

A weekly newsletter from Freshagenda of major events in the domestic and world dairy markets affecting the climate for the Australasian dairy industry.

Highlights

- **Mixed Australian autumn outlook**
- **Fonterra & A2 make a deal**
- **World trade rises 3.2% in 2017**
- **EU milk output up 4% in December**
- **US fluid sales down**

What we are seeing this week

There are a few stories this week pointing to easing supply pressures for the global dairy market. Across the ditch, ex-tropical cyclone Gita is the latest installment in a wild year of weather for Kiwi farmers. It hits during the seasonal slowdown for milk production anyway, but it seems to have had a limited impact on any fears about product availability if the latest GDT results are a guide.

Much more material for the market balance is evidence that EU milk growth may be slowing as the seasonal peak approaches. The jury is still out as to whether the expected slowdown against stronger comparatives is enough to further support commodity values in coming months.

Dairy export index

Index loses ground – The Australasian dairy export index fell this week due to a stronger A\$ and steady to higher commodity values. Spot quotes for major commodities were mixed; butter remained at US\$5,300/t while WMP lifted US\$40/t to average US\$3,250/t. SMP quotes added US\$50/t to US\$2,000/t and cheddar sat at US\$3,700/t. The A\$ lifted just under 1c to **US\$0.79110** – sending the index down by **1 point to 188.7**.



Take note: The index is an indicator of spot trends in gross export returns to the industry based on quoted Australasian export prices, movements in currency and the total milk usage in exports by the Australian industry. It was set at 100 on 1 January 2000.

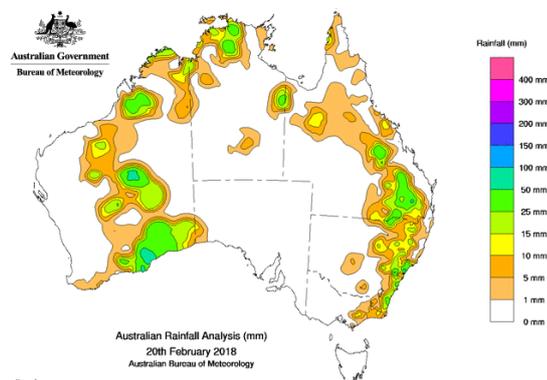
Australian news

Mixed autumn outlook – The Australian Bureau of Meteorology March to May rainfall outlook indicates large parts of Australia are likely to have a drier than average autumn. Northwest Victoria and scattered parts of South Australia and Western Australia will be drier. However, Tasmania is likely to have a wetter than average autumn. Daytime and night time temperatures are likely to be warmer than average for the northeast, central and southern parts of Australia during autumn.

La Nina in the tropical Pacific Ocean continues to retreat and is expected to decay by early autumn.

Saputo: \$1/l milk signals imbalance – Chief executive officer of Saputo Lino Saputo Jr questioned the retail sale of \$1/litre milk at The Australian Dairy Conference. He said as a consumer he saw an imbalance when milk is being sold for \$1/litre in a supermarket, where water could be purchased for \$3. However, the chief executive didn't want to comment on Murray Goulburn's (MG) contract to supply Coles with private label milk to support those prices. Saputo didn't know the economics and the contracts and refused to take a stand for or against \$1/litre milk, but said he would honour all MG contracts if Saputo gets approval from the Foreign Investment Review Board and the Australian Consumer and Competition Commission to purchase the cooperative's assets.

Domino's profit slide – Domino's has announced a disappointing interim result, with earnings and net profit nearly 10% below consensus expectations. New store openings were down 22% YOY, while same store sales growth in Australia and New Zealand slid from 17.4% in the corresponding period to 3.7%. Interim net profit rose 17.3% to \$58.6m on revenue for the six months ended 31 December of \$567.6m, a 5.2% increase on the comparative. Net debt is up 45.3% in six months, now 104.2% of net assets. Chief executive officer Don Meij reiterated that Domino's will remain a high-growth company, despite the weak



results. Citigroup analysts said the market is divided on Domino's. Shareholders would remember the company doubled its store count in five years, while others would be concerned about its Japan turnaround and the big second half it would need.

MDB Plan in limbo – The Senate has voted to block the Federal Government's changes to the Murray-Darling Basin Plan. Despite negotiations between the Opposition and the Government right up to the vote, the Greens convinced Labor to block changes which would have reduced the water being returned to the environment in southern Queensland and northern NSW by 70 GL.

In a response to the blocked plan, NSW Water Minister Niall Blair says he will start the process of withdrawing NSW from the plan. Victorian Water Minister Lisa Neville said the outcome of the Senate vote put the entire plan at risk. In South Australia, Water Minister Ian Hunter said he is prepared to launch High Court action against eastern states and the Commonwealth over the issue. Meanwhile, in letter to the SA Water Minister Federal Agriculture Minister David Littleproud said that if any state walked away from their commitment to the Murray-Darling Plan, the Federal Government will be legally obliged to deliver the original plan, 2,750GL of "real" water.

According to University of Adelaide professor and constitutional lawyer John Williams, states have the option to withdraw. However, the Commonwealth are still obligated to fulfil parts of the plan, and wouldn't require the states' legal authority to implement water buybacks.

New Zealand news

Fonterra & A2 strike a major deal – Fonterra and The a2 Milk Company have entered into a comprehensive strategic relationship, linking Fonterra's global milk pool and supply chain, manufacturing capability, in-market sales and distribution capacity with a2's brand marketing strength and capabilities. Fonterra will source a2 milk pools in New Zealand and Australia, Through a new nutritional products manufacturing and supply agreement, Fonterra will supply milk powder products in both bulk and consumer packaged formats for sale in South East Asia and the Middle East through the establishment of distribution and sales arrangements to assist a2's entry to the new markets. The agreement does not cover China, where a2 has an arrangement with Synlait.

Furthermore, the companies will explore the sale of a2 branded butter and cheese and China sourced liquid milk for sale in Australia, New Zealand and China. As part of the agreement Fonterra will hold an exclusive licensing arrangement for the production, distribution, sale and marketing of fresh a2 milk in New Zealand.

Gita sweeps the nation – Despite a downgrade to "ex-tropical cyclone", meteorologists warned that that wasn't a sign the storm was weakening. Huge rainfalls were recorded across the country and a state of emergency was declared in Taranaki, Nelson Tasman region, Selwyn district, Buller, Westland and Christchurch. The storm crossed the country on Wednesday morning, continuing to move southeast. Heavy rain hit Canterbury and Otago in the South Island, while gale force winds were sweeping across the area. In the North Island, Gita is expected to fan swells of up to six meters around Taranaki and Farewell Spit. It is expected to produce gales, torrential rain and storm surges of varying intensity.

Parliament passes DIRA-law change – The New Zealand Parliament has passed a law, retaining the efficiency and contestability provisions of the Dairy Industry Restructuring Act 2001 (DIRA) – ensuring the provisions to manage Fonterra's dominance don't expire at the end of May. Minister of Agriculture Damien O'Connor said the Government will undertake a review of DIRA considering key issues facing the dairy industry.

The review will include the industry's environmental impact, land use Fonterra's milk collection obligations and how to achieve the best outcomes for farmers, consumer and the economy. Fonterra's chairman John Wilson said Fonterra shouldn't be forced to collect milk from farms with poor environmental credentials. DIRA contains an entry-and-exit clause under which Fonterra must accept any application to become shareholding farmer in the cooperative and accept the farmer's milk supply. DIRA also states Fonterra has to sell up to 20% of its milk to other processors each season. Wilson said until two years ago milk had grown at 5% per annum, with a lot more milk available so other processors have been taking "a slice of a growing pie".

OC offers fixed milk price program – New Zealand's second largest dairy processor Open Country Dairy (OC) is offering suppliers a fixed milk price of NZ\$6.05kgMS for next season. Chief executive Steve Koekemoer introduced the full-season fixed milk price to remove volatility for farmers wherever possible. The offer was extended to farmers until 16 February, but depending on customer demand, OC may roll the fixed milk program out every year.

Synlait inks new Bright deal – Synlait has signed a new 5-year supply agreement with its largest shareholder, China's Bright Dairy for packaged infant formula. The agreement aims for a fourfold increase in product volume and builds on previous supply arrangements from 2011. It includes a commitment from both parties to prescribed production volumes each year for Bright Dairy's Pure Canterbury infant formula brand, which is the Chinese dairy company's flagship infant nutrition brand. Pure Canterbury will be sold throughout China in both online and traditional channels.

Global dairy markets

World trade rises 3.2% in 2017 – Our latest [Global Dairy Directions \(GDD\)](#) Trade Trends report shows that in milk-equivalent (ME) terms, global commodity exports of SMP, WMP and Cheese rose by 1.86bn litres milk equivalent (ME) in 2017, a 3.2% increase on the prior year. December commodity exports increased by 359m litres ME YOY, led by China & HK and MENA demand.

With low prices and improved availability after EU stockpiling in 2016, SMP trade rose 8% in 2017, despite a major slowdown in September and October as EU exports reached an all-time high of 779,003t over 2017. WMP exports fell 3.3% in 2017, despite healthy Chinese demand. December WMP trade lifted substantially, reflecting increased New Zealand shipments. Cheese trade rose 0.4% in December reflecting stronger shipments from the EU and Australia. This followed three consecutive monthly declines in cheese trade, to end 2017 2.5% ahead of the prior year. Trade in fat, particularly AMF, was subdued due to high prices and reduced NZ and the EU availability.

GDT was a mixed outcome – The GDT price index fell 0.5% at this week's GDT auction as commodity prices were mixed on a smaller offering of 20,256t. WMP prices saw a small gain of 0.6% to average US\$3,246/t with small increases across all contracts apart from April deliveries, down 1%. SMP averaged US\$1,832/t, down 5.2% from the prior event. All contracts fell, with an 11.3% decline recorded for March deliveries – a stark contrast to the latest event.

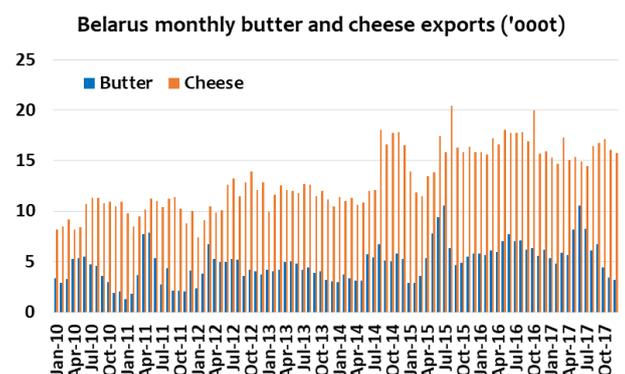
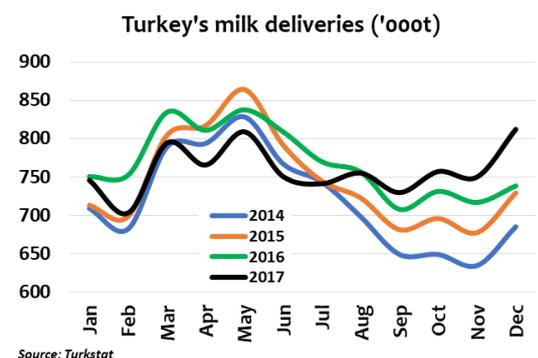
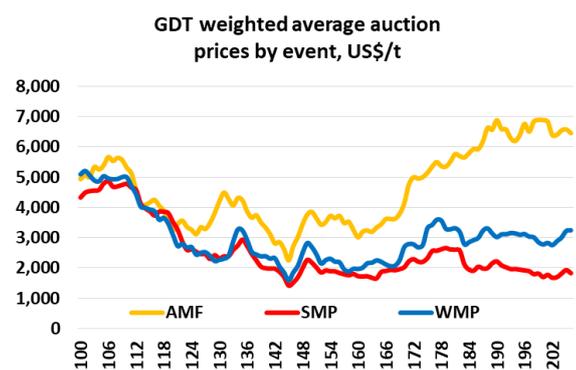
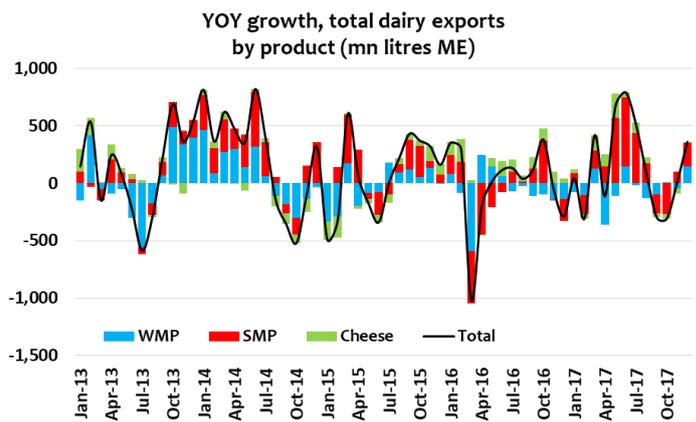
Butter prices rose 1.1% to average US\$5,334/t. All contracts gained, with deliveries in March and April up most 2.2% and 1.6%, respectively. AMF prices slid 1.9% to average US\$6,548/t with falls recorded for all contracts. Cheddar averaged US\$3,686/t, down 1.9% from the prior event. The March and April contracts recorded the greatest falls of 5.7% and 4.1%, respectively.

Turkey's production surged in late 2017 – According to TurkStat, milk collections fell 1.1% in 2017 to 9.1bn kg with slowing supply between January and August. Output recovered late in the year to end the December quarter 6.1% ahead of the 2016 comparative. Drinking milk output rose 7.2% for the year and accounted for 17% of total raw milk deliveries.

Cheese production increased 3.7% in 2017 to 662,151t. There were mixed trends for powders – SMP production rose 12.1% for the year at 87,732t while WMP output fell 1.2% to 45,238t. Cream and butter production rose 3.2% and 3.3% respectively for the year.

Mixed trends for CIS – Full-year data for the CIS region shows diverging trends for milk production. Ukraine's supply fell for the third consecutive year - down 0.6% in 2017 to 10.3bn litres. Meanwhile, milk output increased in Russia and Belarus – up 1% and 2.5% respectively on 2016. In the post embargo-era, Russia has not been able to substantially increase its self-sufficiency in the dairy sector.

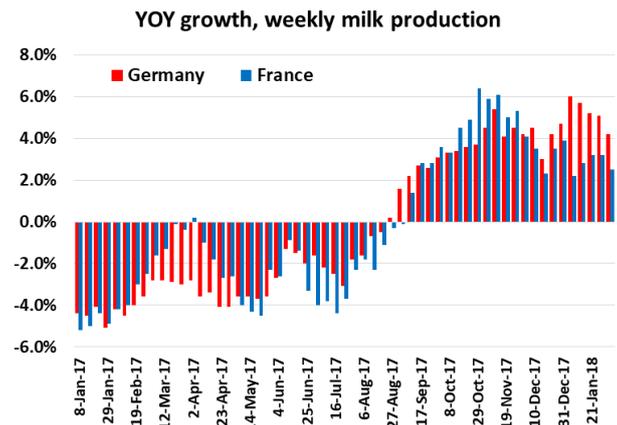
Dairy exports to the CIS region in 2017 were weak, with falling shipments across all product categories except fat-filled milk powders & mixtures and infant formula. Cheese exports fell 7% to 234,100t – this was down 48% on the all-time high reached in 2013. SMP exports fell 10% in 2017 to 145,194t, while total fats (butter equivalent) shipments dropped 18% to 111,887t.



EU dairy market and policy

Milk up 4% in December – EU-28 milk growth is slowing. Eurostat reports milk supply increased 4% YOY in December, following a 5.9% YOY increase in November and 4.9% in October. December output from major suppliers Germany and France rose 5% and 3.1% respectively. UK supply figures were again revised, with output up more than 7% YOY in each month between August and November, before slowing to a 5.4% YOY increase for December. Irish production increased 13.6% YOY in December, while Dutch output fell just 0.1% YOY.

More recent weekly data indicates supply remains healthy but is slowing – in week 5 (ending 4 February 2018) German production rose 4.2% (a little slower than recent weeks) while French output increased 2.5% over the same week in 2017. UK milk production fell 0.3% YOY in the first ten days of February while Dutch supply has reportedly been near flat into the new year.

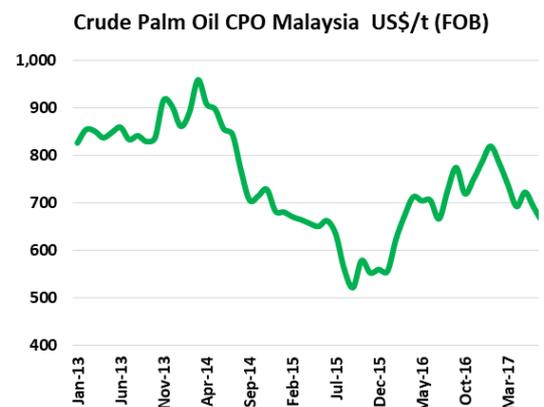


Belgium proposal to lift Russian sanctions – A bill lifting Russian sanctions was introduced to the Belgian Parliament only a week after the EU extended its economic sanctions against the country. EU council president Donald Tusk and German chancellor Angela Merkel said lifting sanctions would send the wrong signal to Russian authorities. In a response to the EU’s extension, Russia has prolonged its embargo of agricultural goods from the EU until the end of 2018. The embargo includes food and agricultural products such as fresh fruit, vegetables, dairy and meat products from the US, EU, Australia and other countries. The Russian minister of agriculture Alexander Tkachev hopes the food embargo will stimulate the production and not be limited to 2018.

Irish milk growth by numbers – Since the abolition of milk quotas in 2015, the Irish national dairy herd has grown almost 350,000 head to 1.4m last year, with a further 2% increase in cow numbers expected this year. Milk volumes have followed suit, with the Central Statistics Office (CSO) reporting 7.268bn litres of milk was collected by Irish processors in 2017. Production is expected to rise 363.4ml to 7.6bnl in 2018. The increase in volume is driven by the maturing of Ireland’s national dairy herd, meaning the milk delivered has a higher fat and protein content, CSO figures showing milksolids were up 0.2% in 2017 to 7.57%.

Ban on palm oil use in biofuels – Members of the European Parliament voted to modify a draft law that would ban the use of palm oil in motor fuels starting with 2021 in order to meet climate objectives and prevent deforestation.

Leaders in Indonesia and Malaysia, which jointly account for 90% of the world’s palm oil supply, are concerned about the decision and are warning of a potential trade conflict with the lives of more than 6m people (mostly farmers and plantation workers) likely to be negatively affected. With 40% of Indonesia’s palm oil exports to Europe converted into biofuels, prices for the commodity fell to US\$655/t in mid-February.

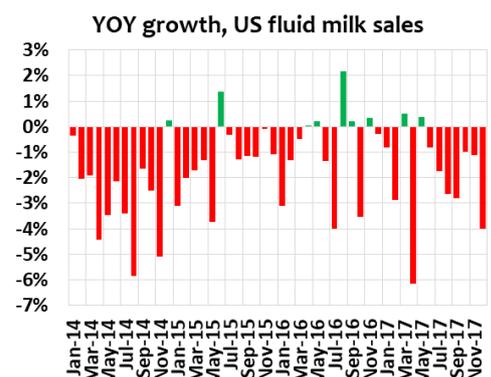


Farming fund for the rich – A special fund to prepare farmers for Brexit was slammed by Labour MP Paul Flynn as “income support for the rich”. Flynn sits on the House of Commons environment, food and rural affairs committee, whose recent report made the recommendation of creating a ‘special fund’. Flynn opposes a fund, while committee chairman and Conservative MP Neil Parish said the Government should help farmers adapt to new trading circumstances.

US dairy market and policy

Fluid sales weaken further – Packaged fluid sales by milk handlers fell 1.9% in 2017 to 21.8mt. Conventional milk sales dropped 2.3% last year despite a 2.2% rise in whole milk sales, offset by a 4.7% fall in fat-reduced sales. Organic milk sales were flat in 2017 and accounted for 5.3% of fluid sales.

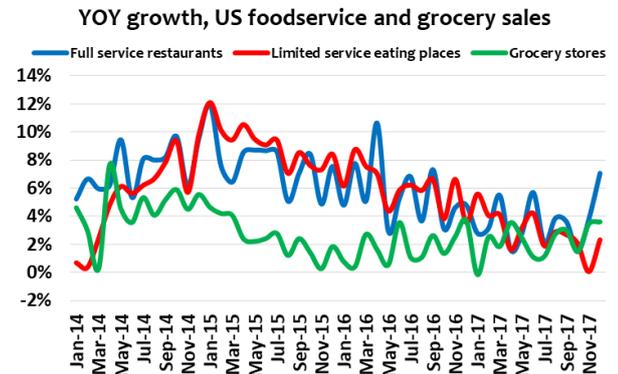
Another record low for milk sales in 2017, the eighth consecutive record low, is



increasing fixed costs for processors and lowering paychecks for farmers from the high-value Class I market. “For decades, USDA reported that total fluid milk sales remained about the same year in and year out. Every year, increases in the US population just about offset declines in per-capita consumption. However, beginning in 2010, fluid sales began a decline that continues today,” said Bob Yonkers, former chief economist for the International Dairy Foods Association (IDFA). According to Cheese Reporter, the average January 2018 retail price for a gallon of whole milk was US\$2.96, down more than US\$0.19 from the prior month and nearly US\$0.36 lower than the same month in 2017.

Fast food sales mixed – According to Census Bureau retail data, sales in limited-service eating outlets rose 2.9% in 2017, but slowed to a growth of 1.5% in the December quarter. Restaurant operators continue to be confident about business conditions in upcoming months. However, stocks of other-than-American cheese varieties (including Mozzarella) are exceptionally heavy and ended 2017 28% above the 5-year average, reflecting a major slowdown in pizza sales over the year.

Sales in full service restaurants rose 3.6% in 2017. Sales in supermarkets and other grocery (except convenience) stores ended 2017 up 2.2% compared to the prior year and picked-up during the December quarter.



Corporate sector

McDonalds drops dairy from Happy Meals – McDonald’s is removing cheeseburgers and chocolate milks from its Happy Meals in the US from June. The fast-food chain is cutting down on the calories, sodium, saturated fat and sugar that kids consume at its restaurant. Customers can still order cheeseburgers and chocolate milk with their Happy Meals, however, the items will not be listed on its menu. Four years ago, McDonald’s removed soft drinks from its Happy Meals and since then orders for sodas have dropped 14%. The aim is for Happy Meals to have 600 calories or less and under 600mg of sodium.

Agropur creates investment platform – Canadian dairy company Agropur booked a 7.7% YOY sales increase in 2017 to CA\$6.4bn. Agropur CEO Robert Coallier attributes the company’s growth to its investments. In 2017, Agropur invested CA\$174m in its facilities, including CA\$133m in Canada and in the US, where it plans to expand its cheese manufacturing plants in South Dakota. Its Natrel milk brand maintained its market dominance in the organic category with a 64% share. Its OKA brand has grown 83% in sales volume since 2014. Agropur’s yogurt brand iögo holds a 13.9% market share in Canada, growing twice as fast as the category. At its annual general meeting, Agropur highlighted its focus on innovation, through its CA\$40m joint investment with investment firm Caisse de depot et placement de Quebec (la Caisse) platform that will support development of businesses within the dairy industry.



Friesland buys Huishan shares – Dutch dairy cooperative FrieslandCampina has acquired the remaining shares in a joint venture with China’s Huishan Dairy Holdings. The Dutch cooperative now has full ownership of Friesland Huishan Dairy, the JV formed in 2015 to produce and market infant milk formula in China under the Dutch Lady brand. The company is located near Shenyang in Liaoning province and also produces tea and coffee creamers for other Friesland companies.

Nestle: slowest growth in more than 20 years – Consumer goods company Nestle has delivered a disappointing result for 2017, with sales growth dipping to a two decade-low. Revenues rose 2.4% on an organic basis, just below analyst expectations of 2.7%.



Nestle is aiming for revenue growth of between 2% and 4% in 2018. Chief executive Mark Schneider said the group is looking at options, including a potential sale of its 23% stake in L’Oreal. Schneider took over as chief executive last year and has overseen the sale of Nestle’s US chocolate business and the purchase of Canadian dietary supplement maker Atrium Innovations for US\$2.3bn. The group indicated that it would continue its strategy of active portfolio management, it’s sweet spot is small to mid-sized deals, says Schneider, but nothing is ruled out.

Danone cuts Yakult stake – French dairy company Danone plans to reduce its 21.29% stake in Japanese probiotics firm Yakult Honsha Co to 7%. Danone’s divestment is set to be completed in March, however, the French company will remain Yakult’s largest shareholder and continue to be represented on its board of directors. Yakult is launching a JPY36bn share buyback program. Analysts are expecting positive market reactions to the divestment.

Danone also announced it has signed an amended memorandum of understanding with Yakult confirming the two companies’ long-term strategic relationship and shared vision to promote probiotics as part of a balanced diet.