



## Public Competition Assessment

17 May 2018

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

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#### The ACCC’s decision

1. On 4 April 2018, the Australian Competition and Consumer Commission (**ACCC**) announced its decision not to oppose the proposed acquisition by Saputo Dairy Australia Pty Ltd (**Saputo**) of the operating assets of Murray Goulburn Co-operative Co. Limited (**Murray Goulburn**) (the **proposed acquisition**), subject to a court enforceable undertaking. The undertaking requires Saputo to divest the Koroit dairy processing plant to a purchaser to be approved by the ACCC. The Koroit plant is close to Saputo’s plant at Allansford.
2. The ACCC considered that the proposed acquisition, in conjunction with the undertaking, would not contravene section 50 of the *Competition and Consumer Act 2010* (the **Act**).
3. 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 considered the competitive effects of the proposed acquisition in the following markets:
  - the market for the acquisition of raw milk in south-west Victoria and south-east South Australia (together, **Western Victoria**)
  - 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.
5. The ACCC considered that the divestiture of the Koroit dairy processing plant would address the substantial lessening of competition that would likely otherwise have occurred in the acquisition of raw milk in Western Victoria.

6. Please note that this and other public competition assessments are subject to the following qualifications:
  - the ACCC considers each transaction on a case-by-case basis and so the analysis and decision outlined in one assessment will not necessarily reflect the ACCC's view of another transaction, even where that other transaction may involve the same or a related market, and
  - as public competition assessments are brief and do not refer to confidential information provided by the parties or other market participants, they do not set out all of the issues and information considered by the ACCC, nor all of the analysis and reasons of the ACCC.

## The parties and the transaction

### The acquirer: Saputo

7. Saputo is a wholly-owned subsidiary of Saputo Inc., which is a Canadian based company.
8. Saputo Inc. is one of the top 10 dairy processors in the world, operating 50 manufacturing facilities across Canada, the United States, Argentina and Australia.
9. Saputo's Australian operations are conducted through Warrnambool Cheese and Butter Factory Company Holdings Limited (**WCB**).
10. Saputo through WCB has a dairy processing plant at Allansford in Western Victoria. Allansford is close to Murray Goulburn's Koroit plant. Saputo also has packaging plants in Allansford and Mil Lel, in south east South Australia. Saputo produces a wide range of dairy products. Its Australian brands include Coon, Cracker Barrel and Mil Lel cheeses and Great Ocean Road milk and cheese.

### The target: Murray Goulburn

11. Murray Goulburn is an Australian dairy co-operative with farmer shareholders plus external investors (through the ASX listed MG Unit Trust).
12. 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 subsequently sold the Edith Creek site to Dutch Mill (Australia) Pty Ltd. It closed the Rochester plant and postponed the closure of Kiewa.
13. Murray Goulburn owns the Devondale and Liddells brands and produces a wide range of dairy products, including fresh milk, ultra-heat treated (**UHT**) milk, milk powder, cheese, cream and butter.
14. Murray Goulburn has recently faced financial difficulties. These are outlined below under 'Recent events in the dairy industry' and 'Future with and without the acquisition'.

## The transaction

15. The Saputo proposal involved the acquisition of all Murray Goulburn's operating 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, and its operating liabilities.
16. 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.
17. As part of the transaction, Saputo agreed that it would make several commitments to existing Murray Goulburn farmers.<sup>1</sup> These commitments include:
  - **Collection:** for at least five years from FY2019, Saputo must collect milk from active Murray Goulburn farmers (who supply milk to Murray Goulburn as at the date of Murray Goulburn's 2017 Annual General Meeting and on completion of the proposed acquisition), on terms no less favourable than Murray Goulburn's existing collection terms. Following this period, Saputo must use reasonable endeavours to continue to collect milk on reasonable terms, provided that Saputo is entitled to charge a reasonable cost-recovery amount for transport, handling and storage costs; and
  - **Future milk price:** For a minimum of five years from FY2019, Saputo must pay active Murray Goulburn farmers a market competitive farmgate milk price (**FMP**). That FMP will be not less than the greater of WCB's FMP or the average of the final available weighted average FMPs published by the two largest competing milk processors in the Southern Milk Region<sup>2</sup> or NSW Milk Region<sup>3</sup> (as applicable).<sup>4</sup>

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<sup>1</sup> See Murray Goulburn's Explanatory Memorandum to shareholders and unitholders for the proposed acquisition, p16, available at <https://www.asx.com.au/asxpdf/20180314/pdf/43sdx65b05z054.pdf>.

<sup>2</sup> 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.

<sup>3</sup> The 'NSW Milk Region' includes the following regions: South Coast of NSW; Southern Central Highlands; Central West; Northern Tablelands; Hunter Valley; and Manning Valley.

<sup>4</sup> The ACCC's informal clearance is a decision not to oppose the proposed acquisition pursuant to section 50 of the Act. It is not an approval or clearance of other conduct (such as the FMP commitment) that may fall for consideration under other provisions of Part IV of the Act.

## Review timeline

18. The following table outlines the timeline of key events for the ACCC in this matter.

Date	Event
17 November 2017	ACCC commenced review under the Merger Process Guidelines.
4 December 2017	Closing date for submissions from interested parties.
21 December 2017	ACCC requested further information from Saputo.
18 January 2018	ACCC received further information from Saputo.
2 February 2018	Former provisional decision date of 15 February 2018 delayed due to the ACCC requiring more time to consider data and other information.
1 March 2018	ACCC published a Statement of Issues outlining preliminary competition concerns.
5 March 2018	Saputo announced its proposal to offer an undertaking to the ACCC to divest the Koroit facility to address the ACCC's competition concerns.
22 March 2018	Closing date for submissions relating to draft section 87B undertaking.
28 March 2018	Former proposed decision date of 29 March 2018 delayed to allow the ACCC to consider the feedback received from market participants on the undertaking proposed by Saputo.
4 April 2018	ACCC announced it would not oppose the proposed acquisition, subject to a section 87B undertaking accepted by the ACCC.

19. The total elapsed time from start to finish was just over four and a half months. The total period net of time taken by the parties to submit information or documents was 71 business days.

## Market inquiries

20. The ACCC conducted market inquiries with a range of industry participants, including farmers, competitors, potential competitors, downstream customers, industry bodies and other interested parties. Submissions were sought throughout the review in relation to the substantive competition issues and the undertaking proposed by Saputo to address the ACCC's concerns.

## Statement of Issues

21. On 1 March 2018, the ACCC published a Statement of Issues on the proposed acquisition identifying a number of competition issues. In the Statement of Issues, the ACCC stated its preliminary view that the proposed acquisition would be likely to substantially lessen competition in the market for the acquisition of raw milk in Western Victoria, due to the overlap between Saputo's Allansford

plant and Murray Goulburn's Koroit plant. The ACCC did not have concerns about other geographic areas as there were no overlapping assets or operations.

22. The Statement of Issues noted that Saputo (at Allansford) and Murray Goulburn (at Koroit) own the two largest processing plants in Western Victoria and while Fonterra and some smaller players would continue to provide some constraint on a combined Saputo-Murray Goulburn, competition for the acquisition of raw milk in Western Victoria would likely decrease if Saputo acquired the Koroit plant. This decrease in competition would likely result in lower farmgate milk prices (**FMPs**), less favourable contractual terms and/or reduced non-price offers (e.g. financial support or sign-on bonuses) for farmers than they would otherwise receive.
23. The ACCC did not consider that processors outside of Western Victoria, or the threat of new entry or expansion, would provide sufficient competitive constraint on a combined Saputo-Murray Goulburn in Western Victoria.
24. The Statement of Issues also stated the ACCC's preliminary view that the proposed acquisition was not likely to substantially lessen competition in the downstream markets for the supply of fresh milk, cheese, cream and butter by processors.

## Industry background

### Farmers

25. Farmers produce raw milk and supply it to dairy processors or milk brokers. This raw milk is processed to create different dairy products.

### Other dairy processors

26. Dairy processors acquire raw milk from farmers and process the milk to manufacture dairy products. There are a number of other dairy processors that operate in Western Victoria, where Saputo currently operates through WCB:
  - Fonterra Australia Pty Ltd (**Fonterra**) is a subsidiary of New Zealand based Fonterra Co-operative Group Limited. Fonterra operates eight processing facilities in New South Wales, Victoria and Tasmania, collecting around 1.6 billion litres of milk annually.<sup>5</sup> It has two processing facilities in Western Victoria, at Cobden and Dennington. Fonterra produces a wide range of dairy products, servicing customers in Australia and overseas.
  - 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 year.<sup>6</sup> The company primarily supplies cheese and bio nutrients (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

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<sup>5</sup> ACCC Dairy Inquiry, Interim Report, November 2017, p 44.

<sup>6</sup> ACCC Dairy Inquiry, Interim Report, November 2017, p 45.

meat processing company) and the Louis Dreyfus Company. It has a processing plant located in Penola, in south east South Australia. UDC manufactures milk powders, anhydrous milk fat and cream, and services both domestic and export markets.

- Other participants in Western Victoria 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.

### **Dairy processors located outside Western Victoria**

27. There are a number of other dairy processors in Victoria, with plants outside of the Western Victoria region, ranging from specialty 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 a plant at Shepparton in northern Victoria, producing UHT milk
- Lion Dairy and Drinks Pty Ltd (**Lion**), which is part of the Lion Group, is a food and beverage company based in Australia and New Zealand. Lion processes around one billion litres of milk annually across Australia.<sup>7</sup> Lion produces a range of dairy products, including fresh milk, flavoured milk, UHT milk, cheese, yogurt and cream. Lion has processing plants in Chelsea Heights and Morwell in Victoria, and Salisbury in South Australia; and
- Parmalat Australia Limited (**Parmalat**), whose ultimate majority shareholder is the Lactalis Group, is a family-owned multinational company based in France. Parmalat collects around 1 billion litres of raw milk a year<sup>8</sup> and owns a number of facilities throughout Australia, including in Echuca, Bendigo North, Longwarry and Rowville in Victoria, and Clarence Gardens in Adelaide.

### **Other dairy companies**

28. As an alternative to supplying milk directly to processors, farmers may supply milk to brokers or third parties that aggregate milk and on-sell it to processors or food manufacturers. Brokers or aggregators active in Western Victoria include Australian Dairy Farmers Corporation (**ADFC**) and Australian Consolidated Milk (**ACM**).

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<sup>7</sup> ACCC Dairy Inquiry, Interim Report, November 2017, p 45.

<sup>8</sup> ACCC Dairy Inquiry, Interim Report, November 2017, p 45.

## Recent events in the dairy industry

29. The period during 2016 and 2017 presented a number of difficulties for the dairy industry in south-eastern Australia. Late-season reductions to the FMPs paid by Murray Goulburn and Fonterra in April 2016 (known as 'step downs') caused severe and unforeseen reductions in the incomes of dairy farmers.
30. In response to the Murray Goulburn step down, a significant number of farmers ceased supplying Murray Goulburn. Some farmers exited the industry; many moved processors. This significantly reduced Murray Goulburn's total milk intake in FY17.
31. Following the end of the FY17 season, Murray Goulburn published an opening FMP for the FY18 season 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 then revised its opening price to \$5.20/kgms. Murray Goulburn's milk intake dropped by 30 percent in the opening months of the 2017-18 season.<sup>9</sup>
32. At the time of the ACCC's review, Murray Goulburn's milk intake across its business was significantly reduced compared to its historical operating volumes. Dairy processing plants tend to have high fixed costs and exhibit significant economies of scale, therefore the loss of raw milk had a significant impact on Murray Goulburn's business.
33. 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.

## Areas of overlap

34. Saputo and Murray Goulburn overlap in:
  - the acquisition of raw milk from farmers located in Western Victoria, and
  - the manufacture and supply of various dairy products to downstream customers (such as supermarkets, food manufacturers, food service providers and international customers).
35. In relation to the acquisition of raw milk, Saputo and Murray Goulburn overlap in the acquisition of milk from farmers located in Western Victoria, where Murray Goulburn has a large processing plant at Koroit and Saputo has a large plant nearby at Allansford. The ACCC focused its review on the acquisition of raw milk within this region.
36. In relation to the manufacture and supply of dairy products, market inquiries indicated that the two parties overlap in the manufacture of various products. However, market participants only raised concerns regarding the manufacture and supply of bulk cream, cheese and butter. For all other dairy products, it

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<sup>9</sup> *The Devondaler*, Issue No 383, available at <http://www.mgc.com.au/media/51271/devondaler-february-2018.pdf>, p1.

appeared that there would be sufficient alternative options remaining after the acquisition and no concerns were raised by market participants.

## Future with and without the acquisition

37. 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, the ACCC considers the effects of the acquisition by comparing the likely future state of competition if the acquisition proceeds (the “with” position) to the likely future state of competition 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.
38. After announcing a strategic review of its business on 6 June 2017, Murray Goulburn received a number of proposals from parties interested in acquiring all or part of its business.<sup>10</sup> Media reports around the time reported that 20 parties had submitted expressions of interest for Murray Goulburn.<sup>11</sup>
39. On 7 February 2018, Murray Goulburn released its half-year results for FY17/18, 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 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.<sup>12</sup>
40. Murray Goulburn said in its results that, if the proposed acquisition or an alternate one did 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, it would need to consider selling certain assets to repay debt.<sup>13</sup>
41. Taking into account the number of proposals received by Murray Goulburn, the ACCC considered it likely that Murray Goulburn’s assets (either in their entirety or separately) would remain in the market and be purchased by one or more alternative acquirers if the proposed acquisition by Saputo did not proceed.
42. The ACCC considered that any alternative acquirer of some or all 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.

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<sup>10</sup> Murray Goulburn, ‘2017 AGM Q&A Summary’, available at <http://www.mgc.com.au/media/51215/AGM-2017-QA-Summary-final.pdf>, p1.

<sup>11</sup> ‘Bell rings for round two in Murray Goulburn contest’, *The Australian*, Business News, 12 October 2017.

<sup>12</sup> Murray Goulburn, Interim financial statements and reports, 7 February 2018, available at <http://www.mgc.com.au/media/51269/2-mgc-half-year-financial-report-fy18-for-asx-.pdf>, p 9.

<sup>13</sup> Murray Goulburn, Interim financial statements and reports, 7 February 2018, available at <http://www.mgc.com.au/media/51269/2-mgc-half-year-financial-report-fy18-for-asx-.pdf>, p 9.

## Competition analysis – Acquisition of raw milk in Western Victoria

43. The ACCC considered that, without the proposed undertaking, Saputo's proposed acquisition of the Murray Goulburn Koroit processing plant was likely to substantially lessen competition in the market for the acquisition of raw milk in Western Victoria.

### Market definition

44. The ACCC considered that the key relevant market was likely to be the market for the acquisition of raw milk in Western Victoria.
45. 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 some processors submitted that this distance can be up to 600km, ACCC analysis of processors' purchase records during its Dairy Inquiry<sup>14</sup> 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 the processing plant.<sup>15</sup>
46. In Western Victoria, a significantly higher share of raw milk is acquired by processors with facilities within or very near to the region (Murray Goulburn, Saputo, Fonterra, UDC and Bulla), rather than by processors outside of the region (for example, Bega, Lion and Parmalat).
47. The ACCC considered that the most substantial competitive constraint on Saputo would be from processors with plants located within 200 kilometres of the dairy farms which supply the Allansford and Koroit processing plants.
48. 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. The ACCC considered that there would need to be a significant decrease in the price of raw milk (more than 10 per cent) paid by those processors to economically compete in a substantive way in Western Victoria.
49. Further, the ACCC's analysis of farmer switching patterns (discussed further below) indicated that during the steps downs, 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.

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<sup>14</sup> On 27 October 2016 the Treasurer, the Hon Scott Morrison MP issued a notice requiring the ACCC to hold an inquiry into the competitiveness of prices, trading practices and the supply chain in the Australian dairy industry. See <https://www.accc.gov.au/about-us/information-for/agriculture/dairy-inquiry>

<sup>15</sup> ACCC Dairy Inquiry, Interim Report, November 2017, p 99.

50. Accordingly, in this matter, the ACCC considered Western Victoria to be the appropriate geographic market.
51. However, the ACCC noted that even based on a broader geographic area – such as a region including all of Victoria and eastern South Australia – a combined Saputo-Murray Goulburn would still have by far the largest market share of raw milk acquisition, with Fonterra the next largest, and other processors with significantly smaller market shares.
52. The ACCC also took into consideration processors' state or region-wide pricing policies. This issue is discussed below under the heading 'Relevance of processor pricing policies'.

### Closeness of competition between Saputo and Murray Goulburn

53. The ACCC takes into account the closeness of competition or rivalry between competing firms in the market to determine which firms exert the most competitive constraint on one another. Where rival firms have in the past competed directly with one another for customers or suppliers, then competition concerns are more likely to be raised if this rivalry is lost as a result of a merger.
54. The ACCC 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.
55. Saputo and Murray Goulburn compete to acquire milk for their respective plants at Allansford and Koroit, which are about 30 kilometres' drive from one another. These two plants are the largest in the region and account for a significant proportion of total raw milk processing capacity in Western Victoria. The ACCC estimated that a combined Saputo-Murray Goulburn would have over two-thirds of the processing capacity in Western Victoria, with Fonterra the next largest but with a much smaller share.
56. Market inquiries indicated 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.
57. The ACCC analysed confidential data regarding the switching of farmers between processors and, in particular, which processors dairy farmers switched to after leaving Murray Goulburn in the period from July 2016 to December 2017. The ACCC considered that this data showed in broad terms that:
  - farmers in Western Victoria predominantly switch between alternative processors with plants within Western Victoria, as opposed to processors with plants outside of Western Victoria
  - Murray Goulburn and Saputo are very close competitors
  - Fonterra is a significant but smaller competitor in the Western Victoria region, compared to Saputo and Murray Goulburn, and

- smaller processors have (or have had) some competitive impact in winning farmers, including in particular UDC during its start-up period.
58. 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 ACCC's Dairy Inquiry found that processors typically experience churn of their milk volumes year-on-year of between two and nine per cent.<sup>16</sup> In FY2017, Murray Goulburn's reported milk volumes dropped by 23 per cent as approximately 370 farmers switched to other processors.<sup>17</sup>
59. The ACCC considered that the ability to switch between processors is an important aspect of competition for farmers in the dairy industry. Saputo provided dairy farmers in Western Victoria that were supplying Murray Goulburn with a commercial alternative. Many farmers exercised that option in the face of a substantial decrease in Murray Goulburn's FMP. 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.
60. The ACCC concluded that Saputo and Murray Goulburn are each other's most significant competitors in the acquisition of raw milk in Western Victoria. Although Murray Goulburn's financial difficulties have impacted its strength as a competitor in recent years, the size of its raw milk processing capacity and the quality of its assets mean that it would be likely to be a significant competitor in the future without the proposed acquisition (likely under different ownership). Saputo's proposed acquisition of Murray Goulburn's Koroit plant would eliminate this rivalry.

### Competition from other processors

61. As noted above, the proposed acquisition would have combined the two processing plants with the largest processing capacities in Western Victoria by a substantial margin. However, the ACCC also considered the likely levels of competitive constraint on a combined Saputo-Murray Goulburn from other processors. The ACCC took into account the views of dairy farmers and other market participants, data and internal company documents.
62. The ACCC considered 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 than those with plants located further away. This is principally because a processor's transport costs increase with distance: it is more expensive for them to acquire milk from farms located further away.
63. The ACCC first looked at those processors within about 200 kilometres of most of the dairy farmers that supply Saputo at Allansford and Murray Goulburn at Koroit.

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<sup>16</sup> ACCC Dairy Inquiry, Interim Report, November 2017, p 17.

<sup>17</sup> Murray Goulburn Explanatory Memorandum, 14 March 2018, available at <https://www.asx.com.au/asxpdf/20180314/pdf/43sdx65b05z054.pdf>, p25.

64. Although there are a number of other processors with plants located in Western Victoria, these plants are much smaller than the combined capacity of Saputo's Allansford plant and Murray Goulburn's Koroit plant. This limits the degree of competition they could provide to a combined Saputo-Murray Goulburn.
65. The four main competing processors in Western Victoria are:
- Fonterra (at Cobden and Dennington)
  - Bega (at Coburg)
  - Bulla (at Colac), and
  - UDC (at Penola).
66. The ACCC considered that Fonterra is a significant competitor with the ability to place a degree of competitive pressure on a combined Saputo-Murray Goulburn in Western Victoria, as it competes to acquire milk for its Cobden and Dennington plants. Dennington is close to Warrnambool and Cobden is approximately 60km away. However, the combined intake capacity of these two plants is significantly smaller than the capacity of either Saputo's Allansford or Murray Goulburn's Koroit plants. Although there is the potential for expansion of processing facilities, this would depend on a number of factors in the market including global and domestic demand for dairy products, financial circumstances of the firm, and whether or not excess capacity already exists in the market.
67. Bega has acquired milk in the Western Victorian region for a number of years, but its share of volumes in Western Victoria are still small compared with Saputo, Murray Goulburn and Fonterra. Bega acquires milk in this region predominantly to supply its plant at Coburg. This plant only represents a small proportion of Bega's overall production capacity, with its larger production facilities being located in New South Wales and northern Victoria. As noted above, although there is potential for the expansion of processing facilities, this can be restricted by a number of factors.
68. The ACCC considered the significance of UDC. UDC is a joint venture between the Warrnambool-based Midfield meat processing group, and global commodities trader Louis Dreyfus. Since commencing operations in mid-2017, UDC has taken on a significant volume of raw milk. It has been reported that UDC also has planning approval for a dairy processing site in Warrnambool.<sup>18</sup> The ACCC considered UDC's processing capacity and likelihood of expansion in assessing whether it would be a strong competitor for dairy farmers in Western Victoria. However, even with the potential expansion, UDC's intake capacity would be small compared to that of Saputo and Murray Goulburn.
69. Other acquirers of milk in the Western Region that farmers cited as options to supply included the following. However the ACCC considered that the degree of constraint that they would be likely to exert on a combined Saputo-Murray Goulburn would be limited:

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<sup>18</sup> 'First product rolls off line at the Union Dairy Company's Penola milk plant', *The Standard*, 10 August 2017, available at <http://www.standard.net.au/story/4846301/first-product-rolls-off-line/>.

- ACM
  - Camperdown Dairy, which has a small processing plant at Camperdown
  - 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, and
  - Australian Dairy Farmers Corporation, which acquires milk to be on-supplied to processors including Bulla's Colac plant.
70. The ACCC considered the competitive constraint that all of the raw milk acquirers mentioned above provide in totality. The ACCC was concerned that, given their processing capacity and the likelihood of entry or expansion (see 'Likelihood of entry or expansion' below), this group of competitors would not be enough to competitively constrain a combined Saputo-Murray Goulburn.

*Processors located outside Western Victoria*

71. The ACCC also considered the extent to which processing plants located further than 200km from the farmers who supply Allansford or Koroit may competitively constrain a combined Saputo-Murray Goulburn in setting its FMP in Western Victoria. This included Parmalat in Bendigo, Fonterra, Bega and Freedom Foods in the Shepparton region, Parmalat and Lion in the south-eastern suburbs of Melbourne and Burra to the east. Information from these processors indicated that the costs incurred in collecting and transporting milk to these plants from Western Victoria meant that they were highly unlikely to source a significant proportion of their required volumes from Western Victoria. In turn, this made them, at most, an unlikely alternative for many dairy farmers in Western Victoria.
72. Moreover, the seasonal milk supply patterns that are typical in Western Victoria affect the incentives and costs of processors outside that region to contract with farmers from that region. Parmalat and Lion (which have dairy processing facilities outside Western Victoria) primarily use these facilities to produce 'fresh' dairy products such as drinking milk and yoghurt. They supply these products into the domestic retail market. Producing 'fresh' dairy products requires a relatively 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.
73. Producers of 'fresh' dairy products, therefore, tend to place a lower value on (and therefore pay less for) supply from farms with a strong seasonal milk supply pattern.<sup>19</sup> These processors tend to target farmers with flat milk production whereas most farmers in Western Victoria have more seasonal production.
74. Accordingly, many dairy farmers in Western Victoria whose milk supply patterns are more seasonal may not be able profitably to supply Parmalat or Lion without changing their calving patterns. The ACCC understands changing calving patterns in this way may take at least two to three years and involve additional investments and foregone income through lost production. Furthermore, switching to an autumn calving system typically results in higher production costs

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<sup>19</sup> Meaning they produce more milk during spring than at other times of the year.

and a greater risk profile for a farming business. Consequently, making this switch may be unviable or unattractive for many farmers.

## Relevance of processor pricing policies

75. The ACCC understands that historically dairy processors in Australia, including Saputo, Murray Goulburn and Fonterra, have applied a single pricing policy and published a single headline farmgate milk price for the area known as the 'Southern Milk Region', which encompasses Victoria, eastern South Australia, parts of southern NSW and Tasmania.<sup>20</sup>
76. 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.
77. The ACCC 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 farmgate prices in Western Victoria, even if it faced limited competition for raw milk in that particular region.
78. The ACCC was concerned that such pricing practices would not provide sufficient protection to farmers in Western Victoria from lower farmgate prices resulting from the proposed acquisition, for the following reasons:
  - the practice of a single pricing policy for the Southern Milk Region does not mean that all farmers supplying a particular processor receive the same amount for their milk. 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 additional offers include offers of financial support, alterations to terms and conditions, offers of no disadvantage contracts, variations to payment timing, and sign-on or other bonuses;
  - single pricing practices for the Southern Region may not necessarily continue in the future. The ACCC noted 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. The removal of Murray Goulburn as a result of the proposed acquisition 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 constrain pricing decisions by processors, particularly if farmers do not have sufficient processor options available to them; and
  - additionally, the ACCC was concerned that if the proposed acquisition leads to Saputo and other processors, such as Fonterra, paying lower FMPs to farmers, Saputo's FMP commitment (which references the prices of WCB and the two

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<sup>20</sup> 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).

largest competing processors in the region) would not be sufficient to protect farmers from price decreases.

### Likelihood of entry or expansion

79. The ACCC considered whether the threat of new entry and/or capacity expansion by existing processors in Western Victoria would be likely to constrain a combined Saputo-Murray Goulburn from exercising market power.
80. There have been some recent examples of new entry (by UDC) and expansion plans announced by a number of existing processors (including Fonterra, ACM, Freedom Foods, Beston Foods and Burra Foods). Conversely, 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).
81. Smaller scale entry and expansion by existing processors may be more feasible. However, the ACCC was concerned that small scale entry and expansion may not provide, on their own, significant competitive constraint on Saputo if the acquisition of the Koroit processing plant were to proceed.
82. Overall, the ACCC concluded that there were likely to be significant barriers to large-scale new entry into milk processing, including:
  - the costs of establishing milk processing infrastructure, equipment and logistics capabilities are significant and many of these would not be recovered if the entry is unsuccessful. 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 farmers. Smaller processors or new entrants may have difficulties matching or countering these advantages; and
  - economies of scale in production are important. A rival processor may be at a cost disadvantage if it is unable to reach the scale of the major processors in the region.

### Summary of ACCC's views

83. The ACCC was concerned that the proposed acquisition of the Koroit processing plant by Saputo was likely to result in a substantial lessening of competition in the market for the acquisition of raw milk in Western Victoria, leading to reduced FMPs, less favourable contractual terms or reduced non-price offers for farmers, compared to the future without the proposed acquisition
84. The ACCC considered that:
  - Saputo and Murray Goulburn are each other's closest competitor and have competed directly with one another for the acquisition of raw milk in Western Victoria. Their plants are the largest in the region and together

account for an estimated two-thirds or more of the processing capacity in Western Victoria;

- Saputo's proposed acquisition of Murray Goulburn's Koroit plant would result in the two largest processors in the region merging and therefore reduce the number of processors in the region to which farmers could readily switch supply or threaten to switch supply, leading to farmers being paid less at least in the medium term;
- Fonterra would remain as a significant competitor in Western Victoria, along with a number of smaller processors. However, the ACCC was concerned that this group of processors independently or collectively would not be enough to competitively constrain a combined Saputo-Murray Goulburn from lowering FMPs;
- transport costs would limit the degree of competition from processors with plants located outside Western Victoria;
- new entry or expansion of the scale required to competitively constrain a combined Saputo-Murray Goulburn seemed unlikely; and
- region-wide pricing policies and Saputo's five year price commitment were not sufficient to address the competition concerns.

85. The ACCC notes that if Saputo acquired Murray Goulburn, Saputo would most likely seek to increase the amount of raw milk processed at the Koroit plant from current levels, but this has to be compared with the likely future if Koroit were owned separately from Saputo's Allansford plant. The ACCC considered that another acquirer of Koroit would also seek to increase the amount of raw milk processed at the Koroit plant and, importantly, this would mean that farmers in the region would continue to have two large processors in the region competing for their raw milk supply.

## **Competition analysis – supply of bulk cream, butter and cheese**

86. In the Statement of Issues, the ACCC stated its preliminary view that the proposed acquisition was unlikely to result in a substantial lessening of competition in the supply of any dairy products.
87. Based on market feedback, the product markets that the ACCC focussed on were:
- 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.

88. During the ACCC's initial market inquiries, some customers raised concerns that the proposed acquisition may lessen competition in the supply of bulk cream, butter or cheese.
89. Some market participants noted that Murray Goulburn had, in the past, been a major supplier of bulk dairy products, in competition with Saputo.
90. However, many of the concerns raised by these market participants appeared to stem from existing market conditions, rather than the likely effects of the proposed acquisition. In particular:
- changes in consumer preferences both in Australia and globally (for example, consumers choosing full fat milk over reduced fat) had led to increased demand for dairy fats. This in turn had led to decreased availability of bulk cream, bulk butter and bulk cheese as dairy processors used the fats from their raw milk in their generally more profitable, retail products (such as packaged cream or butter); and
  - some market participants also commented that Murray Goulburn's significantly reduced milk intake volumes (see 'Recent events in the dairy industry' above) had meant that its supply of bulk products had decreased significantly in recent years as it channelled its available milk volumes into its retail products. The milk volumes lost by Murray Goulburn had been diverted to other processors who had different product mixes.
91. The ACCC considered that after the proposed acquisition, there would be a number of alternate suppliers in each of the three bulk product markets identified above. Alternate domestic suppliers of some or all of these bulk dairy products included Fonterra and (to a lesser extent) Bega, Lion, Parmalat, Beston, Burra Foods, Freedom Foods and UDC. To the extent that these processors currently supply only the retail version of a product (e.g. they supply packaged cheese but not bulk cheese), it appears they could switch to supplying the bulk product relatively quickly and easily if the commercial returns justified it.
92. Further, in relation to bulk butter and cheese, the ACCC considered that actual or potential competition from imports of these products was likely to constrain the prices which Australian-based dairy processors charge. Imports of butter and cheese have been increasing and have already taken significant shares of bulk butter and bulk cheese markets. Although some market participants expressed a preference for Australian-made products, it appeared that imported products would be substitutable for the majority of customers.
93. 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.
94. In light of these factors, the ACCC considered that the proposed acquisition was not likely to substantially lessen competition in the supply of any dairy product.

## Undertaking

95. In order to address the ACCC's competition concerns, Saputo provided a court enforceable undertaking pursuant to section 87B of the Act to divest the Koroit dairy processing plant, and related assets and personnel, within a specified period to a purchaser to be approved by the ACCC.
96. The ACCC consulted widely on the undertaking, including with some potential purchasers of the Koroit plant, other processors and farmers.
97. Some farmers and farmer representative groups raised concerns with the ACCC about the proposed divestiture of the Koroit processing plant and stated their views that Saputo should be allowed to retain the plant, for a range of reasons, including a desire for stability and concerns as to the future purchaser. The ACCC acknowledges those views. However, the ACCC was concerned about the impact on competition as a result of the proposed acquisition and the likelihood that this could result in reduced FMPs, less favourable contractual terms or reduced non-price offers to farmers in Western Victoria.
98. Taking into account the results of the consultations, the ACCC concluded that Saputo's proposed divestiture of the Koroit processing plant addressed these concerns while allowing the broader Saputo-Murray Goulburn transaction to proceed.
99. The undertaking contains a number of requirements for Saputo, including:
  - to appoint an ACCC-approved independent manager to manage Koroit until it is sold to a purchaser approved by the ACCC
  - to provide certain transitional assistance to the approved purchaser, and
  - to provide for independent oversight of Saputo's compliance with its obligations in the undertaking.
100. The undertaking also requires Saputo to supply the Koroit plant with a guaranteed volume of raw milk for a specified period. The purpose of this obligation is to ensure that the approved purchaser has an initial minimum volume of milk to operate the Koroit plant and to allow for a sufficient period of time to enable the purchaser to establish itself and grow a farmer base. The ACCC expects that the approved purchaser will compete to acquire additional volumes of milk from farmers.
101. The divestiture of the Koroit plant largely removes the overlap between Saputo and Murray Goulburn in the acquisition of raw milk in Western Victoria and will allow for an alternative processor to compete in this region. On this basis, the ACCC considered that the undertaking addressed the ACCC's competition concerns arising from the proposed acquisition.
102. A copy of the undertaking is available on the ACCC mergers register and undertakings register.

## **Conclusion**

103. Based on the above analysis, the ACCC concluded that the proposed acquisition of Murray Goulburn's assets by Saputo, in conjunction with the undertaking, would not be likely to have the effect of substantially lessening competition in any market.