



Statement of Issues

1 March 2018

Saputo Dairy Australia – proposed acquisition of Murray Goulburn’s operating assets

Purpose

1. Saputo Dairy Australia Pty Ltd (**Saputo**) proposes to acquire most of the operating assets and liabilities of Murray Goulburn Co-operative Co. Limited (**Murray Goulburn**) (the **proposed acquisition**).
2. This Statement of Issues:
 - gives the Australian Competition and Consumer Commission’s (**ACCC**’s) preliminary views on competition issues arising from the proposed acquisition, and
 - invites interested parties to submit comments and information to assist our assessment of the issues.

Overview of ACCC’s preliminary views

3. The legal test which the ACCC applies in considering the proposed acquisition is in section 50 of the *Competition and Consumer Act 2010*. Section 50 prohibits acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in any market.
4. The ACCC divides its preliminary views into three categories, 'issues of concern', 'issues that may raise concerns' and 'issues unlikely to raise concerns'. For this matter there is one 'issue of concern' and the remaining issues are 'issues unlikely to raise concerns'.

Issue of concern – Koroit

5. The ACCC is concerned that the proposed acquisition would be likely to substantially lessen competition in the market for the acquisition of raw milk in south west Victoria and south east South Australia (together, **Western Victoria**).

6. Saputo (at Allansford) and Murray Goulburn (at Koroit) own the two largest processing plants in the area. While Fonterra and some smaller players will remain, the ACCC considers competition for raw milk will decrease resulting in lower farmgate prices for raw milk offered to farmers.
7. The ACCC does not consider that processors outside of Western Victoria provide sufficient competitive constraints. Data provided to the ACCC as part of this investigation and the Dairy Inquiry indicate that processors outside of the posited market are unlikely to provide a strong constraint because of the expense of transporting milk long distances.
8. The ACCC considers that the proposed acquisition will not substantially lessen competition for the acquisition of raw milk in any other region. The ACCC’s concerns only arise in Western Victoria from Saputo acquiring the Koroit dairy plant.

Issues unlikely to raise concerns

9. The ACCC’s preliminary view is that the proposed acquisition is not likely to substantially lessen competition in the downstream markets for the supply of fresh milk, cheese, cream and butter by processors. The ACCC focussed in particular on bulk cream, but considers that other processors would be likely to constrain Saputo after the acquisition.

Making a submission

10. Interested parties should provide submissions by no later than 5pm on 13 March 2018. Responses may be emailed to mergers@acc.gov.au with the title: Submission re: Saputo/Murray Goulburn - attention John Rouw/Ana Grujicic. If you would like to discuss the matter with ACCC officers over the telephone or in person, or have any questions about this Statement of Issues, please contact John Rouw on 03 9290 1402 or Ana Grujicic on 03 9290 1825.
11. The ACCC anticipates making a final decision on 29 March 2018, however, this timeline can change. To keep abreast of possible changes in relation to timing and to find relevant documents, interested parties should visit the Mergers Register on the ACCC's website at www.accc.gov.au/mergersregister.

Confidentiality of submissions

12. The ACCC will not publish submissions regarding the proposed acquisition. We will not disclose submissions to third parties (except our advisors/consultants) unless compelled by law (for example, under freedom of information legislation or during court proceedings) or in accordance with s155AAA of the *Competition and Consumer Act 2010*. Where the ACCC is required to disclose confidential information, the ACCC will notify you in advance where possible so that you may have an opportunity to be heard. Therefore, if the information provided to the ACCC is of a confidential nature, please indicate as such. Our [Informal Merger Review Process Guidelines](#) contain more information on confidentiality.

About ACCC ‘Statements of Issues’

13. A Statement of Issues published by the ACCC is not a final decision about a proposed acquisition, but provides the ACCC’s preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.
14. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

The ACCC’s current Dairy Inquiry

15. Separate to this review of Saputo’s proposed acquisition, the ACCC is also undertaking a broader assessment of the competitiveness, trading practices, and transparency of the Australian dairy industry. An interim report was published on 30 November 2017 and the ACCC must submit its final report to the Treasurer by 30 April 2018.
16. The Dairy Inquiry and this review are separate processes and require different assessments. However, the ACCC has had regard to Dairy Inquiry findings in assessing Saputo’s proposed acquisition.
17. If you wish to find out further information about the Dairy Inquiry, please see <https://www.accc.gov.au/about-us/information-for/agriculture/dairy-inquiry>.

Timeline

Date	Event
17 November 2017	ACCC commenced review of the proposed acquisition
1 March 2018	ACCC published a Statement of Issues outlining preliminary competition concerns
13 March 2018	Closing date for submissions relating to Statement of Issues
29 March 2018	Proposed date for announcement of ACCC’s findings

The parties

Murray Goulburn

18. Murray Goulburn is an Australian dairy co-operative with farmer shareholders plus external investors (through the ASX listed MG Unit Trust).

19. Prior to May 2017, Murray Goulburn operated 11 processing sites located across New South Wales (1), Victoria (7), Tasmania (2) and Qingdao in China (1). In May 2017, Murray Goulburn announced the closure of three processing sites, following reduced milk intake across the business. These sites were Edith Creek in Tasmania and Rochester and Kiewa in Victoria. Murray Goulburn has since sold the Edith Creek site to Dutch Mill (Australia) Pty Ltd. It has closed the Rochester site and postponed the closure of Kiewa.
20. Murray Goulburn owns the Devondale and Liddells brands and produces a full range of dairy products, including fresh milk, Ultra Heat Treated (**UHT**) milk, milk powder, cheese, cream and butter.
21. Murray Goulburn also has trading stores selling farm supplies and services, and operates a milk broking business.

Saputo

22. Saputo is a wholly owned subsidiary of Saputo Inc.
23. A Canadian based company, Saputo Inc. is one of the top 10 dairy processors in the world, operating 50 manufacturing facilities across Canada (22), the United States (24), Argentina (2) and Australia (2).
24. Saputo’s Australian operations are conducted through Warrnambool Cheese and Butter Factory Company Holdings Limited (**WCB**).
25. Saputo has a dairy processing plant at Allansford, Victoria and packaging plants in Allansford and Mil Lel, in south east South Australia. Saputo produces a full range of dairy products. Its Australian brands include Coon, Cracker Barrel and Mil Lel cheeses and Great Ocean Road milk and cheese.

Other industry participants

Farmer-suppliers

26. Farmer-suppliers (dairy farmers) produce raw milk and supply it to dairy processors or milk brokers. This raw milk is manufactured to create different dairy products.

Dairy processors

27. Dairy processors acquire raw milk from dairy farmers and process the milk to manufacture dairy products. There are a number of dairy processors that operate in Western Victoria, where Saputo currently operates through WCB.
 - Fonterra Australia Pty Ltd (**Fonterra Australia**) is a subsidiary of New Zealand based Fonterra Co-operative Group Limited. Fonterra Australia operates eight processing facilities in New South Wales, Victoria and Tasmania, collecting around 1.6 billion litres of milk annually¹. It has two processing facilities in Western Victoria, at Cobden and Dennington.

¹ ACCC Dairy Inquiry, Interim Report, November 2017, p 44

Fonterra Australia produces a full range of dairy products, servicing both domestic and export customers.

- Bega Cheese Limited (**Bega**) is an ASX listed company with processing facilities located in Melbourne and in Strathmerton and Tatura in northern Victoria and Bega in New South Wales. Bega collects around 650 million litres of milk per year². The company primarily supplies cheese and bionutrients (for the health and nutrition markets).
- Union Dairy Company (**UDC**) is a new entrant that commenced operating in August 2017. UDC is a joint venture between The Midfield Group (a meat processing company) and the Louis Dreyfus Company. It has a processing plant based in Penola, south east South Australia. UDC manufactures milk powders, anhydrous milk fat and cream, servicing both domestic and export markets.
- Other participants in the region include, Beston Global Food Company Limited (**Beston**) and Bulla Dairy Foods (**Bulla**). Beston has recently expanded its operations and is now collecting raw milk from the market in addition to raw milk generated from its own farms. Bulla produces a range of cream-based products and in 2014 it opened a milk separation plant in order to process its own cream from raw milk.

Brokers

28. In addition to acquiring milk from dairy farmers, processors can also acquire milk from brokers. Milk brokers can also sell raw milk directly to food manufacturers. A number of milk brokers are active in the Western Victoria milk region, including Australian Dairy Farmers Corporation (**ADFC**) and Australian Consolidated Milk (**ACM**).

Other processors with plants in Victoria

29. There are a number of further dairy processors in Victoria, ranging from speciality cheese manufacturers to multinational processors. These include:
- Burra Foods Australia (**Burra**), which has a plant in southwest Gippsland and investors that include Chinese dairy processor Mengniu.
 - Freedom Foods, which has plant at Shepparton in northern Victoria, producing UHT milk.
 - Lion Dairy and Drinks Pty Ltd (**Lion**) forms part of the Lion Group, a food and beverage company based in Australia and New Zealand. Lion collects around one billion litres of milk annually³. Lion produces a range of dairy products including fresh milk, flavoured milk, UHT milk, cheese, yogurt and cream.
 - Parmalat Australia Limited (**Parmalat**), whose ultimate majority shareholder is the Lactalis Group, a family-owned multinational company based in

² ACCC Dairy Inquiry, Interim Report, November 2017, p 45

³ ACCC Dairy Inquiry, Interim Report, November 2017, p 45

France. Parmalat collects around 1 billion litres of raw milk⁴ and owns a number of facilities throughout Australia, including in Echuca, Bendigo North, Longwarry and Rowville in Victoria, and Clarence Gardens in Adelaide.

Industry background

30. The past two years have been a difficult period for the dairy industry in Australia, particularly for farmers affected by Murray Goulburn and Fonterra’s Farmgate Milk Price (**FMP**) step downs in 2016.
31. In response, during the first half of FY2016 – 17 a significant number of farmers switched away from supplying Murray Goulburn, reducing Murray Goulburn’s total milk intake and therefore its revenues.
32. Murray Goulburn’s financial situation affected its ability to pay a competitive FMP and, from about April 2016 to about October 2017, Murray Goulburn’s price was below that of many of its competitors. Farmers ceased supplying Murray Goulburn in large numbers. Some Murray Goulburn farmers exited the industry; many moved processors.
33. Farmers switching processors often do so in July and August, after they receive final payments for the previous financial year and season. Murray Goulburn published an opening FMP for FY2017-18 of \$4.70 per kilogram of milk solids (**kgms**), while its competitors opened with effective prices (including bonuses) ranging from \$5.15 to \$5.90/kgms. Murray Goulburn revised its opening price to \$5.20/kgms. Thirty per cent⁵ of farmers withdrew their supply from Murray Goulburn in July and August of 2017.
34. Murray Goulburn’s largest plant, Koroit, is currently running at well below optimal capacity, which has led to Murray Goulburn announcing redundancies at this location. Such plants have high fixed costs and exhibit significant economies of scale, exacerbating Murray Goulburn’s challenges.
35. At the time of the second wave of farmer departures in mid to late 2017, Murray Goulburn announced a strategic review of its business, which led to a number of proposals from different entities to acquire Murray Goulburn or its assets.
36. The ACCC recognises the impact that these events have had on Murray Goulburn’s dairy farmers and shareholders, and appreciates their desire for stability. However, the ACCC is concerned about the longer term impact on competition as a result of the proposed acquisition and the likelihood that this could result in reduced FMPs, worse contractual terms or reduced non-price offers to farmers in Western Victoria.

⁴ ACCC Dairy Inquiry, Interim Report, November 2017, p 45

⁵ <http://www.mgc.com.au/media/51271/devondaler-february-2018.pdf>

The proposed acquisition

37. Saputo proposes to acquire all of Murray Goulburn’s assets related to dairy processing, manufacturing, distribution and sale, including land, equipment, inventory, brands, leases and contractual arrangements with customers and suppliers, including dairy farmers.
38. The acquisition includes Murray Goulburn’s processing facilities in:
- Cobram, Kiewa, Koroit, Laverton North, Leongatha, Maffra and Rochester in Victoria;
 - Erskine Park in New South Wales; and
 - Smithton in Tasmania.
39. The proposed acquisition includes Murray Goulburn Trading Pty Ltd (MG Trading), which operates the trading stores business. Murray Goulburn may however elect to sell MG Trading separately to the broader sale to Saputo, and, if so, it will be excluded from the proposed acquisition.
40. Murray Goulburn is to retain all assets and liabilities associated with the MG Unit Trust, and any liabilities associated with regulatory proceedings and unit holder class action (and any similar such actions). Murray Goulburn will retain part of the proceeds from the proposed transaction until the conclusion of these matters.
41. As part of the transaction agreement, Saputo has agreed to offer a number of commitments for the benefit of existing Murray Goulburn farmer-suppliers. These commitments include:
- Collection: Saputo has agreed to collect milk from all suppliers who are supplying Murray Goulburn at closing, for a period of five years from the FY19 season on terms that are no less favourable than Murray Goulburn’s existing collection terms. Following this period, Saputo will continue to collect milk on reasonable terms, allowing Saputo to charge a reasonable cost-recovery amount for transport, handling and storage costs and
 - Future FMP commitment: For a minimum of five years from the FY19 season, Saputo will pay existing Murray Goulburn suppliers a market competitive FMP. That FMP will be not less than the greater of Saputo’s FMP or the average FMP of the two largest competing milk processors competing in the Southern Milk Region⁶ or NSW Milk Region⁷ (as applicable) at the relevant time.

⁶ The ‘Southern Milk Region’ includes the following regions: eastern South Australia and the western dairy region in Victoria; the Gippsland dairy region in Victoria; the Murray dairy region in central and northern Victoria and southern New South Wales; and Tasmania.

⁷ The ‘NSW Milk Region’ includes the following regions: South Coast of NSW; Southern Central Highlands; Central West; Northern Tablelands; Hunter Valley; and Manning Valley.

Areas of overlap

42. Saputo and Murray Goulburn overlap in:
- the acquisition of raw milk from farmers, and
 - the manufacture and supply of various dairy products to downstream customers (such as supermarkets, food manufacturers, food service providers and international customers).
43. In relation to the acquisition of raw milk, Saputo and Murray Goulburn overlap in Western Victoria, where Murray Goulburn has a large processing plant at Koroit and Saputo has large plant nearby at Allansford. The ACCC has therefore focused its review on the acquisition of raw milk within this region.
44. In relation to the manufacture and supply of dairy products, market inquiries have indicated that the two parties overlap in the manufacture of various products. However, concerns have only been raised regarding the manufacture and supply of bulk cream, cheese and butter. For all other dairy products it appears that there will be sufficient alternative options remaining after the acquisition and no concerns have been raised by market participants.
45. Therefore, in relation to downstream markets, this Statement of Issues only addresses issues relating to the supply of bulk cream, butter and cheese.

Future with and without the acquisition

46. Section 50 of the Act prohibits mergers or acquisitions that would have the effect or be likely to have the effect of substantially lessening competition in a market. In assessing a proposed acquisition pursuant to section 50 of the Act, the ACCC considers the effects of the acquisition by comparing the likely future competitive environment post-acquisition if the acquisition proceeds (the “with” position) to the likely future competitive environment if the acquisition does not proceed (the “without” position) to determine whether the proposed acquisition is likely to substantially lessen competition in any relevant market.
47. Based on the information currently available, the ACCC considers that if the proposed acquisition does not proceed, Murray Goulburn’s assets would remain in the market, most likely through a sale to an alternative purchaser.
48. As Murray Goulburn stated at its Annual General Meeting on 27 October 2017, after announcing a strategic review of its business, it received various ‘unsolicited in bound proposals...[ranging] from discrete asset sales, to equity injections to whole of business transactions’. Media reports around the time reported that 20 parties had submitted expressions of interest for Murray Goulburn.⁸
49. Murray Goulburn recently released its half-year results, reporting a half-year loss of \$27.5 million (compared with a half-year loss a year earlier of \$31.9 million). Murray Goulburn declared in its accounts that, subject to any material

⁸ ‘Bell rings for round two in Murray Goulburn contest’, *The Australian*, Business News, 12 October 2017.

changes in circumstances, its directors continue to be of the view that the group would be able to pay its debts as and when they fell due, for at least a year.⁹

50. Murray Goulburn said in its results that, if the proposed acquisition or an alternate one does not proceed, it may not be able to pay a competitive FMP and further losses of milk may lead to asset impairment, breach of banking covenants and potential withdrawal of creditors’ support. Its accounts stated that, in this case, the Group would need to consider selling certain assets to repay debt.
51. While Murray Goulburn continues to face financial difficulties, given the number of proposals received by Murray Goulburn and the value placed on Murray Goulburn’s assets by potential purchasers, the ACCC considers it likely that Murray Goulburn’s assets, either in their entirety or separately, will remain in the market and be acquired by an alternative purchaser(s) if the proposed acquisition by Saputo does not proceed.
52. The ACCC considers that any acquirer (whether Saputo or another acquirer) of Murray Goulburn’s assets, including the Koroit plant, would have a strong incentive to return them to efficient operation, competing to attract raw milk volume to do so.

Previous ACCC merger decisions

53. On 22 February 2010, the ACCC commenced a public review of Murray Goulburn’s proposed acquisition of WCB. The ACCC published a Statement of Issues outlining preliminary competition concerns in relation to the acquisition of raw milk from farmers, bulk supply of raw milk to dairy product manufactures and supply of bulk cream. On 2 June 2010, Murray Goulburn announced that it did not intend to proceed with the proposed acquisition and withdrew its application for ACCC merger clearance.
54. On 29 November 2013, Murray Goulburn applied to the Australian Competition Tribunal for merger authorisation to acquire WCB. On 23 January 2014, Murray Goulburn withdrew its application. WCB was subsequently acquired by Saputo.

Market inquiries

55. The ACCC sought comment from a wide range of market participants on Saputo’s proposed acquisition of Murray Goulburn’s assets. In particular, we communicated directly to more than 500 potentially affected farmers, by email or post, and received a large number of responses.
56. The ACCC has taken into account both competition concerns from some farmers and the feedback from other farmers that they felt they had options for whom they could supply; and that many dairy farmers want the Saputo transaction to proceed so they have near-term certainty.

⁹ Murray Goulburn Interim Financial Statements 2018 p 9

Issue of concern: Acquisition of raw milk in Western Victoria

57. Based upon its inquiries to date, the ACCC’s preliminary view is that the proposed acquisition of the Murray Goulburn Koroit dairy processing plant is likely to substantially lessen competition in the market for the acquisition of raw milk in Western Victoria.
58. The proposed acquisition represents a major structural change in the Western Victoria dairy region. Saputo and Murray Goulburn are each other’s closest competitors in the region and a combined Saputo-Murray Goulburn would control over two thirds of processing capacity in the region and acquire more than half of all the raw milk in the region. The other significant acquirer of raw milk in this area is Fonterra, with a number of smaller processors and acquirers including UDC, Beston, Bega, ADFC and ACM.

Market definition

59. The ACCC considers that the appropriate market is likely to be the market for raw milk acquisition in Western Victoria.
60. The ACCC found that the geographic scope of raw milk markets is influenced by the distance it is financially viable for processors to transport milk from farm to factory. Whilst processors in the Dairy Inquiry have submitted that this distance can be up to 600km, ACCC analysis of processors’ purchase records during that Inquiry showed that:
- approximately 80 per cent of processors’ raw milk purchases come from farms located within 150km of the processing plant, and
 - in excess of 95 per cent of raw milk is acquired from farms within 300km of a processing plant.¹⁰
61. In Western Victoria, a significantly higher share of raw milk is acquired by processors with facilities within or very near to the market (Murray Goulburn, Saputo, Fonterra, UDC and Bulla), compared to acquisition volumes for processors outside of the region (for example, Bega, Lion and Parmalat).
62. Whilst processors with plants located outside of Western Victoria do acquire some milk from farms located in Western Victoria, the cost of transporting milk long distances limits their presence in the market. This additional cost is likely to limit the competitive constraint provided by processors located outside of Western Victoria. The ACCC considers that there would need to be a significant decrease in the price of milk (more than 10 per cent) for those processors to economically compete in Western Victoria.
63. Further, the ACCC’s analysis of farmer switching patterns (discussed further below) indicates that, even during 2016 when some processors significantly reduced their FMPs (by as much as 15 per cent) only a very small number of farmers switched to processors outside of Western Victoria.

¹⁰ ACCC Dairy Inquiry, Interim Report, November 2017, p 99

64. Accordingly, the ACCC considers that the closest competitive constraint on Saputo after the proposed acquisition would be processors located within 150 to 200 km of the dairy farms which supply Allansford and Koroit processing plants.

Closeness of competition between Saputo and Murray Goulburn

65. The ACCC has considered data, internal company documents and other information to assess the closeness of competition between Saputo and Murray Goulburn for the acquisition of raw milk; and the likely nature and intensity of competition between processors in the region with and without the proposed acquisition.
66. The ACCC considers that Saputo and Murray Goulburn are each other’s closest competitors (the primary competitors to each other) for the acquisition of raw milk from farmers in the Western Victoria region. Saputo and Murray Goulburn compete to acquire milk for their respective plants at Allansford and Koroit, which are about 30 kilometres’ drive apart from each other, near Warrnambool. These two plants are the largest in the region and account for a very large proportion of total raw milk processing capacity in Western Victoria. The ACCC has estimated that Saputo and Murray Goulburn combined would have over two thirds of the processing capacity in Western Victoria.
67. Market inquiries have confirmed that the two companies target many of the same farmers for supply and closely monitor and react to each other’s conduct; and many farmers have changed from supplying one of them to supplying the other.
68. The ACCC has analysed the switching of farmers between processors in the period from July 2016 to December 2017. The ACCC has considered in particular which processors dairy farmers switched to when leaving Murray Goulburn. The ACCC considers that this data shows in broad terms:
- Competition is closest between competing processors with plants in Western Victoria
 - Murray Goulburn and Saputo are very close competitors
 - Fonterra is a significant but smaller competitor in the region
 - Smaller processors have also had some competitive impact in winning farmers, including in particular UDC during its start-up period.
69. The ACCC understands that the events of 2016 were unusual in the industry and farmers switched away from Murray Goulburn in greater numbers than might be expected in the normal course of events. The Dairy Inquiry found that in the normal course of business, somewhere between 5 to 10 per cent of farmers will switch processors in any given year. The switching figures for Murray Goulburn were much higher than this, with reported milk volumes dropping by 20 to 30 per cent in both 2016 and 2017.
70. However, the ACCC considers this is also an aspect of competition. Saputo gave dairy farmers in Western Victoria that were supplying Murray Goulburn a ‘relief valve’ and option to which they could turn. If Saputo were to acquire

Murray Goulburn’s Koroit plant and farmers were to become dissatisfied with Saputo in the future, the reverse option would not be available to them.

Competition from other processors

71. The ACCC has considered the levels of competitive constraint from other processors. The ACCC has considered the views of dairy farmers and other market participants, data and internal company documents.
72. The ACCC considers that, all other things being equal, dairy processors with plants closer to the dairy farms that supply Saputo (Allansford) and Murray Goulburn (Koroit) in Western Victoria are likely to place stronger competitive pressure on a combined Saputo-Murray Goulburn in the region than those further away. This is principally because a processor’s transport costs increase with distance: it is more expensive for them to acquire milk from further away.
73. The ACCC first looked at those processors within about 200 kilometres of most of the dairy farmers that supply Saputo Allansford and Murray Goulburn Koroit. The four largest are:
 - Fonterra (at Cobden and Dennington)
 - Bega (at Coburg)
 - Bulla (at Colac), and
 - UDC (at Penola).
74. The production capacity figures for these plants are however significantly lower compared to an intake capacity for Murray Goulburn Koroit of more than a billion litres and an intake capacity for Saputo Allansford of about a billion litres. In percentage terms, the Allansford and Koroit plants combined would represent over two thirds of the intake capacity in the Western Victoria region.
75. The ACCC considers that Fonterra has the ability to place a level of competitive pressure on a combined Saputo-Murray Goulburn operation in the Western Victoria region, as it competes to acquire milk for its Cobden and Dennington plants. However, the ACCC notes that when Murray Goulburn decreased its FMP in 2016, Fonterra followed soon after.
76. The ACCC understands that Bega has acquired milk in the Western Victorian region for a number of years, but its share of volumes within 200 and 400 kilometres of the Murray Goulburn Koroit plant are still small compared with Saputo and Fonterra.
77. The ACCC understands that Australian Dairy Farmers Corporation acquires milk to be on-supplied to processors including Bulla, which has a plant at Colac. However, as with Bega, the share of raw milk that ADFC-Bulla acquires in the Western Victoria region remains small.
78. The ACCC has carefully considered the significance of UDC. This is a joint venture between the Warrnambool-based Midfield meat processing group, which has a long history in Western Victoria, and global commodities trader Louis Dreyfus. Since commencing operations in mid-2017, UDC has taken on

a significant volume of raw milk. UDC also has planning approval for a dairy processing site in Warrnambool.¹¹

79. The ACCC has considered UDC’s processing capacity and likelihood of expansion in its assessment of whether it will still be a strong competitor for dairy farmers in Western Victoria.
80. Other acquirers of milk in the Western Region that farmers have cited as options to supply include:
- broker ACM
 - processor Camperdown Dairy, which has a small plant at Camperdown; and
 - Beston Global Food Company, which has moved from self-supply of raw milk to acquiring from other dairy farmers, for its plants in South Australia, about 500 kilometres from Warrnambool.
81. The ACCC is considering the competitive constraint all the raw milk acquirers mentioned above provide in totality.
82. The ACCC is also considering the extent to which more distant processing facilities may competitively constrain a combined Saputo-Murray Goulburn from seeking to lower FMPs in Western Victoria. This includes plants in areas such as Bendigo, the Shepparton region and the south-eastern suburbs of Melbourne.
83. The ACCC considers that processors much beyond 200 kilometres from farmers in the Western Victoria region are generally not a close competitive constraint on Saputo at Allansford and Murray Goulburn at Koroit. The ACCC considers that raw milk prices would need to fall greatly before such distant processors would find it commercially attractive to seek such distant raw milk supply in large quantities.
84. Parmalat and Lion have dairy processing facilities in northern and central Victoria and the Melbourne region. However, in Victoria, Parmalat and Lion primarily produce ‘fresh’ dairy products such as drinking milk and yoghurt, which are supplied into the domestic retail market.
85. This means that they require a fairly consistent supply of raw milk year-round, in comparison to producers of products like cheese and milk powder which can be stored for longer periods. Producers of fresh dairy products therefore tend to place a lower value on supply from farms with a strong seasonal milk supply pattern.¹² Therefore, many dairy farmers in Western Victoria whose milk supply patterns are more seasonal may not be able to profitably supply Parmalat or Lion without significant investment to change their calving patterns (which the ACCC understands may take two to three years).

¹¹ <http://www.standard.net.au/story/4846301/first-product-rolls-off-line/>

¹² Meaning they produce more milk during spring than at other times of the year.

86. Further, the ACCC understands that companies which mainly supply ‘fresh’ products have relatively fixed demand for raw milk (due to the stable nature of domestic consumption) and may be unlikely to respond to decreased FMPs by significantly increasing the volumes of raw milk they acquire.

Relevance of pricing policies

87. The ACCC understands that historically dairy processors in Australia, including Saputo, Murray Goulburn and Fonterra, have applied a single pricing structure and published a single headline farm gate milk price for the area known as the ‘Southern Milk Region’, which encompasses Victoria, eastern South Australia, parts of southern NSW and Tasmania. The headline price announced by each processor reflects the price paid to a farm with designated production characteristics, after applying the pricing structure of the particular processor. These pricing structures vary between processors and result in different prices according to a farm’s production characteristics (e.g. some pricing structures may favour seasonal milk production over flat production, or vice versa).
88. Processors have indicated that this policy of having a single pricing structure for the Southern Milk Region is driven by farmer preference and that having different price offers within a state such as Victoria would have a significant negative impact on their reputation with dairy farmers.
89. The ACCC has considered whether the practice of having a single Southern Milk Region pricing structure would restrict the ability of a combined Saputo-Murray Goulburn to lower farm gate prices in the Western Victoria market identified above, even if it did face limited competition for raw milk in that particular region.
90. The ACCC’s preliminary view is that such uniform pricing may not protect farmers in Western Victoria from lower farm gate prices resulting from the proposed acquisition. The ACCC is aware that processors are able to tailor their offer to farmers through various means, to target the retention or recruitment of farmers with particular characteristics or from a particular location. Examples of such deviation from uniform policies include offers of cheap finance, alterations to terms and conditions, offers of no disadvantage contracts, variations to payment timing and sign on bonuses. The ACCC has seen numerous instances of processors making additional offers over and above the Southern Milk Region wide price offers which have a tangible financial impact on farmers.
91. The ACCC also notes that this historical pricing pattern may have been driven largely by Murray Goulburn and its co-operative structure; and other processors may have matched Murray Goulburn’s approach due to its size. With the loss of Murray Goulburn as a result of the proposed acquisition, this may remove the drive for processors in the market to continue this pricing practice. The ACCC understands the industry view that farmers would not accept such a change in policy. However, pressure from farmers may not be sufficient to ensure that uniform pricing remains, particularly if farmers do not have sufficient processor options available to them.

Likelihood of entry or expansion

92. The ACCC has considered whether the threat of new entry and/or capacity expansion by existing competitors would be likely to constrain a combined Saputo-Murray Goulburn from exercising market power.
93. Market inquiries have indicated there may be significant barriers to large-scale new entry into milk processing. Smaller scale entry and expansion by existing processors may be more feasible. The ACCC is concerned that small scale entry may not provide, on its own, significant competitive constraint on Saputo if the acquisition of Koroit were to proceed. Principally, the ACCC is concerned that smaller scale processors may not have the required processing capacity to attract enough raw milk to defeat any attempt at a reduction in FMP by Saputo-Murray Goulburn. The ACCC considers key barriers to entry and expansion include:
- The costs of establishing milk processing infrastructure, equipment and logistics capabilities are high and would be mostly sunk. Further, fluctuations in commodity and exchange markets can increase the risk and costs of entry.
 - Incumbent processors enjoy an established presence in the industry, which can assist in retaining or attracting farmer-suppliers with a strong value offer and certainty of pricing and providing them with incentives (such as loyalty payments) to deter them from switching. Smaller processors or new entrants may have difficulties matching or countering these incentives.
 - Economies of scale in production are important. A rival processor may be at a cost disadvantage if it does not have the scale of the major processors in the region.
94. There have been some recent examples of new entry (by UDC) and expansion plans announced by a number of competitors (including Fonterra, ACM, Freedom Foods, Beston Foods and Burra Foods). On the other hand, there are a number of examples of recent exit or failed entry in the industry, including National Dairy Products, United Dairy Power, Linear Capital/Aerem and Camperdown Dairy International (as distinct from Camperdown Dairy, which is a separate company).
95. The ACCC’s preliminary view is that new entry or expansion may not be sufficiently timely or on a large enough scale to pose a sufficient competitive constraint.

Impact of commitments offered by Saputo to farmers

96. The ACCC acknowledges that Saputo has made several commitments to current Murray Goulburn suppliers, including a commitment for five years to pay a FMP that is the greater of Saputo’s FMP or the average FMP of the two largest competing milk processors in the Southern Milk Region (and a similar commitment for NSW).
97. The ACCC does not consider that the commitments offered by Saputo address the competition concerns arising from the proposed acquisition. The proposed

acquisition of Koroit would result in a structural change in the Western Victorian market, with potential long term impacts on prices, contract terms and service levels. The Saputo commitments would only apply to some suppliers, in relation to certain aspects of the supply relationship, for a period of five years.

ACCC’s preliminary views

98. The ACCC is concerned that the proposed acquisition of Koroit by Saputo is likely to result in a substantial lessening of competition in the market for the acquisition of raw milk in Western Victoria, leading to a reduced FMP paid to farmers and/or a worsening of other supply terms.
99. The ACCC understands that Fonterra will remain as a major competitor in the market, along with a number of smaller processors. However, the ACCC is concerned that this group of competitors will not be enough to competitively constrain a combined Saputo-Murray Goulburn.
100. The ACCC is concerned that:
- Saputo and Murray Goulburn are each other’s closest competitors in the Western Victoria region.
 - Fonterra might follow lower FMPs offered by a combined Saputo-Murray Goulburn.
 - Large processors tend to predominantly focus on the actions of other large processors when making pricing decisions, rather than smaller competitors, which may limit the competitive constraint of smaller processors in Western Victoria.
 - Although there are other large processors outside the Western Victoria region, the cost of transporting large volumes of milk long distances is likely to significantly restrict any competitive constraint that these processors will place on the combined Saputo-Murray Goulburn. In addition, many of those large processors primarily produce fresh dairy products for domestic supply. This means that their level of demand for raw milk is relatively stable so they are less likely to increase their acquisition volumes in response to lower FMPs. It also means that they target farmers with flat milk production whereas most farmers in Western Victoria have more seasonal production.
 - New entrants to the market have been successful in gaining some market share. However, the ACCC is concerned that new entry of the scale required to competitively constrain a combined Saputo-Murray Goulburn is unlikely.
 - Uniform pricing policies and Saputo’s five year price commitment may not remedy any competition concerns, particularly in the medium to long term.
101. The ACCC acknowledges that, if Saputo acquires Murray Goulburn, it will most likely seek to increase the amount of raw milk processed at Koroit from current levels, and that this may increase competition in Western Victoria in the short term, compared to the current situation where Koroit is being underutilised. However, the ACCC must consider how competition in the future with the

proposed acquisition compares to competition in the future without the proposed acquisition. In the future without the proposed acquisition, the ACCC considers it is likely that another acquirer of Koroit would compete strongly with Saputo and Fonterra, leading to higher FMPs than in the future with the proposed acquisition.

Issues unlikely to raise concerns: Manufacture and supply of bulk cream, bulk cheese and bulk butter

102. The ACCC’s preliminary view is that the proposed acquisition is unlikely to result in a substantial lessening of competition in the supply of any downstream dairy products. The ACCC has focussed on:
- the market for the manufacture and supply of bulk cream in Victoria and South Australia;
 - the national market for the manufacture and supply of bulk butter; and
 - the national market for the manufacture and supply of bulk cheese.

Bulk cream

103. The ACCC considers there is likely to be a market for bulk cream in Victoria and South Australia because fresh bulk cream cannot be economically transported long distances.
104. For some bulk cream customers (typically food manufacturers), depending on the product they manufacture, it may be possible to substitute butter or anhydrous milk fat (AMF) (both of which can be imported) for cream. However, this is not possible or desirable with all products (for example, when manufacturing cream cheese). Substituting frozen cream for fresh cream may be another option for some food manufacturers. However the ACCC understands that frozen cream is not commonly used in Australia.
105. Market inquiries indicate the availability of bulk cream is subject to the product mix and markets (including domestic and export) that each dairy processor chooses to pursue, and the volume of raw milk a processor is acquiring.
106. Market inquiries suggest that consumer preferences have shifted away from low fat products towards full cream dairy products. This has resulted in less bulk cream being available in the market. In addition, Murray Goulburn, which has traditionally been a major supplier of bulk cream, has seen a significant decline in raw milk volumes in the past 18 months, which has affected its supply of bulk cream. This milk volume has been diverted to other processors who may focus on a different product mix, which produces less cream as a by-product. Some market participants have raised concerns however that the proposed acquisition may lead to further reduced availability of bulk cream and higher prices.
107. Market participants have indicated that Fonterra, Murray Goulburn and Saputo are the three main sources of bulk cream in Victoria and South Australia. This is based on the large amounts of milk they acquire, their plant sizes and their

product lines (the most common source of bulk cream is as a by-product of skim milk powder production and production of lower-fat products in general).

108. Burra Foods, Freedom Foods, UDC, Parmalat and Lion have been identified as potential alternate sources of bulk cream. Whether they would supply bulk cream is subject to the commercial decisions they make on their product mix and the relative returns they can obtain for them. While a number of processors have capacity to produce bulk cream, many choose to use their cream for their own internal purposes (such as to manufacture retail products which have cream as an input). Processors will sell bulk cream to brokers, food manufacturers and other dairy processors when they have surplus cream available.
109. The ACCC understands that processors could increase their cream production or commence supplying bulk cream relatively quickly, if the commercial returns justified it. Given cream is a by-product of some other production processes, existing dairy processors may not be required to make a significant investment in new or different production lines in order to produce cream.
110. A small number of bulk cream customers may also have some countervailing power to bypass dairy processors and invest in processing facilities to acquire raw milk (either directly from farmers or through brokers) to produce their own cream.
111. Following the proposed acquisition, the combined Saputo-Murray Goulburn would be the largest supplier of bulk cream in the market. The proposed acquisition is likely to result in some lessening of competition. However, the ACCC understands that:
 - dairy processors with processing plants in the market could commence supplying bulk cream relatively quickly, if the commercial returns justified it
 - there are smaller processors that supply or have historically supplied bulk cream
 - Fonterra is an alternative source of bulk cream, given its plant capacity but subject to its commercial decisions on its product mix and comparative returns, and
 - there are substitutes for bulk cream available to some food manufacturers.
112. The ACCC’s preliminary view is therefore that the proposed acquisition is not likely to substantially lessen competition for the supply of bulk cream.

Bulk butter and cheese

113. The ACCC considers there are likely to be national markets for both bulk butter and bulk cheese because there is significant interstate trade in, and imports and exports of, these products.
114. Market inquiries indicate that prices for bulk butter are currently high and there is a shortage of domestic supply, reflecting global trends. Some market

participants have expressed a preference for sourcing Australian made bulk butter and bulk cheese because of downstream customer demand. They note that they have been impacted by the recent scarcity of these products in the domestic market, and have had to turn to imports, which has impacted their business models.

115. While Murray Goulburn and Saputo have competed to supply bulk butter and bulk cheese, actual or potential competition from imports of these products is likely to constrain the prices which Australian based dairy processors charge. Imports for butter and cheese have been increasing and have already taken significant shares of bulk butter and bulk cheese markets.
116. The ACCC also notes that (similar to the situation with bulk cream):
 - Bega, Lion, Parmalat, Beston and perhaps smaller cheese manufacturers across Australia could expand their supply of, or enter into supplying, bulk butter and bulk cheese domestically, if the commercial returns justified it, and
 - Fonterra is a significant potential source of bulk butter and bulk cheese in the market, given its size but subject to its commercial decisions on its product mix and comparative returns.
117. The ACCC’s preliminary view is that the proposed acquisition is not likely to substantially lessen competition for the supply of either bulk butter or bulk cheese given the availability of imports and other mitigating factors described above.

Other downstream dairy products

118. Market inquiries did not suggest that there are likely to be competition impacts in relation to other downstream dairy products, such as fresh milk, due to the number of competitors and the countervailing power of the buyers, particularly supermarket chains.

ACCC's future steps

119. As noted above, the ACCC now seeks submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter. Submissions are to be received by the ACCC no later than 13 March 2018 and should be emailed to mergers@acc.gov.au.
120. The ACCC will finalise its view on this matter after it considers submissions invited by this Statement of Issues.
121. The ACCC intends to publicly announce its final view by 29 March 2018. However the anticipated timeline may change in line with the *Informal Merger Review Process Guidelines*. A Public Competition Assessment for the purpose of explaining the ACCC's final view may be published following the ACCC's public announcement to explain its final view.