Norco Co-operative Limited

Tel +61 02 6627 8000
Fax +61 02 6621 9673
Web www.norco.com.au

Street Address "Windmill Grove" 107 Wilson Street, South Lismore NSW 2480
Postal Address PO Box 486, Lismore NSW 2480
ABN 17 009 717 417 ARBN 009 717 417

23 March 2011

Senate Economics References Committee

Questions on Notice from Senator Xenophon - The impacts of supermarket price decisions on the dairy industry, Melbourne 8 March 2011

Qu 1: The ACCC noted in its review of the National Foods/Dairy Farmers acquisition that Norco had a strategic alliance with Fonterra. Does Norco still have this strategic alliance? What is the nature of this alliance and what does it involve?

A: In 2006, Norco and Parmalat owned the Norco Pauls Joint Venture (NPJV) with 50/50 ownership. Due to Parmalat's financial issues in Italy at the time, Norco had the right to exercise an option to purchase Parmalat's share of the NPJV. Norco exercised this right and for a period of five months owned and ran the NPJV. In Januray 2007, Norco sold the sales and distribution arm of this business to Fonterra. So essentially Norco supplies the milk and makes the finished goods and Fonterra distributes and sells the product into the market. The business is not a joint venture, they are two separate businesses running independenlty. Essentially Norco makes the product and Fonterra sells it. We have a Long Term Supply Contract with Fonterra which governs this relationship and that contract has another sixteen years to run.

Qu 2: The Australian Dairy Farmers have stated that the market share of the supermarkets' private label milk has doubled since the 1999–00 financial year. What direct impact on your business has this had?

A: It is well known that the retailers' private label milk products ("generic products") now account for over 70% of milk products sold in their supermarkets and that the processors' brands ("branded products") are in decline. The impact on our business is that, as we receive more for the branded products than we do for the generic products, and as the share of generic products is now over 70%, we are paid a lower milk price for our milk products overall than would be the case if, for instance, the supermarkets sold 70% branded products and 30% generic products. The current supermarket sales mix adversely affects our ongoing profitability and viability. Processors need substantial branded product sales to ensure that a mix of business exists which allows a sustainable profit.

Qu 3: Coles' managing director Ian McLeod has said that 'Coles believes there should be greater transparency of farmgate pricing by the multinational milk-processing companies so everyone knows what is really going on'.

a) **Do you agree with this view? How transparent are the prices and terms of the contracts for private label milk and branded milk between the major supermarkets and the processors?**

A: Norco publishes its farm gate price in its annual report each year. Therefore we do provide full transparancy on the cost of milk. The reality is that when farmers are investigating their options regarding which processor to supply they freely share other processors' prices between themselves.

When a price is provided to the retailers for private label tenders one price is provided per product, including a pricing mechanism based on the movemenet of the commodity, rather than a break up of each component of the product because the processors need to protect their margin. If the retailers saw each component then they might attempt to reduce the processors' small margins and put these processors out of business.The same pricing method is followed for branded products.

Due to the size of some processors they are able to compete over a wide geographic area and this allows these processors to use a blended (bundled) price to secure contracts with the major retailers. If a regional approach were undertaken it would encourage smaller processors.

b) Do you think there would be noticeable benefits if this information was more widely available?

A: If the information is already available to dairy farmers there would be no noticeable benefit.

From a processor perspective, we would fear that the retailers would try to take a bigger margin and leave the industry with smaller margins, meaning that we could not reinvest in our factories for future improvements, or even maintain existing plant at an appropriate (safe) level.

c) What complications or issues would prevent this?

A: Farmer milk payment systems can differ from processor to processor and this is because they may make different dairy products. For example, a company supplying milk to the fresh drinking milk market requires a different composition in milk to a processor who produces cheeses, skim milk or ice cream.

It would be surprising if the processors would want to adopt an open book pricing methodology with the retailers. The difficulty in achieving this for our business is that we sell to Fonterra which then sell to Coles (and other customers) and we do not know the price at which Fonterra sells the products to Coles. There are also distributor costs and margins that Fonterra deals with that would also need to be taken into account. So the issue here is recognising the need for several distinct businesses to work effectively and efficiently in a variety of markets and sub markets and it is that process which will determine the supply chain costs and margins.

Qu 4: One submission called for the monitoring, collection and publication by Dairy Australia on a seasonal basis of all price agreements and price ranges offered by processors by region. It also appears that Murray-Goulburn publishes changes to its farmgate prices when they are made.

a) Do any other processors publish their pricing information?

A: Norco publishes its milk pricing on a regular basis to its farm base and this sometimes is passed on to non-Norco suppliers. Once a document is sent out to our suppliers, we assume that it is a public document even though it is not intended by us to become so. We understand that Parmalat also publishes its prices to its suppliers using a similar method as Norco.

b) Is this information otherwise available?

A: It is available generally on the premise that farmers talk and compare pricing to work out which processor is offering the best deal in the market from time to time.

c) Would there be any significant benefits to this information being available?

A: Arguably, it would be better for farmers to know who is paying what. On that basis they could seek to enter into commercial arrangements which would provide the best chance for their businesses to remain economically viable. As a farmer owned co-operative, Norco wishes to support its members to achieve that outcome. Regardless of our status as a co-operative, however, in our view maintaining a viable fresh drinking milk dairy supply base is critical to Australia being able to ensure a safe and secure source of supply of one our national staples.

d) How transparent is information on multi-tier pricing structures and any incentive payments and penalties?

A: Milk payment systems can be quite difficult to decifer so a common mechanism of cents per litre price or a price per kilogram of fats and solids would need to be implemented to enable effective comparisons of the different processors' pricing.

e) Do you see any practical benefits or problems that may arise from this?

A: Any milk payment system needs to reflect the requirements of the processor. Different markets will provide different views on the most appropriate methods of establishing prices for goods sold in those markets.

While it would be useful for the processors to know how competitive they are in a given market, making comparisons using the different processors' systems would be difficult.

Yours faithfully,
NORCO CO-OPERATIVE LIMITED

GREG MCNAMARA
Chairman