



Statement of Issues

8 August 2019

Saputo Dairy Australia – proposed acquisition of Lion Dairy and Drinks' cheese business

Purpose

1. Saputo Dairy Australia Pty Ltd (**Saputo**) proposes to acquire the assets related to the cheese business of Lion Dairy & Drinks Pty Ltd (**Lion**) (the **proposed acquisition**).
2. This Statement of Issues:
 - gives the preliminary views of the Australian Competition and Consumer Commission (**ACCC**) on competition issues arising from the proposed acquisition
 - identifies areas of further inquiry, and
 - invites interested parties to submit comments and information to assist our assessment of the issues.
3. Statements of Issues give preliminary views and do not refer to confidential information provided by the parties or other market participants, therefore they may not be a full articulation of the ACCC's preliminary position.

Overview of ACCC's preliminary views

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

Issues that may raise concerns – Acquisition of raw milk

6. The ACCC is concerned that the proposed acquisition may substantially lessen competition in the market for the acquisition of raw milk from farmers in Tasmania.
7. The market for the acquisition of raw milk in Tasmania is already concentrated. The proposed acquisition would combine processing plants of the second and third largest acquirers of raw milk, and significantly increase Saputo’s market share. Lion currently appears to offer a competitive alternative to the other processors on price and non-price terms.
8. While other processors will remain in Tasmania, the ACCC’s preliminary view is that the proposed acquisition may decrease the intensity of competition for raw milk resulting in lower farmgate milk prices or less advantageous terms of supply being offered to farmers.
9. Ranges indicating the approximate market shares for raw milk purchasing in mainland Tasmania are set out in the table below:¹

Fonterra – Wynyard and Spreyton	50 to 60%
Saputo – Smithton	15 to 20%
Lion – Burnie (included in the proposed acquisition)	10 to 15%
Lion – Hobart (not included in the proposed acquisition)	< 5%
Mondelez International (Cadbury)	< 10%
Other	< 5%

Issues unlikely to raise concerns – Supply of cheeses

10. The ACCC’s preliminary view is that the proposed acquisition is unlikely to result in a substantial lessening of competition in the supply of cheese.

Making a submission

11. The ACCC is seeking submissions from interested parties, particularly regarding whether the remaining processors in Tasmania would constrain Saputo post-acquisition from lowering its farmgate milk prices.
12. Further discussion of these and other issues, along with specific questions, is contained in this Statement of Issues.

¹ These are approximate ranges based on the 2017/18 financial year. The figures are indicative ranges only, and they do not add up to 100%.

13. Interested parties should provide submissions by no later than 5pm on **22 August 2019**. Responses may be emailed to mergers@acc.gov.au with the title: *Submission re: Saputo’s proposed acquisition of Lion’s cheese business - attention Alison Hill/Braeden Smith*. If you would like to discuss the matter with ACCC officers over the telephone or in person, or have any questions about this Statement of Issues, please contact Alison Hill on 03 9910 9469 or Braeden Smith on 02 6243 4936.
14. The ACCC anticipates making a final decision on **26 September 2019**, however, this timeline can change. To keep abreast of possible changes in relation to timing and to find relevant documents, interested parties should visit the Mergers Register on the ACCC's website at www.acc.gov.au/mergersregister.

Confidentiality of submissions

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

About ACCC ‘Statements of Issues’

16. 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.
17. A Statement of Issues provides an opportunity for all interested parties (including farmer-suppliers, 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.

Timeline

Date	Event
16 May 2019	ACCC commenced review of the proposed acquisition
18 July 2019	ACCC amended the former provisional deadline for announcement of findings (25 July) to provide time to consider new information and make further inquiries.
8 August 2019	ACCC publication of Statement of Issues

22 August 2019	Deadline for submissions from interested parties in response to this Statement of Issues
26 September 2019	Anticipated date for ACCC final decision

The parties

Lion

18. Lion Dairy & Drinks is part of a food and beverage business that sells beer, wine, and dairy under a range of brands. The Lion business is ultimately owned by Kirin Holdings Company Limited.
19. Lion is one of Australia’s largest dairy processors, manufacturing and distributing dairy products such as cheese, white and flavoured milk, and cream. It has dairy processing plants in different parts of Australia, including cheese processing plants in Burnie in Tasmania (the **Burnie plant**) and on Tasmania’s King Island (the **King Island plant**).
20. Lion produces a range of ‘specialty’ cheeses at these plants, including brie, camembert, blue vein, goat’s cheese, washed rind, specialty cheddar and fetta. These cheeses are sold under brands including South Cape, Tasmanian Heritage, King Island Dairy, Mersey Valley and Australian Gold. These are supplied for retail distribution through grocery chains, and also through food-service channels. Lion also supplies cheese to manufacturers, resellers and private labels.
21. Lion has another dairy processing plant in Tasmania, in Lenah Valley in Hobart (the **Hobart plant**), where it produces drinking milk. The Hobart plant is not included in the proposed acquisition and will be retained by Lion.

Saputo

22. Saputo is a wholly owned subsidiary of Saputo Inc., a Canadian-based company which it describes as one of the top 10 dairy processors in the world.
23. Saputo conducts much of its Australian operations through Victorian-based Warrnambool Cheese and Butter (**WCB**). Saputo Inc. acquired a controlling shareholding interest in WCB in 2014 and subsequently acquired full control in 2017. Saputo also acquired the operating assets and liabilities of Murray Goulburn Co-operative Co. Limited (**Murray Goulburn**) in 2018, and some cheese assets from Lion in 2015.
24. Saputo produces a range of dairy products in Australia, including cheese, fresh milk, Ultra Heat Treated (UHT) milk, butter, cream and milk powder. Saputo’s Australian cheese varieties (and the brands under which they are marketed) include: parmesan (Mil LeI), cream cheese (Sungold), ‘premium’ and ‘everyday’ cheddar (Warrnambool Heritage, Great Ocean Road, Coon, Cracker Barrel, Devondale), mozzarella (Devondale) and lactose-free hard cheese (Liddells).
25. Saputo operates one processing plant in Tasmania, in Smithton (the **Smithton plant**), which it acquired from Murray Goulburn. It is located within 90km of the

Burnie plant. The Smithton plant produces a range of bulk milk powders and bulk butter and cream, primarily for international export and for sale to domestic food processors.

The proposed acquisition

26. Saputo proposes to acquire the Burnie plant, the King Island plant, two farms on King Island, and all other assets required for the manufacture and supply of various cheeses produced at Burnie and on King Island.
27. As indicated above, Saputo and Lion overlap in:
 - the acquisition of raw milk from dairy farmers in mainland Tasmania, and
 - the manufacture and supply of cheese varieties, including cream cheese, parmesan and cheddar.
28. We note that Saputo is also proposing to acquire Lion’s King Island plant. Saputo currently has no presence on King Island, and the ACCC has focused its review on the acquisition of raw milk in mainland Tasmania where the parties overlap.

Dairy industry background

Dairy farming in Tasmania

29. There are more than 400 dairy farms in Tasmania, producing approximately 9-10 per cent of Australia’s raw milk.²
30. The majority of dairy farms in Tasmania are located in the northern regions of the state, with the highest concentration in the far north-west region.³
31. Compared with the Australian mainland, much of Tasmania’s production is particularly ‘seasonal’. There is a strong peak in production in spring, when there is a lot of grass growing naturally, and lower production in the autumn-winter months.⁴
32. Some Tasmanian farmers produce a ‘flatter’ supply of milk, with less of a dip in supply outside the spring peak. This is achieved by making changes such as moving their herd from a seasonal spring calving pattern (where all cows calve in spring), to one where the herd is split (cows calve in two or three distinct time

² Tasmanian Government, ‘The dairy industry in Tasmania: A guide for investors’, January 2019 (**Dairy Industry Guide**), pg 6; ACCC’s Dairy Inquiry Report, April 2018 (**Dairy Inquiry Report**), pg 71.

Compared with other Australian dairy regions, Tasmania has a high average dairy herd size. The milk produced also has a high average butterfat/protein composition:
<https://www.dairyaustralia.com.au/industry/production-and-sales/milk/fat-and-protein>.

³ The primary dairy regions and the number of farms in those regions are as follows: King Island (10 farms); Far North West (141 farms); North West (93 farms); Central North (91 farms); North East (64 farms); and South (13 farms); Dairy Industry Guide, pg 6.

⁴ Dairy Inquiry Report, pg 10-11, Figure 1.8. We note that the seasonality of Tasmanian production has been decreasing in more recent years: see Figure A4.27, pg 195.

periods) or calving is year-round (cows calve throughout the year). Calving outside of spring usually requires greater use of supplementary feed.⁵

33. Accordingly, to produce a flatter supply of milk it typically costs more and requires extra effort, compared with producing milk on a seasonal spring curve. It also takes some time and cost to convert from seasonal production to flatter production, such as delaying calving for some of the cows as they are moved into a different calving pattern.

Dairy processors in Tasmania

34. Dairy processors use raw milk to produce a variety of dairy products. Some dairy products have higher values than others. ‘Specialty’ cheeses are at the higher end of the value chain, whereas milk powders are generally viewed as lower value ‘commodity’ products.
35. The milk intake profile of a processing plant can be associated with the dairy products the plant produces. For example, plants producing fresh cheeses with year-round demand and relatively short shelf life require flatter milk intake. By contrast, milk powder has a longer shelf life and a lower sales value, so milk powder plants often operate on a seasonal intake, with mass production occurring when abundant and cheaper spring milk can be acquired.
36. Lion is the third largest raw milk acquirer in Tasmania, with the majority of its milk going to the Burnie plant. The plant produces ‘speciality’ cheese and has a flatter milk intake. Lion operates a ‘demand driven’ business model, where raw milk is procured on a smaller scale and managed so that acquisition correlates with likely demand for its dairy products.⁶
37. Saputo is the second largest raw milk acquirer in Tasmania. Its Smithton plant produces bulk milk powders and bulk butter and cream. It acquires raw milk across the year but has a more seasonal raw milk intake.

Fonterra

38. The largest acquirer of raw milk in Tasmania is Fonterra, which processes more than half of the Tasmania’s raw milk.⁷
39. Fonterra operates two processing plants in Tasmania. It manufactures cheese in its plant at Wynyard. It also manufactures milk powder at Spreyton. The ACCC understands that Fonterra’s milk acquisition profile tends to have a strong spring peak.

Mondelez (Cadbury)

40. Mondelez International makes Cadbury chocolate in Tasmania. Mondelez-Cadbury acquires raw milk in northern Tasmania for initial processing in its plant in Burnie. Further processing is undertaken in its chocolate manufacturing plant in Claremont, on Hobart’s outskirts.

⁵ Dairy Inquiry Report, pg 11.

⁶ Lion Dairy & Drinks, ‘Response to request for feedback – ACCC Inquiry into the Australian dairy industry Issues Paper’, 12 December 2016, pg 3.

⁷ Dairy Industry Guide, pg 8.

41. Mondelez-Cadbury is the fourth largest acquirer of raw milk in Tasmania behind Lion. Market inquiries indicate that Mondelez-Cadbury acquires milk on a flatter profile than Fonterra and Saputo.

Smaller producers

42. There are a number of smaller dairy processors in Tasmania but their processing capacity and raw milk acquisition is comparatively limited. These include Parmalat, which makes yoghurt near Launceston; Ashgrove Cheese; and Dutch Mill, which owns the UHT plant at Edith Creek.⁸

Previous ACCC decisions

43. The ACCC has conducted a number of public reviews of acquisitions in the dairy industry in recent years. In April 2018, the ACCC decided not to oppose Saputo’s acquisition of the operating assets of Murray Goulburn, subject to a court enforceable undertaking to divest the dairy processing plant in Koroit (in Victoria) to an ACCC approved purchaser (the **Saputo-Murray Goulburn decision**). The Koroit plant was subsequently purchased by Bega.
44. The ACCC also conducted a market inquiry into the Australian dairy industry. The final report, in which the ACCC made various findings and recommendations, was published on 18 April 2018 (**Dairy Inquiry Report**).

Issue that may raise concerns: acquisition of raw milk

45. The ACCC’s preliminary view is that the proposed acquisition may substantially lessen competition in the acquisition of raw milk from farmers in Tasmania by removing an effective competitor in an already concentrated market.

Market definition

46. The ACCC’s preliminary view is that it is likely that the product dimension of the relevant market is the acquisition of raw milk and the geographic dimension is mainland Tasmania.⁹
47. As noted in the ACCC’s Dairy Inquiry Report¹⁰, due to the perishability of raw milk, processors whose factories are located within around 150 kilometres of a farmer are likely to be the closest competitors for their milk.
48. Most of dairy processors and dairy farms in Tasmania are in the north of the state. The only processing plant located in the south of Tasmania that acquires raw milk from farmers is Lion’s Hobart plant. The ACCC understands that processing plants in the north may acquire part of their raw milk intake from

⁸ The Edith Creek plant was closed for development in 2017/18 and may not yet be operating at capacity.

⁹ The term ‘mainland Tasmania’ is used to indicate that King Island is excluded from this analysis. Although market inquiries indicate that raw milk may be moving between King Island and the Tasmanian mainland in small amounts, the ACCC’s preliminary view is such a limited movement of milk is not significant to the analysis of the competitive effects of the proposed acquisition.

¹⁰ Dairy Inquiry Report, pg 68. See also the Saputo-Murray Goulburn Decision, which referred to a distance of 150 – 200 kilometres, at pg 11.

farms in the south, and that Lion’s Hobart plant acquires raw milk both from the south and central northern regions.

49. The ACCC considers the geographic scope of the relevant market is likely to be mainland Tasmania, but that the outcome of the competition analysis is unlikely to change whether a mainland Tasmania-wide or narrower northern mainland Tasmania geographic scope is adopted.

Competition Analysis

Further market concentration

50. The ACCC has previously found that there is a high level of concentration in the acquisition of raw milk in Tasmania (and in most other regions of Australia).¹¹ While the level of concentration in a market is not determinative of the level of competition, the number of processors in a market can impact the intensity of competition for raw milk, which in turn can impact the farmgate milk price received by farmers.¹²
51. Currently, Fonterra and Saputo are the two largest acquirers of raw milk in Tasmania, followed by Lion and Mondelez-Cadbury. The proposed acquisition would combine processing plants of the second and third largest acquirers of raw milk in Tasmania.
52. The proposed acquisition would significantly increase the volume of Saputo’s raw milk acquisition and its processing capacity, and lead to further concentration of the acquisition of raw milk. After the acquisition, between them Fonterra and Saputo would hold over 80 per cent of the total volume of raw milk being acquired in Tasmania, and a similar share of the available processing capacity. Each of them would have market shares several times larger than their largest remaining rival, Mondelez-Cadbury.
53. Market inquiries indicate that for many farmers in Tasmania Fonterra, Saputo and Lion are the only realistic buyers for their milk. The location of some farmers means their viable options are even more limited. While Mondelez-Cadbury may be an option for some farmers, market inquiries indicate that it would be difficult for many farmers to obtain a new supply agreement with them. Other smaller processors with even smaller capacity and volume intakes are unlikely to be available alternatives for many farmers.

Lion’s terms for purchasing raw milk

54. Market inquiries indicated that Lion may be offering competitive contract terms that are attractive to some farmers, in order to secure a stable, flatter supply of raw milk for its year-round production of higher value speciality cheeses. Some farmers suggest that:

¹¹ The ACCC calculated the Herfindahl-Hirschman index (HHI) for Tasmania as part of its assessment of the concentration in Australian dairy regions during the Dairy Inquiry. Based on data from the 2013/14 – 2015/16 seasons, the HHI for the Tasmanian region indicated it was highly concentrated: Dairy Inquiry Report, pg 72-73.

¹² See the Dairy Inquiry Report, pg 107, 140.

- Lion has traditionally offered a higher price for raw milk than other processors in Tasmania – in particular, Lion’s price structure has traditionally meant it offered more than other processors for winter milk, and
 - Lion offers the option of locking in a percentage of a farmer’s milk supply with a fixed price for three years, and this can be a favourable option for farmers wishing to improve their ability to obtain finance and manage business risk. Lion also offers a one year fixed price option.
55. The ACCC’s preliminary view is that Lion appears to compete with the other processors through price and the other competitive features in its offering. With its Burnie plant being acquired by Saputo, competitive constraints placed by Lion on other processors through those features may be diminished or lost.
56. The ACCC has also noted that currently Lion is one of the two processors (along with Mondelez-Cadbury) that appears to have stronger incentives to offer competitive terms to secure flatter raw milk supply.
57. Post-acquisition Saputo may have less incentive to maintain those competitive terms for flat milk, because it could divert off-peak raw milk from its Smithton plant (which produces longer shelf-life milk powder and has more flexibility in relation to the timing of production) to the Burnie plant, in the event that there was a shortfall of winter milk.

Low likelihood of entry or expansion

58. The ACCC has considered whether the threat of new raw milk acquirers entering Tasmania (for example, other processors or milk brokers / aggregators), or the threat of capacity expansions by existing processors there, may also act as a competitive constraint on Saputo post-acquisition. The ACCC’s preliminary view is that this is unlikely to be a significant competitive constraint.
59. We note that there have been examples of fairly recent entry and expansion in Tasmania. For example, Tasmanian Dairy Products (of which Murray Goulburn held a partial and subsequently full share) established the Smithton plant in 2012, at a reported cost of \$70 million.¹³
60. However, consistent with the ACCC’s conclusions in the Saputo-Murray Goulburn decision,¹⁴ the ACCC considers that there are likely to be significant barriers to large-scale new entry into milk-processing in Tasmania as:
- the costs of establishing milk processing infrastructure, equipment and logistics capabilities are significant, some of which may not be recoverable if the entry is unsuccessful
 - incumbent processors enjoy an established presence in the industry, which can help in retaining or attracting farmers – smaller processors or new entrants may have difficulties matching or countering these advantages, and

¹³ ‘NW milk plant opens’, 26 September 2012, Australian Broadcasting Corporation, <https://www.abc.net.au/news/2012-09-25/milk-plant-opens/4279734>

¹⁴ See also the Dairy Inquiry Report, pg 94-97.

- economies of scale in production are important, and a rival processor may be at a cost disadvantage if it is unable to reach the scale of the major processors in the region.

Relevance of milk pricing policies

61. Historically, Saputo and other dairy processors in Australia have applied a single pricing policy and published a single headline farmgate milk price applicable to the wider ‘Southern Milk Region’.¹⁵ In the past processors have indicated to the ACCC that many farmers want a single price for the Southern Milk Region, and that departing from a single pricing policy would have a significant negative impact on a processor’s reputation with dairy farmers. The ACCC considered whether this pricing policy could limit Saputo’s ability or incentives to lower the farmgate milk prices in Tasmania post-acquisition, even if local competitive tension lessened.
62. However, the ACCC’s preliminary view is that the existence of the ‘Southern Milk Region’ would not be enough to restrict the ability of Saputo to lower prices in Tasmania because:¹⁶
- 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 benefits for supplying their milk. Processors may tailor their offer to farmers through various means, to target the retention or recruitment of farmers with particular characteristics or from a particular location and, conversely, may not offer them elsewhere.
 - Single-pricing practices for the Southern Milk Region may not necessarily continue. The removal of the Murray Goulburn business, which historically drove the application of the policy, may have reduced the drive for processors to continue this pricing practice.

ACCC’s preliminary views

63. In summary, the ACCC’s preliminary view is that the proposed acquisition may substantially lessen competition in Tasmania for the acquisition of raw milk from farmers.

The ACCC invites comments from market participants on its concerns in relation to the competition analysis. In particular market participants may wish to comment on the following:

- How does Lion compare to other processors in terms of competition for the acquisition of raw milk from farmers? Is Lion a close competitor to Saputo in the acquisition of raw milk from farmers?
- Will competition from Fonterra and smaller processors be sufficient to constrain Saputo from lowering the farmgate milk price it offers farmers?
- What factors influence farmers in their choice of processor to supply raw milk to (for example, price, fixed term pricing options, additional financial incentives, length

¹⁵ The ‘Southern Milk Region’ encompasses Victoria, eastern South Australia, parts of New South Wales, and Tasmania. See for eg. Saputo-Murray Goulburn decision, pg 13-14.

¹⁶ Note also the Dairy Inquiry Report, pg 59-63.

of contract term, or other factors)? Are there any features of Lion’s cheese business that make it an effective competitor for raw milk? If so, what are they?

- How difficult is it for a farmer to change milk production patterns, including changing from seasonal production to flatter production, and the reverse? What are the costs involved? Are there any other impacts that changing would have on a farm business?

Issue unlikely to raise concerns: supply of cheese

Market definition

64. The ACCC considers that the relevant markets in relation to supply of cheeses are likely to be:

- national markets for the supply of speciality cheeses at a wholesale and retail level, and national markets for the supply of everyday cheeses at a wholesale and retail level, or
- alternatively, national markets for the supply of all types cheese at a wholesale and retail level.

65. Irrespective of how the markets are defined, the ACCC’s preliminary view is that the proposed acquisition is unlikely to substantially lessen competition in the supply of cheeses.

Competition analysis

66. As discussed above, Lion’s cheese business is primarily focused on producing and supplying ‘specialty’ cheeses. These are premium products that are consumed occasionally or have special characteristics, and may be used for entertaining or gourmet cooking. Saputo also supplies cheese, but with a focus on ‘everyday’ varieties that are consumed on a more routine basis.

67. The ACCC understands that Saputo has limited presence in the supply of speciality cheeses and Lion has limited presence in the supply of everyday cheeses. In addition, Lion and Saputo face competitive constraints from domestic competitors, private label cheeses and imports in the supply of speciality cheeses and everyday cheeses respectively.

68. Post-acquisition, Saputo would continue to face competitive constraints from domestic competitors, private label cheeses and imports. These constraints would likely limit Saputo’s ability to increase prices. In addition, these constraints would also likely limit Saputo’s ability to leverage its position in speciality cheeses or everyday cheeses to bundle these two types of products in its wholesale supply.

69. Therefore, the ACCC’s preliminary view is that the proposed acquisition is unlikely to substantially lessen competition in the supply of cheeses.

The ACCC invites comments from market participants on its analysis in relation to the supply of cheeses. In particular market participants may wish to comment on the following:

- To what extent do purchasers of cheese see a difference between 'specialty' and 'everyday' cheese varieties? Would purchasers of 'specialty' cheeses switch to purchasing 'everyday' cheeses in response to a 5-10% increase in price?
- Are either of Lion or Saputo dominant in the wholesale supply of cheese varieties, and do they provide any 'must have' products?
- To what extent would Saputo's ability to raise prices or bundle cheese products post-acquisition be constrained by competition from other domestically produced cheeses, private label cheeses or imported cheeses? Is there a difference between the level of constraint provided in relation to 'specialty' and 'everyday' cheese varieties?

ACCC's future steps

70. As noted above, the ACCC now seeks submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter. Submissions are to be received by the ACCC no later than **22 August 2019** and should be emailed to mergers@acc.gov.au.
71. The ACCC will finalise its view on this matter after it considers submissions invited by this Statement of Issues.
72. The ACCC intends to publicly announce its final view by **26 September 2019**. However the anticipated timeline may change in line with the Informal Merger Review Process Guidelines. A Public Competition Assessment for the purpose of explaining the ACCC's final view may be published following the ACCC's public announcement to explain its final view.