Queensland Dairyfarmers' Organisation

Queensland Dairyfarmers' Organisation Limited ABN: 90 090 629 066

Senator Alan Eggleston
Chairman
Senate Economics References Committee
Department of the Senate
PO Box 6100
Parliament House, CANBERRA ACT 2600
Email: economics.sen@aph.gov.au

31st August 2011

Dear Senator Eggleston,

Re: Inquiry into the impacts of supermarket price decisions on the dairy industry

The Queensland Dairyfarmers' Organisation Ltd (QDO) welcomes the opportunity to provide to the Senate Economics References Committee with the following supplementary submission, which contains new and updated information relevant to the inquiry, for the Committee's consideration.

In particular the QDO wishes to address the statement contained in the Senate Committee's Second Interim Report, "The impacts of supermarket price decisions on the dairy industry", being,

> Page 64, section 5.52, "While the committee is mindful of the many submissions outlining the potential impacts of lower supermarket milk prices on the dairy industry, it is equally cognisant of the benefits to consumers from sustained lower prices. As a general rule, lower prices are good for consumers. Provided farmers have the opportunity to make a reasonable profit and in the absence of substantiated damage to the dairy industry, the interests of consumers must not be overlooked."

The following information is specifically provided to demonstrate and substantiate damage to the dairy industry which is currently being incurred. The current situation, particularly in Queensland is clear evidence of market failure. This failure is further highlighted following the recent devastating impacts of natural disasters on the Queensland dairy industry.

From the evidence presented in the following submission, it is clear that the current use of milk as a close to or below cost 'advertising agent' by major supermarkets is having a direct cumulative and detrimental impact of the domestic fresh milk dairy industry and is progressively undermining the viability and sustainability of the domestic dairy industry.

With this evidence it is clear that the current practices of supermarkets needs to be addressed to ensure the future viability and sustainability of the domestic fresh milk dairy industry, which is in the interests of all in the industry supply chain, including the major supermarkets, all levels of Government and most importantly Australian consumers.

The QDO asks of the members of the Senate Economics References Committee to carefully consider what is the medium to long term implications for dairy farmers, processors, vendors, small retailers etc and employees involved in the fresh milk industry supply chain and to choice and prices to consumers, if the current practices of major supermarkets using fresh milk as a, near or below cost, marketing agent are allowed to continue.

As such, the QDO appeals to you and your committee members to adopt our recommendations and to work with our industry to implement these recommendations as a matter of urgency.

The following submission should be read in conjunction with QDO's other submission's to the Senate Inquiry.

The QDO stands ready to provide any further information, where possible, Committee members may require and would welcome the opportunity to discuss any of the information presented.

Yours Sincerely,

Brian Tessmann
President
Queensland Dairyfarmers' Organisation Ltd

Queensland Dairyfarmers' Organisation Limited ABN: 90 090 629 066

Second
Supplementary Submission to the

Senate Standing Committee on Economics

Inquiry into the impacts of supermarket price decisions on the dairy industry

31ST AUGUST 2011

Contents

Introduction

The current 'milk price war' initiated by Coles supermarkets has major implications for the Australian fresh milk industry.

A range of implications and impacts face the Australian fresh milk industry from the current supermarket discounting, including:

- A higher share of sales of lower-priced, low margin supermarket store brand products, at the expense of higher margin processor proprietary brands, weakening the overall wholesale returns to processors.
- a shift in sales between convenience and food service outlets and supermarket stores, including food outlets sourcing product in supermarket stores rather than the "route trade".
- the flow-on affect of reduced processor margins to farmers in reduced farmgate prices. The impact has already been felt by Parmalat PDA suppliers, as part of their monthly milk payment is directly linked to Parmalat proprietary branded milk sales on a month to month basis.
- A lengthy milk price war will weaken the processor proprietary brand proposition in fresh white milk undermining the viability of marketing and product innovation. Returns from branded products are critical in the mix of returns to processors, which affect affordable prices for milk to dairy farmers at farmgate.
- Lower overall wholesale prices as a result of an increased share of supermarket store brand sales volumes is resulting in greater commoditization of the fresh milk sector. This will force changes in the respective roles and contributions that supermarket store brand supply contracts and branded milk products have in processors' business models.
- The impact on retail sales and wholesale returns has varied state-to-state, due to the differences in retail prices and sales mix. The impacts on supply chain returns are potentially greatest in Queensland, where retail prices of branded lines were typically lower and farmgate prices and production costs for milk typically higher for year-round supply of milk to processors, as opposed to seasonal production in southern states.

Since Coles initiated it's supermarket milk discounting campaign on the 26th January, the Queensland Dairyfarmers' Organisation Ltd (QDO) has been monitoring the impacts in the Queensland market place, to processors and to dairy farmers, in particular for dairy farmers whose milk payments are directly linked to the sales of processor branded milk.

From this monitoring process the QDO has obtained clear evidence that the current, near or below cost, discounting of supermarket store brand fresh milk and associated marketing tactics, initiated by Coles, and followed by other major supermarkets, is directly causing damage to the dairy industry, including through;

1. causing the loss of market share of proprietary brand milk sales as major supermarkets increase the market share of their own supermarket milk brands through discounting their store brands, to near or below cost, which is lowering returns to processors through;
    - processors losing sales and market share of their proprietary branded products which provide processors with sustainable margin,

- forcing processors to increase marketing and advertising expenditure to try and retain market share,
- forcing processors to discount their proprietary branded products to try and retain market share.

Consequently, these impacts on processors undermine the ability of processors to pay dairy farmers sustainable prices.

2. the loss of market share of proprietary brand milk sales to discounted supermarket milk brands causing a direct lowering of milk payments to a group of Queensland farmers whose milk payments are directly linked to the volume of monthly sales of proprietary brand milk.

To date one group of 185 dairy farmers in Queensland, which supply the processor Parmalat, have collectively lost an estimated $767,858 to the end of July, directly due to latest the discount milk price war started on the 26th January 2011, and if the discounting continues this loss could amount to more $1.5 million across twelve months. The impact on this group of farmers will continue to grow if supermarket store brand milk, near or below cost, discounting continues.

At the start of August this year another group of Queensland dairy farmers, which supply the processor Lion (formerly National Foods), had a slight farm gate price increase announced for their new contracts. However the slight increase in price of between half and one cent per litre (1 to 2 percent) for southern Queensland and Far North Queensland respectively is still far below the current rate of inflation and input costs increases, and follows a significant price cut last year of between 15 and 20 percent, which includes for milk which is used to fill Coles store banded milk bottles.

Other analysis of the impacts of the current supermarket milk price war, initiated on the 26th January 2011, clearly demonstrates that impacts are being incurred, particularly with the loss of processor proprietary brand sales and market share to the, near or below cost, discounted supermarket store brand milk.

Analysis of the impacts incurred during 2010/2011 from the current supermarket milk price discounting, compared to 2009/2010, present that the domestic fresh milk industry has lost an additional $77 million in retail value of milk. If the current discounting by supermarket continues through 2011/12, this additional loss of retail value of milk is forecast to increase substantially.

For processors, analysis of the national impacts of the latest supermarket milk price war, present that processors will lose an estimated $44 million in product sale margins for year 2011 if the current discounting continues over a twelve month period and impacts are limited to the current trends in market share shift between processor proprietary brands and supermarket store brands. Whereas, if processors have to resort to discounting proprietary brands to try and protect market share, which has started to occur, the impact to processor margins is forecast to increase to around $199 million. For Queensland these impact estimates are between $6 and $36 million respectively.

For farm gate prices nationally this analysis presents potential impacts of between 4% and 20% respectively. These categories of impact would be catastrophic for the majority of dairy farmers involved in supply fresh milk to the Australian domestic fresh milk market.

In addition to the above direct impacts, the discounting of supermarket store brand fresh milk, to near or below cost, by major supermarkets is also impacting on the dairy industry domestic fresh milk supply chain by causing;

- the postponement of investment in processor infrastructure,
- the postponement of investment in dairy farm capacity and sustainability,
- contributing to dairy farmers deciding to exit the industry and the loss of young dairy farmers to alternative employment.

Further to the above, this impact is also increasing across the whole Australian milk market as the major supermarkets are taking market share from the ‘route’ trade including from independent fuel stations, corner stores, other small retailers, and distributors and vendors.

Critically in Queensland the supermarket discounting is devaluing milk, lowering returns to processors, undermining the ability of processors to pay dairy farmers sustainable prices at a time when the Queensland dairy industry has been devastated by natural disasters and is currently short of fresh milk to meet the demands of the Queensland market. This situation is a clear example of market failure. Natural disaster damage and losses are estimated to amount to around $80 million for 2011 for the Queensland dairy industry.

From the evidence presented in the following submission, it is clear that the current use of milk as a, close to or below cost, ‘advertising agent’ by major supermarkets is having a direct cumulative and detrimental impact on the domestic fresh milk dairy industry and is progressively undermining returns, viability and sustainability of the domestic fresh milk industry.

With this evidence it is clear that the current practices of supermarkets needs to be addressed to ensure the future viability and sustainability of the domestic fresh milk dairy industry, which is in the interests of all in the industry supply chain, including the major supermarkets, all levels of Government and most importantly Australian consumers.

As such, the QDO appeals to the Australian Government to adopt the recommendations presented by Australian Dairy Farmers’ (ADF) and QDO and to work with our industry to implement these recommendations as a matter of urgency.

In particular the need for;

- a mandatory whole of supply chain code of conduct, headed by an Ombudsman or Commissioner that can enforce the code, and ensure that contracts, prices and supply conditions are not unsustainable,
- strengthening the Competition and Consumer Act 2010 to prevent predatory pricing and deceptive and misleading conduct including that:
    - a definition of unconscionable conduct be inserted into the Act;
    - an ‘effects’ test be reintroduced; and
    - a statutory duty of good faith be enacted as part of the Act.
- for the ACCC to use its price monitoring powers under the Competition and Consumer Act 2010 to monitor prices, costs and profits relating to the supply of drinking milk and marketing tactics used by major supermarkets over an extended period of time. And for the Senate Economics References Committee to examine this information annually for at least five years.

Why Do Major Supermarkets Use Fresh Milk as a Discount Marketing Agent?

As an unintended consequence of deregulation, since 2000, due to its unique characteristics, the major supermarket duopoly, with their dominant share and power in the domestic market, has utilised fresh drinking milk as a discount marketing agent to serve a range of purposes. This has led to the progressive unsustainable devaluation of fresh drinking milk products nationally and market failure within the Australian domestic fresh drinking milk market.

Fresh drinking milk is a well defined market in Australia. Fresh drinking milk is unique in nature due to it being an every day, fresh, high quality nutritious, dietary staple of our community. Due to this uniqueness fresh drinking milk as a product is also very inelastic in nature.

Fresh milk is a foundation staple of our population's daily dietary needs and expectations and the vast majority of Australian's take for granted that they are able to purchase milk from any shop in Australia with a refrigeration unit. Public disturbances due to the shortage of fresh milk during the floods in Queensland highlight that demand and expectation of consumers.

Australians drink some 103 litres of fresh milk per year and collectively this equates to the consumption of 2.31 billion litres per year (2010/2011), which makes up some 25.4 percent of the Australian dairy industry annual milk production (data source Dairy Australia). As such fresh milk is one of the most frequently purchased items by consumers.

Due to all of these unique characteristics, fresh drinking milk serves as an ideal discount marketing agent for supermarkets and other retailers.

Coles' current tactics, in using its supermarket store brand milk as a near or below cost advertising agent, are designed to achieve a number of goals including:

1. seeking to promote a perception to consumers that Coles is a cheaper grocery provider than their competitors;
2. luring more consumers into their stores on a more regular basis, away from other retailers, in particular to take market share away from its main large retail competitor Woolworths. It should be noted that Woolworths has stated publicly that the milk price cuts are unsustainable.
3. increasing the sales and market share of Coles' store brand milk at the expense of the market share of other brands, particularly in the reduced fat milk category;
4. increasing the size and purchasing power of Coles' store brand milk tenders, as well as other dairy product tenders; and
5. to gain greater market share in the 'route trade' by taking business away from its smaller retailers such as corner stores and vendors, which could see many smaller operators become unviable.

As Coles' sales of its supermarket store brand milk increase, as a result of it's near or below cost 'loss leading' discounting, the following impacts are occurring;

- Devaluation of fresh drinking milk across the nation as other major retailers have reduced their supermarket store brand retail prices as well, which is resulting in lower returns to the fresh milk supply chain;
- Processors financial returns are impacted due to;
    - the loss of market share of their own proprietary brands, which have sustainable margins compared to the unsustainable supermarket brand milk contracts,
    - the need to discount their proprietary brands to try and retain market share. Already there is evidence that one major processor has dropped the retail price of their whole milk proprietary brand by 15 percent,
    - increasing marketing and advertising expenditure on proprietary brands to try and retain market share,

  All of these affects reduces the financial viability of processors and will inevitably mean that further downward pressure will be placed on farm gate prices when processors seek to renew contracts with dairy farmers;
- Dairy farmers which have farm gate price contracts that are linked with processor proprietary brand sales have already seen a drop in their milk cheques as processors proprietary branded milk lose market share to supermarket store branded milk;
- Smaller retailers are placed at a significant competitive disadvantage because of the higher wholesale prices they pay for branded milk;
- Milk vendors are placed at a significant competitive disadvantage as their regular customers, for example coffee shops, move to purchase milk at a lower price from supermarkets rather than from the vendor,
- The combined impact of lower returns to the fresh milk supply chain will have resulting impacts on investment and employment throughout the supply chain.

It is the contention that Coles is selling their supermarket store brand milk below their relevant cost of supply through to the supermarket 'check out', for an anti-competitive purpose through both misuse of market power and predatory pricing as outlined above, and in particular in the case of regional and remote areas of Australia.

In addition the QDO believes there is a prima facie case of price discrimination from supermarket store brands against processor proprietary brands, where the supermarket has specifically sought to target their supermarket store brand discounting against comparable processor proprietary brands.

The long term risk of continuing to allow major supermarkets to continue to use their market power to take control of more market share, as has been the experience in the United Kingdom, that once such an environment is allowed to develop, particularly at the retail level where supermarket store brands dominate the market, it will result in;

- Devaluation of fresh milk as supermarkets use it as a loss leader marketing agent,
- Unsustainable returns to the supply chain,
- Less competition, choice and higher prices for consumers,
- Little or no investment in product innovation,
- Divestment from the supply chain, threatening supply security.

Impacts of Supermarket Discounting of Fresh Milk in the Domestic Market

On the 26th January, Wesfarmers wholly owned company, Coles launched a national advertising campaign using Coles store brand milk at a discounted price of up to 33 percent reducing the price to $1 per litre.

Immediately following the Coles announcement Woolworths dropped their price of Woolworths brand milk to match the price and other stores followed suit with some such as Aldi, cutting the price even further to $1.99 for 2 litres and $2.89 for 3 litres.

The Coles supermarket strategy of lowering prices of Coles store brand products is targeted at delivering a number of major outcomes;

1. being to attract buyers to shop at Coles stores rather then at their competitors, and
2. to encourage shoppers to buy Coles branded products rather than manufacturer proprietary branded products,
3. attract wholesale and or retail sales away from the ‘route’ trade to their Coles stores.

Over the period from February to the end of June 2011 this discounting has led to a significant change of market share, with discounted supermarket store brands gaining market share at the expense of processor proprietary milk brands, which have lost sales and market share.

By the end of June 2011 discounted supermarket store branded milk sales has grown by 10 percent to account for some 53 percent of total supermarket milk sales nationally and close to 60 percent in Queensland. For the five months from February to June 2011 supermarket store brands increased their market share of all supermarket milk sales by 15 percent.

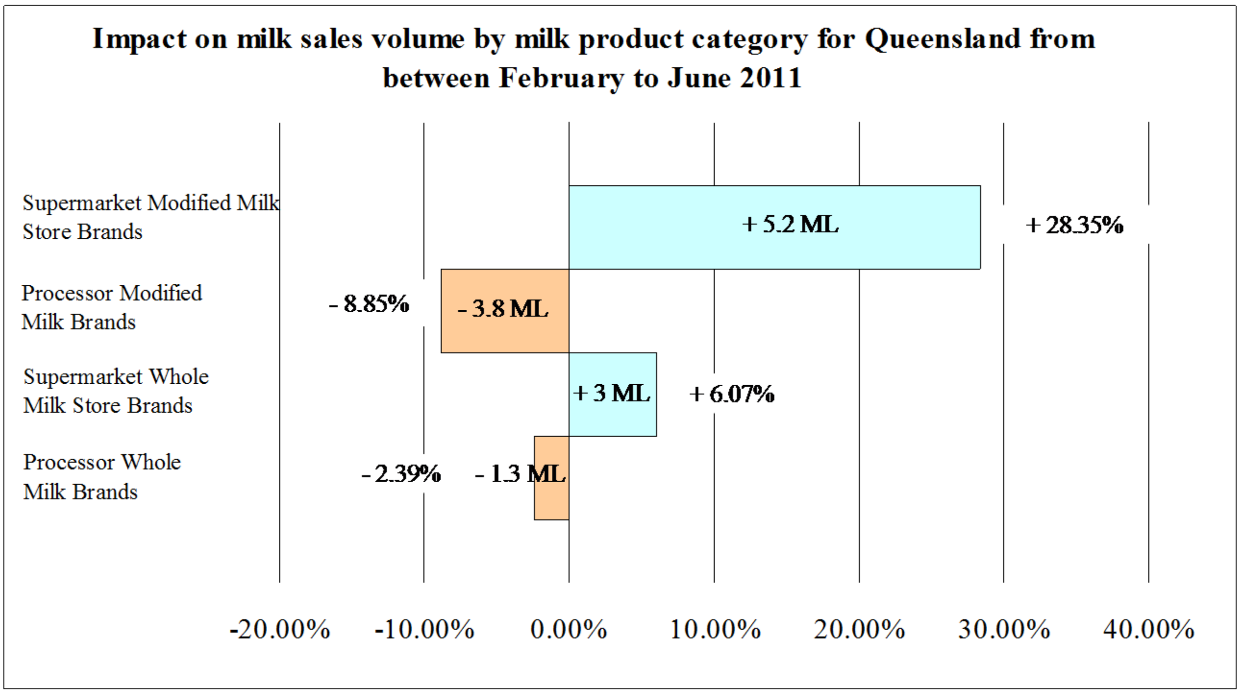
Nationally, from 1999/2000 to 2010/2011 the major supermarkets have used, near or below cost, discounting and other associated marketing tactics to grow their supermarket store brands market shares from;

- 31 percent to 71 percent share of all whole milk supermarket sales, and
- 12 percent to 53 percent share of all modified milk supermarket sales.

The most significant shifts in market share has occurred where the supermarket discounting has been targeted at the highest growth opportunity for Coles from such a strategy, which has been in the modified or reduced fat milk category, where Coles implemented a discount of 33%.

As can be seen from the above market share figures Coles has targeted the largest discount on the modified milk category which has the best opportunity cost for market share growth through the use of near and below cost discounting.

The following graph provides a display of the change in market share for the five months following the initiation of the Coles store brand milk discounting campaign.



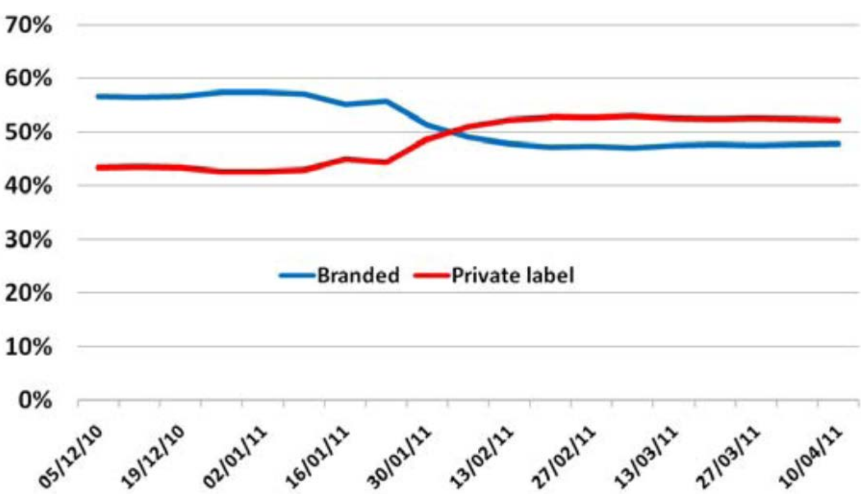
Source: Dairy Australia data

As is presented in the above graph the most significant shift in market share is seen in the modified milk category, where supermarket store brand modified milk over the period of five months has grown by 28.35 percent in Queensland and processor proprietary modified milk brand sales have fallen by 8.85 percent in Queensland.

These changes also indicate that the supermarket store brand modified milk has taken market share from the 'route trade' as well.

Nationally and more so in Queensland the change in market share between the supermarket and processor brands due to the discounting by supermarkets has seen the sales of supermarket store brands exceed the sale of processor brands.

National supermarket sales - % share of fresh white modified milk (Dec 2010 to April 2011)



Source: Dairy Australia

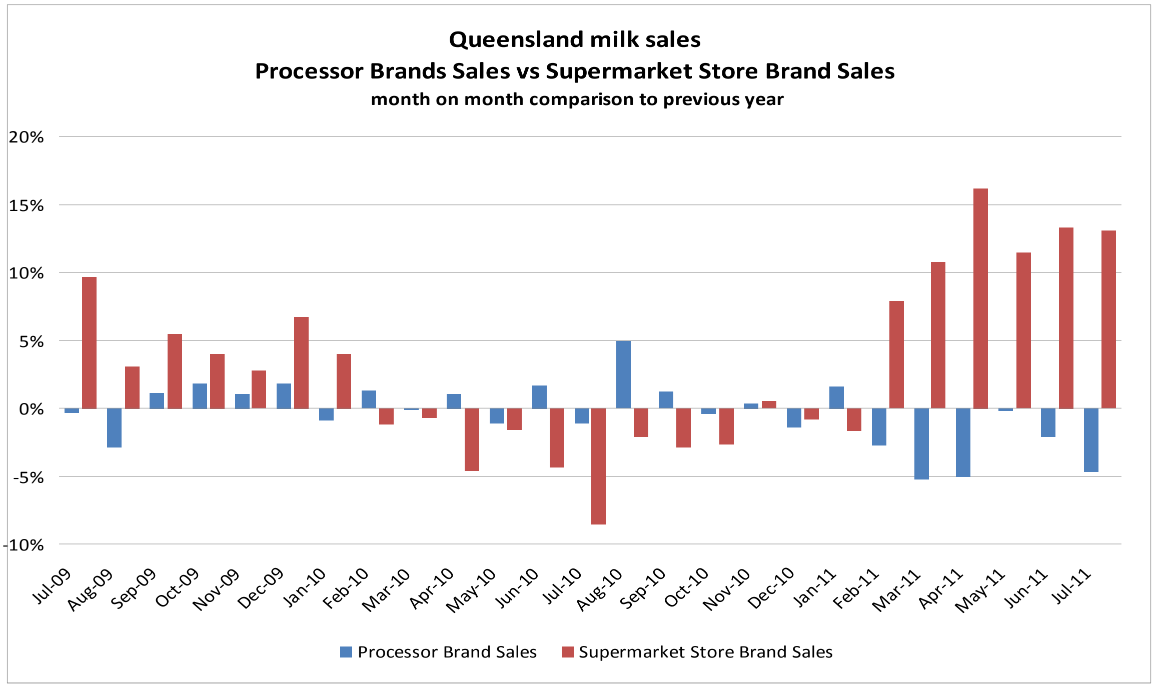
Looking at the supermarket sales trends in more detail, the shift to supermarket store brand in the modified milk segment is dramatic in percentage terms, with a 31% increase in sales compared to the prior year. Conversely sales have been lost from the branded modified category as consumers substitute like for like products. This has particularly affected milk processor returns as this category has provided the greatest scope for brand differentiation and profit margins. As a result, the loss of sales from this category has affected returns much more than the loss of sales from the regular and UHT categories.

The following graph provides a presentation of the impact of the $1 per litre price cut to date, comparing supermarket store brand sales with processor proprietary brand sales for the months from February to June in 2010 and 2011.

While Queensland supermarket sales grew by 4%, total domestic sales data collected by Dairy Australia showed a 2% increase in total milk sales for the state in the five months from February to June 2011 compared to the same period in 2010. The total milk sales increase is broadly consistent with stable per capita consumption rates and population growth in the state which grew 2.0% between 2009 and 2010.

However, the stronger growth in supermarket sales indicates that the non-supermarket or route channel, has lost some share of the milk market to the major retailers. Anecdotally there have been reports of cafes and restaurants substituting Coles branded products for their traditional foodservice distributor.

The supermarket discounts have had a varying impact across the milk category.



Source: Aztec Synovate through Dairy Australia

In December 2010 supermarket store brand regular milk was selling in Queensland for $1.08 per litre on average, while fat modified supermarket store brand products were selling for $1.26.

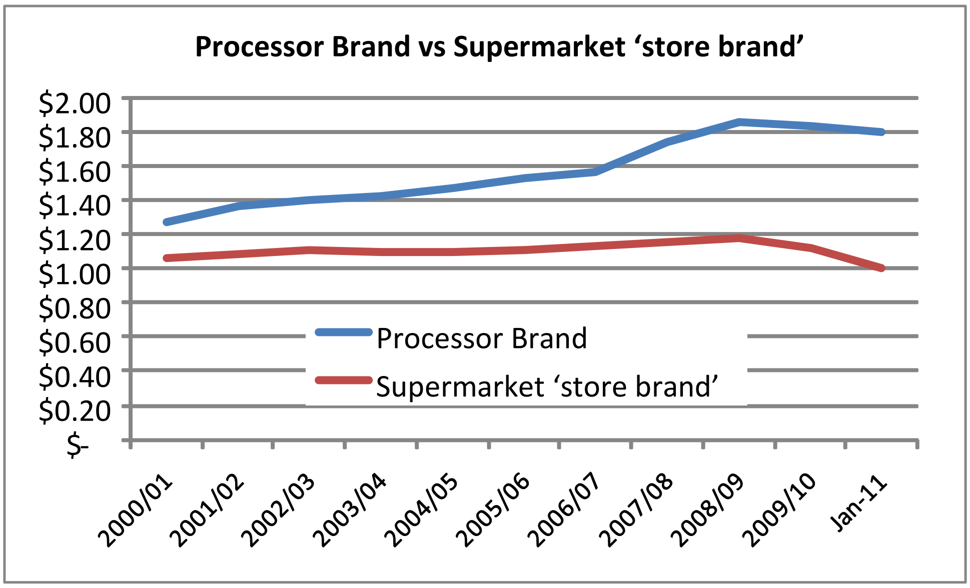
Post the Coles initiated $1 per litre discounting, supermarket store brand regular products have been averaging $1.02 per litre – a 6% decline. However, fat modified products have fallen 20 percent to $1.01. For specific fat modified products the discount cut was even greater – for example Coles dropped the price of their store brand modified milk by 33 percent.

The modified fresh milk category, while smaller in market volume terms, did deliver significant value to the dairy supply chain.

Fat modified products allow for greater differentiation between milk products, and therefore more successful branding opportunities.The erosion of this category has significantly reduced the ability of and incentive for processors to innovate, as they are less able to capture the benefits in a branded product. The level of pricing in supermakrt store brand products provides a significantly lower or neglible margin for both processors and retailers, and limited opportunities to develop the category.

This retail price drop increases the retail price difference between supermarket 'store brand' milk and processor proprietary branded milk. Generic supermarket 'store brand' milk, due to its lower price and margins, gives a lower return to processors and subsequently farmers than processor proprietary branded milk.

As presented by the following graph, over the last decade the retail price per litre for supermarket store brand milk nationally has declined in real terms, while market share of sales have more than doubled. Over the same time the retail price for proprietary brands followed inflation, however sales through supermarkets dropped by more than half.



Source Dairy Australia

In 2000/2001 the difference in retail price between proprietary 'branded' milk products and major supermarket chain 'supermarket brand' label products in 1999/2000 was $0.18 per litre and for whole milk the difference in price was $0.07 per litre.

For 2010/2011 the difference in retail price between proprietary 'branded' milk products and major supermarket chain 'store brand' products in 2010/11 increased to $0.78 per litre and for reduced fat milk the difference in price increased by 23% over the last year to $0.90 per litre.

When this per litre value difference of milk sales is equated across the market share of major supermarket chain 'supermarket brand' sales for 2010/11 (p) compared to the retail value of proprietary brand sales through supermarkets the difference is $490 million and more than $100 million per year in the Queensland market. In 1999/2000 the value difference amounted to some $44.5 million.

As a result processor brands have lost market share and the margin to the industry has been reduced to a point where the loss in retail value to the dairy industry is over $490 million per annum, compared to $44 million in 1999/2000.

If half of this amount of money, $490 million, was retained at the farm gate it would translate to an increase in farm gate price for dairy farmers of 10.5 cents per litre for milk supplied for the domestic fresh drinking milk market.

This is the amount the large retailers have taken out of the value chain with their supermarket brand procurement, branding and marketing policies, which previously flowed back through the industry value chain.

For 2011/2012 if the major supermarkets continue to discount milk to $1 per litre then the price difference is forecast to increase to over $0.86, assuming no other price changes occur in milk processor proprietary 'branded' products. This would see a value difference between supermarket store brand and processor proprietary brand sales through supermarket chains increase by approximately $53 million to $544 million.

Impacts of Major Supermarket Discounting of Fresh Milk to Date

Supermarket discount impacts on processors

The near or below cost discounting of supermarket store brands by major supermarkets, as demonstrated previously presented in this submission, has;

- led to a significant increase in the sales and market share of discounted supermarket store fresh milk brands, and
- a significant loss of market share of processor proprietary brand fresh milk sales.

The significant loss of market share of processor proprietary brand fresh milk sales has had a major impact on the returns from the market place for processors supplying the domestic fresh milk market.

As is clearly demonstrated in this submission, proprietary brand milk is sold at a higher price then supermarket store brands.

This higher price of proprietary brands provide margins that allow processors to be able to pay sustainable prices to dairy farmers for the milk they produce, whereas the margins on supermarket store brand contracts are extremely small to non existent, as publically stated by processor representatives, and do not provide the ability for processors to be able to afford a sustainable price for dairy farmers for that milk.

Impact Assessment by Dairy Australia

Dairy Australia has undertaken another method of assessment to quantify the impact of supermarket discounting of fresh milk on the Queensland dairy industry if the discounting is maintained.

With this assessment the current trends have been extrapolated over 12 months, and the impact on retail sales value and industry margins annualised.

Two scenarios have been modelled, and the impact on processor profitability and farmgate prices paid by milk processors (representing 100% of milk intake) has been quantified.

Scenario 1: Post-discounting and year to date supermarket trend (February to June 2011) is annualised, branded and non-supermarket channel prices are unchanged.

Scenario 2: Annualised quarterly trend <u>and</u> branded products are discounted to maintain relativity with supermarket store brand price in both supermarket and non-supermarket channel.

Future scenarios for the Queensland dairy industry						
		Baseline (2010)	**Scenario 1**	**% chge**	**Scenario 2**	**% chge**
Total value of milk sales	$ mill	839	828	-1%	797	-5%
Change in processor margin	$ mill		- 6		- 36	
Possible impact on farmgate price*	cpl	56.1	54.7	-2.5%	49	-13%

**Baseline price is average 2009/10 paid by drinking milk processing companies*

To estimate the impact on farmgate price it is assumed that the loss of processor profits will be completely passed through to farmers. That is, the pool of funds paid to farmers in 2009/10 is reduced by the amount of the margin loss, and the impact is expressed as a price differential per litre for farmers supplying milk processors.

Scenario 1 is simply a continuation of current supermarket trends. The impact on industry profits and farmgate price reflects the switch from branded products to lower margin supermarket store brand products.

Assuming the loss of margin is passed on to farmers, and all other price drivers remain the same, farmgate price paid to suppliers of milk processors in Queensland would fall by around 1.4 cent per litre.

Scenario 2 combines the impact of consumers switching from branded to supermarket store brand products, but assumes the impact is compounded when branded products are discounted to maintain their relativities with supermarket store brand prices in an effort to protect market share. This has a much greater impact as the margin on branded products in both supermarket and non-supermarket channels are reduced by approximately $36 million annually. If prices paid to farmers are reduced accordingly, the impact would be in the order of 8 cents per litre.

While scenario 1 is based on current market trends and available data, scenario 2 includes wide spread discounting of processor branded fresh products which to date has occurred to a limited degree at this stage, with evidence to date of some discounting of whole milk brands by some 25 cents per litre and UHT by approximately 10 cents per litre. However, scenario 2 does not allow for processors having to increase marketing and advertising expenditure in an effort to protect market share, which increasing costs and further affecting profitability. This additional expenditure has also been occurring in a number of specific categories in the market place.

The combined impacts to farmers would be greater due to the increase costs of producing milk during this period and for farmers in Queensland the added cost of recent floods and cyclones.

Impact Assessment by Fresh Logic

An assessment of the impacts of the supermarket discounting across the three months from February to April was undertaken by Fresh Logic in June 2011.

The analysis;

- was based on the volumes of milk sales lost by processor proprietary brands following the initiation of the current 'milk price war' in January,
- was based on data for the 3 months to April,
- assessed the difference in pricing structures along the chain between brands and supermarket store brand,
- presented a loss of 14 million litres of processor proprietary brand sales in Queensland,
- presented that the impacts of the loss of market share and margins across fresh white milk sales by processor proprietary brands was estimated at $5 million or approximately 1 cent per litre in gross product margins achieved by processors in Queensland.

Fresh Logic has now reviewed this analysis following the discovery of erroneous assumptions in the analysis and revised the impact to processor gross product margins upwards to $6.2 million or approximately 1.34 cents per litre for the same period.

It needs to be noted that the analysis by Fresh Logic does not include any impacts on processor margins from;

- discounting processor proprietary brand products to try and retain market share, and
- increased marketing and promotional expenditure from processors to try and retain market share.

There is now evidence of both impacts being incurred by processors since this analysis was undertaken.

QDO's Impact Assessment

The QDO has analysed both Dairy Australia's and Fresh Logic's impact assessments, relative to the impact data that has been available to date, including the direct impact on dairy farmers that supply the Parmalat PDA scheme.

The QDO has also taken into account that there is now evidence of processors discounting processor proprietary brands and of outlaying additional resources for marketing and promotion in an effort to maintain market share.

Given the market share impact to date and the above factors the QDO believes the impact on the Queensland industry will lie closer to scenario 2 as presented in the impact assessment undertaken by Dairy Australia.

Supermarket discount impacts on Dairy Farmers

The current discounting of fresh milk by supermarkets is causing a number of direct impacts on dairy farmers, including;

1. causing a reduction in milk payments to dairy farmers that have part of their milk payments linked to the sale of processor branded milk,
2. reducing the ability of processor to offer sustainable prices to dairy farmers for new contracts,
3. severely affecting the confidence of dairy farmers;
    a. contributing to dairy farmers deciding to exit the industry
    b. forcing young farmers to leave the dairy farm to seek work in other industries,
    c. post pone planned investment in their dairy enterprises,

all of which is undermining the future capacity and sustainability of the Queensland industry.

1. In Queensland some 185 dairy farmers have had their monthly milk payments directly affected each and every month since the supermarket discounting was started on the 26th January 2011. This group of dairy farmer's, monthly milk payments is directly linked to the level of processor branded milk sales they supply for the previous month.

This group of farmers supply the processor Parmalat, through Parmalat's PAULS Daily Access Scheme (PDA). The PDA scheme only relates to total PAULS branded milk sales and each farmer in the PDA scheme has an allocated daily milk supply volume under the PDA. PDA dairy farmers can trade PDA volume among themselves according to how much milk they calculated they would want to supply in the coming year.

Parmalat pays a higher price for this PDA (or tier 1 milk) but if the farmer failed to supply the PDA amount across the month as specified by the amount of PDA they held, then penalties would apply. All milk supplied over the allocated PDA amount would be collected but paid at a lower manufactured (or tier 2) price. Currently the average base price for PDA milk is approximately 58 cents per litre.

If Parmalats' PAULS branded milk sales do not reach the total PDA level in the state, then farmers are only paid the percentage that sales were of the total state PDA amount. The rest of the farmer's milk supply would attract the lower manufactured (or tier 2) price, which is currently approximately 44 cents per litre.

The PDA scheme is designed primarily to ensure Parmalat reliably receive enough milk for PAULS branded milk sales but avoid or reduce times of excessive production that would need to be sold as lower priced manufactured (or tier 2) product.

From the farmers payment point of view the sales for each month is expressed as a percentage of each farmers PDA on their payment invoice.

As Coles and other supermarkets have discounted the price of fresh milk to $1 per litre, supermarket discounted branded milk sales and market share have increased and as a result processor branded milk sales and market share has fallen. As the sales and market share of processor branded milk have fallen the percentage of the farmer's milk cheque that relates to these sales falls resulting in a lower payment to the farmer.

As a result PDA dairy farmers have been losing the amount of volume sold at the PDA or tier 1 price to the lower tier 2 price. This equates to these dairy farmers being paid less each month since the supermarket discounting started in January.

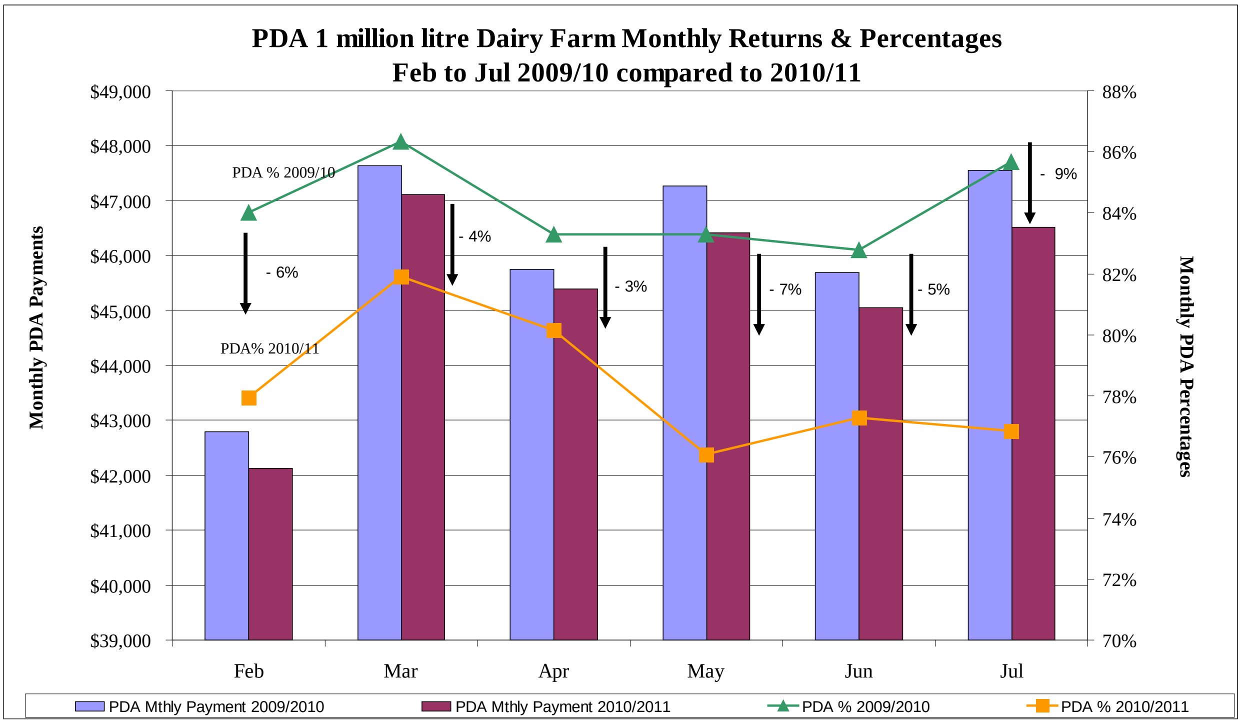
The following figures provide PDA figures from a real dairy farm and thus provide an insight into the impacts being seen already by this group of dairy farmers.

PAULS Daily Access Scheme Results					
Month	PDA Percentage		Change	Farm Result	PDA Group Result*
	Year 2010	Year 2011			
February	84.23%	77.94%	- 6.29%	($676)	($124,973)
March	86.35%	81.92%	- 4.43%	($527)	($97,448)
April	83.30%	80.16%	- 3.14%	($361)	($66,843)
May	83.29%	76.08%	- 7.21%	($857)	($158,600)
June	82.78%	77.29%	-5.29%	($632)	($116,869)
July	85.68%	76.85%	-8.83%	($1,050)	($194,236)
12 Months			-5.90%	($8,205)	($1,517,939)

Source: QDO

*Assumptions

- Based on an average farm production of 1 million litres per annum.
- PDA group farm numbers remain constant at 185.
- The PDA (tier 1) milk priced currently averages around 58 cpl and the manufacture milk (tier 2) price as an average of approximately 44 cpl.



Source: QDO

From the impact already experienced from February until July 2011 the PDA dairy farm above has lost approximately an average of $684 per month and the PDA group collectively has lost an average of $126,495 per month.

The cumulative impact up until the end of July for the individual dairy farm was $4,103 and for PDA group collectively $767,858.

If this impact continues across a full year, the annualised impact can be estimated by extrapolating the average impact per month to the end of July for a full twelve month period.

With an annual impact extrapolation the cumulative impact for the individual dairy farm would be $8,205 and for the PDA group collectively $1,517,939.

This impact will obviously get worse if the $1 per litre discounting and loss of market share by PAULS brands continues and if the rate of loss of market share for processor proprietary brands increases.

This example of direct impact being incurred by dairy farmers due to the action of discounting of supermarket brand milk, to below or near cost, is far from the 'no impact' claim by Coles representatives.

This example does not take into account the potential for much larger impacts as contracts come due for renegotiation with processors with lower returns due to the discounting of supermarket brand milk.

2. The discounting of supermarket store brand fresh milk, to near or below cost, has resulted in supermarkets increasing their sales and market share of supermarket store brand milk at the expense of the sales and market share of processor proprietary brands.

For processors, as publically stated by a number of processor representatives over the last year, supermarket store brand contracts provide poor margins for processors and processors have over the last decade relied more and more on the margins generated from processor owned proprietary brand milk sales to generate the majority of their overall margin and profitability.

As processors proprietary brand milk sales have lost market share to supermarket store brand sales, processor profitability has been lowered. With lower margins processors are then left with less ability to afford to pay dairy farmers higher sustainable prices for milk they supply on new contracts, particularly in relation to milk that is used for supermarket store branded milk.

A clear example of this affect has been seen in the last month where by Lion (formerly National Foods), announced new farm gate prices for the 20011/12 financial year for dairy farmers supplying milk to Lion through the Dairy Farmers Milk Co-operative.

The new farm gate price announcement presented a very slight increase in the base milk price of a half cent per litre for southern Queensland and 1 cent per litre for Far North Queensland for milk sold as fresh bottled milk or what is termed Tier 1 milk.

Tier 1 milk, under the Lion payment scheme, includes all milk sold by Lion as bottled fresh milk including both processor proprietary branded milk and supermarket store brand milk. As such with the current supermarket price war with higher margin processor proprietary branded milk losing market share to supermarket store brand milk with little or no margin, the overall return from the sale of Tier 1 milk by Lion has declined. Consequently Lion’s ability to improve farm gate prices has been undermined directly by the current supermarket price war.

This recent price increase equates to just a 1 and 2 percent increase respectively, which does not even help farmers keep pace with rising input costs, with inflation currently running at 3.6 percent and many farm input costs increasing much more significantly over the last year for example electricity.

To put this into perspective, this announcement follows major cuts to farm gate prices by the then National Foods (now Lion) last year by some 15 percent for one group of Queensland dairy farmers and by more than 20 percent for another smaller group of Queensland dairy farmers. In addition Queensland dairy farmers have suffered major losses from the impact of natural disasters which are estimated to amount to around $80 million for 2011.

In relation to the price announcement, a Lion representative publicly stated that, "We have taken the position that we will hold our prices and slightly increase in south east Queensland when the marketplace is telling we should go the other way."

On the 9th May this year Lion Nathan National Foods, Chief Executive Rob Murray reported publicly that, “NatFoods was under significant margin pressure in both dairy and juice, with supermarkets engaging in deep discounting on supermarket store brand fresh milk, which was reducing returns across the supply chain” and that "In the current year, National Foods' return on invested capital is now expected to be well below an acceptable level."

On the 5th of August, Lion CEO Rob Murray reported publically that, “As previously communicated, conditions in both the dairy and juice sectors remain very difficult for farmers and processors alike. “The dairy and drinks division delivered operating earnings before interest and tax (EBIT) of $68.3 million, a decline of 43.2%. Revenue declined 9.4% to $1.4 billion.” “Lion’s white milk volumes declined 10.9%, largely driven by the supermarket store brand contract losses, however this was compounded as deep discounting saw consumers switch from branded products to supermarket store brand and from convenience stores to grocery – diluting the profit pool available to all players in the supply chain.”

3. The discounting of supermarket store brand fresh milk, to near or below cost, has severely affected the confidence of dairy farmers and contributed to dairy farmers deciding to exit the industry, for farmers’ children to leave the dairy farm to seek work in other industries and post pone planned investment in their dairy enterprises all which is critical for the future capacity and sustainability of the industry.

Since the end of January 2011 to the end of July 2011, approximately 24 Queensland dairy farms have ceased operations and exited the industry. This rate of loss of dairy farmers over this period is much higher then the long term downward trend in farm numbers.

Following severe floods and cyclone impacting all of the Queensland industry during the end of 2010 and start of 2011 the QDO initiated a Natural Disaster Response and Recovery program. As part of that program the QDO contacted all dairy farmers in Queensland to check on their wellbeing, gauge their situation and to assist farmers to access assistance and support services. During April and May the QDO contacted and surveyed all dairy farmers as part of the program. As part of this survey the QDO asked a series of questions including what where key issues, concerns and intentions of dairy farmers.

From the survey results 13% of survey respondents have reported that they intend to exit the industry in the next year and 31% presented that they intend to exit the industry within five years time. These rates of exit, if incurred, are much higher then the long term average of farm number decline of 5.1 % over the last decade.

The majority of dairy farmers interviewed raised serious concerns about impact of the supermarket ‘milk price war’, including dairy farmers with PDA who were already seeing a reduction in their milk payments, and fixed price contracted farmers who were very concerned about the prospects of being able to obtain a price increase and or a sustainable price for their milk in the next round of price negotiations.

A number of farmers have presented during their interview that they have advised their children to seek a career outside of dairying due to the current situation.

The majority of dairy farmers interviewed presented that in the current environment they have decided to postpone planned investment in their dairy enterprises which will delay their recovery from natural disasters.

Of the farmers interviewed that have exited the industry since February, more then 80% have presented that the impacts and outlook due to the supermarket ‘price war’ was a contributing factor to deciding to exit the industry.

All of these impacts will continue to undermine the future capacity and sustainability of the Queensland dairy industry.

Current and Future Fresh Milk Needs of Queensland

The Last Decade

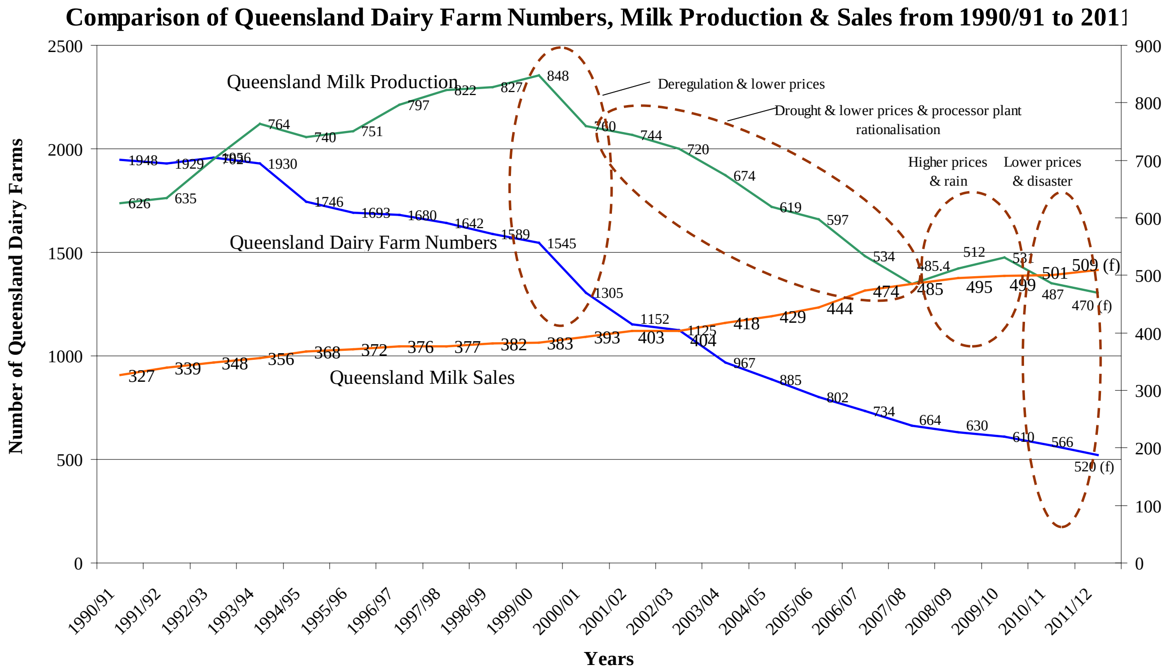
The Queensland Dairy industry has suffered a major contraction in farm numbers and production over the last decade.

Post deregulation, from 1999/2000 to 2010/2011 dairy farm numbers in Queensland have fallen from 1545 to 566, a decline of 63 percent, and production has fallen from 848 million litres to 487 million litres, a decline of 43 percent.

This decline has largely been due to a number of major impacts including;

- flow on affects of deregulation,
- suppressed farm gate prices and poor farm gate returns for much of the decade,
- severe drought for much of the decade,
- severe floods and cyclones,
- a continual erosion of returns from the market place due to the growth in market share of major supermarket store brand milk at the expense of processor proprietary brands,
- rising costs of production,
- competition for resources, and
- an increase in government regulation and redtape.

Even with these many challenges dairy farmers have continued to improve their productivity.



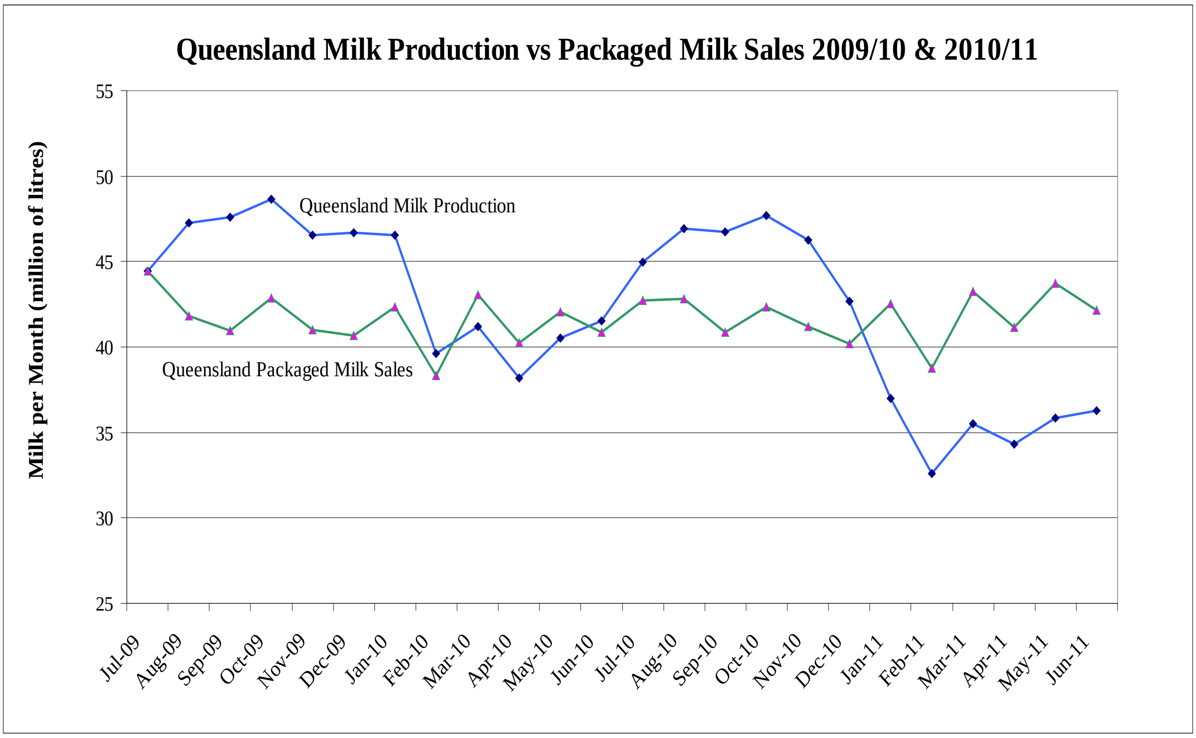
The Current Situation

The Queensland dairy industry is currently short of milk to meet the market demand in Queensland. This shortage situation which started in January 2011, is due to the impacts of natural disasters, poor farm gate returns and farmers leaving the industry. This situation has been exacerbated with the impact of the current Coles initiated milk price war between supermarkets.

The Queensland dairy industry needs to produce more milk to meet the needs of Queenslanders now and even more milk to meet the needs of a growing population into the future.

In the last year Queensland has lost more than 40 dairy farmers, a decline of more than 7 percent, which is extremely concerning to the QDO and reflects the current unsustainable returns that currently exist for dairy farmers.

As presented in the following graph, over the last six months the Queensland dairy industry has not been able to produce enough milk to meet the daily milk needs of Queensland consumers. For this period the Queensland milk production has been approximately 40 million litres under the Queensland market demand requirements.



Source: Dairy Australia data

Based on Queensland Dairy Accounting Scheme data current farm gate prices for many Queensland dairy farmers will barely keep the average sized dairy farmer in Queensland above breakeven, especially given the impacts of natural disasters and rising operational costs. This assessment is also supported by recent survey analysis of the industry undertaken by the ABARE.

The QDO acknowledges that Coles have publicly stated that it had given National Foods a price increase in January this year with new contracts, however at the same time acknowledge that the past head of National Foods publicly stated that there is little or no margin in supermarket store brand milk supply contracts and that has affected their ability to pay dairy farmers who supply that milk.

The QDO had hoped that the price increase Coles had given National Foods would have been passed through to dairy farmers following the large farm gate price cuts last year. However, from the data the QDO has obtained on the market and the growing impact of the Coles led milk price war on processors, is undermining their 'already slim or non-existent' profitability. This impact can be seen with the large loss of sales of processor brand milk across to heavily discounted supermarket brand sales over the last five months and therefore the processors ability to increase farm gate prices to a sustainable level.

The QDO has warned processors, retailers and the Government about these impacts and the implications last year but to date there has been no action to turn around this unfolding disaster.

With natural disasters and the current 'milk price war' the situation has deteriorated. The current situation is not sustainable and needs to change for the betterment of all including dairy farmers, processors, retailers and consumers.

Future Needs

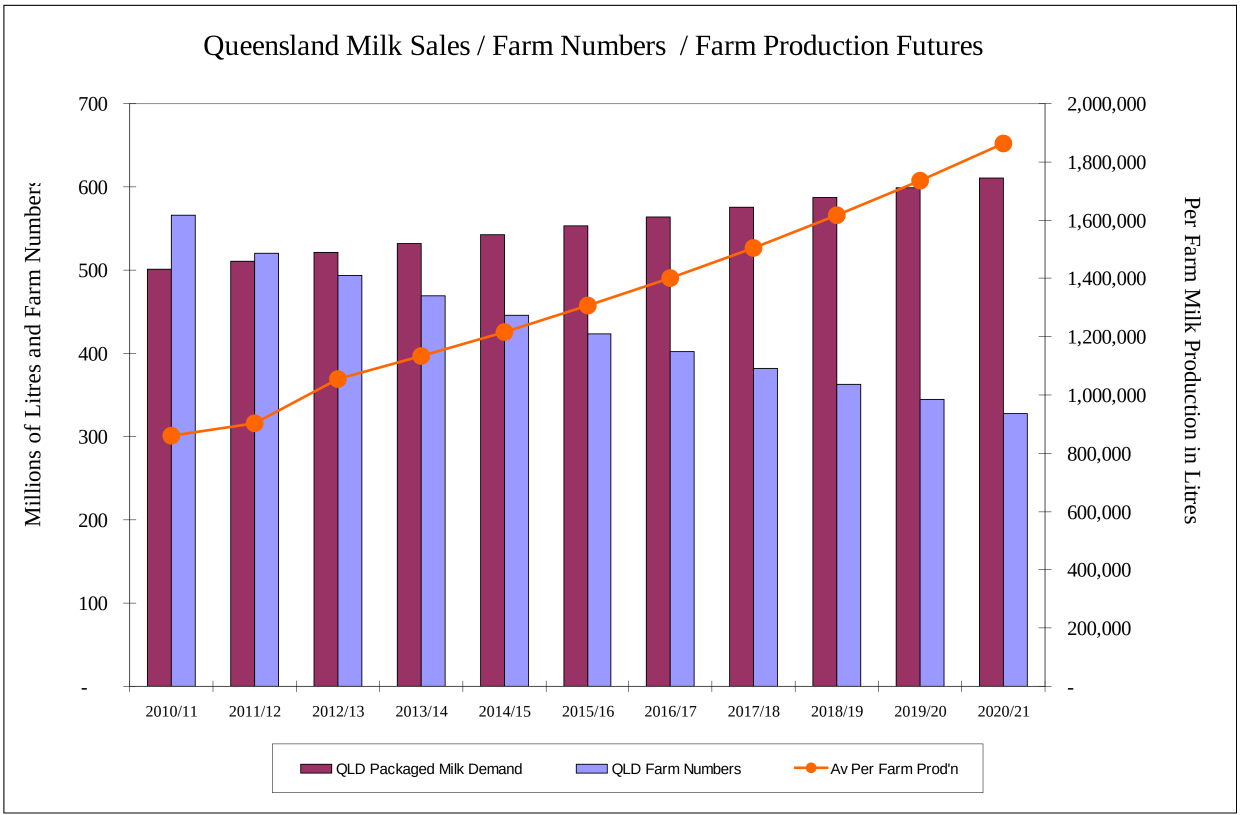
With forecast population growth for Queensland the demand for fresh milk will increase. Medium level Australian Bureau of Statistical (ABS) population growth forecasts for Queensland for the next decade translates the need for more than an additional 100 million of fresh milk per annum.

To meet this increased demand the Queensland dairy industry need to increase its production capacity by at least 22 percent by the year 2020.

A greater challenge to meet this growing demand, in the current environment of declining farm numbers, is the ability of dairy farmers to increase production from their existing farm enterprises.

With the rate of decline in farm numbers of approximately 5 percent per annum over the last decade, Queensland dairy farmers are forecast to potentially decline from 566 currently to approximately 446 by the year 2015 and as low as 328 by the year 2020.

With these forecasts by the year 2015, on average Queensland dairy farmers would need to increase their production by more then 50 percent and by the year 2020 by more then 110 percent.



For Queensland dairy farmers to be able to achieve this dramatic growth in production will require significant new investment.

To produce milk, dairy farmers carry the highest investment and risks per litre of milk and the most volatile returns of the whole fresh milk supply chain.

For farmers to be able justify this investment and risk there will need to be a suitable level of return on that investment.

The current failure of the domestic market caused by major supermarkets using fresh milk as, a near or below cost ‘marketing agent’ is not providing for sustainable returns to the fresh milk supply industry and thus to dairy farmers.

As such for the future demand of the growing domestic market to be met now and into the future in regions such as Queensland sustainable returns from the supermarket store brand contracts need to be restored.

The Need For Sustainable Farm Gate Returns

Prior to deregulation regulated milk prices provided a stable return to the farm enterprise and even in times of natural disasters such as the severe droughts of the 1980’s and 1990’s the QDO was able to negotiate a price increase to cover the costs of the impacts and to ensure a stable supply of fresh milk to the domestic market.

Following deregulation farm gate prices paid to dairy farmers in Queensland for fresh drinking milk dropped significantly from a regulated price of 58.9 cents per litre 1999/2000 to a single farm gate price of approximately 31 cents per litre 2000/2001.

The significant drop in price, even with the provision of the deregulation support packages saw the exodus of many dairy farmers from the industry. Following deregulation the Queensland dairy industry was again plagued by severe drought for over a decade and this impact combined with low farm gate prices and higher operational costs saw farm numbers and milk production continue to decline through to 2007/2008.

At this level of production from the region it barely met annual supply requirements of the market and at various times of the year fell well below market requirements.

With this situation, combined with repeated calls from dairy farm organisations, processors increased farm gate prices and offered longer term contracts. With a return to more normal seasons milk production increased to be in surplus of market needs, however with the impact of severe flooding and cyclones and lower farm gate prices it is forecast that production will decline by more then 12 percent this year and exacerbate the shortfall of milk to market needs.

In the current environment for many farmers the passing through of any margin losses by processors would eliminate their profits altogether.

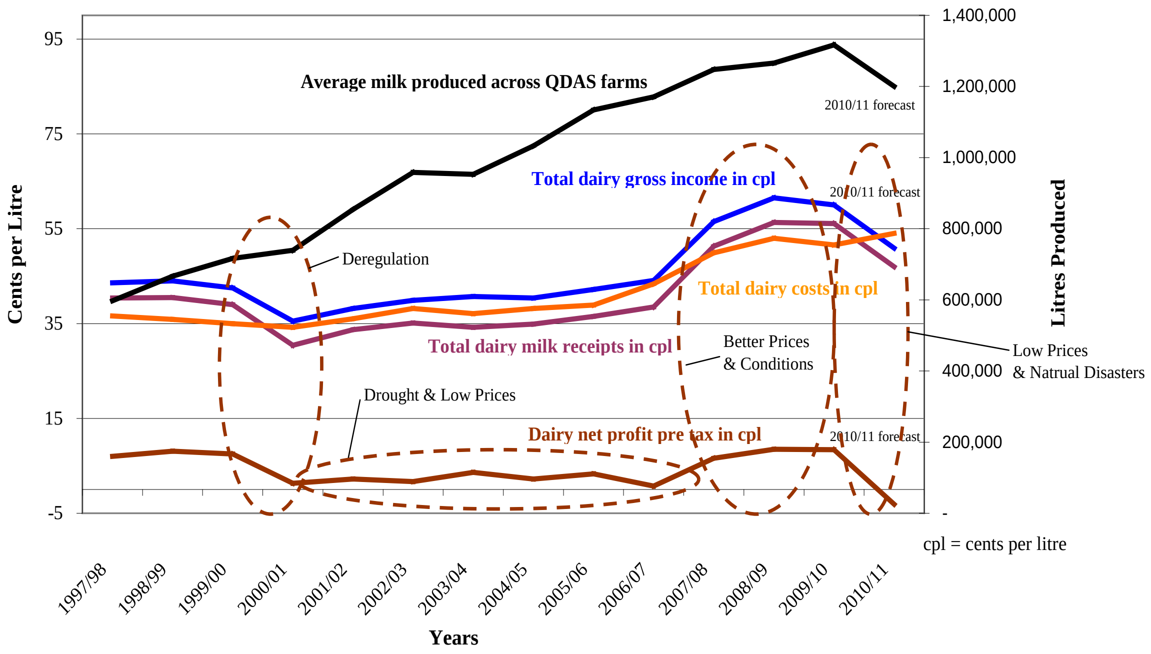
It is estimated by Dairy Australia that in the most exposed region of Queensland and northern New South Wales a 10 percent shift toward supermarket ‘store brand’ label alone would halve farmers’ 2009/10 margins should the processor be forced to pass the impact on to farmers. Average farm incomes for the region have already been drastically reduced in 2010/11 for many farmers due to lower average farmgate price, as well as the impact of natural disasters.

From data presented by the Queensland Dairy Accounting Scheme (QDAS), dairy farm production costs increased by more than 48 percent over the last ten years from 35 cents per litre in 1999/00 to 52 cents per litre in 2009/10. Where as, the price received per litre at farm gate was recorded as 39 cents per litre in 1999/00 and for the year ahead of 2010/11 the price will be approximately 53 cents per litre, an increase of just 36 percent.

It is forecast that farm costs per litre for 2011/12 will increase by at least 2 cents per litre with a range of input cost increases for example with repairs and maintenance, electricity, fuel, labour and animal health.

The following graph provides a presentation of data from the Queensland Dairy Accounting Scheme (QDAS) for income, costs and returns from 1997/08 to 2009/10 with the addition of a forecast for the 2010/2011 financial year.

Queensland Dairy Accounting Scheme Data 1097/98 to 2010/11



For a lot of farmers who suffered significant price cuts last year this will be less, with negative returns for many, as indicated with the above forecast for 2010/2011 year. For the Queensland average dairy farm a one cent per litre drop in price will reduce the bottom line of the farm by $9,000.

This situation presents that the viability and sustainability of the production sector has been slowly eroded over the last decade. This is due to the returns to the dairy industry value chain and through the farm gate declining as the major supermarket 'store brand' procurement and marketing strategies have grown the amount of market share major supermarkets have with their own brands.

Reduced returns to the dairy industry value chain from major supermarket chains 'store brand' strategies is already undermining the profitability, sustainability and viability of the dairy farming sector which produces milk on an 'every day of the year' basis for the domestic fresh drinking milk market.

Coles Promotions and Public Statements by Coles Representatives

A number of Coles public promotional statements are incorrect and misleading and as such need to be corrected. The nature of these statements should be investigated by the Federal Government against the legal requirements of the *Competition and Consumer Act 2010,* with the provision of the following information.

With the launch of the Coles 'Down Down' campaign discounting of Coles store brand milk to $1 per litre on the 26th January 2011, Coles stated in their promotional press release that;

1. *"Coles is not reducing the price it pays to its milk processors either so this move will not impact them or the dairy farmers who supply them."*

2. *"In fact both farm gate milk prices and contract prices with processors recently increased."*

The QDO has been advised that Coles has also given this assurance to senior Government Ministers that the Coles discount campaign would not affect dairy farmers.

Impact on Processors and Dairy Farmers

The continuous public claim by Coles that their discounting of fresh milk to $1 per litre will not affect processors and dairy farmers is **not correct**.

The discounting of supermarket store brands, to near or below cost, as demonstrated in this submission, has;

- led to a significant increase in the sales and market share of discounted supermarket store fresh milk brands, and
- a significant loss of market share of processor proprietary brand fresh milk sales.

The significant loss of market share of processor proprietary brand fresh milk sales has had a major impact on the returns from the market place for processors supplying the domestic fresh milk market.

As is clearly demonstrated in this submission, proprietary brand milk is sold at a higher price then supermarket store brands.

This higher price of proprietary brands provide margins that allow processors to be able to pay sustainable prices to dairy farmers for the milk they produce, whereas the margins on supermarket store brand contracts are extremely small to non-existent, as publicly stated by processor representatives, and do not provide the ability for processors to be able to afford a sustainable price for dairy farmers for that milk.

Dairy farmers are being impacted by the Coles led fresh milk discounting in a number of ways including;

- As presented in section ## (page##) of this submission, in Queensland a group of dairy farmers who have their farm gate price linked directly to processor branded sales have seen monthly milk payments directly impacted since February 2011, as a result of the Coles led discount milk campaign.

  This impact has occurred as the sales and market share of discounted supermarket store branded milk has increased at the expense of the sales and market share of processor proprietary brands.

  This impact on these farmers will continue to increase over the coming months as Coles and other supermarkets milk brands gain an increasing share of the milk sales and the share of proprietary milk branded sales declines.

- As presented in this submission, as processors proprietary brand milk sales have lost market share to supermarket store brand sales, processor profitability has been lowered. With lower margins processors are then left with less ability to afford to pay dairy farmers higher sustainable prices for milk they supply on new contracts, particularly in relation to milk that is used for supermarket store branded milk. A clear example of this affect has been seen in the last month where by Lion (formerly National Foods), announced new farm gate prices for the 20011/12 financial year for dairy farmers supplying milk to Lion through the Dairy Farmers Milk Co-operative. The new farm gate price announcement presented a very slight increase in the base milk price of a half cent per litre for southern Queensland and 1 cent per litre for Far North Queensland for milk sold as fresh bottled milk or what is termed Tier 1 milk. This equates to just a 1 and 2 percent increase respectively, which does not even help farmers keep pace with rising input costs, with inflation currently running at 3.6 percent. To put this into perspective, this announcement follows major cuts to farm gate prices by the then National Foods last year by some 15 percent for one group of Queensland dairy farmers and by more than 20 percent for another smaller group of Queensland dairy farmers.

Farm Gate Milk Prices

Since the 26th January, Coles and Wesfarmers executives have continued to publicly state that farm gate prices for dairy farmers have increased in the last year.

In stark contrast to the Coles' claims, as stated above, during 2010 the farm gate prices for many dairy farmers was reduced significantly by 10 percent in New South Wales and Victorian and between 12 to 18 percent in Queensland, which includes the Tier One price dairy farmers are paid by National Foods (now Lion) that supply the milk for Coles supermarket branded milk.

The reference Coles makes to increasing farm gate prices reflects prices paid to dairy farmers supplying the export market not the domestic market. As such the statement is very misleading and if purposefully preconceived, it is deceptive.

For Coles to publically promote that "*Coles is not reducing the price it pays to its milk processors either so this move will not impact them or the dairy farmers who supply them. In fact both farm gate milk prices and contract prices with processors recently increased.*" (Coles media release 26th January 2011 and various public statements), is tantamount to deceptive and misleading advertising, in that it is seeking to promote to consumers that if they buy Coles branded milk at this dramatically discounted prices it will not have a negative impact on dairy farmers.

QDO Meeting with Coles and Wesfarmers

The QDO has met with representatives of Coles on two occasions following the 26th January, including with a representative from Wesfarmers.

At both of these meetings QDO clearly explained;

- that the industry understood that due to the unique nature of fresh milk, as an inelastic every day dietary staple of our community, Coles was using discounted supermarket store brand fresh milk as;
  - a marketing agent to attract customers away from their competition,
  - to lure sales away from other market channels such as the route trade,
  - as a customer locator and grocery sales multiplier within their stores,
  - while also at the same time growing the market share of their supermarket store brand milk at the expense of proprietary brand sales and there by growing the market power and dominance in both retailing and procurement of products.
- the implications of the Coles led discounting of supermarket store brand fresh milk to $1 per litre and the use of fresh milk as a marketing agent, including;
  - the devaluation of fresh milk in the market place,
  - lowering of margins and returns to the fresh milk supply chain,
  - undermining the market share and viability of proprietary branded milk and investment in processing and product innovation,
  - undermining the market share and potentially the viability of alternative retail channels including smaller retailers and the route trade,
- direct impacts affecting milk payments to farmers caused by supermarkets discounting store brand milk,
- that dairy farmers are leaving the industry at a higher rate and the majority that have left in the last few months have cited the 'supermarket price war' as a key factor in their decision,

- that in the last decade the price per litre for supermarket store brand milk had declined in real terms, while market share of sales had more then doubled and that over the same time the price for proprietary brands followed inflation, however sales through supermarkets dropped by more then half,
- that the widening gap between prices and market share and subsequent reduced returns to the fresh milk supply chain is now clearly unstainable, with the difference per annum now amounting to more than $490 million with the potential to increase to over $580 million if the current discounting continued,
- future implications for the sustainability of fresh milk supply chain, including the ability for dairy farmers to afford to maintain farm systems and standards,
- the current situation for the Queensland dairy industry following the impacts of large price cuts for many farmers last year, severe impacts of floods and cyclones and
- that the Queensland industry was currently not producing enough milk to meet the daily demands of the Queensland market and that for farmers to recover and to be able to invest in producing more milk, stronger farm gate prices are required,
- many dairy farmers are questioning their future in the industry, having endured a decade with severe droughts, floods, cyclones, increasing operational costs and low farm gate returns for much of the period,
- that the ongoing and increasing loss of fresh milk production in regions such as Queensland will result in milk having to be freighted further at higher costs.

The QDO also explained to Coles and Wesfarmers representatives why their public claims were not accurate, particularly in regard to the claim that Coles discounting will not affect dairy farmers' returns.

Even though QDO have met with representatives of Coles and Wesfarmers to directly explain the impacts and implications of their discounting campaign, the QDO is continually frustrated by ongoing misleading public statements from Coles representatives, including the following examples;

At the Victorian Farmers Federation annual conference, on the 24th June 2011, Robert Hadler, Coles' General Manager Corporate Affairs, was reported as stating to a conference audience of more then 300 farmers that the Coles Down Down price reduction campaign had no detrimental to farmers and that "no dairy producer has been suffering as a result of Coles discounting."

This statement is simply wrong and totally misleading and farmers at the VFF conference quite rightly corrected Mr Hadler.

On the 9th May 2011, in a Coles Press Release, Coles Managing Director, Ian McLeod stated, "he was pleased that the committee has recognised that there is no evidence that Coles' milk price cut is damaging the dairy industry.", and that "In all of our dealings with the Senate Committee, and with the Australian dairy industry, we have reinforced that our retail milk price cuts will not have a detrimental impact on Australian dairy farmers."

Again this statement is misleading.

On the 25th July 2011, in a Coles Press Release, Coles Managing Director, Ian McLeod stated, “Increased milk consumption over the last six months, well above long term trends, shows that both our customers and the dairy industry are winning as a result of our Down Down milk pricing initiative.”, and “We have always said we are committed to reducing prices for Australian consumers as well as supporting Australian farmers. We are therefore re-assured that farm gate milk prices are increasing for most dairy farmers and domestic milk consumption is up.”

Again these statements are again potentially misleading as;

- domestic fresh milk consumption continues to track trends in population growth and per capita consumption over the last five years (1.8% and 0.6% respectively),
- increasing sales and markets share of supermarket store brands discounted, to near or below cost with little or no margin for processors, has resulted in the loss of sales and market share of processor proprietary brands. This change in market share has resulted in lower returns to processors,
- there is no support for dairy farmers coming from supermarkets discounting and using fresh milk as a, near or below cost, marketing agent and devaluing milk and returns to the fresh milk production and supply chain,
- farm gate prices have been increasing over the last six months for dairy framers in southern production regions which supply milk for the export market. Farm gate prices for the majority of dairy farmers supplying milk for the domestic fresh milk market have been declining in nominal or real terms, as a direct result of the current near or below cost discounting of supermarket store brand milk.

Other Coles Advertising Issues

In addition there seems to be inconsistencies in the presentations of Coles print advertising compared to the Coles promotional press release of the 26th of January, which may also be tantamount to misleading consumers.

Further more, while Coles is saying in their submission, to the Senate Inquiry, that they ‘just’ reduced the Coles brand milk by 4.3% or 4.5 cents per litre, which is a reference to Coles reducing the price of its Coles supermarket brand from $2.09 to $2.00 for two litres, the full truth is that Coles stopped one line of Coles brand ‘Smart Buy’ effectively reducing the price of those sales from $2.47 to $2 per two litres or by 19% and reducing Coles litre milk from $2.99 to $2.00 for two litres or by 33%.

Coles promoted in its Press Release dated the 26th January 2011 stating that, “The price of Coles Brand fresh milk is being cut by as much as 33% from today……”

“Significantly the price cut also includes Coles Brand reduced fat milk which will be cut to the same low price of $2 for a two litre bottle, bringing it into line with full cream milk so customers will no longer have to pay a price premium for a lower fat milk option.

“By offering the same low price on Coles Brand reduced fat milk we are also enabling more customers to switch to the lower fat option at a price they can afford which is clearly a significant health benefit.” (We note that Coles has not made the same health claim with the discounting of alcohol, in relation to the converse health effects that would come from increased alcohol consumption vis-a-vis cheaper prices).

Appendix 1

Facts and Figures - Australian Dairy Industry & Domestic Milk Market

2009/10	Australian fresh milk sales = 2,269 million litres
2010/11	Australian fresh milk sales = 2,315 million litres Change = + 2 %
2009/10	Per capita consumption = approximately 102.4 litres per head
2010/11	Per capita consumption = approximately 103 litres per head
2009/10	National population growth 2 percent
2010/11	National population growth 1.5 percent
2010/11 (p)	Total milk sold through major supermarket chains accounted for 1,216 million litres or 54% of total domestic milk sales
1999/2000	major supermarket chain ‘supermarket brand’ sales accounted for some 25% of total supermarket sales, compared to
2010/11 (p)	major supermarket chain ‘supermarket brand’ sales have more than doubled to account for some 54% of total supermarket sales or approximately 625 million litres.
2010/11 (f)	major supermarket discounting of milk from the 26th January 2011 to the end of June 2011 has already seen sales growth of ‘supermarket brand’ milk of 10 percent nationally and for some categories of up to 75 percent in some states and up to 25 percent nationally across the modified or reduced fat fresh milk category.
2000/2001	difference in retail price between proprietary ‘branded’ milk products and major supermarket chain ‘supermarket brand’ label products in 1999/2000 was $0.18 per litre and for whole milk the difference in price was $0.07 per litre,
2009/10	the difference in retail price between proprietary ‘branded’ milk products and major supermarket chain ‘store brand’ products in 2009/10 was $0.71 per litre and for whole milk the difference in price was $0.71 per litre,
2010/11 (p)	the difference in retail price between proprietary ‘branded’ milk products and major supermarket chain ‘store brand’ products in 2010/11 increased to $0.78 per litre and for reduced fat milk the difference in price increased by 23% over the last year to $0.90 per litre,
2011/12 (f)	if the major supermarkets continue to discount milk to $1 per litre then the price difference is forecast to increase to over $0.86, assuming no other price changes occur in milk processor proprietary ‘branded’ products,
1999/2000	‘supermarket brand’ label price for regular whole milk was $1.26 per litre, and supermarket market share of whole milk sales through supermarkets was 31 percent and processor brands 69 percent,
2010/2011	‘supermarket brand’ label price for regular whole milk had dropped to an average of $1.07 per litre or 15% and supermarket market share of whole

milk sales through supermarkets increased to 71 percent and processor brands declined to 29 percent,

2010/2011 the current discounting has seen prices drop to between $0.96 and $1.00 per litre,

1999/2000 proprietary 'branded' price whole milk was $1.33 per litre,

2009/2010 proprietary 'branded' price whole milk was $1.83 per litre up 38%,

1999 to 2010 inflation increased by approximately 36%,

1999/2000 'supermarket brand' label price for modified or 'reduced fat' milk was $1.37 per litre, and supermarket market share of whole milk sales through supermarkets was 12 percent and processor brands 88 percent,

2010/2011 'supermarket brand' label price for 'reduced fat' milk had dropped to an average of $1.14 per litre or 17% and supermarket market share of whole milk sales through supermarkets increased to 53 percent and processor brands declined to 47 percent,

1999/2000 proprietary 'branded' price 'reduced fat' milk was $1.47 per litre,

2009/2010 proprietary 'branded' price 'reduced fat' milk was $2.04 per litre up 39%,

1999 to 2010 inflation increased by approximately 36%,

The following Table 1 provides Dairy Australia's figures for 2010/11 (p) and 1999/2000 for branded and supermarket 'store brand' milk sales volumes and average prices sold through supermarkets.

Over the last decade supermarkets have more than doubled their supermarket milk brand market share through using a range of discount and marketing tactics, using fresh milk as a marketing agent.

When this value difference of retail milk sales is equated across the market share of major supermarket chain 'supermarket brand' sales for 2010/11 (p) compared to the value of proprietary brand sales through supermarkets the difference is $490 million and more than $100 million per year in the Queensland market. In 1999/2000 the value difference amounted to some $44.5 million.

As a result processor brands have lost market share and the margin to the industry has been reduced to a point where the loss in retail value to the dairy industry is over $490 million per annum, compared to $44 million in 1999/2000.

If half of this amount of money, $490 million, was retained at the farm gate it would translate to an increase in farm gate price for dairy farmers of 10.5 cents per litre for milk supplied for the domestic fresh drinking milk market.

This is the amount the large retailers have taken out of the value chain with their supermarket brand procurement, branding and marketing policies, which previously flowed back through the industry value chain.

To get a further insight into the impact of the current discounting of milk Table 1 also provides a retail milk sales and price data for 1999/2000, 2009/10, 2010/11 and forecast impact analysis data for 2011/12.

To further assess the impacts of ongoing supermarket discounting in the domestic fresh milk market the following two forecasts have been prepared based on 2010/11 market data.

Forecast 1: The first forecast is based on 2010/11 milk volumes, with the assumption that supermarket $1 per litre discounting continues throughout the year and results in an average retail price for supermarket brand whole and reduced fat milk of a $1.02 and $1.01 per litre, respectively, with no change in market share of either supermarket "store brands" or processor proprietary brands and with consumption growth of 1.5 percent reflecting population growth.

The average retail price for supermarket brand in 2009/10 was $1.19 per litre, where as the average forecast price for supermarket brands if the current discounting at $1 per litre through out the year for 2011/12 is $1.04 per litre. The difference in pricing between the two years is a decline of 15 cents per litre.

Across the volume of sales of supermarket branded milk in this forecast of 634 million litres with a reduction is price of 15 cents compared to 2009/10, there has been an additional loss of $95 million in value on those retail milk sales.

In addition the accumulated retail value difference would increase from 71 cents to per litre in 2009/10 to 86 cents to per litre in 2011/12 between the two categories of milk, being supermarket 'store brand' and processor proprietary brands.

This increasing price difference between the categories provides the supermarkets with a larger price marketing advantage over processor proprietary brands and increasing market share gives the supermarkets greater market power.

Forecast 2: The second forecast is based on the assumptions that;

- supermarket $1 per litre discounting continues throughout the year and results in an average retail price for supermarket brand whole and reduced fat milk of a $1.02 and $1.01 per litre,
- Processor branded milk prices remain static,
- Processor branded milk sales fall by 10 percent and supermarket 'store brand' sales increase by 10 percent,
- consumption growth of 1.5 percent reflecting population growth.

The resultant forecast impacts for 2011/12 compared to 2010/11 include;

- a loss of processor proprietary brand sales of 50 million litres and $106 million,
- an increase in supermarket 'store brand' sales of 72 million litres and $29 million,
- an additional loss of retail value from overall national domestic fresh milk sales of $111 million,
- increasing the retail price differential between supermarket 'store band' and processor proprietary brands from;
    - o 18 cents per litre in 1999/00, to
    - o 71 cents per litre in 2009/10, to
    - o 78 cents per litre in 2010/11, to

    - a forecast 86 cents per litre in 2011/12, to
- increasing the retail value differential between supermarket ‘store band’ and processor proprietary brands from;
    - $44 million in 1999/00, to
    - $414 million in 2009/10, to
    - $490 million in 2010/11
    - a forecast $597 million in 2011/12, to

This data clearly presents that the large discounting of milk by Coles and subsequently other major supermarkets, is devaluing the value of milk sold through supermarkets nationally and is causing a significant loss in returns to the dairy industry value chain which is not sustainable.

Table 1 Comparison of National Milk Retail Sales through Supermarkets

	1999/2000			2009/10			2010/11 (p)			2011/12 (f) Forecast 1 *			2011/12 (f) Forecast 2 *		
										Discounting, 1.5% mkt growth & static mkt shares			Ongoing discounting & 10% branded sales loss		
	Branded Milk Sales			**Branded Milk Sales**			**Branded Milk Sales**			**Branded Milk Sales**			**Branded Milk Sales**		
	Litres	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**	
Regular Whole	325,000,000	$ 1.33	$ 432,250,000	148,000,000	$ 1.83	$ 270,840,000	151,922,000	$ 1.82	$ 276,498,040	154,200,830	$ 1.82	$ 280,645,511	139,008,630	$ 1.82	$ 252,995,707
Reduced Fat	168,000,000	$ 1.47	$ 246,960,000	185,000,000	$ 2.03	$ 375,550,000	182,645,000	$ 2.04	$ 372,595,800	185,384,675	$ 2.04	$ 378,184,737	167,120,175	$ 2.04	$ 340,925,157
Low Fat	88,000,000	$ 1.53	$ 134,640,000	59,000,000	$ 2.07	$ 122,130,000	53,956,000	$ 2.05	$ 110,609,800	54,765,340	$ 2.05	$ 112,268,947	49,369,740	$ 2.05	$ 101,207,967
Flavoured	36,000,000	$ 2.36	$ 84,960,000	74,000,000	$ 3.72	$ 275,280,000	83,332,000	$ 3.64	$ 303,328,480	84,581,980	$ 3.64	$ 307,878,407	76,248,780	$ 3.64	$ 277,545,559
UHT	70,000,000	$ 1.33	$ 93,100,000	110,000,000	$ 1.63	$ 179,300,000	119,640,000	$ 1.56	$ 186,638,400	121,434,600	$ 1.56	$ 189,437,976	109,470,600	$ 1.56	$ 170,774,136
Other	17,000,000	$ 1.57	$ 26,690,000												
	704,000,000	$ 1.45	$ 1,018,600,000	576,000,000	$ 2.12	$ 1,223,100,000	591,495,000	$ 2.11	$ 1,249,670,520	600,367,425	$ 2.11	$ 1,268,415,578	541,217,925	$ 2.11	$ 1,143,448,526
	Private Label Milk Sales			**Private Label Milk Sales**			**Private Label Milk Sales**			**Private Label Milk Sales**			**Private Label Milk Sales**		
	Litres	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**	
Regular Whole	147,000,000	$ 1.26	$ 185,220,000	359,000,000	$ 1.12	$ 402,080,000	368,694,000	$ 1.07	$ 394,502,580	374,224,410	$ 1.02	$ 381,708,898	411,093,810	$ 1.02	$ 419,315,686
Reduced Fat	22,000,000	$ 1.37	$ 30,140,000	177,000,000	$ 1.30	$ 230,100,000	205,101,000	$ 1.14	$ 233,815,140	208,177,515	$ 1.01	$ 210,259,290	228,687,615	$ 1.01	$ 230,974,491
No Fat	3,000,000	$ 1.47	$ 4,410,000	4,000,000	$ 1.63	$ 6,520,000	5,025,000	$ 1.42	$ 7,135,500	5,100,375	$ 1.42	$ 7,242,533	5,602,875	$ 1.42	$ 7,956,083
Flavoured	-	$ 2.74	$ -	5,000,000	$ 2.01	$ 10,050,000	5,157,000	$ 1.98	$ 10,210,860	5,234,355	$ 1.98	$ 10,364,023	5,750,055	$ 1.98	$ 11,385,109
UHT	74,000,000	$ 0.90	$ 66,600,000	40,000,000	$ 1.15	$ 46,000,000	40,883,000	$ 1.13	$ 46,197,790	41,496,245	$ 1.13	$ 46,890,757	45,584,545	$ 1.13	$ 51,510,536
Other	-	$ -	$ -												
	246,000,000	$ 1.16	$ 286,370,000	585,000,000	$ 1.19	$ 694,750,000	624,860,000	$ 1.11	$ 691,861,870	634,232,900	$ 1.04	$ 656,465,501	696,718,900	$ 1.04	$ 721,141,905
	950,000,000	$ 1.37	$ 1,304,970,000	1,161,000,000	$ 1.65	$ 1,917,850,000	1,216,355,000	$ 1.60	$ 1,941,532,390	1,234,600,325	$ 1.56	$ 1,924,881,078	1,237,936,825	$ 1.51	$ 1,864,590,430
	Difference in Branded & Private Label Sales			**Difference in Branded & Private Label Sales**			**Difference in Branded & Private Label Sales**			**Difference in Branded & Private Label Sales**			**Difference in Branded & Private Label Sales**		
	Litres	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**	
Regular Whole	147,000,000	$ 0.07	$ 10,290,000	359,000,000	$ 0.71	$ 254,890,000	368,694,000	$ 0.75	$ 276,520,500	374,224,410	$ 0.80	$ 299,379,528	411,093,810	$ 0.80	$ 328,875,048
Reduced Fat	22,000,000	$ 0.10	$ 2,200,000	177,000,000	$ 0.73	$ 129,210,000	205,101,000	$ 0.90	$ 184,590,900	208,177,515	$ 1.03	$ 214,422,840	228,687,615	$ 1.03	$ 235,548,243
No Fat	3,000,000	$ 0.06	$ 180,000	4,000,000	$ 0.44	$ 1,760,000	5,025,000	$ 0.63	$ 3,165,750	5,100,375	$ 0.63	$ 3,213,236	5,602,875	$ 0.63	$ 3,529,811
Flavoured	-	-$ 0.38	$ -	5,000,000	$ 1.71	$ 8,550,000	5,157,000	$ 1.66	$ 8,560,620	5,234,355	$ 1.66	$ 8,689,029	5,750,055	$ 1.66	$ 9,545,091
UHT	74,000,000	$ 0.43	$ 31,820,000	40,000,000	$ 0.48	$ 19,200,000	40,883,000	$ 0.43	$ 17,579,690	41,496,245	$ 0.43	$ 17,843,385	45,584,545	$ 0.43	$ 19,601,354
Other	-	$ 1.57	$ -												
	246,000,000	$ 0.18	$ 44,490,000	585,000,000	$ 0.71	$ 413,610,000	624,860,000	$ 0.78	$ 490,417,460	634,232,900	$ 0.86	$ 543,548,019	696,718,900	$ 0.86	$ 597,099,548