TULLY SUGAR LIMITED

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TULLY SUGAR 中粮 COFCO

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13 October 2014

The Committee Secretary
Senate Rural and Regional Affairs and Transport
References Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Sir

Submission to the Inquiry into the Current and Future Arrangements for the Marketing of Australian Sugar

Thank you for the opportunity to make the following submission to this Inquiry.

About Tully Sugar Limited

Tully Sugar Limited (Tully Sugar) is a wholly owned subsidiary of Chinese agribusiness company COFCO. COFCO acquired Tully Sugar in July 2011. We operate one of the largest sugar mills in Australia. Tully Sugar employs over 200 people on a permanent basis, and more than 100 additional seasonal workers during the crushing season.

Our principal activity is the milling of sugar cane to produce raw sugar of internationally recognised high quality for the export market. Molasses is produced as a by-product of the sugar extraction process and is a valuable cattle feed supplement. The molasses we produce is sold into both the domestic cattle feed and the international markets. Tully Sugar produces electricity which is exported to the Queensland electricity grid.

The Company also owns and operates a number of cane farms, has commercial and residential real estate interests in Tully and is a Registered Training Organisation.

Tully Sugar is supplied by over 240 growers who produce sugar cane on 30,000 hectares of land in the Tully region. The area of cane produced by growers for Tully Sugar has increased by more than 20% since the late 2000's.

About COFCO

Founded in 1949, COFCO has developed from a grains and oilseeds trading company into China's leading service provider of agricultural products and diversified food services. COFCO is committed to creating an agricultural and food company with an integrated value chain that connects farms to households and creates a full-service urban system, and to utilizing sustainable natural resources to provide nutritious, premium-quality products.

From trading and processing of grains and oilseeds, COFCO's value chain has now extended to origination and husbandry, logistics and storage, raw materials processing, biofuels, branded food production and sales, hotels and real estate, financial services, among others. COFCO is

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committed to building its core competencies in each stage of the value chain and maximising value for our stakeholders, customers and employees, and opportunities for our suppliers.

As a widely recognised global company, COFCO has been awarded as one of the "Fortune 500" companies for 21 consecutive years, the only Chinese agri-food enterprise on the list.

Inquiry Terms of Reference

On 4 September 2014, the Senate moved that the following matters be referred to the Rural and Regional Affairs and Transport References Committee for inquiry and report by 27 November 2014.

Current and future arrangements for the marketing of Australian sugar, including:

a. the impact of proposed changes on the local sugar industry, including the effect on grower economic interest sugar;

b. equitable access to essential infrastructure;

c. foreign ownership levels in the industry and the potential to impact on the interests of the Australian sugar industry;

d. whether there is an emerging need for formal powers under Commonwealth competition and consumer laws, in particular, whether there are adequate protections for grower-producers against market imbalances; and

e. any related matters.

Introduction:

Tully Sugar has for many years been a strong supporter of the QSL marketing system. This support continued following the acquisition of Tully Sugar by COFCO. In March 2012 Tully Sugar and QSL jointly announced the extension of Tully Sugar's Raw Sugar Supply Agreement. Tully Sugar again extended its Raw Sugar Supply agreement in 2013 to the 30 June 2017.

However, following the withdrawal of Wilmar and MSF Sugar from Queensland Sugar Limited (QSL), Tully Sugar announced on the 30 June 2014 that it would also not extend its Raw Sugar Supply Agreement with QSL beyond 30 June 2017.

Tully Sugar assessed the impact of the withdrawal of the largest suppliers to the QSL export marketing system and determined that the loss of major suppliers would fundamentally change the QSL offering.

In announcing this decision Tully Sugar noted that the withdrawal of Wilmar and MSF Sugar meant that QSL "loses more than seventy per cent of its critical export mass and its competitive marketing advantage. This presents unacceptable risks to our business and our growers".

Since announcing its decision Tully Sugar has been working with its growers to better understand the needs of the Tully sugar industry, and define how Tully Sugar will ensure that the services previously provided to Tully Sugar by QSL will be provided in the future.

Tully Sugar has spoken with many of its suppliers individually and at regular group meetings about the changes that will arise. Tully Sugar has arranged for independent commodity risk advisors to speak at monthly meetings about the services that are commonly available in other industries. We have described how Tully Sugar will seek to replace the services that are currently provided by QSL. The discussion with our grower suppliers is focussing on their commercial requirements, and how those can be met effectively.

QSL Services

QSL provides services to the Queensland sugar industry under commercial contracts known as the Raw Sugar Supply Agreement. These contracts are between QSL and the respective sugar milling companies. The sugar mills in turn have commercial contracts, known as Cane Supply Contracts, with the growers who supply them.

QSL has provided services to the sugar milling companies under four main groupings: 1. Price Risk Management, 2. Export Marketing, 3. Financing, 4. Port Terminal Logistics. The sugar milling companies in turn facilitate grower access to these services, either directly or indirectly as appropriate.

Price Risk Management: The operation of various pool products to price Australian sugar on the world market using predominately the Intercontinental Exchange Sugar No.11 futures contract in Australian dollars.

The Sugar No. 11 contract is the world benchmark contract for raw sugar trading. The contract prices the physical delivery of raw cane sugar, free-on-board the receiver's vessel to a port within the country of origin of the sugar. Australian sugar is deliverable against the Sugar No.11 futures contract.

Export Marketing: The sale of raw sugar for export, the majority of which is sold at a price relative to the Sugar No.11 futures contract. The relativity to the Sugar No.11 futures contract is known as the export basis, or the Far East Premium.

Financing: The provision of financing for the inventory of sugar held for export and the cash flow requirements to pay sugar mills which in turn pay the growers for the cane delivered.
Port Terminal Logistics: QSL leases the export terminals owned by Sugar Terminals Limited, and operates these terminals to receive and store raw sugar delivered by the sugar milling companies, and to load that sugar on to bulk export vessels.

Within each of these main groupings there are a range of services that QSL performs including vessel chartering, logistics planning and execution, quality control, futures position management, treasury functions, and many others. All of these services are common to bulk commodity exporters, and while requiring certain expertise, are unremarkable in normal commercial export operations.

The Queensland sugar industry has been progressively deregulated culminating in full deregulation in 2006. The changes were necessary to remove inefficient practices and replace them with proper commercial foundations to underpin a modern progressive industry. One of the major benefits of these reforms was that growers and milling companies alike were able to undertake their own price risk management. As a result growers can set the sugar price that underpins the price they will receive for their cane using services facilitated by the milling company. This pricing is done using the independent and transparent world market price represented by the Sugar No.11 futures contract.

Since deregulation Tully Sugar has maintained a Raw Sugar Supply Agreement with QSL and Tully Sugar will continue to be bound by the terms of the current Raw Sugar Supply Agreement until the conclusion of the 2016 season.

Until the 30 June 2017 Tully Sugar has determined that, with the exception of price risk management services, it will procure services for its raw sugar exports solely from QSL. This was a commercial decision within Tully Sugar's sole control. As a result, Tully Sugar has supported QSL by ensuring the services we have provided to growers incorporated within previous Cane Supply Contracts, and the current Cane Supply Contract, have almost entirely been underpinned by QSL services. Tully Sugar has generally provided its growers access to the full suite of QSL pricing pools each season. Tully Sugar has only offered its suppliers access to a pricing pool managed by a service provider other than QSL on one occasion.

In effect therefore Tully Sugar's decision has meant that while we have supported QSL, we have not provided our growers with any choice regarding the service provider or the cost structure of the financing, logistics, or export marketing services that have been incorporated in the price that is ultimately received by growers for the cane that they deliver.

Prior to being acquired by COFCO, for the most part Tully Sugar did not have access to the necessary financial or human capital to provide these services itself. Since being acquired by COFCO Tully Sugar now has direct access to efficient financial capital, and direct access to sugar marketing and shipping services. Since the acquisition by COFCO, Tully Sugar has been in a position to reconsider where it procures the services required to export raw sugar, and how it facilitates the provision of those services to the benefit of the Tully sugar industry. Tully Sugar did not precipitate the decision to exit QSL itself, however when it became clear that QSL would no longer have the critical export mass beyond the 2016 season, the Tully sugar industry was fortunate to have the backing of a strong mill owner with the resources to facilitate the replacement of services that to this point have been accessed solely from QSL.

a. **the impact of proposed changes on the local sugar industry, including the effect on grower economic interest sugar;**

Raw sugar prices are primarily determined by the world market price. On average well over 90% of the net price received for raw sugar delivered to the port terminal is achieved directly from the Sugar No.11 futures contract converted into Australian dollars.

Additional revenue is earned from the Far East Premium which represents Australia's freight advantage in supplying the Asian markets, and its quality advantage relative to some other origins. A further source of revenue is the Polarisation premium, which is a quality parameter common to almost all raw sugar export contracts, based upon a the International Polarisation Scale under the Sugar Association of London contract rules.

Costs are incurred in terms of shipping and port logistics, financing, and various marketing charges. Under the current pooling arrangements the additional revenue is largely offset by these costs such that the net positive contribution to the final price achieved is commonly less than 5% and may even result in a reduction of the final price.

This structural situation will not change substantially as a result of the change in the service provider.

As Australian raw sugar is deliverable at par against the Sugar No.11 futures contract, there is a clear minimum price that should be achieved relative to the futures market, that is the export basis or the Far East Premium, for Australian raw sugar exports in any futures delivery month. The extent to which the Far East Premium can be maximised is in large part a function of the relative cost of bulk ocean vessel freight from our major competitor Brazil to Asia, relative to Australian ocean freight to Asia. **Tully Sugar as an exporter has a clear interest in maximising that value for itself and its suppliers.**

As a participant in the QSL pooling system Tully Sugar has paid the state average port terminal costs even though all of Tully's sugar is delivered to the Mourilyan port terminal which on a throughput basis is the cheapest sugar export terminal in Queensland per tonne. By remaining in the QSL pooling system Tully Sugar and its suppliers could be incurring a cost of up to A$10/mt on all of the raw sugar Tully Sugar exports through Mourilyan.

Counting against this, in years where the world sugar market is in a wide carry or contango, there can be an advantage in deferring shipments to later marketing periods. Under these circumstances the limited storage capacity at Mourilyan will restrict the quantity that Tully Sugar can carry at the port, and will represent an opportunity cost.

Tully Sugar has acquired services such as financing, logistics and export marketing for raw sugar exports from a third party (QSL) in the past. In the future Tully Sugar will acquire the majority of the services required from third parties. Tully Sugar will access service providers other than QSL, but does not rule out continuing to use QSL services for some components if QSL continues to be a supplier of those services and commercially acceptable terms can be agreed.

In deciding to exit the QSL system, Tully Sugar determined that it could no longer accept the concentration risk of being bound solely to QSL as the provider of raw sugar export marketing services. The changes that QSL would potentially need to make to reduce services, or increase costs for certain services were increasingly likely to be to the detriment of our grower suppliers.

"Grower economic interest sugar" is a term that has only been used since the creation of the current Raw Sugar Supply Agreements which came into force at the end of 2013. It does not appear in the current Cane Supply Contract that Tully Sugar signed with its grower suppliers prior to the start of the 2014 crushing season. It is not a term that has been used historically in the Queensland sugar industry.

The link between the price of raw sugar and the payment the grower receives for the cane they deliver to Tully Sugar is set out in the Cane Supply Contract. The grower currently has the ability to manage their price risk independently of Tully Sugar by using forward and in season pricing contracts to set the price of raw sugar, based upon the Sugar No.11 futures contract in Australian dollars, which is then used as the major input into the formula that determines the price the grower receives for the cane they deliver.

b. equitable access to essential infrastructure;

Tully Sugar does not believe that changes to the marketing system will impact on access to essential infrastructure.

The changes to marketing do not affect the allocation or cost of access to milling capacity.

Access to port terminal infrastructure need not be impacted. There are few if any sustainable alternate uses for the Mourilyan port terminal assets used for raw sugar exports. The owner of the terminal is unaffected by the proposed changes. The operator of the terminal may be affected, however the commercial agreement between the owner and the operator contemplates such changes.

Tully Sugar currently accesses the port terminal infrastructure under a commercial contract with a third party, namely QSL who is the current operator. In the future Tully Sugar anticipates that it will continue to access the port terminal infrastructure under a commercial contract with a third party, which may be QSL or it may be another entity.

c. **foreign ownership levels in the industry and the potential to impact on the interests of the Australian sugar industry;**

Foreign ownership levels have been and will continue to be subject to proper scrutiny by Australian Government agencies including the Foreign Investment Review Board.

The current and future arrangements for the marketing of Australian sugar should have no bearing on Australian policy in relation to foreign investment.

The relevant agencies already have sufficient wide ranging powers to consider and act on any issues that may need to be considered in terms of national interest and competition related to industry participants regardless of whether they are Australian or foreign owned.

d. **whether there is an emerging need for formal powers under Commonwealth competition and consumer laws, in particular, whether there are adequate protections for grower-producers against market imbalances;**

There has been no market failure event described or defined in the Australian sugar industry that would require such powers. In fact the unilateral decision by Tully Sugar to support the single desk monopoly service provision model will now give way to a model that creates greater competitive tension amongst a range of providers for a number of services. Existing Commonwealth competition and consumer laws are sufficient to regulate the industry and there is no need to make a special case for the Australian sugar industry.

If anything the proposed changes to raw sugar marketing in the Tully sugar industry will allow growers to take greater control over the management of the price they receive for their product. Growers have been able to manage their price risk independently of the mill for a number of years. This will not change, and indeed with Tully Sugar no longer solely relying upon QSL to develop the required price risk management tools, the capacity now exists to access a wider range of services for the growers in the Tully sugar region.

e. **any related matters.**

Tully Sugar would refer the Committee to the Australian Sugar Milling Council submission. Tully Sugar is a member of the Australian Sugar Milling Council and supports the content of that submission.

Yours sincerely

Alick Osborne
CHIEF EXECUTIVE OFFICER