

SOUTHERN AGVENTURE LIMITED

SUBMISSION TO THE SENATE STANDING COMMITTEE ON RURAL AFFAIRS AND TRANSPORT

OPERATIONAL ISSUES IN EXPORT GRAIN NETWORKS

EXECUTIVE SUMMARY

Southern Agventure is an unlisted public company of some 165 farmer shareholders in southern New South Wales with a vision to return more of the benefits of farm production to farmers and their communities.

Recent history in grain production and export in this region has been categorised by: prolonged drought; concentration of ownership of farms and support services; larger farms and machinery for grain production; corporatisation and privatisation of farmer established organisations – AWB, GrainCorp etc with ownership in foreign or multi-national hands; deregulation of wheat marketing and the loss of the single desk; concentration of ownership of storage and logistics services (including rail) in AWB (now Cargill) and GrainCorp; rundown of storage and transport infrastructure and a bumper harvest for 2010/11 which will result in substantial amounts of grain in storage by next harvest due to limitations in the capability to move it.

Investment in grain storage and logistics capability in the region has been minimal given the drought and other industry competitive factors. The ability of the supply chain to cope with a normal harvest is highly questionable.

The concentration of ownership and control of storage and logistics facilities at a local and regional level has great potential to impact on and impede competition. Such concentration can restrict access to infrastructure on an open basis as the major companies can, despite public comment, impose conditions favourable to themselves on that access at the expense of competitors in grain accumulation and marketing.

A deregulated market can only operate effectively if there are sufficient numbers of players in the market (and this means the local market) to ensure true competition. An outcome involving a dominant oligopoly does not result in true competition and is open to market manipulation and exploitation.

Experience shows a lack of proper transparency in pricing at the local level for local delivery or at port by the major operators controlling the storage and logistics services (in particular GrainCorp in this region). There appears to be no correlation between at silo pricing and at port pricing and the publicised transport and handling charges. GrainCorp's port service price differentials for grain received from its own up country storage facility versus non-owned up country storage facilities is not

justified and simply the use of its monopoly position to manipulate prices. This ability provides a significant competitive advantage and reduces the market effectiveness of the other accumulators and marketers.

Without effective pressure on the storage, transport and port logistics sector operators to optimise efficiencies in their part of the supply chain, the overall industry is penalised. Without a high level of competitive pressure on such operators, there is little motivation to improve at any significant rate. As a consequence, the main penalty is placed on the beginning of the supply chain – the grain grower – as there is no one for him to pass on the additional costs.

"He who controls storage, transport and logistics and ports, controls the market."

There is considerable inconsistency and lack of uniformity in grain classification and grading resulting from a lack of training, inexperience and policy approaches adopted at receipt. The 2010/11 harvest also highlighted the impact of limited segregation availability at many sites leading to lowest common denominator acceptance. This resulted in lower prices to growers while enhancing the ability of storage and logistics providers to gain the benefit of blending for a higher overall grade and on-sale price. Such manipulation capability on top of a multi-national company's interests not necessarily aligning with that of Australia, its companies and farmers, has a significant potential for Australia's reputation as a high quality grain producer being damaged.

The number of ports supporting the bulk grain export industry in New South Wales and Victoria in itself limits competition and efficiency. Effective rail access to port terminals is also an issue. Containerisation has limitations also and is appropriate to niche markets.

On related matters, there is no comprehensive study and national policy associated with effective land use for agriculture and food security purposes. This has substantial implications for the future.

Suggested Recommendations

Southern Agventure recommends the following be considered as a means to improve the current situation regarding grain export:

- use of the provisions of the Trade Practices Act to more effectively monitor the activities of the oligopolistic / monopolistic operators of grain storage, transport logistics and port facilities to improve transparency and effective competition;
- seek more emphasis by Governments at all levels to improve the efficiency of grain export by investing in regional and local infrastructure directly or in partnership with industry (a regional hub and spoke system involving road / rail to regional hub, rail to port being a suitable model) as well as port facilities;

- encourage investment in operational capital for bulk grain storage and logistics through appropriate taxation concessions and related incentives;
- the Federal Government adopt a more aggressive policy towards ensuring Australia's food production future security by limiting foreign control and supporting Australian production through limitations on imports where there is potential such imports may bring disease or other contaminations to our industry; and
- the Federal Government undertake a comprehensive examination of appropriate land use in the context of agriculture and food production and bring forward measures designed to ensure we sustain our future agriculture production and food security.

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1. INTRODUCTION

Southern Agventure Limited is an unlisted public company established in 2009 by a group of farmers in southern New South Wales frustrated with their position in the agriculture / food industry supply chain. As the producers of substantial raw material for the processing of food for both domestic and international consumption, farmers have seen continued rises in the consumer price of food, improved returns for processors and retailers, but diminishing returns at the farm gate. Farmers have become price takers which has had the compounding effect of reduced farm viability, reduced local economic activity and significant pressures on the ongoing sustainability of local communities.

The privatisation / corporatisation of AWB, Graincorp and other farmer established enterprises plus the deregulation of the grain trading industry with the abolition of the single desk, led the farmer group to decide it was time to take action. This action was to form a company to be involved commercially in the supply chain, owned and controlled by farmer shareholders, to enhance the competitive position of farmers (to reduce the price taker effect) and to improve returns at the farm gate thereby ensuring the local communities received a fairer share of the return from agriculture production.

In November 2009 Southern Agventure Limited was established with some 165 shareholders.

Southern Agventure's first major initiative has been its 50 / 50 joint venture with the Emerald Group: Southern Ag Grain. Southern Ag Grain is a grain accumulation and marketing company based in Wagga Wagga, NSW. It has operated above expectations in both the 2009/10 and 2010/11 harvests.

Southern Ag Grain has brought increased competition to grain accumulation in the region and this has arguably improved prices to grain growers as a result. In the 2010 / 11 harvest, Southern Ag Grain was a major accumulator in the region behind GrainCorp and AWB/Cargill.

Southern Agventure's success through Southern Ag Grain is only the beginning of what is hoped will be further successes. The Company is seeking further shareholders across the wider region in southern NSW and additional equity capital to undertake new projects in grain storage and logistics, prime lamb finishing and marketing and carbon sequestration opportunities. This has involved an offer by Prospectus to the investment market.

Southern Agventure's activities in the grain market combined with its extensive farmer shareholder base, places the Company in a position to comment particularly on the operational issues associated with grain export.

2. GRAIN INDUSTRY OVERVIEW

The grain industry in southern NSW has a proud and effective history, but more recently it has been characterised by:

- almost ten years of prolonged drought;
- continued amalgamation of farms and concentration of ownership including ownership by major corporations and foreign interests;
- increased specialisation in broad acre grain production as against mixed farming leading to larger operations with larger machinery, including contract harvesting and planting;
- privatisation / corporatisation of originally farmer owned and controlled entities AWB and Graincorp and their subsequent sale to foreign, multinational interests with apparent aspirations for vertical integration of the supply chain;
- abolition of the wheat single desk resulting in a much more complex grain export process for growers;
- concentration of grain storage and rail network capability in the hands of two major players - AWB Grainflow (now owned by US family owned mega business Cargill) and Graincorp;
- substantial run down of grain storage and rail network infrastructure, especially smaller sites and branch lines;
- a major harvest in the region in 2010/2011 producing over 4 million tonnes of grain – wheat, barley and canola;
- much of the wheat and barley has been “feed” quality rather than the more traditional higher quality processing grains, although the worldwide reduced supply of grain has meant prices have been higher than what would be usually expected; and
- a considerable amount of grain remaining in the major storage facilities as well as in on-farm temporary storage (plastic silo bags) in the lead up to next harvest as the system is incapable of moving it all.

3. GRAIN STORAGE AND LOGISTICS REGIONAL OVERVIEW

The combination of the prolonged drought with reduced yields followed by a major harvest affected by unusual wet conditions (and flooding) has meant a large quantity of lower grade grain is in storage awaiting transfer to port and shipping overseas. The drought has also meant an extended period of lower than what might be considered usual investment in new or the upgrading and improving the efficiency of existing storage and grain logistics facilities. This has been further exacerbated by very low investment in rail bulk grain rolling stock.

In southern New South Wales, the ownership of grain storage facilities is as follows:

- GrainCorp – 72 sites
- AWB Grainflow (Cargill)– 4 sites
- ABA (Sumitomo) – 3 sites

There are a number of small, privately owned storage facilities sprinkled through the region. These are used primarily for domestic marketing purposes or as “on-farm” storage by larger growers.

On-farm grain storage in the region and Australia overall is minimal and generally temporary – the traditional approach has been to sell or warehouse in an industry storage facility as the grain is harvested.

Two major factors have impacted on farmers’ decisions regarding storage and sale in recent years. The first is deregulation of grain marketing which has introduced numerous grain traders additional to the traditional accumulators. Most farmers now undertake a range of marketing / sale options for their grain – from cash sale, to a range of pool options to simple warehousing with subsequent sale both domestically and for export. This has been a positive result for most.

The other major impact has been the increase in size and capacity of harvesting machinery and road transport capability, especially where contract harvesting / transport is involved, to achieve the level of efficiencies necessary for production.

Grain growers now more than ever are under pressure to move grain into storage as quickly as possible to:

- not inhibit the efficient operation of harvesters (especially contract harvesters); and
- meet the needs of contracted road haulage providers, either in terms of operational efficiency or in terms of access, which this harvest highlighted as being in short supply.

The 2010/11 harvest was impacted significantly by the unseasonal wet conditions. This led to the harvest period extending until March and April in some areas. This extension took much pressure off the storage and logistics operators and road hauliers in comparison to what might be considered a normal harvest period.

In regard to bulk rail capability, only GrainCorp and AWB / Cargill own and operate rolling stock. Both also have port access at Port Melbourne and Port Kembla (ABA has access at Port Melbourne). Pacific National and Queensland Rail operate bulk grain trains which are available to grain marketers on contract. However, generally these have been used by GrainCorp and AWB as they control most of the storage sites.

Based on the experience of the 2010/11 harvest it is highly questionable whether the storage and logistics system can cope with what would normally be considered a normal harvest and annual grain export for the future.

4. TERMS OF REFERENCE – OPERATIONAL ISSUES ARISING IN THE EXPORT GRAIN STORAGE, TRANSPORT, HANDLING AND SHIPPING NETWORK, WITH PARTICULAR REFERENCE TO:

a) any risks of natural, virtual or other monopolies discouraging or impeding competition in the export of grain storage, transport, handling and shipping network, and any implications for open and fair access to essential grains infrastructure;

While deregulation has brought more competition in grain accumulation and marketing during the initial years of change, other factors, particularly the provision of grain storage and bulk transport, are now having an effect on the veracity of that competition.

On a local basis, the ability of most grain growers to quickly physically store their grain ex the harvester in most cases leaves them with either one option or at best two options apart from on-farm temporary storage facilities (silo bags). These options involve one or two of the organisations listed above.

In the context of future normal harvests (including the likely eventuality in the 2011/12 harvest for 2010/11 held over stocks of grain to be still stored in facilities in the region at the commencement of harvest) - the question now is – how long will it be before the owners and suppliers of grain storage and associated logistics services refuse to warehouse grain accumulated by organisations other than themselves. In other words, for growers to store their grain, they must sell to the provider of that storage.

In these circumstances, a virtual monopoly exists at the local level and growers more than ever are forced to be price takers of the storage provider (on the basis that they would be at a considerable competitive disadvantage if they carted their grain to a competitor's site some distance away).

On the announcement of FIRB approval for acquisition of AWB's commodities and Grainflow businesses, Cargill General Manager Australia, Robert Green indicated on ABC Radio on 5 May 2011 that the AWB name and branding would be retained for the marketing of wheat and barley. He also indicated ownership of the AWB port facilities would be transferred to Cargill and presumably this would also mean its storage and rail assets.

While Mr Green did make the comment that it was Cargill's "intention" that access to the storage facilities would remain open, obviously there is no guarantee this will be the case. Given Cargill's approach to business evidenced over many years of operation in Australia, any future access to its storage and logistics capacity decisions will be clearly based on what is of benefit to Cargill – not its suppliers.

Faced with a major, perhaps dominant competitor in the guise of Cargill, GrainCorp will have to seriously consider adopting similar market practices regarding access to storage and logistics services. The probability of a

Coles / Woolworths market dominance oligopoly is high and we submit not in the best interests of farmers and not in the national interest.

A deregulated market can only operate effectively if there are sufficient numbers of players in the market (and this means the local market) to ensure true competition. An outcome involving a dominant oligopoly does not result in true competition and is open to market manipulation and exploitation.

(b) the degree of transparency in storage and handling of grain and the appropriateness of any consequent marketing advantages;

Overall there is sufficient transparency in the ownership and operation of grain storage and handling facilities. However, the real issue is about the concentration of ownership at regional / local level which impacts on competition and access. While overall it is suggested there are a number of major competitors in storage and logistics Australia wide, such is not the case on a regional / local level or indeed a State level in certain instances such as Viterra in South Australia. Unless there are sufficient numbers of effective competitors in any part of the supply chain, the market has the potential to be corrupted and manipulated.

The area criticised as having a lack of proper transparency is in pricing at the local level for local delivery or at port by the major operators controlling the storage and logistics services (in particular GrainCorp in this region). There appears to be no correlation between at silo pricing and at port pricing and the publicised transport and handling charges. GrainCorp's port service price differentials for grain received from its own up country storage facility versus non-owned up country storage facilities is not justified and simply the use of its monopoly position to manipulate prices.

This ability provides a significant competitive advantage and reduces the market effectiveness of the other accumulators and marketers.

It is recommended that all such pricing be subject to full transparency and close oversight by the ACCC. In this regard it is suggested that the major grain terminal operators – GrainCorp, AWB/Cargill, Viterra, CBH, ABA be declared for the purposes of the Trade Practices Act with regard to the provision of storage and handling services to ensure all pricing and service levels are transparent and justified.

(c) equitable access to the lowest cost route to market, including transport operations; and

(d) competition issues arising from the redelivery of grain;

In regard to grain storage and transport efficiency, the concentration of ownership and control of grain storage sites and rail infrastructure plus the limitations on access to bulk grain port facilities has impacted significantly on the efficiency of bulk grain handling from the farm to port and our overseas customers.

Add to that the lack of sufficient investment in rail track, siding, rail loading and unloading facilities and rolling stock as well as effective bulk port facilities and the result is a far from efficient grain export logistics system in New South Wales and Victoria.

This has led to a much greater reliance on road transport which is much less efficient and more costly. The direct costs of these inefficiencies are generally passed back to the farmer. Indirect costs associated with road and related infrastructure, excessive consumption of fuel, impact on the environment via additional gas emissions and increased public risk associated with more trucks on the road are absorbed elsewhere in the Australian economy. There is also the added impact of Australia's export grains being less competitive in the world market because of this inefficiency.

Without effective pressure on the storage, transport and port logistics sector operators to optimise efficiencies in their part of the supply chain, the overall industry is penalised. Without a high level of competitive pressure on these operators, there is little motivation to improve at any significant rate. As a consequence, the main penalty is placed on the beginning of the supply chain – the grain grower - as there is no one for him to pass on the additional costs.

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(e) the absence of uniform receipt, testing and classification standards and practices and any implications for growers and/or for Australia's reputation and a major grain supplier;

The 2010/11 harvest has really highlighted these issues. Receipt, testing and classification standards and practices have been far from uniform. Many grain growers in this region have instances where the same grain has been tested and classified vastly differently at different sites. Very quickly word spread among growers as to which sites were "easy" on the classification and acceptance than others. This led to over supply at some storage venues while others remained at low levels.

These inconsistencies or lack of uniformity were the result of differing levels of training by site staff, different interpretations of the standards required and different policy approaches.

The extremely wet harvest meant the widespread use of "Falling Numbers" machines. Many growers in this region experienced substantial reductions in quality as a result of this testing, however, much anecdotal comment has been critical of the accuracy and correctness of such testing, especially in the hands of inexperienced operators.

Another criticism has been the lack of segregation at local sites leading to lowest common denominator classifications to fit the available segregation. Again the 2010 / 11 harvest experience has pointed to the major difficulty in making available a suitable range of segregations for a

large annual crop with variations across the lower “feed wheat” grades rather than a smaller overall crop with significant high grades (APH, APW) and few other grades.

This situation has led to accusations that the storage and accumulation operators have been able to directly benefit through blending to average out grades to produce a higher grade overall than that paid to growers. While such accusations are not new, they are of even greater significance where they are multi-national companies with processing activities elsewhere in the world.

Such manipulation capability on top of a multi-national company’s interests not necessarily aligning with that of Australia, its companies and farmers, has a significant potential for Australia’s reputation as a high quality grain producer being damaged.

(f) equitable and efficient access to the shipping stem.

Port access and thereby shipping access for the southern NSW region is restricted to Port Melbourne and Port Kembla and to a lesser extent, the Port of Geelong for bulk grain operations. This in itself limits competition and efficiency.

The most efficient operation of bulk grain is by rail directly to the port with bulk unloading capability. Optimal investment in bulk grain rail capability at these ports has not been achieved reflecting the many years of drought and an apparent reluctance on the part of port facility owners / operators to invest beyond what they consider are their company’s needs versus the industry’s needs. This has led to the use of road transport direct to port and with it the inefficiencies and cost associated with it. In general, these extra costs are born by the grain grower.

The operation of Port Access slots generally appears to meet the needs of the industry, although an ability to transfer slots (as against a slot trading scheme) on a fully transferrable basis, may add efficiency.

Recent years has seen the development of grain export in containers. This is of significant benefit for niche markets and markets where there is an absence of bulk grain handling capability at the country of destination. Containers also offer an ability to load up country to obtain the benefits of rail transport to port rather than road and access to other port facilities such as Port Botany. However, in overall terms, the transport of grain via containers is far more expensive and inefficient compared to bulk rail.

The other major current influence on grain containerisation is the lack of suitable “food grade” containers. Availability is generally determined on import requirements rather than export needs. That is, the majority of containers are turned around and shipped out again within 24 hours of unloading. It is our understanding few containers are available to prepare for grain loading, especially up country loading.

One of the reasons we understand for this is that the GFC resulted in an almost cessation of container production in China and this has led to pressures on supply world wide. While it is likely this will change with the return to higher economic activity, containerisation for grain export is likely to continue to be secondary to bulk and appropriate only for niche markets.

(g) any other related matters.

Of particular concern to regional communities and food raw material producers is the usage of agricultural productive land.

Land which is highly productive in agriculture is increasingly being used for other purposes including residential, industrial and mining. Vast tracks of arable land on the coastal flats adjacent to capital cities is increasingly being swallowed up for residential housing as the urban areas of major cities continue to expand. Vegetable growing areas around Sydney and Melbourne, along with dairy production areas along the coast are specific examples. This has led to many farmers in these regions selling out to land developers and moving inland to less productive areas. For example, dairy farmers in the Illawarra and south coast of New South Wales have moved to areas in the south west of the State to establish dairy farms based on growing their own fodder through irrigation (bore and river supplied). This substantial change in land use with its environmental and food production implications appears to have limited or no sanction.

Mining is another significant issue with major implications for our future agriculture production and food security. Almost all of the fertile Australian landscape has been or is to be surveyed for mineral exploration. Mining generally takes precedence over agriculture. Yet mining can have a diabolical impact on future agriculture production even with substantial requirements for post mining remedial work. Some experts indicate that in most cases we do not fully understand the long term implications of current mining practices. Coal stream gas extraction and iron ore strip mining are two such practices where the long term end impact on agriculture production is not known in terms of actual experience.

Little or no major work has been done on fully understanding and overseeing appropriate land use across the country. Most land use considerations are made at local or State level and based around local planning issues, not national, macroeconomic and social needs. For this reason we strongly recommend that the Federal Government undertake a comprehensive examination of this issue and bring forward measures designed to ensure we sustain our future agriculture production and food security.

RECOMMENDATIONS FOR THE FUTURE

Southern Adventure recommends the following be considered as a means to improve the current situation regarding grain export:

- use of the provisions of the Trade Practices Act to more effectively monitor the activities of the oligopolistic / monopolistic operators of grain storage, transport logistics and port facilities to improve transparency and effective competition;
- seek more emphasis by Governments at all levels to improve the efficiency of grain export by investing in regional and local infrastructure directly or in partnership with industry (a regional hub and spoke system involving road / rail to regional hub, rail to port being a suitable model) as well as port facilities;
- encourage investment in operational capital for bulk grain storage and logistics through appropriate taxation concessions and related incentives;
- the Federal Government adopt a more aggressive policy towards ensuring Australia's food production future security by limiting foreign control and supporting Australian production through limitations on imports where there is potential such imports may bring disease or other contaminations to our industry; and
- the Federal Government undertake a comprehensive examination of appropriate land use in the context of agriculture and food production and bring forward measures designed to ensure we sustain our future agriculture production and food security.

May 2011