese price rose 2.1% (to \$13.57/kg), and the average deli cheese price increased 2.8% (to \$25.37/kg).

Yoghurt and dairy snack sales continued to decline in the year to October 2015, falling 3.9%. Dairy yoghurt makes up 77.4% of this category. While declining sales of some products, such as sweetened yoghurts, resulted in total yoghurt sales falling 2.9%, traditional yoghurts continue to grow strongly. A shift in preferences is evident in the fact that, over 12 months, sweetened and traditional yoghurt have gone from making up 30.5% and 34.6% of the yoghurt and dairy snacks category, respectively, to 28.9% and 38.5%. Total sales value for the yoghurt category increased 0.5%, with stronger average unit pricing, despite some discounting for sweetened products. Although the average unit price of dairy snacks rose 6.5%, a 7.4% decline in sales volumes saw category value shrink 1.3%.

While a greater proportion of Australians still eat fruit/flavoured over natural yoghurt, the gap is closing. This increased trend towards natural/plain yoghurt may be the result of increased awareness of sugars both natural and added in many flavoured yoghurts, or part of a broader trend towards more 'natural' foods.

## Infant Formula

Infant formula sales have received a lot of media attention in recent months, with reported shortages in store, and major supermarkets limiting the number of cans that can be purchased in a single sale. Supermarket figures for the 12 months to October show that sales value increased more rapidly than volume (37.3% and 31.6%, respectively), due to a 4.3% increase in the average per kilogram price (to \$24.19/kg). While growth in sales volumes has occurred across formulas for all age groups, the greatest share of growth has occurred in the Third Age category, followed by Second Age, and then 0-6 months.

Source: IRI

Note: Data for the period MAT 04/10/2015.

### Infant Formula

Volume (kt)

14

Year-on-year growth

+31.6%

Retail value (\$ m)

347

Year-on-year growth

+37.3%



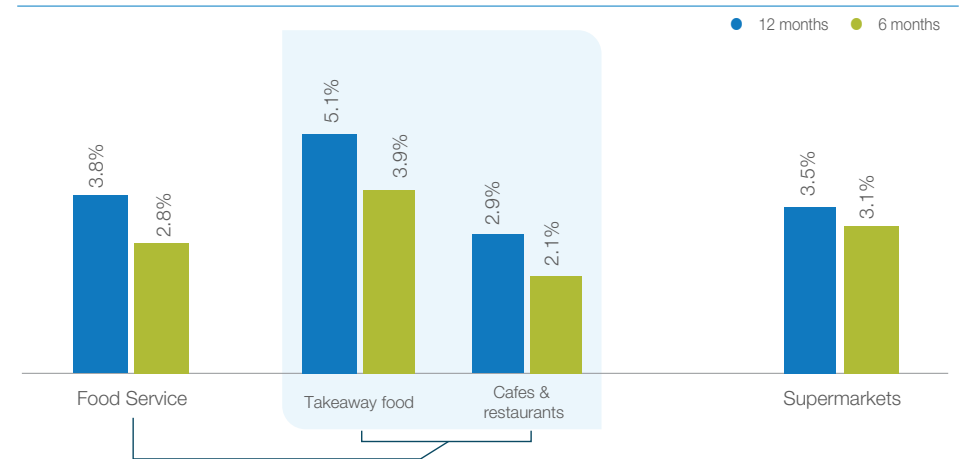
## Australian Economic Settings

Although pessimists outnumbered optimists in the January Westpac-Melbourne Institute Consumer Sentiment Index, it sits 4.3% above its level a year earlier. The index fell 3.5% in January, with negative international and financial market news weighing on respondents' assessments of their own financial positions. Individual assessments of the financial position that their family was in compared to a year ago, and their expectations about how they'll be in the year ahead both declined (by 9.4% and 2.3% respectively), with a concurrent increase in concerns regarding the outlook for unemployment. Despite this, attitudes to the labour market have improved over the last 12 months, with the Westpac-Melbourne Institute Index of Unemployment Expectations being 5.3% lower. Concerns of this type can be expected to translate to decreased inclination to spend on eating out, or more "decadent" food items, as can sentiment around the housing market, which remains weaker than 12 months ago.

Consequently, it is not surprising that Dairy Australia's Food Service Index shows that the pace of growth continues to slow for both the Food Service and Supermarket channels. The index reflects year-on-year growth in retail turnover of the Food Service channel, which aggregates takeaway food, cafes, restaurants and catering services. Comparison of the year-on-year changes in the index (to November) show that growth in spending at cafes and restaurants has slowed particularly dramatically at the 12 month, and takeaway food at the 6 month timescales.

Inflation remains relatively low, and slowed further during the most recent (September) quarter, with the 'all groups' CPI rising 0.5%. Despite this, there was no change at the 12 month timescale, which remained at 1.5%. International holiday travel and accommodation (+4.6%), fruit (+8.2%) and property rates and charges (+4.6%) represented the most significant price rises, while vegetables (-5.9%), telecommunication equipment and services (-2.0%) and automotive fuel (-1.7%) exhibited the most significant falls.

**Figure 4** Dairy Australia Food Service Index (YoY turnover growth to November 2015)



Source: Dairy Australia, ABS

While the dairy and related products index continued to decline, the rate slowed during the September quarter (-0.4%, compared to -0.9% for June). Over the past 12 months the dairy CPI has fallen 1.1%, with decreases in each of the underlying indexes: milk fell 0.6%, cheese 2.5%, and ice cream and other dairy products 0.4%. Dairy has not been the only sub-component of the food and

non-alcoholic beverages index to post falls, with fruit, vegetables, eggs, and bread being other major products to exhibit price falls. However, significant increases in meat (other than poultry), as well as alcohol and tobacco, have more than offset these declines to see the index rise 0.1% during the September quarter, and 0.2% over the preceding 12 months.

# Global economy and exchange rates

**Lower oil prices are weighing on the growth prospects of fuel exporting nations, and, at the same time, the consumption response from importing nations has been lower than might have been expected.**

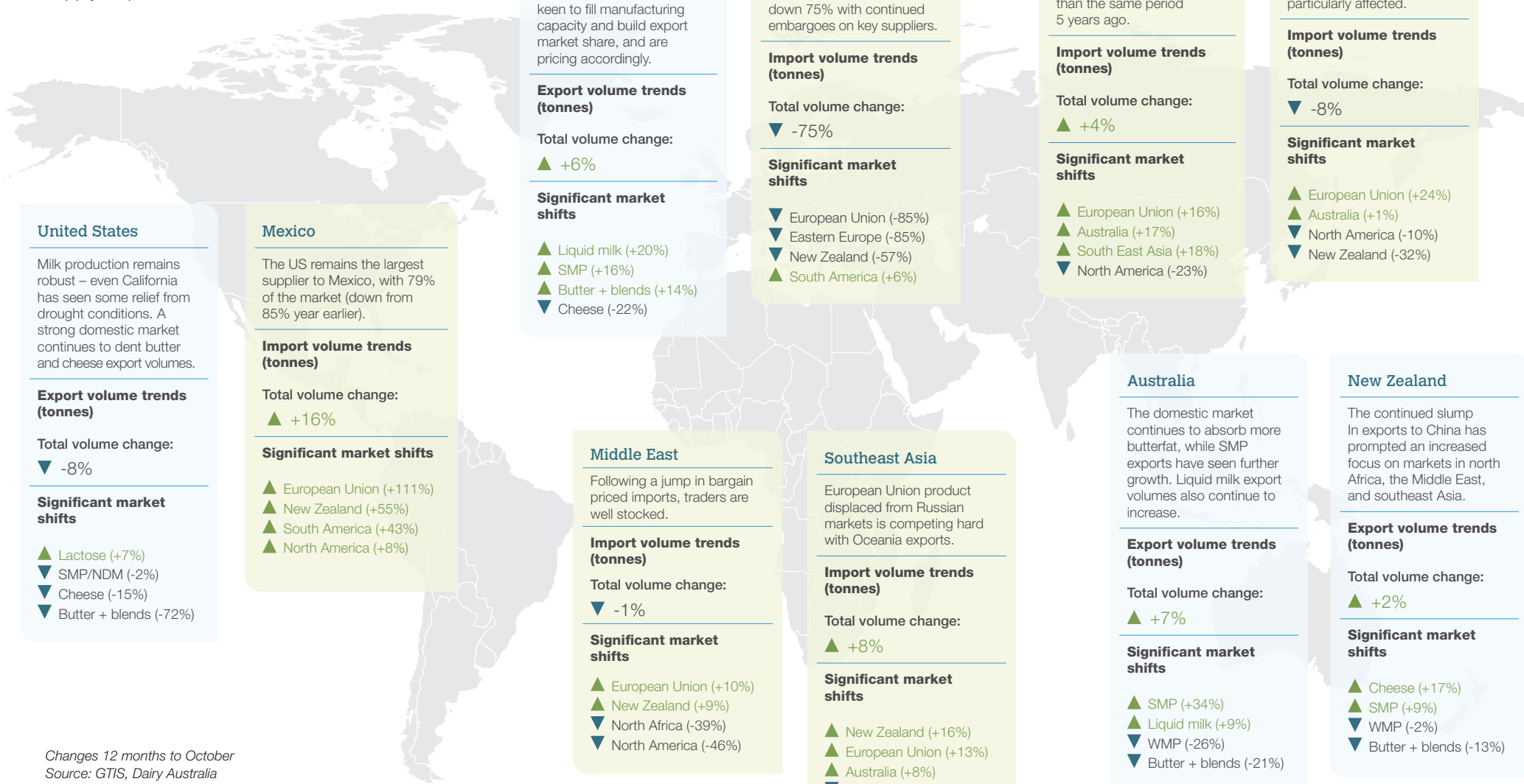
The latest update to the World Economic Outlook (WEO) from the International Monetary Fund (IMF) (January), projects global economic growth at 3.4% in 2016 and 3.6% in 2017. This forecast is slightly lower than that of the WEO's October report, largely reflecting slower acceleration in activity in developing economies and emerging markets (which accounted for over 70% of global growth in 2015). Unanticipated factors contributing to the revision include the severity and length of the recession in Brazil, the impact of lower oil prices on the Middle East, and steady, rather than accelerating, growth in the United States. Global trade growth expectations have also been revised downward due to economic conditions in China and other countries suffering distress, with global manufacturing and trade remaining weak in general.

Global oil production continues to exceed consumption, and prices are generally expected to remain depressed for some time to come. This is weighing on the growth prospects of fuel exporting nations, and, at the same time, the consumption response from importing nations has been lower than might have been expected. According to the IMF, this leaves room for some upside to the current forecast, should prices result in greater demand from oil importers than anticipated. On the other hand, downside risks include the impact on exporters if further commodity price declines occur. In addition, the Chinese and United States economies, escalations in ongoing geopolitical tensions, or a sudden rise in global risk aversion, could also pose downside risk.

Currencies of major dairy commodity exporters have continued to be relatively weak, enhancing their ability to compete on price. The Australian dollar averaged 0.73 AUD/USD during the final quarter of 2015 (having fallen from 0.77 in Q2), according to Bloomberg. Exporters look likely to continue to benefit from this in 2016, with the median forecast fluctuating around the 0.68-0.69 AUD/USD mark. Forecasts for major dairy exporters New Zealand and the European Union also anticipate that their currencies will depreciate further against the USD over the course of 2016, before beginning to appreciate again in 2017 and 2018.

# Global supply and demand overview

Demand remains sluggish overall, and the market has seen only a modest supply response to date.



## United States

Milk production remains robust – even California has seen some relief from drought conditions. A strong domestic market continues to dent butter and cheese export volumes.

### Export volume trends (tonnes)

Total volume change:  
▼ -8%

### Significant market shifts

- ▲ Lactose (+7%)
- ▼ SMP/NDM (-2%)
- ▼ Cheese (-15%)
- ▼ Butter + blends (-72%)

## Mexico

The US remains the largest supplier to Mexico, with 79% of the market (down from 85% year earlier).

### Import volume trends (tonnes)

Total volume change:  
▲ +16%

### Significant market shifts

- ▲ European Union (+111%)
- ▲ New Zealand (+55%)
- ▲ South America (+43%)
- ▲ North America (+8%)

## European Union

European manufacturers are keen to fill manufacturing capacity and build export market share, and are pricing accordingly.

### Export volume trends (tonnes)

Total volume change:  
▲ +6%

### Significant market shifts

- ▲ Liquid milk (+20%)
- ▲ SMP (+16%)
- ▲ Butter + blends (+14%)
- ▼ Cheese (-22%)

## Russia

Global exports to Russia are down 75% with continued embargoes on key suppliers.

### Import volume trends (tonnes)

Total volume change:  
▼ -75%

### Significant market shifts

- ▼ European Union (-85%)
- ▼ Eastern Europe (-85%)
- ▼ New Zealand (-57%)
- ▲ South America (+6%)

## Japan

Global exports to Japan have tracked 10% higher than the same period 5 years ago.

### Import volume trends (tonnes)

Total volume change:  
▲ +4%

### Significant market shifts

- ▲ European Union (+16%)
- ▲ Australia (+17%)
- ▲ South East Asia (+18%)
- ▼ North America (-23%)

## Greater China

Demand remains subdued, with WMP (-47%) imports particularly affected.

### Import volume trends (tonnes)

Total volume change:  
▼ -8%

### Significant market shifts

- ▲ European Union (+24%)
- ▲ Australia (+1%)
- ▼ North America (-10%)
- ▼ New Zealand (-32%)

## Australia

The domestic market continues to absorb more butterfat, while SMP exports have seen further growth. Liquid milk export volumes also continue to increase.

### Export volume trends (tonnes)

Total volume change:  
▲ +7%

### Significant market shifts

- ▲ SMP (+34%)
- ▲ Liquid milk (+9%)
- ▼ WMP (-26%)
- ▼ Butter + blends (-21%)

## New Zealand

The continued slump in exports to China has prompted an increased focus on markets in north Africa, the Middle East, and southeast Asia.

### Export volume trends (tonnes)

Total volume change:  
▲ +2%

### Significant market shifts

- ▲ Cheese (+17%)
- ▲ SMP (+9%)
- ▼ WMP (-2%)
- ▼ Butter + blends (-13%)

## Middle East

Following a jump in bargain priced imports, traders are well stocked.

### Import volume trends (tonnes)

Total volume change:  
▼ -1%

### Significant market shifts

- ▲ European Union (+10%)
- ▲ New Zealand (+9%)
- ▼ North Africa (-39%)
- ▼ North America (-46%)

## Southeast Asia

European Union product displaced from Russian markets is competing hard with Oceania exports.

### Import volume trends (tonnes)

Total volume change:  
▲ +8%

### Significant market shifts

- ▲ New Zealand (+16%)
- ▲ European Union (+13%)
- ▲ Australia (+8%)
- ▼ North America (-11%)

Changes 12 months to October  
Source: GTIS, Dairy Australia

# Global demand

## Overview

Global demand grew 2% in the 12 months to October, with the increase continuing to come largely from price sensitive countries. Demand from Greater China continues to be subdued, and the volume of exports to the Middle East has slowed. Furthermore, exports to

Russia, hitherto the world's second largest single country dairy market, remain extremely low following the embargo on major (western) exporters. However, many Southeast Asian countries continue to stock up on relatively affordable dairy products, and demand growth from Japan remains relatively strong.

## Greater China

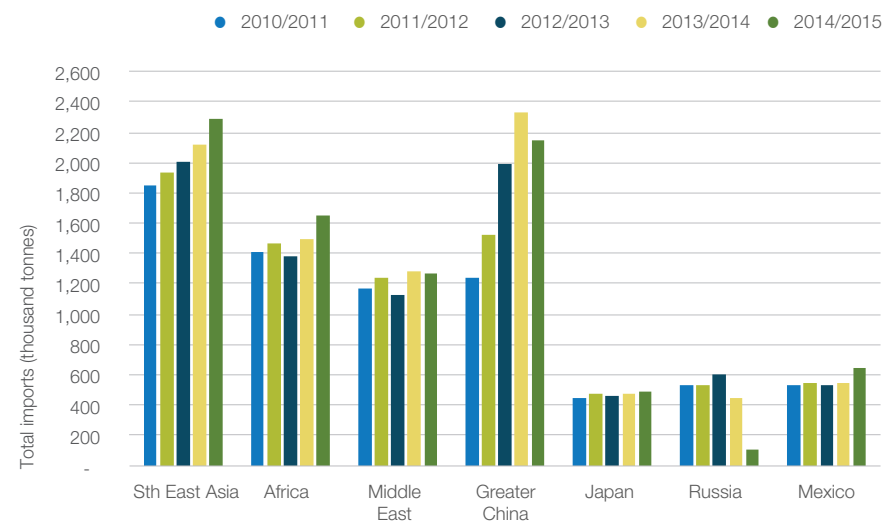
Continued subdued demand, and the significant fall in global dairy prices, resulted in total global exports to Greater China being 8% lower in volume terms, and 27% in value (USD) during the 12 months to October. Demand for milk powder (one of the most significant dairy products exported to the region) remains weak, with WMP and SMP down 47% and 19%, respectively, year-on-year. Infant powder increased 17%, and liquid milk rose 36% (over 132,000 tonnes). The EU was the only major exporting region to increase exports to Greater China (+24%), while Australian exports remained relatively steady at just over 138,000 tonnes (+1%). Australia's largest volume export to the region remains liquid milk (largely UHT), which rose 33%. Exports of butter, infant powder and whey powder also grew strongly, while cheese volumes fell. Exports from New Zealand were severely reduced (-32%), largely due to the ongoing impact of reduced demand for WMP.

## Japan

Global dairy exports to Japan grew 4% in volume during the 12 months to October 2015. Butter (+26%) and SMP (+62%) saw the most significant volume increases. While cheese volumes had grown very strongly last financial year, growth has stagnated overall for the 12 months to October. Cheese made up 85% of Australia's exports to Japan for the period, and sales volumes rose 20% (just under 15,000 tonnes). The total USD value of global exports fell 15% over the 12 month period.

Heifer prices in Hokkaido (home to 58% of Japanese dairy cattle) reportedly reached record levels in December, although they remained slightly lower than the cost of importing livestock from Australia. Contributing factors are large-scale dairy farms seeking stock (for both replacements and herd size increases), and a decrease in availability of heifers with the desired breeding. Japan's dairy herd has been steadily shrinking in recent years, and fell a further 1% between 2014 and 2015.

**Figure 6** Exports to key demand markets (12 months to October)



Source: Dairy Australia, GTIS



## Southeast Asia

Depressed global prices have seen many Southeast Asian countries continue to stock up on dairy products, with volume growing 8% in the 12 months to October, while the USD value fell 21%. In terms of individual markets within the region, Cambodia, Laos, Malaysia, Thailand and Vietnam all continue to demonstrate strong double-digit growth, while the Philippines and Singapore grew more slowly, and Indonesian purchasing remained steady.

While there was significant additional buying activity for milk powders (overwhelmingly from New Zealand) last financial year, this has settled to a steadier pace, with WMP up 9%. While SMP and whey powder both fell (-6% and -8%, respectively), total volumes of these products are only a small proportion of milk powder trade to the region, compared to WMP. Condensed milk, liquid milk and infant powder also grew strongly.

New Zealand increased its market share from 25% to 29%, while the EU rose from 19% to 22%. Australian market share has increased modestly, up from 10% to 11%, and North America shrank from 20% to 17%.

## Mexico

Global exports to Mexico, the second largest single-country destination for dairy (although not a major market for Australia), increased 16% in volume and fell 10% in value in the 12 months to October. The US supplied 79% of total product purchased (down from 84% the previous year), with the EU and New Zealand, the next largest suppliers, each increasing their respective shares by 1%, to a total of 8% and 7%. Major product shifts were in butter oil, SMP and whey powder. Butter oil rose 75% (to almost 27,000 tonnes), SMP increased 40% (to almost 280,000 tonnes), and whey powder fell 17% (to around 52,000 tonnes).

## Trade policy developments.

In addition to recent achievements, the trade policy outcomes of previous years continue to pay incremental dividends. Whilst trade policy continues to provide challenges for dairy exporters – particularly in the area of technical barriers to trade, the beginning of 2016 brings a number of improvements in market access for Australian dairy, including:

- › The implementation of ChAFTA occurred on 20th December, followed by the subsequent quick transition to 2nd year tariff reductions as of 1st Jan 2016.
- › The Korea Australia FTA progressed to year 3 benefits for exporters as of 1st Jan 2016 – bringing further tariff reductions and increased quotas for a range of dairy exports from Australia.
- › The Malaysia Australia FTA moved to 4th year of implementation, including further improvement in liquid milk Tariff Rate Quota access as of 1st Jan 2016.
- › The Thai Australia FTA and the US Australia FTA both celebrated 10 year anniversaries in 2015, providing further increases in duty free quota and reduction in out of quota tariffs for Australian dairy as from 1st Jan 2016.
- › Trans-Pacific Partnership (TPP) negotiations were completed in late 2015.
- › December saw the announcement of the World Trade Organisation (WTO) ministerial agreement in Nairobi to abolish government subsidies on agricultural exports.
- › The Japan Australia EPA may move to year 3 benefits from 1st April 2016.

## Middle East

Depressed global values prompted many buyers in the Middle East to re-stock, causing exports to the region to jump. However, by February 2015 many customers had their immediate needs covered, and the pace of imports moderated. Consequently, exports to the region plateaued out, and ended the 12 months to October down 1% year on year in volume terms. The USD value was down 19%.

Significant product shifts included a 20% increase in exports of WMP to the region, a reduction of 17% in butter exports, and a 13% fall in cheese. The EU increased their market share from 45% to 50%, and New Zealand from 26% to 28%, at the expense of falling market share for North Africa and North America. Australia's market share remained at 4%, with increases in sales of several products including WMP, whey powder and butter, but decrease exports of cheese and SMP to the region.

## Russia

Global dairy exports to Russia continue to be severely impacted by the full year extension (to August 2016) of the embargo on many food products from key western suppliers announced last June. The embargo covers imports of a range of food and agricultural products (including dairy) in response to sanctions imposed over the conflict in eastern Ukraine. Exporting countries affected include the United States, European Union, Australia, Canada and Norway – though exceptions have periodically been made.

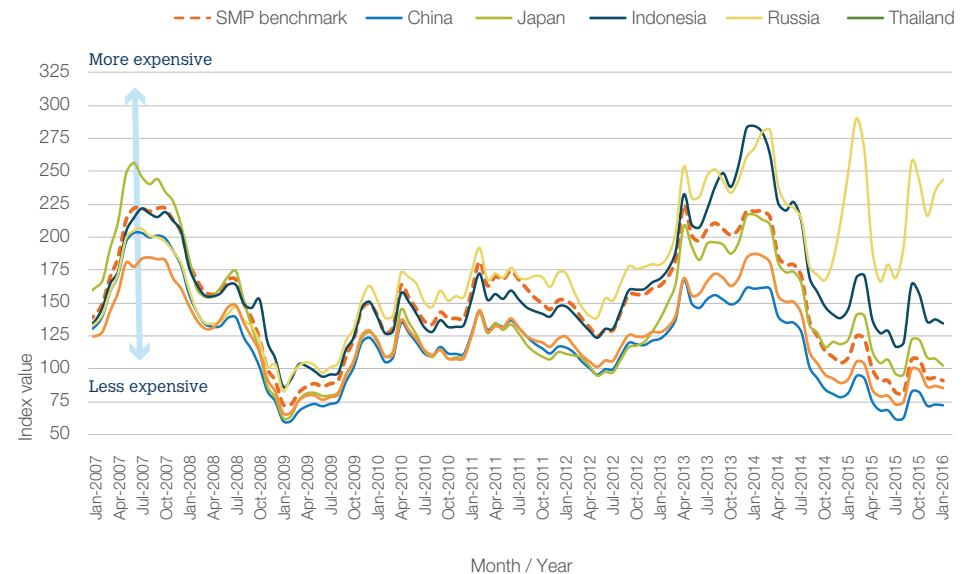
The ban on key suppliers saw Russian dairy imports fall 75% in the 12 months to October, compared to year earlier. This includes a decrease of 284,000 tonnes in EU dairy exports to Russia alone. Exports from Uruguay to Russia have increased 31%, to a total of just under 17,000 tonnes. Exports from China, Brazil and Chile have also increased significantly in percentage (but relatively small volume) terms.

## Dairy affordability

The benchmark SMP price for Dairy Australia's affordability index has eased almost 15% since the October Situation and Outlook report, helping maintain relatively attractive dairy affordability in many key markets. Currency movements have been mixed, and generally muted over this time; the standout exception again being the Russian rouble, which has depreciated a further 11.5% since October's report. Although Russian dairy imports remain restricted by the country's embargo on

most of the world's major exporters, weaker international pricing means the benchmark index still shows a 5% improvement in affordability. Other countries have seen much greater improvements, with Japanese buyers again benefiting from a stronger yen (which has returned to year-ago levels) - affordability has improved by 16%. A 3% currency depreciation since the October report has reduced the year-on year improvement in affordability in China, which had been tracking around 30%, but is now 12% better than January 2015.

Figure 7 Dairy affordability



Source: Dairy Australia, Bloomberg

## Dairy substitutes

Dairy price premiums relative to non-dairy substitutes have shown mixed movements since the October Situation and Outlook report, but were lower by the end of December. In contrast to the large shifts of 2014, the full 2015 calendar year saw some relatively limited overall change, despite some intra-year volatility.

The premium for dairy protein as at December 2015 was around 8% lower than prior-year levels, though markedly (19%, US\$79c/kg) higher than the trough reached in July. The key driver continues to be a weak SMP market, with values trading around 15% lower

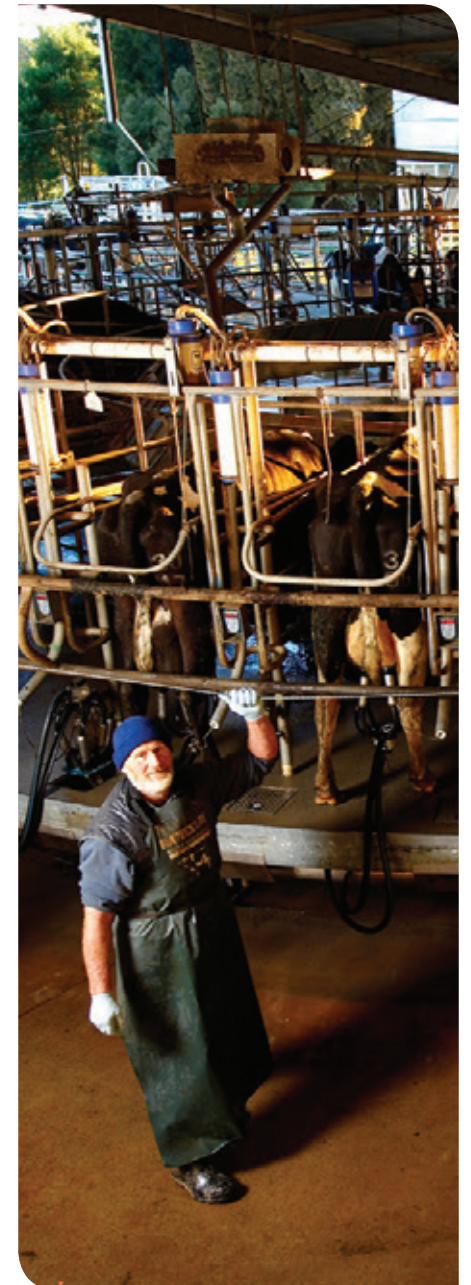
than the same time last year. Over the course of 2015, the average soy meal price has fallen 28%, maintaining a relatively consistent downward trajectory. Despite reports of dry conditions reducing yields in Brazil, large stocks in the US, Argentina and some importing countries are considered more than enough to offset any losses. Soybean stocks are likely to remain burdensome well into 2016, especially given the probable loosening of export controls under the new government in Argentina. Thus, the dairy protein premium is more likely to face upside risk, as SMP prices recover, though this could be some months away.

A robust butterfat market has contrasted with falling palm fat prices to drive a modest (1%) increase in the dairy fat premium over the course of 2015. Palm oil prices fluctuated during the year, but fell 16% overall as slow import demand saw significant stocks accumulate during the second half of the year. Stocks in major exporting countries (particularly Malaysia and Indonesia) remain high, but as the lagged effects of El Nino reduce yields (and therefore production), the situation is expected to reverse during the first half of 2016. Appreciating palm oil prices could at least dampen the effects on relative cost, of an expected dairy price recovery in late 2016.

**Figure 8** Dairy price premium vs palm/soy substitutes



Source: Dairy Australia, Oil World

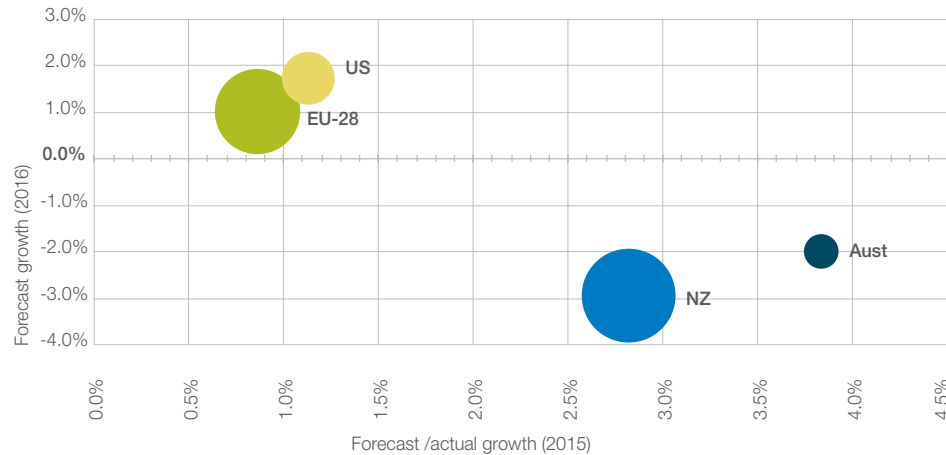


# Global supply

## Overview

While southern hemisphere exporters are experiencing a noticeable supply response due to a combination of climatic and margin influences, modest growth in the northern hemisphere continues. A strong domestic market is keeping the extra US output off world markets, but Europe remains firmly focused on export market development.

**Figure 9** Actual and forecast milk production growth – four largest exporters



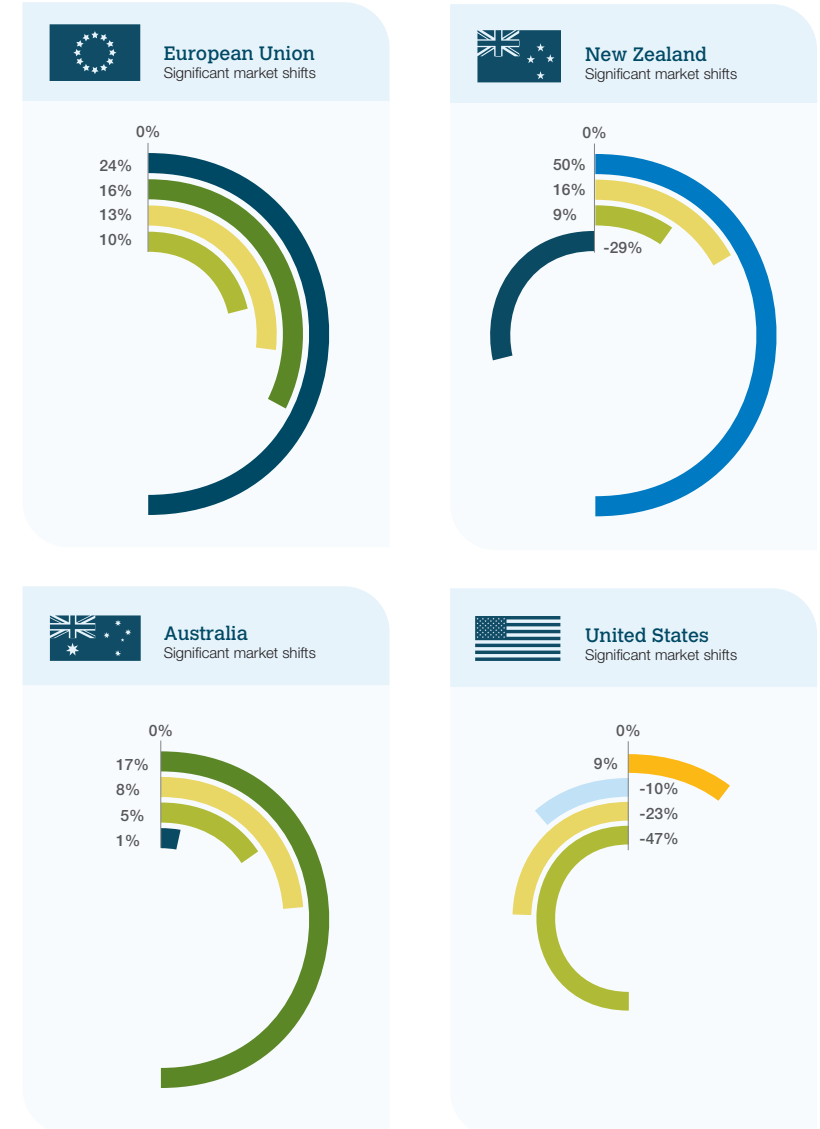
Note: Size of bubble represents export share in MEQ Calendar years for EU/US, production seasons for Aus/NZ  
 Source: Dairy Australia, USDA, Eurostat, DCANZ

**Figure 10** Farmgate price movements – four largest exporters

Change in indicative farmgate price	NZ	EU-28	US	Australia
Compared to last report (October 2015)	▼ -10%	▲ 1%	▼ -5%	■ 0%
Compared to prior year (February 2015)	▼ -11%	▼ -11%	▼ -32%	▼ -6%

**Figure 11** Market trends – four largest exporters

- North Africa
- Middle East
- Greater China
- Mexico
- Southeast Asia
- Japan
- South Korea





## European Union

Despite the continued trough in dairy commodity markets, growth in milk production for the European Union (EU-28) continued to accelerate through 2015. Data for the latest available month (November) suggests milk intakes totalled 11.6 billion litres across the 28 member states, up 5.3% on November 2014. Overall growth for the calendar year to November reached 2.0%, or around 2.7 billion litres. This has cemented Europe's place as the main source of the milk supply 'problem' for sellers in international markets, with the combination of extra supply and no Russian market access maintaining pressure on prices even as El Nino impacts supply from Oceania. At the member state level, the biggest contributions continue to come from northwestern Europe, with Ireland, the Netherlands and the United Kingdom together posting over half of the year-to-date gains (around 1.5 billion litres). Farmgate milk prices are around 10% lower than the same period in 2014, but remained relatively steady for much of 2015. The incentive to increase production remains broadly intact, and consequently a supply response remains elusive. Current forecasts from the European Commission suggest full

2015 calendar year growth slowed to 1% (likely an underestimate), with a further 1% likely in 2016. Given milk production in the first quarter of 2015 remained constrained by quotas, it is highly likely that much larger year-on-year growth figures will be reported over the next few months. Some have suggested that the large cooperatives that dominate northwestern Europe are prepared to lose money on their (proportionally small) export sales in order to better utilise new manufacturing capacity and build international market share. Others have suggested that the prospect of farmer unrest has motivated processors to soften market signals, in the hope that prices will improve before further government intervention becomes a prospect. The EU's price support schemes remain active, and with market prices having fallen back to support levels, the volume of product receiving some measure of support has increased. As of early January, the volume of SMP sold into public intervention was just over 46,000 tonnes, whilst 29,000 tonnes reportedly remains in the Private Storage Aid subsidised storage program. After peaking at around 100,000 tonnes, net sales out have brought the volume of butter stored in the PSA program back to around 60,000 tonnes.

## United States

Milk production in the US is also growing, but at a slower rate relative to Europe. The latest milk production data shows a 0.6% increase in output across the whole country for the month of November, with overall calendar year-to-date production up 1.2% (about 1 billion litres). Nationally, culling rates remained above prior-year levels through November but below the five year average, which as local analysts point out, indicates that widespread herd reduction is not occurring. This is not entirely surprising. Though milk prices are lower than the same time last year, margins remain profitable because lower feed prices have offset most of the impact. The divergence between the two largest dairy states of California (down 4.4% in November) and Wisconsin (up 4.3%) continues, although the current El Nino event has reportedly improved the climatic outlook for the former. A major storm event ('winter storm Goliath') reportedly caused the deaths of between 15,000 and 40,000 cows across Texas and New Mexico over two days in late December. The extreme weather and missed milkings are likely to dampen per-cow production for thousands more in the months ahead, with early

estimates suggesting an impact of between 0.2% and 0.5% on production at the national level. Cheese plants in the area were back at capacity within days of the storm, but the milk to fill these is said to have been diverted from milk powder and butter facilities. The US industry continues to benefit from a strong domestic market for cheese and butter, with exports continuing to track below year-ago levels for these products. Exports of NDM and (more recently) SMP have bucked the overall trend, with these co-products of high-returning butter being shipped in record volumes to Mexico and other Central/Southern American markets in particular. With the milking herd forecast to remain around current levels (9.3 million head) through at least the first half of 2016, the USDA predicts milk production will increase 1.6% for the full year, to exceed 96 billion litres.

## New Zealand

New Zealand farmers continue to deal with the impact of lower farmgate milk prices, as depressed commodity markets hit returns for a second consecutive season. With little in the way of retrospective payments from the 2014/15 season to support cash flow

**Dairy Australia's revised milk production forecast for 2015/16 anticipates an overall decrease of between 1% and 2% for the season to June, implying a total volume of between 9.55 and 9.65 billion litres.**

through winter and early spring, many farmers opted to cull more heavily, and earlier in the season than normal. Strong beef markets made early culling an attractive short term cash flow strategy, whilst the low milk price and an uncertain feed outlook supported a reduction in stocking rates to better manage risk. This culling saw around 5% fewer cows milked through the spring peak, and with below-average pasture growth (due to the impact of El Nino) expected for the balance of the season, milk production is virtually certain to remain below prior-year levels. Dairy Companies Association of New Zealand data to the end of November suggests a drop of 2.1% for the month, and 3.1% for the season to date. NZ-based analysts AgriHQ are forecasting a 3% fall in milk collections for the season to May 31, while Fonterra is reportedly expecting a 6% decrease. Fonterra's farmgate milk price forecast is currently NZ\$4.16/kg MS (A\$4.10/kg MS), having been again revised downwards in early 2016 as the expected recovery in WMP prices failed to materialise. Combined with the escalating risks to water availability in regions such as Canterbury, further tightening in margins poses additional downside risk to the full season milk production outlook.



**Australia**

Australian milk production finished November up 0.8% for the season to date, but down 3.4% for the month itself. A relatively solid start to the season has been followed by slower year on year growth through spring, as the combined impacts of tighter margins and dry conditions limit milk production across many regions. Northern Victoria initially showed the earliest impact as high temporary water prices saw farmers adopt a more conservative approach to the season. The early end to pasture growth has also been pronounced at the farm level in western Victoria, however weaker volumes through spring in 2014 mean the year-on-year comparison was not as stark (southeastern South Australia has seen a similar pattern). In Gippsland, milk flows began to fall away sharply in November as in New South Wales overall (though southern irrigation regions saw earlier impacts). Queensland is seeing the impact of further industry exits, whilst Western Australia continues to grow (albeit more slowly) as a result of the high prices on offer to many farmers. Elevated prices for grain and hay, combined with lower milk prices, have reduced the scope and incentive for farmers to draw on alternative feed sources to maintain or

grow production. At the same time, high beef prices have encouraged many to cull underperforming cows. Early warnings about the impending weather challenges have resulted in strategies being put in place early – bringing forward the volume impact. An 'average' autumn could see volumes prove more resilient later in the season, but even a recovery through this period would be too late to offset volumes lost a slow spring and summer. Dairy Australia's revised milk production forecast for 2015/16 anticipates an overall decrease of between 1% and 2% for the season to June, implying a total volume of between 9.55 and 9.65 billion litres.

# Corporate sector update

**Despite the usual slowdown in activity over the summer holiday period, the corporate sector has seen a number of developments in recent months at both the processing and farm level.**

A number of new announcements were made by Fonterra Australia. The company provided further details on its plans to rebuild the cheese plant at Stanhope that was destroyed by fire in 2014. The new, 'state of the art' facility will represent an investment of \$120 million and produce an extra 15,000 tonnes of cheese per year than the previous facility (with a total capacity of 45,000 tonnes). This will include parmesan, gouda and mozzarella for Australian consumer, foodservice and export markets. Construction will begin next year, and is expected to be completed in 2017.

Fonterra also revealed an agreement to sell its Australian yoghurt and dairy dessert business to Parmalat. The deal includes manufacturing sites at Tamar Valley and Echuca as well as Fonterra's Australian yoghurt and dairy dessert brands. Although the transaction is conditional on regulatory and other approvals, it is expected to be completed in the first half of 2016.

And in further Fonterra news, the company and infant formula producer Bellamy's jointly announced plans to enter into a five year, multi-million dollar strategic agreement to manufacture a range of new baby nutritional powders at Fonterra's Darnum plant in Gippsland, Victoria. A previously announced deal involving the Darnum facility, Fonterra's nutritionals joint venture with Beingmate,

progressed further as well, recently securing approval from the Board of Beingmate China. Under the arrangement, nutritional powders including infant formula will be manufactured at the Darnum plant, which will be owned by the joint venture but continue to be operated by Fonterra. The Beingmate distribution system has access to 80,000 retail stores in China.

Meanwhile, Murray Goulburn (MG) has assumed 100% ownership of Tasmanian Dairy Products (TDP), acquiring the remaining 24.1% of the business from Mitsubishi Corporation for \$4.8 million. MG made a significant equity investment in TDP in 2011 to facilitate the construction of a milk processing facility at Smithton, with a processing capacity of approximately 250 million litres annually. Last financial year, TDP processed over 210 million litres, making it one of Tasmania's largest dairy companies with approximately 25% of the state's milk. Since the start of the 2015/16 season, all milk supplied to TDP has come via MG's Tasmanian suppliers – including TDP suppliers who were integrated into MG's business as supplier-shareholders earlier in 2015.

Murray Goulburn also made a foray into the market for high security irrigation water, reportedly offering a lease price for the first year of the agreement of \$125/ML and \$60/ML "plus standard

water charges and administration costs" to its northern Victorian and Southern NSW Riverina suppliers respectively. The offer was for a single 50 ML parcel per supplier farm. Temporary water on the open market recently hit \$300/ML in northern Victoria.

Murray Goulburn secured a five year supply agreement (commencing 2017) for Coles private label cheese, claiming the deal will generate \$130 million in additional revenue, and provide a larger domestic base for overseas expansion.

Bega Cheese is Coles' current supplier under a similar five year contract, and has flagged a \$60 million inventory benefit, with the surplus milk to be diverted to higher value-added product streams. Bega had previously announced it was joining nutritional supplement maker Blackmores in establishing an equal share partnership to develop and manufacture a range of nutritional foods, including infant formula, through Bega's subsidiary Tatura. The partnership is billed as combining Blackmores' experience in health and nutrition with Bega's in dairy manufacturing - and an understanding of their consumers in Australia and Asia.

A2 Milk (A2M) successfully completed a NZ\$40 million (A\$37 million) capital raising, intended to support its expansion efforts in Oceania, China, the US and UK. Having been put on hold whilst the company's board considered

**A new dairy farming venture in Western Australia is well underway, with ASX-listed company Carbon Conscious signing a memorandum of understanding (MoU) with Chinese-Australian distributor Green Lake.**

an expression of interest from major shareholder Freedom Foods and US giant Dean Foods, the capital raising was oversubscribed within a day of issue. Freedom Foods did not participate in the capital raising, and later sold its A2M stake.

At the farm level, takeover speculation surrounding Australia's largest dairy farming business, The Van Diemen's Land Company (VDL) intensified late last year, with the subsequent announcement that it had been purchased by a group of Australian investors. This group, TasFoods, then launched legal action against VDL's New Zealand owners, New Plymouth District Council (NPDC), when it emerged that NPDC had decided to instead pursue a "commercially superior" bid from Chinese-owned Moon Lake Investments. The case was set to go to trial in the Supreme Court when TasFoods received a \$1.25 million

settlement. VDL is the biggest dairy holding in the southern hemisphere, with around 19,000 hectares across 25 adjoining farms in far northwest Tasmania. They produce around 100 million litres of milk from 19,000 cows. The sale to Moon Lake Investments still requires Foreign Investment Review Board approval.

Established corporate dairy farmer ACE Farming purchased another Victorian dairy farm. The European pension fund-backed company reportedly paid about \$8 million for a 668 hectare farm (with over 2000 megalitres of underground water) near Yarram, in South Gippsland. The company already holds properties across Gippsland, Western and Northern Victoria.

A new dairy farming venture in Western Australia is well underway, with ASX-listed company Carbon Conscious signing a memorandum of understanding (MoU) with Chinese-

Australian distributor Green Lake, which has distribution access through 150 minimart stores across China's Henan Province. Carbon Conscious (which plans to rename itself Alterra), has secured a long term lease on an existing dairy farm in southwest WA, which it plans to ramp up to a 'System 5' US style housed operation. The current herd of 400 will be built up to around 2,500, which under 'System 5' management is expected to produce around 25 million litres of milk per year.

Green Lake will sell the (toll processed) fresh milk through its existing network and a new chain of up to 300 'Capel Farm' branded stores. Green Lake milk is currently processed through Brownes, but Carbon Conscious has noted "discussions are ongoing" about where the milk would be processed in the long term.

# Policy update

## Revision of the Regulation of Nutritive Substances and Novel Foods

The Regulation of Nutritive Substances and Novel Foods is currently under review by Food Standards Australia New Zealand and is open for consultation. This standard affects the ability of the dairy industry to develop, market, sell and trade innovative, high value dairy foods, and specialised dairy ingredients. Examples of the benefits a novel food or nutritive substance may deliver include, reduced production costs, improved product sensory aspects, improved quality and safety attributes, and health benefits to the consumer. Benefits must be greater than the costs of development and complying with regulatory requirements. This means there needs to be a high level of certainty that the novel food/ingredient will be approved for use in major domestic and international markets to rationalise development investment.

Key issues with the current standard include difficulty to enforce and for businesses to determine whether a food or ingredient would be considered 'Novel' and subsequently require an application to assess the safety and benefits of the food/ingredient to the Australia New Zealand food supply.

Updates of related standards raise the need to ensure that all standards work together in a consistent and complimentary way, for example, the recent implementation of the health claims standard provides a process for the assessment of the health benefits of nutritive substances and the ability to communicate benefits that are scientifically supported.

Dairy Australia is providing technical guidance and coordinating the dairy industry submission with the view to guide the review towards a standard that meets the needs of the dairy industry more broadly, through consistency with the following principles: evidence based, proportionate to risk, benefits can be realised proportionate to cost, and supports competition and trade – particularly with our major markets





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