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Miraka Submission to the Commerce Commission: Independent Report on setting the asset beta in the Base Milk Price

On 11 April 2018 the Commerce Commission released an independent report[1] (the CEPA report) into the approach taken for determining the asset beta used in the Base Milk Price calculations. The Commission has sought submissions on the CEPA report.

The CEPA report concludes that the asset beta for a dairy industry comparator group provides a "reasonable proxy for asset betas in the dairy industry in general, and the notional processor in particular". CEPA's independent assessment of the asset betas of the appropriate comparator group falls in the range 0.45 to 0.58. CEPA concludes that is has "not seen sufficient empirical support for an asset beta below the bottom end of this range". The asset beta of 0.38 used by Fonterra in the Base Milk Price calculations since the 2014/15 Season falls well below the bottom end of the range.

Miraka supports the conclusions of the CEPA report. They are consistent with previous submissions Miraka has made on this matter. Miraka refers the Commission to those previous submissions, made variously by Miraka in its own right and jointly with Synlait and Open Country Dairy. The most relevant submissions are listed in the Appendix to this submission.

CEPA has independently assessed the range of comparator asset betas falls between 0.45 and 0.58. This is a relatively wide range: an asset beta chosen from either end of the range would have a materially different impact on the Base Milk Price. The choice of asset beta directly affects returns to key stakeholders in the dairy industry[2]: milk producers by way of the Base Milk Price, and investors in the dairy processing industry by way of the capital charge and underlying impact on profit from dairy processing. An asset beta at the upper end of the range would imply bias toward investors in dairy processing. On the other hand an asset beta at the lower end of the range would imply bias toward milk producers. An asset beta which shows

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[1] Cambridge Economic Policy Associates (CEPA) Pty Ltd: Dairy Notional Processor's Asset Beta, 28 March 2018
[2] While the Base Milk Price directly impacts Fonterra stakeholders, its impact is equally relevant for stakeholders across the wider New Zealand dairy industry because Fonterra's milk price sets the benchmark competitive milk price for the entire industry.

bias to specific stakeholders to the detriment of others would not comply with the DIRA. The asset beta for the Base Milk Price calculations should rather reflect a balance between stakeholder interests. In the case of the range of asset beta's supplied by the independent CEPA study, to avoid bias it would be necessary that the single point asset beta actually used in the Base Milk Price calculations align to the mid-point of the independently assessed range. Miraka requests the Commission take this perspective into account when considering the CEPA report and reviewing the milk price calculations for 2017/18 and beyond.

Yours sincerely

Richard Wyeth
Chief Executive Officer

Appendix: Miraka Submissions, WACC and Asset Beta

Miraka submissions which have addressed the WACC and Asset Beta assumption in the Base Milk Price calculations include:

- Submission on Draft Report – Review of Fonterra's 2015/16 Milk Price Manual – 5 November 2015
- Submission on Process and Issues Paper [2015/16 Milk Price Calculations review] – 4 February 2016
- Submission on asset beta and specific risk premium reports – 17 June 2016
- Submission on review of Fonterra base milk price calculation [2015/16 Season] draft report – 1 September 2016

In addition, Miraka participated and submitted jointly with Synlait and Open Country Dairy in the Milk Price Calculations Workshop convened by the Commission (30.5.17). Relevant papers submitted to that workshop were:

- Discussion Paper (15.5.17)
- Follow-up Comments (13.6.17)