19 September, 2018

New Zealand Dairy News

Fonterra lost NZ$196m in 2017/18:

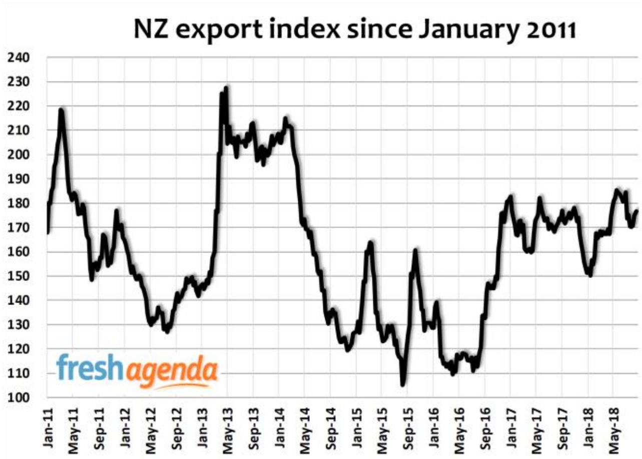
Fonterra New Zealand reported its worst financial result in its 17-year history, with a net loss of NZ$196m in 2017/18. More worrying signs were carried in the result excluding the big write-offs - normalized EBIT fell 22% to NZ$902m and the cooperative's return on capital fell to 6.3% from 8.3%. Sales volumes fell 3% to 22.2bn in liquid milk equivalents, reflecting lower NZ milk intake. According to CEO Miles Hurrell higher butter prices, which impacted sales volumes and margins in fats as well as WMP, a high farmgate milk price and elevated operating expenses all impacted the result. The major write downs were flagged earlier - Fonterra's NZ$232m settlement with Danone and its NZ$439m write down on the Beingmate investments.

There were some silver linings in the profit announcement – consumer products, food service and advanced ingredient sales rose to 45% of total sales, up from 42%. That was not enough to shift the dial on profitability due to higher milk costs, with operating margins falling 1.5% to 15.4%.

With a new management team likely to take the opportunity to clean out the major bad news cupboard, Fonterra promised owner-suppliers it would improve by taking specific, immediate action. Board and management have set out to re-evaluate all investments, major assets and partnerships to ensure they meet current needs. It also promised to lift the level of financial discipline to reduce debt and improve return on capital as well as ensure more accurate forecasting.

NZ Dairy Export Index

Index steady – This week, the NZ dairy export index stood still due to a steady NZ$. Quotes for WMP averaged US$2,850/t, unchanged from the week prior. SMP climbed US$5/t, to US$2,030/t and cheddar rose US$25/t to US$3,800/t. Butter averaged US$4,400/t. The NZ dollar lifted marginally to **US$0.6533**, lifting the index **0.13 of a point** to **167.85**.



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

There was significant reaction to the news on the performance and direction of Fonterra and the Fonterra Shareholders Fund (FSF). Forsyth Barr senior equity analyst Chelsea Leadbetter noted FSF provided no future dividend guidance, with management indicating its priority is reducing gearing levels back to its target 40-45% range, from 49% in 2018. ASB's Nathan Penny said that a "worrying pattern has developed," noting that Fonterra starts each year bullishly with forecasts, but then fails to deliver results. "EBIT has fallen for two years in a row, with Fonterra's underlying profitability falling around a third over this period". Hamilton Hindin Greene's investment adviser Grant Davies said a2 Milk and Synlait Milk were easily proving far better dairy investments for the external investor. Triple-digit returns for shares in each of these comparative minnows over the past year underscored their advantage for external investors over the FSF, which has dropped 18% in same period.

Final milk price lopped:

The final FY2018 Fonterra milk price was NZ$6.69/kgMS according to the company, which was pruned 5c from the formal calculation per the milk price statement to help the group balance sheet. The statement showed the group contained operating cash costs at NZ$1.16/kgMS, despite a 1.4% drop in milk solids throughput in the year. Average selling prices across "reference products" were 10% higher.

The milk price statement showed Fonterra shifted product mix to WMP (which posted an 8.3% price gain) with almost 2% of milk solids moving from the SMP/butter option, which ultimately achieved a better overall shift in average prices. The shift in milk fat from the butter/AMF option showed up in AMF output which fell 12% according to the report.

Fonterra increases WMP GDT offer volumes:

Fonterra has lifted its WMP offer volumes on Global Dairy Trade (GDT) by 20,450t over the next 12 months, reflecting product mix optimization and lifting total offer volumes on GDT to 668,530t over the next 12 months. WMP offered at the latest GDT event (18 September) rose 7.3% from the previous event and will continue to lift throughout New Zealand's peak milk production months.

In October, WMP volumes will lift to 25,850t for each event, up 3,350t from previous forecasts. In November, WMP offered at the first event will lift 3,150t to 24,248t, while WMP volumes will increase 6,600t to 27,697t at the 20 November GDT event, marking the largest increase for any of the six events covering the three-month period.

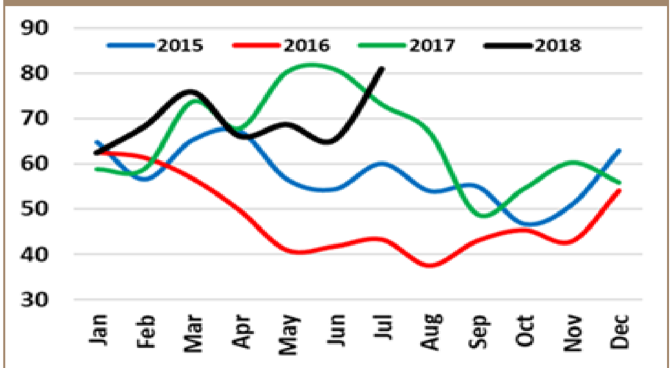
Australian Dairy News

Mandatory code vote gets up…just:

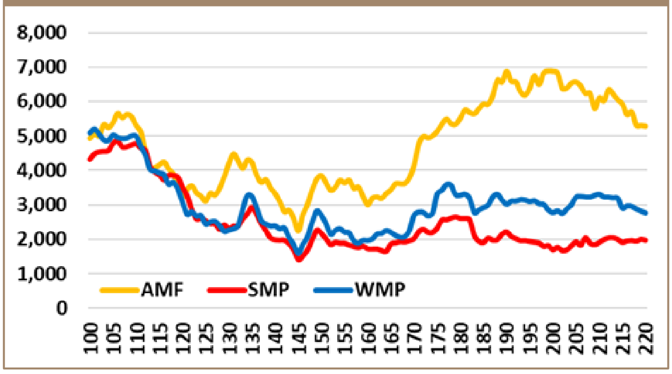
Australian Dairy Farmers (ADF) national council has voted seven to six in support of a mandatory code of conduct, aimed at improving contracting practices between farmers and processors. Tasmania, NSW, Queensland, South and Western Australia voted for the mandatory code, while The United Dairyfarmers of Victoria (UDV) voted against adopting the code.

UDV president Adam Jenkins said the organisation would respect the majority view. Jenkins said frustration was growing with processors sitting on the Australian Dairy Industry Council. There are reports that Burra, Fonterra, Norco and Lion oppose a mandatory code. According to a survey by Dairy Australia across key dairying regions shows 46% of repondents were positive about the mandatory code of conduct, while 26% were neither positive nor negative. Analysis by region, indicated dairy farmers in Tasmania and NSW were more positive while Queensland's dairy farmers were the least positive.

EU-28 monthly SMP exports ('000t)



GDT weighted average auction prices by event, US$/t



Global and Corporate Dairy News

GDT index down 1.3%:

At GDT event 220, the GDT price index shed 1.3% on a larger offering of 39,143t. The index was dragged down by powders as larger offerings have been made available for the upcoming events. WMP fell 1.9%, averaging US$2,768/t most contracts down except for October deliveries up 0.8%. SMP averaged US$1,980/t, shedding 1.2% with the biggest fall recorded for November deliveries down 2.9%. Butter was flat averaging US$4,270/t with mixed contracts as November deliveries rose 1.5%, while December deliveries fell 1.3% and February deliveries were down 2.1%. AMF averaged US$5,294/t, down 0.4% as October and November deliveries fell 5.9% and 0.9%, respectively, while slight gains were recorded for December and January deliveries.

Cheddar dropped 3.5%, averaging US$3,503/t with December deliveries plummeting 8.9%, the only gain recorded for cheddar contracts with November delivery, up 1.1%.

EU SMP exports rebounded in July:

After increasing 34.7% last year to 780,616t, EU SMP exports fell 1.3% for the first seven months of 2018. This includes monthly falls in May and June (on particularly strong comparables) and despite an 11% YOY rise in July to 80,944t – the highest monthly tonnage so far this year. Shipments to Algeria were up 16% for the period, accounting for 19% of total EU SMP shipments. However, SMP exports to other key markets were mixed including a 4% drop in China.

Cheese exports also dropped 0.3% to 486,820t for the seven months to July. There were weaker sales to main destination markets in the period, including the US, South Korea and Saudi Arabia, but with a 13% growth in shipments to Japan.

After a strong start to the year, EU butter exports declined in the five consecutive months to July in YOY terms, taking year to date butter exports down 13.9% to 77,657t. The US was still the leading destination for the period, but butter shipments to this market fell 4% YOY to 15,209t. Year to date exports of WMP were also weaker – down 13% to 212,080t. There were mixed trends for the top 10 destinations, but exports to the key Algerian market were down 60% against the comparable period.

Strong US cheese, butter demand in July:

During the first seven months of 2018, domestic “commercial disappearance” of butter rose 2.8% compared to the same period in 2017. This reflects a July increase of 13% YOY, and despite domestic demand falling in each month between March and May. Our analysis of USDA balance sheets suggests total commercial disappearance (aggregate domestic and export market demand) rose at an equal pace to supply (aggregate production and imports) for the year to date – 3.9%.

Domestic cheese disappearance for the year to date rose 2.6% over the same period last year to 3.2mt, reflecting a 7.1% YOY lift in July alone. Between January and July, American cheese demand rose 2.4% while disappearance of other cheese varieties (such as mozzarella) lifted 2.8%. We estimate that American cheese days-in-stock increased 7.3% from the prior month to 59.1 days, which was 6.3% lower than in July 2017. Other cheese days-in-stock declined 3.7% to 26.3 in July, 2.1% higher than in the same month last year.

Year to date commercial disappearance of dry whey rose 9.1%, despite a slowdown in domestic demand in May, June and July. NFDM/SMP domestic commercial disappearance continued to track lower – down 21% for the year to date. WPC and lactose were also weaker in the same period - down 7.8% and 8% respectively.

EU fat prices continue to weaken:

European fat prices continues to slide with butter spot prices falling to a range of €4,600/t - €5,000/t, down €4,800/t - €5,300/t from the week prior. European butter spot prices peaked in August, reaching a range of €5,400/t - €5,600/t on the 17 August, but prices have weakened since then. In the futures market, prices have dipped too with EEX futures trading between €4,700/t for December deliveries and €4,950/t for October deliveries in the latest week. Futures have experienced a similar pattern to physical prices since reaching a high mid-month in August.

Beef and Lamb News

US import prices slides further:

In the US, the imported 90CL beef indicator is on a downward trajectory, closing at US$1.89/lb CIF, down 0.5% from the week prior and 4.5% behind the same week in 2017. Imported beef trade remains difficult as New Zealand offerings are seasonally limited and Australian packers are exporting to Asia due to more favourable pricing. According to reports from Steiner Consulting, higher cow slaughter is pressureing domestic and imported grinding beef values. Meanwhile, US retail ground beef demand has slowed as retailers diversify offers following Labor Day holiday.

NZ farmers lose 100,000 lambs in storm:

Farmers in eastern and central North Island in New Zealand lost an estimatesd 100,000 lambs over the past two weeks due to spring snow storms hitting the island. While rain is needed in these areas, the economic hit from the storm could be NZ$14.4m and mean processors are short of lambs in the New Year. According to AgriHQ analyst Mel Croad the North Island losses are a double blow as lamb prices are currently on a high, and expected to carry through to December. Beef + Lamb NZ economist Andrew Burtt said lamb losses would be devastating for individual farmers, but wouldn't have a huge impact nationally.

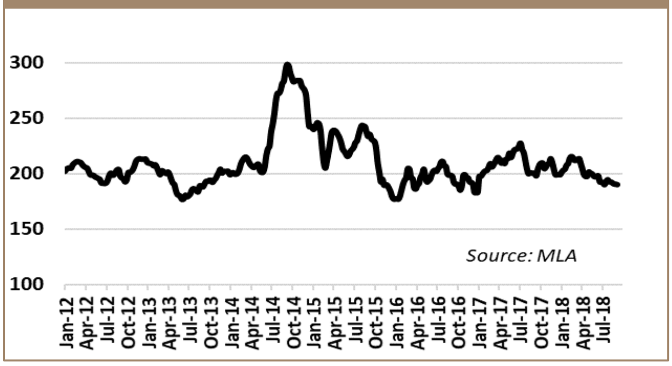
US July beef exports lift:

US beef exports were up 16.8% YOY in July, bringing the year-to-date increase to 15%. Japan continues to be the biggest export market, with a monthly increase of 12.9%, up 7.5% year-to-date, while exports to the second largest US market South Korea grew 61.1% compared to July last year and lifted 45% year-to-date. Third largest US beef importer Mexico grew imports 17.1% YOY, up 10% for the January to July period on the year prior. Exports to Canada and Hong Kong, the fourth and fifth largest export markets for US beef, declined. Exports to Hong Kong rose from January through March, but have rapidly decreased in the past four months, a 32.3% YOY decrease recorded in July.

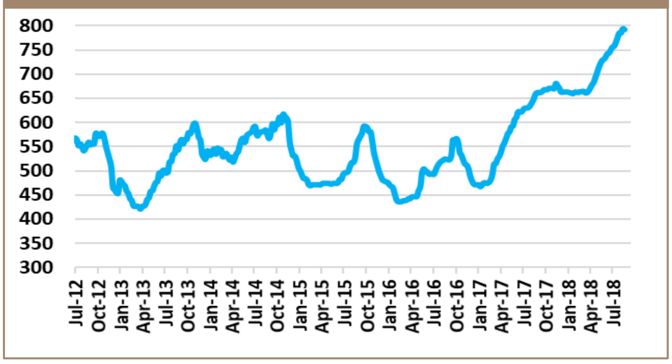
Aus lamb & sheep slaughter rise:

Dry conditions in July elevated Australian lamb slaughter 10% YOY to 1.8m head, bringing the year-to-date total to just over 13.8m head. Lower lamb carcase weights in July offset the higher slaughter with production increasing 5% to just over 400,000t cwt. Year-to-date volumes reached 317,000t cwt, 8% up on the same period in 2017 and the highest on record for the January to July period. Sheep slaughter also increased as farmers de-stock due to low feed availability. Year-to-date totals reached 4.78m head, up 27%. Data from Meat & Livestock Australia indicate that carcase weights for lambs have fallen significantly with heavy lambs (22.1 – 30kg cwt) only accounting for 19% of recent slaughter, compared to 31% for the same week a year prior.

US cow 90CL (USc/lb)



NZ Lamb 17.5kg cwt



Feed and Arable News

Supermarkets opt for Kiwi wheat:

Countdown supermarkets in-house bakeries across New Zealand will be using local wheat and grain for all loaves, rolls, buns and scones, supplied by Christchurch-based Champion Flour Milling. Until this year, more than 180 Countdown supermarkets used premixed ingredients produced in New Zealand and imported from Australia. Champion Flour's business innovation manager Garth Gillam is exploring the potential to sell Kiwi-made premixes to bakeries in Australia. The milling company's contract with Countdown increases the140,000t of milling grains already grown in New Zealand to a possible 150,000t, with further growth potential in the coming years.

Frosts wipe Aus harvest:

Recent frosts across Western Australia are expected to wipe up to 1mt off a bumper grain crop in the state's wheatbelt. Barley is worst affected as frosts hit the state's south-eastern wheatbelt, and growers are expected to start slashing ruined crops for hay. Grain Industry Association of WA (GIWA) forecaster Michael Lamond said the barley losses could be up to 500,000t with an already five-year low canola crop also hit. Lamond said the season had been perfect with great prices for some areas and could wipe A$400m off the on-farm value of the crop. WA remains on track to produce a 10mt wheat crop, however, upon frosts Grain Producers Australia and GIWA now expect an Australian winter harvest close to 26mt, compared to ABARES forecast last week of 33.2mt.