DAIRY DEBACLE

Farmers milked in price war

Rachel Donkin

Harvey Fresh has given WA dairy farmers a gift for Australia Day this year: an annual production incentive under which it will pay suppliers up to 12 per cent more for their excess milk.

The incentive — which will see Harvey Fresh's 70-plus suppliers paid an additional 3¢ to 5¢ for every litre of milk produced on top of their monthly contract — is a welcome contrast to the news delivered to farmers this time last year.

Coles caused uproar in farming communities across the country when it launched its now-infamous milk price wars on January 26.

At the time, farmers, processors and rural politicians warned that Coles' decision to cut the price of its own-brand milk by as much as 33 per cent to $1 a litre — a price not seen since 1992 — would decimate an industry that has survived on slim margins for years.

Instead, a year on, Coles says the milk price cuts — which have since extended to butter, cream and bread and enmeshed Coles' supermarket rivals and processors such as Brownes and Harvey Fresh — have had no negative impact and have saved shoppers $175 million a year in grocery bills.

Coles also points out that production has increased nationally, along with consumption, a factor that has surprised market watchers who have long held the belief milk sales are inelastic.

But although a Senate inquiry concluded the price cuts have not had a negative impact on Australia's dairy industry, Harvey Fresh's announcement appears to paint a different picture.

Harvey Fresh — which supplies both private-label and branded milk to Coles supermarkets in WA — has been forced to offer the production incentive because WA dairy farmers are producing less milk than they used to.

Latest available figures from national industry body Dairy Australia reveal milk production in WA is down 8.3 per cent for the financial year to October 31. Official figures for November and December are unavailable. But sources say anecdotal evidence suggests this trend has continued.

WA Farmers Federation president Mike Norton, who runs a dairy farm at Capel that has been in the family since 1906, says rising costs of production mean farmers need to be paid 50¢ a litre for their milk to break even. At the moment they get closer to 44¢.

"Last year, with the high price of water, hay and grain, dairy farmers lost an awful lot of money and they weren't recompensed by the retail and processing sector," Mr Norton said. "Everybody sold heifers to pay the bills and everybody's very reluctant to go out and (invest)."

Industry sources point out that the Senate inquiry recommended that the Federal Government commission a study of the dairy industries in WA, Queensland and NSW and their capacity to meet future consumer demand.

The majority of milk production in these States goes into drinking milk (in WA it is approximately 70 per cent), thus the need for consistent, year-round supply. It also means retail pricing influences the prices WA producers receive at the farm gate.

DRYING UP

2.26b

Litres of fresh drinking milk consumed by Australians each year, equal to 25 per cent of national production

Source: Dairy Australia

Conversely, so-called "manufacturing milk" States such as Victoria have much bigger, and therefore export-focused, dairy industries.

Coles has repeatedly dismissed claims its actions will have an impact on the price paid to farmers by noting that the farm gate price "is set by the world price because most Australian milk products are exported".

And although the price cuts have resulted in private label's share of fresh milk sales growing from 50 per cent last January to 54 per cent, Coles says "increased payments to milk processors were more than enough to offset any volume switch between branded and Coles-brand milk in our stores".

But while the supermarket retailers have pledged not to pass on the price cuts — Dairy Australia has estimated the discounting has cost Coles and Woolworths close to $75 million a year in private label retail margin — farmers say the "million-dollar question" is how long this status quo will continue.

Price pledge: Farmers lost money.

A2 cashes in on demand for niche milk variety

While major processors are slashing prices of branded milk in a bid to stem the loss of market share to private labels, some niche producers have emerged with their sales and margins intact.

New Zealand-listed A2 Corp says sales of its product — which is produced from cows carrying only the a2 type of the beta-casein protein — have grown 32 per cent since Coles kicked off the milk price wars. That growth has given A2 a 4.7 per cent share of the national market in value terms and a 3.2 per cent share in WA, where sales have increased 33 per cent over the same period.

A2 chief executive Peter Nathan says shoppers are prepared to pay a premium for his company's product — a two-litre bottle costs $4.99 — because the price wars have "sharpened" the distinction between A2 and mass-market milk.

Normal milk has two types of beta-casein protein, a2 and a1 — the latter resulting from a genetic mutation introduced about 1000 years ago. According to A2's research, less than 5 per cent of those with a perceived intolerance to dairy are medically diagnosed with lactose intolerance; the rest are estimated to have a reaction to the a1 protein. That gives A2 a potential market close to 20 per cent of the population.

"Competitive brands have been hit because consumers have perceived that there's little meaningful difference compared with private label," Mr Nathan said. "A2 milk, on the other hand, is a very differentiated proposition. Consumers have identified it (A2) as providing a tangible benefit, so we haven't had to reduce our price."

The growth helped A2 post a $NZ2.1 million ($1.62 million) profit last year, notwithstanding the "significant" expense of supplying its WA customers with milk from Victoria in the wake of the collapse of its local processor, Challenge Dairy, in late 2010.

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