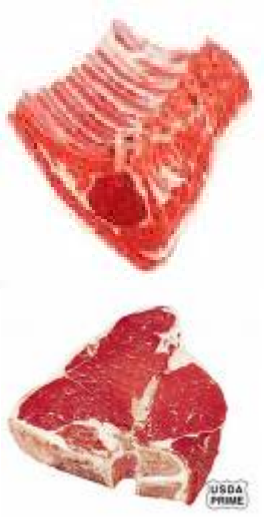
WESTERN AUSTRALIAN RED MEAT INDUSTRY

"Supply chain analysis for retail competitiveness"



Submission presented by the Pastoralists and Graziers Association of Western Australia and the Western Australian Farmers Federation on behalf of the livestock industry of Western Australia

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1.0 INTRODUCTION

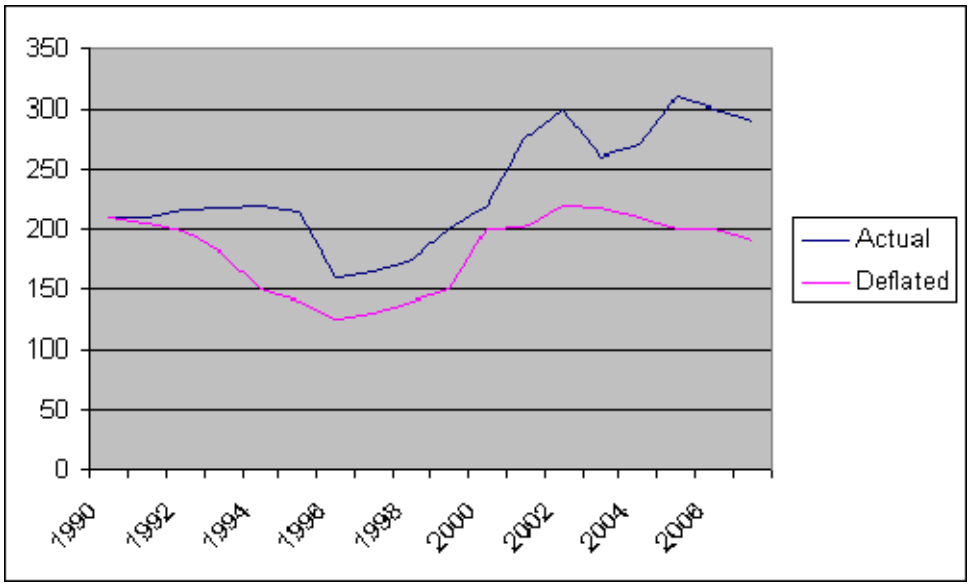
1.1 Background

In the last 12 months cattle and sheep prices in Australia have eased. This trend has been particularly pronounced in Western Australia in recent months, with prices per beast estimated to be $100/head down on the previous year. This has resulted in significant pressure on Western Australian livestock producers. This paper seeks to identify the major production contributing factors.

1.2 Livestock prices

Figure 1. $A c/kg carcase weight: Indexed prices deflated by Consumer Price Index (1990 dollars) based on average Australian livestock prices.

Source: ABARE, MLA's NLRS



The Australian livestock market is not a single homogenous market. Market segments (including quality and type of animal, feeding system, geography, and supply chain) may well be moving in different directions at any point in time. However, over the medium term, if there is sufficient mobility and substitutability, they are more likely to move in the same overall direction.

This means that many market forces are at work, which creates much uncertainty for a producer, who is forever endeavouring to lower his or her costs of production to increase returns on investment. Table 2 on page 12 shows these costs of production, as well as prices received (for beef) in 2007.

2.0 EXECUTIVE SUMMARY

The Western Australian livestock industry requires immediate and honest responses from all participants in the retail supply chain to uncover the causes of record-low farm gate prices for beef and lamb in comparison to record high retail prices.

Industry leaders predict that within twenty years, Western Australia will become a net importer of food, with the red meat industry a prime industry target for food imports.

A beef producers meeting was held in Bunbury on November 15, 2007. More than 400 producers attended to raise concerns and develop actions (via motions) for the Red Meat Action Group, or 'RMAG' (a volunteer group aimed at discovering the causes of price discrepancy between producers and major retailers). Funding was successfully sought from the "Stocktake" Program (part of the Advancing Australian Agriculture Program) to undertake a detailed analysis of the beef supply chain, but the Rudd Labor Government razor gang withdrew the funds.

These motions formed a basis for actions, such as the drafting of this report. This report will identify the high production costs that increase and are coupled against, the low returns to the producer and the record retail process for red meat in Western Australia.

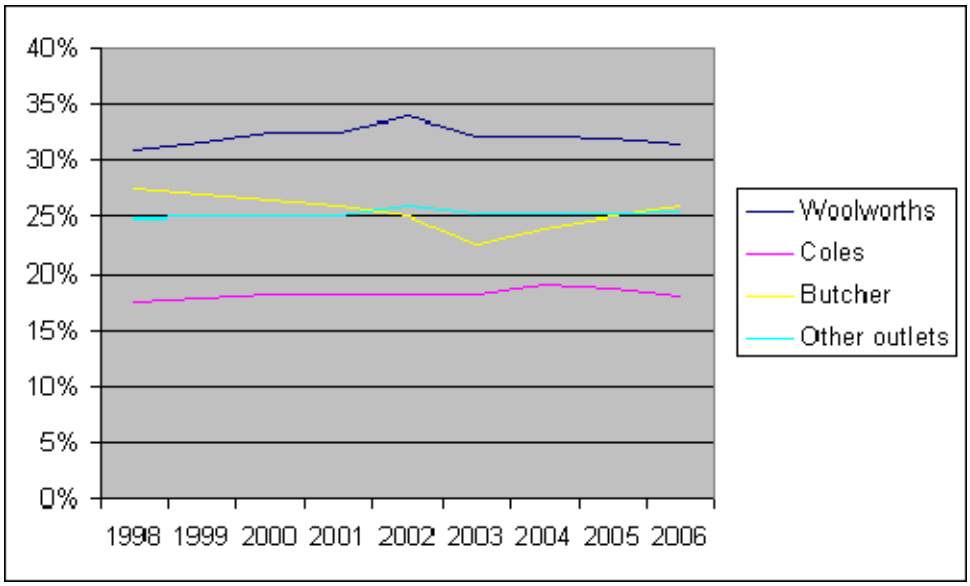
This submission, though brief and written within strict time constraints, would have had the same intended purpose as the findings from the "Stocktake" Program. In relation to the "*ACCC inquiry into the competitiveness of retail process for standard groceries"* Issues paper (11 February 2008), this report will cover points: 17, 18, 19, 20 and 21.

The Pastoralists and Graziers Association and Western Australian Farmers Federation jointly prepared this report not just for our respective membership bases, but also for all producers so that we may continue to feed all who enjoy red meat as an essential part of a healthy diet.

3.0 RETAIL STRUCTURE IN WESTERN AUSTRALIA

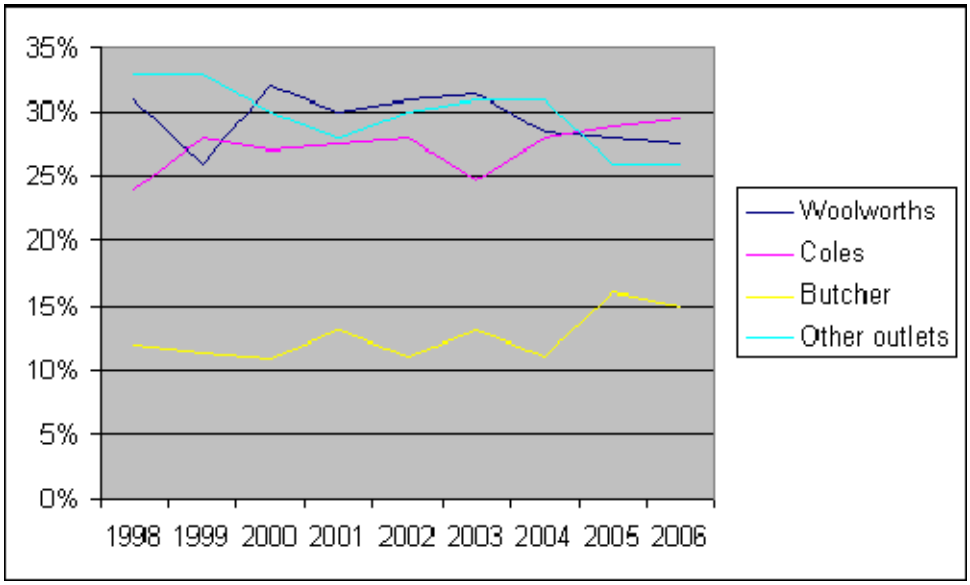
There are four major channels in the domestic market, namely Woolworths, Coles, Retail Butchers and Independents (including IGA), again all competing strongly. Nationally, retail butchers and independents have been growing their share of domestic retail in recent years.

Figure 2. **Retail share- Fresh Meat- National**
Source: DAFF/MLA estimates



This level of competition is also true in W.A., with retail butchers growing strongly but independent supermarkets losing some ground.

Figure 3. **Retail Share (Fresh Meat W.A.)**
Source: DAFF/MLA estimates



This discrepancy has encouraged some eastern states feedlotters and processors to acquire some W.A. livestock and transport them east. When the rising costs of transport are included in the final sale price, this highlights the discrepancy in Western Australian farm gate prices to eastern states prices.

4.0 THE RED MEAT SUPPLY CHAIN

4.1 Supply chain management

The supply chain depicted below illustrates a simplistic flow of animal classes through various growth phases and treatments. This chain simply describes the movement of a newborn calf or lamb through the various sectors to a marketable product.

Breeding → Backgrounding → Feedlotting → Processing → Marrketing

The origin of this chain is the breeding enterprises across the State. To generate herd growth in W.A. it is assumed that the greatest gains will be achieved through higher productivity in the core breeding regions.

4.2 Supply chain issues

Generally speaking, especially with regards to smaller family run operations, cattle producers (and most farmers) are fiercely independent. The concepts of sharing resources and information, or developing innovative ways to enhance business profitability, are not readily accepted.

Such a mindset will prove the largest obstacle to beef and lamb supply chains flourishing in W.A. Even within a corporate environment where senior executives can intervene and impose guidelines, these stumbling blocks are difficult to overcome. So not surprisingly, in cattle and sheep supply chains spread over great distances, substantial frustration and debate can arise over the allocation of transfer values between the manager of one sector and the manager of the next.

While weaving together a supply chain of totally unrelated parties will be difficult, such business relationships have the potential to lift the profitability of the meat sector across W.A. Case studies and demonstrations will help convince producers of the benefits of a connected meat supply chain.

4.3 Demand

Market demand for both beef and sheepmeat has been very strong in recent years, with consumer expenditure on red meat up by $3.7 billion over the last decade to reach record levels.

While this growth has reflected mainly in significantly increased retail prices, it is also in increased volumes, demonstrating greater consumer appeal. This is apparent in both beef and lamb.

These increases in retail prices should be driven by higher livestock prices, however they are not, mainly because major retailers do not want to have large fluctuations in their retail prices in order to retain customers.

Day-to-day fluctuations we see in the saleyards are unlikely to be reflected on retail shelves. Over a longer period though, they generally are.

5.0 VALUE-ADDING AND PRICE STRUCTURE

Transforming a live animal into meat for retail sale reduces the saleable weight of the animal (de-boning, hides etc) by nearly two thirds. It also involves substantial processing and labour inputs before the meat is ready for human consumption. This transformation is outlined in Table 1 and highlights the price per kilogram of meat from farm gate to supermarket shelf.

The journey from paddock to supermarket shelf sees the saleable weight of available meat reduce by approximately 65%. The added value and cost of transforming the meat increases the price per kilo by 80%. The opposite direction of these two variables account for the difference in per kilo price between the farm gate and retail price. The average price per kilogram to the consumer is $9.78. Coles' margin after costs is around 3.5% or 3.5 cents in the dollar.

The farm gate price can vary significantly during any given period depending on seasonal conditions, international trade and input costs such as feed and fuel (see Figure 4).

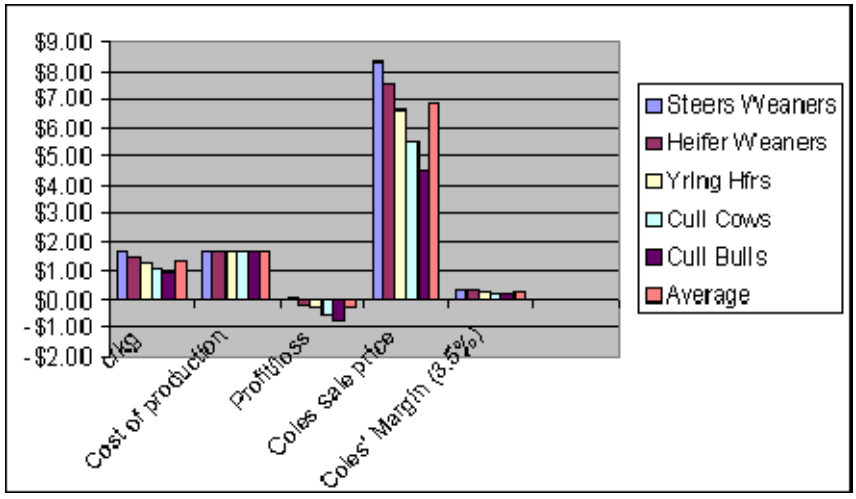
What this does not account for, from a producer's perspective, is the actual fluctuations in the costs of production for meat (see Figure 5). It does not account for the efficiency (or lack of), of advertising (to what extent has the ad campaign reached its communication goals, how has the campaign affected the brand name image or company image etc), and the structure of pricing in comparison to other retail competition.

From killing the beast, to putting it on the supermarket shelf, there are a string of business activities whose efficiencies are not nearly scrutinized as much as the production efficiencies, solely because of the vast array of market activities associated with major supermarkets in comparison the sole business of a livestock producer.

Table 1. **Activities and cost of red meat from farm gate to supermarket shelf**
Source: Coles-Myer submission to the ACCC, 25th August 2005

	Activities and cost	*Kg of Saleable meat*	*Whole Beast price*	*Price per kilo*
1. Farm Gate	• Stock and grazing • Land and labour	410kg	$799	$1.95[1]
2. Freight	• At $21 per head		$820	
3. Hide credit	• At $55 per head		$765	
4. Processing	• Kill • Processing/boning into primals/packaging • Holding for ageing/chiller (approximately 2 weeks)	223kg 65.33% 147kg	$920	$6.26
5. Distribution	• Transport and distribution costs at 10c per kilo	147kg	$935	$6.36
6. Retail	• Slicing and trimming of primals • Packaging • Labour • Shrinkage • Promotion and advertising • Store costs • Retail margin	147kg	$1,438	$9.78

Figure 4. **Producer/retailer return on meat per kilogram**
Source: Coles-Myer submission to the ACCC, 25th August 2005



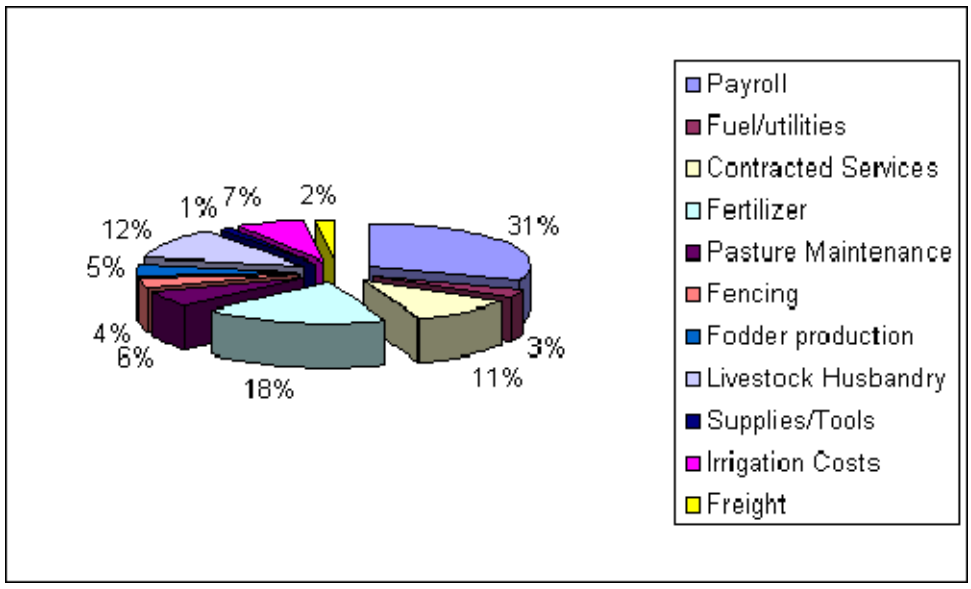
[1] The price of $1.95 quoted is steadily and significantly below this at present in Western Australia.

It must be mentioned that prices since 2005 have changed dramatically. The $1.95 return is a base figure only, however there have been significant decreases in this figure, and this has been coupled with an increase in input costs, most significantly fuel and labour. In table 2, a price of $1.38 per kilogram is a 30% decrease in the price paid to producers in only a two-year period.

Additionally, as mentioned in 4.3 there are fluctuations in saleyard prices that will not be reflected by the price on supermarket shelves. A producer's return on investment will be reduced significantly to the point where the viability of their business and ability to provide a supply of product to major retailers is threatened.

Figure 5. Typical cost proportion breakdown to produce beef or lamb

Source: PGA/WAFF Industry survey, 2008.



6.0 BUSINESS ACTIVITIES

6.1 Breeding

Generally, an animal's intake is related to bodyweight but it is well known that for many animals, including cattle, there is considerable individual variation in feed intake irrespective of size and level of production. Traditionally this is measured in feedlots using prepared rations, by calculating 'feed conversion ratio' (FCR) (weight of feed required to lift live weight by one kilogram). Selecting for FCR will generally increase growth rates but is also likely to lead to increased animal size and consequently feed intake.

Factors that affect FCR include the rate the animal is gaining and the quantity of feed eaten over the same period. A more accurate measurement of feed efficiency is termed Net Feed Intake (NFI), which refers to the

variation in feed intake that remains, after accounting for the requirements of maintenance and growth.

The measurement of NFI is constrained by the necessity to monitor individual intake for each animal along with its weight change over a standard period of 70 days. This generally requires penning animals for ration feeding so that feed intake can be recorded.

6.2 Statistical overview of annual financial performance of beef producers

Table 2 on the following page uses industry data to show the cost of beef production in the present market climate. It uses information from some efficient producers to highlight a diminished return under the current economic and supply chain landscape. It does not show a return on investment.

Table 2. **Profit/loss statement for a Great Southern beef producer**
Source: WAFF/PGA industry survey

Breeding

Sales		$/kg	kg	$/hd	Income	kg L.Wt	$/kg L	$/kg D	$/kg Yield
Hay to F.lot	174	ton	per ton	120	20880				
Irrigation	578	1.50	20	30	17340	11560			
Weaners	476	1.50	311	466.5	222054	148036	1.50	2.80	4.01
Cull Cows	82	0.85	600	510	41820	49200	0.85	1.77	2.95
Cull Bulls	10	1.00	800	800	8000	8000	1.00	1.72	2.30
Mated hfrs	76	1.50	480	720	54720	36480	1.50	2.88	4.44
NIC hfrs	16	1.25	475	594	9500	7600	1.25	2.40	3.70
Strs	91	1.1	532	585	53253	48412	1.10	2.24	3.74
Total					**$427,567**	**309288**	**1.38**	**2.61**	**3.87**
Inputs									
Labour					104000		0.35	0.65	0.97
Fertiliser					120000		0.40	0.76	1.12
Fuel					15000		0.05	0.09	0.14
Cartage					6000		0.02	0.04	0.06
Stock req					5000		0.02	0.03	0.05
Repairs					16000		0.05	0.10	0.15
Seeding					9000		0.03	0.06	0.08
Plant repl					30000		0.10	0.19	0.28
O'heads					50000		0.17	0.31	0.47
Hfr purch	76	1.25	300	375	28500	22800	0.10	0.18	0.27
Str purch	92	1.25	366	458	42090	33672	0.14	0.26	0.39
Int on inputs (5%)					21280		0.07	0.13	0.20
Int on Livestock (10%)					50000		0.17	0.31	0.47
Total					**$496,870**	56472	1.66	3.13	4.64
Profit					**-$ 69,302**	252816	**-0.27**	**- 0.52**	**- 0.77**

Year	**2008**
No.head	578
Feed/Gr Profit	59%
Purchase	467.9
Barl/Trit/Wheat	171.1
Oats	33.3
Lupins	28.5
Hay	36
Additives	14
Vacc/hgp	4.2
Drench/tags	4.0
Cartage (out)	13.7
Fuel/rep/maint	9.0
Deaths/vet	5
Interest	17
Sell costs/levy/penaltys	10
Labour	25
Capital	20
Backgrounding	30
Total costs	889
Gross profit	477
Sale Proceeds	945
Days on feed	89
Gross margin	147
Net return	**56**
% return/costs	6.3%
Profit	**31658**

Feedlot

Kg hay / hd	300
Kg grain / hd	775
Purchase Wt	316
Start carcase wt	167
Final Carcase wt	250
Carcase wt gain	83
Carcase conversion	13.0
Kg Feed / hd	1075
Cost feed / kg	0.263
Conversion cost	**3.42**
Year Ranking	7/14

6.3 Feedlot capacity and utilisation

Compared to other States in Australia, the W.A. feedlotting sector is relatively small. Queensland is by far the largest in terms of feedlot capacity, followed by New South Wales and the remainder of States (see Table 3).

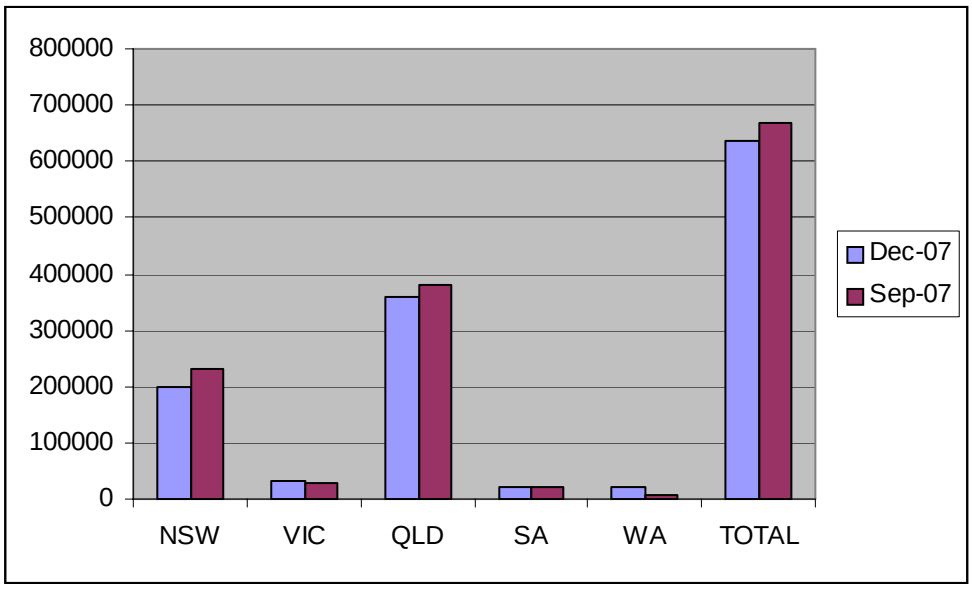
Table 3. Recent Australian lot feed numbers
Source: ALFA/MLA Feedlot Survey

Numbers on feed	*NSW*	*VIC*	*QLD*	*SA*	*WA*	***Total***
Dec 07	197,706	41,189	292,990	24,701	27,886	**584,472**
Sep 07	249,164	32,212	365,372	20,548	13,223	**680,519**
Dec 06	319,067	67,468	440,704	27,161	54,420	**908,820**
Capacity	*NSW*	*VIC*	*QLD*	*SA*	*WA*	***Total***
Dec 07	389,501	77,255	551,567	32,594	101,566	**1,152,483**
Sep 07	388,902	65,255	564,647	32,594	100,399	**1,151,797**
Dec 06	369,521	72,097	528,675	34,539	86,890	**1,091,722**
Utilisation	*NSW*	*VIC*	*QLD*	*SA*	*WA*	***Total***
Dec 07	51%	53%	53%	76%	27%	**51%**
Sep 07	64%	49%	65%	63%	13%	**59%**
Dec 06	86%	94%	83%	79%	63%	**83%**

Western Australia has a Mediterranean climate, which means that there is seasonality in the supply of the grass feed for livestock. In order to suit consumer-eating quality, feedlots are used to add greater live weight to the animal and maintain supply.

The supply has not been achieved because of the inability of feedlotters to source and have honoured contracts with major retailers.

Figure 6. Numbers on feed
Source: ALFA/MLA Feedlot Survey



Only a small proportion of W.A. livestock is finished in feedlots. In the period September 2006 to December 2007 (on which these figures are based) W.A. lot fed livestock comprised only 15 per cent of the total livestock turned off during that period. Across the nation, the corresponding proportion was 27 per cent. Feedlot utilisation in W.A. was some 27% in December 2007, but this had actually increased from 13% in September that same year. This implies an extremely poor feedlot usage rate, which is the lowest in Australia (average 77 per cent) just below SA (55 per cent) and significantly lower than the major States, which approach 80 per cent. Figure 6 demonstrates the relative efficiencies of feedlot use by State.

The use of feedlots in W.A. during the flush growing season (September/December quarters) is low, less than 30 per cent of capacity, despite December being the highest capacity month. Perhaps the dry seasons and high grain prices experienced over the period measured deterred lot feeders from feeding to capacity.

6.4 Processing

There are effectively four major processors of both sheep and cattle in W.A., with very limited killing capacity.

What can be deducted is that an inconsistency of supply of product and labour resources, has seen a rapid decline of processors from the 60+ abattoirs during the 1980s and early 1990s. The situation now is that W.A. has been restructuring its processing sector to the point now where consistent supply of beef is absolutely critical to ensure the year-round viability of processors.

An inconsistent supply of cattle and sheep are linked to the issue with feedlotters and their ability (or lack of) to provide a year-round consistent supply of animals for slaughter. So our chain begins to take a “rippling”, or “domino” effect, with a correlation in trends between Tables 3 and 4.

Table 4. W.A. slaughtering utilisation
Source: Department of Agriculture and Food WA

	Cattle			***Sheep***		
2004	*Slaughter*	*Capacity*	*Utilisation*	*Slaughter*	*Capacity*	*Utilisation*
Jan	12,368	14,833	83%	53,381	92,000	58%
Feb	12,815	14,863	86%	56,717	92,000	62%
Mar	13,063	15,143	86%	66,205	92,620	71%
Apr	11,279	14,723	77%	57,754	91,690	63%
May	11,344	15,003	76%	68,358	92,310	74%
Jun	11,561	15,003	77%	58,732	92,310	64%
Jul	11,242	15,143	74%	56,533	92,620	61%
Aug	11,418	15,143	75%	57,348	92,620	62%
Sep	13,187	15,003	88%	71,219	92,310	77%
Oct	13,699	15,003	91%	69,454	92,310	75%
Nov	14,861	15,143	98%	78,150	92,620	84%
Dec	13,803	15,003	92%	62,185	92,310	67%
TOTAL	**150,640**	**180,010**	**84%**	**756,036**	**1,107,720**	**68%**

6.5 Marketing

Producers pay levies to Meat and Livestock Australia (MLA), with these funds going to two other organisations- Animal Health Australia and the National Residue Survey (NRS) also receive a portion of the livestock transaction levies.

MLA receives $5 for every head of cattle and grain fed cattle sold at sale; with sheep and lamb producers pay 2% of the sale price per head. Of these funds, MLA use 73.2% of levies for marketing activity. With prices falling across the State, the proportion of producer funds to pay these levies increases as the prices decrease.

7.0 RETAIL PROCESS

Both Coles and Woolworths, in a report to the Minister for Agriculture, Forestry and Fisheries in 2007, submitted that they are buying livestock in a competitive market where they buy a relatively small share of total production, and exports play a vital role. Industry participants and observers generally agreed, noting that no one purchaser was able to 'distort' the market because producers that were dissatisfied could alter the specifications of their stock to target other purchasers or export markets.

It should be noted that Woolworths and Coles are the top two market participants for meat, and have a combined 50% share of the retail market, as seen above in Figure 2.

Given the relatively large share of total production being purchased by the largest domestic retailers, it seems unlikely that any one party could not have the ability to suppress prices and/or impose onerous terms and conditions. Producers are left with an inability to alter their specifications to target alternative markets.

Similarly in retail markets, both Coles and Woolworths submitted that they operate in a competitive environment and that they face significant competition from independent supermarkets and butchers. Coles and Woolworths argue that any attempt to inflate prices would see them rapidly lose market share.

While Coles and Woolworths are the two largest competitors with about half of all meat sales, they face competition from each other, other supermarkets and about 3000 independent butchers. It must be remembered that with competition between major retailers for individual food group prices, it is not impossible to inflate prices on some food groups to boost revenue and financial performance.

8.0 CONCLUSION

The concentrated calving and lambing period in Western Australia enables large numbers of straight-line cattle and sheep for sale to feedlots. However, the consistency is coupled with various supply chain weaknesses that the livestock industry is often unable to work on or improve.

The most common industry weakness is exposure of producer prices to supermarket dominance and high reliance on the domestic market. The limited capacity of the local abattoir and limited numbers being rated for export are seen as major limitations.

Extension of practical production information suited to agricultural and pastoral areas should be a major goal of the local industry. Other industry goals include upgrading of the local abattoirs to increase their cattle slaughtering capacity and export certification. Developing a more transparent and fairer auction system and consumer education for appropriate meat preparation is also necessary to make the industry viable in the immediate future.

As supermarket profits continue to climb, Western Australian meat producers continue to ponder new ways of keeping their skyrocketing costs down. The more that can stay in the business, the greater the domestic supply of quality produce available.

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Australian Government

Department of Agriculture, Fisheries and Forestry

Ms Renata Paliskis-Bessell
Chief Executive Officer
Western Australian Meat Industry Authority
PO Box 1434
MIDLAND WA 6936

Dear Ms Paliskis-Bessell

I would like to thank you for your understanding and patience over the past weeks while the government discussed the budget implications surrounding the *Advancing Agricultural Industries Program* in light of its election and new program commitments.

As you are aware, the Australian Government has identified the *Advancing Agricultural Industries Program* for future savings to support its new primary industries policies. Consequently, it was determined that the Industry Stocktake initiative would be concluded and that projects which had not commenced would not go ahead. I wish to advise you that the Australian Government will no longer proceed with the Industry Stocktake grant for the Western Australian Meat Industry Authority.

I understand the disappointment this decision may cause you and your organisation. I hope that this turn of events will not dissuade you from applying for Australian Government grants in the future, especially those that may be developed under future government initiatives.

You may be aware, that the grant was a discretionary payment offered from the previous Government and therefore the announcement of the decision to award this grant did not create any legal obligation on the part of the new Australian Government to proceed. Under such a discretionary grant scheme, a legal obligation is only created through the execution of a Funding Deed, (that is, the signing of a Funding Deed by *both* the Australian Government and the grantee).

If you or any member of your organisation have questions regarding this matter, please contact Ms Tanya Stacpoole, Manager, Advancing Agricultural Industries Program, on 02 6272 5537 or at tanya.stacpoole@daff.gov.au

Yours sincerely

Ian Thompson
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Rural Policy and Innovation
28 February 2008

WEST AUSTRALIAN MEAT INDUSTRY AUTHORITY
04 MAR 2008