

2 December 2016

The Hon. Greg Hall MLC
Chair
Tasmanian Legislative Council Select Committee
Legislative Council
Parliament House
HOBART TAS 7000

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Dear Mr Hall,

RE: Tasmanian Legislative Council Select Committee Inquiry into the Tasmanian Dairy Industry

Fonterra Australia welcomes the opportunity to provide a submission to the Tasmanian Legislative Council Select Committee Inquiry into the Tasmanian Dairy Industry.

Our submission focusses on the opportunities we see for growth in Tasmania.

Introduction to Fonterra Australia

Fonterra Co-operative is a global dairy business and the world's largest dairy exporter, and owned by around 10,500 farmer-shareholders, who have over AU\$1 billion of equity invested in Australia.

Locally, Fonterra Australia works with around 1,100 dairy farmers and employs around 1,500 people, the majority of whom are based in regional areas. Last season we collected and processed roughly 18 per cent of Australia's milk at our seven factories located throughout regional Victoria and Tasmania.

In Tasmania, Fonterra operates two sites, at Spreyton and Wynyard in the north west of the state, producing a range of cheeses, butters and milk powders for the domestic and export markets, primarily in Asia. We employ 250 people across both sites, processing approximately 520 million litres of milk collected from 223 suppliers across Tasmania, which means that although our Tasmanian suppliers represent just a fifth of our supplier base, the milk they produce accounts for almost a third of our milk pool of 1.6 billion litres. Fonterra collects around 60 per cent of Tasmania's total milk production of 880 million litres a year.

We are one of the largest consumer foods businesses in Australia and our dairy brands include some of Australia's best-known and most loved dairy products, including Western Star™ and Duck River™ butters, Perfect Italiano™, Mainland™ and Bega™ cheeses, and Anchor™ milk.

Recent challenges for dairy

The Australian dairy industry has been challenged in recent seasons by the confluence of a number of global and domestic factors, which ultimately led to a reduction in farmgate milk price last season.

Global political and economic factors led to an oversupply of milk and weaker demand, culminating in a reduction in global dairy prices. Russia's self-imposed trade sanctions closed its borders to dairy imports from Europe, the US and Australia, meaning that product that would ordinarily go to Russia was now on the global market, searching for a buyer. On the demand side, lower oil prices affected

Middle Eastern economies, lessening their purchasing power and subsequently their demand for dairy. Similarly, a weaker Chinese economy saw a fall in demand for bulk commodity powders, including Whole Milk Powder (WMP) and Skim Milk Powder (SMP).

In August 2015, less than ten weeks after the season opened, dairy commodity prices hit ten-year lows due to the aforementioned global supply-demand imbalance. This volatility came as the Australian dollar surged relative to the US dollar, which had an adverse effect on the returns received for our dairy exports. Fonterra's contractual obligations under the Bonlac Supply Company agreement meant that we were bound to pay a price not less than the leading Victorian processor, Murray Goulburn, which was \$5.60 per kilogram of milk solids (kgMS) for much of season 2015-16, despite the global market not supporting that price.

Fonterra shifted from bi-monthly to monthly price reviews in August 2015 to provide more regular price advice to suppliers, and warned suppliers that a step down was possible if the global market did not materially improve. In late August 2015 Fonterra Co-operative CEO Theo Spierings made public comments that the Australian domestic milk price was too high,¹ prompting widespread criticism that Fonterra was talking the Australian industry down.

Despite Fonterra's warnings, farmers knew that Fonterra was obliged to pay not less than the price paid by Murray Goulburn. It was not until late April 2016 that Murray Goulburn revised their price to \$4.75–\$5 per kgMS.

Following the price revision by Murray Goulburn, Fonterra reviewed its own farmgate milk price in the context of the global market and our own ability to deliver \$5.60 per kgMS. Unfortunately due to exposure to the global markets and our unfavourable product mix, and the fiscal position of the Australian business, the difficult decision was made to revise our milk price to a season average of \$5.00 per kgMS, with our final 2015-16 season price \$5.13 per kgMS. This price revision was very challenging for our farmers, and led to a drop in confidence across the Australian dairy industry.

A bright future

Despite these challenges, Fonterra is firmly of the view that the long-term fundamentals for Australia's dairy industry are strong. We are investing for the future, with an AU\$140 million investment to build a state-of-the-art cheese processing plant in Stanhope, Victoria, and recently finalised our joint venture partnership with Chinese baby food company Beingmate at our Darnum facility, also in Victoria.

In Tasmania, we've invested significantly in recent years to boost our capacity and capability. We installed eight new cheese vats at our Wynyard cheese plant three years ago, and we recently invested AU\$4.3 million to expand the cheese capability at Wynyard, first established in 1892, increasing its production capacity to 45,000MT each year. Since the fire at Stanhope, Wynyard has handled all of Fonterra's Australian hard cheese production, and the Wynyard expansion will complement our Stanhope cheese facility when it is completed mid-next year.

We also see further opportunities to invest at our Spreyton plant to expand our existing capabilities and further diversify our product mix, and are currently exploring those opportunities.

We've also recently signed a distribution agreement with Aldi for our award-winning Duck River Butter brand, produced at our Spreyton site. The agreement will see Duck River Butter stocked nationwide across Aldi's 400 stores, bringing a premium Tasmanian brand to Australian consumers from mid-December. Aldi currently has a ten per cent market share in the grocery space, and is continuing to grow. Duck River Butter has a rich history, first established in 1904 in Smithton as the Duck River Butter and Bacon Factory, and we're proud to be able to share it with all Australians.

Brand Tasmania

Tasmania enjoys a reputation for being a "clean and green" producer of food, and its status as a GM-free state means it especially enjoys a reputation for pure and natural food.

¹ "Aussie farmers being overpaid amid global dairy rout, says Fonterra boss", Jared Lynch, *Sydney Morning Herald*, <http://www.smh.com.au/business/aussie-farmers-being-overpaid-amid-global-dairy-rout-says-fonterra-boss-20150824-qj645k.html>, 28 August 2015, accessed 11 October 2016

The Tasmanian and New Zealand dairy industries are very similar in that they are both predominantly pasture-based production systems, meaning production follows the natural seasonal curve, and they enjoy similar climatic conditions. Pasture-based farming is more cost-effective as it requires fewer inputs such as additional feed.

Fonterra Australia has previously utilised Tasmania's clean and green reputation in marketing of its former brand Tamar Valley Dairy through the "Little tub of Tassie" campaign, and there may be further opportunities to promote Brand Tasmania as the in-store roll-out of Duck River Butter through Aldi gets underway.

Fonterra Australia does not differentiate its other products made in Tasmania, including milk powders, butters and cheeses for the domestic and export markets, as having originated from the state.

Opportunities and threats

Dairy in Tasmania has been growing at a rate of between three and four per cent per annum. The growth within Tasmanian dairy has come from a mix of existing suppliers becoming increasingly focused on their dairy business, but also a number of new entrants undertaking larger scale dairy conversions. These conversions have been funded either through existing local operators undertaking new ventures, or investor-based models appointing management consultants to develop the project and then operate the entity.

The attraction of the ability to produce milk from a predominately pasture-based system resulting in a relatively reliable low cost of production business remains fundamental to these developments. Recent market volatility has made dairy production business models that focus on pasture even more attractive. Many of these new conversion farms seek expertise from New Zealand to manage the projects and the operation, given the similarity in climate and production systems.

Vital to the growth of dairy in Tasmania is regional infrastructure that can support expansion. Fonterra has previously raised with the Government a number of limitations in transport and freight that hinder growth, including poor quality roads requiring upgrades and changes to load limits to enable the use of larger trucks capable of carrying more milk. The Tasmanian Government has been willing partner in helping to effect change, and we acknowledge their support.

Tasmania's island state status also presents freight challenges, particularly in moving milk between our factories. At our Victorian sites, we have the ability to shift milk between factories and regions as a stop-gap measure to manage surpluses and shortfalls. During peak milk production periods on farm, our Tasmanian sites often have milk surplus to our production requirements, which could be relocated to Victorian sites with additional capacity. However, the cost of moving raw milk from Tasmania to the mainland and unfavourable shipping times makes this option unviable, thereby adding inherent cost to the Tasmanian operations.

As mentioned previously, Tasmania has an enviable reputation as a clean and green producer of food. Fonterra sees an opportunity to build on Tasmania's reputation as a clean and green producer; one of the ways this could be grown is by exploring the potential to develop the organic dairy market.

A major threat to Tasmania's reputation for clean and green dairy production is the consideration of an application to register recombinant bovine Somatotropin (rbST) for use in Australia by the Australian Pesticides and Veterinary Medicines Authority (APVMA), a bovine growth hormone that artificially increases milk production in dairy cows.

A number of Australia's major dairy competitors prohibit the use of rbST, including New Zealand and the European Union. India prohibits the importation of dairy products from the United States, where rbST is approved for use, and Chinese regulators have previously expressed reservations over the use of rbST. If the application to register rbST for use in Australia is successful, it has the potential to destroy Australia's reputation for clean and green food, and will almost certainly place us at a disadvantage to New Zealand, which enjoys a similar reputation for pure and natural food.

Dairy also struggles to attract people to work in the industry, particularly pre farmgate. Dairy Australia and its Regional Development Program DairyTas have invested significant resources into attracting, developing and retaining people into the dairy industry through both its Cows Create Careers and its

Stepping Stones programs, with the support of the Tasmanian and Federal Governments. However, an image problem persists, with many young people viewing dairy as an unfavourable career choice.

Although dairy has endured challenges recently, our industry is resilient, and the outlook for dairy is very positive. Dairy offers a myriad of career options pre-farmgate, in the processing sector, and at an industry level that can directly address youth unemployment issues in Tasmania.

Fonterra's Tasmanian suppliers enjoy the benefit of processor competition through Fonterra's pricing structure, which sees the same farmgate milk price paid to our Tasmanian suppliers as is paid to our Victorian suppliers, despite fewer processors operating in Tasmania. Fonterra's scale within Tasmania gives us greater efficiency and reduces our cost of doing business, enabling us to deliver further benefits to our farmers.

The role of the Tasmanian Government

Fonterra Australia enjoys a strong relationship with the Tasmanian Government, characterised by openness, transparency, and mutual respect, and we look forward to that continuing.

Fonterra sees the role of the Government being to preserve and protect the enviable reputation Tasmania enjoys as a pure and natural food producer, the ongoing promotion of dairy as a fulfilling and rewarding career by continuing to invest in programs that encourage young people to consider a career in dairy, and to remove barriers to investment such as poor regional infrastructure and addressing freight issues.

Fonterra is firmly committed to Tasmania and sees great opportunity for growth within dairy, which has the potential to be the major driver of the Tasmanian economy with the right policy settings. Fonterra Australia has enjoyed a collegial relationship with the Tasmanian Government and its departments for a number of years, and we look forward to working with the Government to realise Tasmania's growth potential.

If you have any questions or would like more information, please contact Rachel Jones in our Communications team, via email, rachel.jones@fonterra.com or on 0408 904 940.

Yours sincerely,



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Managing Director



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