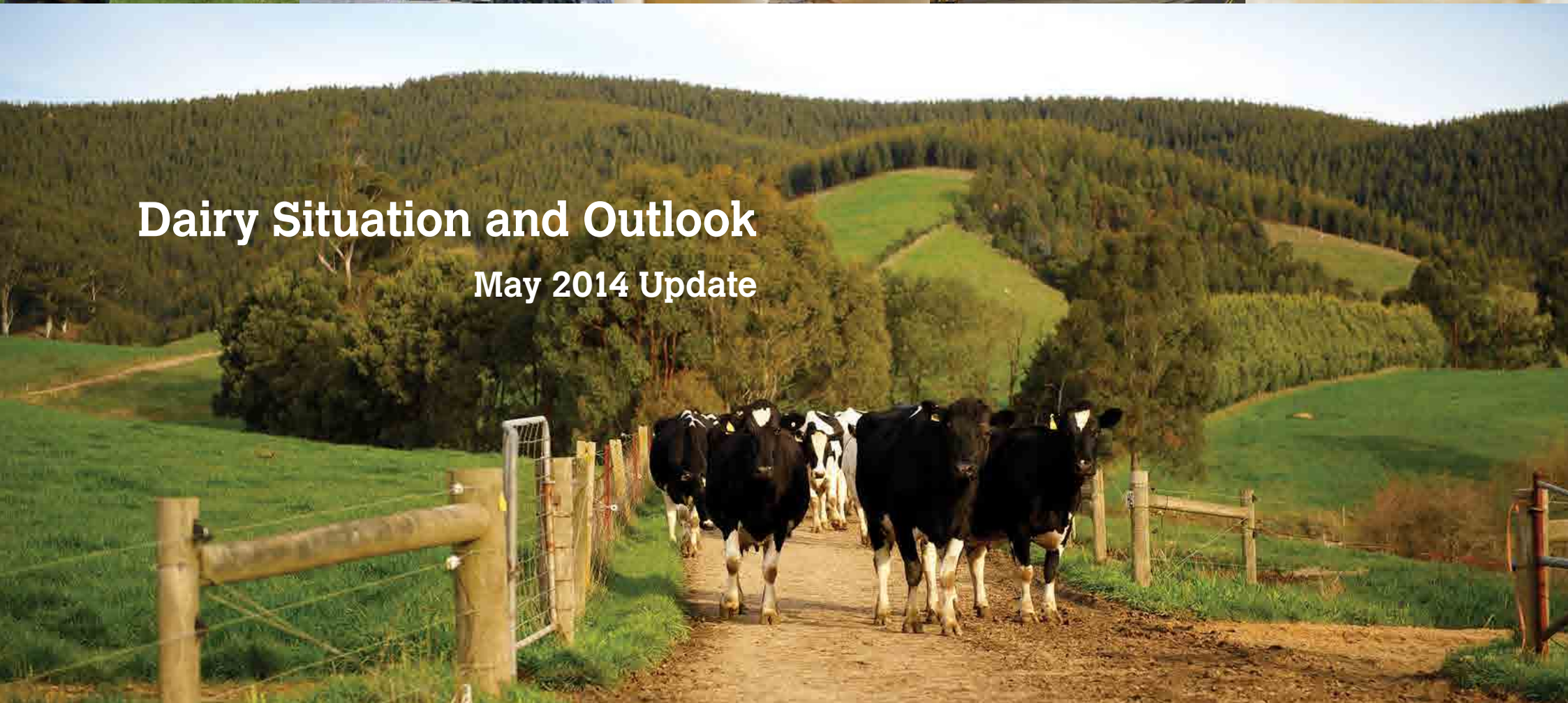




# Dairy Situation and Outlook

## May 2014 Update





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# Australian Dairy value chain

## Inputs

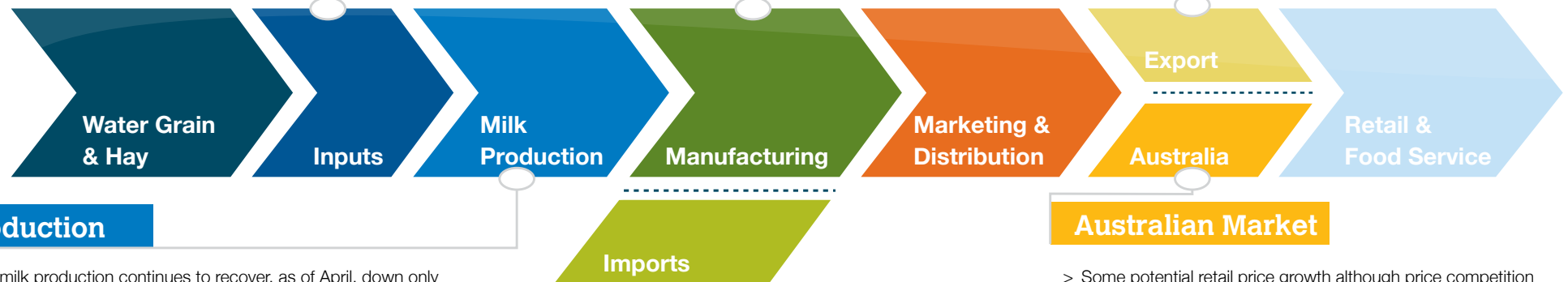
- > International supply concerns maintain upward pressure on feed grain prices.
- > High protein hay in shorter supply than usual.
- > Australian dairy heifer exports remain marginally above long term average.
- > Global fertilizer prices remain relatively low, coupled with a stronger Australian dollar which boosts purchasing power.
- > Average inflow conditions should see all northern Victorian water systems with 100% High Reliability Water Supply by mid-December.

## Manufacturing

- > Parmalat (Lactalis) acquires Harvey Fresh in Western Australia; Woolworths private label deals change Australian fresh milk supply.
- > Ongoing consolidation and rationalisation resulting from competition for Australian milk production and markets and to secure supply for international customers.
- > Investments made in plants to improve efficiencies and boost profits.
- > Many processors offering farmers new incentives to increase milk production.

## Export markets

- > Calendar 2013 was a difficult year for buyers of dairy commodities, with tight supplies and high prices deterring buyers, particularly in markets where affordability is an issue.
- > Markets with ample purchasing power and supply gaps to fill (most notably China) sustained prices at high levels for much of 2013 and the beginning of 2014.
- > Dairy commodity prices have started dropping as booming global supply meets a seasonal slowdown in demand.
- > Easing commodity prices have reduced substitution pressure after holding at near record levels for much of 2013.















## Milk Production

- > Australia's milk production continues to recover, as of April, down only 0.8% on last season to 8 billion litres. In southern, export-focused regions, improved margins have enabled most farmers to reduce short term debts and make incremental investments in their production systems.
- > Increases in month-on-month production at the national level have been generated from southern states. The northern states trail 2012/13, missing the same farmgate benefits from strong commodity prices.
- > For the Australian 2014/15 season, around 2% growth is forecast, suggesting national milk production of 9.3 to 9.4 billion litres. This assumes trading conditions remain broadly favourable, continued debt reduction and the threat of El Niño will temper expansion.

## Australian Market

- > Some potential retail price growth although price competition is constraining value in some categories, but consumers are benefiting from lower prices.
- > Volume and value growing at slower rates for three out of the four major dairy categories. Milk sales stable; dairy spreads exhibiting strong growth; cheese under discounting pressure; yogurt sales slow.
- > Within the milk category, the average retail selling price is \$1.92/litre for branded fresh white milk, on average, private label fresh white milk is selling for \$1.01/litre.
- > Low interest rates and rising asset prices supporting confidence and consumption: café and restaurant sales are up.

# Six key drivers of the Australian Dairy Industry

Global economy		Global demand		Australian market		Global supply		Inputs		Exchange rates	
Situation	Outlook	Situation	Outlook	Situation	Outlook	Situation	Outlook	Situation	Outlook	Situation	Outlook
 Positive	 Neutral	 Neutral	 Positive	 Positive	 Neutral	 Neutral	 Negative	 Neutral	 Neutral	 Positive	 Neutral
<ul style="list-style-type: none"> <li>&gt; Stronger US and Euro area economies supporting higher global economic growth expectations.</li> <li>&gt; But, uneven European economic recovery remains a risk;</li> <li>&gt; China managing economic transition in favour of domestic consumption well.</li> <li>&gt; But credit-induced crises in Chinese and Asian economies present greater risks to global economic outlook.</li> <li>&gt; Crude oil prices have been trending lower, but could start climbing again in light of recovery in USA and continued growth in China.</li> </ul>		<ul style="list-style-type: none"> <li>&gt; Import volumes from major buyers have slowed in Q2 of 2014 as the northern hemisphere season gets underway.</li> <li>&gt; In the medium term, production shortfalls in both China and Russia are likely to persist, and despite recent production increases Brazil is yet to close its dairy supply gap.</li> <li>&gt; With commodity prices having eased, price sensitive markets such as Africa are back in the market. However many buyers are waiting for prices to 'bottom out' before committing heavily to forward purchases.</li> <li>&gt; Southeast Asia remains in a pattern of steady growth: Lower commodity prices are expected to promote continued increases in consumption.</li> </ul>		<ul style="list-style-type: none"> <li>&gt; Low interest rates and rising asset prices supporting confidence and consumption: café and restaurant sales are up.</li> <li>&gt; Within the milk category, the average retail selling price is \$1.92/litre for branded fresh white milk, on average, private label fresh white milk is selling for \$1.01/litre.</li> <li>&gt; Volume and value growing at slower rates for three out of the four major dairy categories: milk sales stable dairy spreads exhibiting strong growth; cheese under discounting pressure; yogurt sales slow.</li> <li>&gt; Unemployment and inflation remain at stable levels. But spending could be challenged in the short term by falling real wages as well as policy impact on some households.</li> </ul>		<ul style="list-style-type: none"> <li>&gt; With the northern hemisphere spring in full swing, the most vigorous sales competition for commodities is coming from the EU28 and US.</li> <li>&gt; European production is particularly strong, based on attractive margins, favourable weather, and the impending expiry of production quotas in 2015.</li> <li>&gt; US growth continues to be mixed. California has performed well despite severe drought, but the Midwest and Northeast states have struggled through a long and difficult winter. Ample soil moisture in these regions will support pasture and crop growth, underpinning milk production for the balance of the season.</li> </ul>		<ul style="list-style-type: none"> <li>&gt; Concerns around international wheat production, political tensions in the Black Sea, dry conditions in northern Australia, and a potential El Niño weather pattern continue to place upward pressure on feed prices.</li> <li>&gt; While hay stocks are reasonable in most of southern Australia, they are very low in the north. Demand for cereal hay remains strong in West Australian markets. High protein hay is in shorter supply than usual.</li> <li>&gt; Due to both supply and demand factors, international fertiliser prices remain relatively soft compared to last year.</li> <li>&gt; Northern Victorian water systems are expected to have 100% High Reliability Water Supply for the 2014/15 season by mid-December under average inflow conditions.</li> <li>&gt; Dairy cattle exports remain above average, with a higher proportion destined for China than at the same time last year.</li> </ul>		<ul style="list-style-type: none"> <li>&gt; US central bank 'tapering' of quantitative easing (reducing its economic support program) has not resulted in the USD strengthening as much as expected.</li> <li>&gt; Strengthening of the USD is now expected to hinge on US rate rises.</li> <li>&gt; The Australian dollar remains at higher than previously anticipated levels, supported also by relatively higher returns on AUD assets, and favourable economic outlooks for Australia and China</li> <li>&gt; But the AUD is still likely to weaken on more rapid US recovery or unfavourable data swaying outlooks on the Australian or Chinese economies.</li> <li>&gt; The weaker Australian dollar remains favourable for export earnings and farmgate prices.</li> <li>&gt; Emerging market importers and households may be tested by still relatively high dairy commodity prices.</li> </ul>	



# May 2014: Situation and Outlook

## Executive summary

Conditions remain broadly positive for the season ahead. Most dairy regions have seen improvements in the farmgate milk price, underscored by strong overseas demand, a drop in the Australian dollar and more favourable seasonal conditions. Risks to an otherwise positive outlook are a potential El Niño, budget-related impact on consumer spending, and latent debt issues in Asia negatively affecting commodity markets.

Since March 2014, dairy commodity prices have weakened considerably as dairy farmers around the world respond to strong farmgate price signals. Prices have eased most notably in Europe where EU based exporters have lowered dairy export offer prices to encourage sales and minimise the possibility of larger falls if strong milk production continues during the European spring flush.

Forward indicators like Dairy Australia's Export Region Weighted Cost and Income Indices suggest leaner dairy margins for southern export regions in the months ahead as export prices settle below recent peaks. But on balance, international markets continue trading at prices above long-term averages and at similar levels to that of early 2013.

The ongoing situation in Ukraine adds uncertainty to global dairy, grains, energy and currency market outlooks and will likely be one of a number of factors processors consider when arriving at farmgate prices for next season. Competition for milk, forward product sales, product and market mix will also influence how processors balance competitive opening prices while avoiding a potential 'step down' if dairy markets drop beyond budget forecasts.

After starting very slowly this season, favourable weather, reasonable input costs and strong farmgate milk prices for most regions have seen Australian milk production recover some ground. However, this growth has come from southern exporting regions as milk production in northern Australia continues to struggle. At this late stage of the season, Australian milk production for 2013/14 is expected to finish between 9.1bn and 9.2bn litres, a modest lift from Dairy Australia's last production estimate, but still roughly on par with 2012/13.

Strong farmgate pricing signals are also reflected in confidence levels across most dairy regions in Australia. According to the latest National Dairy Farmer Survey, farmer confidence has improved significantly in most regions over the last 12 months with 75% of farmers now positive about the future of the dairy industry, compared to a low of 43% this time last year.

Farmer sentiment has increased significantly in six of the eight dairying regions with at least 70% of farmers in each region now feeling positive about the future. The exceptions are Queensland and northern New South Wales, (Subtropical Dairy) and Western Australia (Western Dairy) where sentiment among farmers feeling positive improved marginally to 33% and 60% respectively. Key drivers of negativity reported by farmers in these two regions were low farmgate milk prices, the cost of production and the impact of supermarket milk pricing strategies.

For many farmers higher profitability compared to 12 months ago has improved their outlook. In 2012/13, 57% of farmers reported making an operating profit. Expectations from the latest survey data show 79% of farmers nationally making a profit in the 2013/14 financial year. Confidence to increase on farm investment has increased notably since 2013 with 62% now feeling confident compared to 42% last year.

Since April, the Australian government agreed an Economic Partnership Agreement with Japan (JAEPA) that presents some benefits to Australian dairy but is less comprehensive than the industry had hoped for. The deal could be signed as early as July and will then need to move through a process of formal ratification by the Australian and Japanese governments. With JAEPA negotiations now concluded, trade policy focus has moved toward achieving a more comprehensive deal with China.

China remains a key buyer, but a build-up of inventories within China has allowed buyers to run down stocks rather than source directly from the market. With a key buyer delaying purchases, commodity prices drifted lower with each GlobalDairyTrade auction. Price sensitive buyers who have been locked out of dairy markets for some time are now re-entering to replenish inventories and thereby providing some support to the current pricing environment.

Although dairy markets had largely factored in strong New Zealand milk production, commodity prices have been pushed lower by solid production growth out of Europe (as a result of a mild winter). US milk production is expected to grow around 1% this year, but there are still some concerns about weather-related supply constraints in the USA.

The reduction ('tapering') of US stimulus spending has not delivered the stronger USD as fast as markets expected; and concerns about more quantitative easing (stimulus spending) in the Euro zone are putting downward pressure on the euro. A stronger USD had been a contributing factor behind the depreciation of the Australian dollar and boosts exporter returns. However, resurgent demand for the Australian dollar has pushed the exchange rate back above 93 US cents, increasing the challenge of holding milk prices at current levels.

For dairy inputs, international benchmark wheat prices remain firm, due to concerns about the condition of the US winter crop, and geopolitical tensions in the Black Sea region. Demand for grain and fodder also remains strong from northern Australia, with hay supplies being drawn north from Victoria and South Australia.

Cull cow sales to April are 13% below the five year average, while live dairy export heifer numbers to March are 3% above the five year average. China remains the major market for export heifers. The trend of selling young stock while retaining older cattle reflects farmer efforts to balance income from very high export heifer prices, against retaining older stock to capture more of the high farmgate milk price on offer in southern export regions.

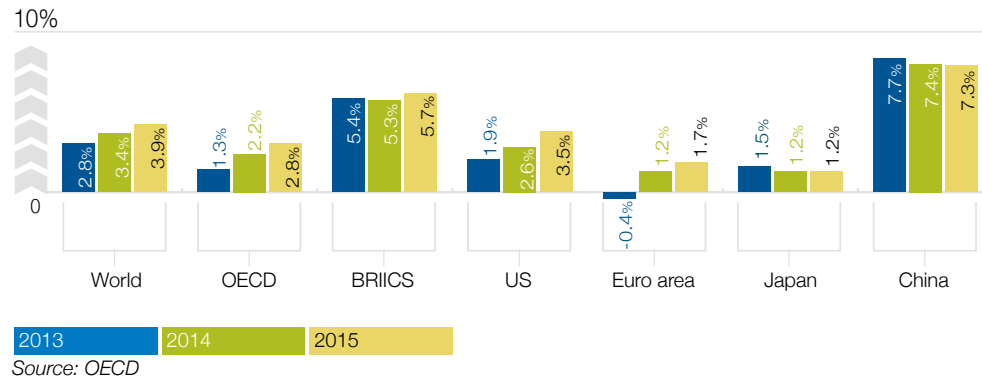
In the Australian domestic dairy market, solid growth has occurred in the food service sector. Retail rivalry remains intense, with price competition affecting cheese and yogurt categories. At a corporate level, following Saputo's acquisition of Warrnambool Cheese & Butter, Parmalat has recently acquired WA dairy producer and exporter, Harvey Fresh. Further analysis of the domestic market will be undertaken in the new Situation and Outlook report scheduled for release in November that will focus on the Australian market.

# Key driver analysis

## Global economy

The OECD's May 2014 Outlook points to relatively stronger growth in the United States and the Euro area to support world growth of 3.4% for 2014 and 3.9% for 2015.

**Figure 1: Real GDP growth**



Supporting stronger growth are increased fixed investment and world trade as well as improved financial conditions in the United States in particular. Unemployment in the United States and the Euro area overall has been falling; however, both the US and especially the Euro area require greater growth in employment to support ongoing economic recovery. Individual economies within the Euro area other than Germany and some of its neighbours continue to struggle with high unemployment and potential deflation. Further east, the situation in Ukraine continues to threaten wider regional peace and stability which could disrupt trade flows and economic growth.

Chinese economic growth has been maintained at around 7% with April data indicating Chinese exports firming in response to improved US demand. China's efforts toward increasing domestic consumption continue. Yet, concerns about growth of non-bank debt, manufacturing overcapacity and a potential property sector-related crisis still cloud the outlook. Some observers estimate that property investment is now at 13% of China's GDP and increasingly point to a debt-triggered crisis in China as the greatest risk to overall growth in the global economy.

The Japanese economy is improving and consumers recently adjusted to the increase in sales tax from 5% to 8%. Despite improvements, onlookers are still calling for the Abe administration to enact reforms to reduce government debt and support consumer demand.

Emerging market countries including the BRICS (Brazil, Russia, India, Indonesia, China and South Africa) are seeing slower economic growth than in the recent past; but like China, the other BRICS economies are still growing at faster rates than the advanced economies. Still, a growing risk is credit growth at the same time as export-driven income from exports to US and

Euro area consumers slows.

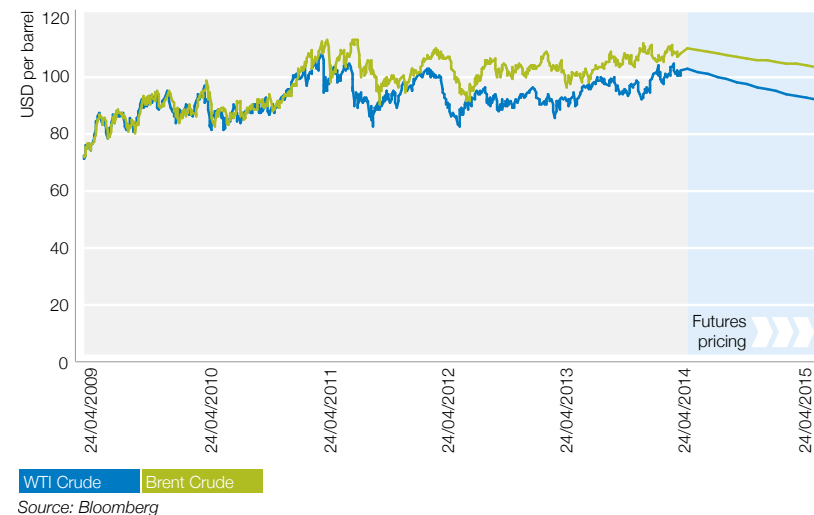
Within Asia more broadly, political change could dampen outlooks for economic growth, particularly with renewed unrest in Thailand after the recent removal of the prime minister; and if victors in Indonesian and Indian elections are unable to complete reform programs. Nevertheless, parts of Asia including Vietnam are benefiting from continued growth in foreign direct investment and reallocation of capital as exporters seek lower cost bases. These trends in conjunction with rising urbanisation and incomes continue to support dairy consumption.

## Oil

Oil exports remain a significant contributor to the economies of many dairy importing nations. Fuel expenses also absorb a significant proportion of disposable incomes for consumers in emerging markets. OPEC's April Monthly Oil Market Report indicates that global oil demand softened due to lower Chinese demand, while supply remained stable despite geopolitical tensions and supply disruptions. OPEC also pointed to higher than previously anticipated global stocks as a key factor that led the organisation to revise its forecast demand for crude downwards.

Subsequent market reports have indicated that crude oil stocks in parts of the US are declining at an accelerating rate, which is putting some upward pressure on the US crude oil price benchmark West Texas Intermediate (WTI).

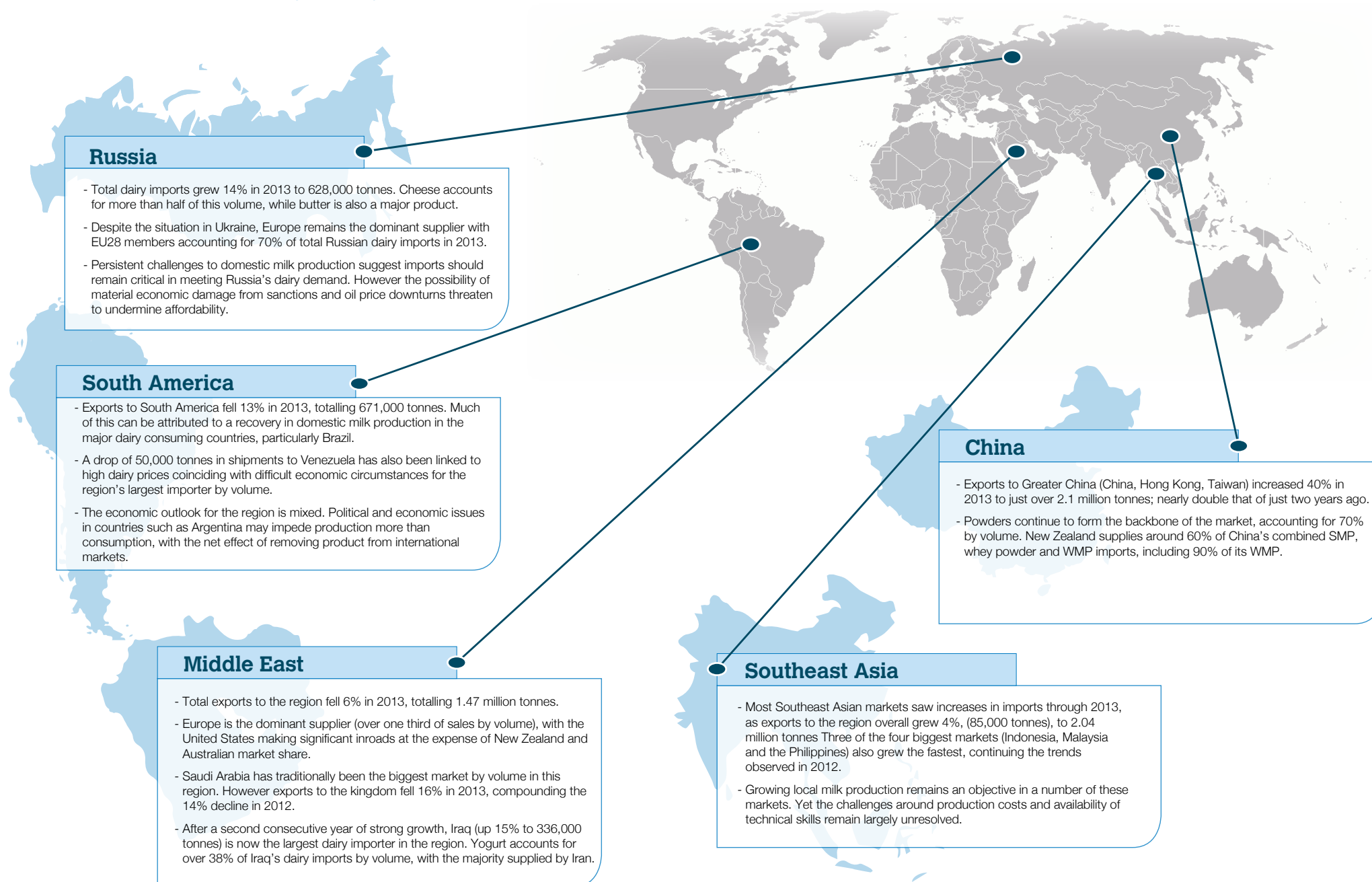
**Figure 2: Crude oil benchmark prices (WTI and Brent)**



More recently, unrest in the Ukraine and concerns about supply disruptions are putting upward pressure on the European and Asian benchmark Brent Crude. At least in the short term, prolonged decline in local fuel prices seems less likely than futures markets suggest. An unanticipated lift in US or Chinese economic activity would put further upward pressure on oil prices given the two countries now account for an estimated 32% of global oil consumption.

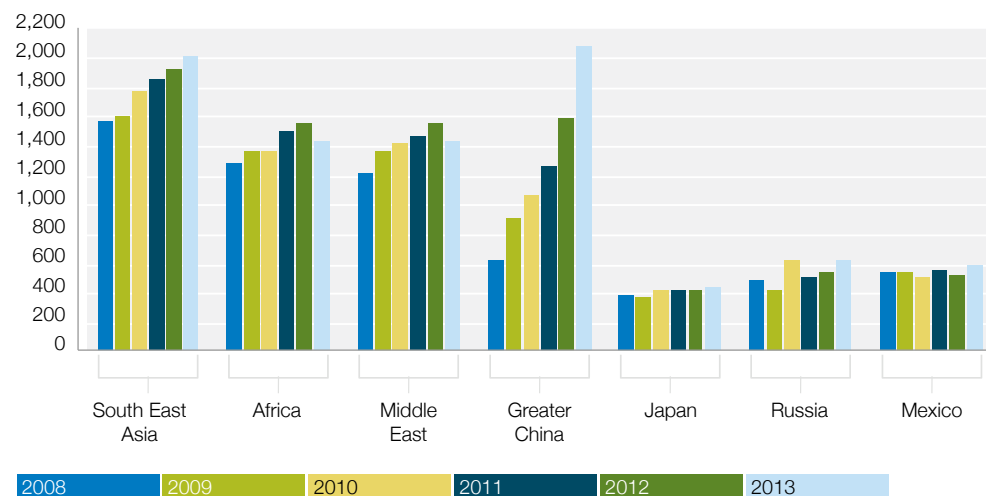
# Global dairy demand

**Figure 3:** International dairy market regions at a glance

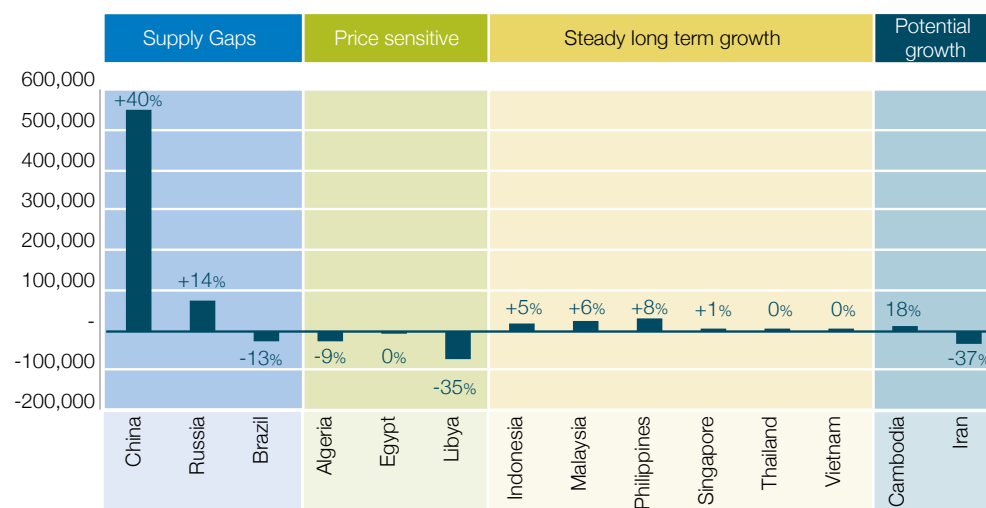


## Global dairy demand

**Figure 4:** Major market by volume ('000 tonnes)



**Figure 5:** Dairy import volume change to December 2013 - Selected markets



Calendar 2013 was a difficult year for buyers of dairy commodities, as tight supplies and a protracted period of high pricing affecting demand in sensitive markets, particularly in markets where affordability continues to be an issue.

As shown in **Figure 5**, the patterns apparent in the data to December intensified over the remainder of the year as market conditions remained broadly unchanged.

### Supply gaps remain

Massive growth in dairy imports into China continued to cover a domestic shortfall exacerbated by additional culling and heat-related production challenges. Preliminary import data to March 2014 highlights that Q1 2014 volumes were 33% above the same quarter's in 2013. But activity reportedly declined in April and early May as healthy stock levels provided comfort to importers and allowed prices to drop while buyers were assessing the recovery in Chinese milk production. Looking ahead, China is expected to resume more regular purchasing in the short term with prices at more attractive levels. The same level of growth in imports into China as seen in 2013 is considered unlikely, unless there are additional domestic production shortfalls.

Russia's domestic dairy industry also continues to face challenges, which supported higher purchasing levels through 2013. Approved suppliers of butter were able to achieve premium prices from the Russian market, with Fonterra's abrupt ban from supplying Russia compounding the short supply situation.

Brazil's milk production continues to recover thanks to strong dairy prices, lower feed costs and more favourable weather. As a result, the trend of increased milk flows displacing imports strengthened through the final quarter of 2013. Although Argentina is traditionally Brazil's largest dairy supplier, Uruguay has gradually increased its market share, which now regularly approaches parity with that of its larger competitor.

### Decreases in imports by price sensitive markets

North African markets continued to struggle with affordability through late 2013. Total exports to Algeria, Egypt and Libya finished the year down 104,000 tonnes compared to 2012. Political unrest in Egypt and Libya is also likely to have played a part in this decline.

Shipments to the Middle East fell 118,000 tonnes in 2013. Recent discussions with traders suggest increased interest from Q2, 2014 as commodity prices have eased. European sellers secured the largest share of this market in 2013 (36% by volume), and are particularly well-placed in 2014 with rising milk production and competitive pricing.



## Steady growth in Southeast Asia

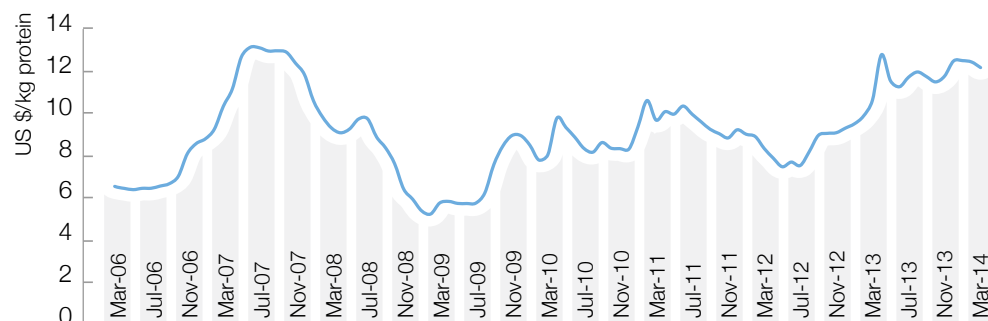
Southeast Asia posted a year of steady incremental growth: overall exports to the region increased 4% (85,000 tonnes) in 2013 to 2.04 million tonnes, with the Philippines, Malaysia and Indonesia responsible for around 80% of this.

New Zealand, the EU28, and Australia all lost market share in the region, while the US grew its presence from 16% of total shipments to 20%. New Zealand exports to Southeast Asia decreased during 2013 (down from 567,000 to 548,000 tonnes) due to drought-reduced production and significant growth in the Chinese market.

Japan's total dairy imports increased just over 2% in 2013, with little change in overall market shares. February data suggests 2014 has started on a slower note as imports are down 9% in the year to date across all products.

## Dairy substitutes

**Figure 6:** Dairy protein price - premium vs. soy meal



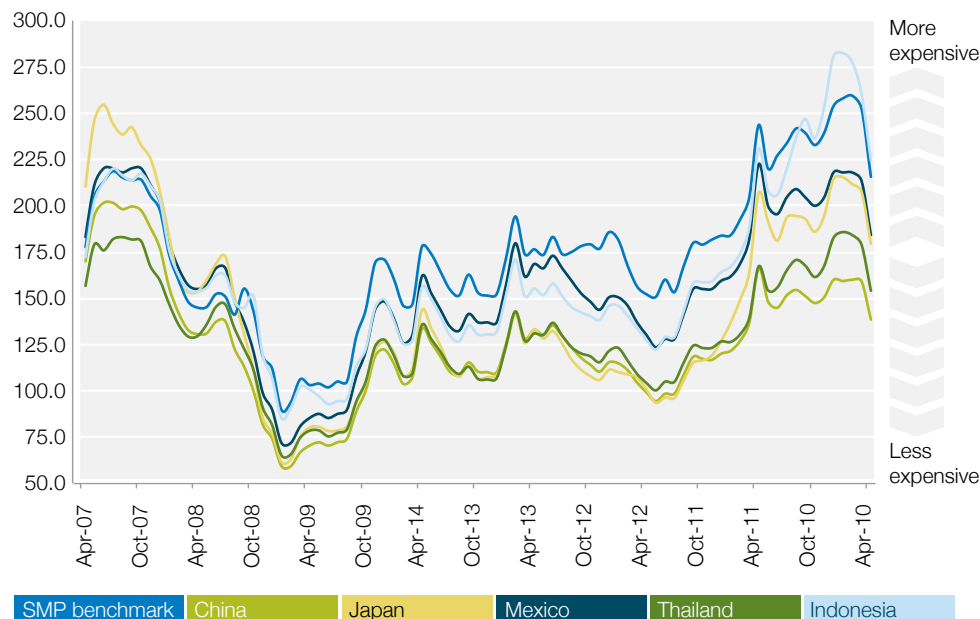
As evident in **Figure 6**, the recovery in dairy commodity prices in late 2012 and early 2013 meant the premiums for dairy proteins and fats relative to oilseed-derived substitutes soared. This was despite soymeal prices averaging 4% above 2012 levels through 2013. Average palm oil prices were 18% lower than 2012.

Rising forecasts for South American soy output and the approaching crushing season will increase supplies and should therefore depress soy prices in coming months. Global palm oil supplies remain tight, but production is increasing seasonally.

## Dairy affordability

Lower international dairy commodity prices have outweighed the impact of currency movements to support greater affordability across major importing markets since 2014 began. Dairy Australia's SMP-based affordability index is now at its lowest point since around March 2013 as the average per tonne SMP price in USD for April 2014 has dropped 15% on December 2013's.

**Figure 7:** SMP affordability index



Although prices have been moderating since December, relative unaffordability (as suggested by the index) nevertheless remains well above long-term average levels. This is especially the case in key markets such as Indonesia, Japan and Russia. So while international dairy commodity prices remain elevated due to robust Chinese demand, in the absence of a more significant price correction, substitution remains a risk in more price sensitive markets.

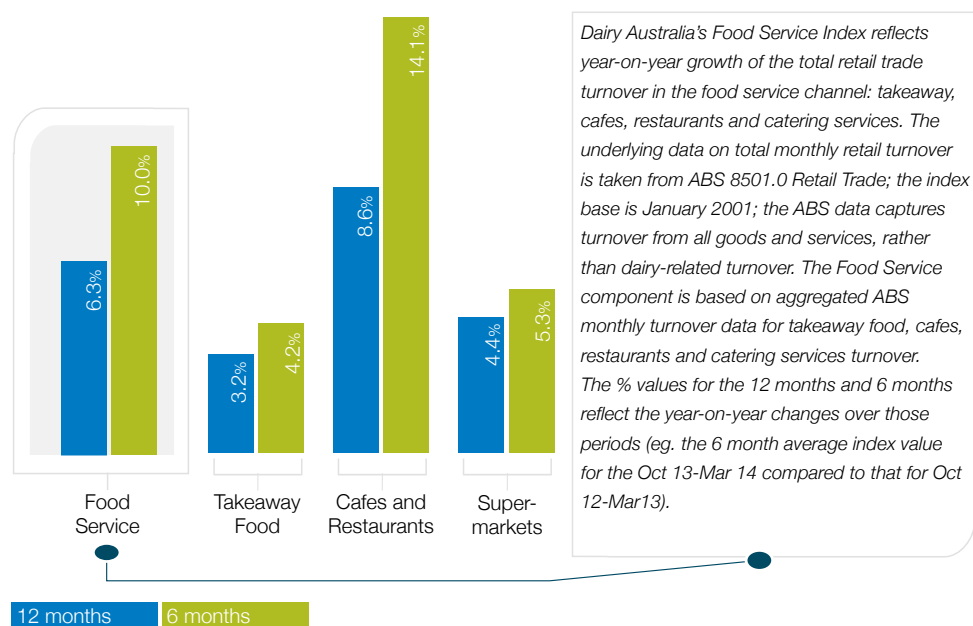
## Australian market

Fundamental economic conditions continue to support broadly favourable demand, although recently announced federal budget measures as well as ABS figures suggesting wage growth is falling behind inflation will likely affect spending across some households. Westpac Melbourne Institute's consumer sentiment index highlighted a deterioration in household confidence, falling from 99.7 in April to 92.9 in May (a level not touched since 2011; a reading of 100 indicates neutral sentiment).

ABS March data indicates total retail sales continue to grow (0.5% in trend terms), along with retail prices (0.8%), as consumer spending on services remains resilient with café, food and restaurant spending the major contributors. DA's Food Service Index reflects this trend, highlighting strong, double-digit growth in food and restaurants. Low interest rates and rising asset prices (including house prices and superannuation accounts) have been supporting spending behaviour.

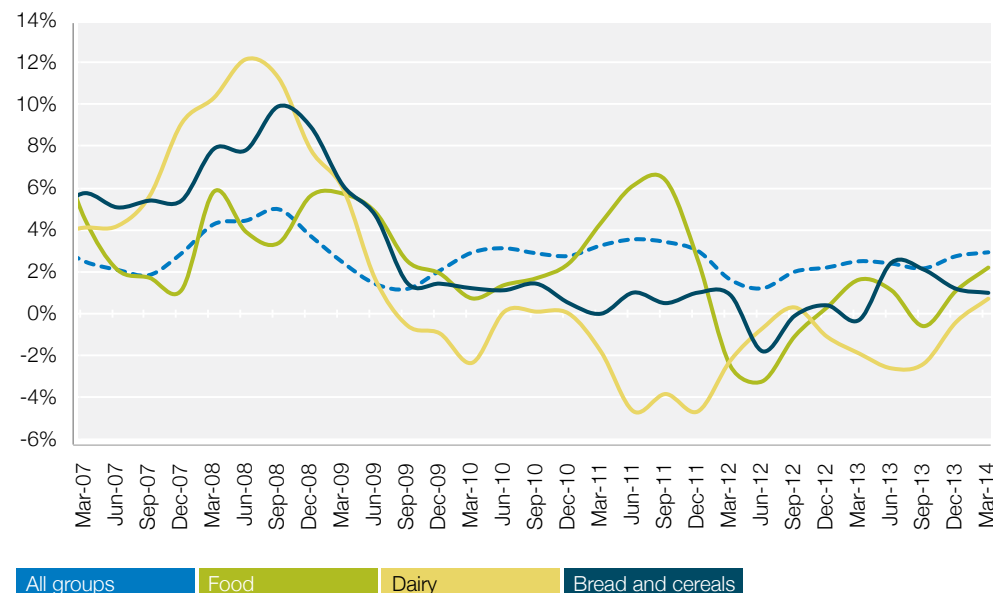
### Dairy Australia Food Service Index to end March 2014

**Figure 8: Dairy Australia Food Service Index (YoY Turnover)**



While inflation remains within the RBA's 2-3% target band, there are indications of some positive price growth coming back into the dairy category over the first quarter of calendar 2014. This recent ABS data (**Figure 9**) is likely to be showing some lifts in dairy pricing that are not captured in the available Aztec data covered below reflecting calendar 2013 pricing.

**Figure 9: Quarterly CPI chart (average prices %)**



Unemployment is also relatively steady at 5.8% in April, with greater than expected growth in full time jobs. Though there have been some reductions in hours worked and the participation rate.

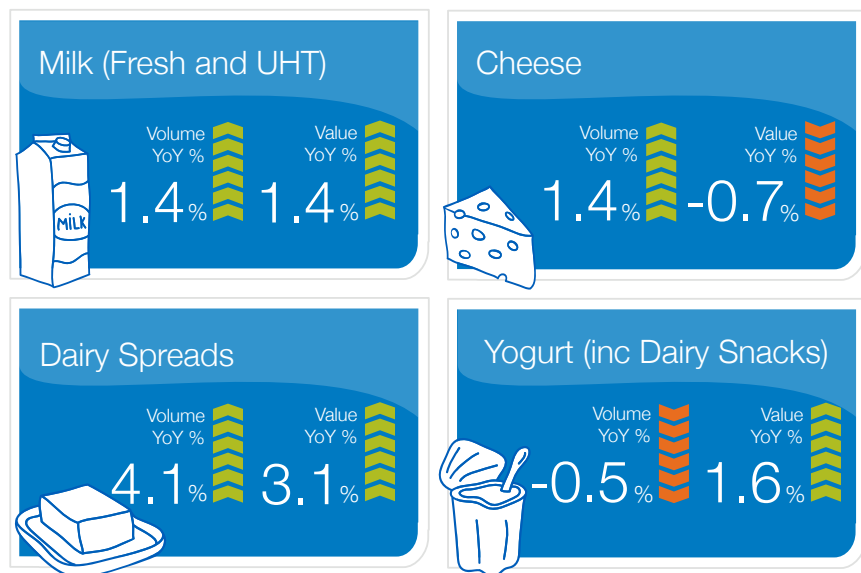
History suggests that announced budget measures may have some lingering dampening effect on consumer sentiment, given the real and perceived impacts of tax and policy changes. Furthermore, pressure on sentiment and discretionary spending may also build in regions where structural change and transition from energy and resources projects are creating less favourable labour market conditions.

Latest Aztec data covering supermarket retail sales value and volume for major dairy categories for the 12 months to the beginning of January 2014 (MAT 05/01/14) shows a slowdown in both volume and value growth for three out of the four major dairy categories.

Within the milk category, the average retail selling price for branded fresh white milk is \$1.92 (from \$1.93, MAT 06/01/13) and that of private label fresh white milk \$1.01 (from \$1.02, MAT 06/01/13). Year-on-year, UHT remains around 13% and 12% of total supermarket milk sales volume and value, respectively. Although UHT volume growth moved up 1.9%, its value edged up just 0.1%, reflecting the price positioning (\$1.45 on branded UHT milk compared to \$1.92 on branded fresh white milk) as well as the increased contribution of private label UHT (\$1.02 on private label UHT milk).

## Australian market

**Figure 10: Dairy category performance**



Source: Aztec Australia – national retail channel comparing changes in total volume and value from 2012 (MAT 06/01/13) to 2013 (MAT 05/01/14)

**Milk** volume and value growth are steady at 1.4%, continuing to grow roughly in line with population growth. Average retail sales prices have remained flat at the category level. With several years now passed since the introduction of \$1-per litre milk, and ‘permeate-free,’ further significant private label-branded share changes in fresh milk are not discernable at this point. Private label share of total supermarket milk (fresh and UHT) stands at 52.9% (52.0% for MAT 06/01/13) and 55.4% (55.7%) of total supermarket fresh milk.

**Cheese** volume growth is steady, but the total retail value of the category continues to decline. Discounting and lower average selling prices have been offsetting growth in sales volume. Comparing 2012 (MAT 06/01/13) to 2013 (MAT 05/01/14) average per kilo retail sales prices, chilled block cheese is down -3.2% to \$12.59 and total cheese by -2.1% to \$14.21. However, Deli cheese retail sales remain strong, with average retail sales prices remaining almost unchanged at just under \$23.70, and total sales growing at 5.4% in volume and 5.3% in value.

**Dairy spreads** retail sales also show relatively strong growth, as the total category increased with volume rising 4.1% and value up 3.1%. Marginally higher average retail per kilo prices for branded butter (at \$11.40 per kilo versus \$5.87 for private label) have helped offset the impact on total category value of lower average prices for dairy spreads.

**Yogurt** (including dairy snacks) retail sales volume has declined by -0.5% overall. However the total category value has increased 1.6% due to product innovation and stronger pricing particularly amongst relative newcomer brands.

**Figure 11: Supermarket retail average selling prices**

	Branded milk			Private label milk		
	Fresh White	Fresh Flavoured	UHT White	Fresh White	Fresh Flavoured	UHT White
<b>MAT 05/01/14</b>	\$1.92	\$3.88	\$1.45	\$1.01	\$1.96	\$1.02
<b>MAT 06/01/13</b>	\$1.93	\$3.94	\$1.42	\$1.02	\$1.99	\$1.05
<b>YoY % as %</b>	0.0%	-1.3%	2.3%	-0.7%	-1.5%	-3.3%

Source: Aztec Australia – national retail channel comparing changes in total volume and value from 2012 (MAT 06/01/13) to 2013 (MAT 05/01/14)

### Manufacturing sector update

The rearrangement of Woolworths’ private label milk supply contracts nationally and the acquisition of WA-based processor Harvey Fresh have been just two of the significant developments in the corporate landscape of the Australian dairy industry since the Warrnambool Cheese & Butter takeover contest concluded earlier in the year.

Fonterra has picked up the contract to supply Woolworths private label milk in Victoria for the next 10 years. This will involve Fonterra investing more than \$30 million in a milk processing plant at its Cobden site in South West Victoria, supporting 30 new jobs, to be commissioned in early 2015. Brownes Dairy secured the WA contract, while Parmalat is set to supply QLD and NSW. Lion Dairy & Drinks (Lion) have held onto contracts in SA/NT and Tasmania. Consequently, Lion, will cease supplying Woolworths’ private label milk in Victoria from February 2015, and in WA from July 2014, impacting volumes at plants in Chelsea (Victoria) and Bentley (WA) (see **Figure 12**).

Lion has held a unique position for several years as a processor with a national footprint. However, since Harvey Fresh was acquired by Italian dairy company Parmalat for about 79 million euros (around \$120 million) this has changed. This acquisition provides the French-owned Parmalat a national footprint in the Australian market. This in turn not only gives Parmalat potential opportunities to expand distribution of its products nationally but also some additional incremental growth through bolt-on export capability, given Harvey Fresh’s export business taking Australian dairy from Perth into Southeast Asian markets.

**Dairy Australia’s November Situation and Outlook report will provide an in-depth update of Australian dairy corporate and product market developments. In the meantime, stay informed about local and international dairy market news and developments through DA’s Fortnightly Update:**

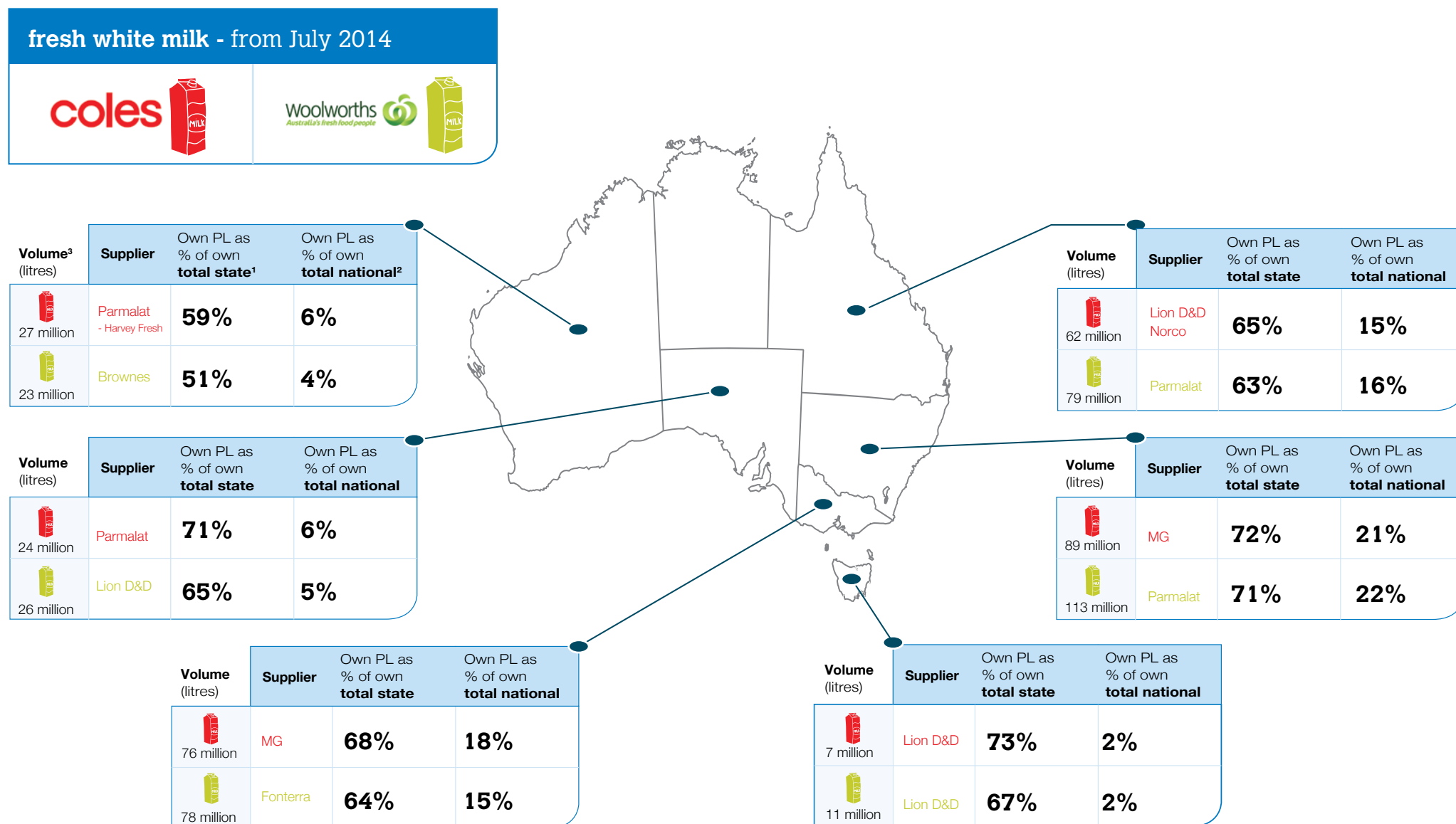
<http://www.dairyaustralia.com.au/Markets-and-statistics/Market-news.aspx>



## Private label suppliers - Australian dairy landscape

**Figure 12:** Private label suppliers from July 2014 of supermarket fresh white milk

Source: Aztec scan data. Note that percentage figures for both <sup>1</sup>own private label (PL) fresh white milk as % of own total fresh white milk sales in state and <sup>2</sup>own PL as % of own total fresh white milk sales nationally (includes both PL and branded) are based on scan data for Woolworths and Coles Group for the MAT (05/01/14). <sup>3</sup>The total litres volume figures provided by state for each retailer are also sourced from Aztec (MAT 05/01/14), not from company information reflecting contracted volumes from July 2014.

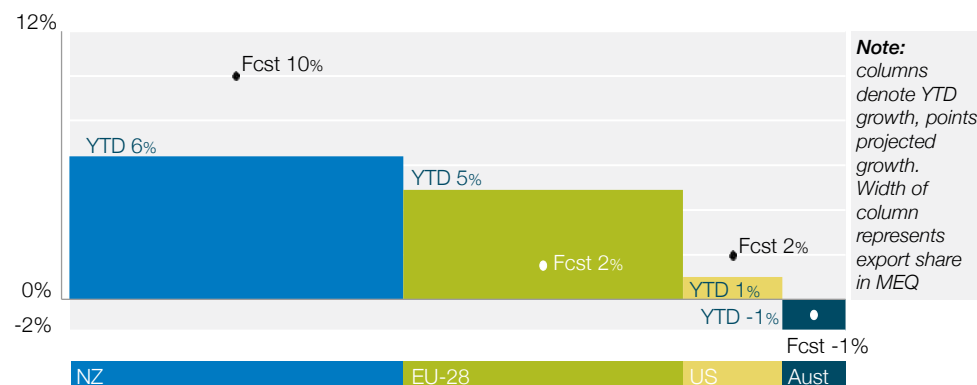


## Global supply

### Overview

Expansion trends in global supply continue to intensify with northern hemisphere spring production in full swing. Margins and weather remain favourable, boosting growth forecasts.

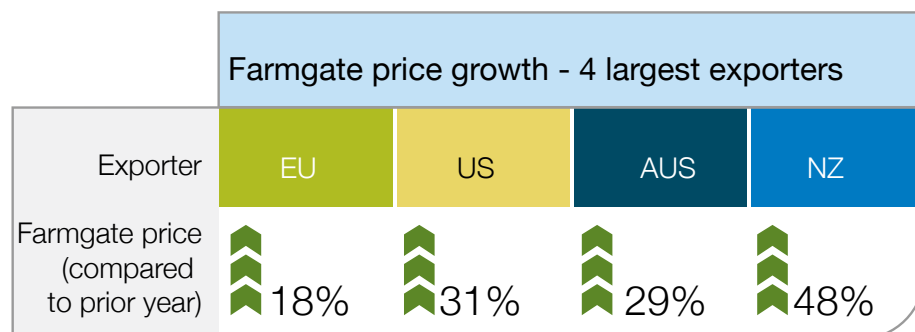
**Figure 13: YTD and projected growth - 4 largest exporters**



### Key drivers

Favourable weather, lower input costs (particularly feed grains) and significantly higher farmgate milk prices continue to drive increased production. In many regions prices have peaked and are now facing downside. This is particularly evident in Europe given the different prevailing pricing system compared to the 'open, step up, close' system in Australia.

**Figure 14: Farmgate price growth - 4 largest exporters**



### Northern hemisphere

With the northern hemisphere spring in full swing, the lowest offer prices in international markets have been coming from major EU28 producers and to a lesser extent the US.

European production is particularly strong, increasing 5% for February compared with February 2013. The European winter was so mild that winter grain crops required seasonal rains earlier than usual, due to rapid development.

US growth continues to be mixed. The Midwest and Northeast continue to track below 2013 levels but are set up for a bumper season; California milk flows are well ahead but the chance of drought remains. Overall, US production is up 1% for 2014 to March; a similar figure to January and February.

The Cooperatives Working Together (CWT) program continues to subsidise large volumes of US butter and cheese exports. In 2013 CWT subsidised exports of just over 40,000 tonnes of butter and almost 58,000 tonnes of cheese, 44% and 18% of total US exports for each product respectively. Asia, and particularly Japan, is the biggest market for assisted cheese shipments, while Saudi Arabia is the top purchaser of CWT- supported butter. For the first five months of 2014, CWT has accepted tenders to subsidise 24,000 tonnes of cheese, 20,000 tonnes of butter, and nearly 5,000 tonnes of WMP. CWT funding for the 2014 calendar year is expected to exceed US\$50 million (A\$60 million) based on membership levels and forecast milk production.

### Southern hemisphere

New Zealand has led the global dairy supply response due to both high exposure to international markets (allowing rapid pass-through of higher dairy commodity prices) and much more favourable weather than that in early 2013. February data reports 6% growth for the season to date, and 12% compared to February last year. Higher growth rates are expected in subsequent data releases for the remaining months of the June-May production year, lifting total NZ milk production to just over 21.4 billion litres for the June 2013-May 2014 season.

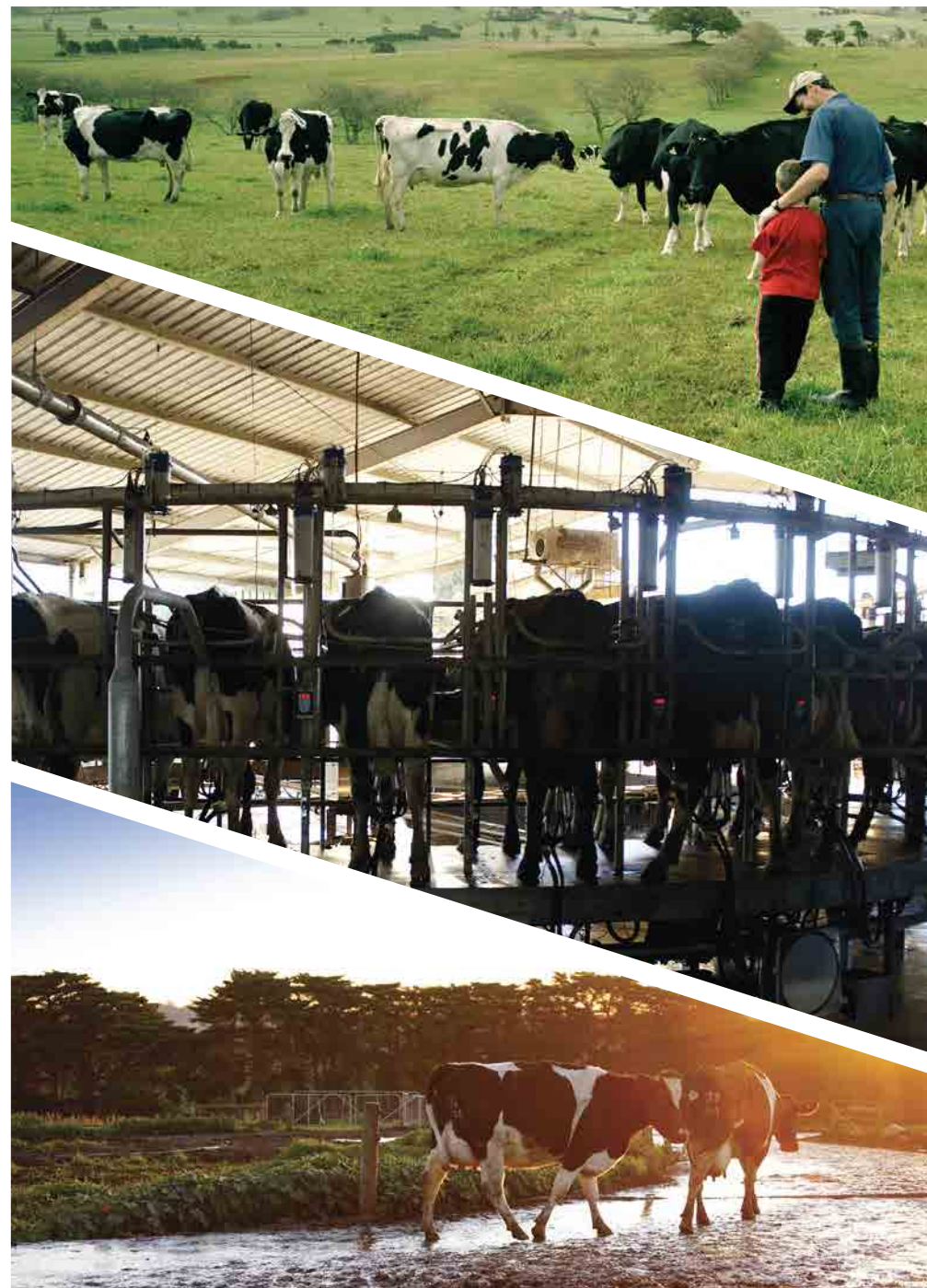
Australia's milk production has remained broadly on a recovery trend, with the first three months of the 2014 calendar year recording improvements compared to the beginning of 2013. In southern, export-focused regions, improved margins have enabled most farmers to reduce short-term debts and make incremental investments in their production systems. Increases in month-on-month production at the national level have all been generated from southern states, while the northern states trail 2012/13. Domestic-focused northern regions have not seen the same farmgate benefits of high international commodity prices, and with climatic challenges added to the mix, profitability and confidence remain under pressure.

## 2014/15 Australian production forecast.

Looking ahead to 2014/15, all major processors forecast growth in Australian milk intakes. Some of this is expected to come through recruiting suppliers from competitors. But the focus on incentivising 'new milk' is as strong as ever, with various price and co-investment incentives in place. Easing international commodity prices may contribute to a moderate reduction in base milk pricing and the possibility of El Niño-induced weather challenges are tempering growth expectations.

With significant capital investment underway, Tasmania is highlighted as a growth region; but growth is also expected from other southern production regions. Milk supply and demand volumes appear to be well balanced at the company level in northern regions, in contrast to recent years where some processors had significant excess volumes. The combination of a more stable demand environment and the opening of new markets such as the 'pipeline' for milk shipments to China should contribute to improved sentiment and help slow the decline in northern milk production.

Dairy Australia's initial forecast for 2014/15 is for national volumes to reach 9.3 to 9.4 billion litres, an increase of around 2% on the expected 2013/14 season total.



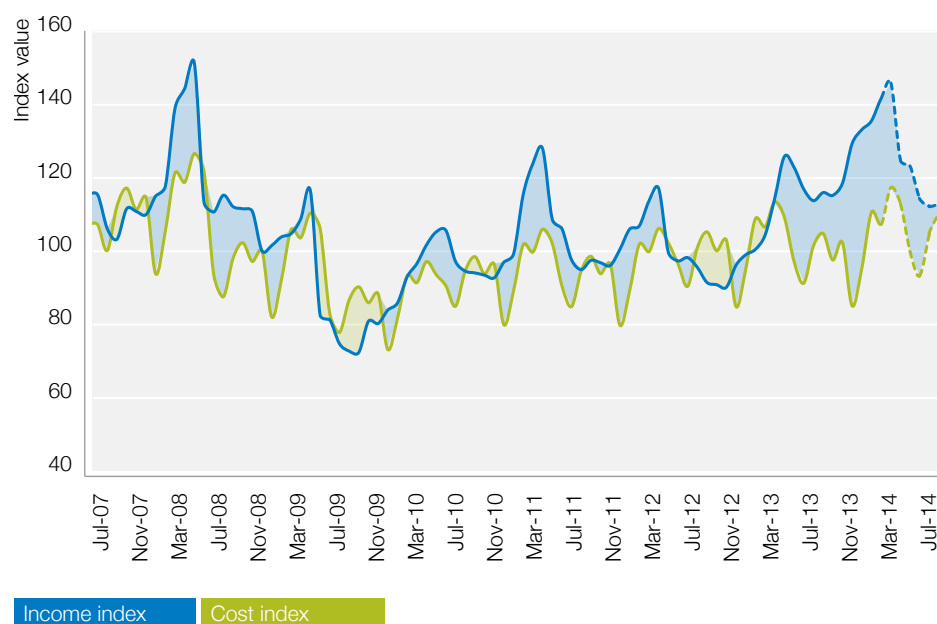


# Input markets

## Export Region Weighted Cost and Income Indices

- > The 2013/14 season has seen improved profitability for farmers in export-focused dairying regions.
- > For the six month outlook period, forward indicators suggest the gap between the indices will tighten.
- > Key income factors include lower contracted prices on GlobalDairyTrade pushing down the index.
- > The cost index increases mainly due to rising ASX grain futures.
- > The weighted cost and income indices consider the near-term outlook and highlight the net impact of market changes.

**Figure 15:** Export Region Weighted Cost and Income Indices



See Appendix Export Region Weighted Cost and Income Indices for further information

## Fertiliser

Urea global benchmark prices have continued to soften since January and are currently around 11% lower than at the same time last year. The fall in prices is linked to increased supply, with Chinese exports reportedly having more than doubled in the first three months of 2014 when compared to the same period in 2013. Contributing factors were reduced export tariffs, low coal prices, and increased manufacturing capacity. According to Canadian exporter PotashCorp, China has accounted for approximately 18% of global urea trade in recent years: hence any significant change in export volumes is going to materially impact world supply.

Potash global benchmark prices appear to have stabilised at around 30% below year-earlier levels following last year's split between major producers, Belaruskali and Uralkali. According to PotashCorp, while North American ending stocks were down for the third consecutive month in March, they remained above the 5-year average. Indian import subsidies have also been cut, reducing the chance of a resurgence in demand.

Demand from important buyers in the Americas and Europe has supported prices for diammonium phosphate (DAP), for which global benchmark prices have risen 5% since January, to sit slightly above year-earlier pricing.

The AUD appreciation since January has improved purchasing power for fertiliser imports, although domestic prices are also influenced by local supply and demand factors. An example of this is the reported rush to secure low-priced fertiliser around last Christmas, driving up prices for nitrogen and phosphate fertilisers as demand for locally available supplies exceeded availability.

## Water

The average temporary water price in Northern Victoria was \$76 per megalitre for April, 54% higher than the previous twelve months. The volume traded was down 22% on the previous year's. For the Murray Irrigation system, the average temporary water price was \$56 per megalitre, virtually unchanged compared to that for April 2013, as was the volume traded.

An outlook for 2014/15 seasonal determinations was released by the Resource Manager for northern Victorian water systems on 15 May. According to the outlook, the Campaspe system will start the 2014/15 season with 100% HRWS (High Reliability Water Supply), and, if inflow conditions are average, all systems are expected to have 100% HRWS by mid-December. Seasonal determinations will be announced on 1 July for HRWS.

The Bureau of Meteorology's ('the Bureau's') new ENSO (El Niño-Southern Oscillation) tracker is currently at ALERT level, reflecting the 70% likelihood of an El Niño event developing in 2014, as early as July. El Niño is generally accompanied by below average winter/spring rainfall across much of southern and eastern Australia, and, according to the Bureau, major droughts have ensued from over 60% of El Niño events since 1900.

**Figure 16:** Irrigation allocations as at 8 May 2014

	High Reliability Water Share	Low Reliability Water Share
<b>Goulburn-Murray Water</b>		
Murray	100%	0%
Broken	100%	100%
Goulburn	100%	0%
Campaspe	100%	46%
Loddon	100%	0%
Bullarook Creek	100%	100%
<b>Southern Rural Water</b>		
Macalister Irrigation District	100%	5%
<b>Murray Irrigation Ltd.</b>		
Class A – Town water	Class B – High Security	Class C – General Security
100%	100%	100%

## Cows

Cull cow sales volumes (year-to-date) are 9% lower than at the same time last year, and 14% below the 5-year average. This is despite cull cow prices picking up in recent months; in January, prices were 15% above year-earlier levels; in April it was 30%. However, the financial year-to-date average price remains 3% below the 5-year average.

According to ABS figures, live dairy cattle export volumes (year to date) are 12% lower than at the same time last year to March, placing exports for the period 3% below the 5-year average. The vast majority of cattle purchased between January and March 2014 were destined for China (91%), followed by Pakistan (3%) and Taiwan (2%). In comparison, during the first three months of 2013, 72% were destined for China and 25% for Pakistan. The average value of an export dairy cow (this includes “Live dairy cattle not including pure-bred dairy breeding cattle” and “Pure-bred dairy breeding cattle”) was \$2,247 in 2012/13, and \$2,145 in 2013/14, so the average price has fallen 5% year-on-year, but remains 2% above the 5-year average.

## Feed grains

Domestic grain prices for the current crop were significantly higher year-on-year in April, with feed wheat delivered Melbourne around 12% more expensive. Northern Australian demand, in combination with international factors, continues to support elevated local grain prices.

Bulk vessels have reportedly been unloading grain in Brisbane to supply the ongoing demand for feed grain in northern Australia, where the sorghum harvest has now begun. Although rains along the east coast have provided good sowing conditions in many areas and boosted confidence, the market will also be considering the 70% chance of an El Niño event, which would support higher prices until greater certainty about the next harvest emerges.

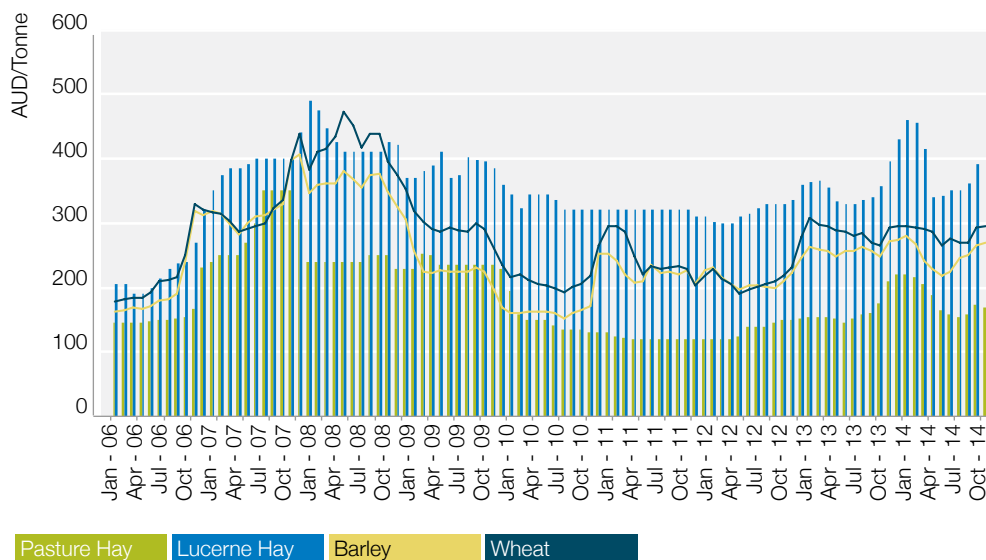
The Bureau’s national rainfall outlook for the May to July period shows a roughly equal chance of either a wetter or drier than normal season over the majority of Australia. A wetter than normal season is more likely in the far southeast of the country, and in the dairying and cropping areas of WA.

International wheat prices have been impacted by geopolitical tensions in the Black Sea region since the end of February. If these tensions ease, upward pressure on prices would be somewhat reduced. However the market has been pricing in a reasonable level of risk for some time, so further dramatic pricing reactions are unlikely unless the movement of physical grain becomes restricted.

US winter wheat crop conditions have been concerning international grain markets in recent weeks. The USDA Crop Progress report for the week ending 4 May rated 31% of the US winter wheat crop ‘good-excellent’ compared to 33% the previous week, and 32% at the same time the previous year. Observers are concerned that inadequate moisture is available to the crop in the southern Plains (particularly Oklahoma and Texas) as it heads into its most moisture sensitive stage of development. So, although harvest is still some way off, average yields become increasingly less likely as rains fail to eventuate. According to the May USDA WASDE (World Agricultural Supply and Demand Estimates) report, US wheat production is projected to fall 8%, global wheat production to fall 2% in 2014/15 (compared to 2013/14) and global wheat stocks projected to rise. The USDA have also forecast record global maize production in 2014/15 and an increase in global maize stocks. This would place downward pressure on global feed grain prices.

Conditions have improved across the EU28 after rain replenished soil moisture levels and according to the May WASDE report, 2014/15 wheat production is projected 1% above 2013/14 levels.

**Figure 17: Feed grain (Melbourne) and Hay (Shepparton)**



Source: Rural Press

## Hay

Steady demand for hay continues from northern Australia, most of which is being met by product sourced out of Victoria and South Australia. Though there is interest in central west NSW in producing cereal hay in the coming season, there are concerns about possible disruption to lucerne production in northern NSW. Low rainfall has impacted on water storage levels, and if this results in low water allocations, production of irrigated fodder crops will likely suffer.

In southern Australia, the market is busier than usual for the time of year, due to the combined pressures of steady local demand, and increased demand from the north. Supplies of cereal hay are good in northern, western Victoria and also central SA. However, in southeastern SA stocks are below average, and low in Tasmania. Cereal hay and pasture hay quality is variable across southern Australia this year. Supplies of lucerne and other protein hays are low with wet conditions slowing hay production in recent weeks. Straw availability is reported to be average.

Cereal hay continues to be in strong demand in WA, although good rain in recent weeks has seen some pastures and winter crops being planted. Supplies of lucerne hay are reportedly very low, and expected to be in short supply throughout winter. There is more straw available than usual, and supplies are of good quality.

**Dairy Australia's Grain & Hay Report provides a comprehensive overview of the market and indicative pricing by dairying region, and is published most weeks at [www.dairyaustralia.com.au](http://www.dairyaustralia.com.au).**



## Black Sea wheat exports

Geopolitical tensions in the Black Sea region have affected international wheat values since the end of February. The region produces a large proportion of world wheat exports: the major exporters in the wider region (Russia, Kazakhstan and Ukraine) accounted for 10% of world wheat production in 2012/13, and 18% of global wheat exports. These figures are projected to be 12% and 22%, respectively, for 2013/14, and 12% and 23% for 2014/15. The Ukraine is the sixth largest wheat exporter globally, representing 2% of world wheat production in 2012/13, and 5% of global wheat exports. These figures are projected to be 3% and 6%, respectively, for both 2013/14 and 2014/15 (USDA WASDE-529, May 2014).

If physical movement of grain from the region were to become restricted, this would have serious implications for world wheat trade (as was seen when Russia responded to drought in 2010 by banning wheat exports and prices soared). Hence global wheat markets have responded to the crisis by beginning to price in this risk. As a global exporter sharing important markets (such as the Middle East) with the Black Sea, this in turn puts upward pressure on domestic Australian wheat markets: great news if you are a wheat producer with grain to sell, but less so if you have cows to feed. As Russian activity within the Ukraine continues, risk premiums could drop if the situation is resolved, or prices could rise further if physical movement of grain becomes restricted. The market will be watching the situation and react accordingly.



# Policy updates

## Murray Darling Basin Plan

The Water Recovery Strategy to accumulate 2750GL of environmental water is still under development, but the Federal Coalition Government that took office in September 2013 has imposed a 1500GL cap on water entitlement buybacks. The Murray Darling Basin Authority (MDBA) is still developing a constraints management strategy to determine whether large volumes of environmental water can be delivered without unacceptable third party impacts. The MDBA has proposed changing operational rules to favour environmental releases, but the dairy industry has opposed changes on equity grounds with irrigators. The environment now accounts for around 26% of water entitlements, with a combination of shares bought from irrigators and new entitlements created from various water saving projects.

## Energy and carbon policy

The Federal Coalition Government elected in September 2013 is seeking the support of the new Senate to repeal the carbon price on 1 July 2014. The carbon price was a temporary impost, due to expire in 2015 with the creation of an emissions trading scheme. Its early repeal will save liable dairy companies more than \$25 million in 2014-15. Repealing the carbon tax may not result in lower power bills for dairy farmers, particularly those who responded to its impost in 2012 by negotiating new tariff deals or joining group supplier schemes. Dairy companies are not liable for meeting emissions baselines under the Coalition's replacement Direct Action Plan to reduce greenhouse gas emissions. The Coalition Government is also reviewing the Renewable Energy Target, which accounts for 1-5% of total power bills, but depresses wholesale electricity prices and reduces the cost of renewable energy systems such as solar panels and solar hot water by around 30%.

## Free trade negotiations

Australia has completed negotiations in the last six months on two new bilateral trade deals with the Republic of Korea (Korea) and Japan. Despite the contents of the agreements having been agreed, both deals are still subject to final ratification before entry into force and the following information is therefore preliminary.

### KAFTA (Korea-Australia Free Trade Agreement)

Trade Minister Robb and his Korean counterpart Trade Minister Yoon announced that they had concluded negotiations on the Korea-Australia Free Trade Agreement (KAFTA) in early December 2013.

The legally verified text of the agreement was initialled by Chief Negotiators on 10 February 2014 and released to the public on 17 February 2014. The Agreement was signed on 8 April 2014 during a ceremony in Seoul. On 13 May 2014, Minister Robb tabled the Agreement in the Australian Parliament, and KAFTA will now be considered by the Joint Standing Committee on Treaties (JSCOT).

The agreement when implemented will set most Australian dairy products on a path to eventual full trade liberalisation into Korea, with the notable exception of milk powders which were left out of the final agreement. Some dairy products will enjoy zero tariffs on entry into force, while the majority will see tariffs phased down over varying periods of time.

Australia will have access to a Country Specific Quota (CSQ) volume for some key items during the phase-in period. Product exported within the CSQs will enter Korea at a reduced tariff (usually zero) while product outside the CSQs will revert to the tariff specified within the relevant KAFTA schedule. Products for which a CSQ is specified for Australia include butter, fats and oils, cheese, and infant formula.

Dairy Australia estimates that the first year benefit of tariff savings for Australia under KAFTA will be in the order of \$US 7.6 million, and that figure will grow year on year as the CSQ volumes increase and the out-of-quota tariffs reduce.

**More information can be found at the DFAT KAFTA website:** <http://dfat.gov.au/fta/kafta/>

### JEAPA (Japan-Australia Economic Partnership Agreement)

The conclusion of negotiations on the Japan-Australia Economic Partnership Agreement (JAEPA) was announced in Tokyo on 7 April 2014 by Prime Minister Tony Abbott and Prime Minister Shinzo Abe. It is likely that the agreement will be signed when Prime Minister Abe visits Australia in early July 2014. As with KAFTA, the JEAPA agreement will be subject to a domestic ratification process in both Australia and Japan before final implementation.

The outcome for dairy under JEAPA is less comprehensive than hoped for by the Australian dairy industry.

Key improvements are the provision of CSQs for cheese for manufacturing into processed cheese, and for cheese for shredding. Limiting the value of these CSQ's is the restricted end use of the products, and the requirement that in order to access the CSQ's the Japanese importer must also utilise domestic Japanese cheese in a specified ratio.

Other cheese products that will achieve marginal improvements in access under the JAEPA include blue veined cheese, grated or powdered cheese, and processed cheese. Non-cheese dairy products to achieve improved access include ice cream; frozen yogurt; casein; milk albumens; lactose and milk protein concentrate.

Dairy Australia estimates that the first year benefit of tariff savings for Australia under JAEPA will be in the order of \$US 4.7 million, and that figure will grow marginally year on year as the CSQ volumes increase.

**More information can be found at the DFAT JAEPA website:**  
<http://www.dfat.gov.au/fta/jaepa/>

Now negotiations with Korea and Japan have concluded the trade policy focus turns to free trade agreement talks with China, as well as to the regional Trans-Pacific Partnership (TPP) negotiations.

## Exchange rates

The AUD/USD rate has defied earlier expectations in lifting from US 0.89c in early March to hover around US 0.93c from April onwards. The US Federal Reserve (the Fed) has continued its staged reduction of asset purchases ('tapering') as expected. Although tapering has not delivered as strong a USD as previously anticipated.

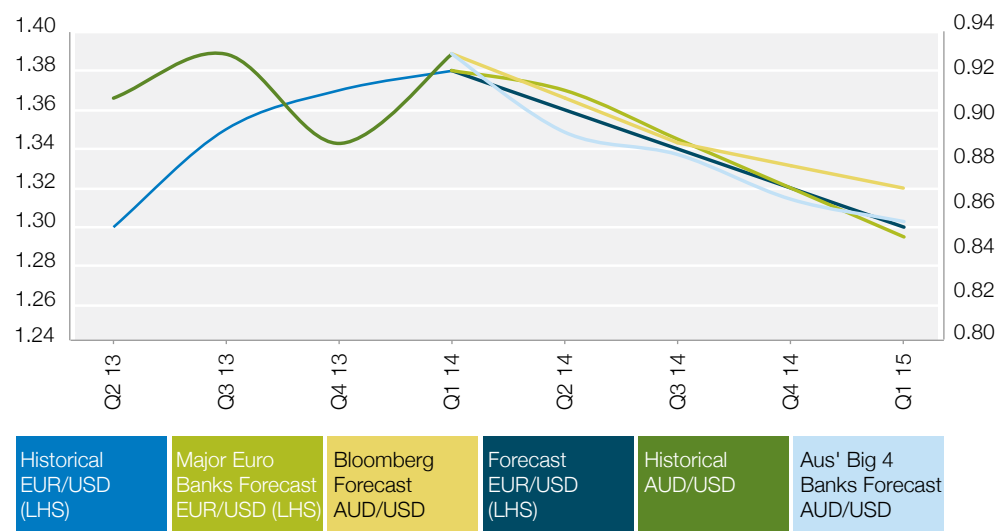
Market observers now expect that it will take a higher Fed funds rate rather than continued tapering to support further strengthening in the USD against the AUD and other currencies (see **Figure 18**). But solid Australian and Chinese economic data have been supporting the AUD at around US 0.93c.

There has also been additional support for the AUD from foreign investors' purchasing of AUD bonds. Market participants are again attracted to the AUD because returns on AUD-denominated assets remain relatively higher than alternatives in other countries.

Expectations that the RBA will raise rates somewhere between late 2014 and 2015, assuming the Australian economy continues performing favourably, add support for a stronger AUD. Ongoing housing and construction activity in place of mining projects are key elements in shaping expectations.

On the other hand, factors that could push the AUD down quickly include more rapid than expected strengthening of the USD as the US recovery exceeds expectations, less favourable data signals out of China in particular and also adverse developments in Australian economic conditions.

**Figure 18:** AUD and EUR: forecast to go lower against the USD



Source: Bloomberg

Meanwhile the EUR/USD appears to be headed onto a downward trajectory following recent statements in Europe that additional quantitative easing (asset purchases) might be pursued by the European Central Bank in an effort to fend off deflation.

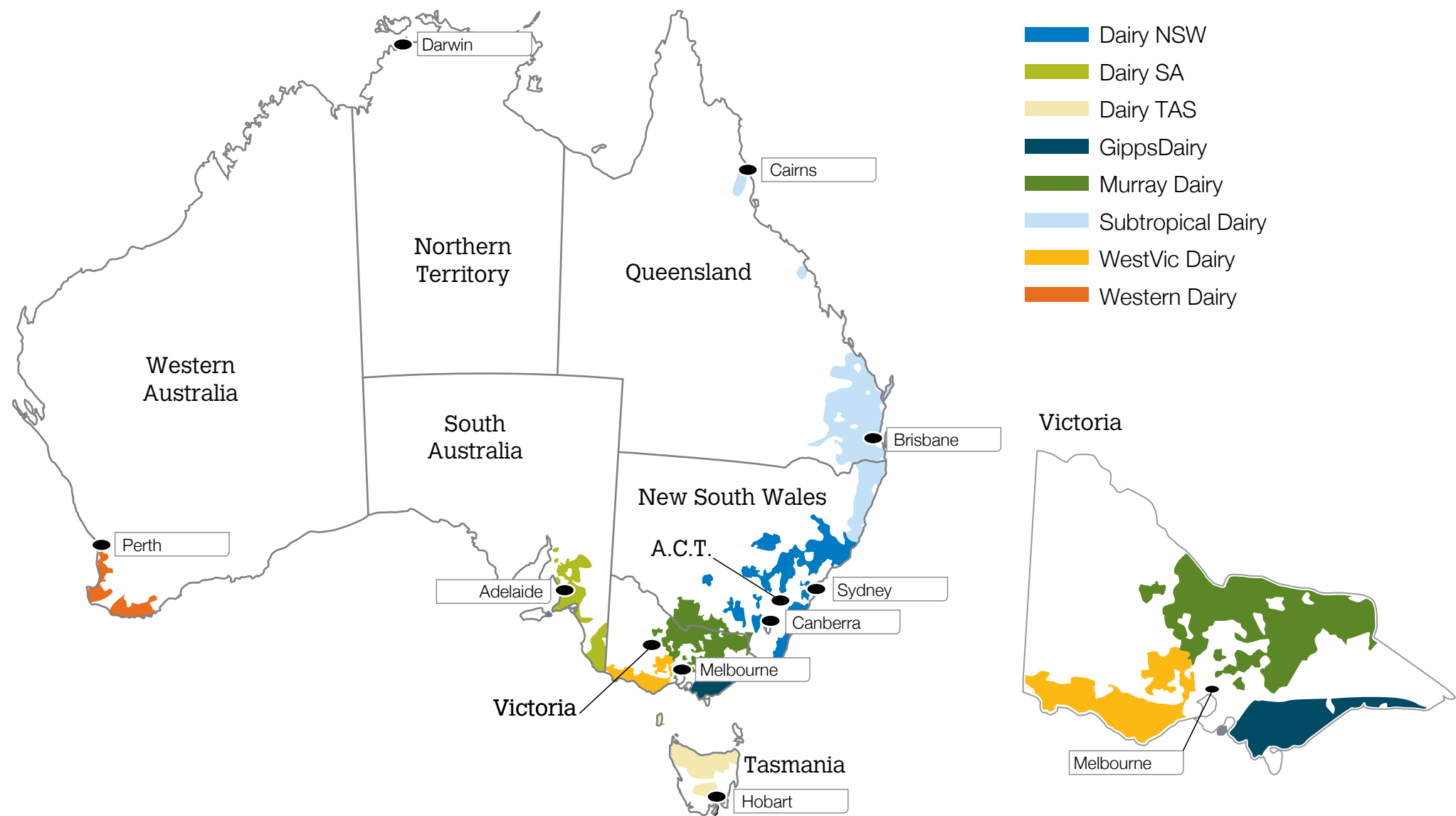
The euro also weakened in May in response to uncertainty around future German economic performance and the deterioration of the situation in the Ukraine. Australian exporters' Northern Hemisphere competitors may likely see some slight improvement in currency relativities, which can negatively affect Australian exporter returns.

Australian exporters nonetheless remain better placed than they had been earlier in 2013 to benefit from a relatively weaker currency. However the AUD would have to return to its earlier downward trajectory in order to provide greater upside for farmgate prices.



# National Dairy Farmer Survey (NDFS)

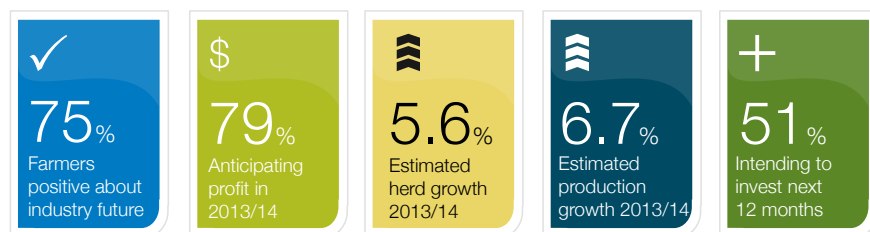
Figure 19: Dairy farming areas by Regional Development Program





# NDFS Summary 2014\*

## National results at a glance



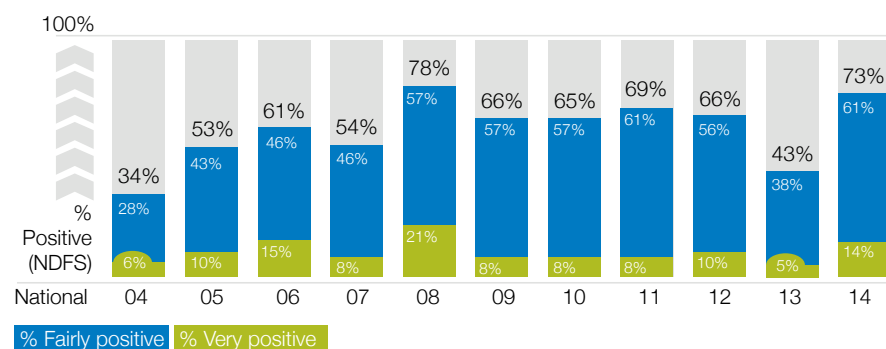
## National overview

There are four overarching themes from the 2014 survey data.

### 1. Significant increase in farmer sentiment since 2013

National farmer confidence has improved significantly in most regions over the last 12 months with 75% of farmers now positive about the future of the dairy industry, compared to a low of 43% this time last year. Interim results from August 2013 indicated a significant shift in confidence following improvements in farmgate milk prices, the drop in the Australian dollar and more favourable seasonal conditions. This more positive outlook has been sustained into 2014.

Figure 12: Farmer sentiment trend



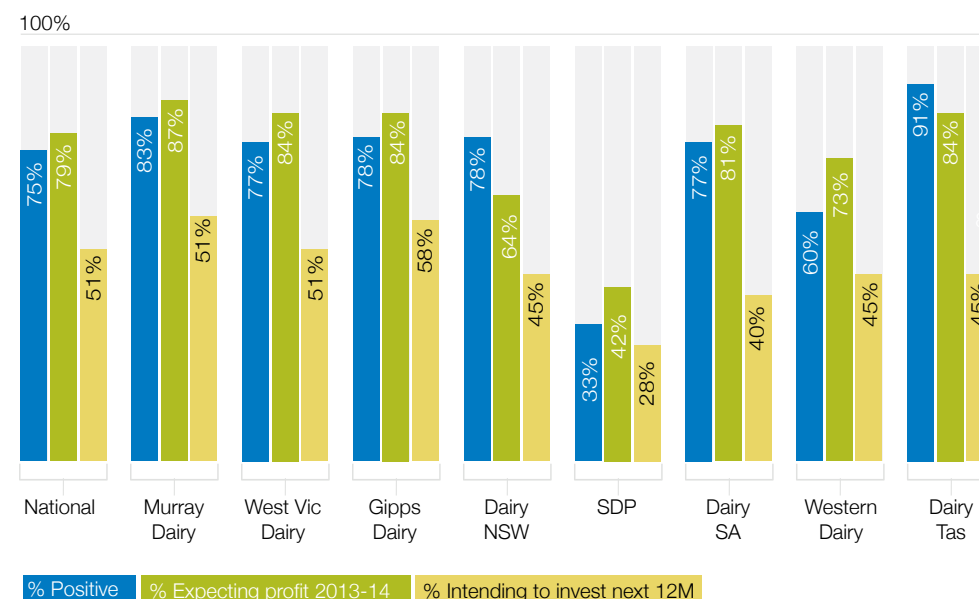
Farmer sentiment has increased significantly in six of the eight dairying regions with at least 70% of farmers in each region now feeling positive about the future. The exceptions are Subtropical Dairy (SDP) and Western Dairy where much smaller improvements in sentiment were reported. Sentiment in these regions is currently at 33% and 60% positive respectively.

Increases in farmgate milk prices (40%) and belief in higher export demand (19%), expected to come primarily from Asian markets, are the two most dominant reasons cited for improved sentiment.

Farmer outlook for many regions would also have been assisted by improved profitability compared to 12 months ago. In 2012/13, 57% of farmers reported making an operating profit. Expectations from the latest survey data show 79% of farmers nationally making a profit in the 2013/14 financial year. More farmers in all regions, with the exception of SDP are predicting an operating profit this year with 58% saying their profit should be higher than that of the average over the past five years.

The improvement in overall sentiment and increased optimism about operating profits is translating into increased confidence to invest on farm. Confidence to increase on farm investment has increased notably since 2013 with 62% now feeling confident compared to 42% last year. With this increased confidence, 51% intend to invest capital on farm in the year ahead. Farmers in Murray Dairy and Gipps Dairy regions are more likely to be making investments.

Figure 21: Sentiment vs. profitability vs. investment by region



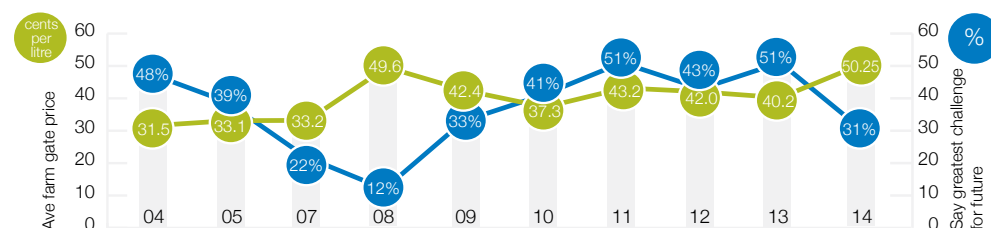
\* The National Dairy Farmer Survey (NDFS) was conducted in March 2014 amongst 1,000 dairy farmers across eight dairying regions. Respondents are recruited randomly and are interviewed by telephone. Results presented are based on survey data which is weighted to represent the structure of the Australian dairy industry.

## 2. Farmgate prices continue to underpin farmer sentiment

Farmgate price is the strongest driver of farmer sentiment. For those feeling more positive about the industry's future, 40% attribute this to improved milk prices; while for those feeling more negative, particularly in SDP and Western Dairy regions, low milk prices is the primary reason for negative sentiment, in addition to related factors of higher operational costs and lower profitability.

When asked about the greatest challenge for their farm businesses in the future, the price received for milk or milk solids continues to be reported as the main concern amongst most farmers. The relationship between average farmgate price and perceptions of "greatest challenge" is apparent in the chart below.

**Figure 22: Average farm gate price vs greatest challenge**



Statistical modelling of the survey data over time shows that variation in farmgate price has the strongest influence on farmer sentiment with an 80% correlation between these two variables. Sentiment is however also affected by a variety of other factors including variation in seasonal conditions, input costs, farm profitability and also regional influences.

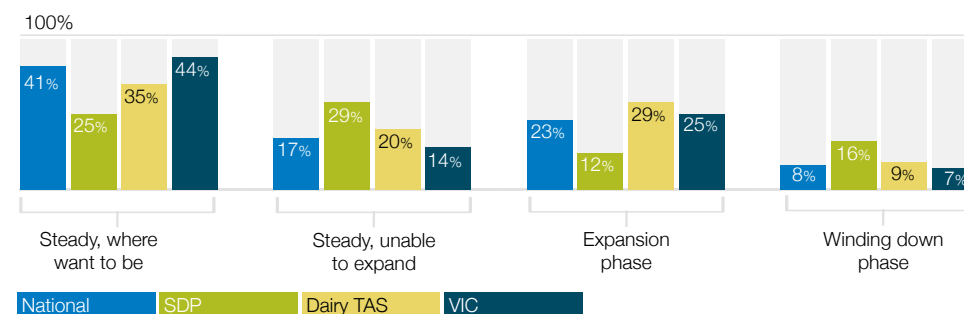
## 3. Domestic focused and export focused regions have a significantly different outlook

The ongoing challenge of farmgate milk prices has a particularly marked impact on farmer outlook in those regions which are focused on meeting domestic milk demand. Survey data shows farmers in these regions are significantly less likely than farmers in export focused regions to have a positive outlook on the future of the industry. Sentiment in these regions has been declining since 2009 as prices drifted downwards from peaks reached in the previous year.

In contrast, the outlook tends to be more volatile in export-focused regions due to fluctuations in dairy commodity prices. Comparisons between survey data from respondents in the SDP region, for example, to farmer's responses from Victoria or Tasmania, highlight the following differences in outlook:

- > Milk price is consistently seen to be the greatest challenge for the future. While this is also the greatest perceived challenge for export focused regions, this concern has diminished significantly in these regions compared to 2013 results, as southern milk prices increased considerably.
- > Farmers in SDP have a far more pessimistic outlook in terms of profit projections for the current financial year.
- > SDP farmers are more likely to be unable to expand their businesses and are also more likely to be in a 'winding down' phase. At the other end of the spectrum, the proportion of farmers rebuilding their farms is higher in this region than any other region. This follows several years of difficult seasonal conditions due to floods, drought and slowly declining prices.
- > Looking ahead, SDP farmers are more likely to pass on the farm to a family member, but they are least likely to continue operating as a dairy farm. In general, they are also the least likely to encourage their families or employees to continue in the dairy industry.
- > In the current low profitability environment being experienced in SDP, farmers are also significantly less likely to recognise opportunities for the industry's future and, as a result, are far less likely to be planning any on-farm capital investment in the next 12 months. Their confidence to increase investment is significantly lower than that of farmers in other regions.

**Figure 23: Enterprise phase**



As a result of low positivity in the industry future, 38% of farmers in SDP are expecting to have smaller herds in the year ahead. However, this trend must be overlaid with the fact many SDP farmers are contracted to flat supply arrangements and not encouraged to grow milk production as are more seasonally based southern dairy producers.

The production profile in SDP also differs considerably to their export focused counterparts. Survey data shows 92% of farmers anticipating production to be less than 2 million litres in 2013/14 and only 1% producing in excess of 4 million litres. The more export-focused regions on the other hand show around 70% of farms producing less than 2 million litres and up to 14% of farms producing more than 4 million litres. Enterprise phase details for all surveyed dairy regions are available in the NDFS regional snapshots.

#### 4. Farmers are optimistic about herd size and production in the year ahead

The improvement in farmer sentiment in the last 12 months is translating into positive predictions in herd size and production volumes for the current year and the year ahead for most regions.

Nationally, 46% of farmers surveyed report increasing their herd size in 2013/14. In Tasmania, and Murray Dairy regions, herds have increased significantly above the national average while in Dairy NSW and SDP; herds are significantly more likely to have remained constant this year.

Overall, survey data suggests a net increase of 5 to 6% in the national herd in 2013/14 with a further 1.8% net increase anticipated in the following year. Note that herd growth figures represent intention and may not represent actual cow numbers, so the real increase in the national herd is expected to be considerably lower than 6%.

In terms of production, the surveyed increase in herd size translates into 54% of farmers anticipating an increase in production this financial year with 27% expecting an increase of more than 10% compared to last year. The overall rate of change predicted is 6 to 7% varying from a low of 0.4% in SDP to a high of 9.2% in Tasmania and 9.9% in Gippsland. Survey data suggests increased production is linked to not only herd size gains but also improved seasonal conditions.

**Figure 24: Net herd size vs. production growth estimates by region 2013/14**



#### Profitability comparison – NDFS and ABARES

When asked if they expected to make a profit in 2013/14, four out of five farmers (79%) surveyed in this year's NDFS replied 'yes'. The range across states was from a low of 36% in QLD; to highs of 84% in TAS and 85% in VIC.

When asked to compare the current season profitability with the average of the past five years, three out of five farmers (58%) expected higher profits in 2013/14, and one in five (20%) expected lower profits.

ABARES Farm Survey estimates for 2013/14 indicate average farm cash incomes are expected to increase significantly from \$44,200 last year to \$129,000. This figure would be nearly 30% above the 10-year average to 2012/13.

Stronger farmgate milk prices for the export-focussed southern regions of the country have produced higher financial performance in all these regions.

Around 17% of farms are predicted to have negative farm cash incomes in 2013/14, down significantly from 33% last year. The proportion of farms with negative cash incomes varied from a low of 10% in WA to a high of 33% in QLD.

**Figure 25** shows a significant degree of consistency across NDFS expectations and ABARES forecasts across the majority of dairy regions.

**Figure 25: NDFS compared to ABARES – expectations around profitability**



\*NDFS - Expect to make operating profit

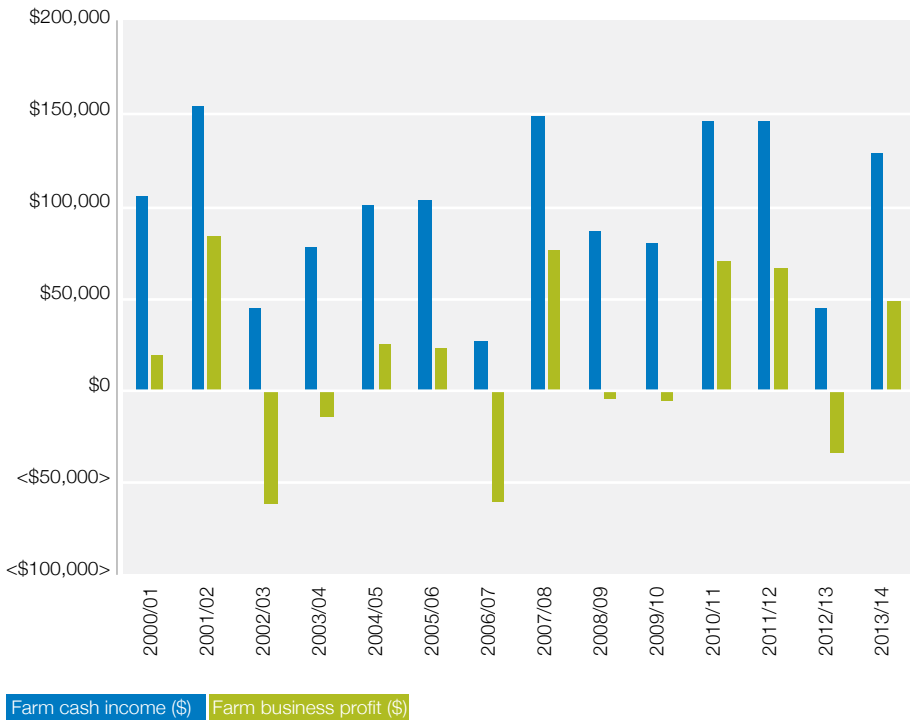
\*\* ABARES - Farms with positive farm cash income

ABARES Farm Survey estimates for 2013/14 indicate average farm business profits are also expected to increase significantly from an average loss of \$33,500 last year to a \$48,000 profit this year.

Around 39% of farms are predicted to have negative farm business profits in 2013/14, down significantly from 68% last year. The proportion of farms with negative farm business profits varied from a low of 23% in SA to a high of 59% in NSW.

Figure 26 places the last two seasons into a longer term perspective over the last decade.

Figure 26: ABARES farm performance (\$ average per farm)





## Regional results at a glance

**Figure 27:** Regional results at a glance

According to data from the National Dairy Farmer Survey 2014 and Dairy Australia's regional milk production data...

### Western Dairy

positive about industry future	made operating profit 2012/13	anticipating operating profit 2013/14	made capital investment 2012/13	planning capital investment next 12 months
60%	75%	73%	55%	45%
forecast net change in herd 2013/14*	forecast net change in prodn 2013/14*	milk production 2013/14 (M. litres)**	share of national prodn**	
+3.7%	+3.2%	329	4%	

### Dairy South Australia

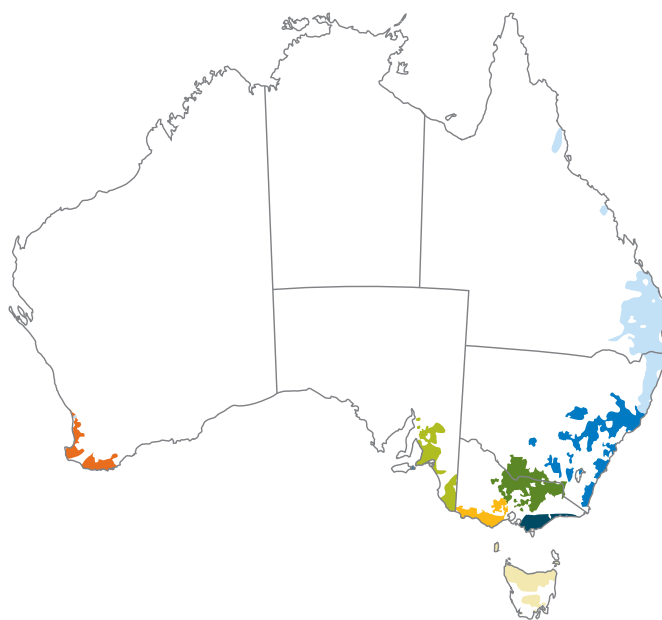
positive about industry future	made operating profit 2012/13	anticipating operating profit 2013/14	made capital investment 2012/13	planning capital investment next 12 months
77%	50%	82%	38%	40%
forecast net change in herd 2013/14*	forecast net change in prodn 2013/14*	milk production 2013/14 (M. litres)**	share of national prodn**	
+8.7%	+6.6%	514	6%	

### Western Victoria Dairy

positive about industry future	made operating profit 2012/13	anticipating operating profit 2013/14	made capital investment 2012/13	planning capital investment next 12 months
77%	46%	84%	38%	51%
forecast net change in herd 2013/14*	forecast net change in prodn 2013/14*	milk production 2013/14 (M. litres)**	share of national prodn**	
+4.6%	+5.9%	2,087	23%	

### Murray Dairy

positive about industry future	made operating profit 2012/13	anticipating operating profit 2013/14	made capital investment 2012/13	planning capital investment next 12 months
83%	69%	87%	58%	59%
forecast net change in herd 2013/14*	forecast net change in prodn 2013/14*	milk production 2013/14 (M. litres)**	share of national prodn**	
+8.2%	+7.5%	2,266	25%	



### Dairy Tasmania

positive about industry future	made operating profit 2012/13	anticipating operating profit 2013/14	made capital investment 2012/13	planning capital investment next 12 months
91%	68%	84%	55%	45%
forecast net change in herd 2013/14*	forecast net change in prodn 2013/14*	milk production 2013/14 (M. litres)**	share of national prodn**	
+5.1%	+9.2%	791	9%	

### Sub Tropical Dairy

positive about industry future	made operating profit 2012/13	anticipating operating profit 2013/14	made capital investment 2012/13	planning capital investment next 12 months
33%	55%	42%	36%	28%
forecast net change in herd 2013/14*	forecast net change in prodn 2013/14*	milk production 2013/14 (M. litres)**	share of national prodn**	
+1.9%	+0.4%	546	6%	

### Dairy New South Wales

positive about industry future	made operating profit 2012/13	anticipating operating profit 2013/14	made capital investment 2012/13	planning capital investment next 12 months
78%	55%	64%	44%	45%
forecast net change in herd 2013/14*	forecast net change in prodn 2013/14*	milk production 2013/14 (M. litres)**	share of national prodn**	
+2.5%	+4.1%	695	8%	

### Gippsland Dairy

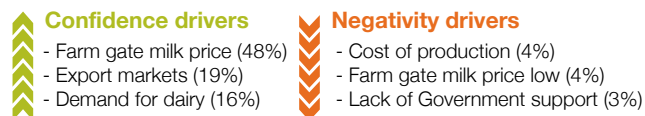
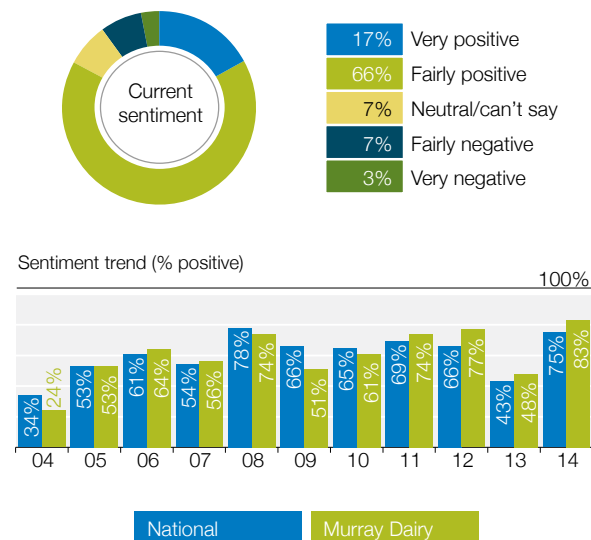
positive about industry future	made operating profit 2012/13	anticipating operating profit 2013/14	made capital investment 2012/13	planning capital investment next 12 months
78%	54%	84%	53%	58%
forecast net change in herd 2013/14*	forecast net change in prodn 2013/14*	milk production 2013/14 (M. litres)**	share of national prodn**	
+5.6%	+9.9%	1,922	21%	

\* net changes for 2013/14 based on NDFS survey data

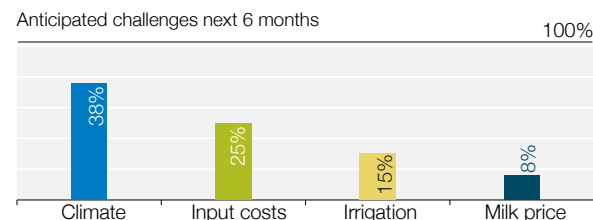
\*\* based on estimates for 2013/14 from Dairy Australia's regional milk production data

# Murray Dairy NDFS snapshot

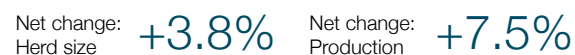
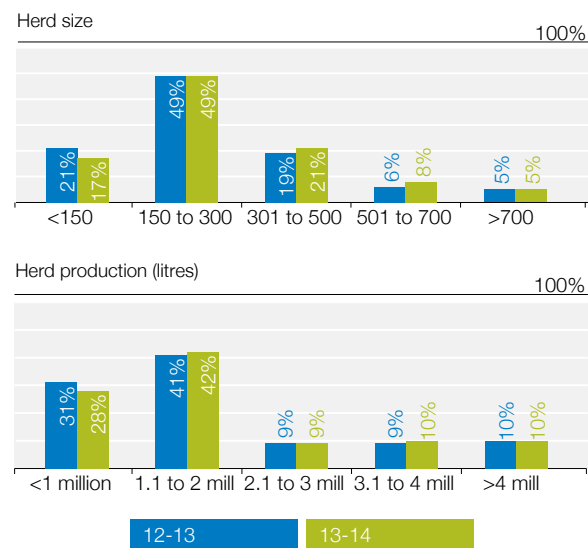
## Sentiment



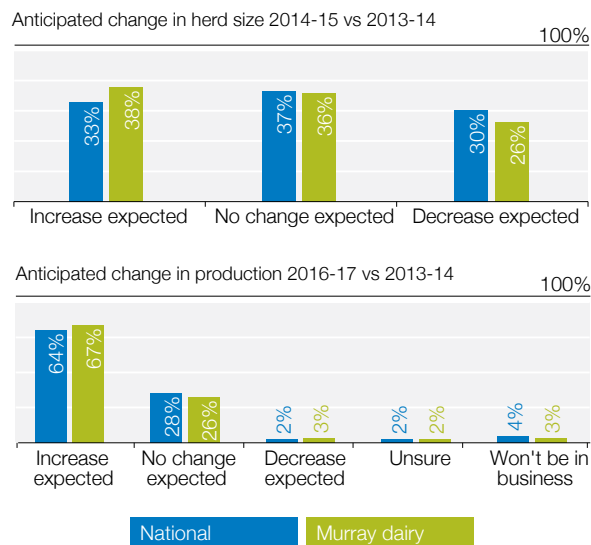
## Profitability and Investment



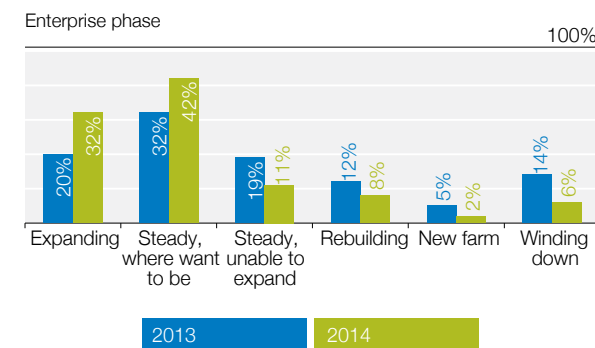
## Current herd size and production



## Forecast herd size and production



## Regional profile



The 'average' Murray Dairy farmer:

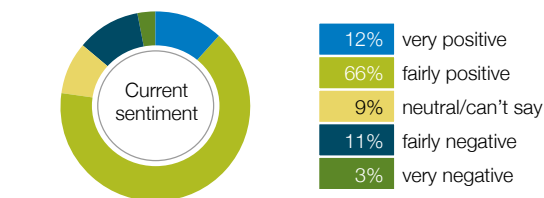
Age:	53 years
Works on family owned farm:	94%
Irrigates:	95%
Feeds moderate to high feed in bail:	58%
Has split/batch calving system:	57%
Is likely to encourage family or employees to remain in dairy industry:	71%

## Summary

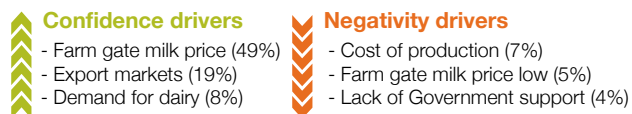
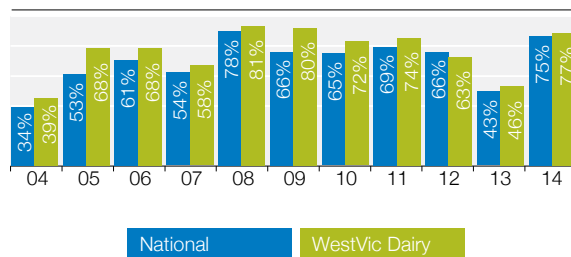
- Recent farm gate milk price rises and resultant improvement in profitability have substantially lifted confidence in the region to the highest level recorded since 2004.
- Price is still considered to be one of the greatest challenges likely to be faced, but more farmers now believe irrigation and input costs will be greater challenges.
- There is widespread expectation that Asian markets will continue to offer opportunities for Australian dairy products.
- Murray Dairy farms are more likely than any other region to be in expansion phase.

## WestVic Dairy NDFS snapshot

### Sentiment



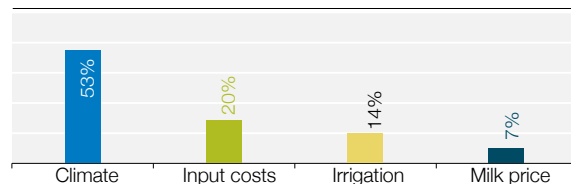
Sentiment trend (% positive)



### Profitability and Investment

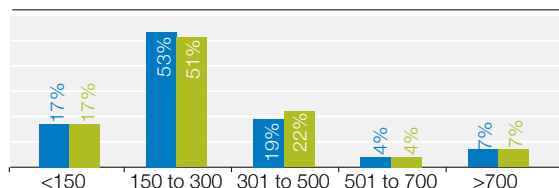


Anticipated challenges next 6 months

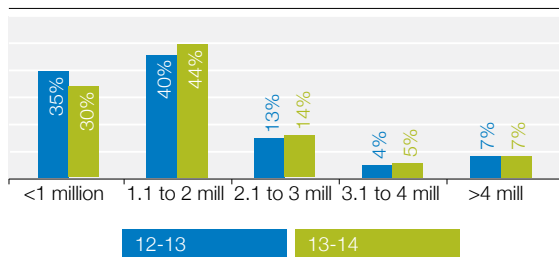


### Current herd size and production

Herd size

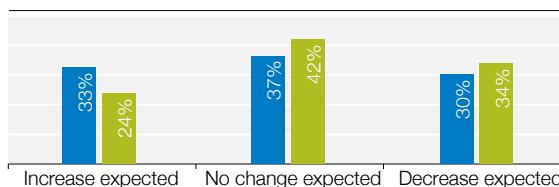


Herd production (litres)

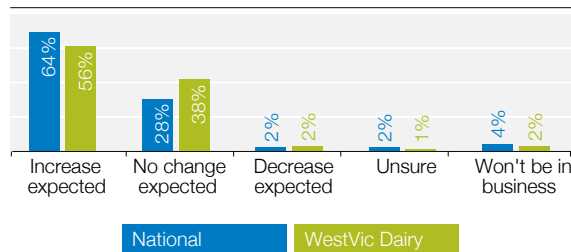


### Forecast herd size and production

Anticipated change in herd size 2014-15 vs 2013-14

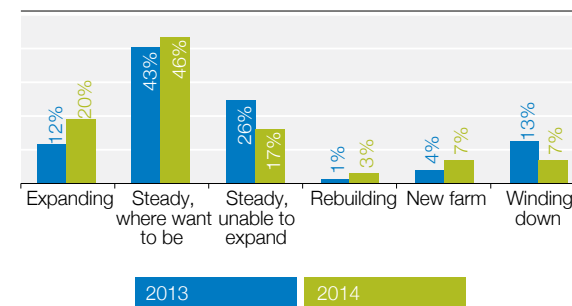


Anticipated change in production 2016-17 vs 2013-14



### Regional profile

Enterprise phase



The 'average' WestVic Dairy farmer:

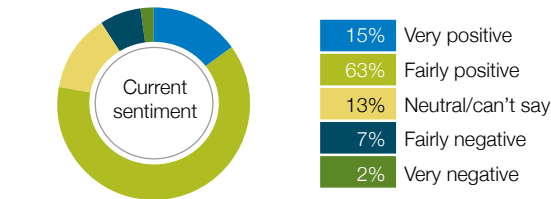
Age:	51 years
Works on family owned farm:	87%
Irrigates:	22%
Feeds moderate to high feed in bail:	58%
Has a seasonal calving system:	64%
Is likely to encourage family or employees to remain in dairy industry:	58%

### Summary

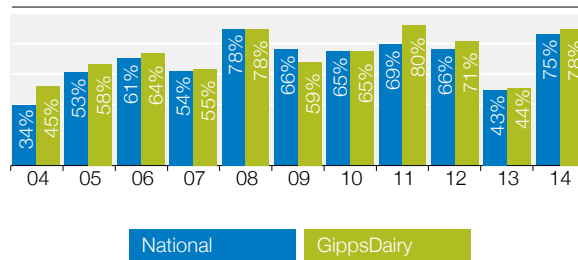
- Recent farm gate milk price rises and subsequent improvements in profitability have resulted in a significant rise in confidence which has almost achieved the 'highs' of 2008 and 2009.
- Price and input costs are still considered to be the greatest challenges likely to be faced, but there is increasing concern over climate factors.
- The proportion of WestVic farms in an expansion phase has increased significantly over the past year.

## GippsDairy NDFS snapshot

### Sentiment



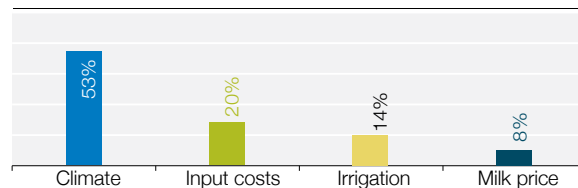
Sentiment trend (% positive)



### Profitability and Investment

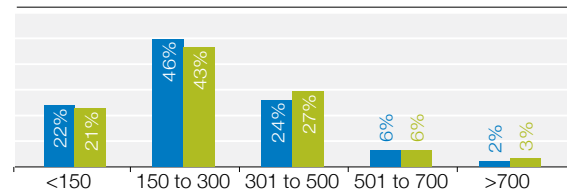


Anticipated challenges next 6 months

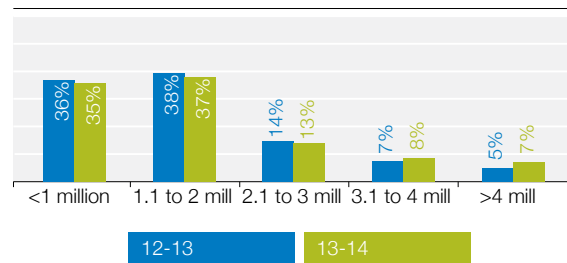


### Current herd size and production

Herd size

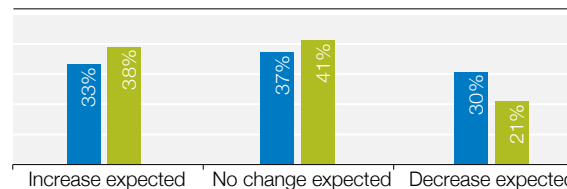


Herd production (litres)

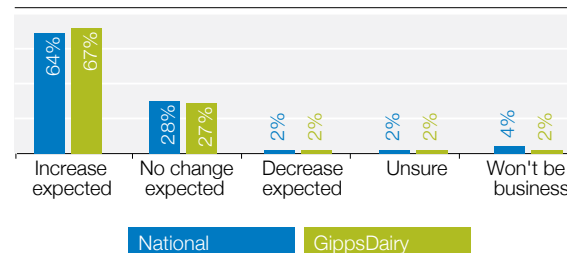


### Forecast herd size and production

Anticipated change in herd size 2014-15 vs 2013-14

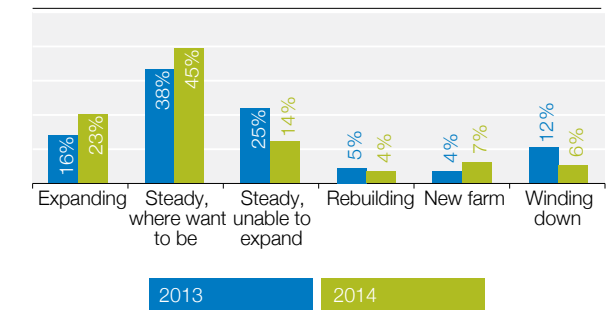


Anticipated change in production 2016-17 vs 2013-14



### Regional profile

Enterprise phase



The 'average' GippsDairy farmer:

Age:	51 years
Works on family owned farm:	88%
Irrigates:	29%
Feeds moderate to high feed in bail:	58%
Has a seasonal calving system:	48%
Has split/batch calving system:	43%
Is likely to encourage family or employees to remain in dairy industry:	63%

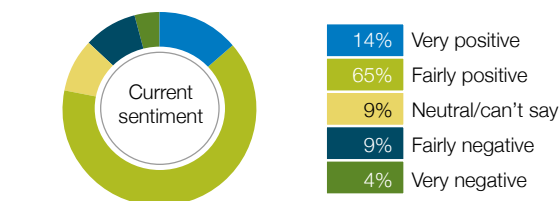
### Summary

- Higher farm gate milk prices and improved profitability have resulted in confidence returning to Gippsland.
- Price and input costs are still considered to be the greatest challenges likely to be faced, but there is increasing concern over climate factors.
- Significantly fewer farms in the region are in a position where they are unable to expand, with slightly more farms now in an expansion phase.

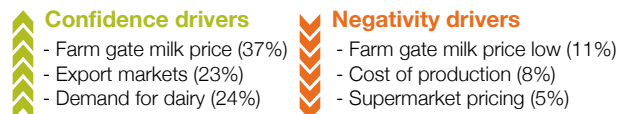
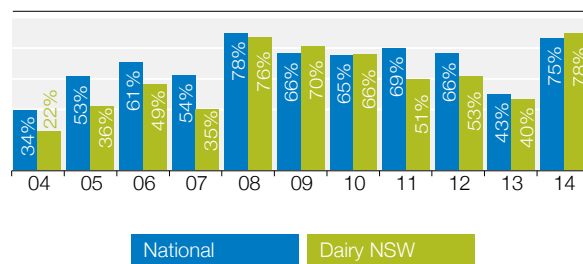


# Dairy NSW NDFS snapshot

## Sentiment



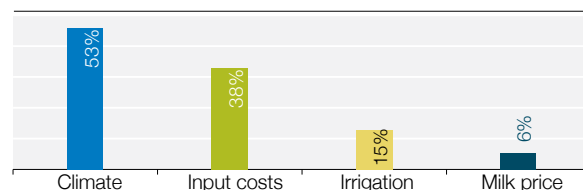
Sentiment trend (% positive)



## Profitability and Investment

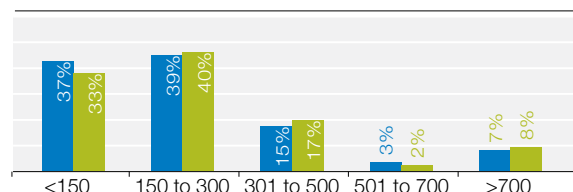


Anticipated challenges next 6 months

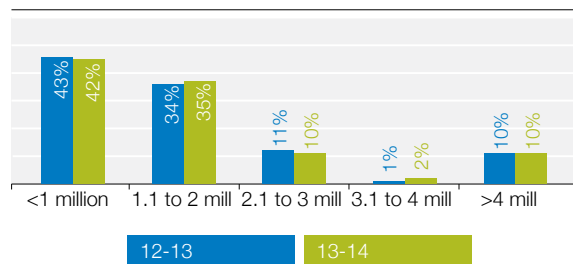


## Current herd size and production

Herd size

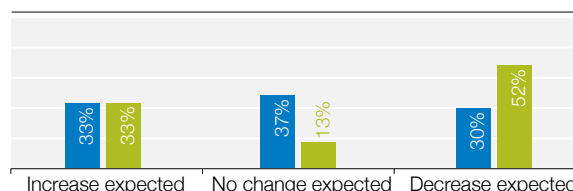


Herd production (litres)

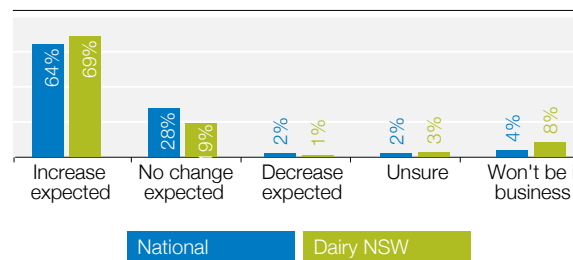


## Forecast herd size and production

Anticipated change in herd size 2014-15 vs 2013-14

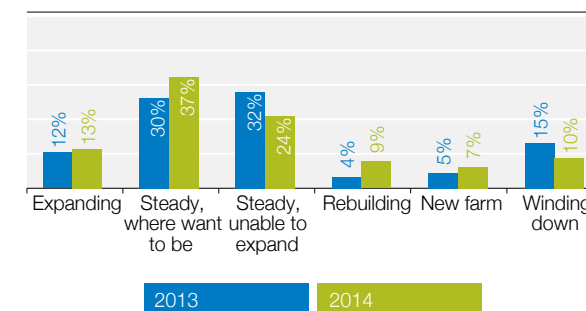


Anticipated change in production 2016-17 vs 2013-14



## Regional profile

Enterprise phase



The 'average' Dairy NSW farmer:

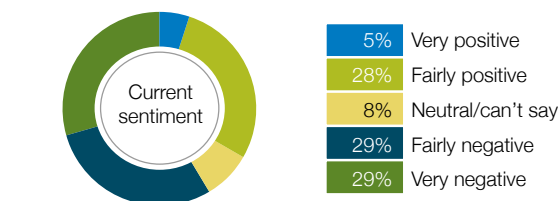
Age:	56 years
Works on family owned farm:	91%
Irrigates:	57%
Feeds moderate to high feed in bail:	65%
Has a year round calving system:	85%
Is likely to encourage family or employees to remain in dairy industry:	67%

## Summary

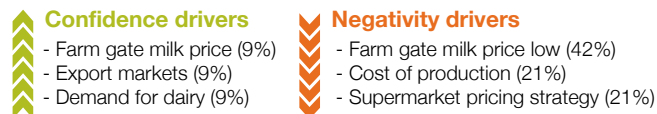
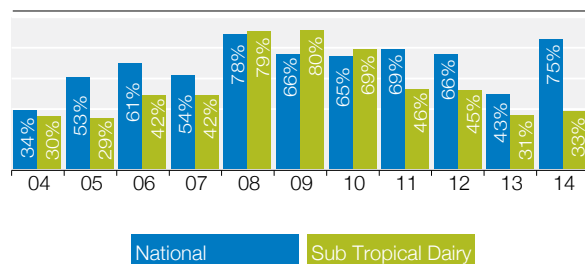
- Recent farm gate milk price rises and export opportunities have seen confidence increase significantly and achieve the highest level recorded since 2004. This is despite profitability levels still remaining arguably low in comparison with other regions.
- Price and input costs are still considered to be the greatest challenges likely to be faced in future.
- There is widespread expectation that Asian markets will continue to offer opportunities for Australian dairy products and Dairy NSW respondents are the most likely to see potential in domestic markets.

# Sub Tropical Dairy (SDP) NDFS snapshot

## Sentiment



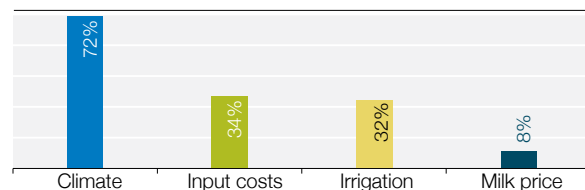
Sentiment trend (% positive)



## Profitability and Investment

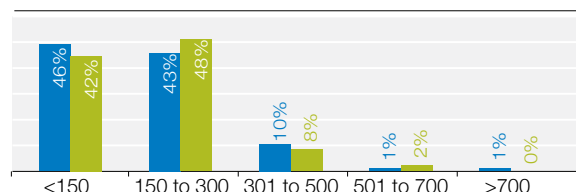


Anticipated challenges next 6 months

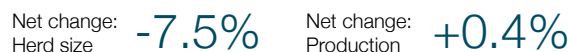
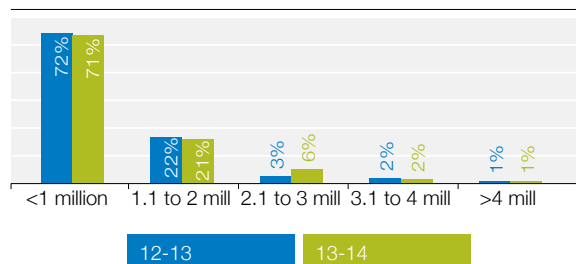


## Current herd size and production

Herd size

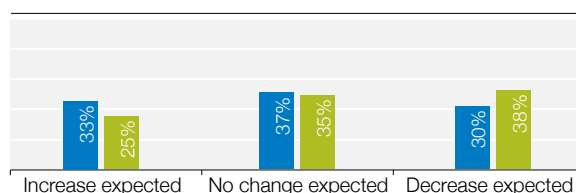


Herd production (litres)

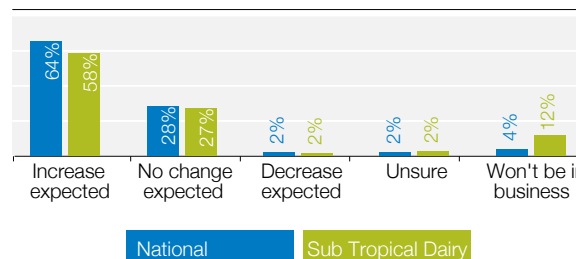


## Forecast herd size and production

Anticipated change in herd size 2014-15 vs 2013-14

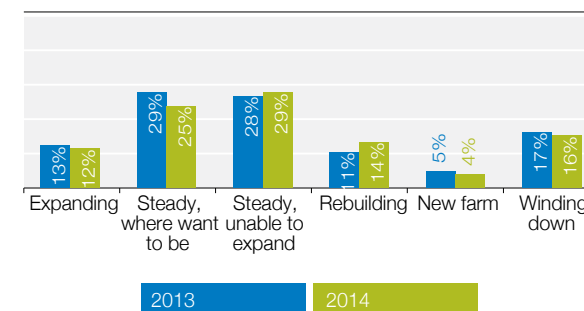


Anticipated change in production 2016-17 vs 2013-14



## Regional profile

Enterprise phase



The 'average' Sub Tropical Dairy farmer:

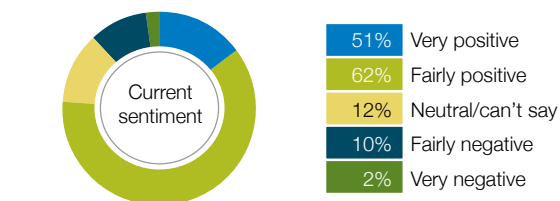
Age:	55 years
Works on family owned farm:	96%
Irrigates:	64%
Feeds moderate to high feed in bail:	57%
Has a year round calving system:	88%
Is likely to encourage family or employees to remain in dairy industry:	42%

## Summary

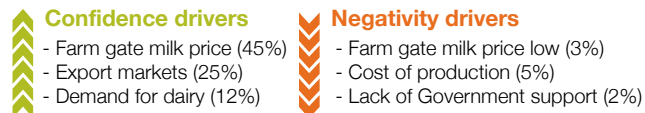
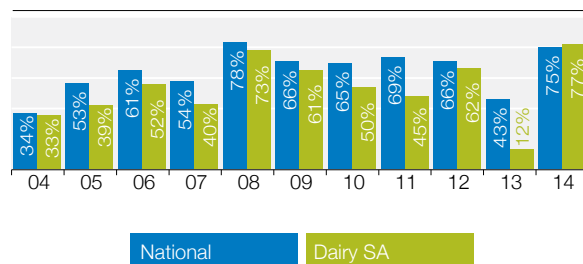
- Confidence in SDP remains at a very low level due to the farm gate milk price and belief there is unlikely to be any substantial increases in future.
- The flow-on effect of supermarket pricing strategies and input costs are also important drivers of negativity in the region.
- There are persistent challenges to morale in SDP at present due to current low profitability, resulting in the region's herd likely to decrease in numbers and 12% of dairies expecting to leave the industry within 3 years.
- SDP farmers are the least likely to be encouraging family and employees to remain in the industry and very few believe the community and government think the industry is vital to the economy.

## Dairy SA NDFS snapshot

### Sentiment



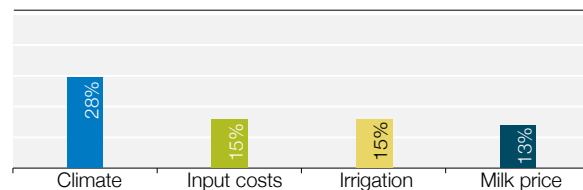
Sentiment trend (% positive)



### Profitability and Investment

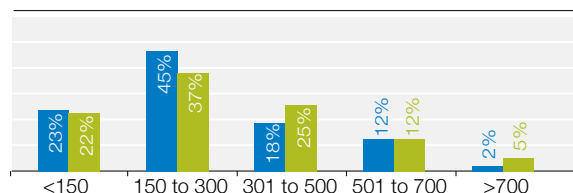


Anticipated challenges next 6 months

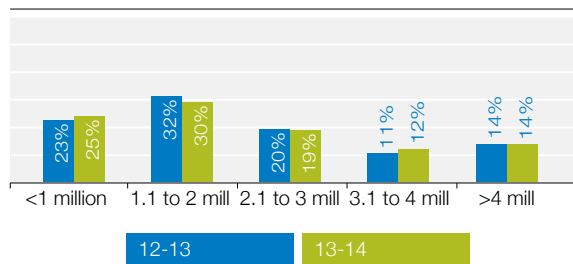


### Current herd size and production

Herd size

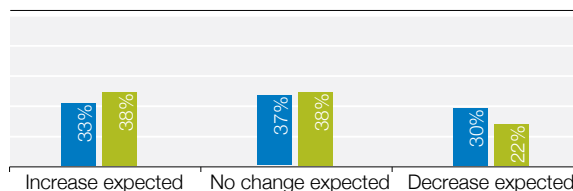


Herd production (litres)

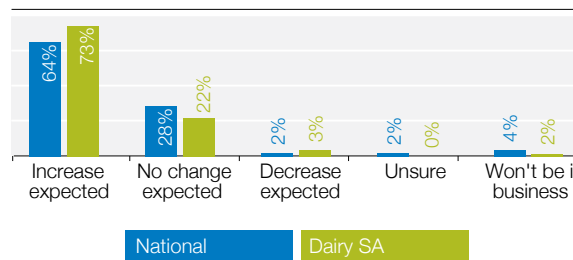


### Forecast herd size and production

Anticipated change in herd size 2014-15 vs 2013-14

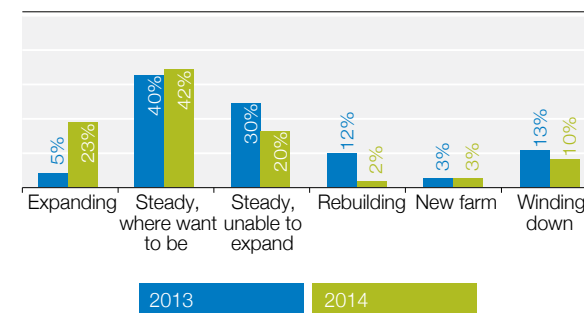


Anticipated change in production 2016-17 vs 2013-14



### Regional profile

Enterprise phase



The 'average' Dairy SA farmer:

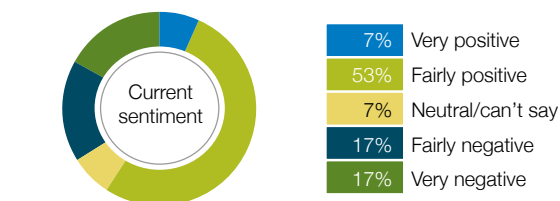
Age:	54 years
Works on family owned farm:	88%
Irrigates:	58%
Feeds moderate to high feed in bail:	73%
Has a split/batch calving system:	38%
Has a year round calving system:	38%
Is likely to encourage family or employees to remain in dairy industry:	65%

### Summary

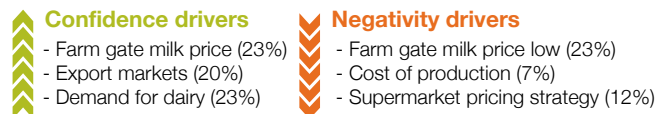
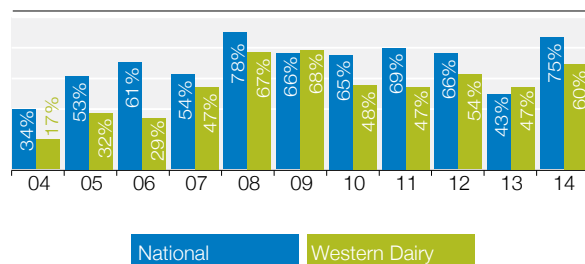
- Recent farm gate milk prices and improved profitability have substantially lifted confidence in the region to the highest level recorded since 2004.
- There is widespread expectation that Asian markets will continue to offer opportunities for Australian dairy products.
- Price and input costs remain the greatest concerns for the future.
- In the past 12 months the proportion of Dairy SA farms in an expansion phase has increased significantly, returning to 2012 levels.

## Western Dairy NDFS snapshot

### Sentiment



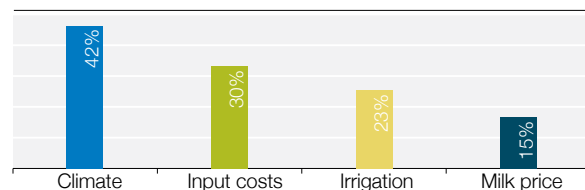
Sentiment trend (% positive)



### Profitability and Investment

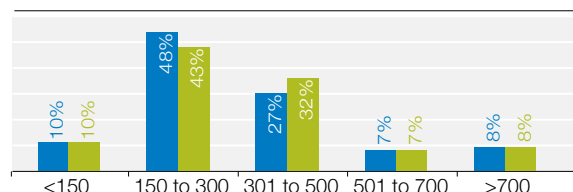


Anticipated challenges next 6 months

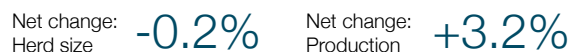
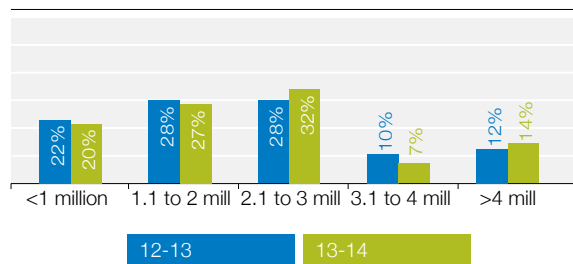


### Current herd size and production

Herd size

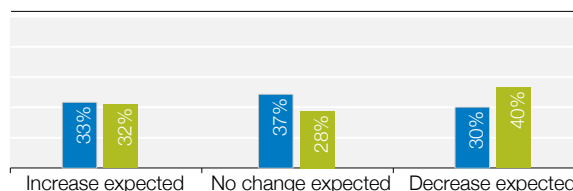


Herd production (litres)

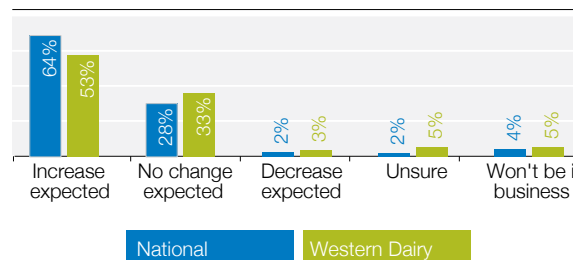


### Forecast herd size and production

Anticipated change in herd size 2014-15 vs 2013-14

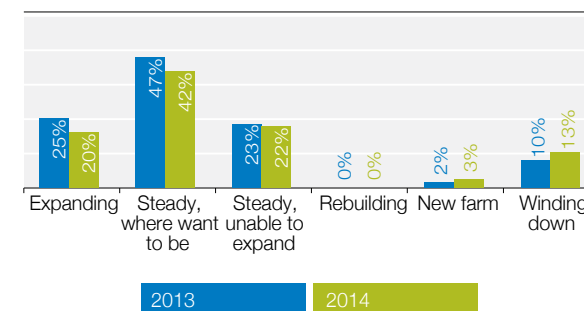


Anticipated change in production 2016-17 vs 2013-14



### Regional profile

Enterprise phase



The 'average' Western Dairy farmer:

Age:	51 years
Works on family owned farm:	98%
Irrigates:	48%
Feeds moderate to high feed in bail:	65%
Has a year round calving system:	50%
Is likely to encourage family or employees to remain in dairy industry:	50%

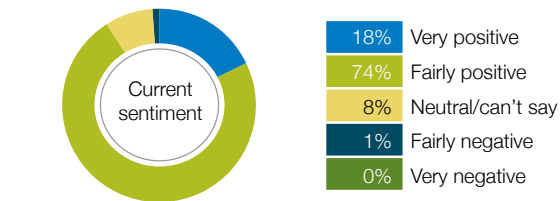
### Summary

- While confidence has risen slightly in WA due to ongoing demand for dairy and increasing export opportunities, it remains significantly lower than the national average.
- Profitability levels have remained relatively consistent (around three quarters making an operating profit at a level typically on par or only slightly different to the average of the past 5 years), but farm gate milk price and input costs continue to be perceived as the greatest future challenges.
- On-farm investment is expected to be slightly less widespread over the coming year than the past year.
- The Western milking herd and production has increased slightly over the past year, but milker numbers are likely to remain relatively unchanged in the next 12 months.

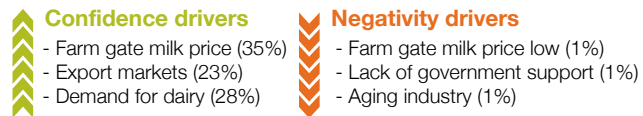
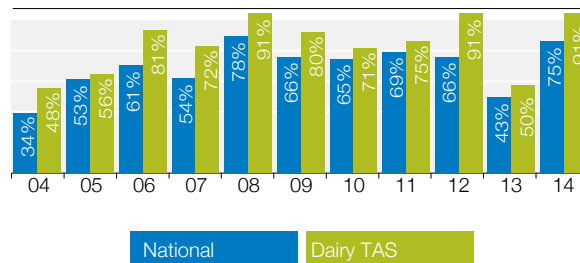


## Dairy TAS NDFS snapshot

### Sentiment



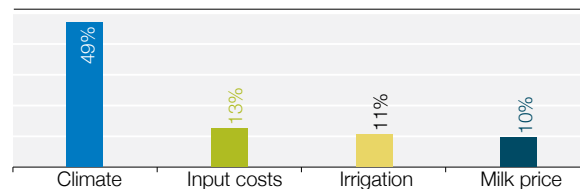
Sentiment trend (% positive)



### Profitability and Investment

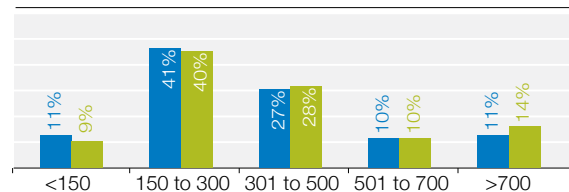


Anticipated challenges next 6 months

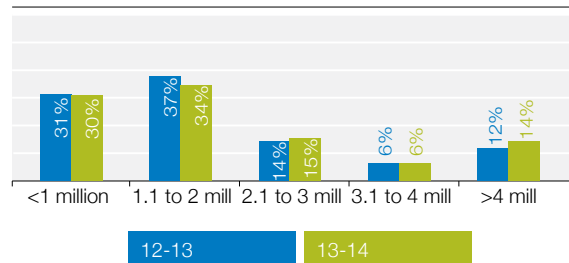


### Current herd size and production

Herd size

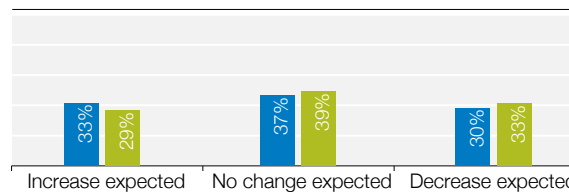


Herd production (litres)

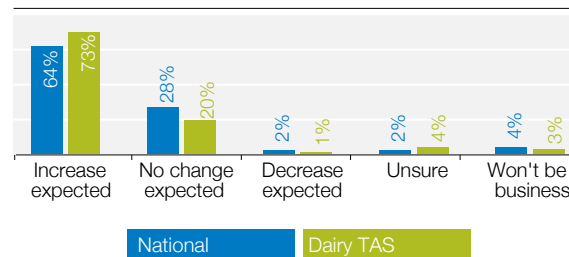


### Forecast herd size and production

Anticipated change in herd size 2014-15 vs 2013-14

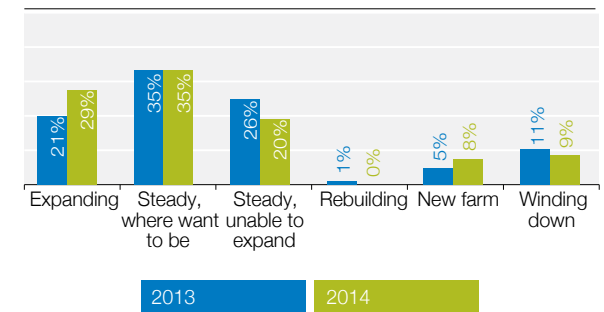


Anticipated change in production 2016-17 vs 2013-14



### Regional profile

Enterprise phase



The 'average' Dairy TAS farmer:

Age:	51 years
Works on family owned farm:	88%
Irrigates:	89%
Feeds moderate to high feed in bail:	45%
Feeds a low amount of feed in bail:	38%
Has seasonal calving system:	64%
Is likely to encourage family or employees to remain in dairy industry:	80%

### Summary

- Confidence has returned in Tasmania on the back of increased farm gate milk prices and export opportunities and is again significantly higher than the national average.
- While milk price and input costs continue to be acknowledged as potential future threats, labour is a growing issue in Tasmania.
- Tasmanian farms are some of the most likely to be in an expansion phase, but poor availability of reasonably priced land is an issue.
- Over the past year, there has been growth in both the Tasmanian herd and production levels, but there is no further growth in herd size predicted.

# Appendix

## Export Region Weighted Cost and Income Indices

### Overview

Dairy farming systems are becoming increasingly complex, and profitability is influenced by a combination of input and output markets. This means that making informed decisions in volatile trading conditions is more difficult than ever. The Export Region Weighted Cost and Income Indices allow a high-level evaluation of key measures under varying market conditions.

### Interpretation

The aim of the indices is to simplify analysis of the macro drivers of farm profitability by considering simultaneously the near-term outlook for milk and input markets. The indices provide generalised sector-level analysis to highlight the potential impact of market movements, framing the broader context in which farmers can apply their own seasonal experience.

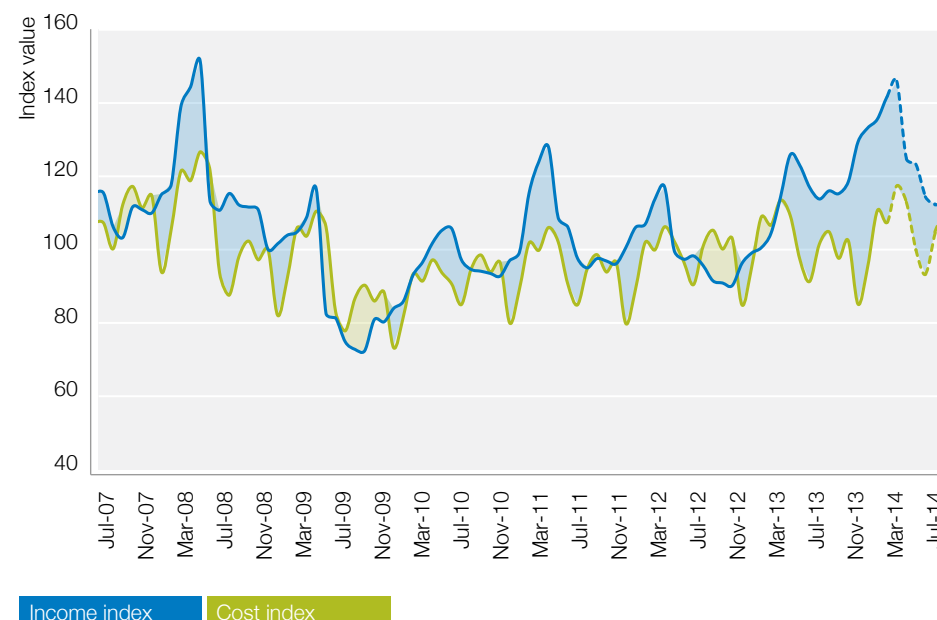
Cost lines for the 'past' component of the analysis are derived from Dairy Industry Farm Monitor Program (DIFMP) results. Please note that reported averages for Victoria were used, and these do not represent any one farm. Over time the wider DairyBase dataset will be incorporated, improving the ability to apply the indices outside southern export dairy regions. Costs are seasonally weighted to reflect the typical expenditure patterns of pasture-based dairying enterprises in south eastern Australia. Income values are derived from milk pricing information published by the major processors.

For the forward-looking component of the analysis, modelling using available market indicators (such as ASX grain futures) was undertaken for cost items that were significant, highly liquid, and for which forward indications are available. Other items were projected at their most recent season levels, given that (although these costs are important to manage) unit prices change on a less frequent and volatile basis.

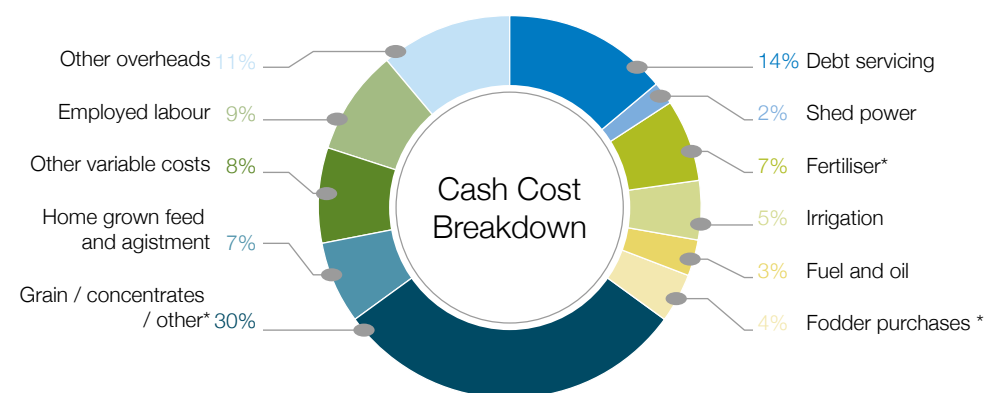
Commodity returns (from GDT) are translated into an income index and seasonally adjusted using representative milk payment schemes to better reflect incomes through the year.

**Figure A1** provides the historical back-series and 'base case' future component for the calculated indices. The two lines on the chart plot the income (black) index and cost (red) index respectively. The size of gap between these lines indicates the relative magnitude of the (positive or negative) cash margin. **Figure A2** illustrates the relative significance of each cost item used in the analysis.

**Figure A1:** Historical and projected margin



**Figure A2:** Cash Cost Breakdown



\*index projections derived from market indicators

## Scenario Analysis

The most useful aspect of the indices is that any combination of market indicators can be used to generate future scenarios for evaluation.

Two hypothetical scenarios have been developed for the next six months, to demonstrate the wide range of margin outcomes possible from one season to the next. These adopt data sets from prior years that preserve the interrelationships between grain, hay and fertiliser markets. Data points were selected to represent 6-year (post-commodity price boom) highs and lows. Monthly milk volumes are plotted on the right axis to demonstrate the seasonal relationship between production and cash margins.

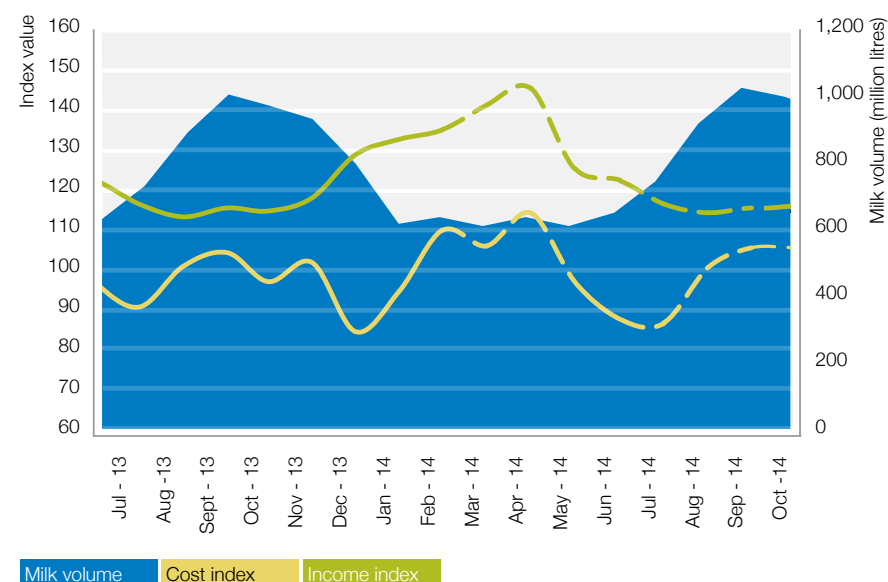
These scenarios used combinations of historical milk and cost price data as follows:

'Margin Expansion' scenario	'Margin Squeeze' scenario
<ul style="list-style-type: none"> <li>&gt; Input prices (feed and fertiliser) from 2009/10;</li> <li>&gt; Milk prices from the current year (2013/14).</li> <li>&gt; This scenario combines the lowest set of input prices, with the highest milk prices, from the 2008 'soft commodity boom' period.</li> </ul>	<ul style="list-style-type: none"> <li>&gt; Input prices (feed and fertiliser) from 2008/09;</li> <li>&gt; Milk prices from the 2012/13 season.</li> <li>&gt; This scenario combines the highest set of input prices, with the lowest milk prices, from the post-global food crisis period.</li> </ul>

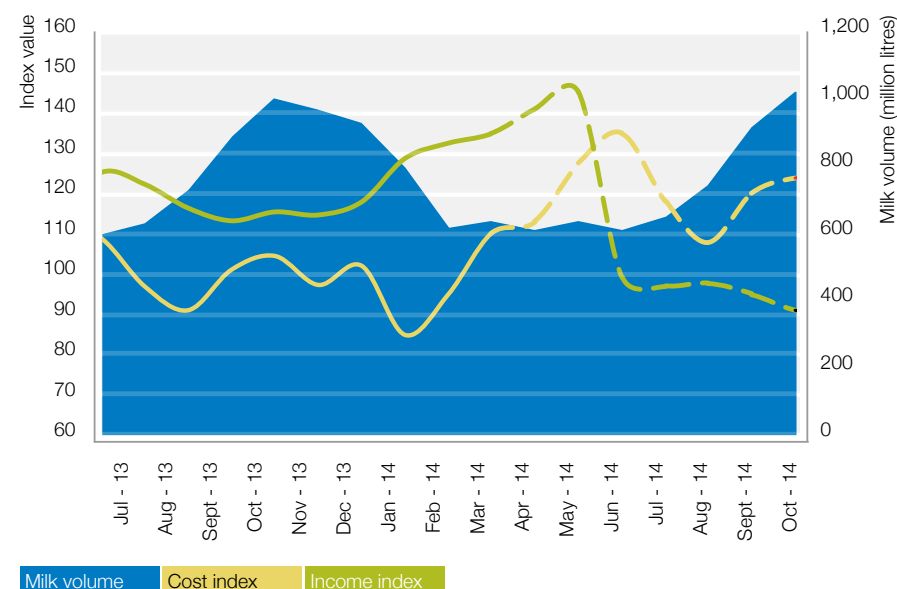
The cumulative effect of moves in the underlying prices for the indices can create significant convergence or divergence in costs and income. In turn, this highlights how external factors contribute to specific outcomes on individual farms, and the importance of a multi-season approach to business and sector-level planning to maximise resilience.

Looking ahead, the market impacts associated with emerging challenges (such as the potential development of an El Niño event) can be incorporated to produce targeted sensitivity analyses.

**Figure A3:** Historical and projected 'Margin Expansion' scenario

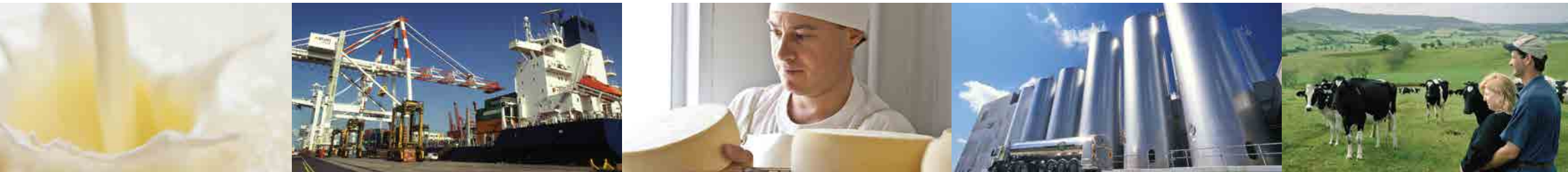


**Figure A4:** Historical and projected 'Margin Squeeze' scenario



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