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31 October, 2007

Editor's Monthly Summary

This month commodity price movements and international supply levels pretty much reflected those recorded in September. The only increase of significant note was casein prices, which increased in value from USD12000 per tonne over the month of October to trade at USD12600 per tonne. Despite the strengthening of the NZD against the USD particularly over the past fortnight, price increases in key components of our Dairy Index resulted in the Index increasing in a similar manner to last month to currently track at 1360.

Following on from our guest commentary last month by Paul Brown, this month Chris Lewis from Baker & Associates has provided our commentary piece entitled "The Future Direction of Stock Prices". In his article Chris investigates the interesting situation developing around current high dairy cow prices, and the potential business risk and opportunities for farmers that this situation is creating.

Rachael Cross

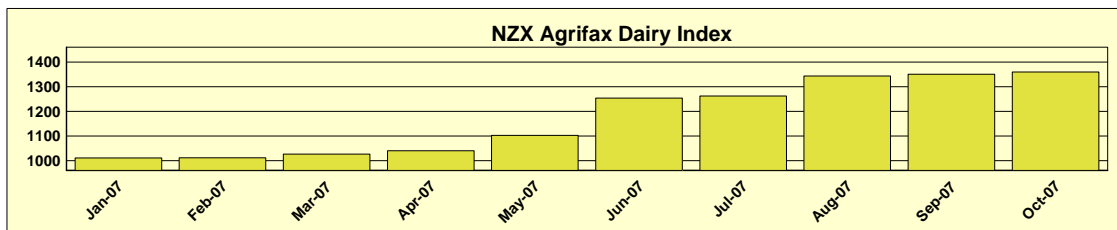
If you have any comments or suggestions for our monthly Dairy Report please tell us about them on +64 4 495 2807 or at info@nzxagrifax.co.nz

I The NZX Agrifax Dairy Index

	<u>This month</u>	<u>Last month</u>	<u>6 months ago</u>	<u>One year ago</u>
Overall Index	1360	1351	1040	992
Land	222	222	186	189
Stock	36	33	21	20
Fonterra Shares	41	41	40	40
Payout	352	352	204	197
Commodity	263	259	186	124
Exchange rate	139	144	142	161
Industry Shares	305	299	262	260

The NZX Agrifax Dairy Index base line is 1000 on January 1, 2007

The Dairy Index gained a further 9 points this month to reach 1360. Increased Index component values were recorded for dairy cows, commodity prices and dairy industry share values. These increases more than offset any negative effect the stronger NZD has had on the Dairy Index this month.



Notes on Index : The NZX Agrifax Dairy Index comprises of the 5 key elements making up NZ's dairy industry: farm capital (25%), farm income (20%), commodity prices (15%), exchange rate (15%), and the share prices of NZ traded equities involved in the dairy industry (25%). The Index had a base level of 1000 on January 1st, 2007.

II Dairy Index Components

a Dairy Commodity Market

The weighted average price for dairy commodities has increased slightly over the past month in USD terms. Positive price movements for butter and casein were offset by weaker skim milk powder prices. Whole milk powder and cheddar prices have remained relatively stable over the past month.

Production levels in the US are currently 3.1% ahead of the previous year for the period from July to September. Increased US production, lower domestic product prices and a weak currency have resulted in increased volumes of US product being offered onto the world markets. This has negatively affected world prices in the cheddar and powder markets.

As US cheddar has a higher moisture content and is a different colour to standard export cheddar, manufacturers do face some barriers when they switch to US produced cheddar. However, current price differentials are significant enough to encourage buyers in markets such as Asia, to purchase cheddar from the US instead of from traditional cheddar exporting countries such as New Zealand and Australia. There have also been reports that Australia is now also importing cheddar from the US due to the current prices. We expect cheddar prices to continue to steadily increase over the next few months and remain firm for the remainder of the current Southern Hemisphere production season.

Powder prices have weakened slightly over the past month, but recent trends indicate prices have stabilised. Production in the Northern Hemisphere is heading towards seasonal lows and production in Australia is hampered by drought, so we do not expect powder prices to fall much during the current season.

Commodity Prices

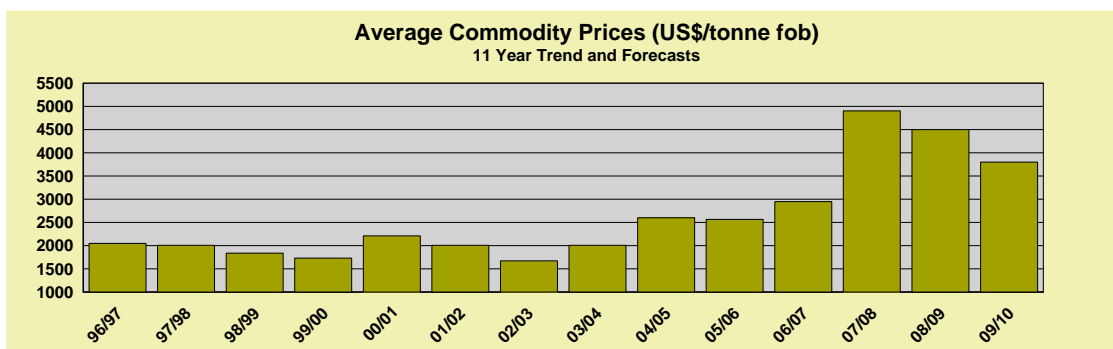
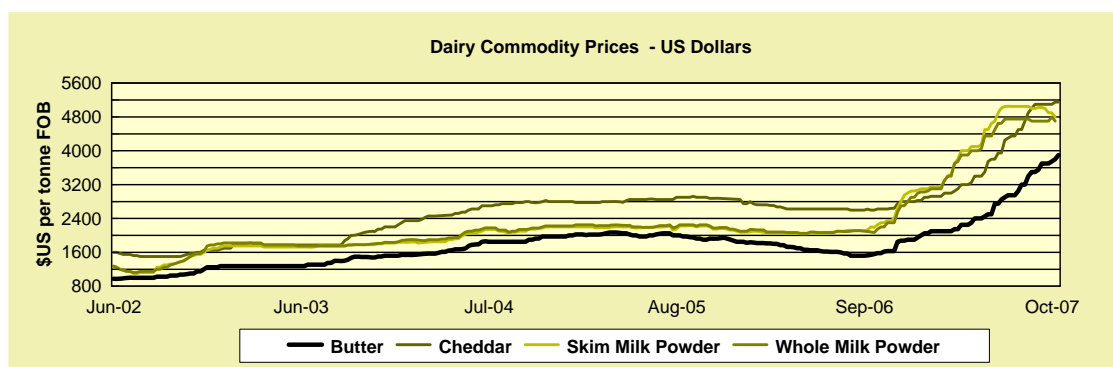
NZ Currency

	Last Week	4 wks ago	3 mths ago	1 yr ago	2 yrs ago
Butter	5130	4900	3970	2470	2720
Skim Milk	6310	6490	6570	3500	3110
Whole Milk	6180	6220	6180	3350	3150
Cheddar	6770	6750	5850	4000	4070
Casein	16570	15890	15600	9590	9910
Weighted Average Spot Price	7009	6951	6527	3820	3778

US Currency

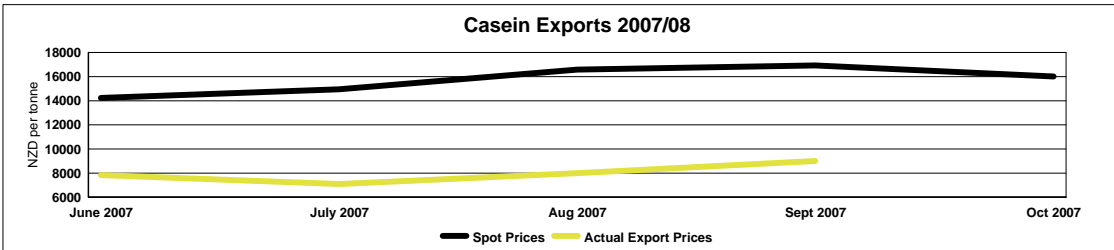
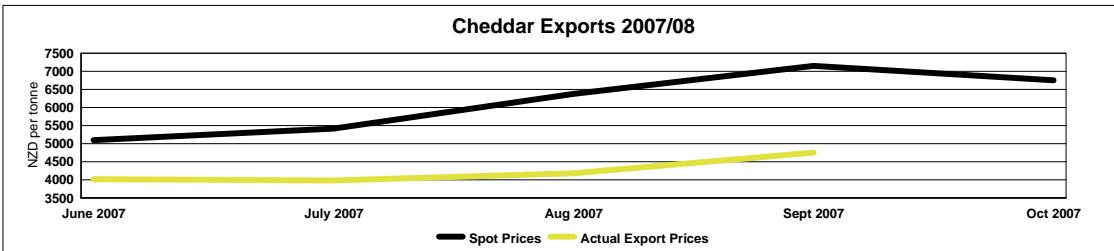
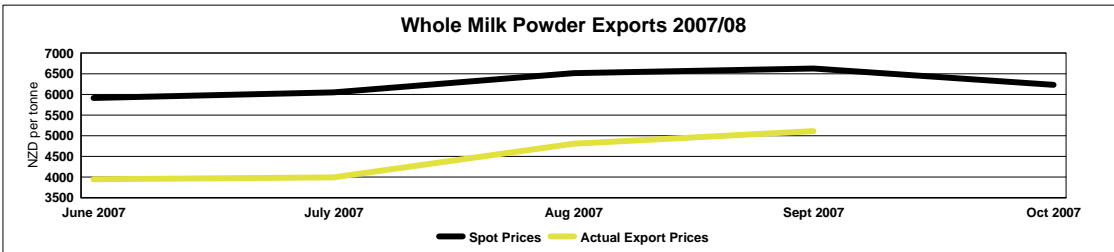
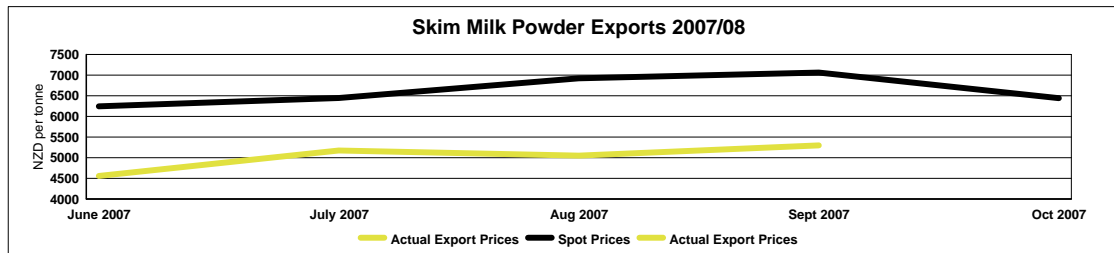
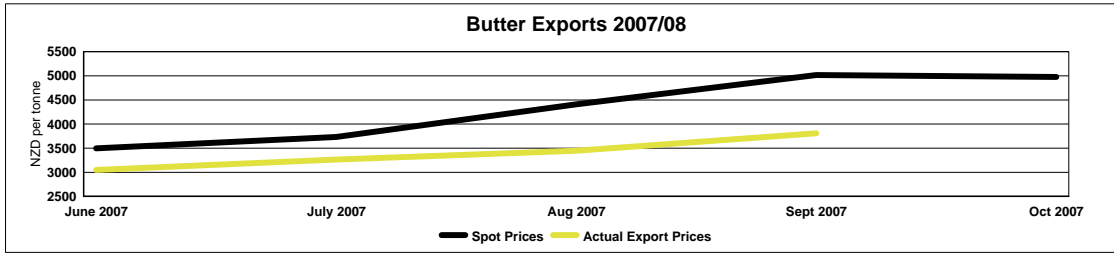
	Last Week	4 wks ago	3 mths ago	1 yr ago	2 yrs ago
Butter	3900	3700	3050	1620	1925
Skim Milk	4800	4900	5050	2300	2200
Whole Milk	4750	4700	4750	2200	2225
Cheddar	5150	5100	4500	2625	2875
Casein	12600	12000	12000	6300	7000
Weighted Average Spot Price	5330	5250	5020	2510	2670

Prices are indicative only. They are compiled from an assessment of sales made worldwide on a one-off basis. Quota Markets and contracts are excluded.



a Dairy Commodity Market (continued)

The graphs below show the actual export prices for each of our dairy commodities (as obtained from Stats NZ) versus the average monthly spot prices. As most goods are sold under a three or six month contract, there tends to be a lag in the transfer of spot price increases through to actual returns. Due to recent shortages of product, spot prices have tended to be higher than contract prices.



Actual Export Prices are obtained from Stats NZ figures. Provision of these figures is a month after the end of each period, hence why the above graphs are not updated to the current month. Spot prices are obtained directly from Dairy Companies by NZX Agrifax.

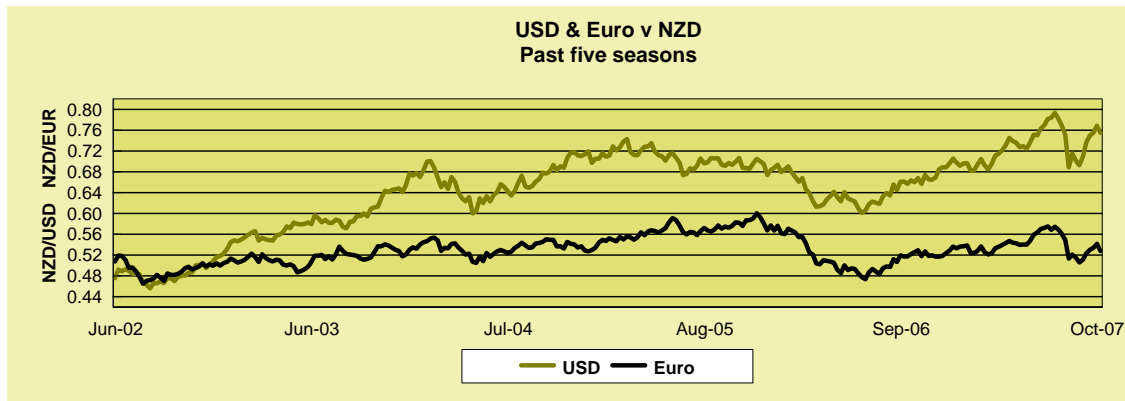
b Exchange Rates

The Official Cash Rate remains at 8.25% p.a. following the RBNZ announcement on Thursday. The impact on the dollar was negligible as this was expected by the market. However, most economists believe that interest rates will rise next year.

A high inflation rate in Australia is causing concern that the Australian Reserve Bank will raise their cash rate to 6.75% on November 7. The narrowing interest rate differential between Australia and New Zealand has seen the NZD fall over the week against the AUD. The NZD is likely to be pulled higher by the stronger AUD, which earlier this week reached 92.72c against the greenback, its highest level since 1984.

Analysts predict the US Federal Reserve will cut interest rates tomorrow in a bid to stop further deterioration of the housing sector and to prevent the US going into economic recession. This has led to a weaker USD against the Euro and all other major currencies. The continuing strong appetite for carry trades along with the weak USD continues to haunt the NZD. Over the past two weeks the NZD has dipped just below 74c. It has since recovered to around the levels seen two weeks ago and is currently trading at 76.5c at the time of writing.

Currency	Last Week	3 mths ago	1yr ago	This Season to Date affects 08/09	Last Season to Date affects 07/08
NZD/USD	0.76	0.77	0.66	0.75	0.67
NZD/EUR	0.53	0.56	0.52		
TWI	0.71	0.74	0.66		



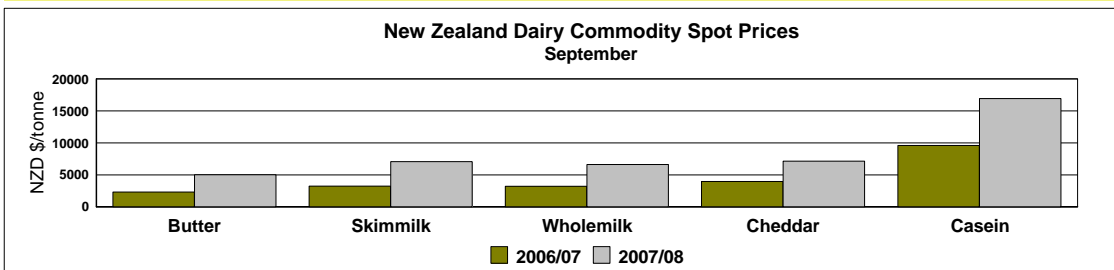
Forex Projections to 2009

These are based on current projections of 10 major banking organisations.

		2007 Q4	2008 Q1	2008 Q2	2008 Q3	2007	2008	2009
NZD/USD	Mean	0.75	0.73	0.72	0.71	0.75	0.72	0.71
	Range	0.7 - 0.78	0.68 - 0.8	0.67 - 0.81	0.65 - 0.81	0.7 - 0.78	0.67 - 0.8	0.64 - 0.78
	Standard Deviation	0.02	0.03	0.04	0.05	0.02	0.05	0.04
NZD/Euro	Mean	0.52	0.51	0.51	0.51	0.52	0.50	0.52
	Range	0.49 - 0.56	0.45 - 0.53	0.44 - 0.53	0.43 - 0.54	0.45 - 0.53	0.42 - 0.52	0.48 - 0.53
	Standard Deviation	0.02	0.03	0.03	0.04	0.02	0.04	0.05

Dairy Commodity Export Volumes & Values

	Sept 2007			2007/08 Season to Date		
	NZD Millions	Tonnes	NZ\$/tonne	NZD Millions	Tonnes	NZ\$/tonne
Butter	83	21,822	3,810	244	71,522	3,413
Skim milk Powder	70	13,230	5,300	260	51,857	5,012
Whole milk Powder	267	52,302	5,114	606	134,589	4,502
Cheddar	91	19,101	4,755	366	87,041	4,208
Casein	88	9,740	9,006	317	39,946	7,932



c Dairy Company Payout

Our prediction for the current season's payout of \$6.87 per kg MS is basically unchanged from last month. The stronger NZD will have a dampening affect, but dairy companies will have put hedging policies in place which will reduce the effect the stronger NZD will have on the current season's payout. Another area of uncertainty lies around the effect that any capital restructuring of Fonterra will have, if any, on the company's payout.

Dairy commodity prices have strengthened slightly over the past month, in USD terms. As the season progresses and more product is sold, greater certainty is established around the average commodity price obtainable for the current season. In our analysis modelling the higher average commodity price has offset the effects of the stronger NZD on the payout.

Next season commodity prices are expected to weaken a little due to consumer resistance. This combined with a stronger NZD, which looks here to stay, has resulted in a \$6.20 per kg MS payout prediction for 2008/09. This level of payout is still extremely strong compared with long term averages.

By the time we reach the 2009/10 season, production systems worldwide will have reacted to the current high price signals and supply levels are predicted to increase. Commodity prices at this time will depend on worldwide growth in demand. If demand growth slows and supply levels increase then commodity prices and payouts could fall significantly.

Payout Predictors

2007/2008 Season						
Season to Date		NZD/USD Exchange Rate				
Weighted Average Prices		0.680	0.700	0.720	0.740	0.760
USD per tonne FOB	Change					
4290	-15%	6.20	6.03	5.86	5.71	5.57
4550	-10%	6.56	6.38	6.21	6.05	5.89
4800	-5%	6.91	6.72	6.54	6.37	6.20
5050	0%	7.26	7.06	6.87	6.69	6.52
5300	5%	7.61	7.40	7.20	7.01	6.83
5560	10%	7.97	7.75	7.54	7.34	7.15
5810	15%	8.32	8.09	7.87	7.66	7.47

2008/2009 Season						
Current		NZD/USD Exchange Rate				
Weighted Average Prices		0.680	0.700	0.720	0.740	0.760
USD per tonne FOB	Change					
3210	-40%	4.73	4.60	4.49	4.37	4.27
4010	-25%	5.82	5.66	5.52	5.38	5.24
4550	-15%	6.56	6.38	6.21	6.05	5.90
5080	-5%	7.28	7.08	6.89	6.72	6.55
5350	0%	7.65	7.44	7.24	7.06	6.88
5620	5%	8.02	7.80	7.59	7.39	7.21
6150	15%	8.74	8.50	8.27	8.06	7.86

2009/2010 Season						
Current		NZD/USD Exchange Rate				
Weighted Average Prices		0.650	0.670	0.690	0.710	0.730
USD per tonne FOB	Change					
3210	-40%	4.88	4.75	4.62	4.50	4.39
3750	-30%	5.64	5.48	5.33	5.19	5.06
4280	-20%	6.38	6.20	6.03	5.87	5.72
4820	-10%	7.13	6.93	6.74	6.56	6.39
5080	-5%	7.49	7.28	7.08	6.89	6.72
5350	0%	7.87	7.65	7.44	7.24	7.05
5620	5%	8.25	8.01	7.79	7.59	7.39

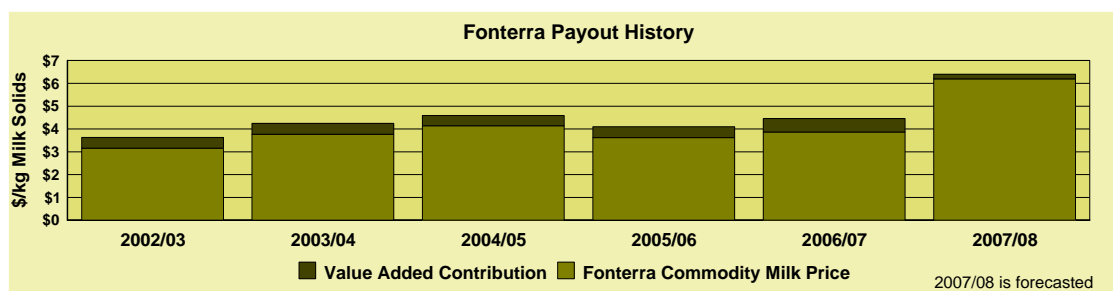
Notes on Payout Predictors

1. The predicted payout is based on the average season to date product prices for this season and the current spot prices for future seasons.
2. Allowance has been made for the increasing level of value added products and improved processing and administrative efficiency.
3. The boxed areas are focused on Fonterra's likely USD exchange conversion rates and probable product price ranges.

d Dairy Company Information

Payout	Forecast 2007/08	2006/07	2005/06	2004/05	2003/04	2002/03
Fonterra	6.40	4.46	4.10	4.59	4.25	3.63
Westland	6.25 - 6.40	4.58*	4.09	4.47	4.07	3.80
Tatua	n/a	4.10	4.35	4.32	4.39	5.60

* Excludes colostrum payments

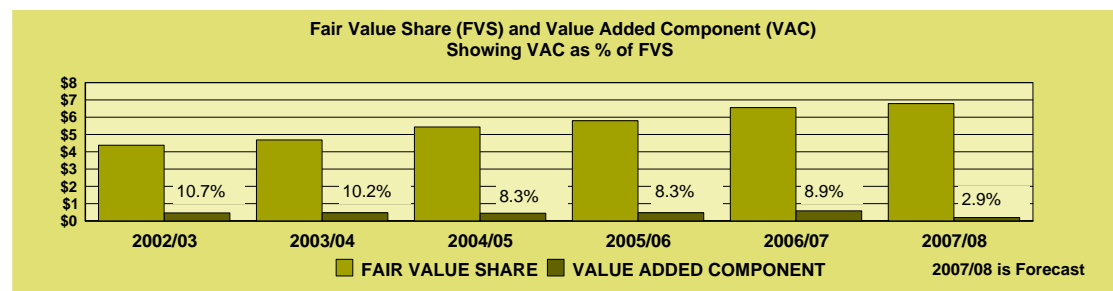


Dairy Processing Companies Share Price

	Current	June 06	June 05	June 04	June 03	June 02
Fonterra	6.79	5.80	5.44	4.69	4.38	3.85
OCC	2.70	2.26	n/a	n/a	n/a	n/a
Westland	1.50					

Dairy Industry Companies Share Price

		Current	Previous Mth	Nov 06	May 06
NZX	PGW	2.03	1.85	1.61	1.95
	DEL	0.44	0.43	0.40	0.43
	AFFCo	0.36	0.38	0.37	0.38
	Allied Farmers	1.63	1.60	2.17	2.40
NZAX	LIC	1.77	1.66	1.70	1.34
	A2	0.23	0.27	0.08	0.09
UNLISTED	Tasman Farms	1.10	1.05	0.67	0.41
	OCC	2.55	2.70	2.40	2.25
	Kaimai Cheese	2.71	2.70		



Dairy Industry News In Brief

-After enduring tough operating conditions during most of 2006/07, PGG Wrightson was now firmly on the front foot, said chief executive Barry Brook. "We are now firmly established on the world stage with significant operations in Australia and South America."

-Craig Norgate - one of the brains behind the merger of Pyne Gould Guinness and Wrightson back in 2005 - took over as chairman of the listed rural services supplier, PGG Wrightson, at its annual meeting in Auckland on Monday.

- Affco livestock general manager Athol Murray is to retire after 43 years in the meat industry, the first 12 with Wilson Meats, followed by 31 with Affco.

-Dairy Equity Limited (DEL) announces its first Annual Audited Result for the year ended 31 August 2007, a year in which it made an after tax profit of \$1.28m.

-A2 Corporation Limited (NZAX: ATM) ("A2C") announced today it has executed an exclusive licensing agreement with Lotte Milk to launch fresh a2 Milk™ in the South Korean market. Lotte Milk is one of the five largest dairy companies in South Korea with a wide range of fresh milk, yoghurt and other dairy products.

-OCC made a profit after tax for the year ended may 2007 of 1,947,383 from 913,254 in 2006.

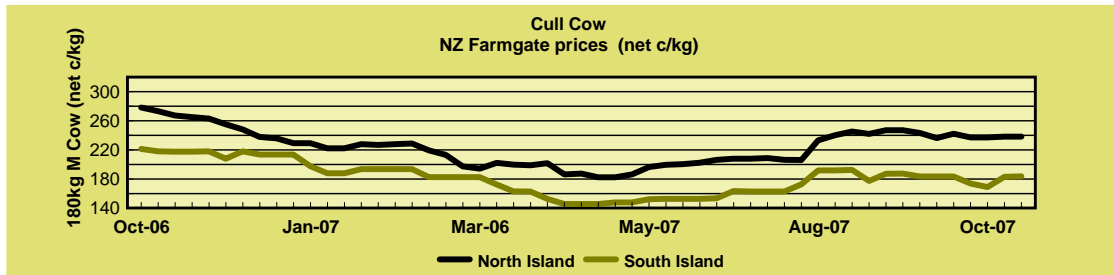
-Fonterra is set to outsource some IT jobs to India as part of a strategy to cut costs and lift efficiency.

e Stock Prices

	Delivery	Northern NI	Southern NI	Northern SI	Southern SI		NZ Range	NZ Average
Herds BW>100	June 1st	\$2300 - \$2500	\$2200 - \$2600	\$2300 - \$2600	\$2300 - \$2700		\$2200 - \$2700	\$2450
Herds BW<100	June 1st	\$2000 - \$2300	\$1850 - \$2300	\$2300 - \$2600	\$2250 - \$2400		\$1850 - \$2600	\$2240
Budget Cows	June 1st	n/a	\$1200 - \$1400	\$1200 - \$1500	\$1300 - \$1500		\$1200 - \$1500	\$1330
In Milk Cows	Immediate	\$1000 - \$1500	\$900 - 1600	\$1500 - \$2000	\$2000 - \$2000		\$900 - \$2000	\$1590
Carry Over Cows	June 1st	\$1300 - \$1500	\$1600 - \$2100	\$1300 - \$1500	\$1500 - \$1800		\$1300 - \$2100	\$1580
In Calf R2 hrs	May 1st	\$1600 - \$1800	\$1600 - \$2000	\$1800 - \$1900	\$1900 - \$2200		\$1600 - \$2200	\$1840
In Calf R2 hrs	Immediate	\$1100 - \$1200	n/a	\$1300 - \$1600	\$1400 - \$1600		\$1100 - \$1600	\$1380
R1 Heifers	June 1st	\$1000 - \$1100	\$1200 - \$1500	\$1100 - \$1200	\$800 - \$1000		\$800 - \$1500	\$1130
R1 Heifers	Immediate	\$700 - \$900	\$500 - \$1000	\$700 - \$800	\$700 - \$800		\$500 - \$1000	\$810

Beef Prices

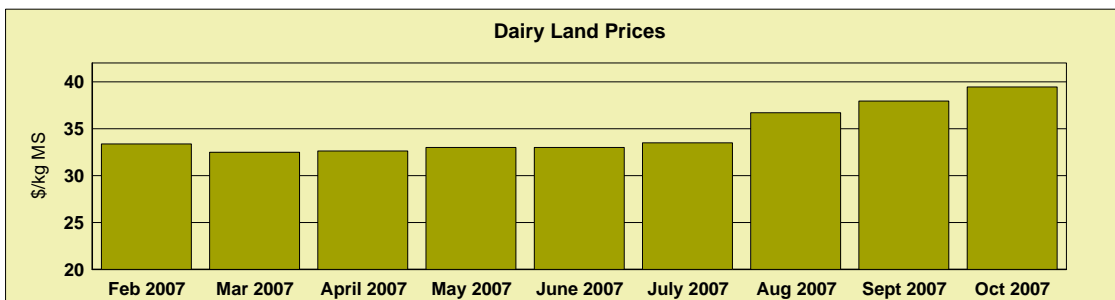
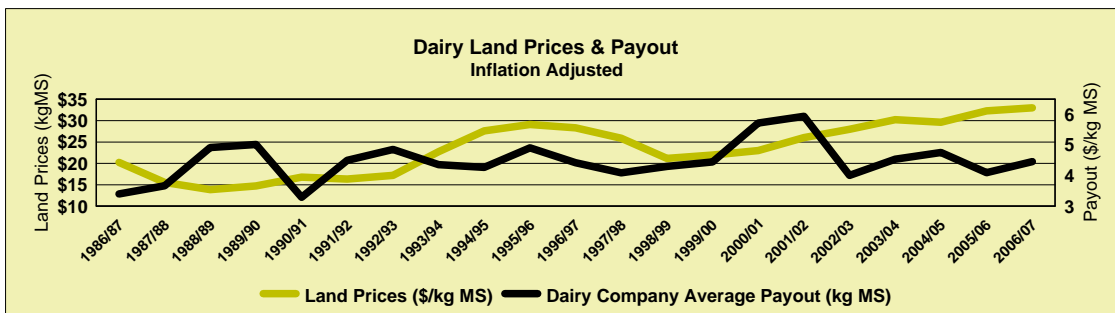
	This Week	Last Week	4 Wks ago	3 Mths ago	1 Year ago
Farmgate Prices (net \$/head)					
North Island					
Weekly Beef Kill (*000)		3.7	2.7	4.7	3.9
150 kg M Cow	347	347	353	339	407
200 kg M Cow	462	462	470	452	542
South Island					
Weekly Beef Kill (*000)		0.5	0.4	0.4	0.9
150 kg M Cow	270	268	269	282	326
200 kg M Cow	359	358	359	376	435
US Manufacturing Prices					
Imported Cow		123.5	125	126	131
Imported Bull		133.5	136.5	140	138



f Dairy Land Prices

	Northern NI	Southern NI	Northern SI	Southern SI	NZ Average
Average \$ per Kg MS *	\$50.00	\$43.00	\$30.80	\$34.00	\$39.45
Range	\$45 - \$60	\$35 - \$47	\$23 - \$31	\$30 - \$40	\$23 - \$60

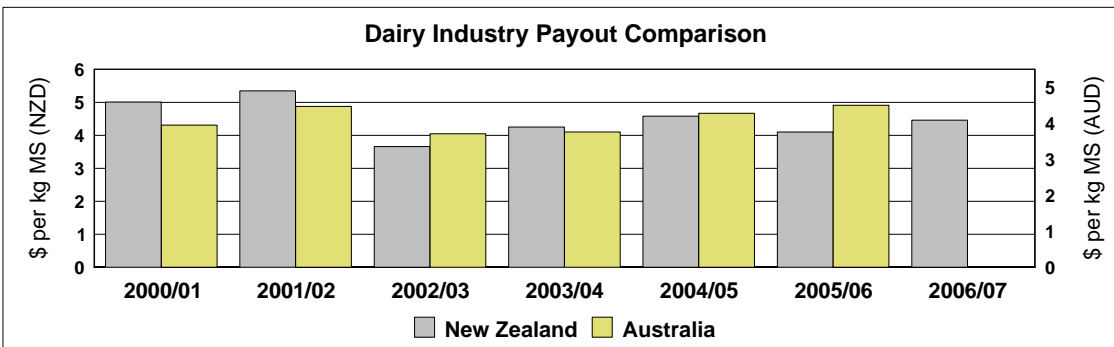
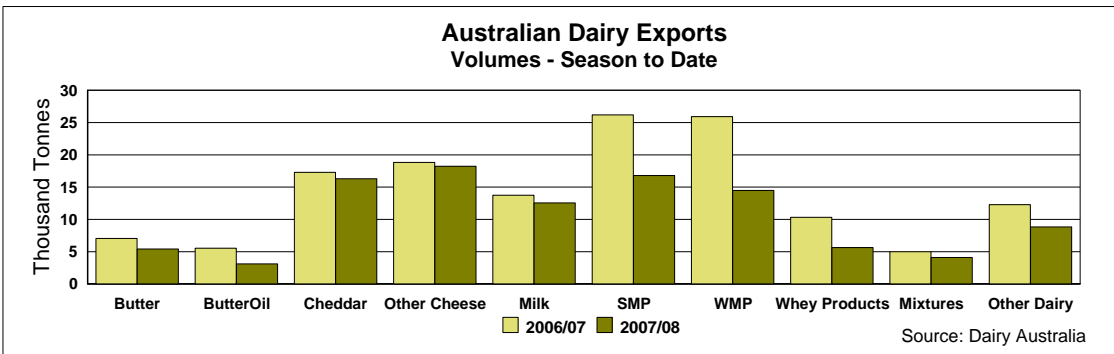
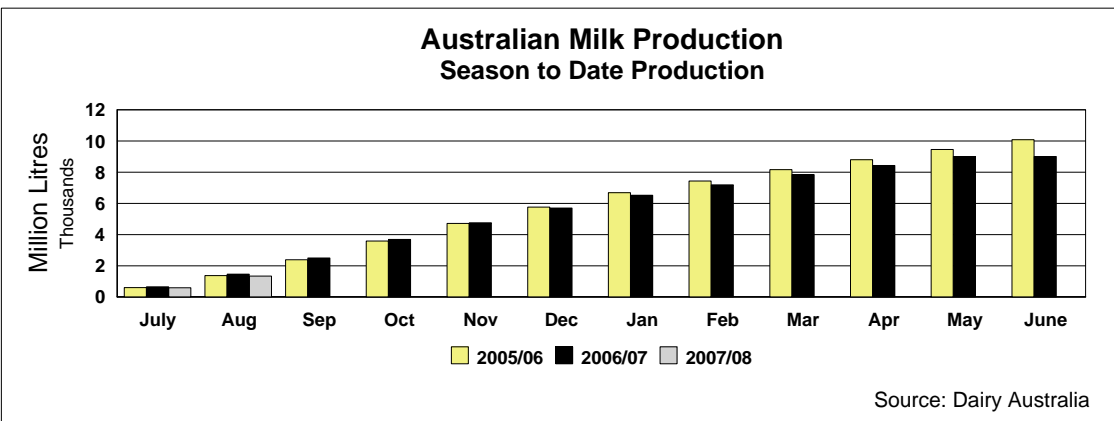
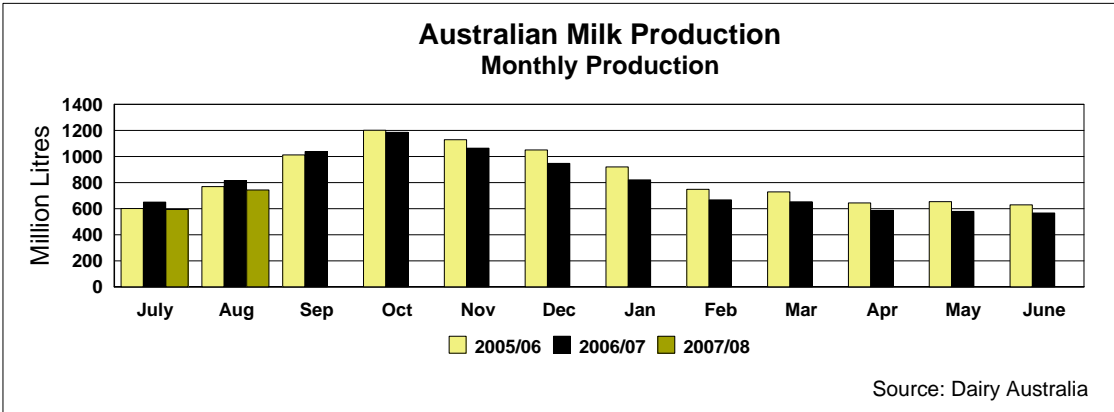
* Land Prices include the value of Fonterra shares



III Australian Dairy Industry

Facts at a Glance for the 2006-07 Season

	New Zealand		Australia	
	2005/06	2006/07	2005/06	2006/07
Annual Milk Production (million litres)	14,702	15140 est	10,092	9578
National Dairy Herd (million cows)	3.83		1.99	
Milk Production per Cow (litres)	3,763		5,034	
Average Herd Size (number of cows)	325		224	
% of Milk Production Exported	95%		50%	



IV Guest Commentary

Chris Lewis is a partner and dairy consultancy specialist with Baker & Associates, farm consultants and valuers based in Masterton and Southland.



If you would like to provide guest commentary in future editions of the NZX Agrifax Dairy Report please contact Rachael Cross at rachael.cross@nzxagrifax.co.nz

Future direction of Dairy Stock Prices

Following last months guest commentary (Paul Brown from South Island Dairy Farmers) I felt it appropriate to provide a longer term scenario from a dairy consultant's perspective.

I am concerned that the current spike in payout and dairy livestock prices will generate poor allocation of resources and potentially dangerous business decisions.

The demand for in-calf cows has a number of drivers. High empty rate in the national herd, live shipments of heifers to China and now the surge of conversions in the Central Plateau and Southland.

This is a good time to sell cows. Conversely it is a bad time to buy cows. As a result we will see significant shifts in livestock and farm ownership, and human resource changes with business risk increasing over the next three years.

In two years time cow values will fall, regardless of the payout. This is a simple interaction between supply and demand. This spring a large number of dairy heifer replacements were reared, some of dubious parentage. These will all be mated next season to calve in spring 2009.

An empty dairy cow (not pregnant) might sell for \$500, but the same animal in-calf on current market prices will sell for around \$2,500. In response empty cows have been retained to get back in-calf for another season. Farmers have indicated that the bulls will be left out longer to ensure there are more cows to sell in-calf at the end of the season, known as the "budget cow market".

It will take two years for the cycle to complete. In the 2008 season demand will stay relatively high because of the time required to build and develop conversion farms. The demand for genuine herd replacements, not budget cows will still be strong.

In 2009 the "surplus" calves from 2007 will hit the market as will any further increase in budget cows. At some stage in the 2009-2010 season an over supply situation will occur and the value of a dairy cow will not be determined by her pregnancy status but her cull (beef) value. Unless there is an unprecedented rise in the beef schedule cows will return to a value of around \$1,000 to \$1,500, in-calf.

What are the implications?

50:50 sharemilkers with contracts concluding this season (or next) would have to seriously consider selling their cows. After all how many times in their career will there be a chance to at least double their equity?

Farm owners will be looking for replacement 50:50 sharemilkers, and who is going to buy cows and run these farms with this potential for downside on the cow values?

The "exiting" 50:50 sharemilker may not be lost to the industry. They may swap the cows for a dairy land investment (equity partnership), and achieve a goal that was otherwise out of reach.

Alternatively they could make a temporary change to take a managerial or negotiable order (no ownership of livestock) sharemilking position, then take their chances in two seasons that they could buy back a herd at a lower cow price and get a new 50:50 sharemilking position.

For dairy farm owners thinking about getting out of dairy farming the good cow prices might be just the incentive to cash up. However the decision to sell land right now is not so easy. This asset sale could represent the culmination of someone's lifetime of effort, naturally they want the best possible deal. We don't know what prices dairy farms will peak at.

Shareholding is now an integral part of the business assets. Fonterra's restructuring proposal to be released later in November could have a substantive impact on value and strategy for managing industry shareholding.

There are bound to be a large number of farmers ready to sell but sitting back and waiting to see what impact this restructuring will have on the share value and the overall value of their farm.

There has to be real concern if financiers are supporting the purchase of cows at \$2500(+) now and worth 50 % less in two years time. The impact on the balance sheet will be significant especially for those who have purchased land or cows at inflated values.

Care is needed in the dairy industry that the heart does not rule the head. For some there are some very real business investment opportunities. For others it might be an opportunity to realise that investment.

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