Agricultural Competitiveness White Paper Submission - IP229-2
Premium Milk Ltd
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PREMIUM MILK LTD

SUBMISSION

AGRICULTURAL COMPETITIVENESS ISSUES PAPER

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Contents

Foreword

Premium Milk Ltd commenced after the deregulation of the market milk industry throughout Australia on 30 June 2000.

Premium Milk is a not for profit voluntary membership company that was formed to assist and represent its dairy producer members in dealings with Parmalat Australia (formerly Pauls Ltd).

In August 2000 Premium Milk lodged an application for authorization with the Australian Competition & Consumer Commission (ACCC) to collectively bargain and negotiate supply volumes, delivery requirements, quality standards and prices with Pauls Ltd. The ACCC granted authorization in December 2001 allowing Premium Milk to engage in collective negotiation with Pauls Ltd until 1 July 2005.

In May 2005 Premium Milk made application for revocation and substitution of its existing authorization. The ACCC made a final determination in November 2005 to grant authorization to Premium Milk for a further five years.

In June 2010 Premium Milk made application for revocation and substitution of its existing authorization. The ACCC made a final determination in October 2010 to grant authorization to Premium Milk for a period of ten years.

The authorizations granted by the ACCC enabled Premium Milk to actively participate in negotiations with Parmalat until January 2011. In that month the major supermarkets announced $1.00 a litre milk and this price barrier has compromised the negotiation process over the past three years.

Premium Milk has been able to demonstrate that its cost structure (using independent Queensland Government analysis) is now well above the price received for milk supplied to Parmalat. Parmalat in negotiations has acknowledged the cost structure of the Premium producer members but also has continually indicated that it does not have the capacity to pay any more because of the $1.00 a litre milk.

This submission will outline the transition of the Queensland dairy industry from a position of strength in 2000 to an industry in rapid decline in 2014. Market milk sales (liquid milk consumption) are now greater each month than milk production. Queensland is a milk shortage state and its dairy producers could soon be a ‘thing of the past’.

Milk Production and Sales in Queensland

Queensland Dairy Producer Numbers

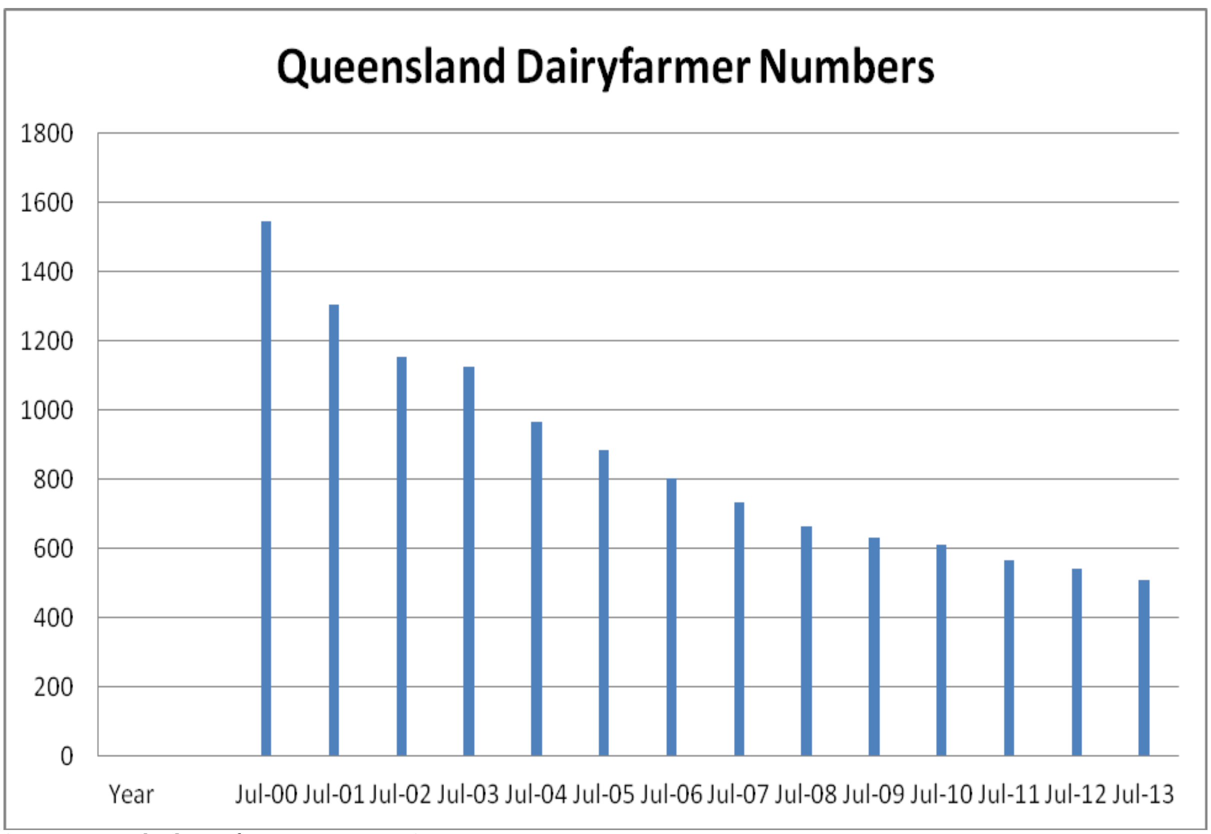
When the industry moved to a fully deregulated market on 1 July 2000 Queensland had 1,545 dairy producers supplying milk to processors. In February 2014 it is estimated that this number is now down to 495. This means that in 13 years the industry has lost more than two thirds (or 66%) of the dairy producers in this State.

In July 2000 there were 580 dairy producers supplying milk to Pauls Ltd and 360 were members of Premium Milk.

In February 2014 there were 217 dairy producers supplying milk to Parmalat Australia (formerly Pauls Ltd) and 146 were members of Premium Milk.

Initially the Premium Milk membership comprised dairy producers in south east Queensland and since 2010 there are now a small number of members in northern New South Wales.

This significant loss of dairy producers is graphically illustrated below:



(Source: Queensland Dairyfarmers Organisation)

Queensland Milk Production

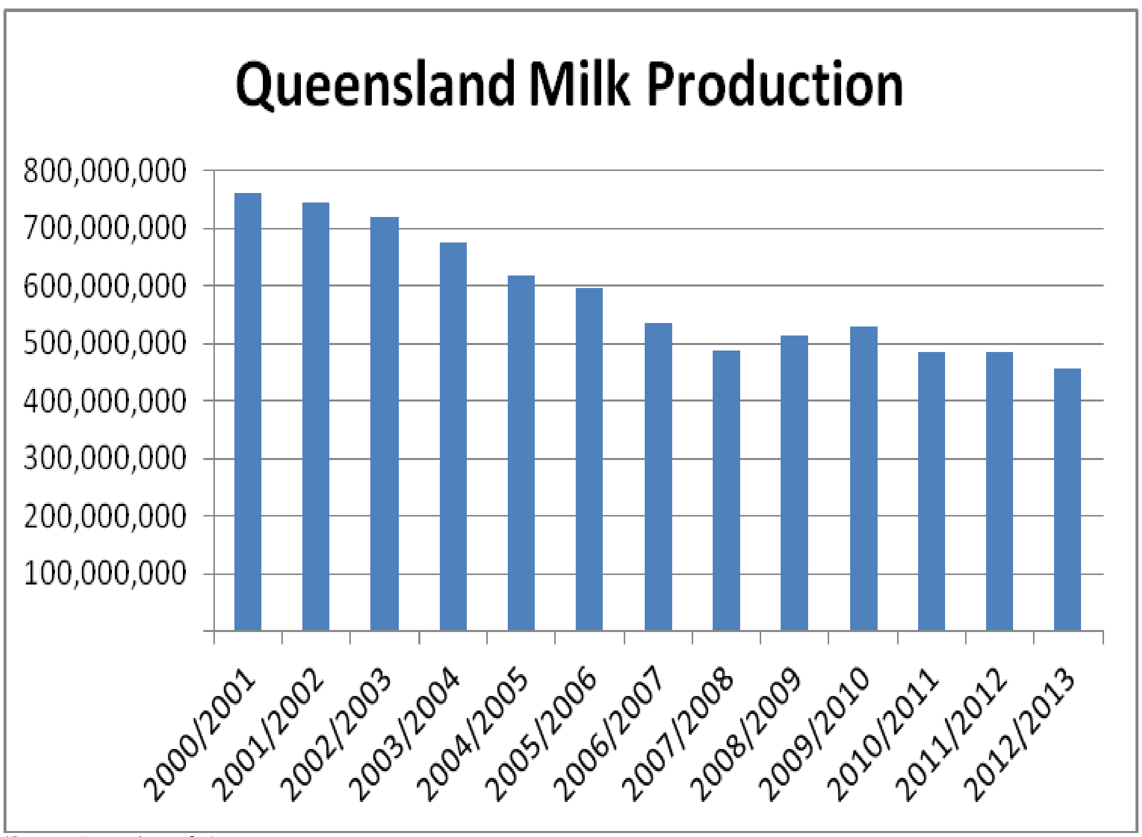
The dynamics of milk production have changed over recent years, largely brought on by the drought years of 2000 to 2007 when dairy producers were on their knees with costs skyrocketing and little or no available water.

By mid to late 2007 milk processors were concerned about shortages in milk and as a consequence improved pricing packages were paid to retain dairy producers. At the same time the rains came and for the first time in years dairy producers had the capacity to rebuild their farms and stock.

With the improved pricing packages milk processors were looking for certainty of supply and introduced individual supply contracts which incorporated both price and term. There are also other milk processor requirements including an ongoing commitment to supply a given quantity (all year) to receive Tier 1 pricing.

These conditions stabilised the rate of attrition of dairy producers and improved milk production in 2008/09 and 2009/10. However since 2009/10 milk production has continued to decline because of a steady reduction in dairy producer numbers, floods and drought in south east Queensland, increasing cost structures and reduced returns.

The overall downward trend in Queensland milk production is illustrated below:



(Source: Dairy Australia)

Queensland Market Milk Sales

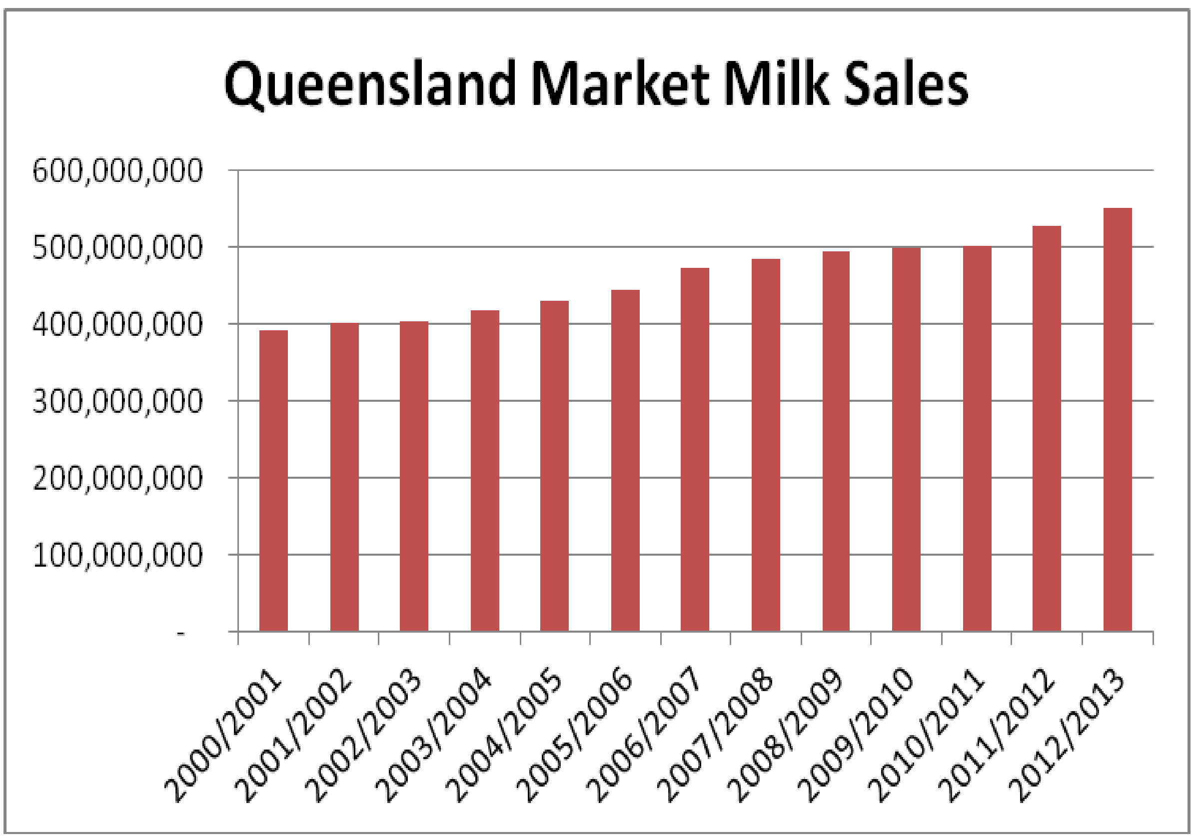
Sales of all Packaged Milk (Market Milk) have continued to grow each year since 2000. The increase in sales is principally due to the annual growth in the Queensland population.

For the past seven years Queensland market milk sales have exceeded milk production for some months of the year, principally from April to July. However over the past three financial years Queensland market milk sales have exceeded milk production and in 2012/2013 the difference was 91 million litres with the gap between sales and production widening each year.

In 2012/2013 market milk sales exceeded milk production in each month of the year resulting in Queensland being a milk shortage state all year round. Queensland milk production is used principally in the manufacture of market milk (both private label and brands).

With dairy producer numbers in decline, cost of production exceeding total farm receipts and annual sales exceeding production, it is of concern that steps are not being taken to enable the retention of a viable Queensland dairying industry.

The upward trend in Queensland market milk sales is illustrated below:



(Source: Dairy Australia)

Farm Gate Returns

Cost of Production (QDAS data)

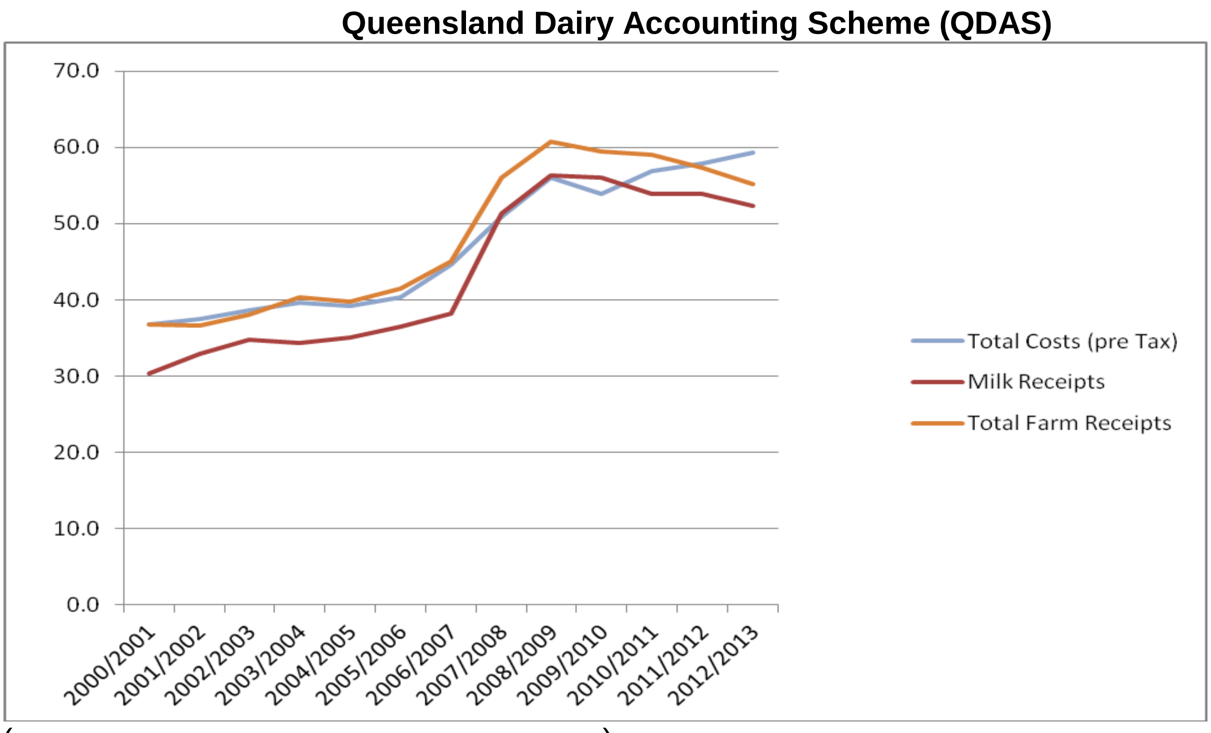
The Queensland Department of Agriculture, Fisheries and Forestry has for many years been compiling the Queensland Dairy Accounting Scheme (QDAS) cost data on an annual basis.

The detailed information contained in Appendix 'A' comprises the annual survey work undertaken on farm which is then averaged to arrive at the 'cost of production' of operating a dairyfarm in Queensland each financial year.

The information in Appendix 'A' covers the period 2000/2001 to 2012/2013. From Appendix 'A' you would note –

1. Milk receipts are recorded separately from total farm receipts.
2. All costs associated with the dairyfarm business are included (cash and non cash items).
3. Total farm receipts peaked in 2008/2009 and have been in decline since then.
4. Total farm costs have been increasing each year since 2000/2001, with only two exceptions in 2004/2005 and in 2009/2010.
5. The average number of cows per farm has increased from 138 in 2000/2001 to 224 in 2012/2013.
6. The average litres sold to a milk processor has increased from 734,595 litres in 2000/2001 to 1,306,571 litres in 2012/2013.

The trends in dairyfarm receipts and costs are illustrated below:



(Source: Queensland Department of Agriculture, Fisheries & Forestry)

Access to Finance

In the past the dairy industry was highly regarded by financial institutions because of the consistent monthly cash flow. This was because dairy producers are paid on the 15th day of the month following the month of supply to a milk processor (eg paid on the 15th of March for milk supplied during February).

While dairy producers are still paid on the 15th day of the following month, financial institutions and credit providers are demonstrating their lack of confidence in the industry. This can best be illustrated from a survey in January 2014 of dairy producers in Queensland where respondents indicated the following (full report attached as Appendix 'B') -

Survey Question	Yes %	No %
Last month could you pay all of your bills with your monthly milk payment?	29	71
Do you operate with a bank overdraft or loan?	82	18
Has your overdraft and/or loan increased during the past year?	69	31
Have you had to defer or cancel repairs and capital items during the past year?	83	17
Are you still able to arrange a loan with your finance institution?	49	16 (35% don't know)
Are you still able to arrange credit from your suppliers?	85	15

(Source: Queensland Dairyfarmers' Organisation Survey - January 2014)

Competitiveness and the Value Chains

In the market milk dairy industry there are three principal participants -

- The dairy producers,
- The milk and dairy processors, and
- The major supermarkets and other large & small retailers.

Dairy Producers

Premium Milk was granted authorization by the ACCC to engage in collective negotiation with Parmalat Australia in 2001 and this now extends to 2020. The range of activities authorized were supply volumes, delivery requirements, quality standards and prices. The negotiations between Premium Milk and Parmalat Australia occur through a Milk Management Committee. The Committee meets as required to consider the above matters, with particular relevance to prices and quality standards.

Despite Premium Milk being able to demonstrate that its cost structure (using QDAS figures) is well above the price received for milk supplied, Parmalat has continually indicated that it does not have the capacity to pay a higher price to its producers because of the ‘retail price’ set by the major supermarkets for private label milk.

This clearly indicates that dairy producers do not have any market power.

Milk and Dairy Processors

At present there are two major market milk processors in Australia, namely -

- Lion (with milk brands of ‘Pura’ and ‘Dairy Farmers’), and
- Parmalat Australia (with milk brand of ‘Pauls’).

Murray Goulburn Co-operative Dairy has won the tender to supply Coles in New South Wales and Victoria from 1 July 2014. This will be a significant change for Murray Goulburn as its focus in the past has been in manufactured dairy products sold in Australia and overseas.

There are two other market milk processors of note, namely -

- Norco Co-operative Dairy, and
- Warrnambool Butter and Cheese.

Norco Co-operative has won the tender to supply Coles in Queensland from 1 July 2014.

This means that Lion and Parmalat will compete by tender for supply to Woolworths in the eastern States from 1 July 2014.

There is unlikely to be any benefit in this process for dairy producers as Coles has already announced that its deal with Murray Goulburn is for $1.00 a litre milk to continue for the next ten years.

Retailers

The two major supermarkets dominate the Australian grocery trade with an ever increasing share of the market milk business, at the expense of milk processors and their brands and particularly at the expense of dairy producers in Queensland.

Conclusion

Premium Milk recognizes the importance of the authorization granted by the ACCC enabling it to participate in negotiations with Parmalat Australia. However the current retail price of private label milk is totally inconsistent with the reality of dairy producer, milk processor and retailer costs.

While Premium Milk does not favour any additional regulation, there must be some tangible means of enabling dairy producers to have a share of the market power in the negotiation process.

Premium Milk believes that without Government intervention the loss of the entire Queensland dairy industry is possible based on the facts outlined in this submission. Given that the Queensland dairy producers are the cheapest source of fresh milk for local consumption, this would be a tragic loss to consumers and the Queensland economy.

Premium Milk supports the Queensland Dairyfarmers' Organisation position for a mandatory Code of Conduct to be applied to the major supermarkets, similar to the Code in the United Kingdom. This would give the dairy industry an opportunity to exist on a level playing field.

If the current circumstances continue into the foreseeable future then it is not unreasonable to speculate that there may not be any dairy industry in Queensland in ten or twenty years.