

From the Trading Floor

KEY MARKET DRIVERS

- Australian/China FTA a big positive for the Australian industry
- GDT falls again...on lower volumes – where to from here?
- Australia peak up YoY but farmers reporting conditions are dry
- Price-sensitive markets increasingly in play

- The long-awaited Aust/China FTA has exceeded all expectations of the Australian dairy industry. Tariffs on all dairy products, including infant formula will reduce to 0% over the coming 9 years. This will match, and in some cases exceed, the terms negotiated by NZ in their FTA with China. Forecasted demand from China post FTA signing has led to a significant number of new start-ups coming into the industry, primarily focused in UHT and infant formula production. The question will be whether there is sufficient supply/demand in the market to support all of this announced new investment.
- We've all heard it from numerous sources "This is the bottom" well last night's GDT proved once again this market is difficult to predict. What we do know is that supply is extremely robust and outstripping demand as China and Russia's subdued buying continues and no major supply disruption is foreseeable.
- Australia has enjoyed a good Spring season – milk production is up 3% YoY, with some processors reporting 6-8% increases YOY. But a dry outlook for Summer and increasing supplementary feed costs will temper any suggestion of a bumper season. Forecasts are now being revised to a 2-3% increase.
- We have seen increased business into very price sensitive markets, especially the Sub-Continent & Africa, indicating prices have fallen to a point that even the most price sensitive markets can participate here.
- From Jakarta: Consumer and industrial markets are robust and visibly experiencing steady growth. There is a sense of relief in the market after the extended period of record high prices and buyers are booking volumes into 2015 at favourable price levels.

Matt Cooper, Director, Ausfine Foods

AUSTRALIAN INDUSTRY NEWS

FTA win for dairy

The dairy industry is a major winner from the free trade agreement signed with China this week after 10 years of negotiation. In a better than expected result, China has agreed to a complete phase out of dairy tariffs in nine years, with tariffs on infant milk formula removed after four years. According to Prime Minister Tony Abbott, "It's at least as good for our agriculture as New Zealand got about six or seven years ago - and their dairy exports to China have gone up from under half a billion to over three billion."

DAIRY EXPORT INDEX

Index slips – The Australian dairy export index fell this week, as a stronger dollar offset returns from a stable commodity market. In spot quotes, all commodities were unchanged from a week ago – butter at US\$2,800/t; SMP US\$2,500/t; WMP US\$2,675/t; and cheddar US\$3,350/t respectively. The Australian dollar closed the week at US\$0.871, trimming the index by 2 points to **144.9**.



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

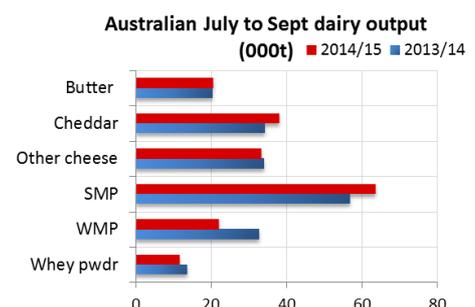
Milk output peaks early

Most major dairy processors have reported an early peak for milk intake compared to last season, with supply from irrigation regions, or those that received consistent rainfall well ahead. Northern Victoria's Tatura was tracking 6-7% higher than the prior-year comparative; while the peak intake on Oct 23 was a "fraction earlier" than last year, production was holding.

YTD milk intake is 4% up at Burra Foods, and Murray Goulburn says milk flow is above last year, but "very dry conditions in some key regions is seeing milk flows slow". WCB CEO David Lord said milk intake had been holding up well and is ahead of last year, but the percentage growth over the previous year had narrowed in recent weeks.

Fonterra Australia's milk collection reached 14.6m kgMS, up 8.1% from

October last year, bringing the YTD volumes to 44m kgMS, up 9.6% from prior-year comparative



Weather highlights

- In Australia, brisk westerly winds over Tasmania are generating showers, mainly west of the ranges.
- In New Zealand, there will be windy conditions this week with gales for the North Island continuing into Gisborne and Hawke's Bay, and a weather warning in place.
- In the US, an early winter storm is blowing across the Midwest, with heavy snow for the northern Plains, cold temperatures will stretch as far south as Texas.
- Strong thunderstorms and heavy rain are erasing the recent unseasonable warmth across northern Argentina, Uruguay, south-eastern Brazil and Paraguay.
- In Europe, torrential rains and high winds are still battering western and central Europe.

Fonterra NZ\$5.30 under review

While Fonterra chairman John Wilson affirmed NZ\$5.30 kgMS payout last week, he also signalled a review in December as volatility continued. CEO Theo Spierings had previously said WMP would have to recover to US\$3,500/t by March 2015 for the coop to be able to achieve its NZ\$5.30 payout, and while he had hoped prices would recover by March, they were "not moving right now."

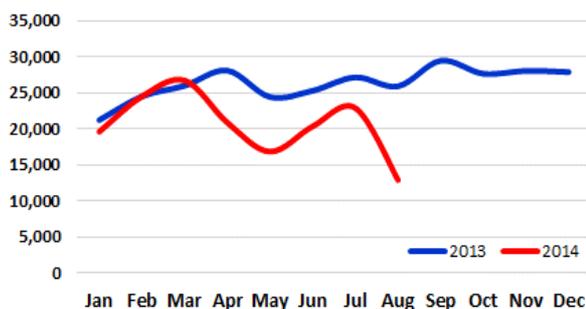
Meanwhile Fonterra's October milk intake reached 232m kgMS, up 4% from October 2013, bringing the season-to-date volumes to 554m kgMS, up 4.3% from last year. Milk collection volumes peaked at 89.7m litres per day in mid-October, up 3.1% from previous season's peak.

Russian milk output to dip 2.5%

USDA forecasts Russian milk output will decline 2.5% to 29.9bn litres in 2014 and a further 2% in 2015, putting pressure on domestic consumption. Costs are weighing heavily on the sector, particularly smaller farms, which make up around 50% of overall milk production.

The resulting shortfall for domestic consumption is expected to be partly met by more fluid milk imports from Belarus (which can be used in cheese production) and more cheese and butter imports from Argentina, Switzerland and Uruguay. Fluid milk imports will rise 14% to 375,000t in 2014; But cheese and butter imports will decline to 230,000t and 120,000t in 2014, down 37% and 12% from 2013.

Russian cheese imports - Jan to Aug (tonnes)

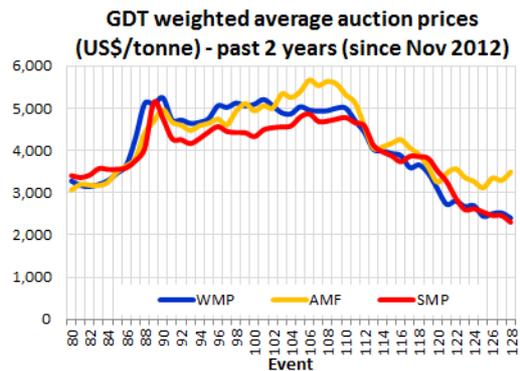


No Chinese recovery until Q3 2015

The combination of built up stocks and perfect milk output conditions will mean Chinese buyers won't be increasing their imported purchases until Q3 2015, according to Rabobank's Sandy Chen. Chen told a visiting Irish delegation that in the longer term Chinese buyers are seeking to diversify their sources of imported product, providing opportunities for EU exporters of milk powders, whey and UHT milk. While local production is on the increase, it is not keeping pace with demand and is reliant on imported corn and soya feed – which makes it costly.

GDT falls by 3.1%

The GDT price index fell 3.1%, on lower sales of 39,613t compared to 45,499t a fortnight ago. Rennet casein plunged 12.2% to US\$6,681/t, followed by SMP and WMP, down 5.7% and 5.1% to US\$2,299/t and US\$2,400/t respectively. The largest drop in WMP price was for contract 4, which ships in Mar 2015. In contrast, AMF and butter rose 6.1% and 6% to US\$3,490/t and US\$2,656/t, while cheddar and BMP rose 5% and 1.4% to US\$2,861/t and US\$2,511/t respectively.



DAIRY FUTURES

Dairy futures mixed – Significant falls in the NZ market for SMP and WMP. CME cheese was down, while prices for butter and NDM were more stable. European SMP strengthened. **All prices are quoted in US dollars per tonne** with Eurex contract prices converted at **1.2521**.

17 Nov 14	SMP		NDM	WMP	Cheese	AMF	Butter
	NZX	Eurex					
Exchange	NZX	Eurex	CME	NZX	CME	NZX	CME
Nov-14	2,430	2,348	3,137	2,440	4,683	3,300	4,193
Dec-14	2,460	2,335	2,980	2,500	4,087	3,450	3,814
Jan-14	2,470	2,341	2,833	2,570	3,889	3,570	3,747
Feb-15	2,520	2,341	2,789	2,610	3,781	3,700	3,742
Mar-15	2,590	2,335	2,635	2,780	3,792	3,800	3,748
Apr-15	2,630	2,335	2,623	2,930	3,812	3,600	3,776
Change	-3%	1%	0%	-2%	-1%	0%	1%
Op interest	1,644	303	3,362	10,544	14,392	10	4,204

Take note: Open interest refers to the number of open contracts for the 6-month period for which futures prices are quoted. This does not indicate volumes to be traded. Change is comparison with previous week, weighted across 6 months based on open interest volume for each delivery date.

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