



**BEGA CHEESE**

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Australian Competition and Consumer Commission  
[dairyinquiry@acc.gov.au](mailto:dairyinquiry@acc.gov.au)

**By Email:**  
[dairyinquiry@acc.gov.au](mailto:dairyinquiry@acc.gov.au)

Dear Sir/Madam

**RE: ACCC Inquiry into the Australian dairy industry**

Bega Cheese Limited (**Bega Cheese**) welcomes the opportunity to make a submission to the ACCC inquiry into the Australian dairy industry. This submission provides a brief history of Bega Cheese and then responds to each of the issues identified in the Issues Paper published by ACCC.

**A BRIEF HISTORY OF BEGA CHEESE**

Dairying started in the Bega Valley in the 1850's. In those days each farmer produced and sold products such as cheese and butter from their dairy. After a period of time local farmers decided to improve their individual production and marketing activities and banded together to establish The Bega Co-operative Creamery Company in 1899.

Bega Cheese's original factory was opened in Bega in 1900. The original site at Lagoon Street still operates today producing cheddar and mozzarella cheese and whey powders. In 1997 Bega Cheese built a cheese processing and packaging facility at Ridge Street, Bega, value adding cheese for both the Australian and International market.

In April 2007 Bega Cheese acquired a 70% shareholding in Tatura Milk Industries Limited (**Tatura Milk**). Tatura Milk was established in 1907 and is located in the township of Tatura in Northern Victoria. Tatura Milk produces a wide range of dairy products and employs more than 300 people. Tatura Milk products are exported primarily to North and South East Asia. The acquisition was a good fit for Bega Cheese as it broadened the company's product range with the addition of cream cheese, milk powders, infant formula and nutraceuticals complimenting Bega's existing range of natural and processed cheddar cheese and whey powders.

In October 2008 Bega Cheese purchased the assets and operations of De Cicco Industries in the Melbourne suburb of Coburg. This site added significantly to Bega Cheese's bulk cheese manufacturing capability.

In March 2009, Bega Cheese acquired the cheese manufacturing facility of Kraft Foods at Strathmerton in Victoria. The asset was one of the largest processed cheese facilities in Australasia and Bega Cheese has further invested in the infrastructure adding natural cheese cutting capacity to the plant.

An important milestone for Bega Cheese occurred in August 2011 when the business listed on the Australia Securities Exchange (**ASX**). Following the successful listing, Bega Cheese acquired the final 30% of Tatura Milk, which then became a wholly owned subsidiary of Bega Cheese.

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In March 2014 a life stage nutritional canning and blending plant was commissioned in Derrimut, Victoria. This new facility added to Bega Cheese's capabilities which now included the supply of retail ready infant formula and growing up milk powders to Australian and international customers. This initiative exemplified the underlying long term strategy of developing value-added products which can be sold throughout the world.

There are now approximately 500 farmers supplying the Bega Cheese group with around 700 million litres of milk from the Bega region in NSW, as well as Gippsland and the Northern and Western Districts in Victoria. Today, with sites spread from Bega to Melbourne to Northern Victoria, Bega Cheese employs over 1,700 people and the company has evolved from its modest and localised co-operative heritage in Bega into a significant and innovative player in the Australian and international dairy industry. Bega Cheese's production of approximately 230,000 tonnes of dairy products equates to a sales turnover in excess of \$1 billion per annum. In the following submissions, the term Bega Cheese is used to refer to the Bega Cheese group including Tatura Milk.

## **ISSUE 1 – COMPETITION FOR MILK**

The ACCC has asked for feedback on:

1. The level of competition between processors for the acquisition of milk, across regions.
2. The ability of producers to switch between processors or other buyers.

### **Bega Cheese's submissions**

The Australian dairy industry is a highly competitive one with a diverse range of players seeking to procure milk for manufacturing and value-adding into a variety of ingredients and consumer goods destined for the Australian and international markets. Victoria is by far the largest dairy state in Australia producing approximately 65% of Australia's dairy products and 85% of Australia's dairy exports. Virtually all major dairy companies in Australia participate in milk procurement in Victoria. Participants range from dairy co-operatives, Australian companies, multi-national companies and boutique dairy companies. As a result, dairy farmers have the choice of supplying a large number of dairy companies in Victoria, including a number of new entrants wishing to procure milk. Competition amongst dairy companies has been intensified by the decline in production over much of the last decade. It is well documented that Australia's milk supply has decreased from 11.3 billion litres a year in 2001-02 to 9 billion litres a year today.

Against this background, milk processors have had the challenge of procuring sufficient quantities of milk to produce their products and achieve efficiencies within their manufacturing facilities. In practical terms, this has resulted in milk processors actively competing for farmers' milk through pricing and the provision of other support services. In addition, a number of companies have adopted strategic approaches to encourage farmers to increase their milk supply and adopt sustainable farming practices. For its part, Bega Cheese announced two new voluntary programs in early 2014, the Sustainability Program and Milk Growth Program to encourage a reliable and sustainable milk supply chain through sustainable farm practices and milk production increases.

In broad terms, this competition for milk means that dairy farmer producers have the capacity to switch their supply of milk between processors and other buyers. While, dairy farmers have historically demonstrated long term loyalty to and association with the processor entity they supply, there has also been a growing trend of farmers changing their milk supply arrangements to secure better financial returns.

The ease with which individual dairy farmers can switch may depend upon whether there are milk processors or other buyers operating within their geographic region. For example, there are numerous milk processors and buyers in many areas of Victoria and dairy farmers will be able to arrange an alternate buyer for their milk. In other regions, it may take a bit longer for dairy farmers to make arrangements with an alternate buyer. However, improved efficiencies in transportation and the overall competition for milk supply means that most farmers will have the opportunity to switch.

It is, nevertheless, important to note that the ability of dairy farmers to switch their supply will be materially influenced by the financial circumstances of the relevant milk processors and the ability of those processors to pay a competitive milk price. If one or more large milk processors encounter financial difficulties, it is likely to increase the number of dairy farmers who want to switch their supply and reduce the availability of purchasers of milk.

The contractual arrangements that dairy farmers enter into with the purchaser of their milk can also affect their ability to switch. Bega Cheese has traditionally not had written contracts with its farmer suppliers, with the contractual terms applicable to those suppliers being set out in standard terms contained in the company's supplier handbook. These terms include the quality requirements applicable to milk supplied. Importantly, these standard terms do not commit suppliers to supply their milk for a set period and therefore allow them to switch their supply at any time.

The prices payable by Bega Cheese to its dairy farmer suppliers are set on a financial year basis. This is consistent with the fact that the company budgets the return it will receive from the dairy products that it produces from the milk supplied over a financial year. While further information on price setting is provided in the following section, it is relevant from a switching perspective to note that if a dairy farmer supplies Bega Cheese for a full financial year, they will be entitled to all price entitlements relating to that financial year even if they subsequently choose to switch their supply to another company in the next financial year. Bega Cheese's experience is that most switching by dairy farmers occurs in the first month of the financial year.

## **ISSUE 2 – CONTRACTING PRACTICES**

The ACCC has asked for feedback on:

3. The different types of supply contracts used across the supply chain and in certain regions.
4. Concerns about anti-competitive conduct or unfair trading practices, including unfair contract terms.

### **Bega Cheese's submissions**

As noted above, Bega Cheese has traditionally not had any written contracts with its dairy farmer milk suppliers in Victoria, with the standard contract terms being set out in a combination of the company's supplier handbook and the letters setting out price announcements.

In or around April 2014, Bega Cheese introduced two new voluntary programs, the Sustainability Program and the Milk Growth Program (**Programs**), to encourage and assist suppliers to produce milk sustainably and invest in milk supply growth projects.

Under the Programs, Bega Cheese offers additional payments to participating suppliers (on top of normal milk pay rates) in respect of both sustainability and growth projects. Suppliers wishing to be part of the Programs enter into a written milk supply agreement with Bega Cheese for a three year period.

It is important to note that the arrangements entered into between Bega and its suppliers under these new Programs are in addition to the regular arrangements for milk supply. In other words, the regular terms governing the supply and pricing of milk continue to apply to suppliers who enter into these Programs and they continue to be eligible for other regularly-offered loyalty and incentive payments, including the productivity and growth payments discussed below. Should a supplier cease to participate in the Programs, the only consequence is that they may be liable to repay a certain amount of the incentive payments they have received under the Programs. The regular supply arrangement continues, unless the supplier elects to cease supply to Bega Cheese.

Likewise, suppliers not wishing to enter these Programs can continue to supply milk to Bega Cheese on the regular terms and continue to be eligible for all other regularly-offered loyalty and incentive payments.

### **ISSUE 3 – TRANSPARENCY AND PRICE SIGNALS**

The ACCC has asked for feedback on:

5. How farmgate milk prices are set and communicated to producers.
6. The availability and use of meaningful global market information and price signals across the industry, including by dairy farmers.

#### **Bega Cheese's submissions**

The following considerations are relevant to the milk prices set by Bega Cheese for the various supply regions:

- place of origin - the significance of the place of origin of the milk used in manufacture of particular dairy products;
- financial returns from dairy products - the financial return expected to be earned from dairy products manufactured using milk supplied by the relevant farmers;
- sustainability of supply base – Bega Cheese will endeavour to ensure the long term sustainability of dairy farming in the relevant region;
- competitive circumstances – the competitive farm gate milk prices in each region.

The determination of the financial returns that Bega Cheese will achieve reflects the range of products that Bega Cheese manufactures. In this respect, each Australian dairy processor will have a different product mix. However, having noted this, Bega Cheese (like other dairy processors) is not insulated from international dairy commodity markets. The recent extended period of low international commodity prices has not only affected commodity style dairy products such as milk powders but also the returns from value added dairy products.

Bega Cheese closely monitors international dairy commodity prices and engages expert economic advisory services to assist in this important process. Bega Cheese's dairy farmer suppliers are aware of the connection between international dairy commodity prices, the financial returns earned by Bega Cheese and the price the company pays them for their milk. This awareness has been fostered by Bega Cheese over many years of close liaison with its suppliers through supplier meetings at which key information on commodity trends is provided and regular information circulars.

While the financial returns from dairy products is the fundamental consideration in the determination milk prices, Bega Cheese also considers other matters including the company's interest in maintaining a sustainable milk supply base and competition for milk supplies. These factors reflect the fact that Bega Cheese, like other milk processors, requires an ongoing supply of a substantial quantity of milk in order to operate its factories and fulfil its customers' orders for dairy products. This robust competition for milk has generally provided a good outcome for dairy farmer suppliers but, as demonstrated in recent experience, ultimately the price paid for milk needs to align with the value that can be extracted from dairy products in the market place. The geographic region in which suppliers are located is also relevant to the milk prices set by Bega Cheese, due to factors such as the significance of the place of origin of the milk, local farming conditions and the products produced from the milk supplied.

As indicated previously, Bega Cheese sets the price it pays to dairy farmer suppliers on a financial year basis. For historical and farming model reasons, the milk price payable to NSW farmers has tended to be set and communicated through a single price announcement at the beginning of each financial year. On the other hand, milk prices payable to Victorian dairy farmers have been communicated through an opening price announced immediately prior to the relevant financial year with incremental payments and price increases announced from time to time throughout the year. The incremental payments are known by Bega Cheese as 'loyalty payments'. Similar types of payments made by other dairy companies may be referred to as back-pay and step-up payments. Loyalty

payments apply retrospectively to current milk suppliers in respect of milk already supplied from a certain point in time, typically the beginning of the financial year, up to a date shortly before or after the date of the announcement. Price increases, on the other hand, apply prospectively, to milk supplied after the date of the announcement.

Bega Cheese also offers certain other incentive programs, which provide supplemental price payments to suppliers based on certain criteria, such as the annual quantity of milk solids supplied.

The pay rate offered by Bega Cheese for raw milk is expressed on the basis of the butterfat and protein content of the milk. The fat and protein components are together referred to in the industry as 'milk solids'. The milk pay rate is also expressed in cents per litre, but this is a less exact expression of price which is arrived at through a calculation based on the average milk solids in a litre of milk. The milk solids content of milk can vary between individual suppliers and may also vary on a seasonal basis.

The dairy farmers who supply milk to Bega Cheese understand the company's pricing methodology and announcements of Bega Cheese's opening prices and all price updates are promptly communicated to dairy farmer suppliers in the form of written circulars that are delivered electronically and by post. Further, like most other dairy processors, Bega Cheese will assist individual dairy farmers to understand the annual income that announced milk prices will provide for them, given their individual production profile. In Bega Cheese's view, so long as the pricing methodology involving opening prices and pricing updates is diligently managed and clearly communicated to dairy farmers, the pricing system works well for both dairy farmers and milk processors.

#### **ISSUE 4 – DOMESTIC RETAIL MARKETS**

The ACCC has asked for feedback on:

7. The major supply channels for the domestic market, including major supermarkets and other retailers.
8. The impact of \$1 per litre milk on the industry. This includes information about the positive and negative impacts of private label product supply contracts.

#### **Bega Cheese's submissions**

The domestic channels through which dairy companies supply the products they process or manufacture depends on their product mix. In summary, the products that Bega Cheese manufactures for supply into the domestic market are:

- Retail cheese products under various brands that are supplied to retailers or customers who on-sell the products to retailers.
- Food service cheese products such as processed cheese slices and cream cheese.
- Infant formula under various brands.

Bega Cheese does not sell fresh milk to Australian retailers. However, in relation to the "\$1 litre milk" it should be noted that that milk processors receive varying returns from the dairy products (either under their own brands or brands owned by retailer) that they sell to retailers and other customers in the domestic market. In some cases, those returns would be less than the return on "\$1 litre milk".

#### **ISSUE 5 – GLOBAL MARKETS**

The ACCC has asked for feedback on:

9. Options for supply into export markets, including products and destinations.
10. Any barriers to selling into export markets.

## **Bega Cheese's submissions**

The Australian dairy industry has evolved differently to the industry in New Zealand which it is often compared to. While the New Zealand dairy industry has a very small domestic market and is almost totally exposed to international markets, the Australian industry is more balanced with a little less than half of its production destined for international markets and the remainder being sold in the Australian domestic market. This difference has seen Australian based companies develop a strong focus on value added retail and food service products and high value dairy ingredients. The benefit of these strategies, and a more stable return in the Australian domestic market, can be seen in generally a stronger price to farmers in Australia when compared to New Zealand in periods where the global dairy commodity price in relative terms is low. In times where global dairy commodity prices are high generally the New Zealand farm gate milk price out performs the Australian price.

While the value added strategy of many companies and the presence of an Australian domestic market provides some level of stability to farm gate milk pricing when compared to businesses that are exposed in a greater way to global commodities, it does not, and never will, entirely insulate Australian farm gate price from the international market and the effects of competition from both Australian produced and internationally produced dairy products. An extended period of low global dairy prices inevitably affects not only commodity value but the return from value added dairy products.

Export markets are important to the Bega Cheese business, with the company selling dairy products and dairy ingredients through a variety of channels. For example, Bega Cheese sells finished cheese products through distributors for sale in the retail market in a number of overseas countries, dairy products such as milk powder, whey powder, cheese and butter to international food service customers and infant formula products to overseas customers for retail sale.

There are well known trade restrictions that limit the export of dairy products into the US and European markets. However, export of products to other regions generally involves compliance with the product regulatory requirements in the relevant market and other commercial considerations such as establishing appropriate relationships with customers or distributors.

It is also worth noting that Australia is a significant importer of dairy products from overseas countries, including New Zealand, and the pricing of these products impacts on the Australian dairy market.

## **ISSUE 6 – PRODUCTION COSTS AND PROFITABILITY**

The ACCC has asked for feedback on:

11. The key factors influencing the profitability of dairy farms, including cost of production.

## **Bega Cheese's submissions**

Dairy farms can be operated in different ways and may be affected by different factors depending on their model or geographic location. For example, some dairy farms operate on high input feed, with the majority of fodder for the cows being either purchased externally or grown by the relevant producer. Most of the farmers that supply Bega Cheese would operate with a combination of pasture and purchased feed models. On many farms, irrigation water is utilised to assist pasture growth during periods of inadequate rainfall. Other farms that may be located in irrigation regions such as Goulburn Murray Irrigation District will utilise irrigation water on a more routine basis. Accordingly, drought conditions and low irrigation water availability negatively impact on the production of and returns from dairy farming businesses both in terms of the cost of farmers producing fodder and the cost of them purchasing externally sourced fodder.

The profitability of dairy farms, like other agricultural businesses, depends on the price at which the milk produced can be sold and the total expenses and capital costs associated with the operation of the relevant dairy farm. In this respect, it is worth noting that Australian dairy farmers are very efficient and have been quick to adopt more effective farming practices and technological innovation where this is available.