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22 October 2009

John Hawkins
Secretary
Economic References Committee
The Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir,

Thank you for your correspondence of September 21st regarding the Committee's inquiry in to Competition and pricing in the Australian dairy industry. Cadbury Australia & New Zealand Ltd recognizes the importance of this issue and hopes our submission helps the Committee's work on this matter.

As Cadbury only purchases Australian milk from dairy farmers in Tasmania, the focus of our submission is on pricing and production arrangements in that particular State, and we have not sought to comment in any detail on wider issues being looked at as part of the Committee's inquiry.

Cadbury's Milk Sourcing History

Cadbury has been buying liquid milk from Tasmanian dairy farmers for over 85 years, a tradition of which we are immensely proud. During this time we have worked in partnership with local farmers to optimise both the quality and the volume of milk production and, as a consequence, their financial returns.

As a business we also remain totally committed to manufacturing in Claremont, Tasmania and purchasing milk from local farmers is an integral part of our current, and future, business strategy. It is also something that has helped us become such a successful business and significant employer within Tasmania.

Cadbury Milk Pricing & Contracts

A number of factors influence the price Cadbury pays for the Australian milk we purchase:

Firstly, in addition to the Australian domestic market, many of the confectionery products we manufacture at our Claremont and Ringwood (Melbourne) sites are exported to overseas markets including New Zealand and South East Asia. As such, the price we pay for Australian produced milk is directly influenced by the movements in international dairy prices. In order to ensure Cadbury products remain competitive and affordable for both Australian consumers and consumers in overseas markets, we must ensure all domestic costs including milk remain in line with the wider market place in which they are used and sold. This is also crucial to ensuring Cadbury products remain competitively priced within Australia against foreign made products imported in to the country.

Secondly, despite the significance of our manufacturing presence in Tasmania, Cadbury remains a relatively small buyer in the market, purchasing only 12% of the available milk in the State. As a result, Cadbury follows, rather than leads, the movement of prices in the market.

Over the years Cadbury has also trialled a range of different supply arrangements in order to establish a pricing model that works beneficially for both local farmers and our business. These trials have always taken place following strong consultation with local dairy farmers. In 2005 we negotiated a three year contract with farmers (commencing in January 2006); and in December 2008 we extended these contracts by a further six months to coincide with the milk season.

Following this extension, we began negotiating new contracts with our dairy suppliers earlier this year. A framework for our current contracts was agreed at the end of these negotiations and a final offer was made to the farmers on the following terms:

1. Three year agreement with volumes mutually agreed at the start of each season.
2. Either party can exit the agreement if we cannot agree on the volumes to be supplied
3. Pricing Model linked to the Tasmanian Seasonal Market Price.
4. Cadbury pays a 10c/kgms loyalty premium over the Tasmanian market price
5. Incentive of up to 15c/kgms at the end of each season based on the tolerance achieved against contracted seasonal volume.
6. Quantity premiums of up to 16c/kgms based on total quantities supplied.
7. Quality standards to be maintained per the previous agreement.
8. Increased milking machine testing allowance from $200 to $300 PA.
9. Payment of 4 x Cell count tests PA.
10. Subsidised Veterinary costs increased from $3 to $10 per cow PA.
11. 5% interest subsidy on new vat purchases
12. Supplier payments remain fortnightly

We believe that these terms are fair to local dairy farmers, are better than those offered by many other commercial purchasers, and are realistic given wider market prices and pressures.

Liquid milk pricing has also been extremely volatile over the last few years. In the 07/08 season farmers received an exceptional price and the 08/09 season saw it return to average levels. The market price for milk does, by its very nature, fluctuate and this is something that both dairy farmers and commercial purchasers seek to manage.

Having established that market mechanisms are the most effective way to buy and sell milk, Cadbury believes it is therefore wholly inappropriate for commercial purchasers to be exposed to the higher prices the market periodically commands but not to be able to realise the benefits when prices return to lower levels.

It is also manifestly not in our interest to see local dairy farmers go out of business as a result of significant downturns in market price, and there is clearly a responsibility for Government, dairy farmers and industry to work together to identify ways in which farmers can be supported through particular ‘troughs’ in the market price.

Between 2002 and 2005 Cadbury did implement a fixed price model to try to alleviate issues caused by significant market fluctuations. However, based on our experience, during the years when Cadbury pricing was higher than the market, those dairy farmers supplying our business were content; but when market forces caused this situation to reverse, a number of farmers supplying our business threatened to leave and supply to our competitors. This resulted in Cadbury having to pay a large financial sign-on bonus to retain their services so we could maintain critical supplies for our Tasmanian manufacturing operations.

In January 2006, we adopted a more flexible model of paying the Tasmanian Seasonal Market Price plus a premium that ensured that we provided a better than average return to those dairy farmers supplying our business. In Cadbury's view, this approach has worked well from its inception. Our dairy farmers also reviewed and endorsed this position as part of contractual negotiations earlier this year.

In February 2009 we did reduce prices in line with the market, and whilst farmers were understandably disappointed at this development most accepted that milk solids pricing is an industry issue which fluctuates according to market needs, competition and environmental factors.

Milk - Cost of Production

As the Committee will be fully aware, there has been significant commentary on the production costs of milk and whether dairy farmers in some States currently have to produce at below cost. Cadbury's knowledge of production costs is based on reports that are available from ABARE, Dairy Australia and other sources. These reports tell us that key differentiating factor for the viability or other wise for most dairy farmers is the level of debt they are carrying.

Recent Developments

For the Committee's information, Cadbury recently announced an increase of 8c/kg Fat and 20c/kg Protein to our contracted dairy farmers' retrospective from July 1st 2009; which equated to approximately 14c/kgms. The Tasmanian dairy farmers that supply our business have already received this back payment and revised rate as part of their fortnightly payments.

Conclusion

Cadbury is committed to working in partnership with our dairy farmers to ensure a fair and equitable price for both parties. We have been purchasing Australian milk for the nation's favourite chocolate for almost 100 years and are confident that this strong relationship will continue.

We would like to also reinforce that we strongly believe that allowing market mechanisms to work is the best way of achieving fair and equitable milk pricing for consumers, dairy farmers and commercial purchasers such as ourselves.

Regards

Mark Callaghan
Managing Director - Aust & NZ