Recent developments in the Australian dairy industry

IDF Melbourne

25 November 2004

The chronicle of change

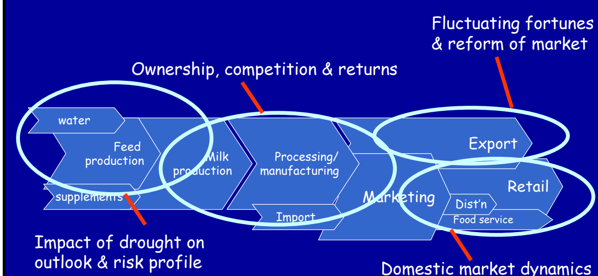
Drivers:

- Deregulation of prices and supply
- Drought
- Consolidation through the chain
  - retail, processing, farm

Implications:

- Working in a transparent, national market
- Managing risk in a volatile global market
- Innovate and optimise…or perish
- A Trans-Tasman juggernaut?
- Where to next?

Change to the Australian dairy industry value chain



Consolidation through the chain

Realities of our retail market

- Demographics are quite different
- "Big two" control 75%+
- Trail "global retail leaders" in many areas
  - Scope of the chain retail offering
  - Category management
  - Supply chain control
  - Use of the private label
- Independents working hard to hold ground
  - Small but important for diversity

The domestic dairy retail market

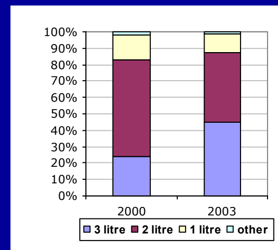
- Growing % of business through major chains
  - 61% of dairy product sales through supermarkets
  - Still a high level of competition across the dairy cabinet
  - Milk drinks, yoghurts, cheese
- Whole milk 2L and 3L is a now a major commodity
- Increased impact of private label and EDLP
- The convenience channel
  - More important for margins in drinks market
  - But retailers quickly taking control
  - Petrol station chains add $10bn in sales to Coles & Woolies
- Scope for profit is in fewer places
  - Where brands have leverage
  - Innovation in convenience, functionality and "trend

The domestic dairy retail market

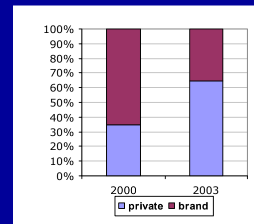
- Not been able to convey a stronger price/value proposition through to the consumer
- We are still in the midst of retail transition
  - "Factory gate pricing" is taking effect
  - Private label's capture of commodity lines
  - Battleground over the convenience market
  - Better performance of the dairy cabinet
- Still a high level of price competition for market share

Supermarkets taking charge of milk

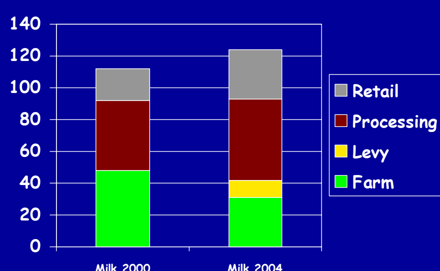
Growth of the 3 litre milk pack…



…and the dominance of the private label (2 litre sales)

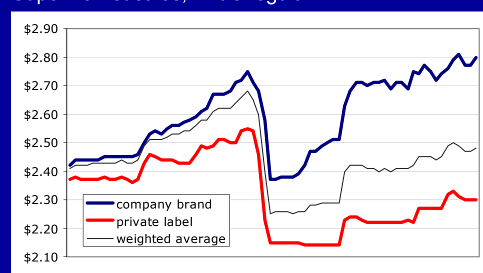


The shift in margins (supermarkets - regular milk)



The consumer is the winner

Supermarket sales, 2 litre regular milk…



Consolidation of dairy companies

- No major consolidation yet:
  - 2 levels: brands, processing capacity/assets
- Chipped at the edges in past 5 years
  - Not a lot of change in the level of competition
- One big change in ownership
  - Entry of Fonterra with dual motives
  - Consolidation of domestic consumer business
- More significant use of alliances & tie-ups
  - Improving use of plant capacity & milk

From the picture a few years ago…

Listed public companies
- National Foods
- Pauls

Global marketers
- Nestle

Traditional co-operatives
- Murray Goulburn
- Bonlac
- Dairy Farmers
- Tatura
- Bega
- Warrnambool

…now we have a variety of models

Listed public companies
- National Foods
- Warrnambool
- Parmalat

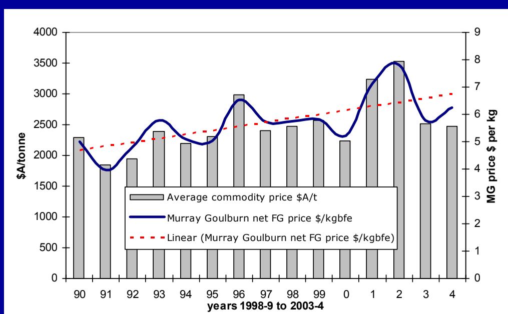
Traditional co-operatives
- Murray Goulburn
- Tatura
- Bega

Global marketers
- Fonterra/Bonlac
- Nestle

Hybrid models
- Dairy Farmers

The value of milk

Export market is the driver



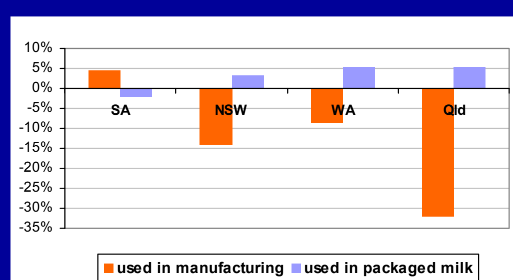
Major production regions

Southern regions dominate the landscape:
- 70% of milk production
- low-cost by world standards

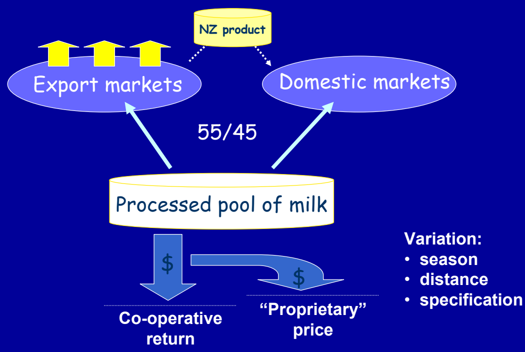
Year-round production regions
…now in decline

Value of other "milk pools" is the blended value that each company can pay based on product returns on:
- Fresh products
- other dairy products (affected by world markets)

Falling volumes for manufacturing
(change in output - last 4 years)



What drives structure & level of prices



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Signals to the farmgate

- Greater diversity in opportunity
- Most change in "market milk" regions
- Limited departure from traditional co-operative pricing approaches
  - Preserving a proven approach?
  - Recent years scarred by drought?
  - Providing sufficient challenge to encourage scale & innovation?

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We are seeing clearer price signals

- Collection efficiency (scale)
- Transport costs

The farm

- Component values
- Seasonality of supply
- Overall return to supply region
- Supply to match demand

The factory

- Milk components for niches
- HACCP/QA compliance

The market

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Milk production

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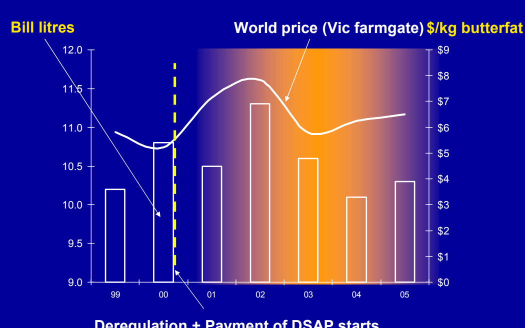
Where have we been…
production & milk prices



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Industry's experience from drought

- The impact was varied: recovery will be uneven
- Has hurt farm sector confidence
- The diverse impact on production, profit, debt
  - National production fell 11%, herd cut 8%
  - Recovery underway but patchy
  - The recent past affected expectations
- Helps define our industry's production limits
  - Somewhere between 13-15BL?
- Has had a significant impact on plant efficiency
  - Lower throughput, overhead recovery

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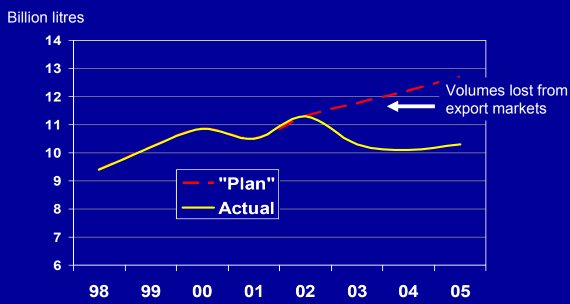
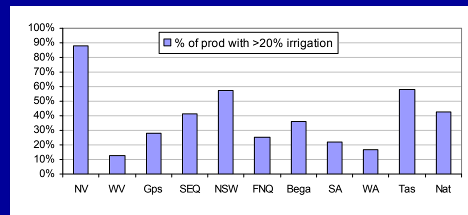
Not just a farm thing…

…drought has hurt our markets

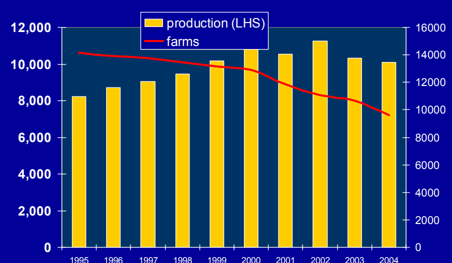


Reliance on irrigation

- Around 50% of milk from farms with dependence on irrigation
- Water reform is one of our most critical challenges
  - affecting value, access, efficiency



Attrition has been significant…



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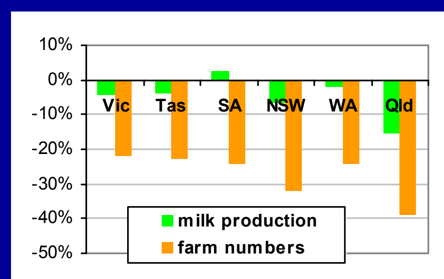
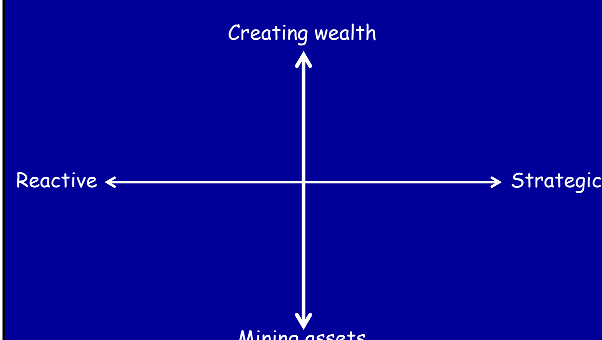


A large spread of farms



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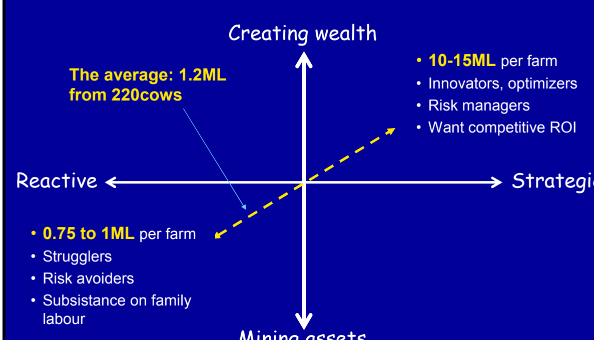

Where to from here?

Industry's future challenges

- Corporate changes will be important:
  - Likely to see 3 major groups emerge
    - Fonterra, MG, + 3rd player (domestic product focus)
  - "Choice" is part of the fabric
    - Competition law
    - Australian culture
- Continuing alignment with developing markets
- Continuing evolution of the production business
- Production challenges are greatest
  - Recovery is underway – 2004-5 will grow 1-2%
  - Managing feed base and climate risk
  - Coping with water market reform
  - Improving the perception of wealth creation opportunity

The industry's future challenges

Farm → Primary Processing → Finished Goods Processing → Marketing Distribution → Consumer

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Understand domestic & international market context

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- What is "competitive"?
- How competitive are we?
- What can we do better to support the value chain?
- To what extent should we integrate along the value chain

The industry's future challenges

- Measuring returns?
- How to optimise the position
- What options are available?
- What is best use of capital?

Understand domestic & international market context

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- To what extent should we integrate along the value chain