Australian Dairy Products Federation

Submission

ACCC Supermarkets inquiry 2024-25

ADPF Australian Dairy Products Federation

ADPF Submission to:
ACCC Supermarkets Inquiry 2024/25 | submitted: April 2024

Acknowledgement of Country

Australian Dairy Products Federation acknowledges the Traditional Owners of Country throughout Australia. We pay our respects to Elders past and present.

Introduction

On 1 February 2024, the Treasurer directed the Australian Competition and Consumer Commission to conduct an inquiry into pricing and competition in Australian supermarkets (the Inquiry), including how prices are set along the supply chain and the associated margins.

On behalf of our members, the Australian Dairy Products Federation (ADPF) appreciates the opportunity to provide comment to the Inquiry. We have opted to respond broadly to the key areas outlined in the Terms of Reference to which we can provide a comprehensive analysis of the current operating environment and the implications and risks to the dairy processing sector. Those being:

A. **Market structure, competition and buying power.**
B. **Pricing transparency and margins.**
C. **Other factors impeding or supporting efficient supply or pricing – referring to the Dairy Code of Conduct.**

We complement this, by first providing an overview of the Australian dairy processing industry, the categories in which they operate, and the economic value they provide through job creation and investment in the vibrancy and livelihoods of the people and community in which they live and work. All potentially at threat. Further supporting detail is in the Appendix.

About ADPF

The Australian Dairy Products Federation (ADPF) is the national industry policy and advocacy body representing commercial, post farm-gate members of the Australian dairy supply chain including processors, traders, and marketers of Australian dairy products.

Our members process more than 90 per cent of Australian milk volumes and provide dairy products for both domestic and export markets.

For about 40 years, ADPF has strived to protect and promote dairy for the future success of dairy processors, providing a trusted source of advice and lead on public advocacy to government and the community, on the economic, social and health benefits of Australian dairy.

Executive summary

Delivering affordable, safe, and nutritious dairy products every day to Australian consumers is at the heart of our dairy processing businesses.

They are vital to our nation's economy, food security and regional development, transforming raw milk into value-added dairy products every day of the year – milk, cheese, yoghurt, butter, ice-cream.

These businesses keep more than 20,000 Australians in direct employment, more than half of whom are in regional Australia and a quarter, highly skilled. We pay $6.1 billion to our dairy farmers annually.

We are fortunate the demand for dairy products remains strong despite the cost-inflationary pressure the sector is navigating.

However, off the back of COVID-19, floods and biosecurity threats, Australian dairy processors are contending with an extremely challenging operating environment. A combination of low raw milk supply, persistent and rising input costs, and competitive pressures is reshaping the dairy industry. Eleven dairy processing businesses have publicly announced their closure over the past 18 months – one as recently as two weeks ago.

You only have to look at our supermarket shelves to witness the range of cheaper imported dairy products available – cheeses, butter, ice cream.

Due to the perishability of dairy, the interdependencies between dairy farmers, processors and retailers are critical to ensure all elements of the industry operate efficiently.

However, the market imbalance and inequity in market power that exists between supermarkets and dairy processors is creating a competitively unfair market that must be addressed.

The aggressive promotion and leverage of home brand milk and other dairy products has removed a significant amount of value from the dairy supply chain.

The entrance of the supermarket into the food service channel – and most recently into dairy processing – heightens this market imbalance and disproportional control, growing their dominance, market power and influence along the supply chain from product mix, to pricing, and sourcing.

This is coupled with the inability of the dairy processing sector to pass full input costs through the supply chain.

For Australian dairy processors this is eroding profit margins, reducing investment into capital, people, and innovation, and impacting industry confidence (at an all-time low of 17 per cent, versus 90 per cent in 2020) – and in turn has consequences downstream.

If we revisit concluding remarks from the 2018 ACCC Final Report into the Dairy Inquiry:

> *"The ACCC has analysed the performance of the dairy industry and the structural and behavioural features which contribute to this performance.*
>
> *"The dominant picture that has emerged is one of significant imbalances in bargaining power at each level of the dairy supply chain. This begins with the relationships between retailers and dairy processors and progresses down to the relationship between processors and farmers.*
>
> *"In the domestic market, the major Australian supermarkets have exercised their bargaining power to elicit lower wholesale prices from processors. The most notable illustration of this is the pricing of private label milk.*
>
> ***The ability of the supermarkets to leverage their bargaining power has reduced the profit margins of processors."***

This is still occurring.

Our asks

1. The status quo is unsustainable and the market imbalance between dairy processors and supermarkets must change to support a viable and competitive dairy industry that invests in people and innovation and can compete with imports:
    - There is a bargaining power asymmetry between supermarkets and processors, which affects processors' ability to negotiate effectively, such as wholesale price.
    - The current influence of the supermarket sourcing milk directly, in addition to their expansion into food service (Woolworths – PFD Foods; Metcash into Superior Foods) and now dairy processing (Coles), further exemplifies their dominance and significant and growing market power throughout the supply chain – from product mix, to pricing, and sourcing.
    - The disproportionate control the supermarkets have across the supply chain and the practices adopted on home brand dairy products is to the detriment of locally produced and branded Australian dairy products.
2. To ensure a robust, fit-for purpose framework is available to protect dairy processors from the effects of supermarkets buying power in Australia – noting the Senate Select Inquiry into Supermarket Pricing and the Review of the Food and Grocery Code are also underway, among others.

ADPF and our members would appreciate the opportunity to work collaboratively with the ACCC on this Inquiry, to ensure the right policy outcomes and framework for securing a viable and competitive Australian dairy industry – void of any increased market power imbalance from the supermarkets.

We expand on this below.

The Australian dairy processing industry – overview

Dairy processors sit at the heart of communities across Australia. From Lismore, to Kyabram, Brisbane, to Bega, Korumburra, Colac, Jervois, Smithton or Balcatta, they create thousands of jobs, and invest in the vibrancy and livelihoods of the people and community in which they live and work. You don't have to travel far in regional Australia to find a dairy manufacturing plant.

They transform raw milk – a highly perishable, low value commodity – into safe, nutritious, and premium dairy products for domestic and global markets every day of the year, from fresh milk and flavoured milk, to cheese, powdered milk, cream, yoghurts and butter, plus a wide range of high value food ingredient dairy fat and protein-based products.

Most benefits stay close to the point of production, in regional areas through jobs, skills and capacity building in manufacturing and on farm.

According to the ADPF's Deloitte Access Economic Report, in 2019-20 the dairy processing sector contributed more than $12.4 billion to the Australian Gross Domestic Product. We create more than 70,000 jobs of which about 20,000 (29 per cent) are directly in dairy processing – of this more than half (56.5 per cent) are in regional Australia and a quarter in the top two-highly skilled categories[1].

[1] Deloitte Access Economics (2021) Economic contribution of Australian Dairy Processing Sector

Most dairy processing jobs are located within 250km of where milk is produced, generating significant economic activity and employment in regional Australia – one of the most significant of any agricultural industry[1].

Our reputation for delivering high quality, nutritious dairy products that are enjoyed locally and around the world is second to none, exporting 30 per cent of our milk production valued at $3.7 billion.

Processing milk is an 'asset heavy' business model requiring significant capital and patient and committed investors. Adequate volumes are needed to maximise capability, capacity and ensure ongoing investment.

Processors thereby bear considerable risk in providing safe and ongoing supply of dairy products to meet consumer's ongoing needs. Such investment drives innovation and supply chain integrity that allows dairy processors to continue to tap into domestic and international markets.

However, a tough domestic trading environment, marked by continued retail price pressures, low volume growth, exorbitant overhead and input costs, and import competition, is hampering the industry and leaving processors with less margin than ever before.

Year-on-year raw milk production volumes have decreased, now at a 30 year low of 8.1 billion litres (2022-23).

Input costs continue to rise: labour (up five per cent), transportation (up 19 per cent), packaging (up nine per cent), and energy (up to 80 per cent for gas, 25 per cent for electricity for 2022-23) – and expected to continue in FY2024.

Many Australian dairy processors continue to assess their manufacturing footprint to optimise business efficiencies – a reality we have witnessed in the past 18 months. Eleven dairy processing businesses have publicly announced their closure – including one in Northern Victoria as recently as two weeks ago:

- Lactalis, Echuca – April 2024
- Betta Milk Burnie Tasmania (Bega) – February 2024
- Sara Lee – (administration announced) November 2023. New ownership announced February 2024
- Gundowring ice-cream – announced in October 2023 it will close in the new year.
- Tamworth's Peel Valley Milk – October 2023
- Margaret River Dairy Company – September 2023. New ownership announced January 2024
- Made by Cow – May 2023.
- Country Valley – April 2023
- Saputo Maffra – February 2023
- Bega Canberra Milk – February 2023
- Camperdown Dairy (fresh milk production) – August 2022.

We are also aware of several other dairy processing factories that have suspended operations, and other companies that have announced significant impairments on their dairy asset value, writing down hundreds of millions of dollars over the last couple of years.

Refer to the Appendix for further information on the Australian dairy processing industry – providing important context to this Inquiry.

A. Market structure, competition and buying power – *the consequence of disproportionate control.*

Market structure – market imbalance. Retail market dominance

The Australian grocery retail sector is valued at about $141 billion and expected to grow 4.6 per cent annually (CAGR 2024-28). It is dominated by four main retailers who account for 80 per cent of the market, with Woolworths and Coles continuing to hold 65 per cent of that share[2].

In FY23, about 71 per cent of liquid milk sold in Australia was sold in retail stores (by volume), versus 29 per cent outside of the retail store[3].

In the retail stores, 61 per cent of the volume sold was private label or home brand milk, compared to 49 per cent of the value – reflecting the lower-than-average price of generic label milk to the branded version (refer to Table 1; Figure 3 and 4 in the Appendix).

This compares to FY13 when 52 per cent of total milk sales where private label (by volume) and 34 per cent by value.

Since 2009-10 to 2022-23, neither home brand nor branded milks have kept up with the all-groups CPI. Private label pricing has increased faster on average than branded. However, the farmgate milk price has increased at a much higher rate, contributing to a squeeze in the supply chain (refer to Tables 2 and 3, in the Appendix)[4].

The key issue of market imbalance disempowers processors from being able to pass on full costs throughout the supply chain – including the variable production cost increases throughout the year.

As one ADPF member noted, "*retailers have the seat of power in any dealings whether it be with processors, farmers, or government. This is because there is so few of them and the fact that they buy the majority of milk*".

They have the balance of power to say 'no'.

It was also noted, retailers use dairy processors contracts as a means of gathering information and gaining a competitive edge. ADPF has heard of members handing over commercial-in-confidence documents on product cost inputs to supermarkets to justify legitimate cost increases only to see these supermarkets use this information to undercut the processor in the creation of their own competitive product.

Since supermarkets have much larger bargaining power with other suppliers such as utility providers or other food suppliers, they can use this power to cut out dairy processors.

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[2] Nielsen Homescan data 2023 c/o Dairy Australia; Statistics 2024; Hunt Export Australian Market Overview 2024
[3] Nielsen Homescan data 2023 c/o Dairy Australia. Retail stores = supermarkets, independents (noting majority volume via main supermarkets).
[4] Dairy Australia, February 2024

Their sheer size and scale are resulting in more sourcing requirements being imposed on dairy processors from using supermarkets 'owned services', to their 'suppliers of choice' – often at much higher costs – from logistics and warehousing to marketing and media.

This also extends to increasing costs through a 'fifth margin' due to a push for dairy processors to pay for supermarket owned data and listing fees.

The supermarkets can also create 'pseudo-brands' to replace proprietary brands – all at their own discretion.

At the heart of this challenge is the inequity of market power that exists. While supermarkets and the ACCC have consistently emphasised that domestic retail price does not determine the milk prices downstream, there is major pressure for deflationary pricing while cost increases occur in the production process – from farming to processing production.

Dairy processors have little power to negotiate with the supermarkets, including the wholesale price paid by the supermarket, and again it is at their discretion to how the consumer accesses products and what the consumer pays for the product. This is the result of a bargaining power asymmetry between the processors and supermarkets, as the ACCC has previously acknowledged.

For example, the supermarket can increase the price of the dairy processor's product more than the price of the farm-gate milk price, distorting the market.

To explain this better, the consumer pays more for the dairy product (i.e., higher retail price) but the margin does not pass downstream through the supply chain – i.e., processors wholesale price for milk remains the same; the farmgate milk price paid to the farmers remains the same; the supermarket 'pocket' the profit margin.

Supermarkets also commonly use private label milk as a bargaining tool for branded products, with supermarkets refusing to sell branded products or give them prominence unless private label milk prices are reduced to unsustainable levels.

When support payments were agreed to in times of difficulty including drought, many of these payments were granted only to fresh milk suppliers, not across the dairy case, hurting processors and farmers who create much loved dairy products such as cheese, yoghurt, and ice cream.

Recently, Norco's 100 per cent farmer-owned milk brand was removed from about 90 Woolworths Supermarkets in central Sydney, favouring imported dairy products such as ice-cream from Slovenia and New Zealand instead[5].

The ADPF is aware of multiple other examples of margin distortion, or the demand for onerous terms of trade, whereby the costs are absorbed by the dairy processor.

This level of ongoing retail margin is inequitable and unsustainable as it places the 'risk' on dairy processors while placing the 'reward' on the supermarkets or retailers. This has the effect of robbing the dairy sector of the proceeds required to reinvest in the future.

This market imbalance enables retailers to reject price increases that simply reflect the market-driven price increase.

[5] February 2024

While the ADPF is aware the revisions to the Food and Grocery Code of Conduct no longer require commercial information to be provided when justifying a price increase and for retailers to respond to a request for a price increase within 30 days, the fact remains supermarkets are continuing to control more parts of the supply chain with the effect of further reducing margins.

Dairy processors are already susceptible to the demands of the retailer, and with them controlling more parts of the supply chain, could have the effect of further reducing margins, reducing competition, and eroding the future sustainability of the dairy sector.

Vertical integration and supply chain bias

With supermarkets driving down the price paid to dairy processors, processors manage their risk and opportunities by diversifying their product and market mix.

This reality was publicised again recently with Coles asking suppliers to 'cut their prices and take price cuts funded by themselves as part of their 'Down-Down campaign' (data source: The Weekly Times, 14 February 2024; The Australian, 10 March 2024 – refer to the Appendix).

However, this market diversification, is now under threat as supermarkets enter into other channels with the power to now dismantle and/ or control the supply chain – such as Woolworths and Metcash into food service, and Coles into dairy processing through the recent acquisition of two processing sites.

For many years, supermarkets have had contractual arrangements in place for their generic branded retail milk and cheese.

Supermarkets were increasingly sourcing primary ingredients (such as cheese) as part of one tender process and processing it elsewhere, capturing the margin previously obtained by the primary manufacturer by having control over the end-to-end supply chain.

In 2014, Woolworths announced its 'Farmers Own' milk working directly with farmers. Woolworths direct sourcing is estimated to account for 40 million litres of milk in the Australia market.

In June 2019, Coles announced its 'direct sourcing model' for its Coles branded fresh milk in Victoria and NSW (with Saputo to process and bottle through a toll processing agreement, i.e., processor is paid a small margin to manufacture the milk).

In July 2020, they announced an expansion of their 'direct sourcing model' into South Australia and West Australia, and then direct sourcing of milk to make cheese, estimated to account for 430 million litres of milk in the Australian market.

Woolworths strategic investment into PFD Food Services – one of Australia's leading food service suppliers – threatens to reduce processors to contract packers, a further example of the distortions of power within the supply chain and push to reduce margins. It threatens to reduce consumer choice and drive out competitors in the food service space through less opportunities and avenues to market these goods – the consequences of which we are to see play out.

Taking Coles as the example: they now have end-to-end control on product mix, pricing and sourcing (farmgate, wholesale and retail prices) of both provide label and branded dairy product prices. This end-to-end control increases their ability to influence the future viability of processors and brands.

The impact of Coles having direct milk supply and processing capacity means that they have the option to pay the farmer more for their home brand milk – as is evident with the above-market farmgate milk prices they have exercised over the years (on average $0.80- $0.90 per kilogram of milk solids above the market average) – and use other methods to recoup these costs to ensure they maintain their margins.

Coles becoming an Australian dairy processor – and expanding upon their current remit of buying milk direct through to controlling retail sales – has the potential to further reduce processor margins, lessen competition and disincentivise new entrants into the sector.

Through sheer size and scale and larger bargaining power with other suppliers (such as utility providers or other food suppliers), the supermarkets pose another unfair advantage through their procurement channels.

Dairy is a perishable product, with high production costs. Raw milk is collected and processed every day of the year, with manufacturing facilities running 24 hours a day, seven days a week. Adequate volumes are needed to maximise capability, capacity and ensure ongoing investment.

This compares to cheese products that require storage and maturation of up to 24 months, before they can be processed into a final product for consumers.

Processors thereby bear considerable risk in providing safe and ongoing supply of dairy products to meet consumer's ongoing needs.

The biggest danger is that dairy processors are relying on packaged foods to survive due to the fact the very same supermarkets are driving down milk and dairy prices.

If the current behaviour from retailers continues, there will no longer be a number of dairy processors available in Australia to result in a workably competitive market, leaving large tranches of the dairy industry at risk as processors are forced to merge or give up their role to retailers, which will further reduce competition.

The contribution of home brand products to the concentration of corporate power

Supermarkets leverage their own range of home brand products to control entire product categories, using them as a bargaining tool during negotiations to their advantage. This is particularly evident in the fresh milk category, where home brand products hold about 65 per cent market share across major supermarket chains.

The strategic use of home brand items by supermarkets, often as loss leaders, to attract foot traffic while simultaneously pressuring branded products demonstrates the significant impact of market power concentration and the utilisation of home brand tools on category value.

Increased promotion of home brand products – which compete on the shelves against the branded products – drives a greater distinction between the two – inclusive of price – again outside the control of the dairy processor.

The practice extends to the arrangement of shelf space within supermarkets, where home brand products exert continual pressure on branded counterparts and suppliers are coerced into producing home brand items, often at minimal to no profit margins.

Or the retailer refusing to replenish fast-selling branded products until their private label milk is sold first.

Suppliers face the constant threat of having their branded products delisted if they refuse to comply with producing home brand alternatives.

Once committed to producing home brand goods and adjusting their production processes accordingly, suppliers become vulnerable to further negotiation tactics from supermarkets, resulting in additional margin erosion in favour of the retailer.

The duopoly nature of the supermarket industry exacerbates the situation, making it exceedingly challenging for suppliers to offset the loss of a home brand supply contract.

Consequently, suppliers find themselves in a precarious position, with little room for negotiation or recourse, ultimately reinforcing the dominance of supermarkets and perpetuating the cycle of margin transfer from the supplier to the supermarket with very little to none of this being passed on to the consumer.

Competition in the grocery supply chain

Australia's dairy industry has dropped its export competitiveness from 36 per cent to 30 per cent (FY2023)[6] not only due to lower supply availability but also due to price competitiveness.

The FY2022-23 Dairy Australia figures reveal export volumes are down by 16 per cent or 137,308 tonnes, while import volumes are up 17 per cent, particularly from New Zealand.

The December 2023 Situation and Outlook also found:

- In 2022/23, close to 344 thousand tonnes of dairy was shipped into Australia or 2.2 billion litres of milk equivalents, largely from New Zealand (NZ), the United States (US) and Europe – the largest volume ever imported in a single season.
- The price difference between Australian and NZ dairy products was at an all-time high, in conjunction with widespread inflation ramping up cost pressures for both buyers and producers.
- This led to a 28.8 per cent rise in imports from NZ and a 16.1 per cent increase in product from the US over 2022/23.
- Imported product accounted for more than 40 per cent of the Australian butter market by volume last season, most of which originated from NZ.
- In 1999/2000, imports accounted for 11 per cent of Australian dairy consumption, whereas the most recent figures show closer to 30 per cent of dairy consumed is from overseas – up from 25 per cent the year prior.

Cost-of-living pressures means buying cheaper products, right across the board, is no longer a choice but a necessity.

[6] Dairy Australia In Focus 2023 – The Australian dairy Industry.

This is placing Australia at a competitive disadvantage domestically and globally, as evidenced by the lower priced imported dairy cheese and butter products on our supermarket shelves.

For processors, profit margins are being reduced, impacting their ability to invest in capital, people, technology and innovation, and impacting industry confidence.

B. Pricing and margins – *the power of the supermarkets*.

Retailer Pricing

As mentioned, Coles is already setting farmgate milk prices that are higher than the industry average, creating unrealistic and unsustainable pricing expectations for the remainder of the industry, and impacting the ability of dairy processors to be cost-competitive.

Refer to the Appendix for an explanation of how farmgate milk prices are determined in Australia (page 22).

For example, the 2022-23 season the Coles expected weighted average southern region farmgate milk price was $10.40 per kilogram of milk solids, versus the expected weighted average southern region milk price for the industry of $9.60 per kilogram of milk solids – eight per cent higher.

Again, for the 2023-24 season, Coles set expectations high, announcing an expected weighted average southern region farmgate milk price of about $10.30 per kilogram of milk solids (February 2023). This is versus the expected weighted average southern region milk price for the industry of $9.40 per kilogram of milk solids (10 per cent higher) – despite global dairy commodity prices being 30 per cent down.

At a similar time, there was about a 30 per cent or AUS$3.00 per kilogram of milk solids higher differential between the farmgate milk prices paid in Australia versus New Zealand – with New Zealand's farmgate milk prices downgraded to reflect the realities of the global market – making Australia an increasingly uncompetitive place to manufacture dairy products. Refer to Figure 5 in the Appendix.

Today, there remains about a 23 per cent or AUS$2.15 per kilogram of milk solids higher milk price differential between Australia and New Zealand.

Through end-to-end control of pricing and supply, Coles has the option to pay the farmer more for their home brand milk and use other methods to recoup these costs to ensure they maintain their margins.

Coles' concentration of buying milk against a higher returning bundle of products on the retail shelf has led to predatory 'acquisition' of milk, forcing large sectors of the dairy industry that have geared their business to lower returning products in the commodity, export, and foodservice sectors to pay a farmgate milk price that does not provide a return for this product.

The result is we have an industry that is no longer export competitive and this is driving decisions regarding rationalisation and closures of factories or businesses.

There is a clear market imbalance that exists between dairy processors and retailers, impacting the future viability of dairy processing sector.

Retailer margins

A comparison of retailer margins in recent industry analysis undertaken by the Australian Food and Grocery Council (April 2024), has found that the profitability of the Australian operation of a multinational food and grocery manufacturers is below that of their global peers' (measured as Earnings Before Interest, Taxes, Depreciation and Amortisation – EBITDA)[7].

However, Coles and Woolworths have an EBITDAR margin – which takes into account differences in rent and property ownership arrangements—above their global peers'.

Additional analysis looking at the return on invested capital (ROIC) for a representative sample of food and grocery manufacturers in Australia (including a mix of multinational and domestic suppliers), is about 10 per cent – lower than that for Coles, Woolworths, and Metcash, which have a ROIC of 13 to 17 per cent.

The AFGC also considered analysis undertaken by New York University on ROIC in similar markets, finding that USA food processing has a ROIC of 17 per cent – which is significantly higher than 10 per cent in Australia. Food and grocery retailing has a return on investment of 11 per cent in the US — significantly lower than the 13 to 17 per cent in Australia.

This analysis provides a very powerful benchmark.

We urge the ACCC to consider all of these factors in its Inquiry.

C. Other factors impeding or supporting efficient supply or pricing.

Dairy Code of Conduct

The Dairy Code of Conduct was introduced in January 2020 and has resulted in greater uniformity and an improved process in the transactional relationship between dairy farmers and processors.

ADPF supports the efforts to improve industry confidence and believes the Dairy Code has facilitated a feeling of improved cooperation and transparency throughout the dairy industry.

However, the Dairy Code did not foresee the impact on pricing and Australia's competitiveness against imports and in export markets.

While we note the Operation of the Dairy Code of Conduct is under review, with the second full review scheduled to start in September this year, is it important to share the current challenges of the Dairy Code amid a period of commercial uncertainty with a disconnect between market demand and Australian farmgate milk prices under a structurally rigid Dairy Code.

[7] Australian Food and Grocery Council (April 2024). Grocery industry returns and margins.

In doing this, it is important to remember that 71 per cent of Australia's total milk production in FY2022/23 (close to 6 billion litres) was trade exposed, and influenced by global commodity markets (fat and protein) and exchange rates – meaning that those dairy products compete with imports in Australia or exports around the world.

The Dairy Code's goal was to create certainty for dairy farmers and processors to confidently plan and invest in the industry and it is clear this is yet to be achieved.

The certainty provided by the Dairy Code comes with an inability to respond appropriately to the commercial realities of a volatile global market, resulting in the cost of Australian dairy products not being competitive with imports.

At a time when New Zealand was responding to global commodity prices, with farmgate milk prices adjusted twice from their seasons opening milk price – Australian farmgate milk prices stayed the same and hit a 30 per cent higher differential (or AUS$3.00 per kilogram of milk solids) between the farmgate milk price paid in Australia versus New Zealand.

This resulted in supermarkets and food service replacing Australian dairy products with cheaper imported dairy cheese and butter products, as evidenced by a 17 per cent increase on our supermarket shelves and in cafes[8].

There remains a 23 per cent or AUD$2.15 per kilogram of milk solids differential.

As previously shared, the Australia's dairy industry has dropped its export competitiveness from 36 per cent to 30 per cent (FY2023)[9] not only due to lower supply availability but also due to price competitiveness. We imported more than 2.2 billion litres of milk equivalents in the past year.

Unlike New Zealand and other competing nations, no other commodity market in the world requires dairy processors to announce farmgate milk prices 13-months out from the seasons end, risking their viability in a market where the costs of Australian products are not competitive with imports.

Dairy processors act as price takers in the global market, where commodity prices dictate the prices for customers. As a result, processors have limited ability to mitigate the fluctuations in their input costs.

This limitation means that processors are unable to secure sales contracts at a fixed long-term milk price, to offset the long-term milk costs that are a requirement of the Dairy Code.

The Dairy Code restricts processor's ability to respond, and this disconnect between dairy farmers and dairy markets affects clear market signals and price transparency needed amongst businesses for planning, investment, and industry confidence.

For dairy processors, margins are being significantly reduced and squeezed, impacting their ability to invest in capital, people, technology, and innovation, and affecting industry confidence.

Since the introduction of the Dairy Code, it is clear, a market equilibrium is yet to be achieved, with dairy processors carrying an unsustainable amount of price risk and commercial risk.

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[8] Dairy Australia In Focus 2023 – The Australian dairy Industry
[9] Dairy Australia In Focus 2023 – The Australian dairy Industry

Unless change is installed to rebalance the value chain, there will be major implications on domestic supply and Australian exports.

Significant transformation and reduction in long term capacity will lead to job losses, reduced investment in regional communities, and impact farmers who rely on having dairy manufacturing assets in their region.

We are seeking genuine and comprehensive consultation, and a refined and more commercially efficient Dairy Code completed as a priority.

We note the Food and Grocery Code is under review and support strengthened dispute resolution provisions, while retaining existing complaint mechanisms – with the Dairy Code used as a reference.

Conclusion

Dairy processors are committed to a creating a thriving and trusted industry, delivering jobs, economic growth and helping people to live well, ultimately built on the value of dairy being recognised throughout the Australian community.

The right market conditions must exist for this to prevail. The major supermarkets already hold significant bargaining power, creating a competitively unfair market, impacting dairy processor's ability to be cost-competitive and remain viable in domestic and international markets.

ADPF and our members would appreciate the opportunity to work collaboratively with the ACCC on this Inquiry, to ensure the right policy outcomes for improving the standards of business behaviour in the food and grocery sector. We must optimise transparency, certainty, trust, and co-operation, and in turn the security and viability of the Australian dairy industry – void of any increased market power from the supermarkets.

Yours sincerely,

[redacted]

John Williams
ADPF Chair
[redacted]

[redacted]

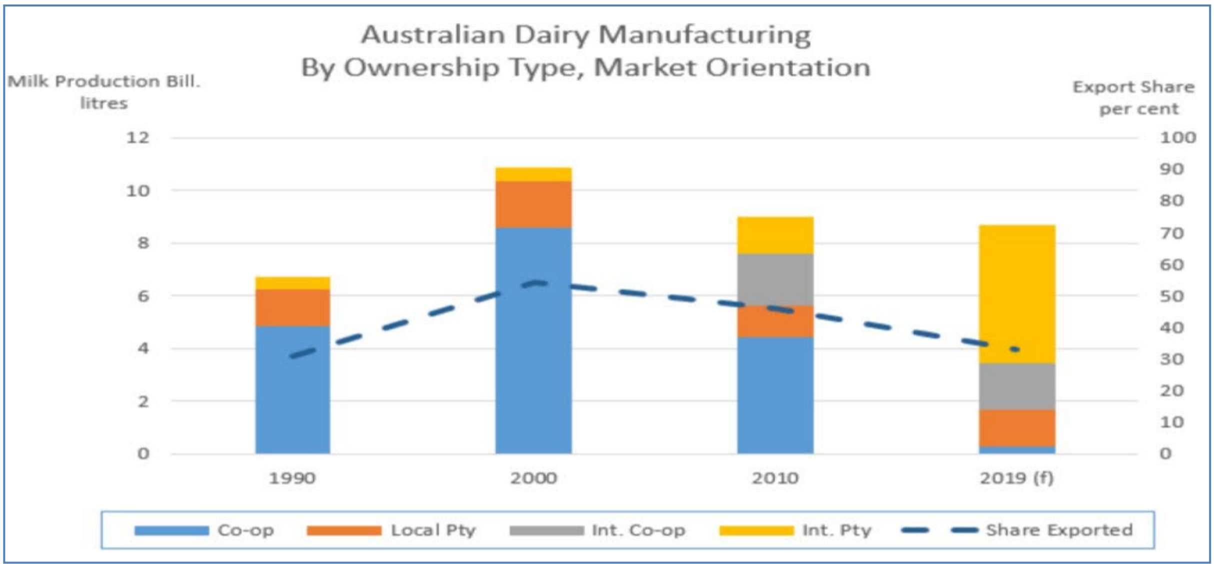
Janine Waller
ADPF Chief Executive Officer
[redacted]

Appendices

Other key dairy processing information (continued from page 5):

- Ten dairy manufacturers process the majority of the milk pool in Australia:
  - Saputo Dairy Australia, Fonterra Australia, Bega Cheese Group, Lactalis Australia, Australian Consolidated Milk (ACM), Brownes Dairy, Burra Foods, Noumi (formerly Freedom Foods), Bulla and Norco Co-Operative – shifting in the last 20 years, from a co-operative dominated industry to having only one remaining local dairy co-operative (Norco) – **Figure 1.**

Figure 1: Australian dairy manufacturing and ownership (Australian Dairy Plan, July 2019)



- There are about **140 dairy processing plants across Australia**, with the processing of dairy products predominantly regionally based, and dairy's impact on regions is one of the greatest of any agricultural industry [Victoria=54 plants; NSW=24; Queensland=17; Tasmania=13; South Australia=20; Western Australia=10; Northern Territory=2] (see **Figure 2**).

- All Australian states produce milk and dairy products[9]. 'Southern states' produce a significant surplus to requirements, and transport excess to NSW and/or Queensland as well as producing exportable products with the surplus:
  - Victoria: 63.5% cent of Australia's national milk production (5.1 billion litres)
  - New South Wales: 12%
  - Tasmania: 11%
  - South Australia: 6%
  - Western Australia: 4%
  - Queensland: 3.5%.

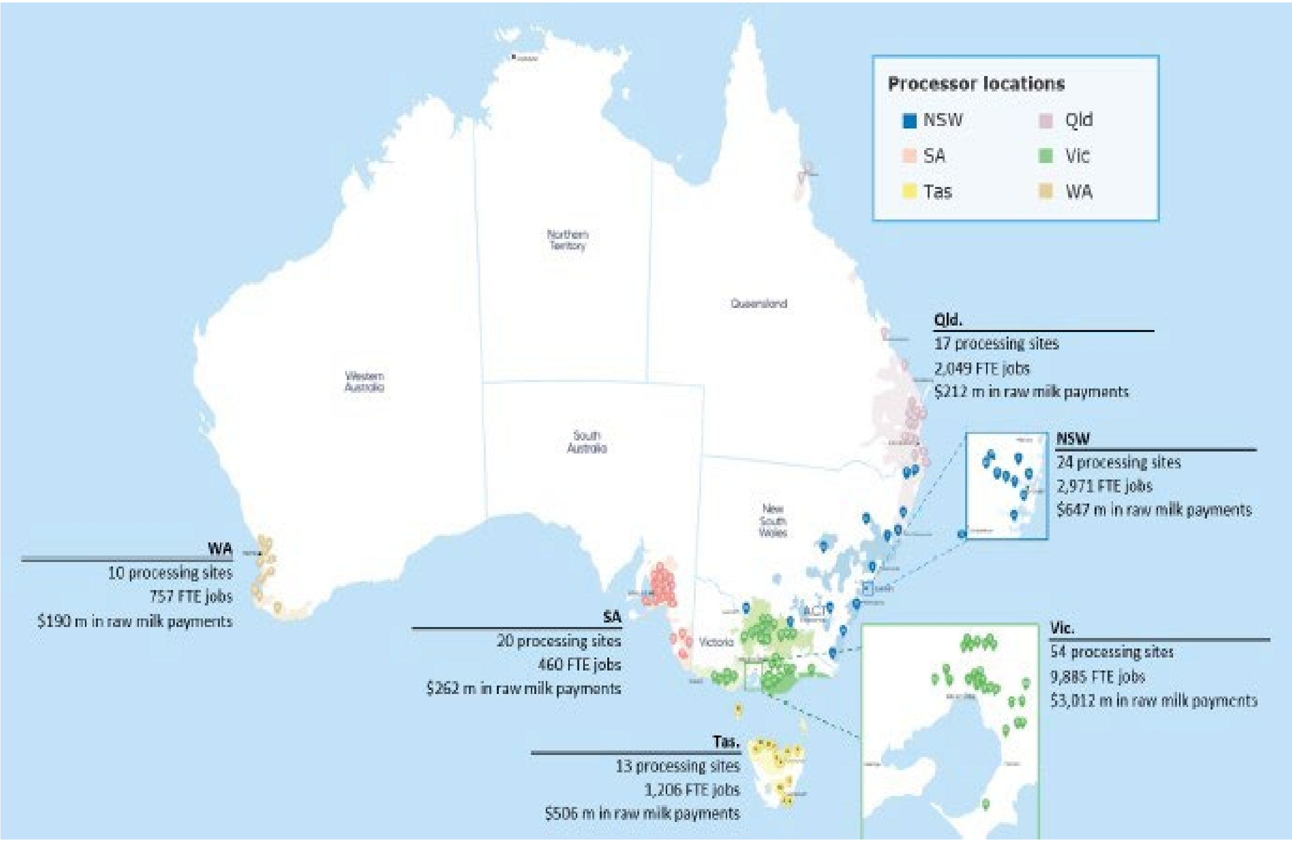
- Victoria, Tasmania, South Australia and southern NSW are collectively referred to as the 'Southern milk region' and supply domestic and export product markets – and account for 80 per cent of Australia's milk production. Queensland, northern New South Wales and Western Australia are the 'Northern milk region' and supply the domestic retail milk market, accounting for 20 per cent of Australia's milk production.

- Australia ranks fifth in the world trade of dairy, with a five per cent share.

- A softening global market has reduced exports by 16 per cent, adding to the pressure of an industry already struggling with domestic competition and high costs.

- During the last 15 years, imports have increased to be equivalent to about 30 per cent of national production in 2022-23 (up from 10 per cent in 2006-07), or 344,000 tonnes or 2.2 billion litres of milk equivalents.

Figure 2: Australian dairy processing locations and summary statistics, Deloitte Report 2021



Economic and Broader Contribution of the Australian Dairy Processing Industry

a vital and important contributor to the Australian economy and our regions.

ADPF

ECONOMIC CONTRIBUTION

$15.7 billion

Dairy processing generated **$15.7 billion** in revenue across products and value chains[*]

Contributed a total of **$12.4 billion** to **Australian GDP – $3.1 billion in direct value-add**[*]

$6.1 billion

Dairy processors employed **$6.1 billion** in capital, and invested **$383 million** in capital per annum[*]

$12 million

Dairy processors invested an average of **$12 million** annually in research and development[*]

EMPLOYMENT CONTRIBUTION

70,158 FTE jobs

Dairy processing's total employment contribution is **70,158 FTE jobs**[*]

20,394 FTE (29%) are direct employees in dairy processing and **49,764 FTE** indirect in aligned industries[*]

56.5% of the direct workforce is located in regional Australia and **23%** are among the two highest job skill categories[*]

Around **2,610** dairy processing positions are needed to meet 2022/23 workforce requirements or **13,050** over the next 5 years[#]

SUPPLY CHAIN CONTRIBUTION

3rd largest

Dairy is the **3rd** largest rural industry in Australia, and ranks **5th** in the world trade of dairy with a **5%** share[^]

In 2022/23 dairy processors made payments to farmers totalling **$6.1 billion** for raw milk[^]

$3.7 billion

In 2022/23, **30%** of milk produced in Australia was exported, worth **$3.7 billion**[^]

$5.1 million trips

In 2020/21, the dairy processing supply chain supported around **5.1 million** vehicle trips, at an estimated cost of **$890 million**[*]

ENVIRONMENTAL CONTRIBUTION

Dairy processing is estimated to account for just **0.2%** of Australia's greenhouse gas emissions[*]

27% emission drop

In 2020/21, dairy processors emission intensity was down **25.5%** (versus baseline)– a **27%** drop in absolute emissions[+]

In 2020/21, dairy processors generated **6.5%** less waste per ML of raw milk processed than 2019/20 or **46%** less than baseline, diverting **87%** of solid waste to landfill[+]

Australian Dairy Sustainable Packaging Roadmap supports processors towards the **2025** national packaging targets[+]

NUTRITION CONTRIBUTION

98%

Drinking milk is a dietary staple in **98%** of Australian households[^]

In 2022/23, per capita consumption of drinking milk remains high – around **90 litres**[^]

Increasing dairy intake to the Australian Dietary Guideline recommendations, can save at least **$2 billion** from the annual healthcare budget[@]

Increasing dairy from **2 to 3.5** serves per day in the elderly can help reduce fractures risk by **33%** and falls by **11%**[$]

References: [*]Deloitte Access Economics (2021) Economic and Broader Contribution of the Australian Dairy Processing Industry (Data points relate to 2019/20 unless specified otherwise); [^]Dairy Australia In Focus FY23; [+]Dairy Manufacturers Environmental Scorecard 2020/21 (baseline: 2010/11); [#]ADPF Workforce Report – Employment Issues and Challenges of the Australian Dairy Processing Industry, December 2022; [$]BMJ 2021, 375; [@]Nutrition 142(9):1772-80

Graphs and tables

Table 1: Supermarket sales: branded vs private label drinking milk [million litres]. Annual averages based of volume and value sold. Data source: Nielsen IQ c/o Dairy Australia 2024

	2000/2001		2010/11		2011/12		2016/17		2018/19		2021/22		2022/23	
	Million litres	Retail price/litre	Million litres	Retail price/litre	Million litres	Retail price/litre	Million litres	Retail price/litre	Million litres	Retail price/litre	Million litres	Retail price/litre	Million litres	Retail price/litre
branded	538	$1.59	591	$2.11	585	$2.13	777	$2.12	606	$2.09	602	$2.26	545	$2.67
Private label/ home brand	508	$1.11	625	$1.11	674	$1.04	697	$1.03	749	$1.13	826	$1.36	859	$1.62
TOTAL	**1046**	**$1.36**	**1216**	**$1.60**	**1259**	**$1.55**	**1473**	**$1.61**	**1355**	**$1.56**	**1427**	**$1.74**	**1404**	**$2.03**

Figure 3: Supermarket sales: Branded versus Private Label milk [volume – million litres sold]. Data source: Nielsen IQ c/o Dairy Australia 2024

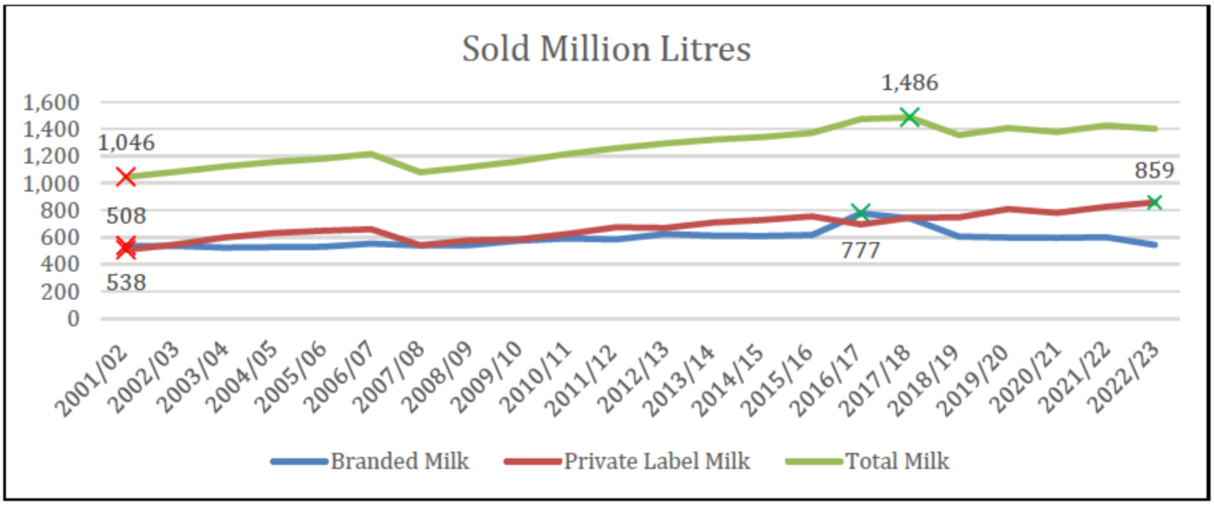


Figure 4: Supermarket sales: Branded versus Private Label milk [price/ litre]. Data source: Nielsen IQ c/o Dairy Australia 2024

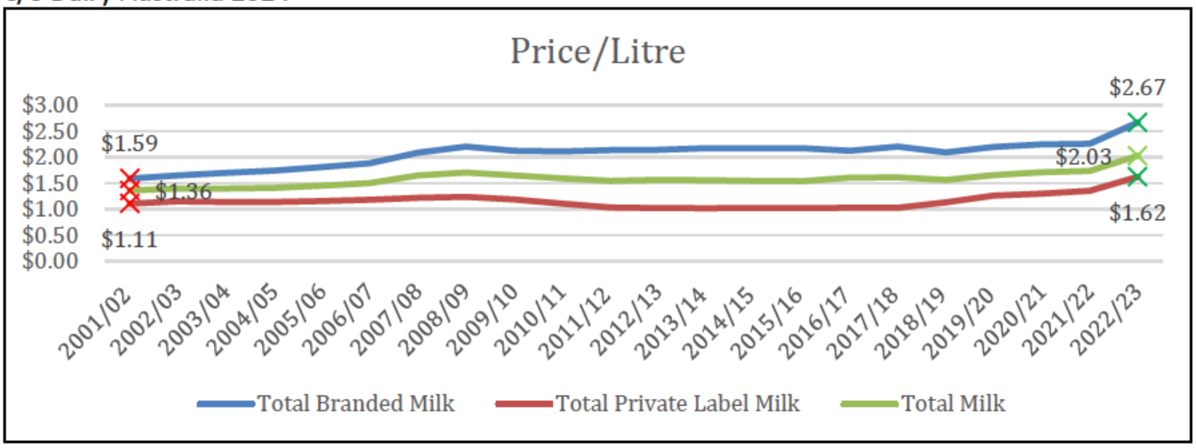


Table 2: Farm-gate milk prices FY11 to FY23 (Dairy Australia, In Focus 2023)

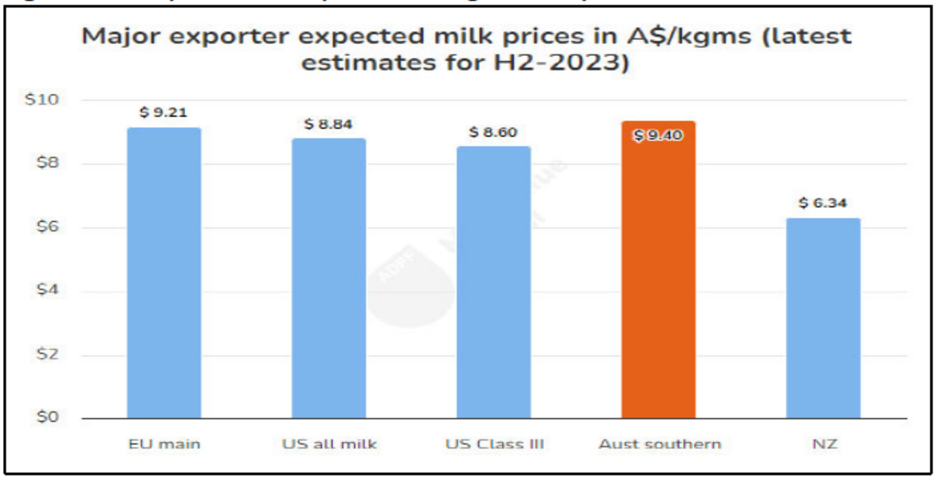
	2011/12	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23 (p*)
cents/ litre	42.0	44.9	40.9	46	49.7	54.7	52.3	56.9	**74.8**
$/kg milk solids	$5.69	$6.01	$5.46	$6.14	$6.64	$7.19	6.95	7.52	**9.80 (30%)**

***p = preliminary data**

Table 3: Australian milk production (Dairy Australia, In Focus 2023)

	2000	2010/11	2011/12	2015/16	2016/17	2017/18	2018/19	2020/21	2021/22	2022/23
billion litres	**10.8**	9.18	9.58	9.68	9.02	9.32	8.79	8.85	8.55	**8.13**

Figure 5: Comparison of expected farmgate milk prices FY24. Data source: Milk Value Portal 2024



COLES SUPPLIERS STORY Data Source: The Weekly Times, 14 February 2024

Coles suppliers called to cut

ELI GREENBLAT

Coles has asked some of its suppliers to cut their prices to reflect cooling inflation, with those savings likely to fund a discounting blitz just as the supermarkets face political and community heat over food and grocery prices.

Suppliers have told The Weekly Times they have been asked to prepare for price reduction requests of as much as 14 per cent — especially in the non-food area — on some products.

Coles has pointed to the improving inflationary outlook, especially in key cost pressure points such as freight, shipping and raw materials, to justify unwinding years of price hikes.

Winning price cuts from suppliers will allow Coles to pass on some of the savings to shoppers — and potentially pocket some for the benefit of its 440,000 shareholders — and comes as Coles and Woolworths face public inquiries over prices and market power.

Some suppliers have been contacted about a new Down, Down campaign that will see a fresh round of price cuts.

Suppliers have been asked to help fund the reductions by taking price cuts themselves.

Small Business Women Australia Founder Amanda Rose has raised concerns for supermarkets who "blame" the suppliers and the growers for high prices.

The political heat around Woolworths and Coles ratcheted up late last year. A Greens-led Senate inquiry into supermarkets was announced, followed by an inquiry by the competition regulator and a gouging report from the ACTU.

The supermarket chains responded by spruiking their discounting and promotions campaigns, and slashing prices on key food and grocery items.

Suppliers are, however, likely to push back against the Coles price cuts, citing labour and energy costs, which are still rising, even if freight and shipping is getting cheaper.

A Coles spokesman declined to comment on its communications with suppliers and negotiations around prices, but stressed the supermarket was squarely focused on lowering prices for its shoppers.

COLES SUPPLIERS STORY Data Source: The Australian, 10 March 2024

Coles pushes suppliers to strip costs as households face cost of living pressures

EXCLUSIVE
By **ELI GREENBLAT**
SENIOR BUSINESS REPORTER

4:21PM MARCH 10, 2024
142 COMMENTS

The Australian Bureau of Statistics has released data that indicates household spending is three per cent higher... than a year ago. This was identified in the national accounts released yesterday. While total spending and non-discretionary spending are higher, discretionary spending is lower, according to data from the Australian Bureau of ... More

One of Coles supermarket's most senior executives has written to packaged food and grocery suppliers urging them to cut costs as affordability remains the key issue for consumers amid cost of living pressures and political pressure for shelf prices to come down.

In a letter to suppliers last week, Coles executive general manager for packaged grocery, Jonathan Torr, reminded them stripping away costs was a "joint obligation" of both the supermarket and its supplier base.

This would help shoppers "stretch their wallet further" he added, as pressure grows on suppliers to cut their prices to help supermarkets bring down shelf prices, as well as preserve their own profit margins.

Coles has begun to tap its vast supplier base on the shoulder to bring down their own prices, reflecting moderating inflation and a slide in many commodity prices, which the supermarket chain will use to lower prices at the checkout and neutralise some of the negative publicity around allegations of supermarket price gouging.

Australian Farmgate Milk Prices Explained.

Farmgate milk prices are often misunderstood within the industry, and how the milk market operates.

The ADPF, with the support of our members, established the Milk Value Portal in 2020 to help farmers and other key end users have a greater understanding of farmgate milk prices and the value of the milk across Australia, and what influences this.

For further detail: visit the Milk Value Portal (milkvalue.com.au).

Australian farmgate milk prices are based on the milkfat and protein content of the milk produced on farm, with different prices for each component. Unlike many countries around the world, the government has no legislative control over the price milk processing companies pay farmers for milk. Since deregulation in 2000–01 all prices within the industry are set by market forces (globally).

Farmgate milk prices vary between dairy processors and geographical areas, depending on how the milk is used in the marketplace.

The ability of dairy processors to set farmgate milk prices is heavily impacted by many factors including freight costs, product mix, marketing strategies, manufacturing capacity utilisation and efficiencies, and exchange rate hedging policies. In addition, competition for milk in different production zones has proven to impact farmgate milk prices often to the advantage of the seller (i.e., dairy farmer).

Global competition also influences milk prices too, as Australia operates in an open and international competitive market and countries are free to import and export milk.

Processor returns from raw milk are exposed to demand for the various products manufactured, which are also regularly exposed to import competition (specifically New Zealand and the European Union) and the AUD/USD exchange rate (majority of exports are priced in USD) – refer to Figure 6 and 7.

The Commodity Milk Value (CMV) is a forward price indicator for farmgate milk prices paid in the southern region of Australia, based on the Oceania (NZ) spot prices of major commodities (cheese, butter, skimmed milk powder and whole milk powder), converted to an Australian dollar-denominated value of milk – noting the final milk price paid by each processor will be influenced by product and market mix.

Typically, there has been a premium (or value-add) paid above commodity returns in the final farmgate prices paid to farmers each season, with the CMV accounting for around 80-90 per cent of average farmgate prices. This reflects returns generated from value-added ingredients, as well as retail and fresh products sold in less volatile domestic market channels – see figure 6 (and figure 9).

Figure 6: What determines the value of milk. Data source: Milk Value Portal 2024

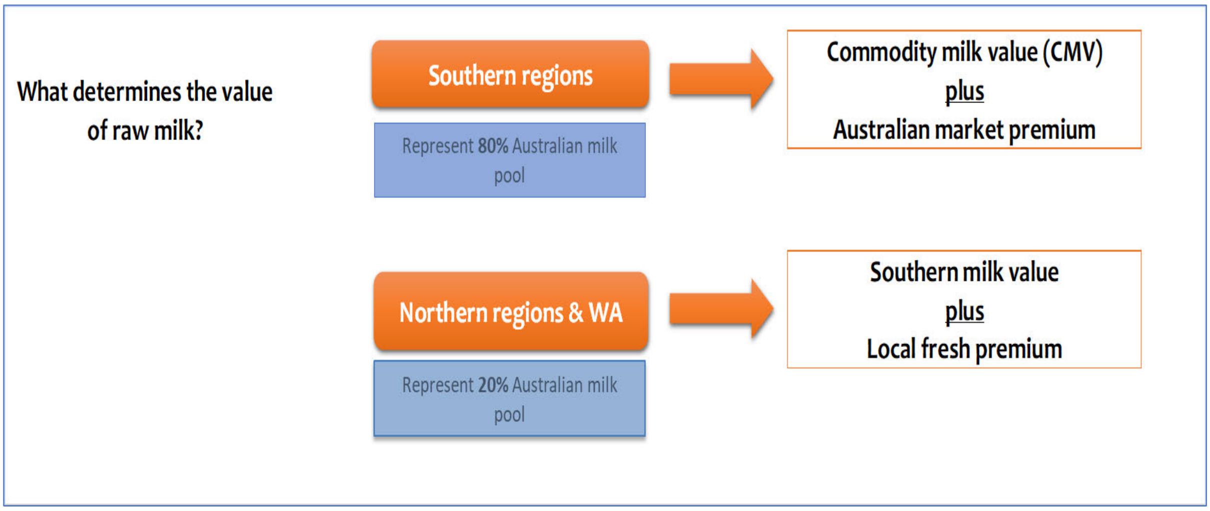
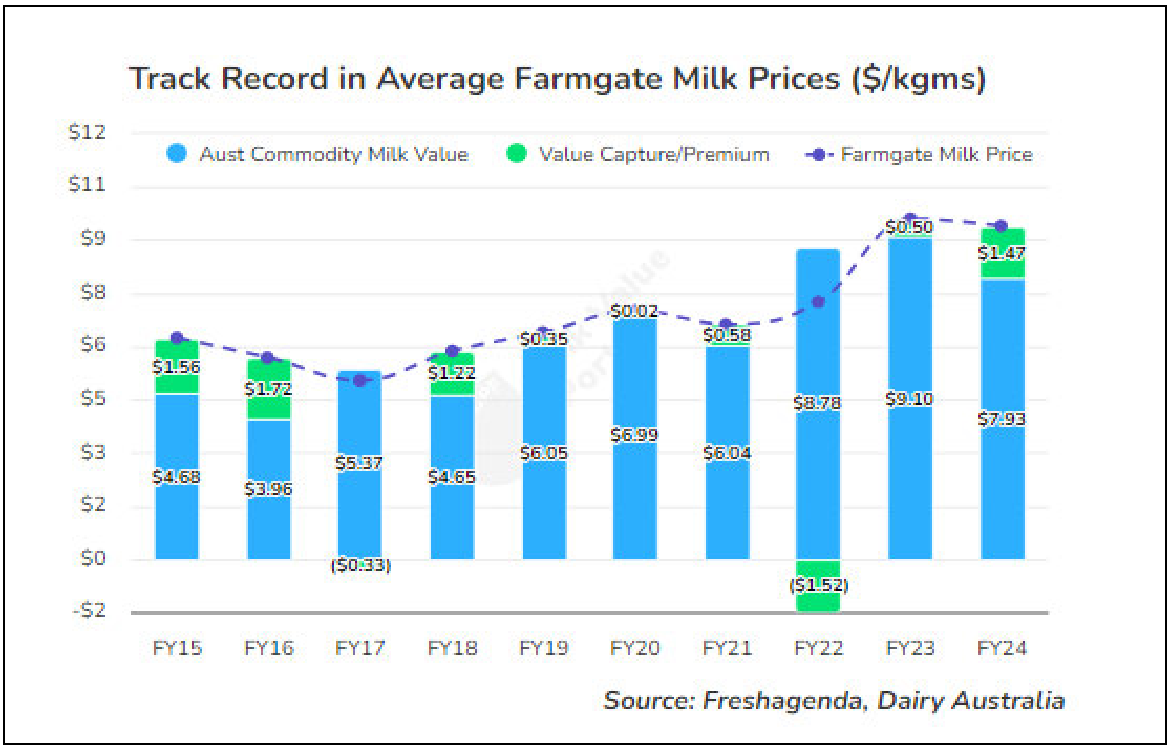
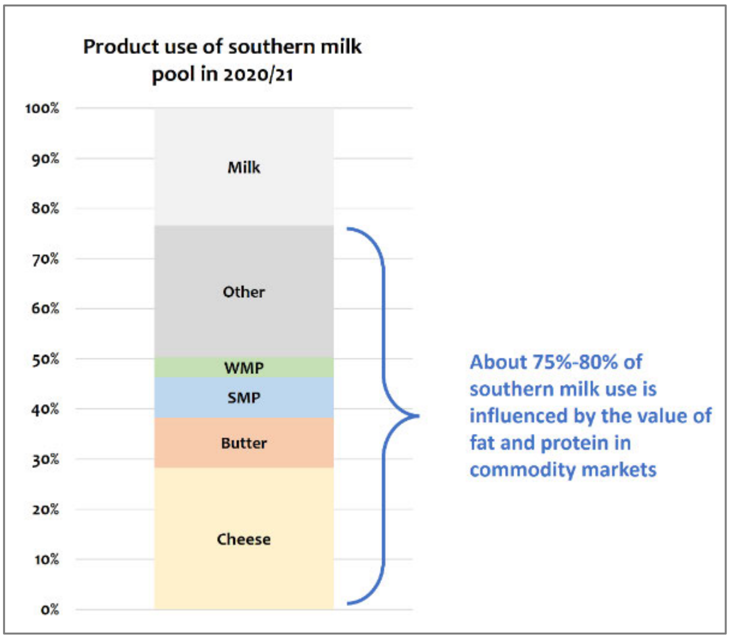


Figure 7: Southern region farmgate milk prices – commodity value + premium (value-add). Data source: Milk Value Portal 2024



About 75 to 80 per cent of milk produced in Australia is exposed to global dairy prices going into butter, cheese and milk powders that are either exported or consumed locally. The remainder is consumed as drinking milk (Figure 8).

Figure 8: Southern milk pool (Vic, SA, Tas) = 80% Australian milk pool. Data source: Milk Value Portal 2024

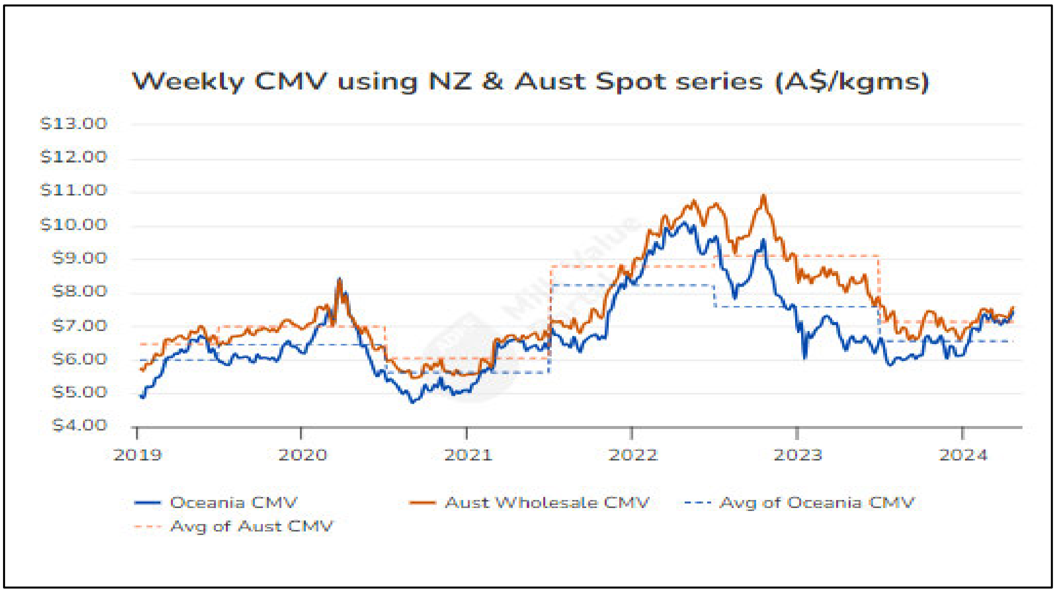


Southern states (Vic, SA, Tas) produce 80% of national milk pool.

Australian wholesale commodity milk (ACMV) is calculated from Australian wholesale dairy product prices, as distinct from spot CMV (NZ export) prices. This forward milk price indicator became more relevant over the past 12 months aligned with a growing disconnect between domestic wholesale prices and Oceania fundamentals due to a steep decline and shortage in local milk production and major retailer pricing and sourcing practices for private label cheese – although this gap is now narrowing.

This has effectively placed a floor on local wholesale cheese and butterfat prices well above NZ prices – see figure 9.

Figure 9: Australian wholesale commodity milk (ACMV). Data Source: Milk Value Portal 2024



Generally, there are two distinct production regions – the Southern and Northern milk regions, reflective of the product mix, as shown in Figures 8, 10, and 11.

The Southern region comprises Victoria, Tasmania, South Australia and southern NSW – and is where the majority, or 80 per cent of Australia's milk is produced. Production varies by season and the composition of milk, and the importance in the manufacturing process is reflected in the farm-gate price of milk. The region is more exposed to the global markets and international demand, AUD/USD rates and import competition.

The Northern milk region – comprising the other states (Queensland, West Australia, central and northern New South Wales) – has a more stable demand and production profile offered by domestic drinking milk and other fresh, short shelf-life products. Higher farm-gate milk prices are paid to ensure year-round supply.

The Southern region may help support the continual demand for drinking milk in the Northern regions, as is the case for Queensland – where they do not produce enough milk to service the needs.

Figure 10. Use of Australian milk by State. Data Source: Dairy Australia, In Focus 2023

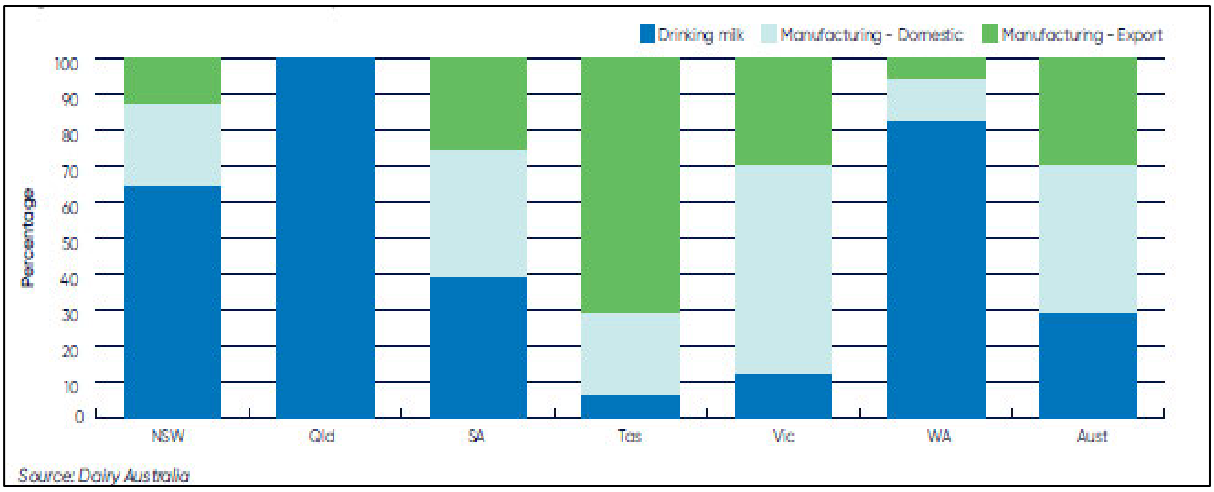
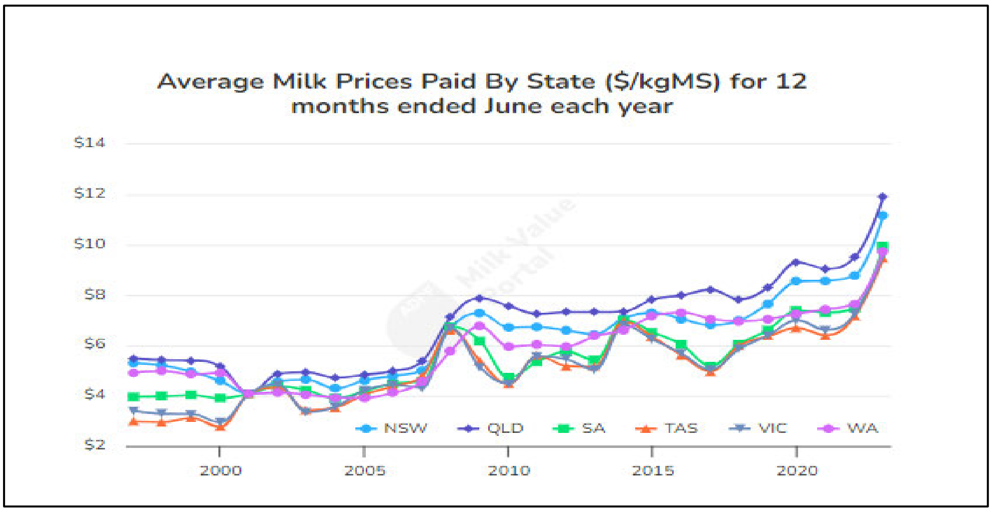


Figure 11: Average milk prices by state. Shows the impact of product mix on farmgate milk price. Data source: Milk Value Portal 2024



As noted above, in Queensland for example, 100 per cent of the milk produced is used for fresh drinking milk, with a requirement for year-round production and no tolerance for seasonality compared with shelf stable products such as cheese and powders.

In Victoria, a large percentage of milk is used in value-added products such as cheese or yoghurt and therefore subject to other price fluctuations including global milk commodity pricing – as these products are either exported and subject to demand pricing or compete with imports.

The major supermarkets have chosen to sell home brand milk under a national pricing policy, despite the fact that farm milk prices vary across states, reflective of input costs.

Producing year round adds to production costs and processors pay more for that milk to ensure it is produced close to a major market all year round. National pricing means in regions like Queensland, the margins are negligible for processors and for retailers the margins would be very thin compared to those in Victoria.

Currently, processors have to offset the costs of paying farmer higher price for milk in Queensland, with a lower price in Victoria.

The same is true for other private label dairy products, such as yoghurt, butter, and cream.