



12 March, 2008

Mr Tom Leuner
Director
Grocery Inquiry
Australian Competition & Consumer Commission
GPO Box 520
Melbourne, Victoria, 3001

Dear Mr Leuner,

Thank you for your letter dated 21 February inviting the Australian Egg Corporation Limited (AECL) to make a submission in response to the public inquiry being conducted by the Australian Competition & Consumer Commission (ACCC) regarding the competitiveness of retail prices for standard groceries in Australia.

I wish to directly address the questions attached to your correspondence. In so doing, please be aware that AECL has no involvement in the commercial transactions of egg producers with their customers. However, AECL can respond to the questions posed based on feedback from egg producers received and anecdotal evidence that AECL has become aware of.

1. ***Briefly describe the nature of your business. Your response should include, but not be limited to the following:***
 - a. ***brief history of the establishment of the AECL***
 - b. ***brief overview of the corporate structure and constitution of AECL***
 - c. ***list of members***
 - d. ***funding arrangements of AECL***
 - e. ***functions undertaken by AECL***

After the cessation of state-based industry regulation that commenced in the late 1980s and in response to declining awareness, product recall, demand, sales and egg consumption, the egg industry considered it timely to establish an appropriately resourced industry service provider. This service provider could raise egg awareness, demand, purchase and hence consumption therefore growing the market for eggs in Australia and the businesses that collectively constitute the egg industry.

After wide industry and government consultation and gaining agreement among 93.7%¹ of all egg businesses polled, the Australian Egg Corporation Limited (AECL) was registered with the Australian Securities and Investments Commission (ASIC) on 18 November 2002 and commenced operations on 1 February 2003. It is a public non-listed company limited by guarantee established under the Egg Industry Service

¹ Egg Industry Service Provision Bill 2002

Provision Act 2002 (“the Act”). The company integrates on-farm, through chain and market service provision for the benefit of all stakeholders.

AECL is mainly funded through statutory promotional levies – 32.7 cents per chick purchased – and Research & Development (R&D) levies – 7.2 cents per chick purchased – received from all egg producers and collected under the Act. The Australian Government also matches the R&D levy amount for the purposes of conducting projects and activities in agreed program areas.

The Act, a Statutory Funding Agreement between the Australian Government and AECL, the Corporations Act 2001 and the company’s Constitution provide the legal framework for all company operations.

AECL operates on behalf of and for all levy-paying egg producers who are entitled to register as a member of the company and renew their membership each year under the terms of the Constitution and in line with Section 231 of the Corporations Act 2001. In total, AECL will have at any one time approximately 100 to 150 egg producer members of the company who constitute approximately 24% of all known egg producers and 64% of egg production in Australia based on Australian Bureau of Statistics (ABS) data² (Note: ABS data includes any egg business with an Estimated Value of Agricultural Operations of more than A\$5,000 per year that would equate to an egg business with a flock of approximately 100 birds. AECL does not consider these egg producers to be commercial or solely reliant on the fortunes of the egg industry).

AECL operates with a small management team who reports to the Managing Director of the company and subsequently to the Board of directors. Please see attached AECL organizational structure. The AECL Board comprises of an executive director, being the Managing Director, and currently five non-executive directors who, under the terms of the company’s Constitution, are either deemed to be ‘elected’ or ‘specialist’ directors. Please refer to www.aecl.org for further information.

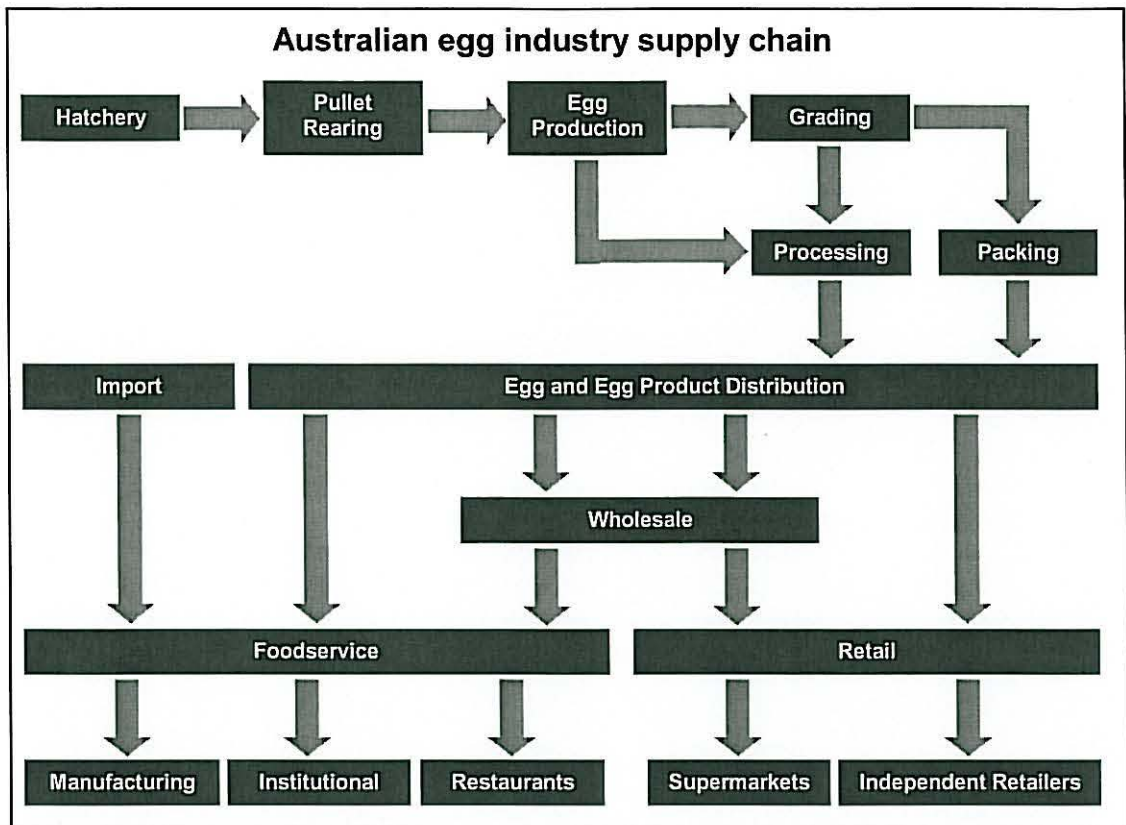
2. *What is the usual form of contract that your members have with their customers? And does the type of contract change depending on the type of customer (i.e. use of long-term contracts, take or pay contracts, etc)*

Egg producers are purveyors or suppliers of fresh shell eggs and egg products to a plethora of retailers and food service operators.

The retail customer environment includes the larger supermarket banner chain stores such as Woolworths, Coles, Franklins, Aldi; smaller retail chain stores such as IGA and state/regional based chain retailers; and independent retailers such as general corner stores, delicatessens, butcher shops, greengrocers and other specialty food outlets. The food service customer environment includes institutional catering, cafés, pubs, clubs, hotels and mid-market to up-market white tablecloth restaurants.

Both the retail and foodservice customer environments are either supplied directly by egg producers or through wholesalers and distributors. Please see flow chart of the supply chain over-page.

² Australian Bureau of Statistics (2008): Agricultural Commodities, cat. no. 7121.0



Source: AECL Strategic Plan 2007-2011

There is no usual or standard form of contract adopted by egg producers with their customers and the type of contract or contractual arrangement will depend on the customer being serviced. However the industry's largest customers are the major supermarket retailers.

Egg producers (suppliers) enter into a contractual arrangement of usually 12 months with each major supermarket retailer for the supply of private-label or generic branded eggs. AECL understands that the supply of proprietary branded eggs is also negotiated at this time but these volumes are well below those of private-label or generic branded eggs. AECL further understands that the contracts are offered to selected egg producers by each supermarket retailer and they can be long, protracted and the terms can be changed by either party during the contract period.

The egg producers (suppliers) selected or invited to tender will be determined by their capability to supply sufficient volume and ability to meet required quality standards determined by each retailer. AECL has been made aware of instances where some egg producers (suppliers) who have been invited to take part may not be able to supply sufficient volumes.

AECL understands supermarket purchasing to be based on a national tendering process to supply regional areas as defined by the supermarket retailer. AECL also understands that it is general practice for supermarkets to shorten the period of a contract in a 'falling' market and lengthen the period of a contract in a 'rising' market.

The contract process among smaller retail customers is usually informal and of an ad-hoc nature with some customers preferring to not enter into contracts but to instead purchase eggs on a daily basis accepting the 'spot' of daily price point that may be offered by their usual supplier or the market. Relative to other natural perishable products, there is no price discovery mechanism in the egg industry.

3. *What degree of buyer power do customers have?*

The Australian egg industry is characterized by many egg producers (suppliers) and many retail and foodservice customers. However, there are a select few customers in the retail and foodservice sectors that cater to the volume of eggs sold in the Australian market. This includes a significant market share in the retail environment that is commanded by two national supermarket chains, the duopoly. Evidence would suggest that the total retail market for eggs would represent approximately 45-48% of total egg supply with the total foodservice sector commanding approximately 52-55% of all eggs sold.

In the egg market, it is usual practice that 3-5 egg producers or marketing entities will be invited by the major supermarket retailers to take part in a tender process that may be convened by the supermarket retailers at a time determined by them.

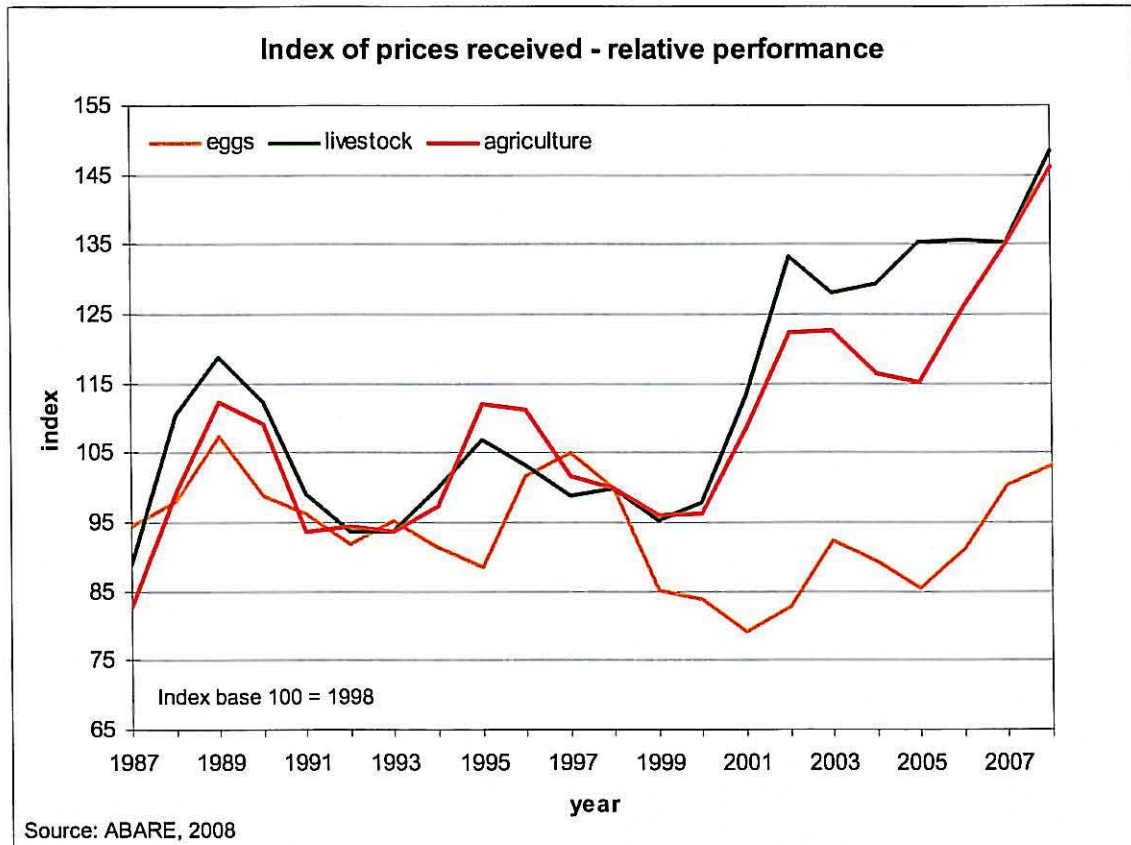
AECL understands that some larger egg producers (suppliers) may be reliant on the continuous trade with supermarkets to maintain an appropriate level of cash flow needed to service debt repayments due to investments in capital infrastructure that have occurred with the purpose of lowering variable or per unit costs to remain competitive. As a result, the degree of market power among some retail customers is significant given this operating environment, especially when there are many egg producers (suppliers) who may be capable of fulfilling contracts.

More recently, significant capital re-investment (up to 60% of the total asset value of a business), has taken place to comply with new jurisdictional laws as they pertain to layer hen housing and supposed improvements in animal welfare outcomes.

4. *How is the price your members receive for their product(s) usually determined? Can you set out changes in the price over the last 5 years?*

Prices are usually determined by negotiation between egg producers (suppliers) and their customers. However depending upon the degree of market power each customer has, will determine to what degree egg producers (suppliers) will be 'price takers'. The greater the market power a customer has, the more likely that customer will exercise forced reductions in prices received that are out of contract or unknown as part of a contract. Such reductions may include ullage (wastage), sales promotions and other unforeseen levies or tariffs.

Changes in the prices received by egg producers (suppliers) since 1987, based on an index price, are outlined below. Prices are depicted relative to other agri-food commodities.



Since 1987, the index of prices received by egg producers (suppliers), relative to other livestock and agricultural products, has been trending down. This is despite retail prices showing handsome increases at the Point-Of-Sale (POS) – see question 10.

5. Do imports (or the threat thereof) of egg products, constrain the price behaviour of egg industry participants?

Currently, there are no imports of fresh shell eggs into the Australian market from overseas destinations due to quarantine barriers in place to protect the relative disease-free status of Australian layer flocks. This is appropriate given the recent emergence and spread of List A OIE diseases such as Avian Influenza in some other overseas markets. However, imports of egg powder are frequent and do impact indirectly on the price of fresh shell eggs in the Australian market depending upon the supply environment.

Imported egg powder is landed at a lower price than what Australian egg producers (suppliers) can produce powder for. As a result, imported powder does displace the local manufacture of powder forcing more fresh shell eggs onto the Australian market increasing supply and hence placing downward pressure on egg prices.

6. What are the key inputs for egg producers? And what has the trend of the price of these key inputs [been] over the last 5 years?

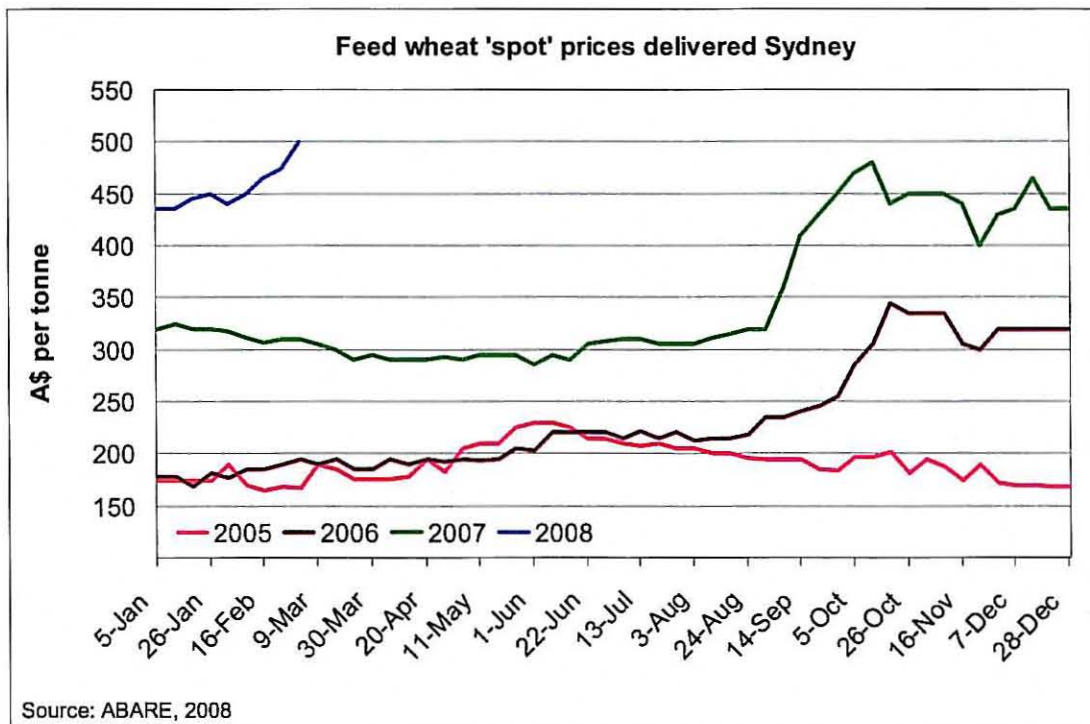
The key variable costs for egg producers (suppliers) in descending order are feed, labour, price of pullets (young birds) and packaging. These four variable costs constitute approximately 80% of all variable costs for most egg production businesses.

Quality grain is an essential ingredient to the diet of laying chickens comprising approximately 40% of all egg producer (supplier) variable costs. "...many commentators had said the grain market had really taken off in the past two years. 'But I would ask, has the grain juggernaut even left the runway yet?' Mr Dalton said..." [Steve Dalton, Ecom Commodities analyst]³.

The grain market over the 1st quarter of 2008 has increased by 44% on 2007 levels and by over 100% on the average price levels achieved over the 2005–2007 periods. These record high prices have been fuelled by increasing demand from traditional grain users and the introduction of new demand from the bio-fuels sector world-wide. "...strong demand for maize for biofuels means wheat prices will end the year at historic highs, according to Rabobank senior commodity analyst Luke Chandler."⁴

This increase in demand has been coupled with record low production levels and inventory stocks around the world due to the failure of grain crops instigated by drought conditions in a number of grain-producing countries. This has especially been the case in the Australian grain industry which is a major supplier of grain to world markets.

Feed grain prices have risen from an average price of A\$191 per tonne in 2005 to A\$233 in 2006. In 2007, this increased to an average of A\$348 in 2007 representing an increase of 49% above the prices recorded in 2006. To date in 2008, feed grain prices have averaged A\$443 per tonne, 27% above the much firmer prices recorded in 2007 and 131% above the prices recorded in 2005.



³ The Land newspaper, 6 September 2007; *Wheat goes berserk*, p118.

⁴ The Australian newspaper, 4 March 2008; *Historic highs tipped for wheat prices*; p23

Grain stocks among bulk handlers and grain traders in Australia have reached record low levels declining from a monthly average of 12.8 million tonnes in-store prior to each winter harvest (Oct-Nov) to 6.1 million tonnes in 2007.

Egg producers (suppliers) compete on a world market to purchase grain paying premium prices to compete with flour millers and other grain users during times of short supply.

Increases in grain price, record low grain production/inventory levels and ballooning demand for grain among traditional and emerging new industries are severely impacting the costs of egg production and hence the margins being generated by egg producers (suppliers) resulting in a cost/price squeeze scenario not yet seen in the Australian egg industry.

The introduction and investment in new technologies by some egg producers (suppliers) is assisting minimize labour costs but the increase in the demand free-range eggs and the production thereof is negating the otherwise downward trend in the number of Full Time Equivalent (FTE) staff required to successfully operate an efficient egg production business. Relative to overseas economies and egg industries, labour costs in Australia are higher.

The egg industry has seen the price of pullets or young layer birds also increase in price. These birds are purchased at approximately 16 weeks of age and are ready to start laying eggs at this age. However, the cost of pullets has increased in line with increases in grain prices as these birds are reared on a similar ration to that fed for laying birds.

Until recently, there were a number of egg packaging suppliers operating in the Australian market. There is now only one commercial operator who has had difficulty catering to the needs of the Australian egg industry. This has driven the price of packaging higher as substantial increases in demand have resulted in supply shortages of suitable packaging. More recently, packaging has been imported from China and Europe to assist meet demand from egg producers (suppliers).

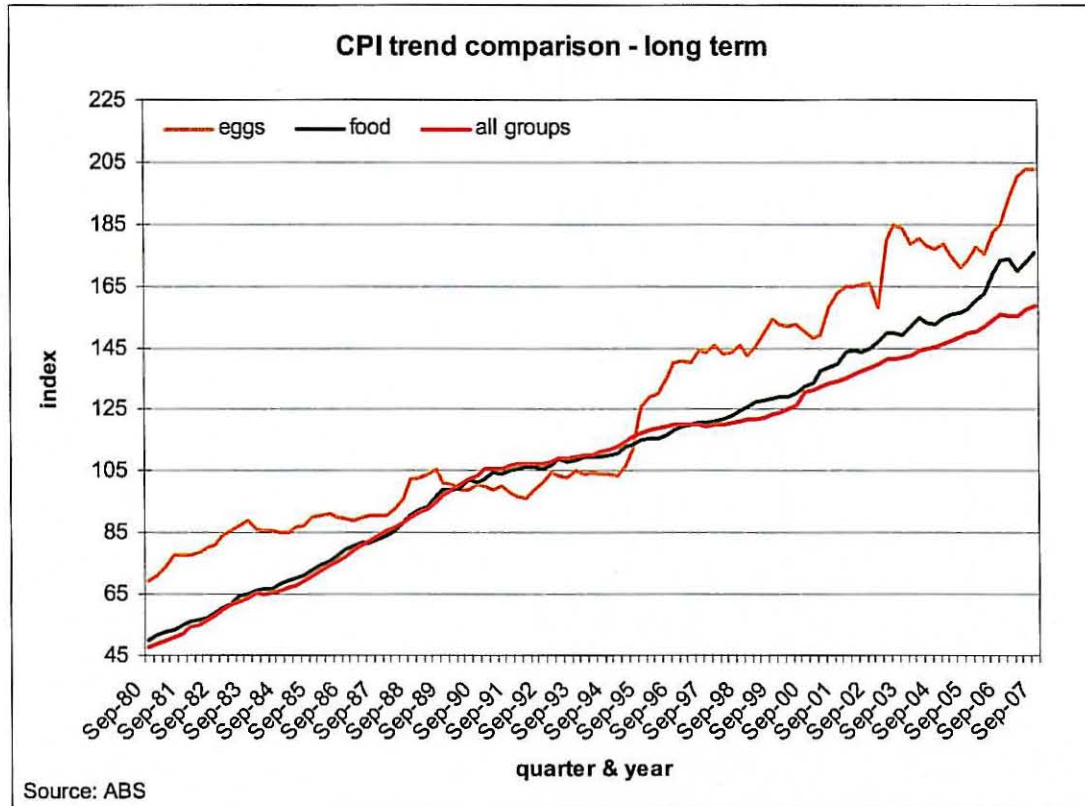
7. *How have increases in the price of inputs changed relative to the price your members receive for their product(s)?*

The price of inputs keep varying depending on supply and the relative demand for such products or services by the egg industry and other competing industries vying for the same resources.

Anecdotal evidence would suggest that there is a significant lag in the impact of input price changes have on the price of eggs. While at times the cost of inputs can decline, most of the time the cost of inputs is increasing. While these increases may be discussed by egg producers (suppliers) and their customers, they are usually not accepted in a timely manner and in some instances, not accepted at all.

8. *Do you have any comments on the retail price of your product(s) compared to the price at which you sell your product?*

The price for most eggs has traditionally been based on the lowest price prevalent in the market at that time due to a lack of product differentiation. Retail egg prices have risen from \$2.07 per dozen on average during 1994 to now average \$4.08 per dozen⁵. This price trend represents an average increase of 5.88% per year. Not bad considering that inflation over the same period, has grown at 2.8% per annum⁶ resulting in retail egg prices moving at a faster rate on average than the price of the general basket of goods that constitute the Consumer Price Index (CPI).



Given a base index of 1989-90, the index of egg retail prices has been above the food index and all groups index from September 1980 through to December 1989 at which time, the index change in retail egg prices slowed and 'dipped' beneath price increases being achieved in all other products. This trend changed again in June 1995 and since this time, egg price increases and the index of retail egg prices has remained above that of the food index and the index that reflects the total basket of goods.

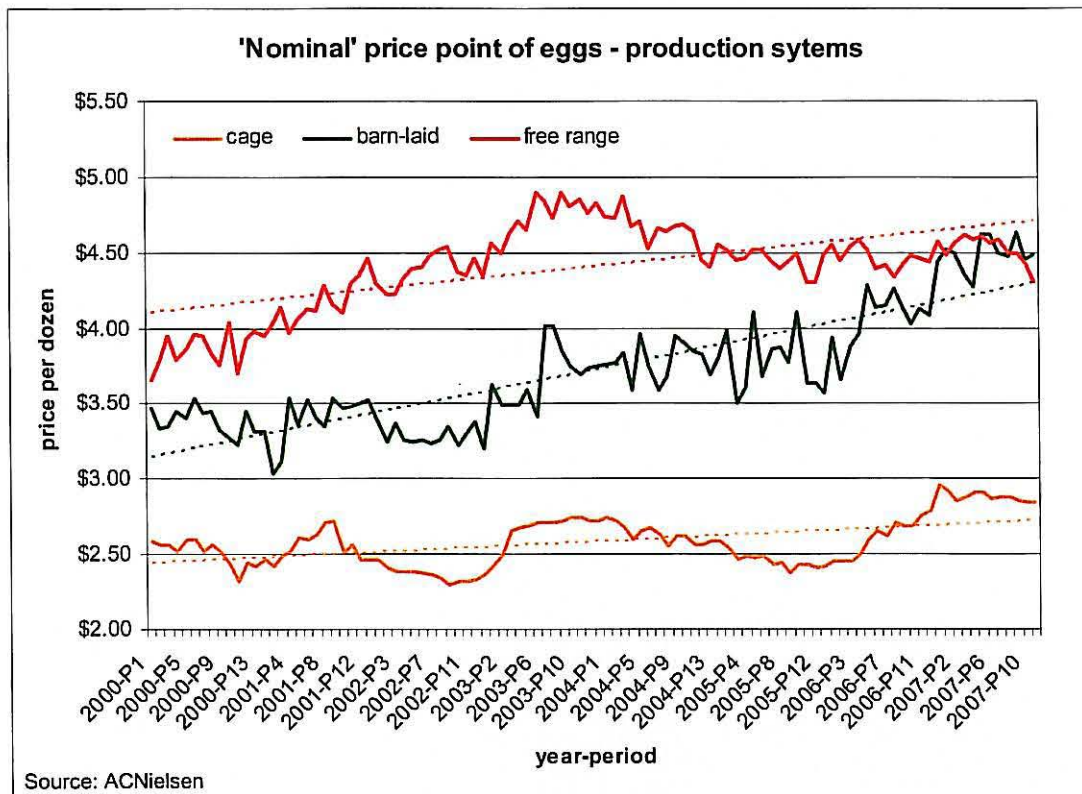
The egg category has started to see a level of differentiation occur in prices based on two factors. Firstly different prices in the egg category as they relate to eggs sourced from the different production system and secondly, price points based on eggs that directly address meaningful product quality characteristics as defined by consumers.

In terms of production system, the relative price points of eggs sourced from each of the three recognised production systems have varied over the last 6-7 years. On a nominal basis, cage eggs have increased in retail price by 14.4% since 2000 while barn-laid eggs and free range eggs have increased by 32.6% and 17% respectively since

⁵ Australian Bureau of Statistics (2007): Average retail prices for selected items, eight capital cities, cat. no. 6403.0

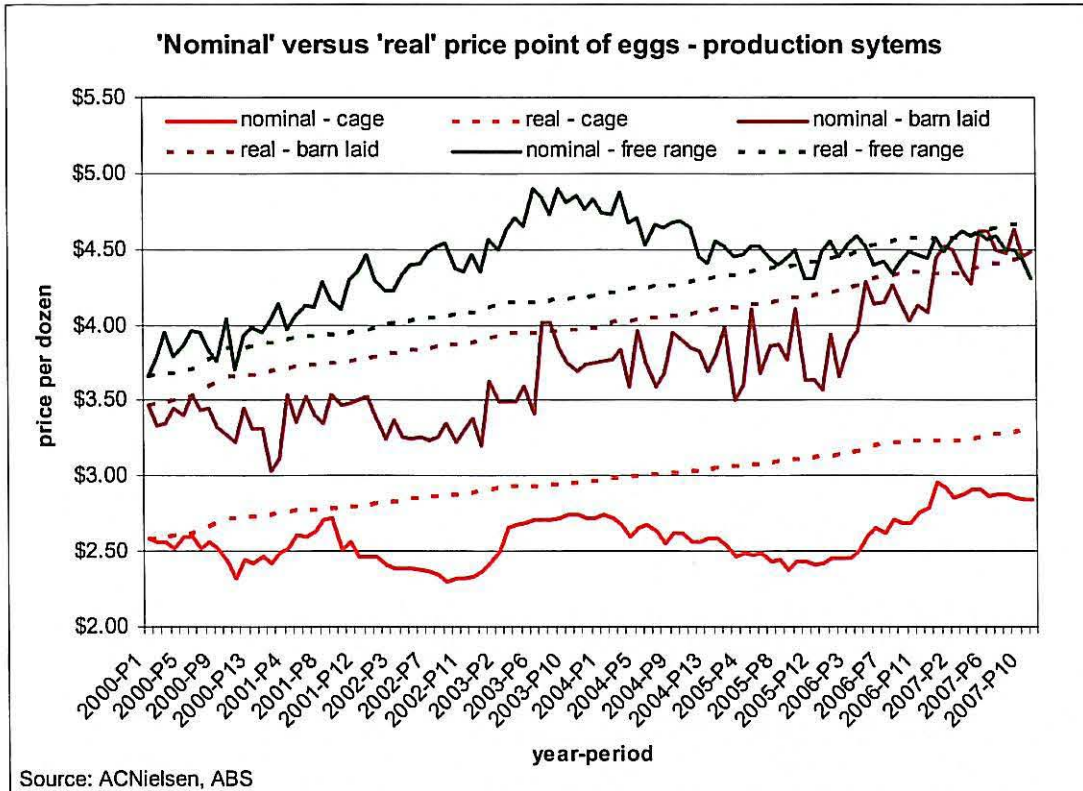
⁶ Australian Bureau of Statistics (2007): Consumer price index, cat. no. 6401.0

2000.⁷ It is interesting to note that while the retail price trend of free range eggs has been well above those prices achieved for cage or barn-laid eggs, the trend started to weaken from late 2003 due to market saturation of this type of egg.



In real terms, retail egg prices for cage and barn-laid eggs have not, in the main, kept pace with inflation given the retail prices prevalent in the market at the beginning of 2000. However, retail prices for barn-laid eggs since the beginning of 2007 have kept pace with inflation due to increases in the nominal price for these eggs. In terms of free range eggs, while the nominal retail price has been increasing at a faster rate than inflation since 2000, retail prices since late 2005 have started to 'dip' below the real rate for these eggs.

⁷ AC Nielsen (2007): Homescan data service



So, are egg producer returns reflecting the trends being recorded at retail? It is interesting to note that while the egg industry has seen effective levels of price increases at retail it does not seem to be translating to the prices being received by egg producers (suppliers) – see question 4.

It would seem that egg prices are growing at retail but on a nominal and real basis, egg prices being received by egg producers (suppliers) seem to be going backwards and not keeping pace with other agricultural products or commodities.

AECL is willing to consider any further questions considered appropriate by the Grocery Inquiry.

Yours sincerely,



James Kellaway
Managing Director

AECL organisational structure

