IN THE AUSTRALIAN COMPETITION TRIBUNAL

MURRAY GOULBURN CO-OPERATIVE CO LIMITED

RE: PROPOSED ACQUISITION OF WARRNAMBOOL CHEESE AND BUTTER FACTORY COMPANY HOLDINGS LIMITED

Statement of MR KEITH MENTIPLAY

Dated 29 November 2013

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I, KEITH MENTIPLAY of Level 15, 2 Southbank Boulevard, Southbank VIC 3006, General Manager Operations of Murray Goulburn Co-Operative Co Limited, say as follows:

1. Where, in this statement I refer to information provided to me by a third person, I believe that information to be true and correct and, at the time I was provided with that information, I believed it to be true and correct, unless I state to the contrary.

2. Where I refer to documents in this statement, I do so by reference to the relevant annexure certificate prefaced by my initials 'KM'.

1 BACKGROUND AND ROLE AS GENERAL MANAGER OPERATIONS

3. I am currently the General Manager Operations of Murray Goulburn Co-operative Co Limited (**MGC**), and have held this position since 12 December 2011.

4. I attained a diploma in Dairy Technology from the Gilbert Chandler Institute of Dairy Technology at Werribee (now part of Melbourne University) in about 1980 and an MBA from Macquarie University in about 1992. I took part in the Australian Rural Leadership Program from 2000 to 2002, as well as the London Business School Senior Executive Program in 2007.

5. I have worked in the Australian dairy industry for over 35 years, working in South Australia, New South Wales and Victoria.

6. Prior to joining Murray Goulburn:

   (a) from 1973 to 1981, I worked at Southern Farmers Co-operative Limited, initially in their laboratory;

   (b) from 1981 to 1992, I worked at Dairy Farmers Milk Co-operative as the Sydney Operations Manager, managing the largest milk plant at the time and overseeing the milk supply in the Sydney region;

   (c) from 1992 to 1993, I worked at Bulmer Australia as Manufacturing Director;

   (d) from 1993 to 1995, I worked as the General Manager for Peters Ice-Cream and, when it was acquired by Pacific Dunlop Limited, as the Director of Operations in the food group of Pacific Dunlop Limited;

(e) in the mid-1990s, Pacific Dunlop Limited sold its food assets, in particular its dairy division was sold to Nestlé Australia. From 1995 to 1997, I continued in the same role as Director of Operations at Nestlé Australia; and

(f) from 1997 to 2011, I worked at National Foods Limited (now Lion Dairy and Drinks), initially as the regional general manager of Victoria overseeing the liquid milk business and eventually becoming the Executive General Manager of Group Operations in 1999, Group Executive of Supply Chain in 2002, Group Executive of Operations & International in 2005 and Group Executive One Company Integration / Operational Excellence in 2008. In these roles, I oversaw general management, national and international operations of National Foods Limited. I was an executive team member in my last 8 years at National Foods Limited. I headed the company's acquisition of Dairy Farmers (as Australian Co-operative Foods Limited) in 2008 and oversaw the integration of Dairy Farmers into National Foods Limited.

Now produced and shown to me and marked as "**Annexure KM-1**" is my curriculum vitae.

7. My involvement in National Foods Limited's acquisition and integration of Dairy Farmers included:

(a) calculating potential synergies prior to the acquisition, which was relevant to National Foods Limited's negotiation of the purchase price;

(b) in particular, I had a lead role in estimating operational synergies as I understood very well the business operations of both Dairy Farmers and National Foods Limited;

(c) being the project manager of the integration between Dairy Farmers and National Foods Limited to ensure that all synergies (and cost savings) identified were realised – in this role, I delivered against plan and realised twice the cost savings identified;

(d) being the "face" of the integration between Dairy Farmers and National Foods Limited, including finalising project newsletters and working with personnel in both Dairy Farmers and National Foods Limited; and

(e) acting as the acting managing director of Dairy Farmers during this period of transition.

8. In the 1980s and 1990s, I was actively involved in various industry associations in relation to manufacturing, including being a board member and for a time President of the Dairy Industry Association of Australia NSW branch, being a board member of the Victorian Dairy Industry Authority, and a board member of Australian Milk Marketing.

9. In my role as General Manager Operations, I am responsible for overseeing MGC's processing and manufacturing facilities and am assisted by a number of people within MGC. The key areas of my responsibility include:

   (a) determining the production timetable and production mix – in this regard, I am involved in discussions with Mr Robert Poole (who is responsible for the acquisition of raw milk), Mr Mal Beniston (who is responsible for the international and domestic ingredients sales), Mr Peter Scott (who is responsible for domestic retail sales) and Mr Aditya Swarup (General Manager Strategy & Corporate Development who is responsible for international retail sales) – I discuss this further in Section 5 below;

   (b) managing the production timetable and production mix, including assessing capability planning and monitoring the allocation of raw milk against budget and plan – I discuss this further in Section 5 below;

   (c) managing the procurement of other raw ingredients (that is, ingredients other than raw milk) – in this regard, I am assisted by Ms Jane Holcombe;

   (d) overseeing the pick-up and distribution of milk from dairy farmers to the processing plants and overseeing transportation between processing plants and overseeing the maintenance and operations of MGC's processing plants – in this regard, I am assisted by Mr Mark McDonald;

   (e) overseeing the production planning, pick-up and distribution of products from the processing plants to customers (such as supermarket and food services), including overseas shipments and outsourcing requirements – in this regard, I am assisted by Mr John W Barnett;

   (f) overseeing the justification and implementation of large capital works programs – in this regard, I am assisted by Mr Rista Brkovic;

   (g) ensuring that MGC's production and transportation procedures and processing plants and all other areas of MGC business activity are safe – in this regard, I am assisted by Mr David Hopkins;

   (h) ensuring that the quality of MGC's products is high and its environmental practices are in line with international and Australian standards – in this regard, I am assisted by Mr Anthony Bourke; and

   (i) overseeing developments and projects within the Operations division – in this regard, I am assisted by Mr Kevin Bull.

10. I am also responsible for managing and overseeing the construction and development of 2 new processing plants in Victoria and New South Wales, which are due to complete in mid-2014. I discuss this in further detail below.

2 AN OVERVIEW OF CONVERSION OF RAW MILK FROM PICK-UP FROM FARMER TO DELIVERY TO CUSTOMER

11. MGC produces and sells fresh milk, daily pasteurised milk, ultra heat treated (**UHT**) milk, cheeses, butters, milk powders, whey powders, milk fats, specialty milk proteins and nutritional products (including infant formula). The primary ingredient in these products is raw milk. These products can be categorised into the following broad 'milk streams':

    (a) cheese and whey;

    (b) powders (which includes standard powder such as full milk powder and skim milk powder, and speciality powders such as milk protein powder, casinates and infant nutrition);

    (c) butterfat products (which includes butter, cream, anhydrous milk fat, cream cheeses etc); and

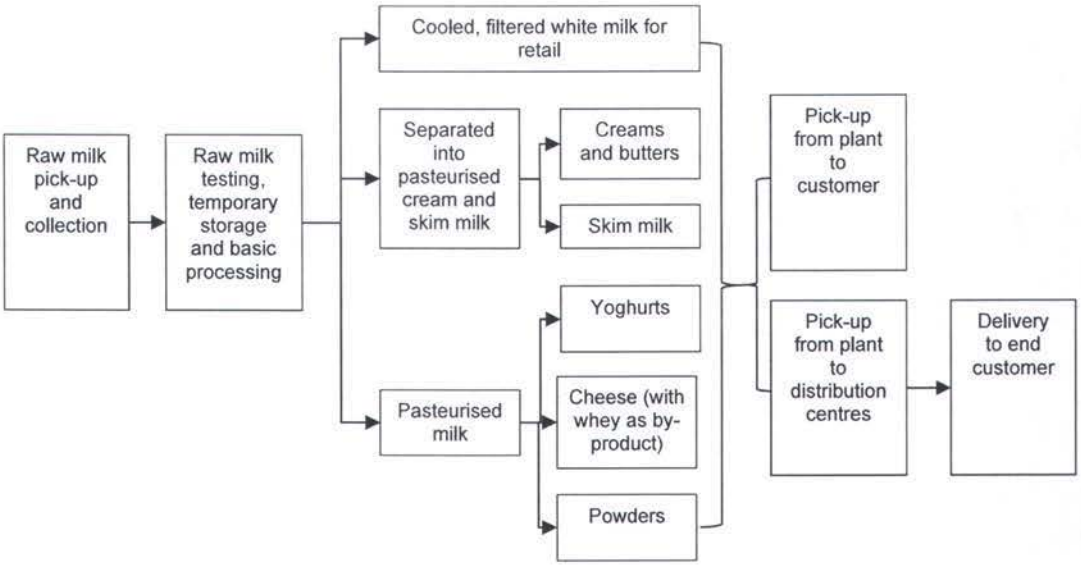
    (d) milk and cultured milk products.

12. There is some process commonality in producing these goods and delivering it to the end customer. This includes collecting the raw milk from farmers, testing the raw milk for any harmful microorganisms, processing the raw milk to be ready for consumption and transporting the goods from the plants to the customers (either directly or via our distribution centres, depending on the product).

13. The processes involved in collecting raw milk include keeping the milk cool at all times, storing the milk in silo tanks to await processing and ensuring the milk is kept smoothly agitated to stop cream separation by gravity.

14. The raw milk is usually heat treated to destroy pathogenic micro-organisms (prior to heat treatment in the 19th century, milk was a source of infection). The duration of the heat treatment depends on the final product, for example UHT milk undergoes long and more intensive heat treatments to increase the shelf-life of milk. Once the raw milk is heated, it is held for a specified time at pasteurisation temperature. The components of the milk are then separated and standardised (usually in a centrifugal clarifier bowl and a standardisation machine) to adjust the fat content of milk, or milk production, by adding cream or skim as appropriate to obtain a given fat content. Depending on the product, the milk is then homogenised to stabilise fat emulsion against gravity separation.

15. Now produced and shown to me and marked as "**Annexure KM-2**" is a diagram which illustrates the processes involved in producing dairy goods. A simplified version of the same appears below:



16. There is a considerable difference in the amount of raw milk required in producing different dairy products. For example, more raw milk is required to produce, say 250g of skim milk powder than is required to produce 250g of infant nutrition powder. This is because there are additional raw inputs or ingredients to produce infant nutrition powder, such as whey, casein, vegetable oils, lactose, vitamins and minerals. Similarly, more raw milk is required to produce, say 250g butter than is required to produce 250g of Swiss-style yoghurt (as fruit, sugar, starch, pectin and gelatin is added to the latter).

3 AN OVERVIEW OF MGC'S PROCESSING PLANTS

17. MGC has 6 processing and manufacturing plants in Victoria:

(a) in northern Victoria, specifically at:

(i) Cobram, which is capable of producing infant formula, specialty ingredients, cheese (bulk and retail), whey powder, whey protein concentrate, whey protein isolate, lactose and specialty whey proteins (**Cobram Plant**);

(ii) Rochester, which is capable of producing cheese, full cream milk powder, whey powder, whey protein concentrate, lactose and speciality powders (**Rochester Plant**); and

(iii) Kiewa, which is capable of producing cream cheese and retail milk/cream (**Kiewa Plant**);

(b) in south-western Victoria, specifically at:

(i) Koroit, which is capable of producing full cream milk powder, fat filled milk powder, skim milk powder, anhydrous milk fat, butter and milk protein concentrate and in particular toddler formulas or 'growing up milk powders' colloquially referred to as "GUMPS" (**Koroit Plant**); and

(c) in the Gippsland area, specifically at:

(i) Leongatha, which is capable of producing butter, retail butter/spreads and cream, UHT products, casin/casinates, milk protein concentrate, whey powders, lactoferrin and milk minerals (**Leongatha Plant**); and

(ii) Maffra, which is capable of producing skim milk powder, butter milk powder, anhydrous milk fat, butter, specialty ingredients and calf milk replacer (**Maffra Plant**).

Now produced and shown to me and marked as "**Annexure KM-3**" is a map of MGC's processing plants with descriptions of the products made at each plant.

18. MGC also has a processing plant in Edith Creek, Tasmania, which is capable of producing specialty UHT products (**Edith Creek Plant**).

19. MGC has a processing plant in Leitchville in northern Victoria, which it closed in 2010. Prior to its closure, the Leitchville plant was comprised of predominantly cheese-making facilities. The plant is now idle.

20. In summary, the dominant production by MGC in northern Victoria is cheese, in the Gippsland area is butter and powder, in western Victoria is milk powder and in Tasmania is UHT milk. MGC currently processes approximately 1 billion litres of raw milk in each of the 3 Victorian milk production areas.

21. The types of products made in each region are largely a result of history and tradition arising from the organic development of MGC since the 1950s when the first plant was opened in Cobram.

22. Our largest plants are the Cobram Plant, the Leongatha Plant and the Koroit Plant, as these plants have multi-purpose facilities attached to it. For example:

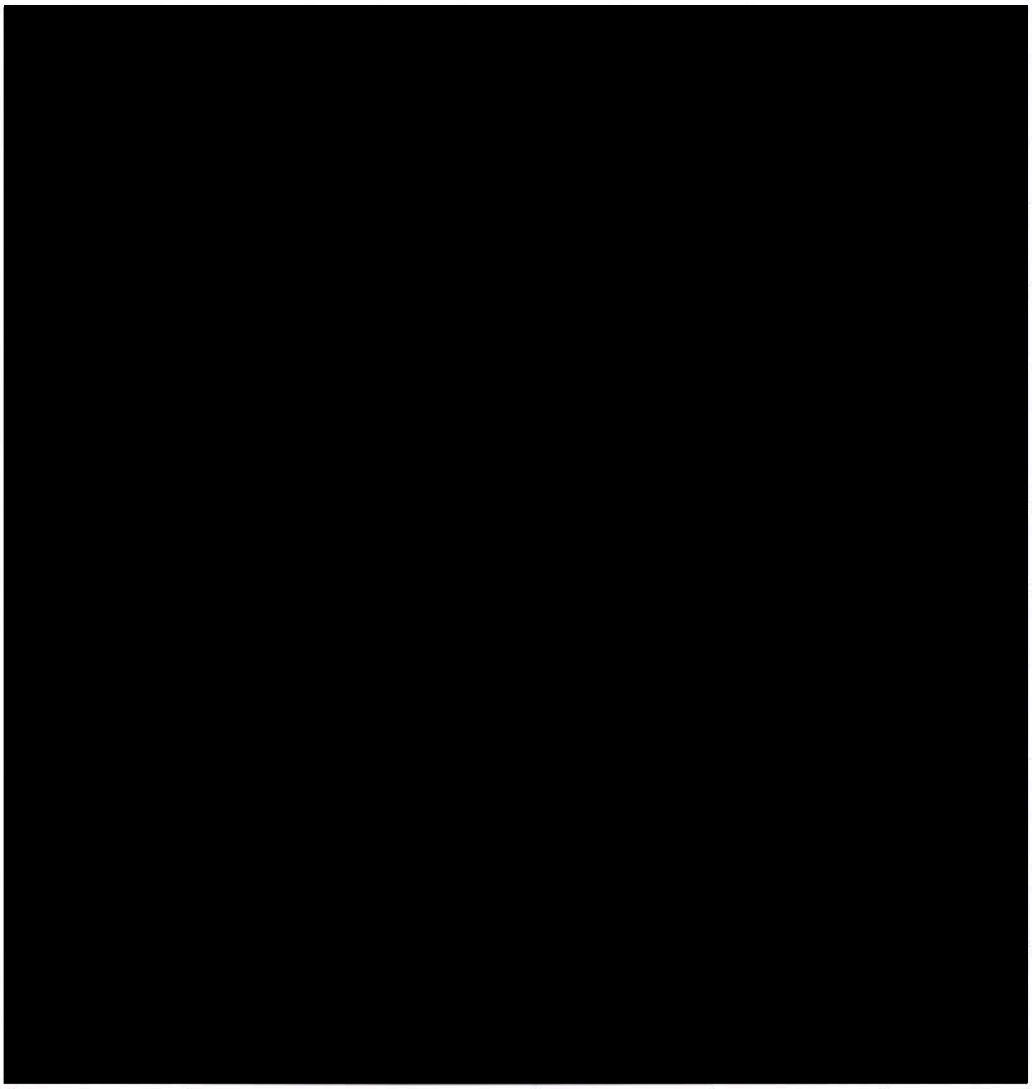
(a) the Cobram Plant has a cheese-making facility, a whey handling facility, a whey powder making facility and an infant nutrition facility;

(b) the Leongatha Plant has a bulk and retail butter facility, a retail cream facility, a UHT milk facility, a filtered milk facility, a lactoferrin facility, and a specialised proteins facility; and

(c) the Koroit Plant is a more traditional powder plant, but has facilities to enable it to make different powders.

23. Within a plant, each of the facilities operate in isolation to a large degree, because they utilise different technologies and require different skilled labour. However, some facilities are complementary with each other (such as the cheese facility and whey-handling facility since whey is a by-product of cheese, and the skim milk facility and the infant nutrition facility since skim milk is an ingredient in infant nutrition formulas). I further note that some facilities engage in "primary processing", where products are manufactured directly from raw milk, for example, 20kg bulk cheeses or 5kg bulk mozzarella cheeses. Other facilities engage in "secondary processing", where products are manufactured from other products, for example, where the 20kg bulk cheeses are cut into 250g blocks or shredded into 600g bags for retail consumption.

24. **[CONFIDENTIAL:** In the table below, I set out in general terms the production capabilities, production capacity, production volume and approximate utilisation forecasted for 2013/2014 for each of MGC's 7 processing plants. This information has been compiled, and provided to me, by Mr Swarup.



[redacted]

[redacted]

25. The capacity of a plant refers to the amount of milk a plant is able to consume. The capacity of a plant is not a static figure as it is dependent on the production mix profile of that plant. The production mix is subject to change as it is in turn dependent on MGC's strategic decisions to make certain products at each plant. These decisions are usually based on existing supply obligations and the profitability of products at that time.

26. I note that the capacity of a plant is different from the *capability* of a plant. For example, the Leongatha Plant has the processing capacity to process 365 million litres of UHT milk but it does not have the ability to package 365 million litres of UHT milk and it may not have the ability to package UHT milk in the format required by the customer (eg 200ml bottle, 200ml cartons, 1 litre cartons). The capabilities of a plant act as constraints on capacity. In estimating the capacity of facilities in the table above, I have had regard to the following constraints:

(a) packaging capability – for example, say there is demand for UHT milk in 250ml formats. We may have a plant that has the capacity to produce more UHT milk, however, the on-site packaging may have limited capacity to produce 250ml formats or indeed may not have the capability to produce 250ml formats;

(b) by-product handling capability – for example, it may be possible to increase cheese production, however cheese production results in whey as a by-product and there may be capacity constraint in respect of the whey handling facility;

(c) special handling requirements – for example, a dryer which is producing kosher grade products will not be able to produce products that contain animal-derived ingredients.

27. I further note that, when considering annual capacity, there is generally excess capacity in each of MGC's plants (and indeed for the plants of MGC's competitors). This is

because milk production is seasonal and there is therefore fluctuations in the volume of raw milk during the course of a year. Further, because raw milk is produced every day, the daily volume can vary, sometimes dramatically during hot or very wet spells and processors have to optimise their production planning based on daily receipt. As all dairy processing companies must receive raw milk produced by its farmers or pursuant to arrangements with its milk brokers, it must have plant capacity to receive and process that raw milk at any given time and in particular during peak season (in and around October each year). Milk must be processed within a short period after extraction from cows as the quality deteriorates quickly after 24 hours. Accordingly, dairy processors such as MGC must take all the raw milk supplied and manage the shortfall or excess supply within their system or trade to other dairy processing companies. I discuss the dynamics of raw milk production in further detail in Section 5 below.

28. MGC is currently building 2 new, essentially identical plants at Laverton, Victoria and Erskine Park, Sydney to meet its liquid milk supply obligations for Coles. The new plants are due for completion in mid-2014. Each plant will be producing approximately [redacted] and will also be producing milk products under MGC's Devondale brand. Each plant will only have the capability to produce liquid milk and will have [redacted] but at this stage we have no plans to run these plants at full capacity. We have built in additional capacity upfront because:

(a) constructing and running a new plant is a reasonably significant investment and it makes commercial sense to build upfront potential future production capability; and

(b) it is necessary to build in "high intensity" production capacity in the event that there is a 4 to 8 hour disruption to production (for example, if the machinery breaks) because notwithstanding the disruption there will be a standing obligation to deliver the required amount of 2L or 3L bottles of milk by the deadline.

29. Aside from the 2 new plants, MGC's plant infrastructure and equipment are ageing. Some of MGC's infrastructure was built in 1950s or earlier and over time new buildings or facilities have been added onto the original infrastructure. Some of its production assets are not contemporary and require renewing or upgrades. Some production capacity and capability is constrained by the current plant infrastructure and equipment. By way of example:

(a) the Maffra Plant has 4 spray dryers and 5 evaporators, but some of the dryers are so old that they are not able to meet the hygiene standards required to produce certain products (eg infant nutrition powders);

(b) the Cobram Plant and Leongatha Plant infrastructure requires an upgrade to higher capacity electricity transformers (at an estimated cost of $15 million each); and

(c) much of the effluent treatment facilities (ie waste management) was last upgraded in the 1980s and is likely to require upgrading to meet more exacting environmental standards.

30. One of the reasons plants are not replaced but instead facilities are "bolted-on" or added, is the high costs of building a plant. Indeed, the dairy industry is a high capital cost industry. For example, the Rochester Plant has $20 million in fixed costs with 2 dryers built in the late 1990s (and switched on during September 2000) which have limited ability to make infant formulas or other new powders. However, to replace the Rochester Plant in its entirety will require an investment of approximately $150 million, based on my estimates. Any investment to replace old plants with new plants will only be economically viable if there is sufficient and certain raw milk volume available for processing through the new plants (to ensure recovery of costs). Therefore, even though the base amount of capital (including compliance costs) required to keep an "inefficient" plant running may be high, it is not as high as replacing the plant, which requires a large, initial cash outlay. This is not unique to MGC but applies to all traditional dairy processing companies as they face similar legacy issues.

31. In addition, many of MGC's processing plants (such as the Rochester Plant and Cobram Plant) are located in the centre of townships. Not only is there a lack of land on which those plants could be extended, but the management costs of such plants are higher as there are more stringent regulations and local government by-laws to comply with, such as noise pollution.

32. The Edith Creek Plant, an old dairy production plant that had been turned into a UHT factory, was acquired by MGC in 2005. We buy approximately 45 million litres of milk from a Tasmanian Dairy Products Pty Ltd joint venture (in which MGC has a 56% stake).

4 LOGISTICS OF MOVING MILK FROM FARMERS TO PLANTS/BUYERS AND MOVING PRODUCTS FROM PLANTS TO BUYERS

33. MGC has over [redacted], and approximately 300-350 people to operate and manage the fleet. During peak production periods, we also engage subcontractors.

34. MGC will pick up milk from farmers and, depending on location and other factors, may:

(a) deliver it straight to customers;

(b) deliver it to MGC's processing plants for processing and reformulation; or

(c) deliver it to other competitors' processing plants pursuant to a "milk swap" agreement (a milk swap occurs to save logistics costs in transporting milk, for example, instead of transporting milk from our farmers in location A in the south to our factory in location B in the north, we would transport milk from our farmers in location A to our competitor's factory in the south and in return our competitor would transport milk from their farmers in the north to our factory in location B).

35. I am involved in implementing milk swaps but have no involvement in negotiating milk swap agreements as this is within the purview of Mr Poole. I understand that milk swaps are calculated on the fat solid content of milk, rather than a per litre basis. Based on my 35 years' industry experience and observations, I estimate that these milk swaps generate approximately $50-60 million in savings in logistics costs across the Australian dairy industry.

36. Milk swaps have the following impact on my responsibilities and duties:

(a) the amount of raw milk that is processed in each of the plants – for example, if we swap our milk out of south-eastern Victoria in exchange for a competitor's milk in northern Victoria, there will be less milk going to the Maffra Plant (as it will go to a competitor's processing plant) and there will be more milk going into the Rochester Plant or Cobram Plant; and

(b) in so doing, it affects the overhead recoveries on a per litre basis – for example, if we are obliged to swap our raw milk out of south-eastern Victoria and there is a low raw milk production that day, the amount of raw milk available for processing in the Maffra Plant may be lower than budgeted. Accordingly, there may be more people on shift than necessary. Conversely, there may be high raw milk production, or the competitor has declined to swap milk that day, and there is higher than anticipated amount of raw milk for processing and people are required to work overtime (and be paid penalty rates) in order to process that milk.

37. In other words, milk swaps affect the operational aspects of MGC's business on 2 levels: (i) overhead recovery (ie the overall efficiency of production); and (ii) production volumes and the amount of product we have to sell. However, that impact is not substantial in the medium term.

5 PRODUCTION CAPACITY, CAPABILITY AND MIX

38. During budget time in April/May each year, the production timetable is set, taking into account likely sales and product demand as well as raw milk production and acquisition (including anticipated milk swaps). As production is dependent on customer demand, profitability and acquisition of raw milk (the main ingredient in all of our products), Mr

Beniston, Mr Poole, Mr Scott and Mr Swarup are involved in setting the production timetable and production mix.

39. There is a constant level of domestic demand for fresh milk and daily pasteurised milk and other products such as cut cheese. As a result, domestic sales have less dynamic impact on the production timetable during the course of a year.

40. From time to time, however, there is an imbalance between the supply and demand of raw milk used in liquid milk processing (ie milk that is used in everyday consumption) in New South Wales. At these times, MGC diverts its milk from Victoria to supply in those regions to meet demand. For example, in October this year, there was a hot spell in New South Wales for about 4-5 days such that the cows' milk yield decreased. As such, more of MGC's raw milk in northern Victoria was diverted to New South Wales around this period. If MGC had not diverted its milk into New South Wales, it is likely that dairy companies in New South Wales would have sought the milk directly from Victorian farmers (including that of MGC) or other Victorian dairy companies, such that raw milk will be diverted away from MGC in any event. In this way, MGC has a commercial imperative to meet unfulfilled demand as and when it arises.

41. However, above this demand, we produce other products depending on:

(a) forward sales contracts and other supply contracts we have entered into – in other words, we produce products to meet our contractual obligations;

(b) forecast product demand – in other words, we produce depending on our projected commodity prices for cheeses, powders and dairy products; and

(c) commodity prices for cheeses and powders and dairy products – for example, if the price for a type of product increases during the course of the year, we may shift the allocation of raw milk into processes which produce these "higher value" goods to obtain a better return.

Now produced and shown to me and marked as confidential "**Annexure KM-4**" is a diagram of the actual "milk curve" for MGC's production in 2011/2012 which shows the allocation of raw milk to products and exemplifies the matters discussed in paragraphs 39, 41 and 42.

42. Our busiest production period is around mid-October, where raw milk production is at its highest. This means that there is a lot of raw milk in the market, which requires processing. Accordingly, in and around this period, high volumes of milk must be processed quickly, so MGC tends to increase its production of base commodities which have a high raw milk content, such as skim milk powder and butter. Plant activity is generally low in and around April, as raw milk production is low.

43. The production of raw milk is explained by dairy farmers' calving patterns. Raw milk production is highest in spring season where there is grass for the cows to feed.

Accordingly, raw milk production in other seasons is dependent on the use of dry-grass or feed. [redacted] Now produced and shown to me and marked as confidential "**Annexure KM-5**" is a document showing MGC's supply profile and the breakdown of MGC's calving patterns.

44. As the processing plants are not used in a uniform manner year-round (due to fluctuations in the production of raw milk by dairy farmers), I am also responsible for managing the winding down and winding up of the plants, as they move in and out of high activity. The 'winding down/up' process takes approximately 2-3 months lead time to organise and involves:

(a) managing labour (however we do not tend to move skilled labour between plants); and

(b) attending to maintenance of the plants, particularly when they are not in operation.

45. Since I have started at MGC, I have initiated a regime where we flex the production mix and capacity of certain plants by physically turning off plant processing facilities. For example, in the last year, we have turned off the dryers at the Maffra Plant for a period of 8 weeks as there was not enough raw milk for processing. In this way, we manage overheads per plant per production. At other plants we tend to keep the production mix and utilisation flat, such as the Rochester Plant and Leongatha Plant. The Rochester Plant is kept at close to full capacity, as we have a large Japanese buyer who prefers the flavour of the cheese produced at Rochester, [redacted]

46. Even with flexing the production mix and utilisation by physically turning off plant processing facilities during periods of low raw milk production, there are large fixed costs associated with dairy plants. Once a plant is up and running, it is more efficient if the plant is kept filled with the maximum amount of raw milk. This is the most effective way of reducing overhead cost per litre of milk processed.

47. For the Laverton plant, the raw milk will be sourced from MGC's existing pool of milk in Victoria. For the new Erskine Park plant, MGC has entered into agreements for the acquisition of milk from a range of farmers in NSW.

6 INDUSTRY CONSTRAINTS

48. In this section I discuss the industry constraints on production and the ability for Australian dairy companies to compete in global markets.

6.1 Liquid milk demand

49. Overall, there is a level of constraint on the value that the industry as a whole can extract from raw milk. This is because there is a base level of domestic demand for basic commodities, such as liquid fresh milk or daily pasteurised milk, such that there is an inability to divert raw milk production from liquid milk to 'higher value' goods. This issue is compounded by the fact that Australia has been producing approximately 9 to 10 billion litres of raw milk nationally for the last few years. In the last ten years, raw milk production has decreased by almost 20%. In the 2013 financial year, Australia's milk production fell by 1.4% relative to the previous financial year. Now produced and shown to me and marked "**Annexure KM-6**" is an extract of the Dairy 2013 Situation and Outlook report by Dairy Australia recording the 1.4% decline.

50. This issue affects some companies more than others. For example, in Victoria, MGC is most affected as it acquires most of the raw milk in the State. MGC also acts as a 'balancer' of raw milk volumes when there are shortages in other surrounding States (as discussed in paragraph 40 above).

6.2 Ageing infrastructure

51. Across the industry in Australia, the infrastructure of dairy processing plants is generally old and there has been little investment in replacing aging infrastructure with new technologies. Many dairy companies are *converting* their spray dryers, used for lower value milk powders, into nutrition dryers, which produce higher value products, but there is little investment in building new dryers. MGC last invested in new dryers 14 years ago when it built 2 dryers at the Rochester Plant at a cost of $50 million.

52. Based on my observation, no dairy company in Australia has invested heavily in the latest technology to improve current processes. I discuss further the costs of building plants in section 8 below. There is some investment, but such investments are "bolt-ons" to

existing plants and infrastructure (the rationale of which is discussed in paragraph 30) and therefore latent inefficiencies of such plants and infrastructure continue to persist despite the additions of new equipment. For example, in about 2010, Lion Dairy and Drinks (formerly National Foods Limited) reported that it was undertaking a $65.5m investment into its plants, including the closure of one plant and the additional of new equipment and production capabilities to other plants. In about 2012, Bega indicated that it was upgrading its cream cheese plant in Tatura to increase production capacity. Now produced and shown to me and marked "**Annexure KM-7**" and "**Annexure KM-8**" respectively is a copy of a media release of National Foods Limited dated 29 June 2010 and an extract of Bega's 2012 Annual Report discussing its Tatura plant.

53. Given the persistently flat production levels of raw milk (ie no growth), any investment in infrastructure will be to replace old plants with new. Further, as discussed previously, any investment to replace old plants with new plants will only be economically viable if there is sufficient and certain raw milk volume available for processing through the new plants (to ensure recovery of costs). In my view, the diminishing national production of milk has been a significant factor in discouraging investment in plants.

54. I discuss at Section 12 below the contrasting position with infrastructure investment in New Zealand.

7 COMPETITORS AND RECENT ENTRANTS

55. MGC's main competitors in dairy processing are:

(a) Fonterra Australia (**Fonterra**) – see section 7.1;

(b) Lion Dairy and Drinks (formerly National Foods Limited) (**Lion**) – see section 7.2;

(c) Warrnambool Cheese and Butter (**WCB**) – see section 7.3;

(d) Bega Cheese Limited (**Bega**) – see section 7.4; and

(e) Parmalat Australia (formerly Paul's Australia) (**Parmalat**) – see section 7.5.

Now produced and shown to me and marked as "**Annexure KM-9**" is a map of all processing facilities in south-east Australia. I consider this map to be broadly accurate.

56. MGC's other competitors include a number of smaller specialist dairy processors, such as United Dairy Power Pty Ltd (**UDP**), Longwarry Food Park Pty Ltd (**Longwarry**) and Burra Foods Pty Ltd (**Burra Foods**). There are many smaller dairy processors, some of whom produce products that directly compete with MGC while others are not in direct competition with MGC. These include Procal (which produces chilled milk) and Floridia Cheese (which produces mozzarella and other cheeses).

57. The traditional dairy processing companies (including MGC) are all looking to increase raw milk acquisition. In the table below, I set out a short summary of the production mix

and raw milk acquisition for the 2013 financial year of each of MGC's main competitors. The processing plants, production mix, capacities and capabilities of each are discussed in further detail in the relevant sections.

	Summary production mix	Approximate annual raw milk acquisition (million litres)
MGC – as per section 3 above	• Milk powders (whole and skim) • Butter / fats • Proteins (caseinate) • Cheeses (bulk and retail) • Whey products • Fresh milk • UHT • Bulk liquids	2,990
Fonterra – see section 7.1	• Milk powders (nutritional, skim, whole) • Fresh dairy (yoghurts, dairy desserts) • Milk and whey protein • Cheese • Butter	1,800
Lion – see section 7.2	• Fresh milk • Fresh dairy (yoghurts, dairy desserts) • Retail cheeses • Specialty cheeses • Cream	1,000
WCB – see section 7.3	• Bulk cheese • Retail cheese • Powders (skim and whey) • Butter and cream • Fresh milk (Sungold brand)	890
Bega – see section 7.4	• Bulk cheese • Retail cheese • Processed cheese • Milk powders (skim) • Infant powders • Lactoferrin	641
Parmalat – see section 7.5	• Fresh milk (including flavoured milk, cultured milk, full cream and white milk) • Fresh dairy (including and yoghurt and dairy desserts) • UHT	[redacted]

58. In my following discussion of MGC's competitors, I focus primarily on the major products manufactured by each company.

7.1 Fonterra Australia

59. Following its recent closure of its Cororooke plant, Fonterra now operates 9 primary processing and manufacturing plants across Victoria, New South Wales and Tasmania. Fonterra predominantly manufactures nutritional milk powders, whole and skim milk powders, fresh dairy, milk and whey proteins, cheese and butter. Fonterra annually processes approximately 1.8 billion litres of raw milk from 1,400 farmer suppliers (as disclosed on its website http://www.fonterra.com/au/en/About/Company+Overview, accessed on 27 November 2013). As a result of its full acquisition of Bonlac Foods in 2006, Fonterra continues to collect raw milk from Bonlac Supply Company, which is now a wholly owned subsidiary of Fonterra.

60. [redacted]

[redacted]

[redacted]

61. Fonterra's Cororooke plant is the subject of a phased closure (ie the plant marked with an asterisk in the above Confidential Table 2), with its ricotta manufacturing facility moving to its Stanhope plant in early 2014 (see http://www.standard.net.au/story/1831311/end-near-for-cororooke-dairy-factory/, accessed on 27 November 2013).

7.2 Lion

62. Lion (formerly known as National Foods Limited) operates 11 primary and 2 secondary processing and manufacturing plants across New South Wales, Victoria, South Australia, Tasmania and the ACT, and predominantly manufactures fresh milk products, fresh dairy products and retail cheeses. Lion annually processes approximately 1 billion litres of raw milk (as disclosed on its website http://lionco.com/brands/dairy-and-drinks/milk/, accessed on 27 November 2013).

63. Lion is the only company in the industry with fresh milk production capabilities in all Australian states.

64. [redacted]

[redacted]

[redacted]

[redacted]

65. I understand that Lion is proposing to close its plants in Simpson and Campbellfield in Victoria and King Meadows in Tasmania (ie the plants marked with an asterisk in the above Confidential Table 3) and consolidating the cheese production in those plants to Burnie, Tasmania (see http://lionco.com/2011/03/16/tasmania-the-focus-of-national-foods-cheese-manufacturing-operations/, accessed on 27 November 2013).

7.3 WCB

66. WCB owns 2 processing and manufacturing plants: in Allansford, Victoria and Mil Lel, South Australia.

67. The majority of WCB's processing and manufacturing takes place at its plant in Allansford. The Allansford site covers approximately 17 hectares and comprises separate manufacturing facilities for cheese, milk powders, whey protein concentrate, butter, cream and packaged milk. WCB's Mil Lel plant produces retail cheese and has cut and wrap capabilities, which are used to assist in the finishing of cheeses for the Great Ocean Road Milk and Cheese brand. WCB currently has an exclusive supply contract with Coles to supply the WCB owned brand of Great Ocean Road Milk and Cheese. These products are only sold in Coles supermarkets. In its 2013 financial year, WCB collectively processed approximately 890 million litres of raw milk. Now produced and shown to me

and marked "**Annexure KM-10**" is an extract of WCB's 2013 Annual Report which discloses this volume.

68. [redacted]

[redacted]

69. WCB is currently in the process of building a lactoferrin facility at its Allansford plant, which is due for completion and commission in mid-2014 (see http://www.wcbf.com.au/news-media/news-releases/wcb-tatua-sign-lactoferrin-agreement.aspx, accessed on 27 November 2013).

7.4 Bega

70. Bega owns 5 processing and manufacturing facilities across New South Wales and Victoria. In its 2013 financial year, Bega processed approximately 641 million litres of raw milk across Victoria and New South Wales. Now produced and shown to me and marked "**Annexure KM-11**" is an extract of Bega's 2013 Annual Report which discloses this volume.

71. Bega has 2 operating segments:

(a) "Bega Cheese", which produces bulk, retail, cut and wrap and processed cheese out of the Bega region; and

(b) "Tatura Milk", which primarily produces milk powders, including milk powders, infant powders and milk protein concentrates.

72. Bega, along with Lion, is also part of a joint venture in Canberra called Capitol Chilled Foods Pty Ltd (operating under the brand Canberra Milk) which services the ACT and surrounding districts with fresh milk.

73. Since 2001, Bega has granted Fonterra a long term trade-mark licence to use the "Bega" trade marks on natural and processed cheddar cheese, string cheese and butter products supplied in Australia, with Bega receiving a royalty based on retail sales. Bega also supplies retail cheese products to Fonterra under the "Bega" brand and other brands. Now produced and shown to me and marked as "**Annexure KM-12**" is an ASX announcement of Bega dated 15 November 2012 setting out the terms of this arrangement between Bega and Fonterra.

74. I consider Bega to be a large contract packing player in the industry. [redacted]

75. [redacted]

7.5 Parmalat

76. Parmalat operates 4 processing and manufacturing plants across Victoria, New South Wales and South Australia, and predominantly manufactures fresh milk and fresh dairy products. Parmalat manufactures a small amount of UHT milk. Parmalat also operates processing and manufacturing facilities in Queensland and Darwin. [redacted] Now produced and shown to me and marked as confidential "**Annexure KM-13**" is a document recording this information.

77. Because of its historical roots in Queensland, Parmalat has a large presence in Queensland. Parmalat has been aggressively moving into south-eastern markets to access cheaper raw milk. It has a strong presence in Victoria, largely as a result of its acquisition of Ideal Dairy (located in Rowville). Its competitive strength in New South Wales is growing, due to its acquisition of the Lidcombe processing plant from National Foods Limited, who was required to divest its New South Wales business as part of an undertaking it gave to the ACCC when it acquired Australian Co-operative Farmers. Aside from processing capacity and capability, the acquisition of the Lidcombe plant in Sydney also gave Parmalat access to manufacture, distribute and sell the Daisy Fresh and Pura range of fresh white milk in NSW and the ACT for 2 years following the acquisition.

78. [redacted]

7.6 Other competitors

79. MGC also competes against a number of smaller players. For example:

(a) United Dairy Power, which owns two processing facilities in South Australia, produces and supplies various cheeses, butter and whey powders. United Dairy

Power acquired these facilities from Lion in or around 2011 (see http://www.udp.com.au/hello-world/, accessed on 27 November 2013);

(b) Burra, based in Korumburra, Victoria, acquires more than 275 million litres of milk per year and produces milk powders, nutritional milk powders, bulk cream, milk concentrates and dairy desserts (see http://www.burrafoods.com.au/our-business/operational-capability, accessed on 27 November 2013); and

(c) Longwarry Food Park (based in Longwarry, Victoria) [redacted] produces fresh milk, long life milk, extended shelf life milk, cream cheeses, milk powders and dairy concentrates.

80. New entrants into the market have, in recent times, tended to be smaller niche manufacturers such as Burra and Longwarry. These niche players are usually required to pay a relatively higher price to acquire milk. However, they are able to recoup their margins by effectively servicing niche markets either in Australia or overseas. For example, by operating an office in Japan, Burra is able to effectively operative in a niche market by selling its products into Japan for a premium price.

81. [redacted]

[redacted]

[redacted]

8 BARRIERS TO ENTRY

82. The cost of entry depends on the particular dairy product. For example, the cost of entry in producing multiple dairy products is high, compared with the cost of entry in producing certain dairy products such as cut and shredded cheese (as it merely involves buying block cheese, including off-cuts, cutting it and packing it into bags) where the cost of entry is quite low.

83. In this section, I discuss the barriers to entry in multi-purpose dairy production. In brief, I consider that a new entrant would have the following challenges: (i) high cost of building a dairy processing plant; (ii) substantial lead-time to build a fully-functionally dairy processing plant; and (iii) accessing raw milk.

8.1 High cost of building dairy processing plant

84. A new entrant which seeks to enter the dairy processing industry on its own (that is, without taking over another company) is likely to build a new dairy processing plant. A new entrant could potentially buy a plant from another company, but this is unlikely as the majority of existing plants are currently utilised.

85. The cost of building a new dairy processing plant (of at least 200 million litre capacity) is high and can cost more than $200 million for a plant that has the ability to produce standard powders (ie skim milk or full milk powders).

86. The basic infrastructure in setting up a processing site (such as having water treatment facilities and other effluent systems, electrical transformers, storm water storage, access roads etc) is uniform, regardless of the type of dairy product to be produced. In my experience, it generally costs approximately $50-70 million to build basic infrastructure on a greenfield site. This is a cost which must be incurred, regardless of the type of product to be produced.

87. The remainder of building costs depend on (i) the volume of milk to be processed; and (ii) the types of products to be produced. For example, as set out in paragraph 15, raw milk can be separated into milk fat (to produce cream and butter) and skim milk (to produce skim milk powder) and therefore in this instance a plant would require a cream-making equipment costing approximately $50 million and a single 6 tonne spray dryer costing approximately $100 million. Therefore to build a milk powder plant on a greenfield site will cost approximately $200-$220 million. A liquid milk processing facility is cheaper to build.

MGC's new liquid milk plants at Laverton, Victoria and Erskine Park, Sydney (which were built on greenfield sites) will cost approximately $160 million combined.

88. In the table below, based on my experience, I set out the approximate minimum costs in acquiring equipment and building special infrastructure to produce liquid milk, cheese (which includes the by-product whey), standard powders, special powders (such as milk protein powder, infant nutrition powder and lactoferrin):

End product	Approximate cost	Comments
1. Liquid milk (including flavour milk)	$60m	Estimated maximum annual production is 250 million litres of liquid milk.
2. Cheese (and whey)	$100m (cheese) $50m (whey)	As whey is a by-product of cheese production, whey-handling equipment is necessary. Whey itself is sold as a product. Estimated maximum annual production is 2,000 tonnes.
3. Standard milk powders	$100m	Estimated maximum annual production is 50,000 to 60,000 tonnes.
4. Special milk powders	$150m	Estimated maximum annual production is 50,000 to 60,000 tonnes. The additional cost arises from further equipment to meet hygiene standards in producing special powders.
5. Butter and cream	$50m	This equipment matches the capacity of the aforementioned dryers. Estimated maximum annual production is 10,000 tonnes.
6. Fresh dairy (eg yoghurt)	$50m	Estimated maximum annual production is 50,000 to 60,000 tonnes.

The approximate costs above are in addition to the infrastructure costs in building on a greenfield site of $50-60 million.

89. Once a particular product mix is selected for a plant and the relevant equipment is purchased and/or built, it is difficult to transform the production capability for that plant into other dairy products. For example, to change a cheese-making facility to a powder producing plant will require a whole new investment in the relevant equipment, such that it will essentially become a different plant (as there are minimal common processes in cheese production and powder production).

8.2 Substantial lead-time

90. A new entrant which seeks to enter the dairy processing industry on its own and build a new dairy processing plant will face substantial lead-time before it can begin to sell products. This is because of the time required to construct a new plant and to put in a purchase order for equipment. The majority of dairy equipment is manufactured in Europe and is built to order. In particular, given the growing demand for special milk powders such as infant nutrition, I expect that there will be a significant wait-list for spray dryers capable of processing raw milk into infant nutrition powders. Overall, based on my experience, I estimate that it would take at least 2 years for a dairy processing plant to be built and commissioned.

8.3 Access to raw milk

91. Australia is producing approximately 9 to 10 billion litres of raw milk nationally, of which approximately 6 billion litres are produced in Victoria.

92. In the last 10 to 12 years, raw milk production in Australia (and in Victoria) has been relatively stable but has been declining. This is because there is a lack of farmers investing in dairy farming or production. As water is a critical aspect of dairy farming, the drought conditions in Australia and the Murray Darling river scheme undermined the confidence of many dairy farmers, who have either gone off the land or moved into other areas of farming. In addition, dairy farm costs have increased significantly over the last five to six years, with commodity prices (and consequently raw milk prices) increasing at a much slower rate.

93. Currently, the declining production levels of raw milk is a significant constraint on industry. This is because raw milk is the primary ingredient in the manufacture of dairy products and the sale of dairy products is a key consideration in any investment to increase plant efficiency.

9 EFFECT OF ACQUISITION OF WARRNAMBOOL CHEESE AND BUTTER FACTORY

94. As I noted above in section 7.3, WCB has 2 processing plants:

(a) in south-western Victoria at Allansford (**Allansford Plant**), which includes a large cheese making facility, liquid milk facility and infant nutrition facilities; and

(b) in south-eastern South Australia at Mil Lel (near Mount Gambier) (**Mil Lel Plant**), which is considerably smaller and houses a 'cut and wrap' cheese facility and cream cheese making facility. Notably, the Great Ocean Road branded dairy products is produced in the Mil Lel Plant.

95. Based on my experience in the dairy industry for over 35 years, and having been through a post-merger integration during National Food Limited's acquisition of Australian Co-

operative Farmers, I consider that the following significant synergies and cost savings in the area of processing and manufacturing could be achieved by MGC if it was to acquire WCB. **[CONFIDENTIAL:** The synergies which could be realised in a one-to-three year timeframe include:

(a)

(b)

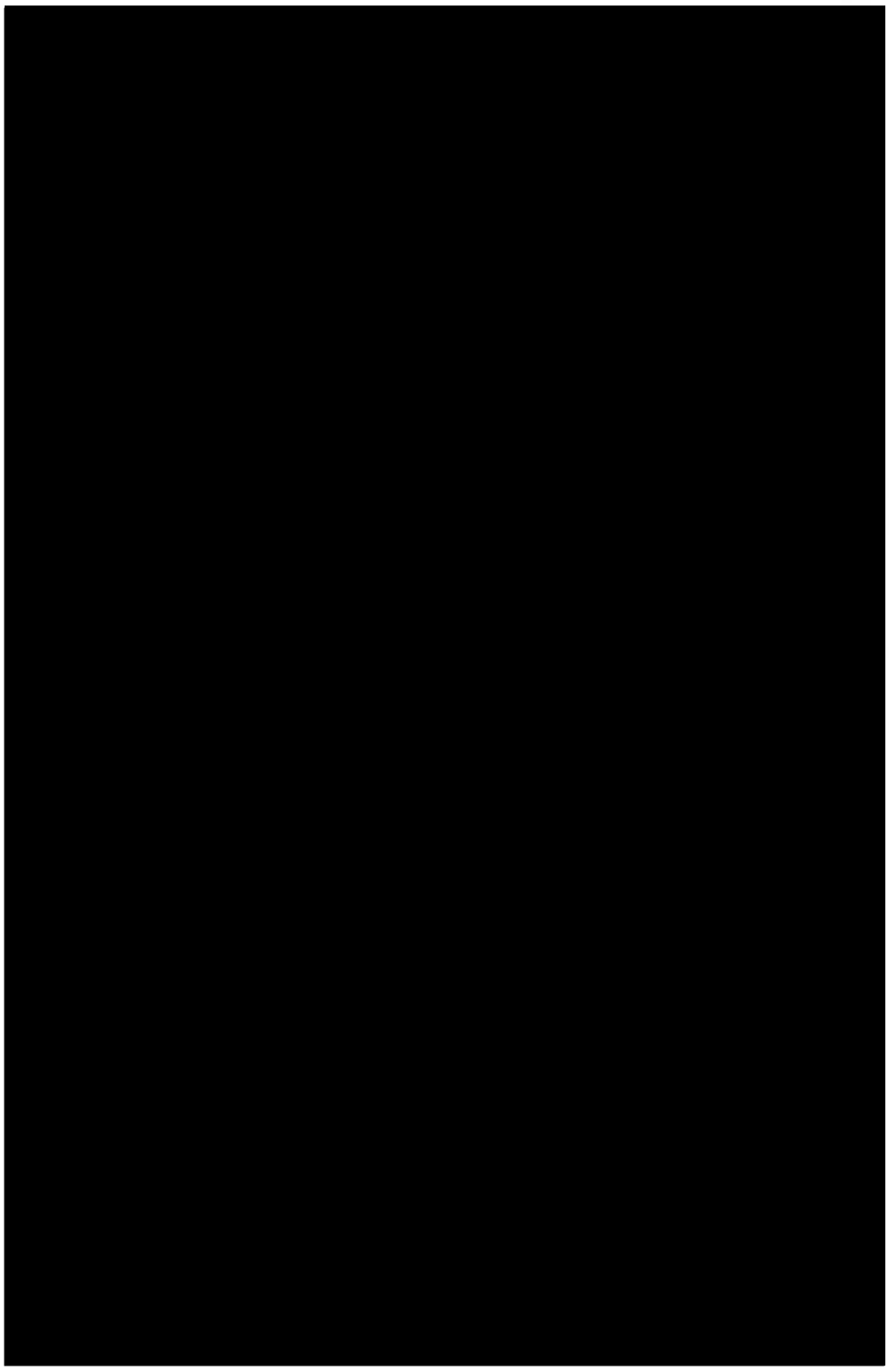
(c)

(d)

(e)

(f)

(g)



(h) [redacted]

(i)

10 EFFECT IF BEGA ACQUIRES WCB

96. As I noted above, Bega currently acquires approximately 641 million litres of raw milk per annum. By acquiring WCB, Bega's annual milk pool would increase to a total of approximately 1.5 billion litres of raw milk. This would result in Bega being a similar sized player to Fonterra Australia, which acquires approximately 1.8 billion litres of raw milk a year. Accordingly, the Bega-WCB merged entity is likely to be a more robust competitor in dairy processing.

97. Based on my experience and observation, I anticipate that Bega would obtain the following benefits and synergies if it acquired WCB:

(a) Closure and consolidation of production of the Coburg plant – Bega currently operates a cheese manufacturing facility in Coburg. If Bega were to acquire WCB, I anticipate that Bega could close its Coburg plant and consolidate cheese production into WCB's Allansford Plant because of cheaper operating costs in Allansford.

(b) Efficiencies derived from increased volumes – the addition of 890 million litres of milk to Bega's milk pool may drive costs savings through the reduction of incremental costs in processing and manufacturing operations.

98. Bega's synergy opportunities are more limited in comparison to MGC. This is largely due to the lack of geographical overlap between Bega's operations and WCB's operations, as Bega does not have any processing plant in western Victoria. For example, Bega is unable to obtain any synergies from the consolidation and sharing of plant management and service personnel [redacted]

[redacted]

99. Even if some efficiencies could be achieved through the consolidation of processing plants, it is likely to be offset by increased transport and haulage costs.

11 EFFECT IF SAPUTO INC. ACQUIRES WCB

100. Saputo Inc currently has no presence in Australia and I cannot identify how Saputo could, through an acquisition of WCB, achieve any operational synergies within Australia which would benefit the domestic dairy industry.

12 NEW ZEALAND DAIRY INDUSTRY

101. Over the last 35 years whilst I have been in the dairy industry, I have observed with interest the changes to the New Zealand dairy industry (particularly in comparison to the Australian dairy industry). In this section I discuss briefly the developments in the New Zealand dairy industry with a specific focus of raw milk production.

102. Annually, New Zealand produces approximately 19 billion litres of milk. This production has been growing annually, and is mainly driven by increased land usage, that is, growth in hectares of farm size. The majority of raw milk produced in New Zealand is seasonal and is pasture-based (compared to Australia where there is a greater use of supplement feed), [redacted]

103. The New Zealand milk supply profile provides New Zealand dairy companies with the scale required to efficiently invest in more and larger equipment. For example, the majority of dairy companies in New Zealand tend to use 20 tonne dryers, as this is the only way in which they are able to process the large quantities of raw milk. This is in comparison to the majority of Australian companies who use dryers with a capacity of about 5 tonnes.

104. In addition, New Zealand processing and manufacturing facilities are more commonly wound up / down to cater for the steeper fluctuations in milk supply. Indeed, much of the equipment in New Zealand sits idle for about six months of the year. This adds to the overall efficiency of the New Zealand dairy industry, as companies are able to reduce overhead expenses during periods of low milk production.

105. The New Zealand dairy industry also benefits from a free trade agreement with China, as well as a unified industry supply chain which reduces export costs.

106. Approximately 95% of New Zealand's dairy produce is exported.

SIGNED by KEITH MENTIPLAY

on 29 November 2013