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Australia's Sugar Industry: Sweet or Sour?

The status quo

Approximately 95% of sugar produced in Australia is grown in Queensland. Over 80% of this sugar is exported as bulk raw sugar, making Australia the world's second largest raw sugar exporter.

This means that international competitiveness is a focal point of the Australian sugar industry. Prior to deregulation of the Queensland sugar industry on 1 January 2006, all raw sugar produced in Queensland was collectively sold through a 'single desk' arrangement operated by Queensland Sugar Limited (QSL).

Since that date, QSL has entered into voluntary agreements with seven Queensland millers to market their export raw sugar, making QSL responsible for over 90% of raw sugar exported from Australia. Mills not contracted to QSL have been marketing their sugar independently.

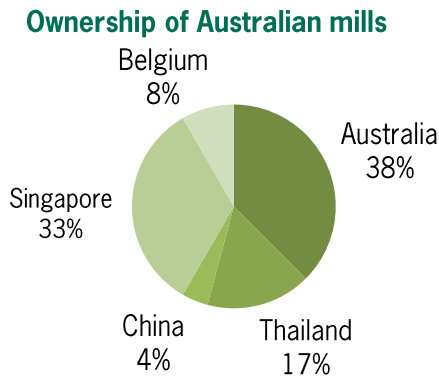
Proceeds from QSL's export sales are pooled. QSL then deducts its marketing costs and distributes the balance to its owners, being the millers and growers. Due to the pooling of proceeds, producers receive an average of the actual sale prices.

QSL uses its bulk marketing power to leverage better deals for Australian sugar on the international market. The return to producers is mainly determined by the world futures price of sugar; however other influential factors include the Australian dollar, regional sugar premiums, marketing costs and transportation costs.



Changes ahead

In recent years, large international commodity trading groups have been highly acquisitive of milling assets in Queensland and Australia generally, as detailed in the pie graph below (please note the level of production in each mill varies):



Source: www.canegrower.com.au

There has been a widely-held belief that, once existing marketing contracts with QSL expire, these businesses will independently market the sugar they produce. Singapore-based Wilmar Sugar has advised it will be exiting the voluntary QSL marketing arrangement in 2017. Thai-owned MSF Sugar and Tully Sugar, a subsidiary of Chinese-owned COFCO, have since served notice on QSL that they will be terminating their agreements at the end of the 2016 season as well.

Wilmar – the main player

Wilmar is one of the world's largest sugar traders with a global presence in key sugar markets. According to data collected by Wilmar, Wilmar achieved the following results over the 2012 and 2013 seasons in comparison to QSL:

- Wilmar traded and marketed twice the volume of sugar.
- Wilmar's net sugar price, including premiums, was \$45 per tonne higher, which would have increased the cane price by \$4 per tonne and increased growers' farm margins by over 50%.

- Wilmar's marketing premiums were 60% higher, which would have increased the realised sugar price by \$11 per tonne.

In 2017, Wilmar will terminate its existing arrangement with QSL and market its own sugar through a new marketing company (JMC). The JMC will be jointly controlled by Wilmar and Wilmar's growers. Additionally, every Wilmar grower will be a member of the JMC.

Wilmar believes establishing the JMC will offer its growers a range of benefits that are not achievable under the existing structure with QSL. These proposed benefits include:

- Better returns.
- Greater involvement in marketing and pricing decisions.
- More flexibility and security on grower advances.
- More pricing options; and
- Transparency of sugar marketing, premiums and costs.

Wilmar recognises the potential impact of its decision on both the Australian sugar industry and QSL, and believes QSL's future is largely dependent on decisions made by QSL and QSL's millers and growers. Wilmar has advised that the JMC will be able to accommodate sugar from other millers by commercial agreement.

Industry response

Canegrowers is a lobbying, representative and services group that represents the interests of Australian cane growers. Canegrowers believes growers want a system which ascribes them the right to choose how their sugar is priced and sold. Wilmar's proposal denies growers of this right and enables Wilmar to exercise its regional mill monopoly power to advance its interests above those of the growers.

If Wilmar were to leverage predatory pricing to undermine QSL, non-Wilmar growers would be forced to market either through Wilmar or independently. Canegrowers has quashed the benefits cited under Wilmar's proposal for the following reasons:

- There is no proof that growers will receive better returns. Even if greater returns were



generated, growers would not know whether or not they were receiving their rightful share of sales income.

- Growers will have no involvement in marketing and pricing decisions. The JMC will outsource the marketing function to Wilmar Sugar Trading (WST), a related company over which growers will have no control or influence.
- Increased flexibility and security on grower advances could be achieved under the existing structure if all parties were to agree.
- Better pricing options could be offered under the existing structure if Wilmar chose to do so.
- There will be no transparency of sugar marketing, premiums and costs because the books of the marketing company (WST) will not be open to the growers. The profits and losses associated with futures, foreign exchange and freight market hedges will be questionable, as will be the transactions within the Wilmar group of entities¹.

Government intervention

The decision of three dominant millers to market their own export raw sugar from July 2017 will result in QSL losing the majority of its critical export mass and competitive marketing advantage. This has created unprecedented angst in the sugar industry, prompting government intervention.

Queensland Agriculture Minister John McVeigh has initiated an investigation into potential legislative solutions and has requested action by the federal government under the Federal Competition and Consumer Act. In addition, the Agricultural Cabinet Committee will investigate if the current Sugar Industry Act 1999 can preserve the traditional practice of growers choosing where their economic interest in the sugar is marketed.

A senate inquiry has also recently been announced with their report expected to be presented by 27 November 2014.

¹ Canegrowers, Sugar Marketing: choice, rights and your future. Available from www.canegrowers.com.au [3 September 2014]

Under the inquiry's terms of reference, the Rural and Regional Affairs and Transport References committee will examine supply chain issues, foreign ownership impact and whether the current competition laws need to be strengthened².

Impact on stakeholders

Wilmar's foreshadowed move to commence its own marketing in 2017 and cease its involvement with QSL, has and will continue to have a, direct impact on the following stakeholders:

QSL and its employees and main contractors

- Standard & Poor has downgraded QSL's credit rating from "A long term" to "BBB minus" due to Wilmar terminating its marketing arrangements with QSL from 2016. QSL has indicated that the downgraded credit rating has restricted its ability to access cheap, short-term debt facilities. This has increased QSL's financing costs by approximately \$1,000,000³.
- Media reports suggest that QSL does not have a finance package in place with its main long-term financiers from 2017 onwards⁴.
- QSL currently employs approximately 160 people in a variety of areas including marketing, research, bulk storage and vessel loading operations. Employees and any contractors utilised for QSL's research, bulk storage and vessel loading operations may be affected if QSL's operations decrease from 2017.
- QSL charters approximately eighty vessels each year to export sugar internationally. A reduction in QSL's raw sugar exports may affect operators in the maritime industry because fewer vessels will be chartered.

² Queensland Country Life, *Inquiry announced on sugar's 'raw deal'*. Available from www.queenslandcountrylife.com.au [4 September 2014]

³ Queensland Sugar Limited, *Developments Queensland Export Sugar Industry fast facts*. Available from www.qsl.com.au [2 September 2014]

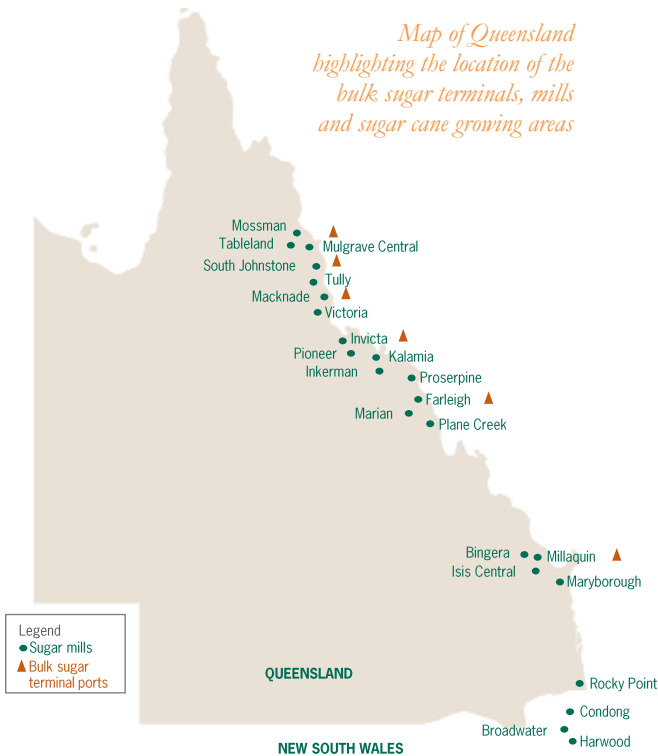
⁴ Dow Jones News Service, *S&P Downgrades Queensland Sugar To 'BB-/B'*. Available from www.newsadvisen.com [7 March 2014]; Green Pool, *Another miller pulls the pin on sugar export pool*. Available from www.greenpoolcommodities.com [29 June 2014]



Wilmar already has extensive infrastructure in place in relation to exporting sugar from other countries.

- QLS currently leases six bulk sugar facilities from Sugar Terminals Limited, the location of which are spread across the Queensland eastern coastline as detailed in the map below. A reduction in the quantity of sugar QLS is marketing and exporting may create uncertainty in relation to the longevity of the aforementioned leases.

Map of Queensland highlighting the location of the bulk sugar terminals, mills and sugar cane growing areas



Cane farmers

Canegrowers has indicated that one of the major impacts of millers using Wilmar's subsidiaries to market raw sugar will be the removal of a cane farmer's choice to market through QSL.

Cane farmers are concerned that a lack of competition for the marketing of raw sugar will result in lower prices for their sugar cane. Market research has demonstrated that the price of sugar cane is directly related to the price of raw sugar.

Sugar mill owners

Australia has twenty-four sugar mills that are owned by seven different entities. As Wilmar gains support from sugar millers, the smaller mill owners might be inclined to negotiate marketing arrangements with Wilmar as well.

Commercial Customers

If QSL and Wilmar compete in the same markets with the same product from 2017, then commercial customers may expect the increased competition will lower sugar prices in the supermarkets.

Financiers

As mentioned above, QSL's credit rating has been downgraded, which consequently affects QSL's ability to obtain cheaper short-term finance⁵. QSL's long-term financing requirements may need to be reviewed if an increasing number of millers terminate their marketing agreements with QSL. QSL currently offers its cane farmers short-term finance at relatively cheap rates by way of advance payments. If Wilmar does not provide this facility, then some cane farmers may need to restructure their short-term finance arrangements.

Assessing the future

Wilmar is a global trading company focused on maximising profits for its shareholders. Wilmar believes its global market intelligence and scale of operations in key international markets will enable it to generate better returns for both its growers and the company.

QSL is an industry-owned, not-for-profit entity. QSL believes an industry-agreed, grower-choice model will be competitive, innovative and fair for all millers and growers. Will Queensland have a sustainable sugar industry in 2017 and beyond? Time will tell.

⁵ Queensland Sugar Limited, QSL Update. Available from www.qls.com.au [30 September 2013]



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