Australian Competition and Consumer Commission

GROCERY PRICE INQUIRY HEARING

EXCERPTS FROM CONFIDENTIAL TRANSCRIPT OF PARMALAT AUSTRALIA LIMITED

CONDUCTED AT: HOTEL IBIS, BRISBANE
DATE: 9.00 AM, THURSDAY, 3rd APRIL, 2008

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MR HOULIHAN: I think there is, in the sense that there is a disconnection or a sense of disempowerment from the dairy farmer community from what's happening at the retail level. From what I've been able to see, it's almost global; the same sort of issues arise in England, the UK, throughout Europe. So, many farmers are unhappy with what they see happening at retail versus what they see at their farm gate. It doesn't matter whether it's milk or vegetables or fruit.

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MR HOULIHAN: There hasn't been. I thought Mike's point was that most of the increase that the CPI would be recording, I thought it would be skewed to the last two year. The first three years of that time period, I would be surprised if it was more than 1 or 2 per cent a year on average for a litre of milk.

MR O'DONOVAN: What is it the farmers are seeing that is causing this level of dissatisfaction about the discrepancy between the farm gate and the retail price?

MR HOULIHAN: Essentially it's their inability to extract increases out of the marketplace at the time at which cost movements occur. Their cost movements occur, every week they ring up and order some more grain, they discover it's gone up $50 a ton since they last ordered some, he wants an increase next week to compensate for the grain coming in at a higher price. That may have increased his cost by [redacted] a litre.

Of course, the processor sees an increase and has to assess his ability to recoup that increase out of a very competitive processing market, and at the same time then - that's what Mike was alluding to - if anything there has been a lag factor in this environment, where the retail price rises have actually lagged, if you like, the underlying cost increases coming up the supply chain. At the same time, what's overridden if in effect even some of the retail downward pressure has been the global dairy market, which really made Victoria so buoyant, it just created a whole new benchmark for the east coast, and basically forced every processor to match those levels that were being achieved globally.

Finally, we actually had a domestic market being dragged up to a global level, whereas historically Australian dairy prices were above global prices. So we actually had this extraordinary reversal, and Australian prices of cheese, for instance, I suspect would have been lower than what major co-ops were achieving in contracts every week overseas.

So we basically saw processors having to respond to that pressure by responding to farmers' needs for more farm gate price to pay for costs, and it' was flowing through at that level. But it wasn't necessarily that it was all being recouped at a shelf price. In most cases processors got touched. They started paying higher farm gates and had to wait to get the price rises.

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MR O'DONOVAN: When their costs are rising, the fact that retail prices are close to static is actually a cause of concern to a farmer?

MR COOMBER: Yes.

MR HOULIHAN: Yes, because they think ultimately they will pay for it.

MR O'DONOVAN: If the retail price was more responsive, they would be getting the benefit.

MR COOMBER: That's the conclusion they reach.

MR O'DONOVAN: From the farmer's point of view, the interests of the farmer and the consumer are well and truly diverged at this point?

MR COOMBER: Yes.

MR HOULIHAN: The other thing to comment about is that Victoria is a good benchmark because it's the lowest cost of production, but the issues faced in the South-East Queensland market are far more complex post deregulation. In particular one of the real emerging issues in South East Queensland has been urbanisation of land and rising land values. In fact, one of the big structural issues post deregulation was that you had land at places like the hinterland and the Gold Coast which simply was not viable for dairy it, had to get turned into housing blocks, and producers look at it and say, "I'm not making any income out of dairying," when in fact their land is worth 10 times what it was five or 10 years ago.

The South-East Queensland dairying environment is actually still going through a major transition of farmers having to migrate out of highly urbanised areas into areas like the Darling Downs and the Western Downs. Until that transition is completed, in another five, six or seven years, there will be individual farmers in South-East Queensland who will never make money out of dairying because their land really belongs in a housing lot.

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MR COOMBER: There is no rationale for the gap to be as high as it is, except the early days of deregulation and dynamics in the marketplace were very different. I think the power of the retailers - every one of us in this room buys something at some time, and we wish to buy things at the lowest price we are able to, I think the retailers continue to do that because of their scale - they are able to leverage that scale more effectively than any individual.

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MR HOULIHAN: If I could just say, I think the significant change that occurred in the last 18 months has been the speed at which the farm gate price has moved and has caught all processors by surprise. [redacted]

MR COOMBER: I think it would be fair to say that if you were to take a view of the annual report of any of the milk processors in Australia last year, all of them had a significant decline on the prior year, and benchmarked against food companies in general would be significantly lower.

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MR O'DONOVAN: Has the improvement in the international price of milk delivered to the processors a better financial outlook?

MR COOMBER: From a selling perspective, which is my role, I guess I can see a longer term benefit, in that I do see it having a direct impact on the suppliers to select where they sell that milk to. But in our case we are in the fresh milk business and dairy business locally. We have a [redacted] business that we export, but we have been limited [redacted] But in the longer term I can see that choice, meaning that if a supplier of milk products to Coles and Woolworths can get a better return elsewhere, they can actually look and Coles and Woolworths and say, "This is the price I'll supply you at." The dependency has been diminished.

MR HOULIHAN: I was going to say that I think the cost increases in the supply chain, particularly at the farm level, particularly through the drought environment of the last few years, preceded any sort of retail response. Then in a sense there's this coincidence of the global circumstances driving global dairy products, which then

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flowed back into the Australian market, particularly the Victorian marketplace, so farmers saw a very sharp rise in their farm gate prices, which really just offsets the very high increases in costs that they were incurring.

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Australian Competition and Consumer Commission

GROCERY PRICE INQUIRY HEARING

EXCERPTS FROM CONFIDENTIAL TRANSCRIPT OF PARADISE FOODS INDUSTRIES PTY LTD

CONDUCTED AT: HOTEL IBIS, BRISBANE
DATE: 9.00 AM, THURSDAY, 3rd APRIL, 2008

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MR O'DONOVAN: In the 12 months that you were with the company was there a wholesale price review?

MR BARTLETT: Yes, there was.

MR O'DONOVAN: Only one?

MR BARTLETT: Only one.

MR O'DONOVAN: What was the result of that?

MR BARTLETT: We had a price increase across our range to approximately [redacted] depending on what range of products you are looking at. It was October/November last year.

MR O'DONOVAN: Was that directly as a consequence of the increase in commodity prices?

MR BARTLETT: Yes, it was, absolutely.

MR O'DONOVAN: Were you able to pass through all of the additional costs through to your customers, or did you have to, I guess, take a reduced margin?

MR BARTLETT: I'm guessing, but I don't think we passed on all our costs in that one.

MR O'DONOVAN: When you made the decision to increase your wholesale price, was that communicated to all of your customers at the same time?

MR BARTLETT: Yes.

MR O'DONOVAN: Did any of your customers resist the increase in wholesale price?

MR BARTLETT: No.

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MR O'DONOVAN: When these costs are taken out of the supply chain, do you see them being passed on for the benefit of consumers or do you think they are mostly

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retained in the major supermarkets, in terms of bigger margins, or to provide a benefit for the manufacturer, I guess?

MR BARTLETT: I think it goes more to the point where the reduced costs help both the retailer and supplier manage their own businesses, as opposed to [redacted]. That's the way we tend to view it, that if we can manage our cost base better, we don't have to pass higher costs on in times of raw material increases.

MR O'DONOVAN: [redacted] So, if they have pushed down your costs to them, is some of that benefit then passed further on down the chain? Or do you think the retail market doesn't discipline them to keep passing on those savings that are being accumulated in the supply chain?

MR BARTLETT: That is a pretty hard one to answer. I think you are saying that, if they can be more efficient in their business and we can be more efficient in ours, does that reflect in lower pricing?

MR O'DONOVAN: Yes.

MR BARTLETT: There are times when I think that happens. [redacted]

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GROCERY PRICE INQUIRY HEARING

EXCERPTS FROM CONFIDENTIAL TRANSCRIPT OF ONE HARVEST

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DATE: 9.00 AM, THURSDAY, 3rd APRIL, 2008

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MR O'DONOVAN: You don't see market concentration as resulting in you being exploited or squeezed to a degree?

MR ROBSON: A lot of that is up to how we handle it, too. Would it be easier to work in a less concentrated market? It might be. But it's how we manage that concentration too. One of the things we do, which I know a lot of other companies don't do, we know more about our product's performance at retail than many of our retailers do. [redacted]

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MR O'DONOVAN: Packaged sales are a relatively new thing - as the market is maturing are [redacted] expectations about how big a margin they are going to get increasing?

MR ROBSON: Absolutely, but it's not their first margin, it's their final margin that they are chasing.

MR O'DONOVAN: What do you mean by that?

MR ROBSON: Their first margin is what everyone identifies as their gross margin. The final margin is the margin they have actually made out of the product after their shrink, and it's incumbent on us, if we want to stay in business, that we help them reduce their shrink. How do we do that? We do it by improving the product, by making sure the product is fresher, whatever that takes to mean. [redacted]

[redacted]

I notice one of your questions was around specifications. In almost every case we have helped the retailer drew the specs up. If you strike a period - we had a period in winter last year where a little beetle got into the whole [redacted] crop, the [redacted] crop that was being grown [redacted], a little beetle got into the skin and actually wrecked the skin in just about all [redacted] grown in the [redacted] yet the inside was great. We actually went to [redacted] and changed the specs. We sat down with them and said, "Hey, here is the story, guys. If you want to stick with the same specs you are not going to get any [redacted] because we just can't supply, and no one will supply. Available to the consumer is still a great [redacted] with great colour, good eating, but every one of those [redacted] is going to have a skin blemish." We changed the specs for the period of time. So I guess - what I'm suggesting is that, providing you are proactive with these guys, there's quite a lot of give and take in the relationship.

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MR O'DONOVAN: Your observation of the supermarkets themselves, do you think [redacted] keep each other under margin pressure in your category?

MR ROBSON: Yes, absolutely.

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MR ROBSON: Yes. The shrink, they absorb the shrink, it's their brand. That's one of the advantages of a private label, the product is their problem.

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MR O'DONOVAN: I suppose there are people who sell through the wholesale markets, who see Coles and Woolies as earning huge margins on the wholesale product. I suppose the first question is does Coles and Woolies's size deliver to them fruit and veg at a much lower price than is observable in the wholesale markets?

MR ROBSON: I don't think it does. Going back to my background, until 2000, I actually had 25 years in the Brisbane Markets, so I was a market trader in there for 25 years. In that time, I sold on the market floor to independents and we served Woolies and Coles through a subsidiary. For a start, our experience is that the costs

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of serving Woolies and Coles is less than - under the system we operate at the moment, is less than the costs of operating in the central market.

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MR O'DONOVAN: Can I finish up with some questions, back on to the question of retail groceries. The information from the Bureau of Statistics indicates to us that food inflation has been higher even than the CPI and that fruit and vegetables in particular seem to have been above the general rate of inflation by a fair amount. Apart from some specific exceptions, do you think that's generally right?

MR ROBSON: Do I think the food inflation or fruit and vegetable inflation?

MR O'DONOVAN: I suppose fruit and vegetable?

MR ROBSON: I think the banana issue had a big impact on the CPI. As you know, there was argument as to whether people substituted, which they did. My job is to go out there and actually get a better price for my growers than I got last year. You know, that's acting as an agent, or to maximise their return that's what keeps getting me the business. My summation is across products we handle, avocados, asparagus, melons, and mangos, is there's been no great inflationary change in the average prices over the last four or five years.

MR O'DONOVAN: At the wholesale level only or at the wholesale level and the retail level?

MR ROBSON: Certainly at the wholesale level. You know, I guess the other interesting - I couldn't speak confidently about the retailer, but the other interesting thing is every one of those product lines we're in, in fact it's important for us in our business that we are in a category that is showing or is capable of showing growth. We're only interested in products that have that, and in all those areas we are getting both volume growth at retail and dollar return growth. I suspect that if we pulled those figures down, both the volume growth and the dollar return growth would be within a few per cent of one another. There would be no great retail selling price growth outdoing the volume growth.

If you think about the fact that we're not eating any more - our box of fruit and vegetables in this country has pretty much been stable, a little bit of an increase, but pretty much stable. What we are about is share steal. If we are selling more asparagus through to the retailers this year then we are really stealing off the broccoli and the other products, and if we're not in line price-wise, the consumer is going to substitute. The consumer substitutes very quickly, especially in the vegetable area.

MR O'DONOVAN: You wouldn't subscribe to the caricatured view that's often put out there that farmers are being pushed down to wafer thin margins and the retailers are making increasingly large margins because of market concentration?

MR ROBSON: No, I certainly don't. But I think the farmers, like any other business, have a responsibility to be participating in the supply chain and looking at ways to cut costs out of the system. If you are just going to sit back and cop a fuel price, without looking at whether the product should be in a - for instance, we changed the mango industry this year, our company changed the mango industry. We went from a 4kg carton to an 8kg carton, and we did that deal [redacted] and we showed them how much of a saving that could be. The whole industry watched and told us we were crazy, that it wouldn't work. The industry will be in that carton next year, I'm sure. I just think there's a responsibility on - - -

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