
Australia Dairy Farmers

"How can you govern a country which has 246 varieties of cheese?"

----- Charles de Gaulle

"Land of the Rainbow Gold, For flood and fire and famine, She pays us back three-fold."

----- "My Country" -Dorothea Mackellar

The Great Ocean Road is probably one of the most beautiful coastal drives in the world. Curving around the edge of the great Pacific Ocean, on one side you can see layers of white waves gently padding the limestone cliffs, on the other side you have a view of beautiful picturesque green, green English dairy farms, decorated with herds of black & white spotted dairy cows chewing under the lazy sun. You feel this country is well blessed; the famers make our country so nice.



In fact, around the Great Ocean Road, the farmland that is called the golden triangle, blessed with bountiful rainfall and sunshine, producing most of our country's dairy supply and the famers had been doing pretty well until lately.

Now many of those hard working farmers are facing a lifetime crisis, mainly affected by external global market forces, but also by their misreading of dairy commodity markets and financial management.

The forecast for the milk price they could get has proved to be well over optimistic. Dairy prices hit a 15 years low last year, and most of the farmers have been making a loss. Actually this is not just

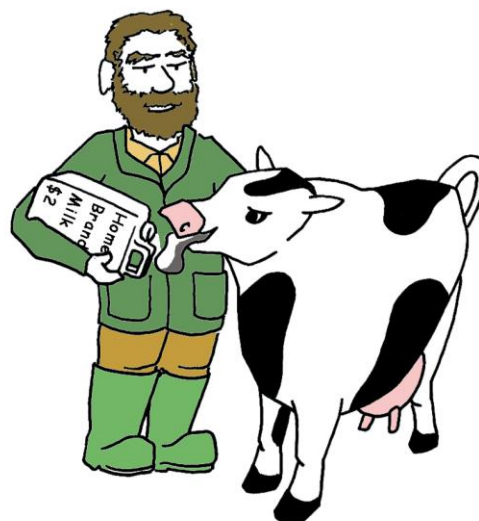
Australia, it is a global over supply problem. Even China's dairy industry is facing a crisis.

I asked our young analyst Felicity to do some research on the dairy industry and the listed dairy companies, and here is a conversation that took over our Block Arcade desk.

Talk around the Block Arcade Desk

Felicity: Aussie farmers have been impacted heavily by international markets, i.e. Europe, US and New Zealand. Supply outgrew demand. According to the Australian*¹, on average the cost of production in Australia is AU\$5.6 a kilogram, that is 42c a litre of milk, but Bega (BGA) is only offering farmers \$5.00 a kilo for the FY17 opening farmgate price, Warrnambool Cheese & Butter (WCB) \$4.80, Murray Goulburn (MGC) \$4.80 and Fonterra (FSF) \$4.75*².

Big Feet Charley: This is miserable. What are the fresh milk prices around the world?



Felicity: In table 1, you can see the Aussies are enjoying the cheapest (home brand) milk price in the world, and table 2 shows how milk price has changed over the years. It is estimated home brand accounts for about 63%*³ of total milk sale in the market.

Table 1: Home Brand Milk Price around the World

Country	Supermarket	Price per Litre (AUD)
Australia	Coles	\$ 1.00
UK	Tesco	\$ 1.29
US	Kroger	\$ 1.55
NZ	Countdown	\$ 1.50
HK*	Wellcome	\$ 3.68
Japan*	Daiei	\$ 2.05
Germany*	SPAR	\$ 1.35
China*	Carrefour	\$ 3.16
Brazil*	Pao de Acucar	\$ 1.95
Indonesia*	LOTTE Mart	\$ 2.79

Source: various supermarket websites in August 2016, based on 2L milk price, countries with * bases on 1L prices

Table 2: Average Price for Milk before Coles \$2 Milk Campaign

City	Average Price (c) for 2L Milk	Average Price (c) for 1L
Jun, 2011	278.875	137.74
Dec, 2010	360.625	179.54
Dec, 2009	356.250	178.64
Dec, 2008	373.250	187.39
Dec, 2007	350.875	174.37
Dec, 2006	320.625	160.23

Source: Australian Bureau of Statistics

Big Feet Charley: the Coles** \$2 (for two litres) milk marketing campaign has been too successful and that was followed by Woolworth and others, while this has been a good thing for marketing and provided a benefit to consumers, it may lose some of its effectiveness now, as farmers are impacted. I think the “caring concept” may play a more importance role. I don't think shoppers worry too much about paying another 10c or 20c for 2 litres of milk, even though they still buy the \$2 milk instead of farmers’ brands. I guess it is more habit than value. So maybe now is time for a rethink.

“You should look at not only your own interest, but also the interests of others”.

So what’s the solution for the farmers?

Felicity: it is estimated 25%*⁴ of the milk produced is made into drinking milk, and Australia consume about 2.5b litres of milk a year (the other 75% was made into dairy products and milk power etc.). If the Government charged 10c to 20c a litre levy for supermarket drinking milk sales (1.32billion litres pa) for one or two years, it could raise \$132million pa to \$264million pa, and the cash could be handed directly back to farmers according to their productions, it could help them to come out of the storm.

Big Feet Charley: it would be a good idea, as the big super markets signed deals with MGC and others at prices linked to the milk index price, it would be hard to amend those signed commercial contracts now. I wonder why the suppliers didn’t set a minimum price level, e.g. if it falls below the cost of production then they can reduce or stop supply. Levy payments by the Government or supermarket rebates may provide some relief for famers temporarily, at least giving them one or two years to adjust their production levels, change their product mix or shift to other farming products to sort out their financial affair. Of course in the long run, the global supply and demand is still the key driving force, you don’t want Governments around the world to continue to subsidise farmers and continue to create an oversupply. The listed companies that have good brand products tend to do better, and we hope they do well, to pay taxes and pay dividends to shareholders.

We want to keep an eye on those dairy companies, as they tend to be cynical, and I think they should not bank on a lower currency to save them in the long run, they need to start to manage such risks, the dollar is much lower than a couple of years ago already.

I feel like some nice cheese now, could you please prepare a cheese platter for our weekend drink?

Felicity: sounds great, I love (well aged) cheese!

Cheese,

Charley Wang

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Notes, Acknowledgements & Disclosure

^{*1} *The Australian*: “More dairy drama as Bega Cheese cuts milk prices” 22 June 2016

^{*2} *The Australian*: “Fonterra price cuts continue to sour, with milk collections plunging in June” 14 July 2016

^{*3} *Dairy Australia*: “Dairy Situation and Outlook” October 2015

^{*4} *Dairy Australia*: “Dairy at a Glance”

**** Disclosure: the writer or his controlled investment vehicle hold Wesfarmers Ltd shares, owner of Coles.**

*** Cartoon by Richard Li**

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