Media release
October 9, 2014

More milk matters – Australia's dairy industry at a 'crossroads'

Across the Tasman, the Australian industry appears well placed to tap into export markets, however it currently sits at a 'crossroads' due to its inability to grow milk supply which has significantly reduced the sector's role in global dairy trade, says specialist agri-lender, Rabobank.

In a recently-released report, **Australian Dairy – More milk matters**, Rabobank says the global dairy market will remain 'an engine for growth' but the Australian dairy sector will need to reignite growth at the farmgate if it is to be in a position to fully capture the opportunities.

Rabobank senior dairy analyst Michael Harvey says without improved profitability on-farm, the dairy industry is unlikely to see the milk production growth that will be required for the whole industry to tap into the opportunities that lie in regional export markets.

"The dairy processing sector is evolving rapidly and is poised for growth," Mr Harvey says.

"This period of change will have ongoing implications for milk producers. Very simply, dairy processors are in search of more milk supply and stronger supplier partnerships.

"Right now, we are seeing record investment in the processing sector, with more the AUD one billion committed in the past few year."

However, the processing sector needs to prove that the opportunities it sees and the investments they have made can lead to not just improved margins for them, but also a better return to Australian dairy farmers, Rabobank warns.

"Many offshore customers place a strong importance on high-quality, safe products with strong traceability across supply chains and these factors mean that Australia is a favoured exporter, but the sector also needs to be able to match export customers' growth," Mr Harvey says.

Mr Harvey says that if milk producers in conjunction with the dairy processing sector can align the vision and strategy to cope with complex and volatile global markets, the opportunity for the sector could be "golden".

The corporate sector finding new capital

The Australian dairy sector is also undergoing rapid change of ownership and structure, Rabobank's report says.

While consolidation has been a longstanding trend in Australia's dairy processing sector, Mr Harvey says in recent times, there has been renewed corporate activity, with the possibility of further consolidation.

"This has also been met with new entrants to the marketplace and should be viewed as a positive, given this brings much needed capital for further investment in the sector," Mr Harvey says.

"The appetite for dairy processing assets comes down to the potential of the sector. At the core of this interest are Australia's strong credentials as a supplier of high quality dairy products and the strategic advantage provided by geographical proximity to Asian customers and existing linkages into these markets."

Coinciding with this change, Mr Harvey says Australia's largest dairy cooperative is embarking on a capital restructure – a core objective of the restructure is to raise alternative capital to assist in funding projects that modernise the dairy plants, improve capabilities and help increase the returns paid to milk producers.

Extracting more value key to future success

While Australia still has a globally competitive farm sector, there are cost pressures – some of which are unique to Australia – that create a growing reliance on downstream efficiencies to maintain competitiveness.

Mr Harvey says this underpins the drive by processors to divert more milk to high valued products, vital to optimising returns and helping lift profitability across the value chain.

"The move up the value chain is the logical step to optimise Australia's reputation and food safety credentials," he says.

"Collectively, there is a focus on building a key platform around nutritional powder and infant formula for booming baby food markets across Asia and specifically China; moving to downstream branded products with a focus on packaged milk products; consumer and foodservice cheese products; extracting more value from by-products, particularly whey streams; and improving production efficiencies as a means to boost profitability."

The Rabobank report also notes that processors are looking for capital investment partnerships and ways to work more closely with export customers, which is opening up new opportunities for strategic partnerships throughout the supply chain.

What needs to happen to reignite growth?

Meeting the sector's ambitions to lift production to 15 billion litres by 2020 will require a fundamental shift in milk supply growth, Rabobank says.

The 2013/14 season closed at 9.2 billion litres and 2014/15 should see milk production expand by two per cent but achieving the goal of 15 billion litres by 2020 would require average annual growth of eight per cent.

Mr Harvey says rebuilding confidence levels to underpin investment is an important factor on the road to recovery for the Australian dairy sector.

"For the majority of the farm sector, 2013/14 was a profitable season on the back of record-high farm gate milk prices," he says.

"This provided the opportunity for balance sheets to be restored, debtors to be serviced, bank debt to be reduced and equity levels were also rebuilt. With many processors having consolidated their positions, the 2014/15 season should see a return to growth in the milk supply."

Rabobank's report highlights that there has been a focus on providing a number of operational, business and financial tools to assist milk producers in investing for growth.

Greater supply chain cooperation extends beyond the relationship between milk producers and dairy processors, Mr Harvey says.

"Australia's large retailers are adopting new value chain models by forming direct supply relationships with milk producers," he says.

"The benefits of stronger collaboration provide milk producers more certainty through annual pricing and longer contractual terms.

Looking forward, there will need to be further collaboration across the supply chain – the efforts being made are a strong forward step and milk producers will need to embrace the assistance and tools on offer."

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Rabobank New Zealand is a part of the international Rabobank Group, the world's leading specialist in food and agribusiness banking. Rabobank has more than 110 years' experience providing customised banking and finance solutions to businesses involved in all aspects of food and agribusiness. Rabobank is structured as a cooperative and operates in 41 countries, servicing the needs of about 10 million clients worldwide through a network of close to 1600 offices and branches. Rabobank New Zealand is one of the country's leading rural lenders and a significant provider of business and corporate banking and financial services to the New Zealand food and agribusiness sector. The bank has 32 branches throughout New Zealand.

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