Submission to:

ACCC Inquiry into the Australian Dairy Industry

Issues Paper

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Introduction

The Western Australian Farmers Federation Inc. (WAFarmers) is the State's largest and most influential rural advocacy and service organisation. Founded in 1912, WAFarmers boasts a membership of over 3,300 farmers including grain growers, meat and wool producers, horticulturalists, dairy farmers, commercial egg producers and beekeepers. Collectively our members are major contributors to the $5.5 billion gross value of production that agriculture in its various forms contributes annually to Western Australia's economy. Additionally, through differing forms of land tenure, our members own, control and capably manage many millions of hectares of the State's land mass and as such are responsible for maintaining the productive capacity and environmental wellbeing of that land and the animals that graze it.

WAFarmers welcomes the opportunity to provide a response to this important Inquiry and it submits the following comments for consideration. We also support the findings, discussion and recommendations submitted by Australian Dairy Farmers Limited.

WA Dairy Industry

WA dairy has unique challenges caused by its isolation, which prevents access to large scale manufacturing to enable us to take advantage of emerging export markets and also causes complexity around balancing supply.

Western Australia is not self-sufficient in dairy products. Currently, the state imports (interstate transfer) approximately 35,000 tonnes of cheese, 10,000 tonnes of butter, up to 45 million litres of ice cream, a significant volume of UHT milk and about half, if not more of the Yoghurt consumed.

The dairy industry comprises of approximately 142 dairy farming businesses producing 387 million litres of milk in 2016. Dairy farms are located in the South West of the state around three main areas: Harvey, Margaret River, and Denmark on the south coast. The state's processing sector is dominated by three companies along with a number of small boutique businesses including organic operations. Western Australia does have the animal feed and water resources to produce many times the domestic consumption of milk but with limited processing capacity dairy farming businesses are unable to take advantage of this opportunity. The agricultural area in the South West consists of approximately 15 million hectares.

The WAFarmers Dairy Council is the only Western Australian based peak industry advocacy body committed to ensuring the dairy industry is involved in shaping the regulatory framework under which dairy businesses must operate. Key areas of policy include community engagement activities, animal health welfare and biosecurity, water management, milk pricing and supplier contracts, technical and youth development projects.

Discussion

A. Competition for Milk

1. The level of competition between processors for the acquisition of milk, across regions

Because the industry in WA is quite isolation, supply and demand are the driving forces for the acquisition of milk. So it is a very competitive market when the State is short of milk, but when there is too much milk it becomes less competitive. The State is in a boom and bust cyclic situation quite frequently.

In WA, supply contracts are mainly governed by the length of contracts which are generally more than two years. A farmer gets paid the same regardless of whether their product becomes drinking milk, yoghurt or milk powder. Milk payment systems have been developed as a result of a competitive environment for milk rather than a true reflection of the market returns.

In Western Australia, farmers get paid in the more familiar cents per litre. But even then it's not that simple. The cost of producing and transporting milk varies depending on location, which affects how much a processor might pay. It's a situation that plays out across the country, with deals and discounts specific to each processor.

At present the three processors have different requirements regarding notices to terminate a contract. These notices can vary from seven days, to three months and longer. However, a farmer who is locked into an existing contract is not permitted to sell milk over and beyond a contract to another processor.

Western Australia (WA) is certainly not immune to production variability and due to the relatively small size of the industry and distance from other milk production regions can experience significant variability in supply and demand from time to time.

As well as being a small industry with the unique challenges this brings, the industry is also isolated with limited opportunity to negotiate contracts, particularly given there are only three processors operating in WA where milk production outstrips demand at certain times of the year. This does place constraints on the options available to dairy farmers who are mainly supplying milk to the domestic market without export product options.

The decision by a milk (Brownes) processor in July 2016, to terminate the supply contracts of four long-standing farmers, all of whom were meeting the required growth targets set by the processor, forcing them to dump milk and leave the industry, is unprecedented, despite extraordinary efforts to find processors or new contracts to collect this milk. These farmers suffered insurmountable hardship and loss of income in their businesses, even though they have not done anything wrong. This has a huge impact across the entire supply base and put fear in to the market place and made farmers feel very vulnerable when in contract negotiations.

In September Harvey Fresh, gave notice to five more farmers advising their contracts would terminate in January 2017, without any hope of these farmers finding new contracts. In December these farmers were offered new six month contracts with a reduced base price per litre payment with additional terms and conditions.

WAFarmers believes it was unprecedented in Australia for such farms to be refused a contract and not have their milk collected by a processor given the farms in question were an ideal size for milk production and in a good location to service both processors and the market.

WAFarmers recommend clearly defined clauses must be adopted for termination notices which should apply to both parties – the processor and the farmer.

2. The ability of producers to switch between processors or other buyers.

The option to switch processors is only available to farmers in WA at the end of their existing contract. Generally speaking milk contracts from processors in WA vary in term from 2-5 years and include 'exclusivity' clause, which lock the farmer to the processor for the entire duration of the contract. This clause prevents a farmer from selling excess milk (over and beyond the agreed contract quota), or from shifting to another processor during the term of the contract.

WAFarmers believes scheduled negotiation periods should be incorporated into supply contracts particularly if the contract agreement extends for a two year period. Six monthly meetings allow both parties the chance to review the current agreement and make any changes to meet the needs of both parties. Good negotiations contribute significantly to business success, as they help build better relationships, and deliver lasting, quality solutions that satisfy the needs of either party over the course of the contract.

An 'exclusivity' clause restricts a farmer from entering into contracts with other processors. If an exclusivity clause is contained within the contract, provisions should be made to ensure the farmer is fairly compensated for being prevented from taking his/her business elsewhere under law.

A court may not enforce an exclusivity clause that is too restrictive or unreasonable. To determine this, the court will consider factors such as whether the clause protects only the genuine interest of the supplier, the period of exclusivity and the geographic area to which the clause applies.

If a farmer is offered a contract with an exclusivity clause and he/she can't negotiate its removal, the supplier should ensure that there is a 'break free' clause included in the contract. This allows the supplier to recover some or all of the costs if circumstances change. However, this requires evidence of your losses. It may be easier to agree on a payment (noting the amount) in the contract clause.

As a point of reference there are no exclusivity clauses in the grains contract terms and conditions between CBH (Cooperative Bulk Handling Group) and 4,200 grain growers.

Reference: The terms and conditions apply to the sale of the Commodity by the Supplier named in the Grain Purchase Contract Confirmation (Supplier) and CBH Grain Pty Ltd ABN 39 089 394 883 (formerly Grain Pool Pty Ltd) (Buyer).

WAFarmers recommends exclusivity clauses should not be included in processor agreements.

B. Contracting Practices

3. The different types of supply contracts used across the supply chain and in certain regions

In WA, there is a range of fixed term contracts with different start and due dates. If all WA dairy farmers had fixed term contracts with a common expiry date and time, then this would enable farmers and processors to negotiate all in the same time period ensuring that when the time period is complete everyone could settle down knowing their contract and pricing was fixed for given term. This would resolve the issue of processors picking farmers off, and leaving others high and dry, and realigning the base price per litre downwards to reflect global market dynamics even though over 90% of milk produced in WA is consumed on the domestic market.

WAFarmers recommends a common due date for contract negotiations should apply. This would encourage processors who need a seasonal supply to establish a pricing system that will attract the most suitable farmer to fulfil the contract term.

WAFarmers recommends a three month termination notice period should apply to both the dairy farmer and the processor. At present one WA processor gives 3 months' notice while another gives 7 days' notice, but this variance in processor termination notices certainly does not apply to farmers. Contracts must be more flexibility to maintain continuous supply and continuity.

WAFarmers believes we must have open and positive relationships with all processes to avoid conflict and hardship issues. This is specifically relevant in WA when farmers were forced out of the industry after their contracts were terminated and they could not secure new contracts.

Until recently, processors excluded the use of independent negotiators, although this has now been permitted by one processor in WA, at the expense of both parties.

The WA dairy industry and the general public were appalled at the public execution of the four dairy farmers supplying Brownes whose contracts were not renewed, and every effort must be made to ensure this situation is not repeated. The industry needs an independent arbitration system to deal with milk out of contract.

WAFarmers fully supports the inclusion in section 46 of the Competition and Consumer Act 2010, which will address the current unequal distribution of market power and encourage transparency to the benefit of producers, consumers and retailers. We believe this legislation will prevent companies with significant market power from engaging in conduct that has the purpose, effect or likely effect of substantially lessening competition. The effects test is another tool to help provide integrity and transparency regarding the impact of retailer and processor actions on suppliers. We believe this ruling has brought processors to the table and encouraged fairer contract terms.

4. Concerns about anti-competitive conduct or unfair trading practices, including unfair contract terms.

The main problem that faced the nine dairy farmers supplying Brownes and Harvey Fresh this year was the inability to find alternative contracts on termination of their existing contracts.

There certainly was no dispute concerning breach of contract terms and conditions, as all nine farmers more than adequately met the terms and conditions set in their existing contracts.

WAFarmers is supportive of the Collective Bargaining Arrangements but success is limited to competition in the market place, which is a real issue in WA.

C. Transparency and Price Signals

5. How farm gate milk prices are set and communicated to producers

A voluntary code of conduct agreement with processors should ensure pricing adjustments throughout a contract are clearly defined and that there will be no price change made retrospectively. There must be assurances around a defined pricing formula within contracts.

As mentioned above there are significant issues with pricing mechanisms within contracts which are confusing and there is a need to simplify this. WAFarmers propose there is a need for a simplified pricing mechanism to apply across Australia. The complexity of global markets is often used as an excuse to change domestic pricing structures even though they are more stable.

A classic example of poor price transparency and unconscionable behaviour is the Murray Goulburn Milk Price Step Down situation, echoed by Fonterra a couple of weeks later.

Dairy processors in Western Australia have over the past two years, encouraged farmers to increase production through the payments of summer premiums and other incentives, specifically in increase milk production. Output has risen from 327 million litres to 387 million litres over this two year period. However, the average required domestic consumption in WA is approximately 290 million litres. Although processors encouraged this growth they did not factor-in how or where they were going to sell this extra milk and certainly didn't invest in new infrastructure to manage this seasonal oversupply.

Consequently, processors reacted by issuing termination notices to nine highly efficient dairy farmers, without discussing the seasonal supply issues with industry stakeholders first. This action has caused enormous damage to the industry and extreme hardship to the farmers affected.

6. *The availability and use of meaningful global market information and price signals across the industry, including by dairy farmers.*

The significant issue for Western Australia is the lack of secondary processing facilities to add value to white milk production. There is an urgent need to find long term solutions to manage spring production outputs and should include investment into infrastructures to produce products like cheese or ice cream for domestic or export consumption. To achieve this, consideration could be given to a two tiered price scheme split between domestic and export market access. For example, a premium stable flat price relating directly to supplying the domestic market on a level supply pattern, and then a second tiered pricing mechanism specifically targeted towards the export market. This concept may prove beneficial to all parties.

To achieve these urgent solutions WAFarmers is requesting ACCC consider a special dispensation to allow all industry partners to come together to discuss and agree solutions for the betterment of the industry and consumers. The dairy industry in WA may be small in comparison to the number of dairy farms in the southern eastern states but the aim must be to retain the existing dairy farmers in the State who still want to remain in the industry.

D. Domestic Retail Markets:

7. *The major supply channels for the domestic market, including major supermarkets and other retailers.*

Australia has the most concentrated supermarket sector in the world with Coles and Woolworths collectively controlling 74% of the grocery retail share. In most other developed countries, the market is usually shared between five to10 retail players.

This extreme market concentration places processors in a ‘catch 22’ position. The major retailers are not only the largest sales avenue to consumers for the sale of processor’s own branded products but the supermarket ‘home brand’ milk tenders are now a major component of the overall domestic drinking milk market.

This means that processors are understandably cautious about pushing back on the major retailers due to their market power. It also means there are significant impacts down the supply chain with farmers bearing the brunt of risk and reduced value in the supply chain and changes in contract supply requirements in different regions.

WA has been more affected by the $1per litre milk sales campaign driven by major supermarkets, than any other State. Approximately $25 million has been taken out of the white milk supply chain.

The Dairy Australia Situation Report presented the total value of milk sales increasing since the Milk Price War started in 2011, but fails to accurately disclose the more than $200 million per annum to processors in losses sustained by branded sales to supermarket private label fresh white milk. The processors could have used these funds to invest in secondary processing for products like cheese, ice cream, etc., in light of the spring surplus production.

The figures presented by the Dairy Australia Situation Report cover all milk sales including flavoured milk which disguises the impact in the fresh white milk category where the Milk Price War is occurring. Secondly the analysis didn’t take account of discounting forced on the trade.

Dairy Australia has accepted these comments and did adjust their analysis to exclude flavoured milk from the analysis which has indicated the true cuts in the value of fresh white milk sales. The effect of $1 per litre milk on the dairy supply chain over the last five years has been profound. Whether the retail sale value has risen is irrelevant if the value is not being returned to the supply chain.

Please refer to the report in Appendix One for further detail on the impacts of the supermarket $1.00 per litre campaign for WA dairy farmers.

Generally dairy farmers do not deal directly with multiple retailers, there contracts are directly with primary processors. It could be said retailers have undue power over processors because they are operating under a tendering process as a marketing exercise rather than reacting to market forces and this places the WA dairy industry in a significant disadvantage given its reliance on domestic market sales of white milk.

Given this unique position WA dairy farmers and relying on the ACCC to grant special provisions to allow industry participants to collaborate and implement urgent solutions to not only safeguard WA dairy businesses but to ensure a constant supply of high quality milk and dairy products can continue to be supplied to consumers residing in WA.

WAFarmers requests ACCC grant permission under its regulations to permit the industry to cooperate to find urgent solutions to milk balancing issues, or if this is not acceptable, WAFarmers requests ACCC provide a clear explanation on the options available to it within the law to achieve beneficial outcomes.

We understand the ACCC obligations are to promote competition and fair trade in markets to benefit consumers, businesses, and the community. Also to regulate national infrastructure services. Its primary responsibility is to ensure that individuals and businesses comply with Australian competition, fair trading, and consumer protection laws, in particular the Competition and Consumer Act 2010.

8. The impact of $1 per litre milk on the industry. This includes information about the positive and negative impacts of private label product supply contracts.

Please refer to the report in Appendix One for further detail on the impacts of the supermarket $1.00 per litre campaign for WA dairy farmers.

E. Global Markets:

9. Options for supply into export markets, including products and destinations

There are opportunities for the dairy industry in WA to take advantage of export markets given its proximity to Asia. However, the industry can only capitalise on these opportunities if industry partners (farmers, processers, etc.) can work together with key stakeholders and government to find solutions and investors with the support of the ACCC. It should be recognised that employees and employers are consumers of dairy products and their livelihoods should be protected under the ACCC's legal obligations to protect the rights of consumers.

An issue facing all dairy businesses in Australia is the simple fact that the world is currently awash with dairy products and Australian businesses are competing for markets against businesses in the EU or USA that are heavily subsidised and can sell dairy products cheaper than what can be produced in Australia without subsidised support. Although Australia has successfully negotiated a Free Trade Agreement with China, potentially the largest market for WA, tariffs and quotas will still apply for some years, which is not the case for countries like NZ, and this places further disadvantages on Australian processing who are forced to sell dairy products to China/Asia at a discount.

10. Any barriers to selling into export markets.

As noted above, Australian businesses are at a disadvantage because of existing tariffs and quota barriers and restrictions, which only time and persistence will resolve. Even though we have FTA's we still have many non-tariff barriers as well as dealing with the complexities of dealing in Asian markets.

F. Production Costs and Profitability

11. The key factors influencing the profitability of dairy farms, including costs of production.

In WA there are significant variability's within farming systems and processing businesses, which all affect profitability and cause contract distortions. Farming systems and the costs of production vary from farm to farm, region to region and year to year. To complicate this, the price in WA varies significantly from farm to farm and from year to year. Again this price variation is caused by isolation and lack of infrastructure to balance and grow supply.

For example, the Brownes processing company have implemented huge cost cutting measures to encourage a new investor to buy the business. Harvey Fresh and Lions Food have contracted all the dairy farmers it needs to meet domestic market demands. It is unrealistically expensive to transport milk produced in WA to eastern states or to the Northern Territory. This is why the majority of milk produced is sold on the domestic market in WA with a population of 2.6 million people. This is why there is urgent need to find new solutions to balance milk supply on an annual basis by investment into new infrastructure particularly to accommodate secondary processing to capitalise on export market access.

Key Recommendations

WAFarmers proposes the following areas could be investigated as part of this inquiry:

a. Investigate Predatory Pricing
b. Definition of Unconscionable Conduct
c. Unfair Contract Terms
d. ACCC Monitoring Powers

a. Investigate Predatory Pricing

The ACCC, as part of this Inquiry, investigates all avenues of predatory pricing practices particularly in regional and remote areas.

The ACCC grants special dispensation to allow industry partners to find solutions to the current milk balancing issues in WA. Dairy farmers are constantly told by processors that collaborative discussions cannot be undertaken as it is in breach of ACCC rules. Clarification is needed on the ACCC's rulings on this matter. WAFarmers requests the ACCC grant a special dispensation to allow the industry to come together to find solutions through cooperation. Furthermore, we need clarification on what is legal and what is not under the ACCC laws in terms of cooperation.

While we work towards finding solutions to these issues we must remember that we are a resilient industry with a long, sustainable future ahead and our profitability depends greatly on cooperation across the value chain and the continued support of the Australian public, which we are always thankful for.

b. Definition of Unconscionable Conduct

What is the ACCC's definition of Unconscionable Conduct?

There is a need for greater certainty in terms of the legislative definition which could assist farmers' from unconscionable conduct. The exact meaning of 'unconscionable conduct' is not defined in the Act. The Act lists several factors that the court considers when deciding if a party has acted unconscionably. However, the court is able to consider any other matters it believes are relevant.

WAFarmers believes that anything that provides clarity for the courts and reduces the limitations of the current Act is worth pursuing.

c. Unfair Contract Terms

Dairy farmers generally supply one processor and have a contract in place with that processor. The contract specifies the minimum amount of milk the farmer will supply, with financial penalties for the under-supply of milk. When farmers produce more milk than specified in the contract they are prohibited from supplying over volume contracted amounts to a third party which may provide a higher price to the farmer – to other processors, other farmers or retailers.

This inability to supply a third party puts a cap on the future growth of dairy farming businesses which may affect the future viability and scale of their business.

The lack of the ability to have dual supply or sell their milk elsewhere limits farmers' ability to invest and grow and acts as a restraint on trade. This is particularly concerning given that the markets where this is taking place are experiencing supply and demand issues. The above issue warrants further investigation.

d. ACCC Monitoring Powers

It is appropriate that consideration be given to regular price surveillance across 'at risk' industries. The 'at risk' industries could include certain primary production industries most vulnerable to anti-competitive behaviour, such as perishable goods.

ACCC to consider changes to its powers to allow supply chain representatives to cooperate with the purpose to agree long term solutions to balance milk supply in WA specifically to pursue export market opportunities.

In Conclusion

WAFarmers welcomes the opportunity to submit its response to this Inquiry and we welcome the opportunity to discuss these matters in more detail with the ACCC representatives at the forums to be held in Western Australia in early 2017.

If you require any further information or wish to discuss these matters, please do not hesitate to contact Michael Partridge, President of the Dairy Council, on 0417 911 504.

Appendix One: (Below).

Impacts of the $1.00 per litre campaign on the Western Australian Dairy Industry Report.

Source: Steve Hossen, Agricultural Consultation.

Attachment One:

IMPACT OF THE $1.00 PER LITRE PRIVATE LABEL MILK PRICING ON THE WESTERN AUSTRALIAN DAIRY INDUSTRY VALUE CHAIN
STEVE HOSSEN RURAL CONSULTING PTY LTD

Conclusion

The lower price private label milk has taken $25.2M per year out of the Western Australian milk value chain.

Summary

In January 2011, Coles lowered the retail price of private label milk to $1.00/L, with the promise to keep the price down. Woolworths lowering its private label price rapidly followed.

The retail price change for the private label milk, has had an effect over all Australia, I have restricted my analysis to Western Australia. Milk pricing and sale in one sector of the retail industry should not be looked at in isolation, sales data since January 2011 discounting, illustrate the price and volume impact on the different market sectors.

1. Changes in total milk demand resulting from the lower milk price. The price elasticity of demand for milk has historically been seen as low, that is milk is regarded as an essential and a lower price will have little impact on the overall demand. The sales figures available do not provide data on this effect, all milk sales need to be recorded and in a consistent way across ail retail sectors, branded fresh, private label, UHT and powdered milk for this determination to be made. It is expected that total milk sale would increase with lower prices, but the reported sales changes is not a measure of more milk being sold but a change in customers behaviour as they move to the lower priced product, perhaps from higher priced products in smaller retail outlets or new customers to milk as a beverage, I believe the largest factor is a product change and not a switch to milk. Consumers have moved from smaller retailers, without access to the $1/L milk to retailers with access to this discounted product, customers are likely to move at the margin from UHT milk to the $1.00/L milk, as well as the more visible transition from branded milk to private label milk.

2. In all situations the rate of change in customer preference is not static. The move to the lower priced product is driven by the relative prices for what they consider to be like products; customer awareness of the price differences; the customers perception of value of the lower cost milk relative to the alternatives and relative shelf exposure. It is likely that over time the relative market share of the competing alternatives will stabilise, at the time of writing this report stability has not yet been achieved, the private label market penetration is still increasing but at a diminished rate.

3. The claim that if contract prices are maintained for milk going into the private label product, there should be no impact on the farming sector is wrong. Farmers are a component of the total milk value chain, if value is lost in the chain as a result of retail discounting, it is logical to conclude that any component of the chain, including farmers, is immune from the loss of value in the chain.

4. The loss of milk value at the retail level is not an issue that should be seen in isolation. Lower returns in the supply chain can act as a stimulus for productivity improvement in that supply chain, that is, if productivity improvements are possible. These improvements can be made anywhere in the supply chain from the dairy farmer, milk collection, milk processing through to milk distribution to the retail. If market pricing power is not in the long term balanced between the farmers and the processors a disproportionate amount of the impact will be transferred down the supply chain, in this case the farmers.

The objective of this report is to focus on the impact of the private label change from a WA Dairy Industry perspective, and the value chain immediately above the farming sector. I am aware that there is a wide range of potential economic impacts to the customers, retailers, milk manufacturers and farm sector.

Economic Impact

The manufacturers were very reluctant to provide detailed information about the sales and pricing of their branded lines of product, before and after the $1.00/L initiative, directing me towards the published data. The retailers were not asked to provide the same information from a WA perspective but I strongly suspect that they would have responded in the same way and directed me to the published data.

The value decline measured at the retail level is made up of a number of components that have changed as result of the introduction of the $1.00 per litre private label milk:

1. Lower price for private label milk.
2. Branded milk price response following the private label price drop, the branded milk could have remained at its previous level, but the branded price product price fell, I assume in an attempt to protect sales.
3. The change in the relative sales volume, that is the increase in private label and the fall in branded milk categories as customers shift to the lower priced private label milk.
4. The interaction with UHT and Corner Store milk sales. The lower priced private label milk will cause a corresponding drop in price for UHT or the small retailer branded milk sales. If there is not a corresponding price fall in these categories, then it is likely that sales in these categories will decline over time. I do not have access to the Corner Store milk sales or UHT sales statistics, it would be logical to assume that the price drop for the private label milk will also impact on these sectors within the market.

Milk Market in Transition

The available milk sales data suggests that the milk retail market is now near a new stable level post the impact of the $1.00/L private label milk, the initial changes have been significant and are now the new norm.

Private label price is down by 4.3% to 32.7%[1], the weighted average is not known but the Aztec data shows that the April 2011 private label price was $1.02/L in Western Australia, in April 2010 the corresponding price was $1.23/L and prior to January 2010 the price varied but was always above $1.25/L. In my calculation of the price drop I have assumed a price drop from $1.20/L to $1.00/L.

The price impact is not confined to the private label milk, branded full cream milk has fallen from $1.64 to $1.57 and branded modified milk prices have been stable at $1.67 in 2009-10 to $1.66, quarter ending May 2011[2]. In Western Australia about 1.5 litres of branded while milk is sold for every litre of branded modified milk, and as such I have assumed the average branded price has declined by 5 cents per litre, from $1.65c/L to $1.60c/L.

The wider price gap between private label milk and branded milk has resulted in increased sales of private label milk relative to the branded product. Private label sales increase varies greatly across Australia from 0.5% in NSW, full cream to 28.3% in QLD for modified private label[1]. In WA the private label full cream sales increased from 1.46ML to 1.86ML {April 2010 to April 2011} or 27%[2].

David Losberg, Policy Manager, ADF calculates that the WA private label increase is 9% in WA, this appears to be a conservative estimate of the change in sales, I have used this estimate in my calculations.

The relative size of each market, private label verses branded milk impacts on the value chain loss, assuming all the private label milk is reported within the Aztec data then the annual sales of private label milk totals 51ML up until April 2011.

The total sales of milk from all sources, is approximately 240ML in Western Australia.

Estimated Impact (WA)

Pre Discount	Market Share	$/L	Post Discount	Market Share	$/L
Branded	79%	$1.65	Branded	75%	$1.60
Private Label	21%	$1.20	Private Label	25%	$**1.00**
Weighted Average		$1,555	Weighted Average		$1.45

Value lost per litre of sales measured at the retail point 10.5c/L, a decline from $1.55 to $1.45/L, based on 240ML sales per year in WA the impact is $25.2M.

[1] - NF producer presentation WA June 2011.

[2] - Aztec milk sales data.

There are three sources of value loss associated with the reduced price of the private label milk Plain Label Price

Reduction	51 ML $10.2M per year
Branded Milk Price Reduction	189ML $9.4M per year
Customer switch from Branded to Plain Label	$5.6M per year

Supply Chain Response

In the months since the $1/L price initiative, there has been very little visible supply chain response to the lower value, essentially there are three ways to restore profitability or at least close the gap:

1. Reduce costs in the manufacturing controlled sections of the supply chain; milk collection, manufacturing efficiency and distribution to retail.
2. Lower the price of milk paid to suppliers, forcing a heightened search for on farm efficiency gains.
3. Manufacturers develop other milk markets to better offset their fixed capital in place and labour.

The financial impact on the milk value chain is $25.2M. The quality of the data is not perfect and as such there is a range likely with respect to the value and I expect the loss to be within $22-$28M per year in Western Australia.

Source: Steve Hossen Rural Consultant WA.