TO WHOM IT MAY CONCERN:

DIRA and The Commerce Commission on Fairness Within The Dairy Industry

The big players – Fonterra, Open Country, Sinlay and Chinese Pokeno all have a farm gate price to buy milk at the lowest price and make maximum profit.

Chinese factories will have milk supply controlled and delivered by Fonterra and Open Country which are our high end infant market.

If overseas companies e.g. Vietnam etc want NZ milk for high end product the NZ farmer will create competition at the farm gate, which is separate from the domestic market. Fonterra will continue to keep opposition factories full, to stop their suppliers leaving and supply other milk processors.

DIRA has expired in the South Island as 22% of Fonterra's milk is supplied into opposition factories.

Let's be fair to the dairy farmer and create some competition for our milk at the farm gate.

All dairy companies support DIRA because they want to buy at a low price which is considerably below the cost of producing the milk by the dairy farmer. The last 10% of milk product is sold on GDT which is the milk price of the surplus product paid to the farmer – NOT the cost to produce.

Many dairy farmers are in financial difficulty trying to produce milk at below cost as their overheads of stock, feed, wages, maintenance of land and buildings, administration, shares, capital investment and interest – just to name a few, all accumulate to make dairy farming in NZ unviable.

If DIRA stopped tomorrow farmers would have a choice.

The Fonterra supply of factory gate price milk to other factories is keeping them full, hence no Fonterra supplier can supply other factories.

All companies want to make huge manufacturing profits. GDT is not the method or the milk price calculation.

Demand at the farm gate would be welcomed with farmers going into high end markets with overseas dairy processors.

Trevor Bain

State of Competition in NZ Dairy Industry

Further to all comments and reading of Fonterra rivals advising the Commerce Commission review there is insufficient competition for dairy industry de-regulation (NBR) I would like to make the following points:

1. Fonterra generally supports the 22% South Island DIRA at 31 May 2016 and should not be extended.

2. Miraka says insufficient competition. The fact is farmers cannot supply this company due to special contract with DIRA.

3. Open Country is not a start-up company – they are the 2nd largest company and have a waiting list of suppliers. They are blocked by Fonterra and DIRA and special contracts. The Talley Group shareholding is 55 – 69%. 1 year Open Country recorded an after tax profit of 29.8m indicating they could stand alone. This is exclusive of fishing and meat works. They only pay milk price model as specified by the Commerce Commission and Fonterra.

4. Goodman Fielder competes in the domestic milk market against Fonterra brands and other processes. Goodman Fielder Wilmar wants continued regulation and required to retain downstream competition with independent processors unable to guarantee year round supply of milk or be unfeasible for Goodman Fielder to source its own raw milk supply before current arrangements with Fonterra expire in 2021.
   Wilmar International or Goodman Fielder are not a start-up company and have never advertised for milk supply from the farmers. It is hiding behind DIRA and The Commerce Commission. Wilmar bought Goodman Fielder for 1.3 billion (NZ and Australia). It is a Wilmar international company owned by Robert Kuok, net worth 10 billion in 2015.

5. Federated Farmers said farm gate milk competition varied around the country with many of the independent processors, because they are either full or seeking special contracts. There is little competition on price as all processors peg their milk price to Fonterra's. This has to stop.

6. Fonterra appears good in the add-on ingredients business with some profits and no payments to the farmer resulting in farmers having to get a Fonterra loan.

7. Yashili, Danone Pokeno milk plant are supplied by Fonterra and Open Country DIRA milk. What profit and what market are they taking off NZ dairy farms? They expect to grow to $32 billion by 2017 in infant formula sales. (Read attached information)

8. There is no doubt in my mind there is sufficient competition for milk in NZ and start-up companies should not exist as they are big multi-national companies working within the structure that the Commerce Commission provide and the NZ Government. Please correct this NOW as some contracts are being signed up to 2026!!

CONCLUSION

A) DIRA is out, but milk can be traded at a profitable rate that reflects the market that it is intended e.g. longlife milk or infant etc.

B) All companies that have special contracts of supply with Fonterra should cease 31/5/2016 and this would create farm-gate competition. All companies must independently offer a fair market price for farm-gate milk as in Australia.

C) Goodman Fielder NZ and Australia was purchased by Wilmar in October 2014 for $1.3 billion. It is not correct that we subsidise large worldwide Asian companies with milk at below cost of production until 2026. Wilmar are hiding behind the Goodman Fielder brand.

D) Fonterra you can work with them but competition is so strong that the big players are going to own the dairy market in NZ and Australia and the World.

Yashili, Danone collaboration to cover new Pokeno milk plant

Fonterra & Open Country – to supply milk
Danone to sue Fonterra Botulism Scare
Yashili is not seeking farmer supply.

Monday, 27 July 2015, 12:26 pm
Article: BusinessDesk

Yashili, Danone collaboration to include new Pokeno milk plant

By Fiona Rotherham

July 27 (BusinessDesk) - Chinese-owned Yashili International Holdings will collaborate with French dairy giant Danone on its new $212 million plant in Auckland, as part of a wider deal for the Chinese milk formula maker to buy Danone's Dumex China brand amid tightening competition in the world's largest infant formula market.

Yashili, which is 25 percent-owned by Danone and one of China's top 10 infant formula makers by sales, said it plans to acquire Dumex Baby Food for an undisclosed amount. Danone will use the proceeds to buy shares in milk producer China Mengniu Dairy, which owns an indirect 51.04 percent stake in Yashili.

The filing to the Hong Kong stock exchange also said Yashili and Danone intend to collaborate in New Zealand with respect to a manufacturing plant with the aim of "achieving synergies and support in various areas".

The official opening of Yashili's Pokeno plant has been delayed eight months until October while the company awaits the required approvals under China's complex food safety regulations. The company has been negotiating with Fonterra Cooperative Group and Open Country Dairy for raw milk supply.

Yashili had previously imported milk powder from New Zealand for 10 years. The factory will be the biggest single drying plant for infant milk in Asia, processing 300,000 litres of milk daily when it reaches full production. All of its products will be exported to China, where its website said infant formula sales are expected to grow to $32 billion by 2017.

Yashili Employs 5000 +
2008 Chinese milk scadal.

Latest News

CHINA AND FRANCE COLLABORATE ON NEW AUCKLAND DAIRY PLANT

A new $212 million dairy plant will open in Auckland in a joint venture between Chinese-owned Yashili International Holdings and French dairy giant Danone. Yashili, which is 25% owned by Danone, plans to acquire Danone's Dumex Baby Food China brand. The companies are working together in New Zealand to build the manufacturing plant. The Pokeno plant's opening has been delayed until October, and negotiations are underway with Fonterra and Open Country Dairy to supply the raw milk.

This entry was written by Dominique Visini, posted on Wednesday, 29 July 2015 Bookmark the permalink.

Danone's local subsidiary, Danone Nutricia, ended its supply contract with Fonterra after the August 2013 botulism scare and launched a $1 billion law suit against the dairy cooperative in compensation for disrupted sales. It has since been sourcing product from Synlait and other manufacturers and last year bought two Kiwi dairy processing companies, Sutton Group and Gardians, with the latter providing access to milk supply from 18 farms owned by Grant Paterson of Dunedin.

In its first-half results, Danone said its early life nutrition division reported an 11 percent increase in second quarter sales to 1.23 billion euros, following a boom in online sales in China. Despite that positive environment, Dumex brand products remained well below 2013 levels, "hit hard by the false alert raised by Fonterra and by the shift in consumer preferences from supermarkets to both online sales and specialised distribution", it said in the statement.

Danone had revised long-term sales projects for Dumex in China and taken an impairment charge of 398 million euros as at June 30.

Bloomberg reported analysts saying China's infant formula market is suffering from too much competition while Chinese consumers are increasingly buying foreign-made infant formula online due to concern about the safety of local product. Yashili and Beingmate Baby &Child Food Co. in which Fonterra has bought an 18.8 percent stake to push its Anmum brand in China, are expected to be market consolidators.

(BusinessDesk)

Marketing and sales channels

Yashili sell its products via a comprehensive national sales and distribution network, which covers all regions within mainland China. The milk powder products sales network comprises around 1,500 regional distributors, who directly or indirectly further distribute Yashili's products to over 105,000 retail outlets, including supermarkets, department stores, specialty stores and large membership chain supermarkets as well as grocery stores. Yashili also sells its products to 15,000 maternal and child stores, which it claims had pushed up market share in this channel, bringing new growth points for the Group's performance. The company's extensive milk powder products distribution network is formed by more than 2,300 marketing staff under the support of over 600 liaison locations.[19]

Brand building

In the "2011 Annual Meeting on Competitiveness of Chinese Brand and Third Summit of Chinese Brands and Brand Leaders" held in Beijing in March 2012, Yashily was given the "2011 Most Influential Brand Award in China". In July 2012, "Yashily" was named 500 Most Valuable Brand in China with a brand value of RMB9.865 billion, ranking 154 overall. Compared to 2011, Yashili's brand value increased by RMB2.09 billion, while its ranking went up nine places.[20]

Brand image association with New Zealand

Early in 2012, Yashili began a marketing campaign promoting the company's infant formula's New Zealand milk powder content by adding the slogan "Pure New Zealand, Cherish Yashili" to its product range (Chinese: 纯净新西兰 真爱雅士利 pinyin 'chunjing Xinxilan, zhen'ai Yashili).[21] The company's marketing slogan is also featured across the home page of the Yashili company website. The company's leading brand 'a-Golden Stage' (Chinese: 1段婴儿配方奶粉）has the byline 'made from high quality New Zealand sourced milk' (Chinese: 来自新西兰的优质奶源）In the company's 2012 interim report Yashili noted that "All of our branded paediatric milk formula products are mainly produced by imported premium raw materials procured from New Zealand".[22] An interactive internet event named "Experience excellent milk sources with a trip in New Zealand" was held in 2012 with 5 million participants. Also, over 2,000 parent-child roadshows and activities were held from first-tier cities to second and third-tier cities, and winning consumers were invited to participate in "6-day trip to experience milk source in New Zealand".[23] Since August 2010, Yashili has sourced all its milk for its infant formula products from New Zealand.[24]

Overseas Investments

Fonterra's approach to the weighted average cost of capital is still not practically feasible

The asset beta and WACC Fonterra is using for the notional processor is still too low, and this requires the Commission's urgent attention. As we have noted in the past, WACC is a very sensitive input. Accordingly, despite improvements in other areas of the milk price, the WACC is leading to a milk price that is still not yet practically feasible. In particular, Dr Marsden's report for Fonterra on the notional processor's asset beta:

- Provides little basis for the point estimates reached
- Underplays the volatility in demand faced by the notional processor
- Overplays the strength of regulation in reducing asset beta
- Overplays the distinctions between Fonterra and the notional processor in creating a 'notional processor discount' of 0.1 to the asset beta that is not explained.

Open Country is disappointed that the Commission is not engaging any independent advisors to analyse Dr Marsden's report and would have expected this would happen—particularly given this is the standard in other regulated industries. Because the Commission has not yet taken this step, Open Country has engaged Castalia to undertake substantial additional analysis of Dr Marsden's report. Castalia's findings support the position Open Country has consistently held, and we urge the Commission to take urgent action in pushing Fonterra to amend its approach to WACC.

Open Country disagrees strongly with the Commission's views on Fonterra's incentives

Open Country is surprised and concerned that the Commission has formed the view that Fonterra's overall incentivise is to maximise profits (and therefore dividends) rather than the milk price. Open Country's view (and the views of many stakeholders) has consistently been that Fonterra's overall incentive is to maximise the milk price. Castalia's report supports this view, stating that there are robust reasons why Fonterra would not under-price milk—because it would harm its farmer shareholders and Fonterra would lose market share.

In its draft report, the Commission states "we consider Fonterra's management has a stronger incentive to maximise profits...relative to increasing the base milk price".[1] In reaching this conclusion, the Commission emphasises Fonterra's need to ensure its TAF capital structure works and also that transparency through the listing of FSF units also incentivises Fonterra to maximise the dividend.

Fonterra's incentives are dominated by its farmer shareholders. FSF unitholders only supply approximately 6 percent of Fonterra's equity, and they have no rights to vote in the co-operative. While one of Fonterra's interests is to ensure TAF works, this is therefore a small part of Fonterra's overall incentives. We would also expect that the incentives on Fonterra's management would be strongly driven by their incentive schemes—which there is no clarity on.[2] We ask that the Commission clarify whether it has reviewed these incentive schemes—if the Commission has not, we request this be a focus in next season's review.

Beyond any conceptual arguments, if it was true that Fonterra's incentive is to maximise its profits (which it would do by maximising the notional processor's costs) then we would expect to see at least some evidence of this in the milk price calculation. However, the reality is the opposite:

- **Where Fonterra has choices to make in its modelling approach it consistently chooses options that minimise costs.** For example, Fonterra assumes the notional processor's

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[1] Commerce Commission 'Review of Fonterra's 2014/15 Base Milk Price Calculation: Dairy Industry Restructuring Act 2001—Draft Report' at Attachment A, para A4

[2] As noted by market commentator Tony Baldwin for the New Zealand Herald 'Why Hasn't Fonterra Worked?' 28 August 2015, accessible here

NBR

Fonterra's rivals tell review there is insufficient competition for dairy industry deregulation

FIONA ROTHERHAM · TUESDAY JULY 14, 2015

Fonterra CEO Theo Spierings (Tinaz Karbhari)

Competitors of Fonterra Cooperative Group [NZX: FCG], the country's largest dairy processor, claim there is still insufficient competition to deregulate the industry.

In submissions to the Commerce Commission, which is undertaking a government-ordered review of the industry's competitiveness, rival processors either want the status quo or the regulations tightened.

Farmers lobby group, Federated Farmers, says the Dairy Industry Restructuring Act 2001(DIRA) will need to be amended if it's retained long-term.

Fonterra's submission generally supports the process and methodology suggested in the commission's consultation paper and says it will comment separately on substantive issues raised by the review. The cooperative said the commission should consider the full period since the DIRA came into effect rather than the most recent five years, and that it was particularly important to examine the entire "life cycle" of entry and growth of independent processors.

Among the issues under investigation is whether the DIRA competition thresholds have been met. The current threshold frees Fonterra from its obligation to supply milk to smaller competitors once at least 20% of supply is taken by competitors in both the North and South Islands. Fonterra currently has an 86% share of the nation's milk pool, down from 96% when it was set up in 2001.

In its submission, Westland Milk Products said it had successfully attracted milk supply from dairy farm conversions but had been less successful in wooing existing Fonterra suppliers to switch. Only a quarter of its Canterbury shareholders are ex-Fonterra and it said Fonterra's actions to secure supply are contrary "to the purpose and principles of the act."

"We are concerned that actions employed by Fonterra in response to competition for milk supply at the farm gate demonstrate that Fonterra has used, and has the potential to continue to use, its position of dominance to restrict competition and, thus, there remains the need for regulation of Fonterra to sustain competition in this area," it said.

Westland said new Fonterra suppliers were being locked into long-term supply agreements of up to seven years, which typically relieved them from the usual requirement to buy one Fonterra share for every kilogram of milk solids produced.

"Without the regulations we would expect to see Fonterra to continue to jealously guard its supplier base as, even with the regulations, we have seen such behaviour," Westland submitted.

2) New dairy processor Miraka submitted that there was currently insufficient competition at the farmgate milk market and that the threshold should be lowered to 75% rather than 80% before deregulation is triggered.

3) Open Country Dairy, the country's second-largest processor, submitted that while competition between dairy processors is evolving, it hasn't reached

the point whether it can discipline Fonterra's market power without the open entry and exit regime that allows suppliers to switch over. While independent processors have grown their market share, there has also been the bankruptcy of New Zealand Dairies Ltd, and a series of recent and untested investments by new players, it said.

"Since the 2010 review, we have seen Fonterra continue to set market prices and hold substantially the same level of market power and influence that led to DIRA being extended in 2010," it said.

Talleys Group, a 75% shareholder in Open Country, described the open entry/exit requirement as the "singularly most important policy in the DIRA regime."

A Castalia report, commissioned by Open Country, suggested the commission should focus particularly on how Fonterra might react to various deregulation scenarios being considered – and the consequences to efficiency.

Dairy processor Tatua said it had reservations about the review's scope because it didn't permit the possibility of better regulations to promote efficient New Zealand dairy markets, except as a pathway to deregulation.

"The review appears to be premised on a view that the regulations were not intended to last indefinitely. While some parties may have anticipated their falling away, that is not a universal view," it said.

Federated Farmers said farmgate competition varied around the country with many of the independent processors because they are either full, close to capacity, or seeking special contracts, able to cherry-pick the best farms and farmers closest to the factory gate. There is little competition on price as all processors peg their milk price to Fonterra's, it said.

Under DIRA's raw milk regulations, processors with no or limited own supply are allowed unfettered access to regulated raw milk. Federated Farmers submitted that all processors should be treated the same whether they have their own supply or not and that farmgate competition would be increased by limiting this access to three years.

It said the rule allowing Fonterra suppliers to divert up to 20% of their milk supply daily to independent processors should be either dropped, changed to a volumetric limit that would still protect boutique cheesemakers and small processors, or be tied to the amount of milk taken in October.

Federated Farmers also said the legislation should be altered, so any new processors coming into areas where competition is close to the thresholds, such as Canterbury, Waikato, and the Manawatu, should be denied access to regulated raw milk.

Goodman Fielder, which competes in the domestic processed milk market against Fonterra Brands and other processors, said continued regulation was required to retain downstream competition, with independent processors unable to guarantee year-round supply of milk of the scale it required.

It said it was unlikely an alternative supplier will develop within a reasonable timeframe or be feasible for Goodman Fielder to source its own raw milk supply before its current supply arrangements with Fonterra expire in 2021.

It said the current 20% rule was inadequate and should be changed to require 20% of milk solids required by independent processors at the factory gate monthly for at least two years to ensure guaranteed year-round supply.

(BusinessDesk)

COMMENTS & QUESTIONS

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