GROUP

24th November 2007

Safeguard Inquiry into the Imports of Pigmeat
Productivity Commission
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Dear Commissioner

Submission to the PC Inquiry into the Pigmeat Imports:

This is a submission from **Australian Pork Farms Group** [APFG] to the Productivity Commission Inquiry into the Australian Pig Meat Imports.

I wish to address the damaging impact of the recent huge surge in imports on the industry and the need for appropriate trade measures to be implemented to assist the Australian pig industry restructure in the face of this ongoing threat.

By way of introduction and background, I am an Australian who spent almost 18 years overseas in the pig industries of Europe and the USA up until 2000. I spent 8 of those years in the US industry in two of their largest pork production systems. [Murphy Family Farms (350,000 sows) and Heartland Pork Enterprises (65,000 sows)]. I have intimate knowledge of their costs and systems approach. I will at times refer to this experience as key issues are raised and would be happy to answer any additional questions the Commission may have given this background.

I. APFG BUSINESS OVERVIEW

HISTORY AND SCOPE

The Australian Pork Farm Group is made up of 3 businesses:

- Shea-oak Piggery Holdings Pty ltd (formed in 1992)
- Wasleys Piggery Pty ltd (formed in 1994)
- Australian Pork Farms Pty Ltd (formed in 2001)

<u>APFG is part of an Integrated Supply Chain consortium</u> - where they represent the majority shareholders in a number of businesses from farms to wholesale meat sales:

- The 18 owners and shareholders of APFG represent some of the major independent piggery operators in their own right in SA and Victoria.

- They are the majority shareholders [owning over 75%] of "**Ausport Limited**" – the marketing and abattoir owning entity based in Laverton [Victoria], which was developed by this group to assist stronger supply chain linkages 'Beyond the farm gate' for its Farmer Suppliers.

- APFG is also a direct Capital investor in the **Big River Pork** Abattoir and Boning Operation at Murray Bridge – and along with Ausport own 50% of this business.

- 15 years ago these independent family farmers first came together to:
  - Buy out the assets of Metro Meats (ex Adelaide Steamship Company) who had decided to divest themselves of their piggery assets. These farmers pooled their resources and pig farming investment capital to create larger enterprises in the belief this was required to be competitive for their long term futures.
  - These Farm businesses realized the need for an integrated supply chain even in these early days and subsequently formed the Ausport companies, who have owned Abattoirs, exported to both Japan and Singapore, and are now [as well as the above], involved in value adding branded Pork operations based at Laverton, Vic.
  - In 2003, the group (prior to the relaxing of the IRA protocols and US FTA announcements) took the decision to purchase the George Weston Foods pig farms in SA.

A summary of the key aspects of the combined businesses today would be as follows:

- 16,000 sows producing in excess of 300,000 pigs per annum sold to key abattoirs in SA and Victoria. Together the group represents approximately 33% of the SA Industry's combined 50,000 current sows.

- All sow Breeder farms are owned; but have a network of contract farmers in both states that house and manage up to 40% of our total production. (These contract sites of typically local farmers take no market risk and receive a flat fee for use of facilities and/or labour).

- Until recently the group had grown through capital reinvestment and/or acquisition from 6,500 sows at the beginning of 2000, to today's 16,000 sows. This has given increased efficiencies and cost reductions – BUT an expansion outlook has now turned fully to analyzing our future viability.

- The group employs over 130 people directly; PLUS our ‘contract’ enterprises have (we estimate) another 30 plus full and part time staff.

- All feed is purchase from Ridley Agriproducts 2 Mills in SA where we represent approximately 50% of their volume. Our arrangement with them is again on a toll milling basis where we buy all ingredients and pool purchases to further lower our costs while utilizing Ridley feed milling technologies.

- Our significant ownership [including Directorships] in “**Ausporkʼ**” and **Big River Pork** has allowed us to be very focused and directed towards maximizing Pork Meat sales and Pork Cut Value – not just a live pig. We are intimately involved in these businesses to ensure we “optimize the supply chain value all the way from the farm through to meat sales” --- NOT just the sale of an animal.

SUMMARY RECENT APFG FARM PROFITABILITY AND ECONOMICS

I believe the best way to highlight the issues that face our business is to summarise these into a reference table of key financial ratios. Together this highlights the core issues and plight of APFG and of the industry, as it relates to our returns and ability to survive long term.

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APFG RECENT ACTIONS TO IMPROVE COMPETITIVE POSITION

As a business, particularly in as tough a business as pig farming, we are constantly looking at how to improve our competitive position. Over the past few years, we have taken the following significant actions to assist us in this goal:

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II. ARE IMPORTS IMPACTING OUR INDUSTRY?

I trust that via APL and the data presented by them and others, that this has undoubtedly been shown/proven.

Our perspective is very much from looking at the last 3 to 4 years – a period in which we have invested considerably and taken a number of actions to reposition and improve the long term competitiveness of our business. From a COMBINED 3 year period where volumes lifted a total of 50 to 55%, and hence around 15% per year; to the last 12 months data showing a 45 to 50% increase IN ONE YEAR.

Hence, from a period of gradual rationalisation and refocus of our industry; to a stampede that the marketplace just could not/ can not absorb!

And I would add that the current indications from all quarters indicate that the US and Canada in particular are in a SEVERE overproduction situation relative to 12 months. Their very integrated Industry look at exports [15% of their current output in the US] as their ONLY way of assisting this situation. They publicly state that imports out of the country at any price will lift they price domestically. Economist Glen Grimes out of U of Missouri estimates that more than 20% of the current farm gate price can be credited to exports leaving the domestic market!

III. THE BUYING MARKETPLACE FOR PORK TODAY

From our companies unique perspective where we have integration into a number of segments of the pork chain, we believe there has evolved a segmentation in the marketplace which has aided the above situation, and significantly enhanced the distorting effects of imports, and why imports have produced their large and unreasonable impact over the past 12 months.

The Pork Buying industry has evolved and is set up with predominantly three types of buyers of carcass meat today:

A. Buyers and Users of Australian pork only. [Eg Auspork, BE Campbell, etc.]

B. Buyers and Users of a combination of Australian and Imported Pork.

C. Buyers of only Imported pork – and further process this into Smallgoods products. (these are generally smaller players but together represent a sizable part of the smallgoods industry)

   It is this latter group who produce the major market distortion:

   - As they are only dealing with Imported product, it is import pork prices only that determine their pricing structure.
   - But their prices (even though only representing 15 to 25% of the market) set the price for the other buyers of Australian and Imported product [Group B] who must compete.
   - Group C put a depressing price on the larger marketplace of Group A and B, which would otherwise have market forces that would push to higher prices in response to Farmer Suppliers needing to recover costs to stay viable.
   - I have talked to most of these major Buyers and believe they would all like to respond to the needs of their 'long term Farm Supplier's, but cannot due to competitors [Group C] who do not have these Australian supplier relationships and pressures.

IV. CRITICAL ISSUES RELATING TO IMPORTS AFFECTING APFG FARMS DIRECTLY

Import Product Pricing versus Farm Pricing:

APFG is part of an integrated supply chain, as we have ownership in Abattoirs and a Marketing company. We are selling both carcasses and meat cuts on to Wholesalers and Retailers. As such, we are in a unique position to understand the costs of the "Pork Chain", and how import pricing impacts the cost of meat.

The Australian Pork Market we estimate is essentially 90% vertically integrated given our hooks pricing approach. [different from the US Live pig pricing]. This is coupled with the vast majority (in fact it could be ALL major?) Abattoirs and their Boning Rooms act as 'toll or service' kill and bone operations:

- They charge a set fee for the act of killing and dressing a carcass,
- Then set fees to bone and cut up that carcass.
- Hence the Buyer of the meat knows the cost of implementing these value adding processes (kill, bone, cut) and so,
- Prices the carcass according to his known value for the 3 key parts of the carcass – ham, middle and shoulder – 2 of these being the direct cuts in competition with imports.

Therefore, even though as farms we are selling carcasses, the price we receive (due to toll kill and bone) is directly calculated by what the primal values are of competing meats – and in the smallgoods sector, this is imports.

<u>How are Imports holding Prices down in the Australian Marketplace?</u>

From APFG's perspective, this can be answered or tackled in a number of ways.

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V. WHAT WILL OUR BUSINESS DO IF THERE IS NO RELIEF TO THE PRESENT CRISIS?

<u>INITIAL ACTIONS:</u>

Our businesses immediate reaction over the past 3 to 4 months of significant financial hardship has been as follows:

- Alter a number of Feeding and Nutrition practices reducing our feed costs --- which we feel we can do in the short term with no detrimental impact on our animals.
- Sourced a number of alternative feed stuff ingredients.
- Reviewed all staffing and to date let go [or not replaced approx 5 to 8%] of our workforce.
- Halted all but essential Capital and Repair/Maintenance projects.
- Fast tracked any Feed Savings investments and activities.
- Hastened implementation of a number of management initiatives targeted at improved on farm practices.
- AND
- Renegotiated a number of financing arrangements to aid our medium and longer term Cash Flow.

Please Note: The above are direct actions to lower and change costs. At the same time, the business as a whole has had to maintain the normal ASIC requirements of a functioning company, and hence be sure to be able to honour its short and long term financial commitments. I.e. To not be in a position of trading insolvent. This means constantly projecting out 12 months given the life cycle of the pig.

POST CHRISTMAS 2007

All these items are minor in comparison to the impact of altered pricing. This impact traditionally will hit us in late December and January.

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RETURNING TO PRODUCTION AFTER EXITING

For APFG [and I would suggest most pig farming businesses] the likelihood of returning facilities that have been depopulated into working order and restarting is highly unlikely. Why?

- The amount of Capital needed to get back into the industry is huge, with a lead time from decision making of a minimum of 15 months from the time Breeding Stock is ordered, to when your first pigs are sold. And at close to $1,500 per sow of working Capital needs – this is a huge commitment.

- Once Pig buildings are closed down, they deteriorate rapidly if no ongoing maintenance – which is unlikely.

- In many situations, recommencing will require Local and State permits, which may be difficult to get given facilities will be view as "new" and have to meet new building and permitting guidelines which may be ridiculously onerous in old facilities and locations.

- The workforce people have developed and trained over time will have moved on. It will be extremely difficult to find people, let alone re-train them.

- The risk: reward for re-investing is unlikely to be attractive given the experiences that led to exit in the first place.

- And given the lead times involved if the industry Overshoots its re-structuring targets, as has been highlighted previously to the commission, we feel there will be huge pressure to open the door to fresh meat Imports and so the certain introduction of diseases we do not have – destroying the cost structure we do have AND the "clean green healthy" image we feel continues to be the major selling point for Australian pork both Domestically and Overseas.

VI. REQUEST TO PC

Our Business strongly urges the Commission to find in favour of the need for both immediate Provisional Safeguard Action followed by some form of ‘phased out Safeguard Program’ for our industry. The industry needs this relief to ensure we have time to adjust, but we recognise this must still allow for:

- Imports to increase but at a measured pace (not the 50% increase seen in the last 12 months). [We would urge consideration of Japan style ‘Gate Price’ scenario which the Japanese industry used effectively (and under WTO rules) to buffer their domestic industry as it reduced its proportion of their total domestic markets.]

- Allow Producers to have some vision (and have confidence) in planning for the future making appropriate plans to either;
    - become very competitive, including adoption of major CRC findings, or
    - to exit the industry with some dignity and equity that many have been part of for decades, if not generations.

- We strongly feel that a planned phased increase in imports will see many producers use the next 2 to 4 years to make significant decisions about the business, and allow the industry to reach the right equilibrium/mix. The need to assess and either “make change” or “exit” is already seen by many given:

    - Welfare changes the industry has committed to for the public good that will require significant capital investments in the near term.

    - An increase investment in Human Resource development will be needed, AND this is in the face of a diminishing rural workforce. Result – even more capital investment in new technologies to take out labour while still investing in more training.

    - There will be continued re-alignment and stronger contractual relationships develop with fresh meat suppliers – thereby forcing stability for some; and realisation for others of the need to exit.

    - Industry bodies [APL and CRC] will focus strongly on Farm/Producers understanding and improving competitiveness. Part of the above will occur via industry programs that force an understanding of the need for further capital investment to remain competitive in an increasingly high risk business. The result will be:

        - Programs will be implemented and show improved competitiveness for some;

        - While there will be an appreciation by others of their relative position and hence result in a planned exit.

Finally - we realise the Commission only deals with the issue of "Immediate harm by Imports". However, it would be remiss of me to not point out that as a business with a substantial investment in the industry, we believe there are further significant issues surrounding Import product that the Commission should factor into its deliberations.

These are:

1. We are not competing with Imports on a level playing field. Our competing countries all have significant subsidies – mostly being indirect via help/control of input costs and/or marketing assistance.

2. Most import countries do not have the same Welfare standards imposed on them as we do in Australia, again increasing our costs that we cannot recover when compared to overseas competitors.

3. Although we compete in a global marketplace – when it comes to grain we have internal Australian rules that does NOT allow us to take "cheaper" imported grain into rural Australia [where it is needed] – another tilting of the playing field that does not allow us to compete fairly! We estimate this could be impacting us as much as $50 plus per tonne or a potential lowering of costs by > than 20c per kg.

4. Human health rules are not the same in the America's – allowing use of medications and antibiotics that significantly help reduce their costs, while the reverse happens to our costs.

5. Finally, it is difficult to adequately express the magnitude of our concern regarding the increase in risk of an exotic disease outbreak due to the Import surge. Critically to us, a huge part of this increase is to more operators, and importantly to smaller less skilled and less inspected operators – with the bio-security risk to our industry we believe being exponentially increased in the last few years. There is no doubt that the "lack of control" over imported meats to ensure proper cooking and disposal of packaging material, poses a **huge** risk. It is now in so many plants, widely spread throughout the country, that it is only a matter of time before contamination occurs. AQIS do not have the time and resources to properly manage this risk.

   To reinforce this view that we are not competing on a level playing field I quote the following from the US publication PORK Magazine July 30th 2007:

   "The House bill will help pork producers remain competitive in the global marketplace," says Jill Appell, NPPC president and pork producer from Altona, Ill. "Being competitive means producers can sustain the profitability they've enjoyed now for 40 consecutive months." ……….

   *"The U.S. pork industry wants a 2007 Farm Bill that maintains producers' competitive advantage in the global marketplace**, that strengthens their competitiveness and that protects producers from initiatives that would adversely affect their livelihoods, such as mandates on production practices**," Appell says. "**The House bill achieves those goals,** and NPPC is pleased to offer its support for the Farm, Nutrition, and Bioenergy Act of 2007."*

VII. CONCLUSION

Our businesses have one of the largest investments in the pig industry in Australia. We have always felt the opportunity for success and growth was available for those who ran their businesses efficiently. We feel we have done this with increased investment, improved technology and resource commitment - but the recent events surrounding Import volumes are beyond our control and put serious questions in our minds as to why we should continue at all, or at the very least consider reducing our size and commitment.

We need some level of relief with time for the industry to restructure. The consequences of an unstructured exiting of the industry both in terms of the social affect on those exiting and losing their businesses in a crisis situation, as well as the huge risk of "overshooting" our industry restructure targets, will create turmoil.

Import levels, with no upper limits, are creating havoc in an already cyclical industry. When combined with monopolistic power of the key supermarket chains (unique to Australia in the degree of influence they have), we are in a squeeze that is creating chaos in our industry. Every other country gives some reasonable protection to its agriculture industries, especially when;

- It can be competitive IF on a level playing field
- There are reasonable reasons/rationale for protection.
- It is a major employer **in rural economies** that are crying out for employment.
- The damage that will be incurred to producers and processors almost certainly cannot be reversed due to the combined impact of high cost special purpose facilities, difficulties of regaining skilled labour in rural communities once it has left, and the long lead times and large working capital needs to get back into the industry.
- There are clear reasons for the government to consider a safeguard action.

I would be happy to talk about any of these points further to the Commission and can be contacted at 0421 072 779 or by email at rod@austporkfarms.com.au.

Additionally, I or someone from our group would be happy to further address the Commission if required. We would like to attend and/or present to the Commission in the public hearings scheduled for December 2007. Our preference is to attend a meeting in Adelaide.

Rod Hamann

CEO Australian Pork Farms Group