



Australian  
Competition &  
Consumer  
Commission

24 July 2008

## Statement of Issues — Parmalat SpA and Murray Goulburn Co-operative Co Ltd - proposed acquisition of Australian Co-operative Foods Limited (Dairy Farmers)

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (ACCC) in relation to the proposed acquisition of Australian Co-operative Foods Limited (**Dairy Farmers**) by a consortium comprising Murray Goulburn Co-operative Co Ltd and Parmalat SpA (**proposed acquisition**).
2. 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.
3. In line with the ACCC's *Merger Review Process Guidelines* (available on the ACCC's website at [www.accc.gov.au](http://www.accc.gov.au)) the ACCC has established a secondary timeline for further consideration of the issues. The ACCC anticipates completing further market inquiries by 7 August 2008 and anticipates making a final decision on 21 August 2008. However, the anticipated timeline can change in line with the *Merger Review Process Guidelines*. To keep abreast of possible changes in relation to timing and to find relevant documents, market participants should visit the Mergers Register on the ACCC's website at [www.accc.gov.au/mergersregister](http://www.accc.gov.au/mergersregister).
4. 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.

### Background

5. On 19 May 2008 Murray Goulburn Co-operative Co Ltd and Parmalat SpA provided their submission seeking informal clearance from the ACCC.

## The parties

### Parmalat Australia Ltd

6. Parmalat Australia Ltd (formerly Pauls Limited) is a wholly owned subsidiary of the Italian based global dairy company, Parmalat SpA (**Parmalat**). Parmalat is a processor and distributor of fresh milk and dairy products for Australian retail.
7. Parmalat primarily produces fresh milk and other fresh dairy products. Its production and distribution of fresh milk and cream is concentrated largely in Queensland and Victoria. Its other long life and fresh dairy products and beverages are manufactured primarily for domestic markets and some export supply.
8. In addition to production of private label dairy products, Parmalat produces under the following major brands:

Product	Brands
Fresh White Milk	Pauls Full Cream, Pauls Trim, Pauls Trim healthplus + FIBRE, Pauls Smarter White Milk, Pauls Slim, Pauls Froth Top, REV, REV Healthplus + FIBRE, Skinny Milk, PhysiCAL, Pure Organic, Pure Bio Dynamic, Zymil, Farmhouse Extra Creamy
Fresh Flavoured Milk	Breaka, Ice Break, Rush, Pauls Iced Coffee, Pauls Shake, Pauls Malt & Honey, Pauls All Natural
Yoghurt	Pauls Natural Yoghurt, Pauls Fruit Yoghurt, Vaalia
Creams	Pauls Pure Cream, Pauls Thickened Cream, Pauls Light Thickened Cream, Pauls Extra Light Thickened Cream, Pauls Double Thick Cream, Pauls Sour Light Cream, Pauls Sour Extra Light Cream
Other	Soy Life (soy milk and yoghurt), Pauls Buttermilk, Pauls Goat Milk, Pauls Custard, various fruit juices

### Murray Goulburn Co-operative Co Ltd

9. Murray Goulburn Co-operative Co Limited (Murray Goulburn) is a wholly Australian owned company by around 2,500 supplier-shareholders. Murray Goulburn produces a range of products both for domestic consumption and export. Murray Goulburn has a raw milk intake of approximately 3.3 billion litres acquired from its farmer shareholders and other producers.
10. Murray Goulburn produces around 84,000t of butter products, 124,000t of cheese, 260,000t of milk powders and 130,000t of UHT products annually. Murray Goulburn exports to more than 100 countries and its international business

accounts for 48% of Australian dairy exports by value and 9% of world dairy trade. It has eight manufacturing sites located in Victoria and one in Tasmania.

11. In addition to production of private label dairy products, Murray Goulburn produces under the following major retail brands:

Product	Brands
Fresh White Milk	Kiewa
UHT White Milk	Devondale Full Cream Milk, Devondale Skim Milk, Devondale Semi-Skim Milk, Devondale Point One, Devondale Smart Milk, Devondale Smart Plus, Devondale Reduce, Liddels Lactose Free Milk (full cream, low fat, skim)
Flavoured UHT Milk	Liddels Lactose Free Chocolate Milk
Cheese	Devondale Moo Zoo, Devondale Organic Tasty, Devondale Mild, Devondale Colby, Devondale Tasty, Devondale Light'N Tasty, Devondale Vintage, Devondale Sandwich Slices, Devondale Seven, Cobram Vintage Cheddar
Butter & Spreads	Devondale Butter, Devondale Dairy Soft, Devondale Extra Soft, Devondale Light, Devondale Light with Calcium
Yoghurt	Liddels Yoghurt
Creams	Devondale Thickened Cream, Devondale Long Life Thickened Cream, Devondale Sour Light, Liddels Lactose Free Thickened Light Cream
Other	Devondale Skim Milk Powder

12. Murray Goulburn also produces a wide range of products for food services which are packaged in bulk, including:

Product	Brands
Fresh White Milk	Devondale Pasteurised Milk
UHT White Milk	Devondale Full Cream Milk, Devondale Skim Milk, Devondale Point One, Devondale Smart Milk, Devondale Smart Plus
Cheese	Cream Cheese, Mozzarella, Easy Melt Pizza Block, Pizza Block, Sandwich Slices, Seven, Tasty Cheese slices, Tasty Cheese Sauce, Liquid Cheddar, Cobram Tasty, Cobram Vintage, International Selection Brie, International Selection Blue, International Selection Fetta, Devondale Light & Tasty, Mozzshred, Shredded Tasty, Cubes Tasty, Cheddar Mild, Cheddar Tasty, Goday Cheddar, Cheddar vintage, Colby, Natural Slices

Butter & Spreads	Devondale Butter, Devondale Dairy Soft, Devondale Extra Soft, Devondale Light, Devondale Light with Calcium
Other	Devondale Skim Milk Powder, Devondale Instant Skim Milk Powder, Devondale Dairy Bake, Devondale Full Cream Milk Powder, Devondale Instant Full Cream Milk Powder, Devondale Coffee Creamer

13. Murray Goulburn also produces a range of ingredients for manufacturing under the Murray Goulburn Ingredients brand including various skim milk powders, full milk powders, buttermilk powder, milk protein concentrate, milk fat products (anhydrous milk fat, salted butter, unsalted butter, frozen cream, prepared edible fat, lactic butter), cheese products (cheddar, gouda, mozzarella/pizza cheese, colby, goshred, hard cheese, cream cheese, swiss cheese), whey products, casein and caseinates.

#### **Australian Co-operative Foods Limited (Dairy Farmers)**

14. Dairy Farmers is a milk processing co-operative business owned by 2,000 Australian farmers. Its principal activities are the collection, processing, manufacturing, packaging, distribution and marketing of milk and dairy products. Dairy Farmers retail brands include:

Product	Brands
Fresh White Milk	Dairy Farmers Whole Milk, Dairy Farmers Lite White, Dairy Farmers Skim Milk, Dairy Farmers Take Care, Dairy Farmers Crema (cafes only), Farmers Best, Shape
UHT White Milk	Dairy Farmers UHT
Flavoured UHT Milk	Oak, Moove, Dare, Just Natural, Jacaranda
Cheese	Coon Tasty, Coon Swiss, Coon Pasta, Coon Pizza, Coon Light & Tasty, Coon Mild, Cracker Barrel, Vintage Light, Cracker Barrel Extra Sharp, Cracker Barrel Farmhouse Style, Mil Lel Parmesan, Mil Lel Extra Aged Parmesan, Mil Lel Romano, Mil Lel Mozzarella, Mil Lel Chilli Pecorino, Dairy Farmers Cottage Cheese.
Butter & Spreads	Dairy Farmers Butter
Yoghurt	Dairy Farmers Thick & Creamy, Dairy Farmers Traditional, Dairy Farmers European, SKI, Bornhoffen, Dairy Farmers Kids Selection.
Creams	Dairy Farmers Thickened Cream. Dairy Farmers Pure Cream, Dairy Farmers Sour Cream.
Dairy Desserts	Dairy Farmers Custard, Dairy Farmers Kids Selection (custard)

15. Dairy Farmers currently manufactures and supplies whole fresh white milk, modified fresh white milk, UHT white milk, fresh flavoured milk, soy milk, buttermilk, yoghurt, dairy desserts, custard, cream, sour cream, cheese and milk powders.
16. Under a 2004 restructure, Dairy Farmers was established as a separate co-operative from Dairy Farmers Milk Co-operative Limited (Supply Co-operative). 19.99% of Dairy Farmers is held by the supply cooperative, with the balance owned by members of Dairy Farmers.

### **Transaction structure**

17. Parmalat and Murray Goulburn have formed a consortium with a view to acquiring Dairy Farmers. The structure of the transaction has not yet been finally determined but key aspects of the structure currently proposed are outlined below:
  - Parmalat will merge with the fresh dairy business of Dairy Farmers (comprising the white milk, impulse and dairy foods businesses of Dairy Farmers) to create a fresh dairy focussed company (**Fresh Dairy Co**);
  - Murray Goulburn will acquire the non-fresh dairy businesses of Dairy Farmers, (comprising the dairy cheese and ingredients businesses of Dairy Farmers); and
  - Parmalat will ultimately hold 51% of Fresh Dairy Co, giving Parmalat operational control of the fresh dairy business, and Murray Goulburn will hold 49% of Fresh Dairy Co.

### **Other industry participants**

18. The industry is characterised by a mix of large, diversified dairy processors, product specific manufacturers and customers of varying size and complexity.
19. Other diversified dairy processors include National Foods Limited and Fonterra Cooperative Group Limited. Processors in this category have a range of products across most, if not all, dairy categories.
20. Some processors tend to be more export focussed including Warrnambool Cheese and Butter Factory Company Limited, Tatura and Fonterra. This category of processors operate mostly from Victoria and focus on export dairy products such as cheese, milk powders, milk proteins and whey.
21. Specific product manufacturers are largely those in the fresh dairy category, and include the Tamar Valley and Jalna yoghurt producers.
22. Customers of dairy processors include retailers who on-sell dairy products and input consumers who use the products as an input for further consumer products. Retailers include the major grocers of Coles and Woolworths, independent grocers and suppliers of grocery items, and members of the route trade including service stations and convenience stores. Input consumers include the food service industry such as restaurants, take away stores and consumer foods manufacturers.

## **Areas of overlap and market definition**

23. From its inquiries, the ACCC understands that the primary areas of substantial overlap between Dairy Farmers, Parmalat and Murray Goulburn to be:

- the acquisition of raw milk in south east Queensland and northern New South Wales;
- the manufacture and wholesale supply of fresh white milk in Queensland;
- the manufacture and wholesale supply of flavoured milk in Queensland;
- the manufacture and supply of dairy deserts such as yoghurt nationally;
- the manufacture and supply of cheese nationally;
- the manufacture and wholesale supply of custards nationally, and;
- the manufacture and wholesale supply of UHT white milk nationally.

## **Market inquiries**

24. On 19 May 2008 the ACCC commenced market inquiries regarding the proposed acquisition. Interested party responses were received from a range of industry participants, including participants in the route trade, food service industry and other suppliers of processed dairy products.

## **Statement of issues**

25. For the purposes of this Statement of Issues, the issues in this matter are divided into three categories, 'issues of concern', 'issues that may raise concerns' and 'issues unlikely to pose concerns'.

### **Issues of concern**

#### ***Competition in the supply of flavoured milk in Queensland***

26. The ACCC has formed the preliminary view that the proposed acquisition will be likely to substantially lessen competition in the market for the manufacture and wholesale supply of flavoured milks in Queensland.

27. From its inquiries the ACCC understands that both Parmalat and Dairy Farmers are significant suppliers of flavoured milk in Queensland. Market inquiries indicate that Parmalat has approximately a two-thirds market share in Queensland with its Breaka and Ice Break brands. Dairy Farmers has approximately one quarter of the Queensland market with its Moove, Oak and Dare brands. Post acquisition the merged entity may have approximately 85-90% of the sale of flavoured milk in Queensland.

28. The ACCC invites further information and comments as to the strength of competitive constraints operating on the merged entity for the manufacture of flavoured milk post-acquisition. The possible constraints identified by the ACCC are discussed below, and include the threat of entry and expansion, competition from suppliers of impulse beverages, countervailing and bargaining power from retailers.

*Threat of new entry and expansion*

29. Inquiries have indicated that manufacturers of non-incumbent brands have experienced significant difficulties in expanding their operations beyond their 'home' states/territories, with brand loyalty a key impediment to expansion. For example, some market participants have noted difficulties faced by National Foods in gaining market share for its flavoured milk brands in Queensland whilst being a significant competitor in New South Wales.
30. Brand strength may also make it difficult for suppliers with a fresh milk manufacturing presence in Queensland to expand into flavoured milks.
31. The ACCC is concerned that the threat of new entry or expansion, in a timely manner and with sufficient scale to defeat an increase in price of flavoured milk by the merged entity, is low. The ACCC invites market participants to provide comment on, and preferably provide specific examples of, the competitiveness of other actual or potential Australian suppliers of flavoured milks, particularly with regard to entry into and expansion in the Queensland market.
32. The ACCC seeks information which supports or challenges the view that the level of brand loyalty in the flavoured milk markets prevents new entry or expansion. The ACCC also seeks information and data (including market shares) regarding product launches and any failures in the flavoured milk market in recent years, particularly where these involve a launch beyond a firm's traditional 'home' state or territory.
33. The ACCC also seeks information supporting or contradicting the view that the level of brand loyalty in the flavoured milk markets prevents or hinders new entry or expansion.

*Impulse beverages*

34. Some market participants have indicated that flavoured milks participate within a more general impulse beverages market. Impulse beverages include soft drinks, sports drinks, energy drinks and breakfast drinks. In support of this argument it has been suggested that:
- on the demand side, flavoured milk provides an impulse beverage for immediate consumption, and that a price increase would lead to a switching to other impulse beverages; and
  - the target demographic for soft drinks and flavoured milks are similar, such that flavoured milk producers encourage route trade placement of products in close proximity to soft drinks.

35. The ACCC notes the entry of Coca-Cola Amatil (CCA) into the flavoured milk market in Western Australia with the Goulburn Valley flavoured milk product in September 2007. That CCA developed its own flavoured milk product rather than compete using its Powerade (sports drink) or Coca-Cola (soft drink) may be a strong indication that the products of other impulse beverage manufacturers are not close substitutes for flavoured milks.
36. The ACCC also notes significant supply side differences between flavoured milks and other impulse beverages. There are significantly different input and processing requirements, requirements for refrigerated transportation and distribution, and in the case of fresh flavoured milks, the limited shelf life also limits transportation distances.
37. The ACCC is of the preliminary view that other impulse beverages offer a weak constraint, at best, for flavoured milks. The ACCC will consider further submissions on the extent to which, if any, impulse beverages constrain flavoured milk pricing. In particular, the ACCC is seeking data or information quantifying the likely decrease in flavoured milk volume sales and increase in other impulse beverage volume that would be expected in response to a specific price increase for flavoured milk.
38. The ACCC is further seeking comments on the extent to which Murray Goulburn and Parmalat could profitably increase prices of flavoured milk in Queensland above competitive levels after acquiring Dairy Farmers. To what extent would price increases be unprofitable due to the loss of significant volumes of sales to other impulse beverages?

*Bargaining and countervailing power*

39. The ACCC notes that, unlike fresh white milk products, up to 70% of flavoured milk products are sold through the route trade. The ACCC also notes that there is not the prevalence of private label flavoured milk as there is of fresh white milk.
40. The ACCC is therefore of the view that the bargaining power that may be enjoyed by supermarket chains and others through the volume of sales and the prevalence of private label products may not be as effective to resist a price rise above competitive levels post-acquisition in the Queensland flavoured milk market.
41. The ACCC also notes that countervailing power – or the threat to self supply, bypass or sponsor new entry – does not appear strong in the Queensland flavoured milk market.

*UHT flavoured milk*

42. The ACCC notes that UHT flavoured milk and its different supply side attributes make it more transportable, for example by removing the need for chilled refrigeration. Estimates provided during inquiries indicate that UHT flavoured milks constitute approximately 6% of overall flavoured milk sales. The ACCC therefore is of the view that the analysis is unlikely to change with or without the inclusion of UHT milks.



## Issues that may raise concerns

### *Supply of fresh white milk in south east Queensland*

43. Inquiries have indicated that the merged entity will be the largest supplier of fresh white milk in south east Queensland post acquisition. The ACCC considers the proposed acquisition may raise concerns for competition for the supply of fresh milk in Queensland. Competition concerns will arise if the merged entity is able to use its post acquisition market position to sustain an increase in the price of fresh white milk in south east Queensland.
44. The ACCC has considered wholesale supply of fresh white milk markets in a number of previous circumstances, including Fonterra Co-operative Limited - proposed acquisition of National Foods Ltd, 2005; Australian Co-operative Foods Limited – proposed acquisition of Perfection Dairies Pty Ltd and its subsidiaries, 2008.
45. Given an average transport cost of 2.2cpl for fresh white milk, and its limited shelf life, the ACCC considers the relevant economic market for the purposes of this competition assessment is likely to be the wholesale supply of fresh white milk in south east Queensland.
46. Post acquisition, the merged entity will have in excess of 50% market share in south east Queensland. Some post-acquisition competition will remain with National Foods at approximately 25-35% market share and Fonterra and others making up the remainder of the market.
47. Inquiries indicate that private label fresh white milk sales in south east Queensland account for approximately 30% of the fresh white milk market.
48. The ACCC seeks more information in relation to this issue, including any information that goes to:
  - a. the extent to which National Foods and / or Fonterra would be able to provide a competitive alternative in the event of a small but significant non-transitory price rise by the merged entity;
  - b. the extent to which each of the following factors affects the ability for National Foods and / or Fonterra to provide a competitive alternative:
    - i. the role of branding in Fresh White Milk;
    - ii. being a supplier of Fresh White Milk private labels; and
    - iii. any other relevant factors,
  - c. whether the proposed acquisition would affect the ability of incumbents or new entrants to obtain a private label contract, and

- d. the extent of barriers to entry and whether the proposed acquisition will increase the barriers to entry to the south east Queensland fresh white milk market.

***National supply of UHT white milk***

49. Inquiries have suggested that Murray Goulburn is the largest domestic supplier of UHT white milk in Australia. Information provided to the ACCC suggests that Murray Goulburn's nearest competitors are National Foods, Dairy Farmers and Parmalat with a combined market share of around 20% of domestic sales of branded UHT white milk.
50. The ACCC is therefore concerned that with such significant market share a further increase arising from the proposed acquisition may raise concerns for the national supply of UHT white milk.
51. The ACCC invites market participants to provide comment on the competitiveness of the national UHT supply market both with and without the proposed acquisition. The ACCC particularly seeks responses to:
  - i. Whether there any other competitors in the national UHT supply market who have spare capacity and would be able to constrain the merged entity in the event prices are raised above competitive levels.
  - ii. By how much would the merged entity have to increase the price of its branded UHT white milk in order to prompt fresh white milk processors - who do not also produce UHT white milk at certain plants - to expand into producing UHT white milk at these processing plants.
  - iii. By how much would the merged entity have to increase the price of its branded UHT white milk before consumers turned to fresh white milk or other possible substitutes.
  - iv. Whether the potential for imports of UHT white milk would be likely to constrain the merged entity from raising prices above competitive levels.
  - v. The significance of private label sales as a proportion of total sales of UHT white milk, including the level of bargaining or countervailing power the large supermarket chains (such as Woolworths and Coles) have in relation to the prices of these private label products.

**Issues unlikely to pose concerns**

***Acquisition of raw milk in south-east Queensland and northern NSW***

52. The ACCC considers the proposed acquisition is unlikely to raise concerns for competition for the acquisition of raw milk in south-east Queensland and northern NSW.
53. The ACCC has considered raw milk acquisition markets in a number of previous circumstances, including a series of merger reviews and applications for

authorisation in the dairy industry. For the purposes of this matter, the ACCC has explored the acquisition costs of raw milk, and in particular the transport costs to acquire raw milk. The ACCC considers that transport costs associated with acquiring raw milk from other regions are likely to limit the market geographically. Therefore, the ACCC has delineated a market for the acquisition of raw milk in south-east Queensland and northern NSW.

54. Inquiries have indicated that Dairy Farmers and Parmalat are the two largest acquirers of raw milk in the relevant market with a combined share of approximately 60-70%. Their nearest competitors are Norco/Fonterra and National Foods with approximately 10-20% each.
55. However, the ACCC understands that these competitors have available spare capacity, and compete strongly with Parmalat for the acquisition of raw milk. The ACCC considers that there are no significant barriers preventing farmers from switching between processors. Based on these factors, the ACCC considers that competition for the acquisition of raw milk provided by Norco/Fonterra and National Foods is likely to mitigate potential competition concerns.
56. The ACCC is therefore of the view that the proposed acquisition is unlikely to raise concerns in relation to the acquisition of raw milk in south-east Queensland and northern NSW, but will accept further submissions from industry participants and will further consider this product area if it considers that such an assessment is warranted.

#### ***National supply of cheese***

57. The ACCC considers that the proposed acquisition is unlikely to raise concerns in relation to the manufacture and national supply of cheese.
58. The ACCC understands that cheese is both an export and import product for Australia, and that most cheese suppliers in Australia also compete on international markets for cheese supply. There is no significant difference between the cheese that is exported and that sold on the Australian domestic market such that should the merged entity attempt to increase price post acquisition export cheese may be redirected to the Australian market and may serve to restrict a price rise to some extent.
59. The ACCC also notes that there will be significant excess capacity with those cheese producers who will remain as competitors to the merged entity post acquisition.
60. The ACCC is therefore of the view that the proposed acquisition is unlikely to raise concerns in relation to the manufacture and national supply of cheese, but will accept further submissions from industry participants and will further consider this product area if it considers that such an assessment is warranted.

#### ***National supply of custard***

61. Inquiries have indicated that Parmalat and Dairy Farmers are the two most significant manufacturers of custard and will hold most of the post-acquisition

market share. Despite market share figures, the ACCC considers that an effective competitive constraint on the merged entity will be held by the threat of new entry, given that barriers to entry appear low. The ACCC also notes information from market inquiries that end consumers may have some countervailing power due to their ability to make their own custard.

62. The ACCC is therefore of the view that the proposed acquisition is unlikely to raise concerns in relation to the national market for the supply of custard but invite further submissions from industry participants and will further consider this product area if it considers that such an assessment is warranted.

### ***Other markets***

63. The merger parties also overlap in varying degrees in other markets outside of those discussed above, including: regional markets for the acquisition of raw milk, state markets for the supply of fresh and flavoured milks, fresh dairy products (dairy desserts and yoghurts) and non-fresh dairy. On the basis of limited aggregation, existence of remaining strong competitors and/or the strong bargaining position of customers, the ACCC does not believe that competition concerns are likely to arise in those markets.

64. The ACCC will accept further submissions on these areas from industry participants, and will further consider these areas if it believes such an assessment is warranted.

### **ACCC's future steps**

65. The ACCC will finalise its view on this matter after it considers market responses invited by this Statement of Issues.
66. 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.
67. Submissions are to be received by the ACCC no later than 7 August 2008. The ACCC will consider the submissions received from the market and the merger parties in light of the issues identified above and will, in conjunction with information and submissions already provided by the parties, come to a final view as to the appropriate course of action to take to resolve any competition concerns that remain.
68. The ACCC intends to publicly announce its final view by 21 August 2008. However the anticipated timeline may change in line with the *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.