‘Australia’ session at the Global Sugar Summit 2019

27 March 2019 - David Rynne, Director of Economics, Policy and Trade, Australian Sugar Milling Council

INTRODUCTION

Thank you for the opportunity today to bring you up to speed on Australian developments. Specifically I’d like to discuss three matters:

1. Our 2018 and likely 2019 performance
2. What we consider to be our enduring competitive strengths
3. Our proposed revitalisation strategy to ensure we can continue to harness these strengths.

SLIDE 1 - REVITALISING AUSTRALIAN SUGAR

SLIDE 2 – MILLING SNAPSHOT

- Australia’s sugar mills between June and November 2018 manufactured 4.7 million tonnes of raw sugar of which 85% was exported to mainly Japan, Indonesia and South Korea.

- This was 5 percent up on 2017 mainly due to higher CCS values (or sugar content in the cane) but tempered by lower cane volumes because of dry conditions.

- The Australian sugar industry is vitally important to the state of Queensland. Recent analysis demonstrates that it injected $4 billion into the Queensland state economy and employed around 23,000 people.

- There are also many regions in Queensland highly dependent on a prosperous sugar industry. The full economic contribution analysis can be found on our website and is part of our ASMC strategy to assist the industry earn and maintain its social licence to operate.

- Our 2019 cane production outlook is mixed. From Mackay and to the north, climatic conditions have been favourable and the cane is looking in reasonable condition. South of Mackay the cane is very drought impaired and we are expecting lower cane tonnes.

SLIDE 3 – OPERATING ADVANTAGES

- Australia is close to the lowest cost manufacturer of raw sugar globally. There are a number of reasons for this:

  (1) We don't receive any form of government subsidy assistance. Our exposure to intense global competition has spurred innovation and efficiencies in farming and milling practices

  (2) We have six storage terminals with 2.5 million tonnes of bulk storage capacity. The ability to export during favourable market conditions and supply year round to refinery customers is invaluable

  (3) Most mills are energy self-sufficient – also invaluable when the cost of Australian electricity purchased from the grid has almost doubled over the past 10 years

  (4) State and Federal Governments and the Industry injects $30 million per annum into applied R&D through Sugar Research Australia. This runs the industry's world class plant breeding program

(5) The dismantling of our antiquated single-desk marketing arrangements has fostered competition in marketing and innovative new pricing risk instruments for growers and millers and the direct relationships between customers and manufacturers has increased supply chain efficiencies

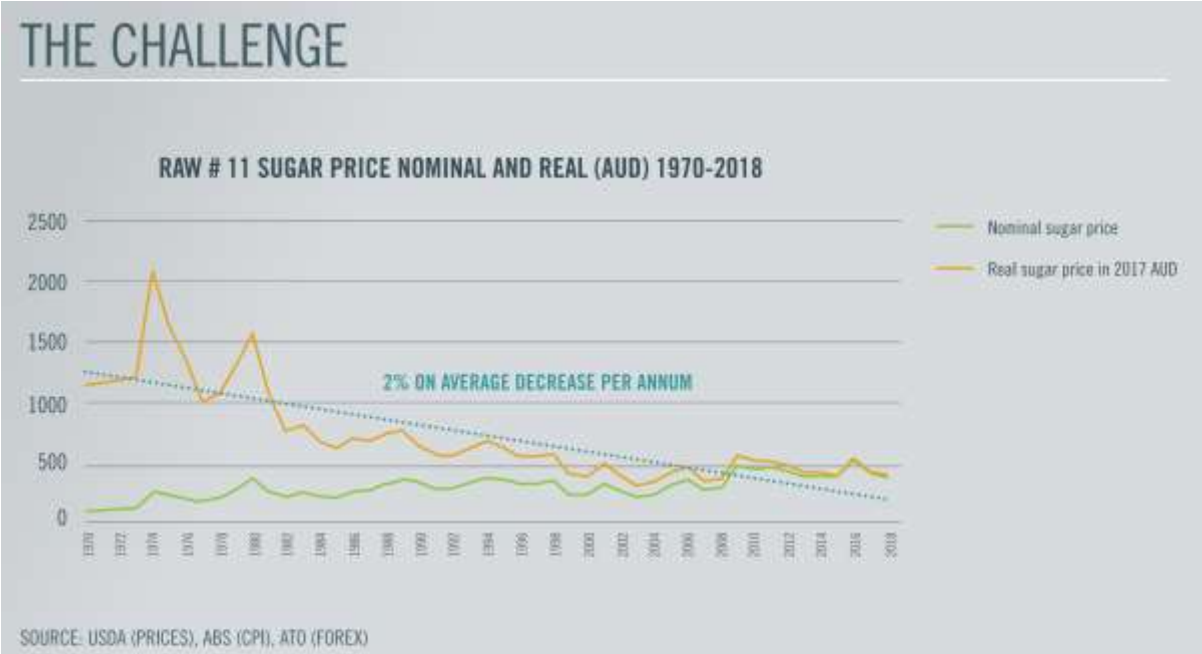
(6) Our proximity to burgeoning Asian markets and strong relationships has allowed the industry to take advantage of its freight cost advantage as well as tailor the sugar to the evolving needs of its refinery customers

(7) Our efficient rail infrastructure with 200 locomotives, 3,000 kms of rail and 4,500 cane bins has created very large efficiencies and cost savings.

(8) Significant foreign ownership has seen capital injection and renewal. The current binding, but conditional proposal of Nordzucker to move to a 70% shareholding in return for $120 million in equity and loans and some other conditions in the Mackay Sugar business offers hope for this business and the community.

SLIDE 4 – THE CHALLENGE

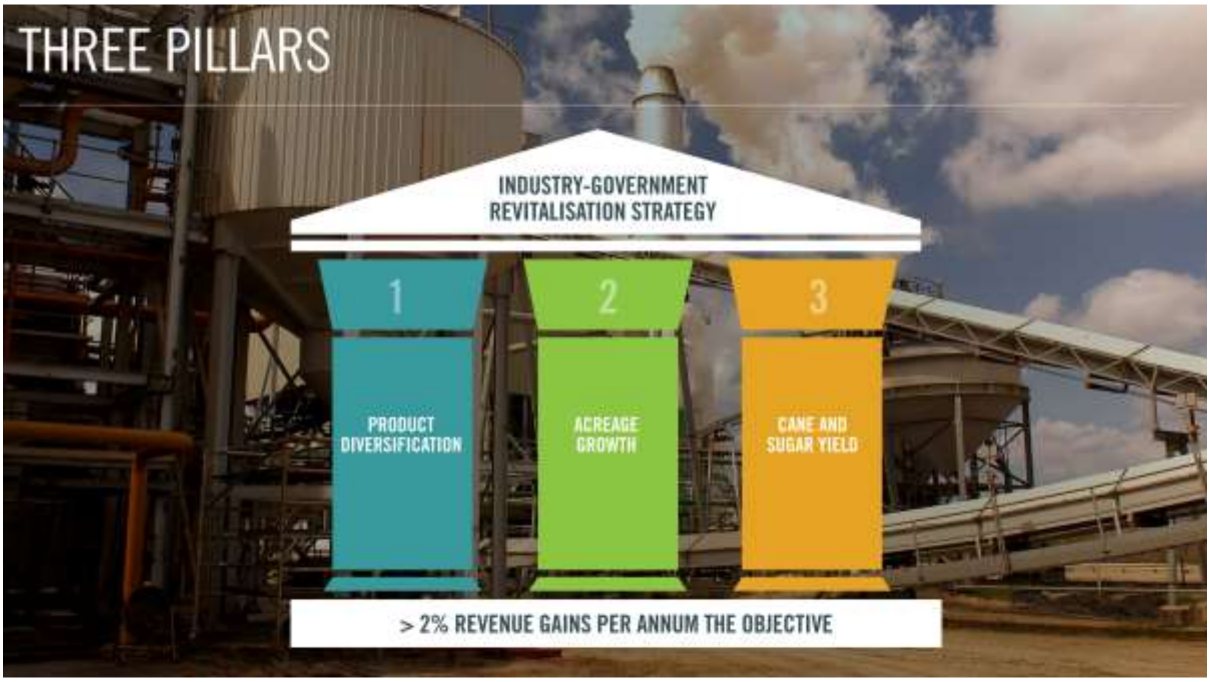
- We do however see a number of headwinds which will require us to consolidate our cost competitiveness and improve our resilience if we are going to operate profitability over the sugar price cycles and continue to earn investment capital from competing destinations.
- Global raw sugar prices have fallen in real dollar terms on average 2 percent per annum since the 1970s.
- Assuming constant commercial cane sugar (CCS) values, sugar prices, and exchange rates, this means milling revenues (i.e. production and productivity for these purposes) need to grow more than 2 percent per annum to improve profitability and maintain our competitiveness.



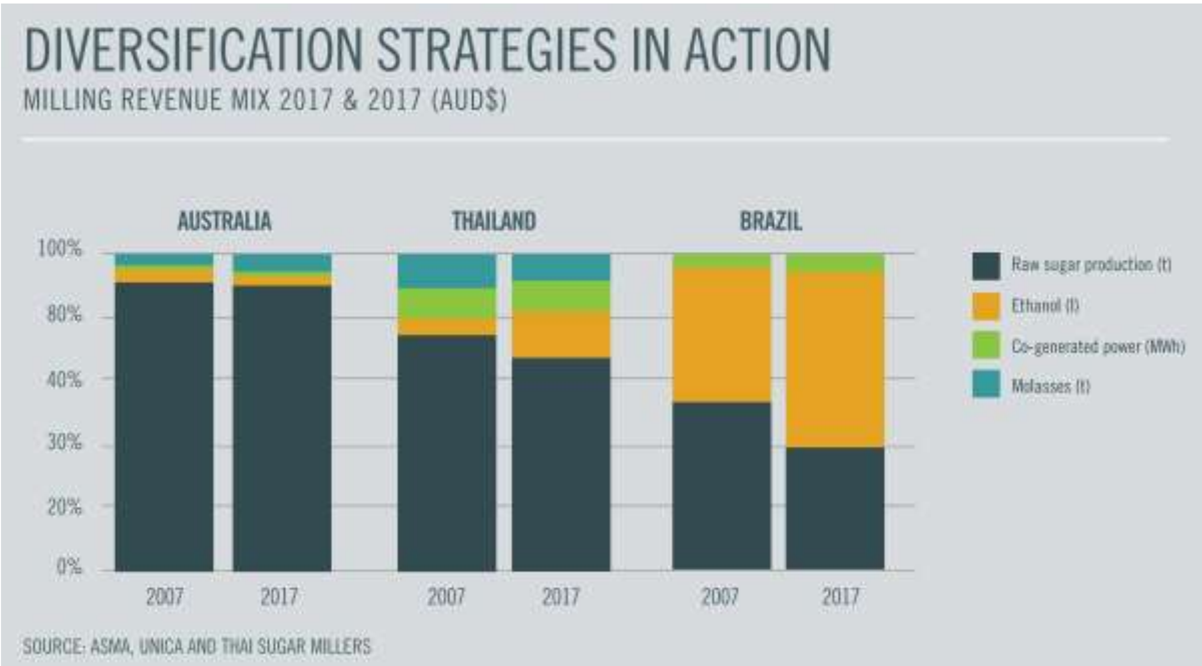
- Deteriorating terms of trade (output prices relative to input prices) is a common feature of competitive commodity markets and requires concerted industry and government effort in response.
- Our biggest competitors – Brazil and Thailand - are pursuing multiple strategies whereas Australia has no co-ordinated plan, and no strong supporting policy framework.

SLIDE 5 – THREE PILLARS

- Our board have coined the task as the "Revitalisation Agenda" – and there are three main pillars:
  (1) achieving more land under cultivation, be that cane or alternate crops for co-generation
  (2) improved sugar yields through a combination of improved cane per hectare and higher sugar content in the cane, and thirdly product diversification – be that diversified bio-energy, bio-chemicals, purity products or animal feeds.



SLIDE 6 – DIVERSIFICATION STRATEGIES IN ACTION



- It is worth the time to look at the success of Brazil and Thailand in diversifying risk, value adding and increasing revenues
- This chart looks at the change in the revenue product mix between 2007 and 2017 within the Brazilian, Thai and Australian milling sectors
- From our perspective, there are four developments of note:

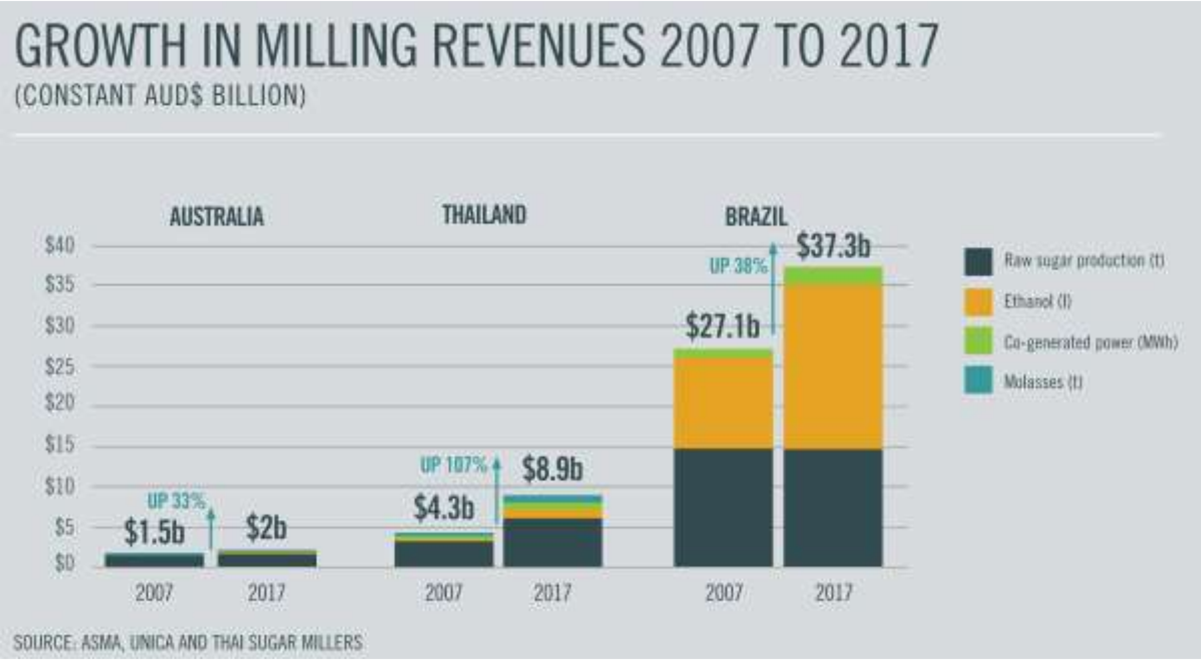
  (1) the relative move away from sugar by Thailand and Brazil

  (2) the relative increase in ethanol production by Thailand and Brazil

(3) the inability of all countries to substantially increase co-generation capacity and production

(4) bio-products remain in their infancy.

SLIDE 7 – GROWTH IN MILLING REVENUES 2007 TO 2017

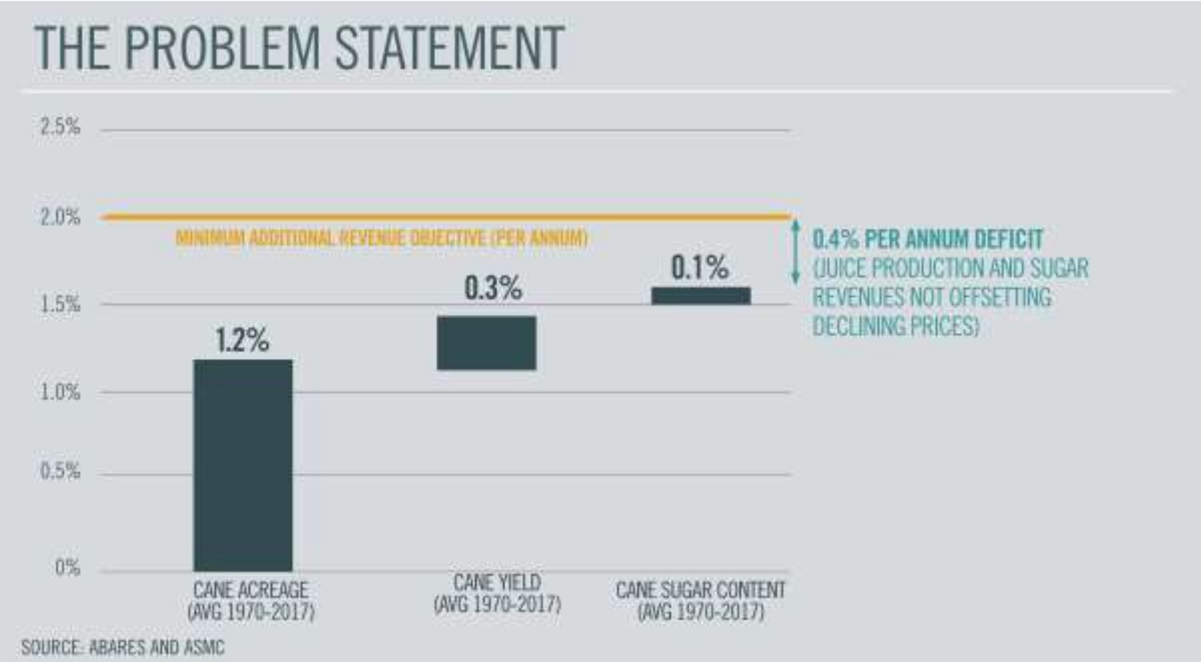


- The commercial strategies and policies of Brazil and Thailand are generating higher revenues for their respective milling industries. On a constant dollar basis, and again between 2007 and 2017, Thailand have increased revenues 107% and Brazil 38%.
- Despite the potential, the Australian sugar industry has not been able to substantially diversify its revenue base, mitigate risk and create arbitrage opportunities and there remains no real policy framework in place to support diversification.
- In 2017, 90 percent of the almost $2 billion in revenues earned by the Australian sugar manufacturing industry were derived from raw sugar production - of which 85 percent was sold into a highly competitive and distorted global raw sugar market. In the same year, only 5 percent of revenues were derived from molasses, 3 percent from ethanol and 2 percent from co-generated power.
- In comparison, Brazil can readily switch between sugar and various forms of ethanol production and Thailand is investing actively in value-added bio-product innovation and manufacture. Furthermore, both countries have supporting diversification strategies and policies in place.
- Through co-generation upgrades and expansions, and changes to steam on cane usage, our analysis is that the Australian milling sector has significant potential to increase the amount of power it exports to the grid. Furthermore, there is

significant potential to expand ethanol production with the right policy and commercial incentives.

- Whilst we continue to assess global and domestic market demand for bio-products this is an emerging and promising value-add opportunity for the industry.

SLIDE 8 – THE PROBLEM STATEMENT



- A review of the industry's past performance reveals that 2 percent production and productivity gains per annum have not be achieved.
- Australian government data reveals[1] that from 1974 to 2018 sugar production (and revenue) has increased 1.6% per annum, but short of the required 2 percent. There are (3) components to the 1.6% per annum performance:
  (1) Cane acreage recorded a 1.2 percent per annum increase over this period
  (2) Cane yield recorded a 0.3 percent per annum increase over this period
  (3) CCS or sugar content of the cane recorded a 0.1 percent per annum increase over this period.
- Significant improvement in cane yields has been stymied by onsets of disease (orange rust in 2000 and smut in 2006) resulting in the removal of better performing varieties from production and use in the plant breeding program.
- Expansion of the area under cane has been hindered by a lack of water, urban encroachment and substitution to other crops.

[1] ABARES, Agriculture commodities and trade data, rural commodities – sugar

SLIDE 9 – POTENTIAL REMEDIES

ASMC plans to meet industry stakeholders and government over the coming months to stimulate development of an Australian revitalisation strategy, including a discussion on what government policy and commercial reforms are required to achieve diversification (ethanol, co-generation and other bio-products) and increased cane acreage along with improved sugar and cane yields.

Whilst there are at least nine (9) remedy areas that we will actively explore, **government policy settings** will be a particular area of focus. What's not well understood in Australia by industry and probably by government itself is just how much government policies influence industry behaviour in our (3) pillars. For example:

- Governments in Australia have marketing legislation in place whereby growers can seek independent arbitration if commercial arrangements between them and a mill cannot be adequately resolved. This stymies investment by mills because of the uncertainty associated with not knowing what future revenues in a new investment such as cogeneration plant might be. All the while there has been very few instances of proven market abuse by millers in their engagement with growers
- This same marketing legislation also gives growers the right to allocate a percentage of the sugar manufactured from their cane to a marketer of their choice. In effect, the mill is not entitled to market all the sugar that they own which introduces sovereign risk.
- Government's regulate the prices of water and electricity consumed by growers and millers. This is to be expected because they are natural monopolies but the issue is that the monopolies are owned by government, competition is controlled, and prices are increasing significantly.
- After decades of disagreement, Australia has no national energy and climate change policy meaning potential energy investors do not have certainty on what emission controls may be placed on generators or how government might address potential

market failures in the reliability and security of electricity networks because of the under-investment.

- Despite large customers like Coca-Cola Amatil accepting the industry's own steps to improve sustainability through the SmartCane BMP environmental certification scheme, the Queensland government has opted to impose stricter environmental conditions on farmers who operate adjacent to the Great Barrier Reef. This will deter growers and be counter to our goals.
- The Australian sugar industry has plenty of work to do in shaping its journey over the next 10-years and whilst these issues have been around for decades, the realisation that deep long price troughs caused by, amongst other things, continued payment of government subsidies contra to World Trade Organisation rules, means we need to consider alternative pathways and pursue multiple commercial and government policy reform.

SLIDE 10 – ANY QUESTIONS?

Thank you.

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