Rabobank Australia Ltd
ABN 50 001 621 129 AFSL 234 700

Postal Address *GPO Box 4577*
Sydney NSW 2001

Office Address *Darling Park Tower 3*
Level 16, 201 Sussex Street
Sydney NSW 2000

Telephone *(02) 8115 4111*
Facsimile
Internet *www.rabobank.com.au*

Committee Secretary
Senate Standing Committees on Rural and
Regional Affairs and Transport
PO Box 6100
Parliament House
Canberra ACT 2600
Email: rrat.sen@aph.gov.au

Date: 3 December 2019

Subject: **Submission to inquiry into performance of Australia's dairy industry and the profitability of Australian dairy farmers since deregulation in 2000**

Rabobank Australia Limited (RBAL) welcomes the opportunity to respond to the Senate Standing Committee on Rural & Regional Affairs and Transport inquiry into the *Performance of Australia's dairy industry and the profitability of Australian dairy farmers since deregulation in 2000*.

About Rabobank

RBAL is a part of the international Rabobank Group headed by Coöperatieve Rabobank U.A. (CRUA)[1], a global leader in food and agribusiness banking. In Australia, Rabobank is one of the leading agricultural lenders and a significant provider of business and corporate banking and financial services to the region's food and agribusiness sector.

Rabobank has 61 branches throughout Australia, 56 of which are in regional and rural areas, contributing to Australia's regional economy and employment opportunities. Rabobank is an active promoter of food, agribusiness and rural development. Through RBAL, an authorised deposit-taking institution incorporated locally in Australia, and the Australian branch of CRUA. Rabobank uses 100% of all deposits raised in Australia to fund lending to the food and agriculture sector.

As a major provider of financial services to the dairy industry, including farmers and processors, Rabobank welcomes the opportunity to provide comment on this inquiry.

---

[1] CRUA (Coöperatieve Rabobank U.A.) is structured as a cooperative and operates in 40 countries, servicing the needs of approximately 8.6 million clients worldwide through its own Branch presence (such as CRUA Australia Branch) and/or locally incorporated subsidiaries (such as RBAL) and a network of more than 1000 offices and branches internationally. CRUA has nearly 120 years' experience providing customised banking and finance solutions to businesses involved in all aspects of food production and agribusiness

Rabobank

The ability of Dairy Australia to act independently and support the best interests of both farmers and processors

The growth and viability of the dairy industry is reliant on the expansion of supply, predominantly for export markets. Supply chain collaboration will be central to ensuring the continued viability of the dairy industry.

By global standards Australia is a small producer of milk. However, Australia has long been a net exporter of dairy products and ingredients, given milk production volumes have consistently been in excess of domestic market volume requirements. Australian dairy farmers are operating in a deregulated and open market and have done so for nearly two decades.

Exports will continue to be a key driver of growth for the Australian dairy sector. There are significant opportunities to supply international markets as consumption growth in emerging economies expands, driven by the rapid growth of middle classes in Asia and their increasing dietary preference for animal proteins. In many emerging economies, the local dairy industry is unable to keep pace with consumption growth leading to a widening of the milk-supply deficit.

Given growth of the industry will be led by export markets, the industry needs a clear path to sustained milk-supply growth. A globally competitive cost-base across the entire Australian supply chain is vital to the long-term sustainability of the industry. Given the export-orientation of the sector, it highlights the importance of supply-chain collaboration in terms of product innovation, supply chain integrity, market access, and trade development as means to stay competitive in a global arena.

Also, volatility in local and global dairy markets will be an ongoing challenge. This highlights the need for upskilling farm business operators and continued focus on farm capability and financial performance.

It is in this capacity that Rabobank recognises that Dairy Australia plays an important role, given its investments in essential activities across the dairy supply chain that promote coordination and collaboration.

The accuracy of statistical data collected by Dairy Australia and the Australian Bureau of Statistics

Dairy Australia provides sectoral data that is comparable to that provided by global peers.

Rabobank prides itself on knowledge-based banking. RaboResearch is Rabobank’s global Food & Agribusiness (F&A) knowledge provider. The team comprises a global footprint of analysts that

Rabobank

continuously accumulates knowledge in major F&A sectors, issues and trends. We share this extensive sector knowledge across the bank to provide actionable insights to our F&A clients.

Key to research and analysis of the global food and agricultural sector is the ability to collate supply chain data from all parts of the world, which feeds into a global picture. Rabobank utilises Dairy Australia data to analyse these market and sectoral trends, and finds the data comparable to that provided in other jurisdictions.

The funding of Dairy Australia and the extent of its consultation and engagement on the expenditure of levies revenue

The funding of Dairy Australia sits at the midpoint of levies imposed in other comparable milk-producing jurisdictions. Rabobank does not have a view as to the efficacy of Dairy Australia's consultation and engagement process.

A global scan of voluntary and mandatory funding models of peer organisations with similar mandates confirms that the Dairy Australia levy is comparable to levies imposed in other jurisdictions. In Australia, the dairy service levy - based on national average milk composition, was equivalent to approximately **0.0352 cents per kgMS.**

- In New Zealand, the DairyNZ levy equates to **AUD 0.034 cents per kgMS**.
- In the US, for the Dairy Research and Promotion Program (known as the Dairy Checkoff Program), US dairy farmers pay 15-cents-per hundred-weight (cwt) on their milk (the equivalent of **AUD 0.065 cents per kgMS**).
- In Ireland, Dairy Research Ireland is funded by a contribution from milk producers to the amount 0.036 cent/litre (**the equivalent of AUD 0.04 cents per kgMS**).
- In the Netherlands, there is a voluntary levy of €0.05 per 100/kg of milk to fund ZuivelNL. This Levy is deducted by the dairy processors from the milk cheque (the equivalent of **AUD 0.06 cents per kgMS).**

The merits of tasking the ACCC to investigate how it can regulate the price of milk per litre paid by processors to dairy farmers to ensure a viable dairy industry

Issues negatively impacting the profitability and viability of the sector have been related to market and seasonal forces, and historical issues to do with farm-gate milk pricing. These issues were highlighted in the 2018 ACCC Dairy Inquiry, which recommended the implementation of a Mandatory Code of Conduct for Dairy, amongst other initiatives. These changes have yet to be implemented and embedded in the market.

Rabobank

The Australian dairy supply chain has seen constant change, particularly since deregulation. More recently, a number of events have led to significant tensions in the supply chain, resulting in major changes in the way milk is procured, priced and processed.

Unlike most of their competitors (excluding New Zealand), Australian dairy farmers operate in a deregulated and open market, and have done so for almost 20 years. This does make supply chain participants more exposed as an industry to global market shocks that increasingly define the global dairy market.

At the epicentre of the headwinds has been extreme market price volatility and climatic disruption. These factors have stifled Australian dairy farm confidence, and threaten to hinder the appetite for on-farm investment.

Between 2014 and 2016 dairy commodity prices (in US$ terms) collapsed to lows not seen in more than a decade. The extent of the collapse was beyond expectation for most in the industry. This downturn was exacerbated by several key forces:

- A period of significantly reduced imports of dairy commodities from Chinese importers
- A Russian ban on imported foodstuff, including dairy products, from the EU and other suppliers
- Global supply growth across the major export regions – largely led by the removal of milk quotas in Europe in April 2015.

During this period, farm-gate milk prices in export regions were depressed –reflecting global market conditions and created margin pressure for many farm businesses.

Domestically, there were upheavals in the price discovery process for milk that created significant volatility in the farm-gate milk price, and subsequently created major changes in the structure and make-up of the dairy processing sector.

To address this, the Federal Government initiated the ACCC inquiry into the dairy industry, which found the need for a Mandatory Code of Conduct for dairy, amongst other initiatives. The Code has yet to come into effect, and the impacts and outcomes sought by the introduction of the Code have not had the chance to come to fruition.

Recent drought conditions have had a direct impact on farm-gate margins and further consolidation in the sector. Across the 2018/19 and 2019/20 seasons, farm profitability and productivity have been negatively impacted by adverse weather events.

There have been recent green shoots within the market. From July 1, 2019, Australian dairy farmers have entered a season of record farm-gate milk prices. Despite this, margins remain challenged by high input costs and challenging seasonal conditions and will do so until 2020. Changes to seasonal conditions will provide more favourable margins for dairy farmers.

Rabobank

Alternative approaches to supporting a viable dairy sector

Increased resourcing for, and focus on, improving farm financial and operational management practices will be a significant contributor to ensuring the viability of the dairy sector.

The dairy industry in Australia continues to consolidate and Rabobank recognises the pressure points this is creating within the sector, including the rising costs of input (feed, water, labour and energy). Farm cost structures have increased in response to the need to adapt to drier conditions, with rain fed pastures contributing a lower proportion of the total feed available. The outlook for continued dry conditions is likely to see ongoing pressure on feed costs, though conditions are favourable in some areas.

However, Rabobank is confident about the future of the Australian dairy industry. Volatility is not isolated to the dairy sector alone, but more a global phenomenon across a broad range of commodities. Building the sector's financial and management capabilities will be the major enabler to ensure a viable dairy sector. In the end, farmers and processors cannot control weather or market conditions. What they can control is how they prepare for, and respond to, these challenges and opportunities.

The need to build financial and business management capabilities is particularly important with respect to dairy farmers. According to the latest farm performance data from the Dairy Farm Monitor Project[2], there is a wide gap between the top and bottom performers of dairy farmers. Embedding best-practice farm, financial and business processes can lift the performance of underperforming farms, which will significantly improve the viability of the dairy industry as a whole.

As a lender to the farming community, understanding and improving the practices of farmers will have an impact on the access to finance of our clients and the success of our business. To this end, Rabobank has put together a host of programs to lift the financial skills and business management capacity of current and prospective clients, including:

- **Financial workshops for young farmers:** Across the country, the next generation of farmers will have the opportunity to access financial literacy workshops designed to give young people a 'leg up' in financial management to help grow their family farming businesses. The practical one-day 'Growing the Family Business' seminars, are being rolled out across regional Australia, with the aim to deliver the free program to 2000 young farmers by 2020. Rabobank is also exploring follow-up programs with these young farmers and their parents to work through the important issue of succession planning.

---

[2] https://www.dairyaustralia.com.au/-/media/dairyaustralia/documents/farm/farm-business-management/dairy-farm-monitor-project/vic/dfmp-vic-annual-report-201819.pdf?la=en&hash=6CF531AE7EDDB9BB588566F35B1AF57788B4A6B5

Rabobank

- **The Farm Managers Program:** Rabobank has been offering this Program for 20 years, which is designed to strengthen the operational and strategic skills of farm managers. The Program covers global trends in agriculture, business planning, financial management, leadership and succession planning.
- **The Executive Development Program:** This Program is a fast paced program comprised of two week-long modules run over consecutive years. Stepping away from the operational functions, the course develops farmers' critical assessment skills, aids the development of long-term strategies and provides new insights to promote future success.
- **Succession planning:** Given the dominance of family farming in Australia and the ageing of the farming sector, ensuring robust farm succession planning across the sector is a significant challenge. Since 2001, Rabobank has been offering independently facilitated sessions for family succession planning and farm succession workshops – a two day workshop that explores the establishment of business and family goals across generations and the establishment of processes and strategies to facilitate succession.

Increased resourcing and focus on improving farm management practices and capabilities will be a significant contributor to ensuring the viability of the dairy sector.

Other issues impacting the dairy sector's viability

The Australian dairy industry, particularly in the southern regions, will remain globally competitive due to a low-cost pasture-based production system, flexible and innovative processors and proximity to growing demand in Asia. Market conditions, including the increasing cost of feed and water due to sustained adverse weather conditions, will continue to negatively impact the sector's viability in the short to medium term.

Australia's role and reputation in the global dairy arena is being challenged by a dwindling milk supply. The industry has seen a significant reduction in export volume over the past decade as milk supply falls and domestic markets are prioritised. As a result, Australia is serving fewer export markets and faces speculation from international buyers about its long-term capacity to grow supply for the international market.

At its peak, Australia exported more than 55% of production and enjoyed a 16% share of global dairy trade. By contrast, in 2018/19, Australia exported just over one-third of the milk that it produced (in liquid milk equivalents) and accounted for around 5% on global dairy trade. Based on Rabobank modelling, at its peak Australia was exporting more than 6 billion litres of milk (in liquid milk equivalents) - his has now fallen to less than 4 billion litres (LME). It is worth noting that the largest portion of this decline has come from dwindling milk pools in Northern Australia and the Murray Irrigation district.

Nonetheless, Australia remains one of the larger dairy exporters.

Rabobank

Australian farmers continue to compete with countries that benefit from lower labour costs, less regulation and more government support.

Historically, countries in the Southern Hemisphere have been known for their low-cost exports. Extensive low-cost pasture-based production systems and plentiful natural resources gave the regions a competitive advantage. In recent years milk production costs have converged in key export regions[3], as Australian dairy farmers face difficult trading conditions, including:
• increased feed costs (price of purchased grain/fodder, cost of irrigation water to grow feed);
• rising on-farm energy costs; and
• a challenging labour market (labour shortages and increasing wages).

The profit pool of the entire supply chain is under pressure. According to the most recent Dairy Farm Monitor[4] report, a report on the Victorian dairy industry prepared by Dairy Australia and Agriculture Victoria, highlighted that it was a challenging year with mixed performance across the region. On average, Earnings Before Interest and Tax (EBIT) was AUD85,000; a significant decline from the previous year.

Australian dairy processors have not been immune to challenging market conditions and are also battling reduced earnings. Underutilised processing plants and cost pressures due to milk shortages and rising costs of inputs have been the main cause.

These pressures have led to the loss of milk supply in Southern Australia. Reduced profitability, loss of confidence and poor seasonal conditions have seen some farmers exit the industry, with many of those left with more debt and a reduced short-term appetite for major on-farm investments.
There is also a changing of farm scale and ownership, with an increasing incidence of multi-farm operations and a trend towards corporate ownership.

Despite current challenges, the long-term future for the industry looks bright. At the core of the sector's competiveness is:

- A pasture-based production system
- A flexible and innovative processing sector
- Access to the consumers exhibiting robust demand.

The medium-term presents some complex challenges to the industry – most importantly the need to lift milk production through sustained profitability on farm and across the supply chain.

---

[3] Agriculture in Focus – No longer low-cost milk down under, Rabobank November 2013
[4] See: http://agriculture.vic.gov.au/about-us/media-releases/dairy-farm-monitor-project-shows-mixed-results-across-the-state

Rabobank

The adoption of production systems to deal with climatic uncertainty and increasing market volatility is important. Rabobank firmly believes the sustainable and resilient dairy farm industry in Australia is one that can endure milk price and input cost volatility.

Sufficient capital is the best long-term strategy.[5] Years of reduced profitability on farm have resulted in cash-flow pressures and dwindling equity capital for many existing dairy farm operations. As a result, Australian dairy farmers should be encouraged to use the next cycle of profitability to strengthen their business structures – mostly through reducing debt and rebuilding equity.

Rabobank wishes to thank the Committee for the opportunity to comment on this important matter.

[5] Agriculture in Focus – Oceania Dairy – Let's Debt Serious, Rabobank June 2016