



2 December 2016

The Hon Greg Hall, MLC  
Chair  
Legislative Select Committee - Dairy Industry in Tasmania  
Parliament of Tasmania  
Hobart TAS 7000  
By email: [dit@parliament.tas.gov.au](mailto:dit@parliament.tas.gov.au)

Dear Chair and Committee Members

### **Murray Goulburn submission to Tasmanian Dairy Industry inquiry**

Murray Goulburn Co-operative Co. Ltd (MG) welcomes the opportunity to make a submission to the Select Committee appointed to inquire into and report upon the options for the Tasmanian Dairy Industry.

Our submission contains a summary of MG and its operational footprint in Tasmania, and responds to the Terms of Reference of the inquiry. The responses to these Terms of Reference are made in the context of our existing operating model in Australia.

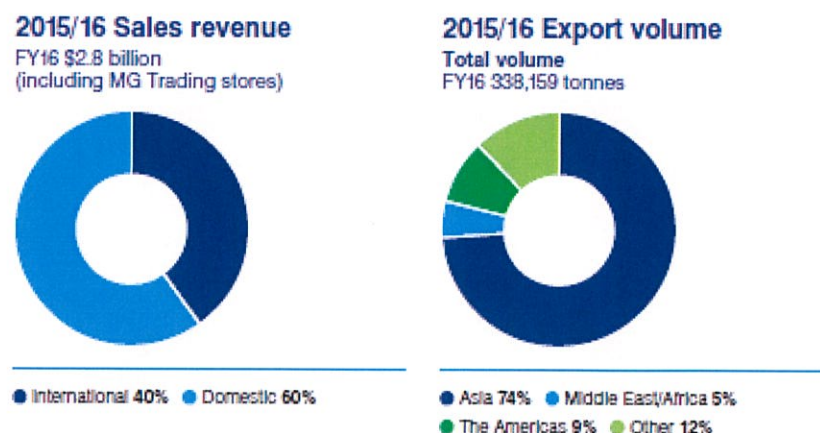
#### **About Murray Goulburn Co-operative Co Limited (MG)**

MG is Australia's largest dairy foods company and is 100 percent dairy farmer controlled by approximately 2,200 farmer-suppliers (suppliers), with all suppliers holding shares in MG.

In FY16 MG received approximately 3.5 billion litres or 36.6 percent of Australia's milk and generated sales revenue of approximately \$2.8 billion. Sixty percent of revenue was generated from the Australian market and 40 percent in international markets.

MG has played a significant role in developing export markets for Australian dairy producers

As the country's largest dairy foods exporter, MG is responsible for approximately 50 percent of Australia's dairy exports and sells to the major markets of Asia, the Middle East and North Africa, and the Americas (see Figure 1).



**Figure 1.** 2015/16 Sales revenue and 2015/16 export volume (Source: MG Annual Report FY16<sup>1</sup>)

MG produces a full range of dairy foods, including drinking milk, milk powder, cheese, butter and dairy beverages, and a range of ingredient and nutritional products, such as infant formula. We supply the retail and food service industries globally with our flagship Devondale, Liddells and MG Ingredients brands.

MG is a major employer in regional Australia and a significant contributor to rural economies. The Co-operative employs approximately 2,350<sup>2</sup> people based at 10 processing plants, ancillary businesses (including MG Trading stores) and corporate offices located across Victoria, New South Wales, South Australia and Tasmania.

### MG's Strategy and Capital Restructure

MG's vision is to be a 'first choice dairy foods company' for suppliers, customers and consumers.

Our strategy focuses on two key areas<sup>3</sup>:

**Operational excellence** – invest in modern, flexible and globally competitive dairy foods manufacturing and supply chain infrastructure to deliver and sustain business efficiency and cost leadership.

**Innovation** – drive the ongoing shift to value-added products in the key growth categories of nutritional powders, consumer cheese and dairy beverages.

In July 2015, MG successfully completed a significant capital restructure following listing of the MG Unit Trust on the Australian Securities Exchange (ASX). This raised \$500 million to fund capital investments as part of its growth and value creation strategy to sustainably

<sup>1</sup> MG Annual Report 2016, page 7. Source: <http://www.mgc.com.au/media/40795/murray-goulburn-annual-report-2016-web-.pdf>

<sup>2</sup> Employee numbers are expressed on a Full Time Equivalent (FTE) basis (as at 11 October 2016).

<sup>3</sup> MG's Annual Report 2016, page 5. Available at [www.mgc.com.au](http://www.mgc.com.au)



maximise farmgate milk prices (FMP) and future earnings<sup>4</sup>. Of the \$500 million, approximately \$438 million was raised from the Unit Trust<sup>5</sup>, and the balance from supplier shareholders as part of the Supplier Share Offer (SSO).

The purpose of the capital structure was to enable MG to fund its growth and value creation strategy in order to become the first choice dairy foods company for its suppliers, customers and consumers, and specifically to fund investment in planned capital projects in the nutritionals, dairy beverages and cheese product segments. In addition, the capital structure enabled MG to meet the following key objectives:

- retaining 100 percent supplier control of MG;
- reducing MG's reliance on debt funding;
- creating a market value for supplier's shares through the operation of the Shareholder Trading Platform, as opposed to the \$1 value that had historically existed prior to the capital structure;
- strengthening suppliers' balance sheets by facilitating the recognition of the value of their shares as an asset (prior to the capital structure banks did not recognise the value of the shares);
- helping to fund MG's growth strategy of operational excellence and innovation to deliver over time a sustainably higher FMP; and
- ensuring MG not only remained competitive with other processors, both domestically and internationally, but became the first choice dairy foods company for its suppliers, customers and consumers<sup>6</sup>.

MG will continue to optimise its manufacturing footprint to ensure that the mix of products across its network is competitive on the global stage. Tasmania remains an important region for sourcing milk for the manufacturing of premium dairy products.

### **MG's operations in Tasmania**

MG is proud to have played a role in the development of Tasmania's dairy industry over the past decade. Over the same time period milk production in Tasmania has grown by over 43 percent<sup>7</sup>.

MG first entered the Tasmanian dairy industry at the request of dairy farmers as there was a gap in the market for a farmer controlled co-operative. For MG it also provided an opportunity for the co-operative to expand our milk supply base, while also addressing a processing capacity constraint that had begun to develop in Tasmania. The additional processing investment allowed for milk supply growth to be realised.

In FY16 MG collected approximately 215 million litres of milk from our Tasmanian supplier base, representing around 25 percent of the total milk production for Tasmania in the 2015-2016 season and six percent of MG's total milk pool. There are almost 90 MG farmer supplier-shareholders in Tasmania.

In addition, MG employs approximately 170 Full Time Equivalent Employees (FTEs) across two manufacturing facilities, located at Edith Creek and Smithton, and two MG Trading stores, located at Smithton and Deloraine.

<sup>4</sup> MG media release (2015), *MG Unit Trust Lists on the ASX*. <http://www.mgc.com.au/media/25039/mg-unit-trust-listing-media-release.pdf>

<sup>5</sup> MG media release, *MG Unit Trust Lists on the ASX*. 3 July 2015. <http://www.mgc.com.au/media/25039/mg-unit-trust-listing-media-release.pdf>

<sup>6</sup> MG Unit Trust, *Product Disclosure Statement*, page 9. <http://www.mgc.com.au/media/23437/mg-unit-trust-product-disclosure-statement-29-may-2015.pdf>

<sup>7</sup> Source: <http://www.intodairy.com.au/>



MG Trading is a subsidiary business of MG that offers competitively-priced farm inputs and services to dairy farmers and rural customers. There are 25 stores and six fertiliser depots servicing most of the south-east dairy region of Australia and the business is focused on reducing the cost of farm inputs and supporting increased profitability through services.

With the opening of two MG Trading stores in Tasmania (following the purchase of assets of AgriCorp Pacific Pty Ltd in March 2015<sup>8</sup>) we are now providing expanded services to support dairy farmers, as well as the wider agricultural industries and communities in the state.

#### Edith Creek Facility

MG commenced operations in Tasmania after purchasing the Classic Foods business at Edith Creek in 2006. Operating as a speciality dairy beverages plant, MG produces a range of UHT ready-to-consume dairy drinks at this facility.

This includes the Devondale Milkshakes range, which was launched in November 2015. This product has recently won two prestigious industry awards including 'Product Launch of the Year' at the Independent Grocers of Australia (IGA) Retailer of the Year Awards and WorldStar's '2016 Global Award for Packaging Excellence'.

The dairy beverage products manufactured at this facility are sold into both the domestic and export markets.

#### Smithton Facility

The Smithton facility is a modern, efficient facility manufacturing milk powder products primarily for the export market.

In 2011 MG announced that, via a joint venture with Tasmanian dairy farmer investors, construction would commence on a \$75 million Tasmanian Dairy Products (TDP) facility at the former Gunns Limited timber mill in Smithton<sup>9</sup>.

In 2012 Japanese corporation Mitsubishi acquired a 24 percent stake in the joint venture, with MG (56.1 percent) and local Tasmanian investors (19.9 percent) holding the remaining ownership<sup>10</sup>.

In June 2014 the local Tasmanian investors subsequently sold their interests to MG, increasing MG's stake in the joint venture to 76 percent, with Mitsubishi Corporation retaining its 24 percent ownership<sup>11</sup>. In October 2015 MG acquired the remaining 24 percent stake from Mitsubishi Corporation and assumed 100 percent ownership of TDP<sup>12</sup>.

MG also offered current and prospective TDP suppliers the opportunity to become members of the MG co-operative from July 2015. This provided those suppliers with the right to participate in the capital restructure that was being implemented<sup>13</sup>.

<sup>8</sup> MG news release (2015), *MG Trading opens two stores in Tasmania following AgriCorp acquisition*, 2 March. Source: <http://www.mgc.com.au/media/20931/devondale-murray-goulburn-mg-trading-opens-two-stores-in-tasmania-following-agricorp-acquisition.pdf>

<sup>9</sup> MG Supplier Letter dated 6 September 2011. Source: <http://www.mgc.com.au/media/6203/MG-to-Co-Invest-in-Tasmanian-Dairy-Processing-Facility-6-Sep-2011.pdf>

<sup>10</sup> MG news release (2012). *Mitsubishi Corporation partners with MG to invest in Tasmanian Dairy Products (TDP)*. 20 June. Source: <http://www.mgc.com.au/media/6242/Mitsubishi-Corporate-Partners-Media-Release-20-June-2012.pdf>

<sup>11</sup> MG news release (2014). *MG's \$14 million investment supports dairy foods innovation*. 11 June. Source: <http://www.mgc.com.au/media/16241/Media-Release-Edith-Creek-FINAL.pdf>

<sup>12</sup> MG news release (2015), *MG acquires Tasmanian Dairy Products*. 29 October. Source: <http://www.mgc.com.au/media/30287/MG-acquires-Tasmanian-Dairy-Products.pdf>

<sup>13</sup> MG Supplier Letter dated 30 March 2015. Source: <http://www.mgc.com.au/media/21845/mg-supplier-letter-tdp-change-of-supply-march-2015.pdf>



## **Response to the Terms of Reference**

MG provides the following specific responses to the Terms of Reference.

### **1. Marketing Opportunities for the Tasmanian Brand**

As outlined above in this submission, MG's strategy is to pursue value-added dairy products to achieve a premium over and above the commodity return for our products.

To support this strategy our marketing effort is centred on our flagship consumer brand 'Devondale'. The Devondale brand is a well-established, market leading brand in the dairy foods category both domestically and internationally. This brand does not have specific origin and is a brand MG has invested in over a long period of time to ensure it is trusted by consumers.

In general our products manufactured in Tasmania are aligned to and marketed under our national brands. In addition to Devondale this includes Liddells (lactose-free), 8 Bar (MG's iced coffee range), and MG Ingredients<sup>14</sup>. These products are sold in both the domestic and export markets.

There is one exception to this approach as MG currently sells Instant Full Cream Milk powder in 400gm sachets in China under the Tasmanian Dairy Products (TDP) brand. This process commences with the manufacture of 25kg bags of Full Cream Milk powder at the Smithton facility, which are then exported to MG's packing plant in Qingdao, China. In Qingdao MG packs the bulk powder into 400gm sachets and sells through a selected number of distributors.

However, because Chinese consumers are looking for the same products that are sold and consumed in Australia, together with the high cost to invest in and support a brand, MG is planning to switch product manufactured at Smithton to the Devondale brand once all existing TDP packaging is exhausted. This will provide MG with greater opportunity to focus and develop a more targeted range of brands in both the domestic and export markets.

In relation to export markets, MG's own research shows that Australian origin brands have several attributes that international consumers identify as being 'trusted' and 'natural' and which help reinforce quality.

In our opinion, the degree to which Tasmanian branded products will resonate with international or domestic consumers will depend on the category, product or brand. This would need to be researched with consumers. It would depend highly on the consumer perception of brand 'Tasmania' and what features of that brand could be differentiated from other regions.

However, given it is expensive to establish and promote a brand, MG supports a concerted effort around a nationally identifiable 'Brand Australia' over a generic, state-based campaign such as 'Brand Tasmania'. For a sector like dairy, with the products we currently manufacture and the national approach to our brand management, MG believes it would be a better to pool resources to support and strengthen 'Brand Australia' in the export market over the development of a separate Tasmanian strategy.

### **2. Processing opportunities in Tasmania**

<sup>14</sup> A summary of MG's brands is available at <http://www.mgc.com.au/our-products/brands/>

As outlined earlier in this submission, MG will continue to optimise its manufacturing footprint to ensure that the mix of products across its network is competitive on the global stage.

MG has invested in processing capacity in Tasmania over the past decade to become the second largest dairy processor in Tasmania. Any future investment will be driven by the optimisation required across all of our manufacturing capability in Tasmania, Victoria and NSW. Tasmania also remains an important region for sourcing milk for the manufacturing of premium dairy products.

### 3. The role of the Tasmanian Government

It is MG's view that it is not the Government's role in a deregulated market to attempt to assume responsibility for proprietary brands and processing investment. This is the role for commercial industry participants. However, reducing the barriers to operate can help to maximise the commercial investment in the state.

The Government can play an important role in facilitating an operating environment that will support industry investment.

A major barrier to additional processing capacity in regional areas is often the required enabling infrastructure, particularly energy and transport infrastructure. For example, the Smithton facility continues to be challenged due to the cost of delivering gas in Smithton, forcing MG to rely upon pelleted gas to meet our energy demands at the factory. Whilst Government supported the potential delivery of a gas pipeline to the region, the terms of the supply agreement offered to deliver gas made it financially cost prohibitive for MG to accept the offer.

Another specific example for Tasmania is the challenge of exporting from the island state. MG's existing logistics operation is centralised around our Integrated Logistics Centre in Laverton, Victoria and the Port of Melbourne. Continued support around the export challenges from Tasmania are critical to maintain the international competitiveness of the region. Therefore, the expansion of the Tasmanian Freight Equalisation Scheme to include goods shipped through a mainland port was a welcome announcement and should be continued to be supported by the Tasmanian and Federal Governments<sup>15</sup>.

Ensuring effective tax reform, government regulation and investment in critical infrastructure across the supply chain will support the continued expansion of the dairy industry in Tasmania. This includes the ongoing response to manage increasing climate variability, including ensuring farmers have capacity to access fodder following extreme weather events and the continued development of sustainable irrigation systems.

### **MG and the Tasmanian Dairy Industry**

MG's Board and management are committed to our strategy of pursuing value-added dairy products, to achieve a premium over and above the commodity return for our products. It is also a strategy that continues to receive the support from our supplier shareholders and investors.

Murray Goulburn has an essential role to play in the industry and we look forward to working with the Committee on advancing the future of Tasmania's dairy industry.

<sup>15</sup> Source: <https://infrastructure.gov.au/transport/programs/maritime/tasmanian/>



Feel free to contact MG's General Manager Policy, Industry and Government, Ben Gursansky, on 03 9040 5000 or [ben.gursansky@mgc.com.au](mailto:ben.gursansky@mgc.com.au) should you require any additional information.

Yours faithfully

David Mallinson  
**Interim Chief Executive Officer**