Independent Expert Report

Australian Competition Tribunal

Murray Goulburn Cooperative Co Limited

Re: Proposed Acquisition of Warrnambool Cheese and Butter Factory Company Holdings Limited

28 November 2013

Prepared by

M. Craig Norgate

Introduction

1.1. My name is Michael Craig Norgate and I live in Auckland, New Zealand.

1.2. I have a Bachelor of Business Studies, majoring in Accounting and Finance, from Massey University in New Zealand (1986). I have participated in the International Executive Program at Insead in France (1995), the Enhancing Corporate Creativity Programme at Harvard in the USA (1996) and the AVIRA Leadership Programme at Insead (1997).

1.3. I am a Fellow of the New Zealand Institute of Chartered Accountants (FCA), a Fellow of the New Zealand Institute of Management (FNZIM) and an Accredited Fellow of the New Zealand Institute of Directors (AFID) .

1.4. I was New Zealand Young Chartered Accountant of the Year in 1994, the New Zealand Herald Business Person of the Year in 2005 and awarded World Class New Zealander status in 2008.

1.5. I have had an extensive career as an executive, investor and director in agribusiness spanning over twenty five years. Key roles with respect to my expertise in this matter include:

1.5.1. Chief Executive/General Manager of Kiwi Co-operative Dairy Company 1991-2001. Kiwi was New Zealand's second largest dairy company throughout that time and grew from turnover of $NZ285m in 1991 to $NZ4.4b when it became part of Fonterra in 2001.

1.5.2. Non-executive director of the New Zealand Dairy Board 1998-2001. NZDB was a statutory marketing board responsible for all New Zealand's dairy exports. It was New Zealand's largest company with operations in 72 countries around the world.

1.5.3. Chief Executive of Fonterra Co-operative Group 2001-2003. I was the inaugural CEO of Fonterra which was created from the merger of three of New Zealand's six largest companies. It was responsible for the processing and marketing of over 95% of New Zealand's milk production with revenues of $13.9 billion in 2002. Fonterra had over 20000 staff in 72 countries and represented 25% of the country's exports and 7% of its GDP. Among other things it required an Act of Parliament to facilitate its creation.

1.5.4. Chairman/Non-executive director/Controlling shareholder in PGG Wrightson Ltd (NZX:PGW) 2003-2009. PGG Wrightson was formed by the merger of the three largest rural servicing businesses in New Zealand. Aside from being the New Zealand market leader in wool and livestock broking, cattle exports, farm input sales, and farm insurance and real estate broking, PGG Wrightson is the largest pasture seed supplier in the Southern Hemisphere –a critical technology for dairy farmers.

1.5.5. Director of Dairy New Zealand (2006 – 2008). Dairy New Zealand was the industry body responsible for on-farm research on behalf of all New Zealand dairy farmers. Its principal output was to drive improvements in on-farm productivity, work with the New Zealand government with respect to dairy industry policy and promote dairy farming as a career option.

1.5.6. Non-executive director/Promoter/major shareholder in New Zealand Farming Systems Uruguay 2006-2009. NZFSU was set up to adapt New Zealand dairy farming technology and systems to the temperate regions of Latin America. It rapidly became the biggest dairy farmer in Uruguay. It is now owned by Olam International and remains one of the biggest dairy farmers in the world.

1.5.7. Advisor to Tasman Farms Ltd 2011-2012. Tasman Farms owns Australia's largest dairy farming operation based in the North West of Tasmania. My role was to advise on operating 7 development strategies and the capital raising process to fund it.

1.6. I am currently the Chief Executive of the New Zealand Institute of Chartered Accountants (NZICA) and have just led members to an historic vote to merge with the Institute of Chartered Accountants in Australia (ICAA).

1.7. My career has involved extensive experience in leading merger and acquisition transactions including over thirty where I have been principal as either CEO or the major shareholder. Many of those have involved competition issues similar to those in this matter.

1.8. I also presented the Fonterra Case Study at the Harvard University Agribusiness programme in 2003. This case study is attached as Appendix 1.

1.9. My summary curriculum vitae is attached as Appendix 2.

2.1. I hereby acknowledge that I have read, understood and complied with Practice Note CM7 – Expert witness in proceedings in the Federal Court of Australia.

2.2. My opinions are based wholly on the specialised knowledge gained from the activities set out above.

2.3. The questions I have been asked to consider are attached at Appendix 3 and are also repeated in the body of this report.

Questions

3.1. Describe the structure of the New Zealand Dairy industry prior to the creation of Fonterra. In answering this question, have regard to matters including the following:

-the volume of production of the New Zealand dairy industry up to the creation of Fonterra, how it was comprised and what constraints on efficiencies was there.

-the market share of New Zealand produced dairy products in the total global dairy trade.

-the structure of the industry and ownership constituencies

-the marketing of dairy products internationally, including the success or otherwise of such ventures.

-the rural earnings of farmers

3.1.1. Prior to the creation of Fonterra the New Zealand dairy industry structure was dominated by the New Zealand Dairy Board (NZDB), which had statutory marketing rights to market all New Zealand's dairy exports. NZDB was owned by a number of regional dairy co-operatives which were in turn owned by their dairy farmer suppliers.

3.1.2 The NZDB had an impressive international network with operations in 72 countries and over 10000 employees. It was the largest player in the traded dairy ingredient market and had strong consumer goods positions in South East Asia, Latin America and the United Kingdom.

3.1.3 The number of regional dairy companies reduced dramatically through the last decade of the twentieth century with consolidation driven by the need for economies of scale in processing operations. By the year 2000 the two largest, New Zealand Dairy Group and Kiwi Co-operative Dairies, processed over 95% of the nation's milk and owned over 95% of the NZDB.

3.1.4 In 2000/2001, New Zealand dairy farmers produced approximately 12.925 billion litres of milk. This was processed into a range of products including milk powders, milk proteins, cheese, butter, anhydrous milkfat, nutritional powders, UHT milk and liquid milk.[1]

3.1.5 The international market structure was dominated by trade and tariff barriers that meant approximately 93% of global production was consumed within the country in which it was produced.[2]

3.1.6 The largest markets in the world (Europe, USA, India) restricted imports to minimal quantities in order to protect high price levels to their consumers and farmers. In addition Europe and the USA provided subsidies to farmers to increase production.

3.1.7 Prior to the GATT Uruguay round the traded market price was determined by the amount of subsidised exports from these countries and the level of subsidy. Being a dairy farmer in a non-subsidised industry like New Zealand's was not an appealing option.

3.1.8 The GATT Uruguay round constrained the volume of subsidised exports and allowed international prices to rise once that volume had been sold each year. Price was then generally constrained by the level at which the USA could export without subsidy which was generally a factor of grain prices.

3.1.9 This saw an improvement in returns to dairy farmers in the second half of the 1990's to a level where they could start reinvesting on farm. Prices were still constrained though and it was only through ongoing productivity gains that farmers were able to offset rising cost pressures.

3.1.10 By 2000, with the industry structure dominated by three of New Zealand's largest companies, the inefficiencies of the lack of integration between processing and marketing were increasingly transparent. Costs were high because of multiple overhead structures, the supply chain and product mix could not be optimised and the NZDB's strategic initiatives internationally were being

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[1] See Dairy New Zealand, *Dairy New Zealand Statistics 2011/12*.

[2] Excluding intra-EU trade.

undermined as potential partners could see that the industry structure was going to change and they didn't know who they would be dealing with.[3]

3.2. Describe your role in the lead-up to and following the creation of Fonterra.

3.2.1 I was appointed as one of two General Managers to lead Kiwi Co-operative Dairies Ltd. in 1991. The other GM ran what was the world's largest dairy processing site at Whareroa in South Taranaki. I ran the rest of the organisation. Kiwi was the second largest regional dairy company although at that stage was only responsible for about 12% of New Zealand's milk production. In 1996 I became Chief Executive Officer.

3.2.2 Between 1991 and 2001 Kiwi grew from revenue approximately $285m to $4.4b through mergers and aquisitions with other regional dairy companies in, the domestic consumer goods market and in the Australian consumer goods market.

3.2.3 As CEO of Kiwi I was also a non-executive director of the NZDB.

3.2.4 By the late nineties the number of regional dairy companies was declining rapidly and it was clear that the industry structure needed to change. As CEO of the second largest I took a lead role in industry forums that tried to commercialise industry payment systems to make them more market responsive and in developing an industry strategy to optimise overall returns.

3.2.5 That work kept emphasising the need for an integrated structure between processing and marketing and in 1999 I lead the first attempt to bring the industry together into a single company.

3.2.6 That attempt failed by early 2000 due to disagreements over relative value and the fact that there were too many parties involved.

3.2.7 Kiwi then merged with a number of those parties whilst continuing to work with New Zealand Dairy Group to progress the overall structure.

3.2.8 At the end of 2000 NZDG and Kiwi announced that they had reached agreement to merge and create a new company involving both of them and the NZDB.

3.2.9 I lead the process to obtain the necessary approvals from Government and in July 2001 was appointed Fonterra's first CEO.

3.2.10 As CEO my mandate was to lead the integration of the three companies, deliver the cost savings identified and progress the international strategy it was predicated upon.

3.3 What objectives of New Zealand dairy industry policy underpinned the creation of Fonterra?

3.3.1 The objectives underpinning the creation of Fonterra were:[4]

3.3.1.1 Preserve the NZDB's international network with the abolition of its statutory marketing powers

[3] See Economics and Law Consulting Limited, A report for the Ministry of Agriculture and Forestry, *Evaluation of the December 2000 Dairy Industry Merger Package from the perspective of the competition policy*, January 2001.

[4] See Fonterra Annual Report, 2001-02.

3.3.1.2 Create a platform for growth of the added value ingredient and consumer businesses through merger and acquisition

3.3.1.3 Optimise supply chain efficiency through integration of processing and marketing

3.3.1.4 Improve responsiveness and decisiveness of decision making

3.3.1.5 Reduce overhead costs

3.4 Have those objectives been met? In answering that question, please have regard to matters including the following:

-The growth in production of dairy product, and the causes of this.

-Any increases or decreases in market share of New Zealand dairy product in the total global dairy trade

-Any efficiency gains realised as a result of consolidation of the New Zealand dairy industry

-Any capital growth or losses of farmers following the creation of Fonterra

-The extent to which, if at all, the co-operative structure of Fonterra contributed to the success or otherwise of Fonterra

-Any return on capital to farmers by way of dividend or milk price

-The ability of new Zealand farmers to obtain lending finance to develop and intensify their farming and productivity

Any increase in the use of agricultural land devoted to dairy production

-Any increase in the volume of raw milk produced

-The enrichment or otherwise of rural communities consequent upon the creation of Fonterra, including any increase in employment, support industries, or any collateral effect on rural commerce and social harmony

-What social benefits, if any, flowed as a result of the creation of Fonterra

-Any generational change in the make-up of farmers and farm labourers in the New Zealand dairy industry

-Any effect on competition in the domestic market within New Zealand

-Investment in research and development initiatives and the development of new dairy products or manufacturing processes

-The ability to set or influence the price of dairy products traded globally.

-Any increased tax revenue received by the New Zealand government from the New Zealand dairy industry

-Were any segments of the New Zealand community better off as a result of the advent of Fonterra, and conversely were there any segments worse off?

-How quickly did the benefits, if any, that were realised by the consolidation of the New Zealand dairy industry into Fonterra, flow? Were the benefits that flowed through to New Zealand dairy industry participants broadly dispersed or did they accrue only to a limited number of stakeholders?

3.4.1 All of the objectives set out in paragraph 3.3.1 were met:[5]

3.4.1.1 The NZDB's international network was integrated into Fonterra without loss of staff, partners or contracts

3.4.1.2 The added value ingredient and consumer businesses grew rapidly through merger and acquisition with major partnerships formed with Nestle in Latin America, Arla Foods in the United Kingdom and Dairy Farmers of America in the USA inside the first year. Smaller transactions in India and China meant that the strategic footprint was complete inside two years of the company being formed

3.4.1.3 The integration of processing and marketing created a seamless supply chain which generated cost efficiencies well ahead of target and facilitated significant growth in business with major global food companies.

3.4.1.4 The single commercial governance structure improved decision making responsiveness and decisiveness

3.4.1.5 Overhead costs were reduced by well over the business case level

3.4.1.6 In short, within two years of formation, Fonterra had delivered the cost savings and revenue benefits promised and had become a true 'national champion' for the New Zealand economy.

3.4.1.7 Those benefits flowed directly to Fonterra's supplying shareholders due to its structure as a co-operative. That increased wealth had a dynamic effect as it flowed through rural economies increasing GDP for the economy as a whole and tax revenues for the government.

3.4.2 Since Fonterra was formed dairy exports have increased from 1,554,000 tonnes in 2002 to 2,521,000 tonnes in 2012.[6] This growth in production is a direct result of the growth in milk supply through that period. Approximately 60% of that growth is due to farmers improving the productivity of cows and grass. The remaining 40% is due to conversion of land use into dairying from less intensive uses, mainly sheep farming.[7]

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[5] See Fonterra Annual Report 2001-02; Fonterra Annual Report 2003-04; Economics and Law Consulting Limited, A report for the Ministry of Agriculture and Forestry, *Evaluation of the December 2000 Dairy Industry Merger Package from the perspective of the competition policy*, January 2001.

[6] Includes milk powders, cheese, butter and casein; see NZ Stat Infoshare database (http://www.stats.govt.nz).

[7] See Dairy New Zealand, *New Zealand Dairy Statistics 2011/12.*

3.4.3 This is in stark contrast to Australia where industry milk production has actually declined from 11,271 million litres in 2002 to 9,480 million litres in 2012.[8]

3.4.4 The creation of Fonterra played a significant part in that growth. Industry confidence was at a significant high with a stable and performing national champion at the forefront. Farmers and bankers had the confidence to invest throughout the supply chain driving efficiency and growth.

3.4.5 The improvement in efficiency both on farm and through the supply chain has seen New Zealand's dairy industry remain profitable despite considerable increases in exchange rates.[9]

3.4.6 That industry growth and profitability has changed the nature of rural communities throughout New Zealand. Dairying is a much more intensive form of land use than the alternatives.[10] The increase in on farm employment is also matched by employment in servicing industries which are also more intensive when supporting dairying. With that critical mass of employment underpinning social infrastructure rural towns in dairying areas that were decaying twenty five years ago are now vibrant with young people who now see bright career prospects and real lifestyle choices outside the major urban areas.

3.4.7 The integration of the supply chain and the scale that came with the creation of Fonterra has led to better targeted research and development expenditure and manufacturing process improvements as well as a far greater velocity in new product development. Fonterra has continually rolled out innovative products, in particular with some of the minor components of milk that can only be efficiently processed with a critical mass of raw material e.g. lactoferin, ClearProtein™, probiotics and complex lipids.[11]

3.4.8 The creation of Fonterra also facilitated significant improvements in the international marketplace. Fonterra's increased transparency and responsiveness, along with its partnerships in Australia and the USA (where it took responsibility for almost all US exports) meant that it was the clear leader in the traded market. With a responsible market leader, the Europeans changed their behaviour and reduced export subsidies significantly as Fonterra allowed them to move their WTO permitted volumes without dropping prices.

3.4.9 Eventually Fonterra's market position allowed them to establish the Global Dairy Trade platform, an online trading platform that maximised transparency and gave both buyers and sellers confidence in what the market price really was. In a time of rapidly rising demand this has facilitated an orderly transition to higher market prices as international food companies accepted the new reality.[12]

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[8] See Dairy Australia, *In Focus 2013.*

[9] See New Zealand Industry for Primary Industries, *Farm Monitoring Reports 2001 – 2013*; Bloomberg.

[10] See New Zealand Ministry for Primary Industries, *Farm Monitoring Report 2013*; NZIER Report to Fonterra and Dairy NZ, *Dairy's role in sustaining New Zealand – the sector's contribution to the economy*, December 2010.

[11] See www.fonterra.com; Fonterra Annual Reports; IUF Dairy Division, *New Zealand Dairy Industry*.

[12] See http://www.globaldairytrade.info; Fonterra Shareholders Fund Prospectus and Investment Statement 26 October 2012.

3.4.10 The improved efficiency on-farm and through Fonterra has seen farmers build significant equity in their businesses. Land prices have increased to reflect the greater return.[13]

3.4.11 This improvement in equity has further increased the confidence and capacity to invest in productivity and growth thus creating a powerful dynamic effect.

3.4.12 Fonterra's co-operative ownership structure is a significant factor contributing to that success. With milk producers owning and controlling the company in proportion to milk supply the company is strongly focused on maximising milk price. Profit is only taken at one point in the value chain –when product is sold to a final customer. Market signals as to the value of milk are immediately communicated to farmers enabling production to be optimised. With transparency and control farmers have the confidence to make long term investment decisions both on farm and through the supply chain. This long term, integrated focus is in stark contrast to investor owned companies where profit is taken at various points in the supply chain and pricing is set based on countervailing power.

3.4.13 The role of that structure in determining the efficiency of the industry financing is also significant. In contrast to other land use forms dairy farmers receive regular cash flow and long term price forecasts. This ultimately delivers a lower cost of capital than in situations where farmers are price takers at the farm gate.

3.4.14 Barriers to entry in the domestic market were reduced with Fonterra being required to make raw milk available at cost to competitors.

3.4.15 The fact that Fonterra is a New Zealand owned and headquartered business adds to the benefit to the wider economy. Business is all about taking and managing risks. Net risk is generally lowest when investing where you have your greatest knowledge. Companies therefore have a greater propensity to invest in their home market than elsewhere. Fonterra has continued to make substantial investments in improving its operating platform in New Zealand –investments that far outweigh its investments internationally.

3.4.16 Aside from the economic benefits flowing to the wider economy there has been a real benefit to the nation from having a globally significant organisation based in New Zealand. Among other things this manifests itself as an incubator for globally competitive talent that then spreads through other organisations in the economy.

3.5 To the extent not answered in response to the above questions, what were the principal benefits arising from the creation of Fonterra?

3.5.1 The principal benefits have been outlined above.

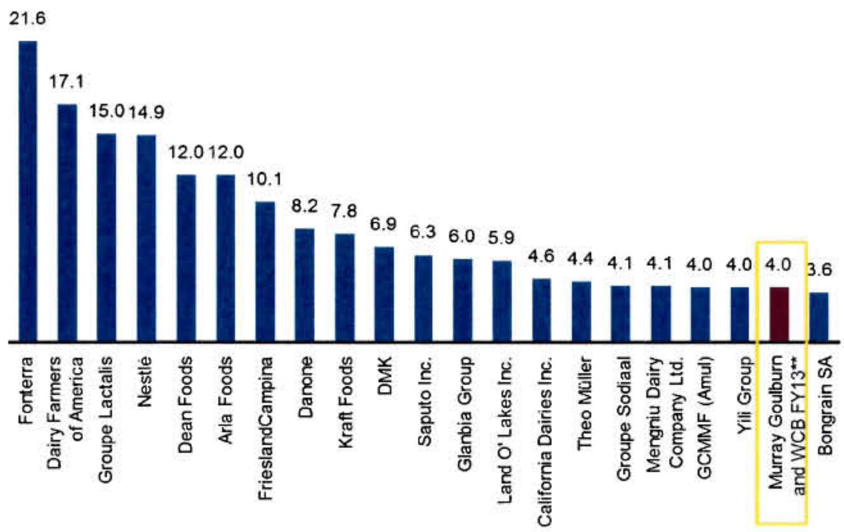
3.6 To what extent and in what ways might there be parallels between the benefits that were realised as a result of the creation of Fonterra and a merger of WCB and Murray Goulburn?

3.6.1 Whilst Murray Goulburn already operates an integrated supply chain most of the other benefits from the creation of Fonterra will have parallels in a MG/WCB merger:

[13] New Zealand Industry of Primary Industries, *Farm Monitor Reports, 2001 – 2013.*

3.6.1.1 The improved scale will mean the merged company is better placed to serve the needs of global food companies. Murray Goulburn will move into the top twenty global producers.

TOP GLOBAL DAIRY PROCESSORS RANKING BY MILK INTAKE*, 2012
Million tonnes



* Milk intake represents milk volume collected for main company and subsidiaries. Milk intake figures are in million tonnes, and in some cases recalculated from litre 1L = 1.033kg
** Murray Goulburn and Warrnambool Cheese and Butter FY13 milk supply
Source: IFCN dairy reports; Murray Goulburn; Company Annual Reports

3.6.1.2 The improved scale of the merged company will lead to better efficiency with research and development expenditure and manufacturing process improvements as well as greater velocity in new product development.

3.6.1.3 Scale benefits will also accrue with respect to supply chain efficiency, overhead costs and processing capacity investment

3.6.1.4 Murray Goulburn's existing operating platform includes strong capability in milk powder and nutritional powders.[14] Global market pricing is growing fastest in these categories and MG will be well placed to reallocate production to these higher returning products.[15]

3.6.1.5 The merger will facilitate further improvements in the international marketplace. The removal of a small but significant seller will improve market dynamics.

3.6.1.6 The improved efficiency within MG and on-farm will see farmers build equity in their businesses. Land prices will increase to reflect the greater return and MG's farmer shareholders will also enjoy growth in the value of their shares from improvements in the profitability of the added value business that underpins them.

[14] See http://www.mgc.com.au; Murray Goulburn 2013 Annual Report; Murray Goulburn Media Release, 2 August 2013.
[15] OECD, *OECD-FAO, Agricultural Outlook 2013 – 2022*.

3.6.1.7 This improvement in equity will further increase the confidence and capacity to invest in productivity and growth thus creating a powerful dynamic effect.

3.6.1.8 MG's co-operative ownership structure will be a significant factor contributing to that success. With milk producers owning and controlling the company in proportion to milk supply the company is strongly focused on maximising milk price. The benefits of the merger will flow directly to farmers and through them to the wider community.

3.6.1.9 Industry confidence will be enhanced with a stable and performing Australian champion at the forefront. Farmers and bankers will have improved confidence to invest throughout the supply chain driving efficiency and growth.

3.6.1.10 Industry growth and profitability can change the nature of rural communities throughout Victoria. Dairying is a much more intensive form of land use than the alternatives. The increase in on farm employment is also matched by employment in servicing industries which are also more intensive when supporting dairying. With that critical mass of employment underpinning social infrastructure rural towns can offer young people bright career prospects and real lifestyle choices.

3.6.1.11 Aside from the economic benefits flowing to the wider economy there will be a real benefit to the state from having a globally significant food company based in Victoria. Among other things this manifests itself as an incubator for globally competitive talent that can then spread through other organisations in the food industry.

3.7 What benefits might flow upon a merger as between WCB and:

a) Murray Goulburn

b) Saputo

c) Bega?

In answering these questions please have regards to the degree of likelihood of such benefits arising and how quickly they be realised. In addressing each question please consider matters including: the relative productive capacity of the various entities and their product mix; any synergies that may be available; the growth potential in the global dairy industry for particular products and the suitability of WCB's assets to be deployed to service same; the most likely utilisations of WCB's assets by the potential aquirers; and the ability to increase prices for product produced internationally by WCB

3.7.1 WCB and Murray Goulburn

3.7.1.1 Section 3.6 outlines the wide scope of potential benefits from a merger between WCB and Murray Goulburn. Such a transaction is MG's, only opportunity to improve its critical mass to such an extent.

3.7.1.2 With overlapping supply catchments such a merger significantly improves the productive efficiency of the operations of both companies. Aside from cost efficiencies, product mix can be optimised across the combined operating platform. The flexibility to rapidly respond to shifts in market demand will be an additional benefit.

3.7.1.3 Merging of these two companies is relatively straightforward so execution risk is low and benefits can be expected to accrue from year one.

3.7.1.4 These benefits are not available to Saputo or Bega.

3.7.1.5 The benefit of having a global scale food company based and owned in Australia cannot be understated. Companies have a lower risk when investing in what they know so they naturally have a greater propensity to invest in their home market. Murray Goulburn's focus is completely in Australia so there is no competition for scarce capital from other jurisdictions.

3.7.2 WCB and Saputo

3.7.2.1 The Saputo transaction appears to be a simple acquisition of an existing asset.

3.7.2.2 Whilst Saputo may be able to bring some improvements from their knowledge of their other operations the reality is that the reverse is more likely to be the case. Alongside New Zealand, Australia leads the world in processing efficiency so Saputo is likely to extract knowledge from WCB for use in their other operations.

3.7.2.3 Saputo can be expected to gain some minor overhead cost efficiencies from not operating WCB as an independent company but, given their lack of existing infrastructure in Australia, for WCB to remain effective they will need to retain most of the existing overhead structure.

3.7.2.4 Without significant capital expenditure Saputo will need to continue WCBs existing product mix strategy.

3.7.2.5 Saputo states its intention to 'accelerate its growth[16]'. This can only come be investing in additional milk processing capacity and taking supply from other processors resulting in poor capacity utilisation and a reduction in efficiency.

3.7.2.4 None of the other benefits available to a WCB/MG combination accrue to Saputo

3.7.3 WCB and Bega

3.7.3.1 As with Saputo the Bega offer is a simple acquisition of existing assets.

3.7.3.2 Bega gets the additional advantage of protecting the existing contracts it has with WCB.

3.7.3.3 There will be greater scope for overhead cost reductions given Bega already has an independent operating platform in Australia

3.7.3.4 There is limited scope for operating efficiencies given the discrete geographies of the two operating bases

[16] See Saputo Press release 25 October 2013.

3.7.3.5 Without significant capital expenditure Bega will need to continue WCBs existing product mix strategy

3.7.3.6 None of the other benefits available to a WCB/MG combination accrue to Bega

3.8 When Australian dairy companies participate in the global dairy market, what are the characteristics of the leading competitors they confront? What makes those entities effective competitors? Does the scale of their operations provide an advantage, including being 'relevant' to international customers?

3.8.1 The reality of the international food market is that 'big deals with big'. Large dairy ingredient customers are increasingly forming partnerships with suppliers that integrate the supply chain to reduce cost and increase responsiveness. To play in that game suppliers need the scale to service a large proportion of a customer's business including the flexibility to respond to potential risks such as climate or plant failure.

3.8.2 The remaining suppliers are left to focus on the 'scraps' – smaller volumes the large players award them to keep the market honest, or smaller customers. Quite simply, without scale you lack relevance and struggle to build profitable, enduring relationships.

3.8.3 This leverages the scale advantage of larger organisations as supply chain costs are optimised.

3.8.4 Further down the value chain scale is even more critical for success. To participate in the fast moving consumer goods (FMCG or Retail) market requires significant investment in brands, inventory, distribution networks and people capability. Scale is a necessary pre-requisite to establish a meaningful presence in the fast growing markets of the developing world and even more so in those that are more mature.

Declaration

I hereby declare that I have made all the inquiries that I believe are desirable and appropriate and that no matters of significance that I regard as relevant have, to my knowledge, been withheld from the Tribunal.

Signed

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M. Craig Norgate

28 November 2013

Appendix 1

HARVARD | BUSINESS | SCHOOL

9-903-413
R V: MAY 29, 2003

RAY A. GO DB RG
OSÉ M GU ORRAZ

Fonterra: Taking on the Dairy World

In October 2002, Fonterra's CEO Craig Norgate met with his leadership team to discuss the events that had occurred during Fonterra's inaugural year but, more importantly, the challenges that lay ahead. These included the long-term decline of commodity prices, diminishing margins, the rising power of retail chains, increasing competition throughout the entire value chain, and a shift in consumer demand in respect to health, nutrition, and convenience.

Fonterra was founded one year earlier through the merger of New Zealand Dairy Group, Kiwi Cooperative Dairies, and the New Zealand Dairy Board. The newly founded company was cooperatively owned by 13,000 New Zealand dairy farmers, who represented about 96% of all dairy farmers in the country. Furthermore, Fonterra was the country's largest company, contributing 7% of gross domestic product (GDP) and 20% of exports.

In 2002, Fonterra employed 20,000 people throughout the world, marketed more than a billion kilograms of milk solids[1] in 140 countries, and achieved $6.6 billion in revenue.[2] It was the fourth-largest dairy company in the world in terms of sales, the second largest in terms of the volume of milk processed, and the world's largest exporter of dairy products (see **Exhibits 1** and **2**).

In its first year, Fonterra was able to successfully manage the integration of the full supply chain, from milk collection to marketing quality ingredients to the food business globally. The company was in line to deliver the costs savings from the merger and had created several new partnerships that strengthened its global position, such as a joint venture with Nestlé in the Americas. This partnership alone was expected to create a business with turnover of $1.4 billion and become the market leader in every country in which it would operate.

Norgate explained that Fonterra's overall goal was a simple one: "to deliver the highest possible return to our dairy farmer shareholders," and to do that "we need to maximize both the value of the milk that they deliver to us and also the long-term value of the cooperative." This was not an easy task, especially because it had to be done in a context where developed countries were increasing subsidies on milk, thus encouraging overproduction in those regions and forcing the international price of this commodity to hit rock-bottom levels.

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[1] New Zea and da ry farmers use the term m k so ds to descr be the amount of m k fat and prote n conta ned n the m k One k ogram of m k so ds s equ va ent to approx mate y 12 k ograms of m k

[2] A f gures are n U S do ars un ess otherw se stated The exchange rate used was 2 12 New Zea and do ars for one U S do ar

Professor Ray A. Goldberg a d Research Assoc a e José M guel Porraz, Global Research Group, prepared h s case. HBS cases are developed solely as he bas s for class d scuss o . Cases are o e ded o serve as e dorse e s, sources of pr ary da a, or llus ra o s of effec ve or effec ve a age e .

Fonterra was recognized as one of the most successful cooperatives in the world. To maintain its leadership role as a model for other global cooperatives and to achieve its full potential, Fonterra needed to maintain its cost leadership; be a step ahead on safety, health, environmental, and animal welfare issues; provide the best customer service globally; develop innovative specialty dairy products; exploit the health and nutritional benefits of milk; build broader and deeper relationships with its suppliers and customers; provide the highest long-term return to its dairy farmer shareholders; and be a product, logistic, manufacturer, distributor, and research leader in the dairy system. All of these had to be achieved at the same time that Fonterra needed to finalize the integration of its legacy companies and develop a new culture for the company in order to encourage effective coordination and efficient use of Fonterra's resources.

Norgate and his leadership team knew that to remain the global leaders Fonterra needed to grow shareholder returns at about 15% per year. What were their options for growth, how could they effect them, and how could they finance them given Fonterra's cooperative structure? How did New Zealand's dairy farmers' needs fit with Fonterra's plans to become a global company? How should Fonterra manage its relationship with its partners, given that they were also its customers and competitors? How should Fonterra compete in an industry in which the vast majority of the product was not traded internationally?

The Global Dairy Industry

In 2000, the average world per-capita consumption of milk and milk products was 95 kilograms (equivalent weight of liquid milk), ranging from over 500 kilograms in the Netherlands to under 10 kilograms in China. Dairy consumption varied significantly throughout the world as a result of income and cultural differences.

Overall consumption growth was forecasted at an annual rate of about 2% for the next four years. The demand growth was not uniform; it ranged from a 5% growth in fresh products to a decrease of 0.5% in butter (see **Exhibit 3**). The main drivers of this demand growth were the increase in living standards of low- and middle-income countries, which accounted for 56% of the world dairy trade (see **Exhibit 4**).

Local dairy producers played a vital role in every country given that only 7% of the milk produced was traded on the world market. Rabobank estimated that 32% of the milk produced was not even delivered to factories for processing but was consumed or sold on the farms.[3] As a result, domestic consumption of milk was almost 10 times more than world trade. Of the internationally traded dairy products, about one-third came from the European Union, one-third from New Zealand, 15% from Australia, 4% from the United States, and the rest from other countries (see **Exhibit 5**).

Regulation

An intricate network of national and international laws, regulations, agreements, and treaties affected the dairy industry (see **Exhibit 6**). The evolution of subsidy programs was key in defining this aspect of the dairy industry. Because the main interest of policymakers in highly regulated countries was to dispose of the milk surplus created by dairy subsidies, emphasis was placed on exporting the surpluses as skimmed milk powder and butter/butter oil, considered bulk products. However, as subsidies and trade restrictions became smaller and surplus disposal was a less

[3] "Wor d Da ry Trade F ows Sh fts n Products and Reg ons," Rabobank Internat ona , March 2001, p 6

important element in the market, exports migrated toward value-added and niche products, which competed directly with the products being marketed by producers from countries that did not have subsidies and were not protected by government policies. These changes in governmental policies were among the most important factors responsible for the great variability in the commodity prices of dairy products (see **Exhibit 7**).

Consolidation of the Dairy Industry

From January 1998 to September 2002, there were a total of 641 mergers and acquisitions in the dairy industry. The rationale behind the consolidation was that dairy companies wanted to become more efficient in manufacturing, access new markets, gain market share and market power, expand their brand portfolios, get access to new technologies, secure additional origination of milk, and improve their access to capital. These deals reflected the internationalization of the industry, as 23% of the deals were done at the regional level and 21% were cross-continental deals. During this period cooperatives were very active in the dairy consolidation process, as one out of every third deal included a cooperative (see **Exhibit 8**).

Among the major buyers of dairy products were food retailers and food manufacturers, which were consolidating on a global basis. For example, the top five food retail companies in the United States represented more than 40% of food retail sales; in the United Kingdom, the share handled by the top five food retailers was more than 70%.

The consolidation of dairy consumers had significant implications for the industry because of their market power and also because they wanted to reduce the number of suppliers that they had to deal with. Consequently, dairy companies had to compete on price, be acute and skillful in managing the global trading environment, move into additional value-added opportunities not only in consumer products but also in industrial applications, and become more responsive to global customers by delivering value-added services like global deliveries customized to match local tastes.

Agricultural Biotechnology

There were a number of technologies that were having a lasting impact on the dairy industry, but none had more potential than agricultural biotechnology. Agricultural biotechnology offered the potential to produce new, cheaper, and better products. The advocates of this technology argued that it had potential to create new products with better nutritional content, improve milk yields, increase farmer's revenue, and contribute to delivering milk to the millions of families around the world that did not have access to dairy products. Also, the environment would benefit from a reduction in the acreage dedicated to dairy farming (as a result of increased yields) and because of the reduction in manure (as a result of a more efficient digestive system in the animals and a reduction in the number of animals). The opponents of the technology argued it would negatively affect dairy farmers and consumers. Farmers would be hurt because improved yields would lead to oversupply and a reduction in the price of milk. Consumers would lose because of the potential side effects that this technology could have on the safety of milk.

One product that reflected the tension between advocates and opponents was Monsanto's recombinant bovine somatotropin (BST), a protein hormone produced naturally by cows that had the potential to improve milk yields by 20%. Immediately after Monsanto introduced the product in 1994, consumer groups organized boycotts, despite the fact that the FDA had completed a comprehensive review of the product s safety and efficacy. With time, consumers in the United States became more comfortable with consuming milk from cows treated with BST, and the product became the largestselling dairy animal pharmaceutical product in the United States. However, use of BST remained banned in Europe, New Zealand, and a number of other nations.

Consumer Tastes

Consumers in developed economies were aging and changing their eating habits. People were putting more attention on the nutritional content of their food, and this was reflected in greater demand for low-fat milk products. In contrast, consumers in developing economies tended to prefer full-fat milk because of its nutritional and caloric content.

In developed economies dairy consumption had reached a plateau. Thus, dairy companies had increased the segmentation of the market and were creating new value-added products. As a result, the number of dairy products grew exponentially. A quick look at the dairy counter of most supermarkets showed the vast array of milk products targeted to the specific needs of pregnant women, breast-feeding mothers, babies, children, adolescents, athletes, and older persons.

Developing countries were expected to be the main drivers of world demand growth. This growth was going to be characterized by consumers being able to afford more dairy products as their disposable income expanded and having more access to dairy products as economic development increased migration toward urban areas in which electricity allowed for the longer life of dairy products. In these types of countries branding and innovation would also become more important, but to a lesser degree than in developed economies.

The way in which food was being eaten was also changing. People were eating outside the home more, and the meals eaten at home had a higher content of pre-prepared dishes and snack foods. Dairy had been able to participate in the growth of the outside-the-home market share through products such as drinkable yogurts and sports drinks (many of which were based on milk protein). However, dairy accessibility outside the home still lagged other products like soft drinks.

One important factor of eating outside the home had been the impact on countries in which dairy was not part of the traditional diet. As fast-food chains entered these markets, the perception of the quality of dairy products changed, leading to increased consumption.

Other Applications

Milk was a versatile raw ingredient for multiple products beyond its obvious use as a beverage or in the manufacture of cheeses, butter, and ice cream. Milk's main protein, casein, was used in coffee whiteners, infant formulas, diet supplements, sports drinks, pharmaceuticals, paints, glues, and papers. Whey protein was used as a binder in reformed meats, fish, and poultry, and it was also used in the manufacture of food coloring, deodorants, perfumes, and pharmaceuticals. Lactalbumin was used in nutritional foods and protein supplements. The challenge for dairy companies was to continue to find new uses for milk components.

Fonterra

The New Zealand dairy industry began in the early 1800s with the importation of the first bulls and cows. Since then, the industry had grown consistently because New Zealand's temperate climate made it an ideal place for dairy farming. Cows were left outdoors year-round and were fed predominantly fresh grass with silage and hay supplements when grass growth slowed during three months in the winter. This, coupled with highly efficient farm systems and automated milking units, ensured that New Zealand's dairy farms were among the most effective and efficient in the world (see **Exhibit 9**).

In the 1930s when it became increasingly difficult for hundreds of small New Zealand dairy companies to service markets half a world away, dairy farmers and the government formed a partnership and established the New Zealand Dairy Board. Since then the industry had grown and prospered. The New Zealand Dairy Board was responsible for handling all export marketing of dairy products. Unity gave the board scale to become New Zealand s biggest company and, more importantly, it gave New Zealand's farmers power to access new markets and obtain better return for their dairy products. This was followed by rapid consolidation of the industry, and by the end of 2000 more than 95% of the industry had consolidated around two major manufacturing companies, New Zealand Dairy Group and Kiwi Cooperative Dairies (two smaller cooperatives held the remaining 5%).

In March 2000, there was an attempt to merge the two largest cooperatives and the Dairy Board, but the effort failed because of government opposition, disagreement on the management structure of the new company, and different views regarding the valuation of the companies. A year later, in July 2001, 84% of the farmers involved voted to accept the merger of the New Zealand Dairy Board, New Zealand Dairy Group, and Kiwi Cooperative Dairies. In October 2001, the merger was consummated and Fonterra was created (see **Exhibit 10**).

The merger agreement was able to end a fierce competition between New Zealand's leading dairy companies. However, it created a new set of internal conflicts relating to the role that each company was going to play in Fonterra. To resolve this problem, Fonterra was set up as a new company that bought the assets of both cooperatives and the Dairy Board. This allowed Fonterra to get the best of each company and avoid duplicate functions. For example, after creating an organizational structure, Fonterra opened all the jobs for competition, and all the employees of the acquired companies had to apply for a job at Fonterra. However, some employees had the impression that the process was biased to favor employees of one company over the employees of the other two companies.

The merger also created the challenge of communicating to the company's stakeholders the changes that were taking place. Initially, farmers did not understand very well the new economics of the company. Farmers did not like the new "peak notes" system, which brought a stronger market focus to the cooperative's capital structure. The employees of Fonterra did not like the uncertainty created by having to apply for the job they had previously held. Finally, shareholders questioned why the members of the two smaller New Zealand cooperatives were receiving a higher payout[4] than the one Fonterra was paying them.

Despite these challenges, by the end of its first year Fonterra was the largest company in New Zealand with $6.6 billion in sales, contributing to 7% of its GDP and 20% of its exports (see **Exhibit 11**). It was the largest exporter of dairy products in the world, responsible for one-third of international dairy trade. In terms of volume of milk processed it was the second-largest milk-processing company in the world, behind only Dairy Farmers of America. Fonterra's global supply chain stretched from its shareholders' farms to customers in 140 countries. Fonterra was able to create new partnerships around the world that had given it access to new markets and ways to move into higher-margin products. Relationships with customers were strengthened because Fonterra was able to increase its reliability as a supplier and as a result reduce the risk for its customers. The business case for the merger identified annual benefits of around $150 million by the end of the third year as a

[4] The payout rece ved by New Zea and da ry farmers comb ned payment for m k supp ed w th the return on the r nvestment n the r da ry company

result of eliminating duplicated facilities and activities, productivity improvements resulting from economies of scale and scope, and the capacity to exploit new markets, technology, and biotech opportunities. During the first year of operations, Fonterra was in line to achieve these economic benefits as it realized $42 million (the business case contemplated $38 million in benefits for the first year). Finally, shareholders received a record payout in 2002 despite the fact that Fonterra had to process 6% more milk solids than the previous season.

Organizational Structure

New Zealand's farmers had decided to organize as cooperatives to limit their exposure to risk and to maximize their returns. Fonterra's shareholders were no different, as John Roadley, founding chairman of Fonterra, explained:

> We are organized as a cooperative not because we espouse a sort of vague collectivism. It is, firstly, because it suits the long-term nature of our dairy farming business, and secondly and most importantly because it gives us market power. And quite simply, market power has always been exercised by those who have it over those who do not. By having market power, Fonterra gives the farmers the only viable means by which they can move ever more of their milk towards the higher end of the value chain and utilize the value creation potential of the business itself.

Fonterra had three main objectives: collect, process, and market all the milk that its shareholders produced; maximize the return on the capital invested by the shareholders; and retain its cooperative ownership—limiting shareholding in the company to farmers who supplied the company with milk.

To achieve these objectives, Fonterra had three departments—finance, corporate development and human resources—as well as three divisions—NZMP,[5] New Zealand Milk, and Fonterra Enterprises (see **Exhibits 12** and **13**).

NZMP was the largest dairy ingredients company in the world. The scope of its operations encompassed milk collection from 13,000 suppliers, the manufacture and packaging of more than 1,000 product specifications, and the operation of a supply chain linking production plants in New Zealand and offshore. NZMP marketed products in over 100 countries, operating a network of offices covering every continent except Antarctica. NZMP was responsible for the entire cow-to-customer value chain, from milk collection through manufacturing and logistics and ultimately to the marketing of quality ingredients to the international food industry. Among NZMP's customers were some of the world's most successful marketers of consumer milk products, such as New Zealand Milk, Nestlé, Dumex, and Kraft.

New Zealand Milk provided dairy-based consumer and food-branded products for customers around the world and was Fonterra's fast-moving consumer goods business. The fundamental marketing strategy of New Zealand Milk was founded on the vision of providing consumers with products that provided them with nutrition for their current life stage (e.g., expectant women, breast-feeding mothers, and children). This division leveraged New Zealand's positive environmental image and a reputation for quality through its leading brands Anchor, Anlene, Anmum, Chesdale, Soprole, and Mainland. New Zealand Milk's primary business operations were in sales, marketing, and distribution. Additionally, it owned and operated plants globally that packed bulk dairy and nondairy products into branded consumer presentations.

[5] Prev ous y known as New Zea and M k Products, the name NZMP was forma y adopted by the New Zea and Da ry Board n 1999

Fonterra Enterprises was made up of innovative venture and growth businesses in support of Fonterra's core business. They included the company's biotechnology company, ViaLactia Biosciences; a technology development business named FonterraTech; a rural retailer, RD1; and an agricultural Web site called Fencepost.com.

Building a Winning Team

To become a global leader, Fonterra needed to go beyond building a global operation and doing business around the world; Fonterra needed to become globally integrated, which had to do with process, procedure, operation, and infrastructure as well as with people and organizational culture and values. That is why from the outset Fonterra set out to create an atmosphere that maximized each individual's contribution. Fonterra's recruitment was based on a rigorous process undertaken to identify key strengths and weaknesses of each candidate and match them with the skills and capabilities that Fonterra needed to develop. Fonterra specifically emphasized looking for the best people and working hard to retain and develop its top talent. Glen Peterson, group director of human resources and a member of Fonterra's leadership team, explained:

> Fonterra went to great lengths to attract outstanding talent but went even further to retain and develop its people. To this end, we worked with employees to create a personal development plan that engaged them in their career, what they were going to do, and how they were going to develop. This process helped our employees reach their full potential and as a result helped Fonterra reach its aspirations.

To ensure that Fonterra continued to grow, delivering strong returns and meeting the expectations of its key stakeholders, the company worked to establish a culture focused on performance and growth.

Perform! was a system developed to establish and monitor expectations around behavior and performance throughout Fonterra. It ensured that everyone had clear goals and objectives and understood how their individual contributions were linked to the organization and business unit objectives. Finally, it provided a consistent and objective process for assessing performance and linking it to rewards and development.

Grow was the process used to identify talented people throughout the organization and track their development and deployment to enable them to achieve their potential. It started by articulating what it took to be successful at Fonterra and measured its employees against these success factors. The process then created a personalized development plan for key employees.

Governance

When Fonterra was created, a new board of directors was elected to govern the business, and an additional body was established with the primary responsibility of monitoring business performance and ensuring that the interests of the shareholders (as suppliers and owners of the company) were safeguarded.

Board of directors The board was responsible for establishing the strategic direction of the company, appointing the CEO, monitoring Fonterra's performance, ensuring regulatory and legal compliance and adherence to high ethical standards, and guaranteeing an appropriate level of interaction with shareholders.

Of the 13 directors who comprised the board of directors, the shareholders elected nine and the board of directors appointed the other four. Each share in the company gave the right for one vote during the election of board members. The directors were elected for three-year terms and could stand for reelection.

Shareholders' Council Fonterra's size and the spread of shareholders throughout New Zealand made direct contact between directors and shareholders difficult. To overcome this potential problem and to ensure that shareholders maintained a strong voice and real influence within the company, the Shareholders' Council was created.

The key role of the Shareholders' Council was to serve as a performance watchdog over Fonterra. Among its key roles was to appoint the valuer, who determined the fair-value range for Fonterra's shares, and the milk commissioner, whose role was to consider and facilitate the resolution of shareholders' complaints or disputes with Fonterra. In addition, the council monitored Fonterra's performance against its objectives and developed and trained potential future directors. It also had the authority to call a special shareholders' meeting if it had serious concerns with Fonterra's compliance with its cooperative principles or its performance.

The shareholders elected the 45 councilors from among themselves. Each farm had two votes regardless of the number of shares held. This was done so share-milking farms would have one vote for the owner of the animals and one vote for the owner of the land. To ensure the independence of the council, directors and executives of Fonterra could not be elected as councilors, and the council's budget was approved by all shareholders at their annual meeting.

New Economics

Prior to the merger, the New Zealand Dairy Board did not report long-term performance measures, and its only visible performance measure was payout, which was compared with what other dairy companies paid. Because there was no market for the shares held by farmers, they could neither determine the value of their shares nor whether the company was creating or destroying value.

The merger that created Fonterra and the deregulation of the New Zealand dairy industry brought a new set of economics to evaluate Fonterra's performance. The two key elements of the new economics were the commodity milk price (CMP) and the fair-value share price. The CMP made it possible to separate business performance from the underlying commodity price cycles, served as the benchmark with which farmers could compare Fonterra's payout for raw milk, and was the key measure of performance of the commodity products business. The fair-value share price served as the basis for valuing entry and exit to and from Fonterra for shareholders and was the key measure of long-term performance of the business (see **Exhibit 14**). The way these metrics were calculated is explained below.

Commodity milk price (CMP) Because Fonterra controlled 96% of the milk produced in New Zealand, there was no benchmark with which Fonterra's payout for the milk it received could be compared. To overcome this limitation, Fonterra's board decided to estimate the highest theoretical price that an efficient competitor could afford to pay for New Zealand's milk while making an adequate return on capital. This measure was called the CMP.

The CMP was forecasted at the beginning of each season by Standard & Poor's based on historical international commodity prices, forecasted foreign exchange rates, and an assessment of theoretically efficient manufacturing and capital costs of a notional product portfolio.

The CMP was used as a benchmark for Fonterra's actual milk return (AMR). The gap between them was the result of differences between Fonterra's actual performance and that of an efficient competitor. Some of the reasons that could explain the gap were differences in product mix, working capital, infrastructure utilization, operating costs, and efficiency of asset utilization. Closing the gap was one of Fonterra's focus areas and a key performance target.

Fair-value share price Prior to the merger, shareholders in Fonterra's legacy companies could not assess the value of their shares because there was no market for them and transactions between the companies and shareholders were based on nominal value. After the merger, it was established that it was the responsibility of the Shareholders' Council to appoint an independent valuer to estimate before each season the fair-value share price. In 2002, the valuer was Standard & Poor's.

The fair-value range was estimated by performing a discounted cash flow valuation. The most important variables taken into account were the likely future earnings of Fonterra's separate businesses, corporate overhead, research and development (R&D) and other operations, as well as the forecasted volume of milk supplied to Fonterra, expected exchange rates, and the number of shares. The CMP was not an important determinant of the fair-value share price because suppliers (shareholders) effectively took the commodity price risk.

After the valuer determined the fair-value range, it was up to the board of directors to then set the fair-value share price. For 2003, Fonterra's directors set the fair value of a share at $1.82, which was within the range determined by Standard & Poor's of $1.72 to $2.00. The fair value was used as the price for the sale/purchase of shares between Fonterra and its shareholders. Shareholders were required to sell/purchase shares in response to changes in their milk production so that they maintained one share for every kilogram of milk solids supplied to Fonterra during the year.

Peak notes Because of the seasonal nature of New Zealand dairy farming, Fonterra's processing plants were fully utilized for only a very limited time each year (see **Exhibit 15**). The peak dictated the total amount of processing capacity needed. Because Fonterra had a mandate to process all the milk that its shareholders provided, as the peak grew more capacity was required. However, an increase in milk supply outside the peak did not contribute to any need for additional capacity. Therefore, Fonterra determined that it was only fair that farmers with high peak profiles (those delivering milk during the peak days) should contribute more capital to fund the required additional capacity by buying these peak notes.

Payout The payout was the return farmers received for supplying milk to Fonterra. It had two main components: the AMR and the value-added component. The AMR was calculated by Fonterra using the same methodology as applied by Standard & Poor's to calculate the CMP. The difference was that the AMR was calculated using actual revenue and actual costs instead of the theoretically efficient ones used for the CMP. The value-added component included cash generated from Fonterra's investing activities in high-value consumer markets and in value-added dairy ingredients, less the retentions required to fund future investing activities.

Research and Development

New Zealand had a very strong reputation for research and innovation in the dairy industry. Fonterra was the country's largest private investor in R&D, and it had focused its efforts in several streams: develop biologically active components in milk for application in new food ingredients, nutraceuticals, and pharmaceuticals; provide food and environmental assurance; develop and launch new products; achieve manufacturing efficiency gains; and enhance long-term dairy production and on-farm productivity.

The R&D was done mostly either by joint ventures with research institutions or through Fonterra's research centers (located in New Zealand, Japan, Mexico, and Germany). ViaLactia Biosciences, a wholly owned subsidiary of Fonterra, was in charge of conducting the biotechnology R&D efforts.

Partnerships

Since its creation, Fonterra had established significant partnerships with key players in the dairy industry to strengthen its position as a global leader in the industry. These partnerships provided Fonterra with growth opportunities, access to new markets, ways to develop new capabilities and skills, and a source of funding.

Dairy Partners America In March 2002, Fonterra established an alliance with Nestlé to set up joint ventures in the dairy business in North, Central, and South America. Fonterra and Nestlé had equal stakes in the alliance, and it was expected to have a first-year turnover of US$1.4 billion. Fonterra would provide expertise in the development of dairy farming; its technologies and know-how in large-scale milk procurement, processing, and management; and its strong brands and positions in several countries. In exchange Nestlé would provide its brands, infrastructure, and product-development expertise. The joint venture would source its fresh milk from dairy farmers in the Americas and get its dairy ingredients from New Zealand. [6]

Bonlac In July 2002, Fonterra merged its consumer products operations in Australia and New Zealand with those of Bonlac, an Australian cooperative. This merger created the largest dairy consumer products group in Australasia, with annual sales of $1.1 billion. Fonterra owned 75% of the new venture, named Australasian Food Holdings.

Britannia Industries in India Fonterra was able to enter the Indian dairy market through a joint venture with Britannia Industries, India's market leader in the organized (as opposed to informal) biscuit and bakery product market. A key success factor for the partnership was the strength in distribution that Britannia offered, with over half a million retail outlets covered directly on a weekly basis and an additional quarter million of retail outlets covered indirectly. The Indian market was particularly important because it was the largest milk-producing country in the world, and although most of the milk was delivered through informal markets, the formal milk market in India was around US$3 billion.[7]

Arla Foods in the United Kingdom To improve its profitability in Europe, Fonterra entered into a joint venture 75% owned by Arla Foods AmbA, Europe's largest dairy cooperative group. The agreement brought Fonterra's Anchor brand together with Arla's Lurpark brand, with the objective of improving their positioning in the yellow fats market. Fonterra was going to supply the bulk product from New Zealand, and Arla would do most of the processing and packaging. This joint venture provided Fonterra with a basis for a broader relationship with Arla.

Mexican acquisitions In December 2001, Fonterra completed the acquisitions of La Mesa and Eugenia, establishing Fonterra as the number one player in Mexico's cheese market and number three in spreads. In addition, Fonterra signed a deal with Liconsa, a Mexican state agency that distributed milk to the poor and was Mexico's largest importer of milk powder, to supply it with 38,000 tons per

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[6] Sven Koops, "New Zea and Da ry and Products," U S Department of Agr cu ture, GAIN Report #NZ2013, May 28, 2002, p 18

[7] Ib d , p 17

year (about US$45 million).[8] In 2002 Mexico was the fourth-largest dairy market for Fonterra with sales of over US$200 million.

Dairy Farmers of America Fonterra extended the joint venture it had with Dairy Farmers of America, the world's largest dairy cooperative, to include the expansion of an existing plant in New Mexico to produce the first commercial milk-protein concentrate in the United States. This would help Fonterra better target the needs of its customers in the NAFTA region.

Dairy America NZMP, Fonterra's ingredients division, signed an agreement with Dairy America, a marketing company representing major U.S. cooperatives, to export skim-milk powder from the United States on commission. The anticipated sales volume would make NZMP the largest marketer for skim-milk powder. This deal would also help Fonterra balance its portfolio, given that production in New Zealand had been skewed toward whole-milk powder.

LactoPharma Limited The objective of this joint venture between Fonterra and the University of Auckland was to discover biomedical components in milk targeted to bone growth and the treatment of inflammatory diseases and cancer. The program included new fundamental research and clinical trials aimed at discovering food ingredients, nutraceuticals, and drug leads.

boviQuest Fonterra established a joint venture with Livestock Improvement, a herd improvement company, to unlock the secrets of the bovine genome. This knowledge would allow Fonterra to accelerate the rate of improvement of the dairy cows of its shareholders. These improvements were not limited to increased health and productivity of the animals but also included milk composition that could lead to new value-added products.

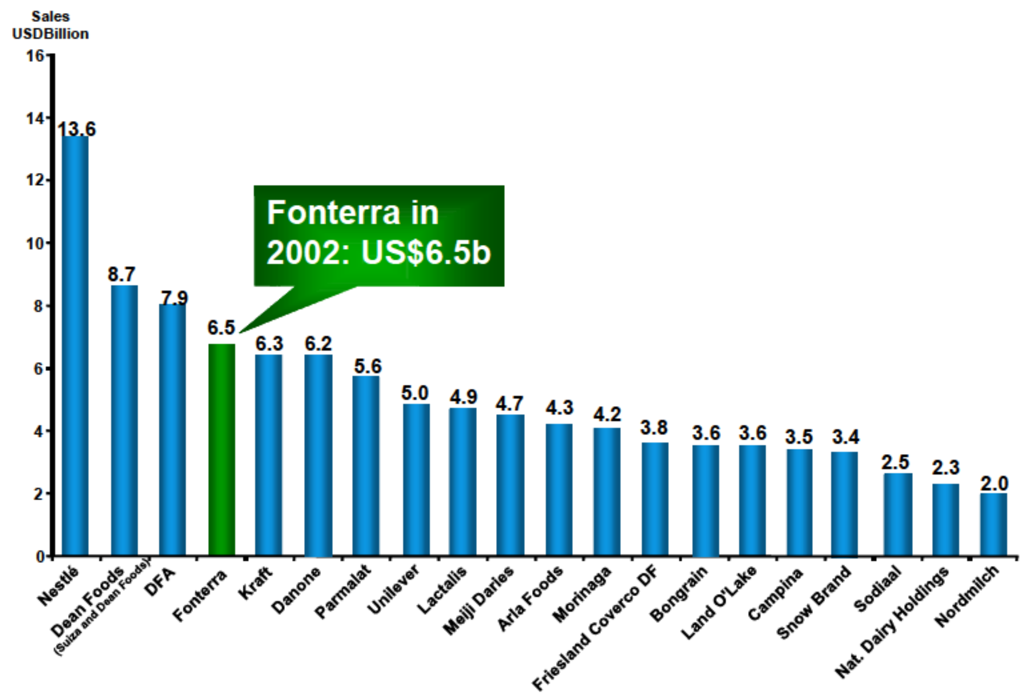
Challenges and Opportunities for the Future

Fonterra had been able to overcome most of the challenges resulting from the merger of the three companies. It had been able to operate without disruption to milk collection, processing, or international sales. It had achieved more economic benefits than it had promised its shareholders. It had created key global partnerships that established Fonterra as an industry leader. Fonterra's underlying results were strong despite the fall in commodity prices and the rise in the New Zealand dollar. In 2002, shareholders received a record payout for their milk, and Fonterra processed 6% more milk solids than the previous season.

Despite these initial successes, Norgate was well aware of the economic pressures facing farmers and their cooperatives all over the world. These pressures were partly the result of changes in governments' price-support policies, trade policies, and product-standard policies. Also, these economic changes were the reflection of evolving consumer needs in different parts of the world. Being efficient and global and constructing effective partnerships were only part of his strategy. He had to find a way to develop new market niches and nutraceutical values in Fonterra's products and a way to always be one step ahead of the competition. Historically, successful cooperatives had stumbled after years of great success. He wanted to avoid that pitfall and position Fonterra to remain as the leader in the global dairy industry. These were the issues that he wanted to discuss with his leadership team.

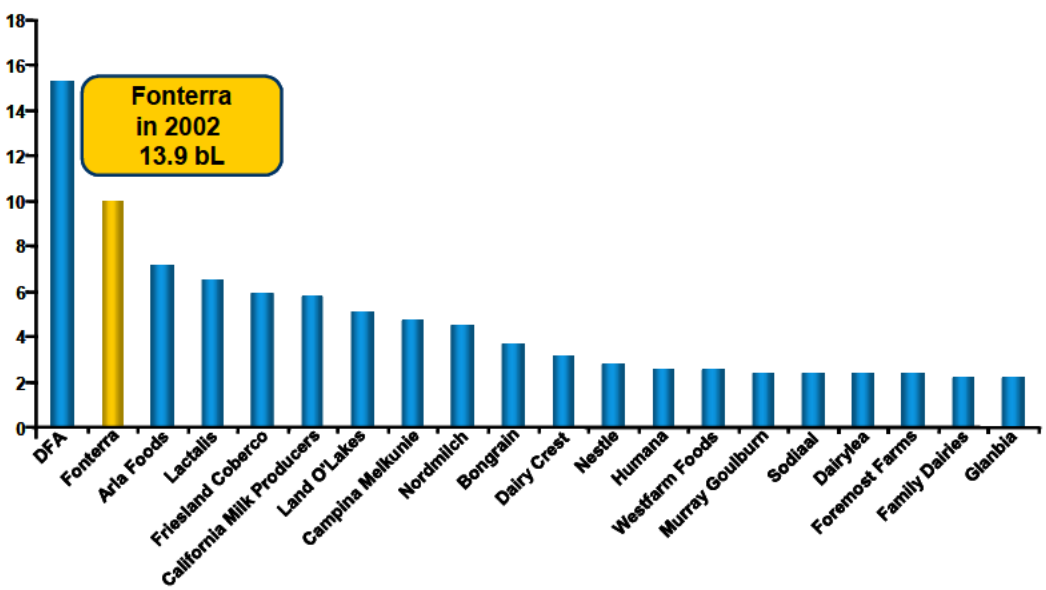
[8] Ph ppa Stevenson, "Dea He ps War on Poverty," *Weekend Herald*, p C4

Exhibit 1 Top Dairy Companies by Sales (US$ billion)



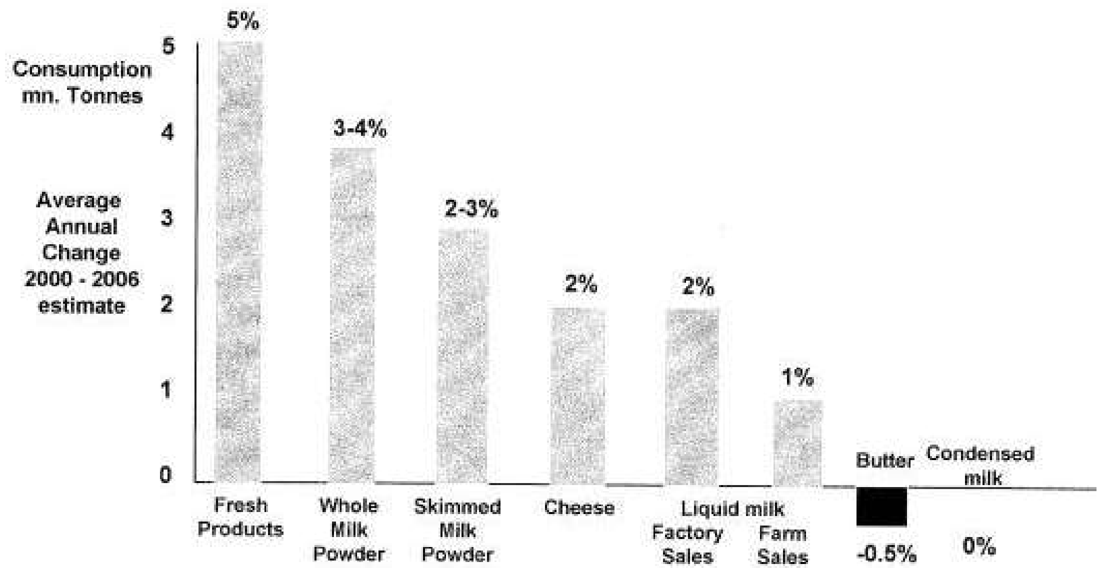
Source Fonterra

Exhibit 2 Top Dairy Companies by Volume (billion liters)



Source Fonterra est mate

Exhibit 3 Demand Growth by Product Group



Source Rabobank Internat ona , 2001

Exhibit 4 Demand Growth by Region

	Consumption 1999[a]	Average Annual Change 1997 1999	Average Annual Change 2000 2006 est.	Population Annual Growth Rate
World	556	0.6%	2%	1.1%
High Income Regions:	217	1.2%	1%	0.3%
Western Europe	118	0.8%	1%	-0.1%
USA + Canada	81	1.8%	1%	0.7%
Japan	11	0.5%	1%	-0.1%
Austra a + New Zea and	7	0.7%	0.5%–1%	0.7%
Low and Middle Income	314	0.5%	2%	1.2%
Centra Europe	36	-0.8%	1%	-0.2%
Russ a + Ukra ne	66	-2.8%	1%	-0.5%
South As a	99	4.3%	2%–3%	1.5%
Lat n Amer ca	66	2.4%	4%	1.3%
M dd e East + North Afr ca	29	1.5%	2%–3%	1.8%
Sub-Saharan Afr ca	18	1.0%	1%	2.2%

Source "Wor d Da ry Trade F ows Sh fts n Products and Reg ons," Rabobank Internat ona , March 2001, p 8

[a]M on tons of m k equ va ents

Exhibit 5 International Dairy Trade

Producers[a]

Country	Production[a]	Per Capita[b]
Ind a	81,790	81
U.S.	76,294	269
Russ an Fed.	31,895	219
Germany	28,442	346
Pak stan	26,284	186
France	25,628	432
Braz	22,275	130
U.K.	14,489	242
Ita y	12,889	224
Ukra ne	12,657	255
New Zea and	12,235	3,238
Ch na	12,173	9
Total World	***577,836***	***95***

Consumers

Country	Consumption[a]	Per Capita[b]
Ind a	81,708	81
U.S.	79,910	282
Russ an Fed.	32,053	220
Pak stan	26,373	187
Germany	24,041	293
Braz	23,615	139
France	21,291	359
Ita y	15,742	274
U.K.	15,165	254
Ch na	12,173	9
Ukra ne	11,956	241
Mex co	11,506	116
Total World	***577,836***	***95***

Exporters

Country	Exports[a]	Per Capita[b]
New Zea and	11,397	3,016
Germany	8,855	108
France	7,387	125
Nether ands	6,906	435
Austra a	6,486	339
Denmark	3,042	572
Ire and	2,599	684
U.K.	1,998	34
U.S.	1,984	7
Po and	1,159	39
Ita y	1,439	25
Argent na	1,262	34
Total World	***68,028***	***11***

Importers

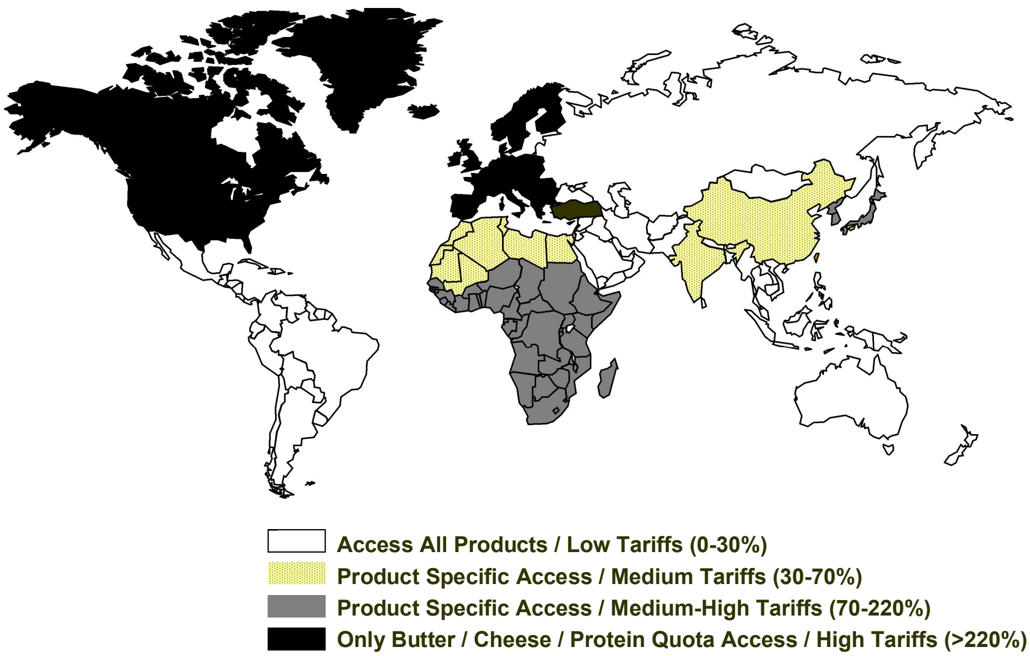
Country	Imports[a]	Per Capita[b]
U.S.	6,215	22
Nether ands	4,972	313
Germany	4,944	60
Ita y	4,764	83
France	3,385	57
Japan	3,230	25
U.K.	2,968	50
Mex co	2,416	24
A ger a	2,164	71
Ph pp nes	2,026	27
Spa n	1,564	39
Braz	1,522	9
Total World	***68,028***	***11***

Source Adapted from Food and Agr cu ture Organ zat on of the Un ted Nat ons

[a]Tons of m k equ va ent products

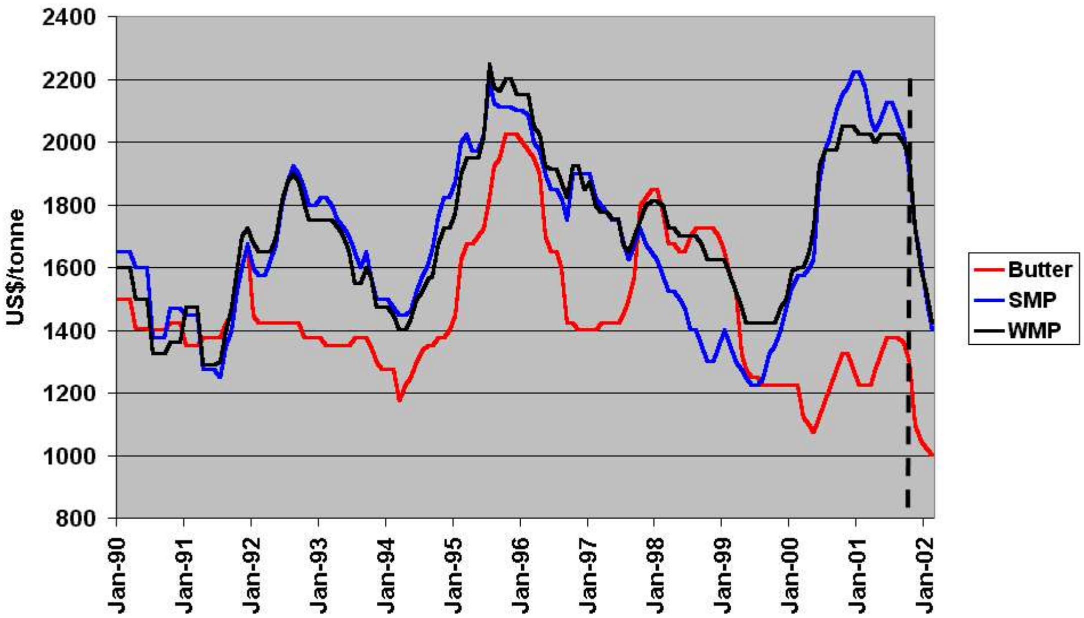
[b]K ograms of m k equ va ent products

Exhibit 6 Regulation of Dairy Trade



Source Fonterra

Exhibit 7 Comodity Prices



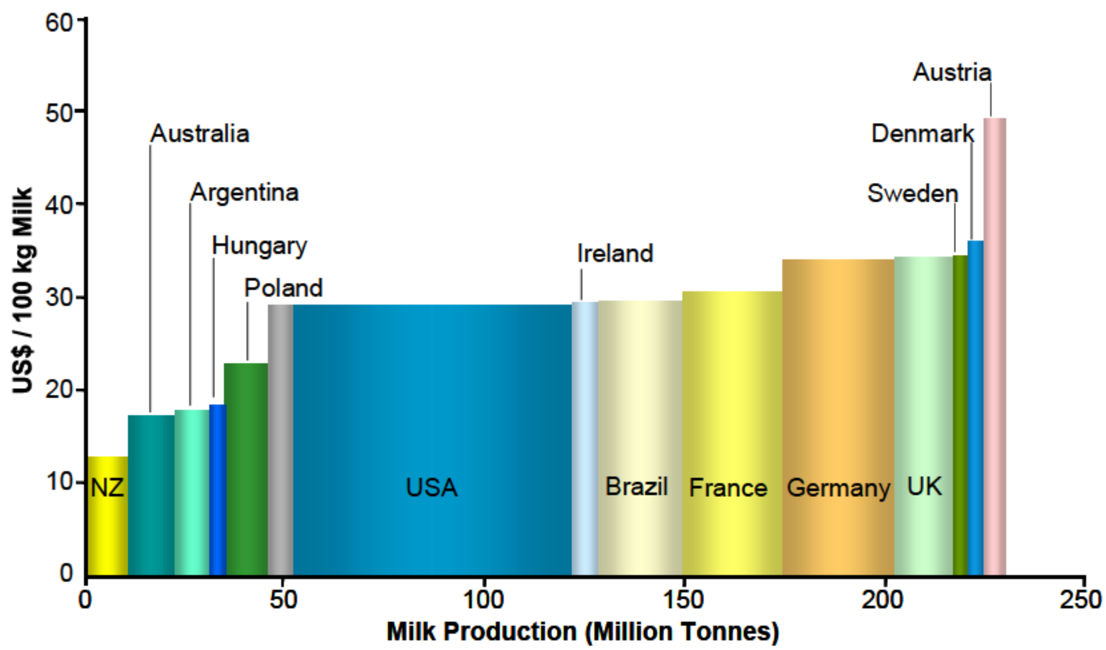
Source Fonterra

Exhibit 8 Mergers, Acquisitions, and Alliances in the Dairy Industry (January 1998–September 2002)

	Total	Cooperatives
Number of Mergers, Acqu s t ons, and A ance Dea s	641	218
Domest c	56%	66%
Reg ona	23%	23%
Cross Cont nenta	21%	11%

Source Adr e Zwanenberg, "Internat ona zat on Consequences for Cooperat ves and non Cooperat ves," Rabobank Internat ona , September 25, 2002

Exhibit 9 Global Dairy Industry Cost Curve



Source Fonterra

Exhibit 10 Letter to Shareholders

13 June 2001

Dear Shareholders:

On Monday, you, the shareholders of our two biggest dairy co-ops, will make the most important commercial decision in New Zealand's history.

It has taken us several years to get to this point, with everyone in the industry involved in the debate about our future. The New Zealand Dairy Group, Kiwi Co-operative Dairies and the New Zealand Dairy Board are all fully supportive of the merger proposal. Both the Government and the Opposition say they will support the necessary legislation. It is unlikely we will ever have this unique line up of support again.

Everyone in the industry agrees the status quo has to be changed, and change can only be through commercial negotiations between the two co-ops. Dairy Board CEO Warren Larsen says the negotiated merger is "essential" if the industry's strategic plan is to be achieved.

The key benefits of the merger:

- It maintains the unity of our industry to ensure we have the necessary scale to compete on world markets against rapidly-growing competitors
- It keeps the assets of the New Zealand Dairy Board in one piece, and stops us from being forced to compete with one another overseas
- It maintains co-operative principles so that the returns from our efforts are delivered to the farm gate
- It integrates our manufacturing and marketing arms, allowing us to operate more strategically on world markets and eliminating the costs of unnecessary duplication
- It will give our industry the sense of direction we need to build on the successes of the last 50 years and be benchmarked against the world's best dairy companies

To ensure the merger happens, your vote counts. If you don't vote, you will not have a say in the future of the industry. From Monday 18 June, it will be 14,000 New Zealand dairy farmers - shareholders in one co-op - taking on the world and winning.

Yours sincerely

John Roadley Chairman New Zealand Dairy Board	Henry van der Heyden Chairman New Zealand Dairy Group	Greg Gent Chairman Kiwi Co-operative Dairies

Source: Fonterra.

Exhibit 11 Fonterra Financial Statements (US$ million)

Income Statement	**For the Year Ended 31 May 2002**
Operating Revenue	**6,568**
Operat ng Expenses	3,767
Tota Payout to Supp ers	2,805
Operating Deficit before Taxes	**(4)**
Taxes	10
Net Deficit	**(14)**

Balance Sheet	**For the Year Ended 31 May 2002**
Cash ba ances	50
Rece vab es and prepayments	890
Inventor es	1,676
Taxat on rece vab es	22
Other current assets	83
Total current assets	**2,722**
Property, p ant and equ pment	1,877
Investments	180
Intang b es	748
Other noncurrent assets	37
Total noncurrent assets	**2,843**
Total assets	**5,566**
Bank overdrafts	33
Ow ng to supp ers	478
Payab es and accrua s	438
Prov s ons	27
Current borrow ngs	1,393
Taxat on payab e	12
Other current ab t es	57
Total current liabilities	**2,441**
Prov s ons	46
Term borrow ngs	755
Deferred taxat on	112
Cap ta notes	94
Total noncurrent liabilities	**1,008**
Total liabilities	**3,450**
Equity	**2,115**
Number of shares (m on)	1,110

Source Fonterra

Exhibit 11 (continued) Fonterra Financial Statements (NZ$ million, years ended 31 May)

	1997	1998	1999	2000	2001
New Zealand Dairy Group					
Revenue	2,346	2,576	2,451	3,427	4,578
Operat ng Surp us	1,366	1,471	1,393	2,157	3,150
Payout to Supp ers	1,356	1,471	1,401	2,139	3,139
Net Surp us	10	0	(8)	1	10
Tota Assets	1,313	1,492	1,650	2,590	3,418
Tota L ab t es	546	618	775	1,121	1,676
Tota Equ ty	767	874	875	1,469	1,742
Kiwi Cooperative Dairies					
Revenue	1,410	1,543	1,756	2,587	3,866
Operat ng Surp us	858	868	887	1,449	2,127
Payout to Supp ers	841	868	896	1,442	2,106
Net Surp us	17	(3)	(14)	1	3
Tota Assets	1,289	1,535	1,631	2,067	3,213
Tota L ab t es	645	855	887	1,012	1,885
Tota Equ ty	644	680	744	1,055	1,328
New Zealand Dairy Board					
Revenue	6,129	7,677	7,421	7,651	9,992
Operat ng Surp us	34	49	49	53	399
Net Surp us	2	8	5	8	242
Tota Assets	3,719	4,200	3,649	4,346	5,756
Tota L ab t es	2,235	2,601	2,164	2,667	3,659
Tota Equ ty	1,484	1,599	1,485	1,679	2,097

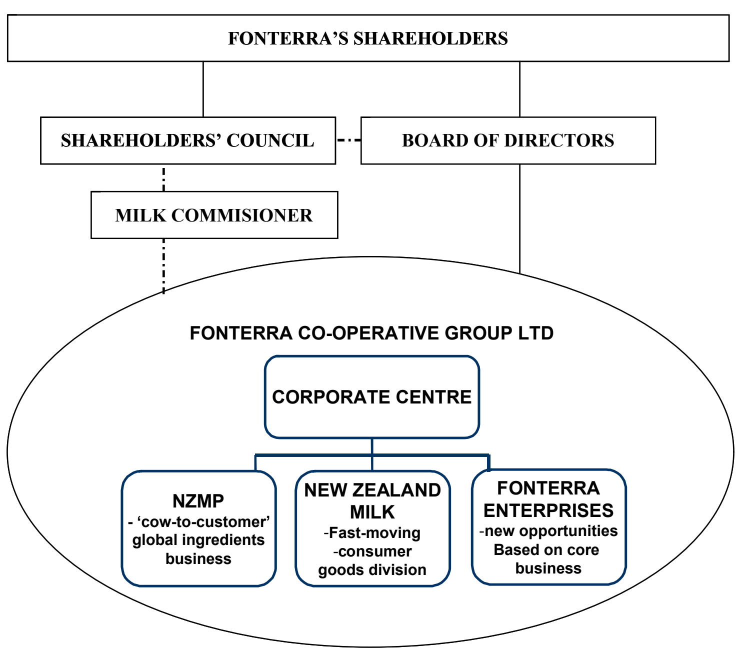
Source Fonterra

Exhibit 12 Performance Summary of Fonterra's Divisions

NZMP		New Zealand Milk	
Revenue[a]	3,663	Revenue[a]	2,634
EBIT[a]	142	EBIT[a]	142
Tota Assets Emp oyed[a]	3,424	Tota Assets Emp oyed[a]	1,701
Tota Permanent Emp oyees	6,894	Tota Permanent Emp oyees	12,583
Tota Vo ume Sa es[b]	1,532		
Tota New Zea and M k Processed[b]	1,080		
Or g n of Revenue		Or g n of Revenue	
Amer cas	35%	Amer cas	32%
As a	34%	As a	21%
Austra a/New Zea and	7%	Austra a/New Zea and	33%
Rest of Wor d	24%	Rest of Wor d	14%

Source Fonterra
[a]US$ m on
[b]M on k ograms

Exhibit 13 Fonterra's Structure



Source Fonterra

Exhibit 14 New Economics

Measure	2001/2002 NZ$ per Kg of Milk Solids
Commodity Milk Price (CMP)[a]	**5.45**
Var ance between CMP and AMR	(0 39)
Actual Milk Return (AMR)[b]	**5.06**
Return from va ue-added act v t es	0 53
Fore gn exchange hedg ng	(0 19)
Merger account ng adjustments	(0 12)
Payments from Reserves	0 05
Final Payout	**5.33**
ndustry Good Act v t es	(0 03)
Actual Payout[c]	**5.30**
Fair Value Share[d]	**3.85**

Source Fonterra

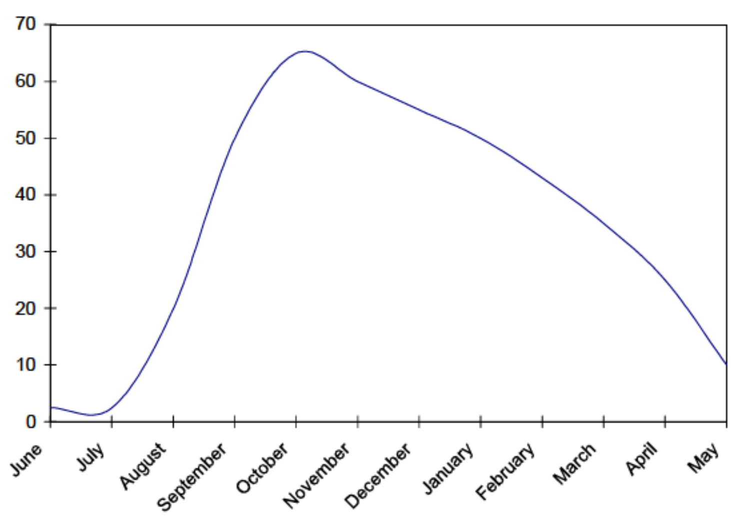
[a]CMP s the h ghest theoret ca pr ce that an eff c ent compet tor cou d afford to pay for New Zea and's m k wh e mak ng an adequate return on cap ta Standard & Poor's est mates th s f gure

[b]AMR s the actua commod ty pr ce Fonterra ach eves w thout account ng for ts va ue added act v t es and ts hedg ng act v t es

[c]Actua payout s what Fonterra's supp ers rece ve for each k ogram of m k so ds they supp y

[d]Fa r va ue share s determ ned by the board of d rectors based on Standard & Poor's assessment of the under y ng va ue of the bus ness and the company ownersh p structure

Exhibit 15 Seasonality of Milk Deliveries to Fonterra (volume, millions of liters)



Source Fonterra

Appendix 2

(Michael) Craig Norgate

A highly experienced CEO with large company international leadership experience across rural, commodity and branded businesses. Chartered Accounting-trained with fifteen years Managing Director-level experience. Led the largest integration in New Zealand corporate history as inaugural CEO of New Zealand's largest company, Fonterra. Significant and varied Board level experience as NED & Chair. Strong finance background as a leader in the New Zealand accounting profession.

EDUCATION & AFFILIATIONS

Educational Qualifications
Bachelor of Business Studies Massey University: Accounting and Finance
Year 1 - Accounting Prize
Year 2 - Corporate Finance Prize

International Executive Education
International Executive Program: Insead 1995
Enhancing Corporate Creativity: Harvard 1996
AVIRA Leadership Programme: Insead 1997

Professional Affiliations
NZ Institute of Chartered Accountants: Fellow
NZ Institute of Directors: Accredited
NZ Institute of Management: Fellow

Non-Executive Directorships

Whey Products NZ Ltd	1994 - 1996
Mainland Products Ltd	1996 - 2001
Otago Cheese Ltd	1997 - 1998
New Zealand Dairy Board	1998 - 2001
Peters & Brownes Foods Ltd	2000 - 2001
NZ Rugby Football Union	2000 - 2002
NZ-US Council (Inaugural President)	2002 - 2004
Growth & Innovation Advisory Board	2002 - 2008
Foundation for Research, Science & Technology	2004 - 2007
DairyNZ	2006 - 2008
Wrightson Ltd	2003 - 2005
PGG Wrightson	2005 - 2010
PGG Wrightson (as Chairman)	2007 - 2009
New Zealand Farming Systems Uruguay Ltd	2006 - 2010
Wool Partners International Ltd	2008 - 2011
Aotearoa Fisheries Ltd	2004 - 2011
Sealord Group Ltd	2005 - 2012
New Zealand Institute for Chartered Accountants	2009 - 2012
Taranaki Rugby Football Union	2004 - 2013
Port Taranaki Ltd	2004 - ongoing

Significant Awards

NZ Young Chartered Accountant of the Year	1994
NZ Herald Business Person of the Year	2005
World Class New Zealander	2008

PROFESSIONAL EXPERIENCE

New Zealand Institute of Chartered Accountants 2012 – Current

Chief Executive

NZICA represents 33000 Chartered Accountants in New Zealand and around the world. Having stepped down from the board in November 2012 I was asked to step in as CEO when the incumbent left a few weeks later. NZICA is in the late stage of a merger process with their Australian counterpart (ICAA) to create a New Institute with 90000 members and a vision 'to be the trusted leaders in business and finance'. I have been tasked with giving leadership to the process, given its complexities, and to NZICA given the significant change involved.

MCN Rural Investments Ltd 2003 – 2012

Principal

MCN Rural is the company through which I undertook my consulting activities and was the holding company for my interest in Rural Portfolio Investments.

Rural Portfolio Investments (RPI) Limited 2003 – 2010

Managing Director

RPI was a private investment vehicle based in New Zealand. Executive leadership of the company's investment in Wrightson Limited, which then became PGG Wrightson Limited –New Zealand's largest provider of rural services and the Southern Hemisphere's largest supplier of forage seed (www.pggwrightson.co.nz)

Key Achievements

- Led successful hostile takeover of Wrightson in 2004
- Led subsequent takeover of Williams & Kettle (third largest player) in 2004 and merger with Pyne Gould Guinness (second largest player) in 2005
- Created PGG Wrightson, New Zealand's largest agricultural servicing company with revenue of $1.3 billion and 2,500 employees spanning rural services, financial services and technology
- Launched New Zealand Farming Systems Uruguay (www.nzfsu.co.nz) in 2006 raising $120 million with a further raising of $160 million in 2007. At the time of being taken over by Olam in 2010 NZFSU was milking 20,000 cows on 33,500 hectares in Uruguay and is today one of the two largest dairy farmers in the world.

Fonterra Co-operative Group Auckland 2001 – 2003

Chief Executive Officer

First CEO of Fonterra which was a new organisation formed from the merger of three of New Zealand's largest companies, with revenues $13.9 billion in 2002. Fonterra had over 20000 staff in 72 countries & represented 25% of the country's exports and 7% of its GDP. Among other things it required an Act of Parliament to facilitate its creation.

Key Achievements

- Drove the processes leading to the creation of Fonterra
- Over-delivered on the promised cost savings ($300m+)
- Created a new aligned culture for the organisation from three significant sized organisations
- Led significant strategic progress in Europe, Asia and North and Latin America including the formation of Dairy Partners of America – a joint venture with Nestlé

Kiwi Co-operative Dairies Limited Hawera/Auckland 1991 – 2001

Chief Executive Officer 1996-2001
General Manager Administration 1991-1995

Joined Kiwi as General Manager Administration to provide commercial and financial leadership to the company. Became Chief Executive Officer in January 1996 with the retirement of the other General Manager.

Key Achievements
- Led the Company through a period of continuous and rapid growth from turnover of $285 million in 1991 to $4.5 billion in 2001
- Changed the culture from a production driven farmer focused and political organisation to a strategy and customer driven organisation focusing on people as the key to its competitive advantage
- Repositioned the company from a low cost undifferentiated commodity producer to a diversified consumer foods and Ingredients Company
- Implemented organisation structure and performance management disciplines that produced superior results
- Three major mergers with companies approximately half our size: Moa-Nui (1992), Tui (1996), Northland (1999), each with increasing levels of integration success
- 13 other mergers and acquisitions through this period including the first North Island/South Island merger and the first major Australian acquisition by the industry
- Development of Mainland into one of Australasia's second largest consumer foods businesses ($2.4 billion revenue)
- At the forefront of driving the change in the New Zealand dairy industry

Lactose New Zealand Hawera 1988-1991

Commercial Manager 1988-1991
Head Office Accountant 1988

Key Achievements
- First CFO and senior management role
- Led implementation of new IT system
- Led development of foreign currency hedging policy
- Process re-engineering to bring month end accounting from 4 weeks down to 2 days and year end down to 10 days
- Role included Company secretarial responsibilities

Lowe Walker New Zealand Ltd – Hawera 1987 – 1988

Company Accountant

Key Achievements
- Senior finance executive for a period of six months including October 1987
- Development of foreign currency hedging policy
- Oversaw liquidity management through rapid period of expansion
- Led change management initiative with closure of Hawera and relocation of head office
- Gained initial exposure to international marketing

Department of Maori Affairs 1983 – 1987

District Accountant – Hastings (1986-1987)
Accounting Bursar – Wanganui (1983-1986)

Key Achievements
- First senior management and leadership role
- Oversaw implementation of new Goods & Services Tax on a national basis
- Led investigation into Hauhungaroa 2C Incorporation which resulted in the administration of the Incorporation being vested in the Maori Trustee by the Maori Land Court

PERSONAL DETAILS

Date of Birth: 14 April 1965
Marital Status: Married, with three independent children (ages 24, 22, 19)
Email: craig.norgate@gmail.com
Telephone +6421445751

Appendix 3

HERBERT
SMITH
FREEHILLS

Craig Norgate
craig.norgate@gmail.com

20 November 2013
Matter 82230139
By Email

Dear Mr Norgate

Confidential

Murray Goulburn - merger authorisation application - expert retainer

1 Introduction

We act for Murray Goulburn Cooperative Co. Ltd (**Murray Goulburn**).

This letter is to confirm your retainer to act as an independent expert in relation to Murray Goulburn's merger authorisation application in respect of its proposed acquisition of Warrnambool Cheese & Butter Factory Company Holdings Limited (the **Proceedings**) and to set out the terms of your retainer.

Murray Goulburn will be responsible for payment of your fees, although your accounts are to be addressed to our office as referred to below.

In addition to the terms set out below, your retainer is governed by the Federal Court Practice Direction — 'Guidelines for Expert Witnesses in Proceedings in the Federal Court of Australia'. A copy of the Guidelines is attached as **Attachment 1** to this letter. You should fulfil the duties and responsibilities set out in the Guidelines in undertaking your work and preparing for the presentation of evidence that you may ultimately be required to give in the Australian Competition Tribunal (the **Tribunal**).

2 Scope of your assignment

Murray Goulburn has made a bid to acquire all of the shares of Warrnambool Cheese & Butter Factory Company Holdings Limited, and is intending to make an application to the Tribunal for merger authorisation in respect of its proposed acquisition.

We would like you to prepare a report in which you address matters based on your expertise of the dairy industry. For your assistance, we include a short guide to preparation of an expert report as **Attachment 2** to this letter.

Attachment 3 is a list of questions that we would like you to address in your report. Please let us know if there are any further documents or materials which you think should form part of your brief.

From time to time you may also be required to respond to further evidence or expert opinions if and when received from other parties.

You may need to be available to give evidence in the Tribunal, most likely to be in Melbourne at some time during the course of the Proceedings.

We may also ask that you be available at other times when experts retained by the other parties to the Proceedings are giving evidence.

3 Confidentiality

Your independent expert report and any drafts prepared in accordance with your retainer are confidential and are not to be copied or used for any purpose unrelated to the Proceedings without our permission.

Material supplied to you by Herbert Smith Freehills is confidential and is not to be copied or used for any purpose unrelated to your retainer without our permission.

You may be requested to execute a confidentiality undertaking. You may be required to return all documents, copies and workings at the conclusion or termination of your retainer.

4 Conflicts of interest

As an independent expert, it is important that you are free from any possible conflict of interest in the provision of your advice. You should ensure that you have no connection with any party to the Proceedings which would preclude you from providing your opinion in an objective and independent manner.

We have enclosed as **Attachment 3** to this letter a list of the parties in the Proceedings.

5 Fee estimate

Please provide us with details of your rates.

Expenses such as taxis, parking, couriers, printing etc are to be billed at cost.

You should present your memoranda of fees on a monthly basis. This will assist us to deliver an overall memorandum to Murray Goulburn.

From time to time, should you become aware that your fee estimate is likely to alter in a material way, you must notify Herbert Smith Freehills immediately of the likely change and obtain approval for any material increase.

As mentioned above, it is Herbert Smith Freehills' client which is responsible for paying your fees.

6 Communications

All communications, whether verbal or written, should be directed to our office, so that we can coordinate, manage and integrate work activities with legal requirements and ensure privilege is maintained as appropriate.

7 Your duties and responsibilities as an expert witness

Your role is that of an independent expert.

You are not an advocate for any party.

Though you are retained by Murray Goulburn, you are retained as an independent expert to assist the court and you have an overriding duty to it. The court expects you to be objective, professional and to form an independent view as to the matters in respect of which your opinion is sought.

Your duties are set out in the Guidelines at Attachment 1 to this letter.

Would you please sign and return this letter to confirm your agreement to the terms of the retainer.

HERBERT SMITH FREEHILLS

7 Your duties and responsibilities as an expert witness

Yours sincerely

Chris Jose
Partner
Herbert Smith Freehills

+61 3 9288 1416
+61 411 514 487
chris.jose@hsf.com

Alan Mitchell
Partner
Herbert Smith Freehills

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+61 409 003 519
alan.mitchell@hsf.com

sign here ► ______________________________
Craig Norgate

HERBERT SMITH FREEHILLS

Attachment 1

Practice Note CM7 — Expert witnesses in proceedings in the Federal Court of Australia

Commencement

1. This Practice Note commences on 4 June 2013.

Introduction

2. Rule 23.12 of the Federal Court Rules 2011 requires a party to give a copy of the following guidelines to any witness they propose to retain for the purpose of preparing a report or giving evidence in a proceeding as to an opinion held by the witness that is wholly or substantially based on the specialised knowledge of the witness (see **Part 3.3 - Opinion** of the *Evidence Act 1995* (Cth)).

3. The guidelines are not intended to address all aspects of an expert witness's duties, but are intended to facilitate the admission of opinion evidence[1], and to assist experts to understand in general terms what the Court expects of them. Additionally, it is hoped that the guidelines will assist individual expert witnesses to avoid the criticism that is sometimes made (whether rightly or wrongly) that expert witnesses lack objectivity, or have coloured their evidence in favour of the party calling them.

Guidelines

1. General Duty to the Court[2]

1.1 An expert witness has an overriding duty to assist the Court on matters relevant to the expert's area of expertise.

1.2 An expert witness is not an advocate for a party even when giving testimony that is necessarily evaluative rather than inferential.

1.3 An expert witness's paramount duty is to the Court and not to the person retaining the expert.

2. The Form of the Expert's Report[3]

2.1 An expert's written report must comply with Rule 23.13 and therefore must

(a) be signed by the expert who prepared the report; and

(b) contain an acknowledgement at the beginning of the report that the expert has read, understood and complied with the Practice Note; and

(c) contain particulars of the training, study or experience by which the expert has acquired specialised knowledge; and

(d) identify the questions that the expert was asked to address; and

(e) set out separately each of the factual findings or assumptions on which the expert's opinion is based; and

[1] As to the distinction between expert opinion evidence and expert assistance see *Evans Deakin Pty Ltd v Sebel Furniture Ltd* [2003] FCA 171 per Allsop J at [676].

[2] The "*Ikarian Reefer*" (1993) 20 FSR 563 at 565-566.

[3] Rule 23.13.

(f) set out separately from the factual findings or assumptions each of the expert's opinions; and

(g) set out the reasons for each of the expert's opinions; and

(ga) contain an acknowledgment that the expert's opinions are based wholly or substantially on the specialised knowledge mentioned in paragraph (c) above[4]; and

(h) comply with the Practice Note.

2.2 At the end of the report the expert should declare that "[the expert] has *made all the inquiries that* [the expert] *believes are desirable and appropriate and that no matters of significance that* [the expert] *regards as relevant have, to* [the expert's] *knowledge, been withheld from the Court.*"

2.3 There should be included in or attached to the report the documents and other materials that the expert has been instructed to consider.

2.4 If, after exchange of reports or at any other stage, an expert witness changes the expert's opinion, having read another expert's report or for any other reason, the change should be communicated as soon as practicable (through the party's lawyers) to each party to whom the expert witness's report has been provided and, when appropriate, to the Court[5].

2.5 If an expert's opinion is not fully researched because the expert considers that insufficient data are available, or for any other reason, this must be stated with an indication that the opinion is no more than a provisional one. Where an expert witness who has prepared a report believes that it may be incomplete or inaccurate without some qualification, that qualification must be stated in the report.

2.6 The expert should make it clear if a particular question or issue falls outside the relevant field of expertise.

2.7 Where an expert's report refers to photographs, plans, calculations, analyses, measurements, survey reports or other extrinsic matter, these must be provided to the opposite party at the same time as the exchange of reports[6].

3. Experts' Conference

3.1 If experts retained by the parties meet at the direction of the Court, it would be improper for an expert to be given, or to accept, instructions not to reach agreement. If, at a meeting directed by the Court, the experts cannot reach agreement about matters of expert opinion, they should specify their reasons for being unable to do so.

J L B ALLSOP
Chief Justice
4 June 2013

[4] See also *Dasreef Pty Limited v Nawaf Hawchar* [2011] HCA 21.

[5] The *"Ikarian Reefer"* [1993] 20 FSR 563 at 565

[6] The *"Ikarian Reefer"* [1993] 20 FSR 563 at 565-566. See also Ormrod *"Scientific Evidence in Court"* [1968] Crim LR 240

HERBERT
SMITH
FREEHILLS

Attachment 2

Preparation of your expert report

1 Introduction

Your introduction should contain the following information:

(a) A summary of your qualifications and experience (or reference to the appropriate paragraph in a statement you have previously filed in the Proceedings).

(b) The scope of your assignment, including:

(1) the questions you have been asked;

(2) the assumptions (if any) you have been asked to make; and

(3) reference to the appendices or attachments in which these are set out.

(c) A list of people who have assisted you in the preparation of your report, including their qualifications and the roles they played.

(d) Reference to the appendices or attachments setting out the lists of documents you have relied on, and been supplied with.

(e) An acknowledgment of having read the Guidelines for Expert Witnesses (and having agreed to abide by it) and a reference to the appendix or Attachment in which it can be found.

(f) Each paragraph of the report should be numbered, the pages should be numbered and the report should be in double spacing.

2 Summary of opinions

In the case of reports where a number of opinions have been expressed, a summary of your opinions should appear between the introduction and body of the report.

3 Appendices or attachments

As a minimum, your report must have the following appendices or attachments:

(a) Your curriculum vitae (if this is the first report you have filed in these proceedings).

(b) The question(s) supplied by Herbert Smith Freehills which you answered in your report.

(c) The assumptions (if any) you were asked to make for the purposes of preparing your report.

(d) A list of documents you have relied upon for the purposes of preparing your report.

(e) A list of documents supplied to you by Herbert Smith Freehills.

(f) A copy of the Guidelines for Expert Witnesses (this will be provided to you by Herbert Smith Freehills).

4 Checking the report

(a) Guideline for Expert Witnesses

Ensure you have read and are familiar with this document.

(b) Paragraph numbering and cross referencing

If you have made multiple drafts of your report it will be necessary to check the paragraph numbering remains sequential and that cross referencing is still accurate.

(c) Footnote

Check footnotes are on the same page as the paragraphs to which they refer

Check every document referred to in a footnote is in the list of documents relied upon in the appendices.

(d) Documents relied upon

Check every document referred to in the report is in the list of documents relied upon in the appendices.

Prepare a copy of every document relied upon in your report for sending to Herbert Smith Freehills when your report is filed. In the case of journal articles, internet printouts, media reports, statistics etc, copies of the entire document are required. In the case of text books or other large publications, a copy of the front cover, title page, page showing publication details including edition and year of publication, and entirety of any chapter containing material referred to are required.

(e) Signing off on your report

When your report is fully completed you must ensure that the last page of the body of the report (ie before any appendices, exhibits or attachments) is signed and dated. There is no requirement that the signature be witnessed.

(f) Statement and exhibit

Your statement (not including any exhibits) should be 3 pages long. The first 2 pages are the cover page listing the Proceedings and the parties. The formal parts of the statement will be provided by Herbert Smith Freehills.

The first column of the first page sets out the name of the signatory of the statement between 2 horizontal lines. The date must be typed in where indicated on the cover page provided by Herbert Smith Freehills.

The third page contains the text of the statement. You must ensure that this page is signed and dated by you as the author of the report. At the time you sign the statement you must have a copy of the exhibit (your report) in front of you, as you are signing the statement to this effect.

Your report should be exhibited to the statement. This requires that the report be placed behind an Exhibit Note, which will also be provided by Herbert Smith Freehills. The first 2 pages of the Exhibit Note are, as for the statement, cover pages. You do not need to do anything to these pages. The third page exhibits your report to the statement.

Before signing this page you must type in the date of making your statement. You must then sign this page, making sure you have your report in front of you at the time.

At this point you should have signed and dated 3 documents: the report itself, the exhibit note and the statement.

Attachment 3- List of Questions

Fonterra

1 Describe the structure of the New Zealand dairy industry prior to the creation of Fonterra. In answering this question, have regard to matters including the following:

- The volume of production of the NZ dairy industry up to the creation of Fonterra, how it was comprised and what constraints on efficiencies were there.
- The market share of New Zealand produced dairy products in the total global dairy trade.
- the structure of the industry and ownership constituencies.
- The marketing of dairy products internationally, including the success or otherwise of such ventures.
- The rural earnings of farmers.

2 Describe your role in the lead-up to and following the creation of Fonterra.

3 What objectives of New Zealand dairy industry policy underpinned the creation of Fonterra?

4 Have those objectives been met? In answering that question, please have regard to matters including the following:

- The growth in production of dairy product, and the causes of this.
- Any increases or decreases in market share of New Zealand dairy product in the total global dairy trade.
- Any efficiency gains realised as a result of consolidation of the New Zealand dairy industry.
- Any capital growth or losses of farmers following the creation of Fonterra.
- The extent to which, if at all, the cooperative structure of Fonterra contributed to the success or otherwise of Fonterra.
- Any return on capital to farmers by way of dividend or milk price.
- The ability of New Zealand farmers to obtain lending finance to develop and intensify their farming and productivity.
- Any increase in the use of agricultural land devoted to dairy production.
- Any increase to the volume of raw milk produced
- The enrichment or otherwise of rural communities consequent upon the creation of Fonterra, including any increase in employment, support industries, or any collateral effect on rural commerce and social harmony.

- What social benefits, if any, flowed as a result of the creation of Fonterra.
- Any generational change in the make-up of farmers and farm labourers in the New Zealand dairy industry.
- Any effect on competition in the domestic market within New Zealand.
- Investment in research and development initiatives and the development of new dairy products or manufacturing processes.
- The ability to set or influence the price of dairy products traded globally.
- Any increased tax revenue received by the New Zealand government from the New Zealand dairy industry.
- Were any segments of the New Zealand community better off as a result of the advent of Fonterra, and conversely were there any segments worse off?
- How quickly did the benefits, if any, that were realised by the consolidation of the New Zealand dairy industry into Fonterra, flow? Were the benefits that flowed through to New Zealand dairy industry participants broadly dispersed or did they accrue only to a limited number of stakeholders?

5 To the extent not answered in response to the above questions, what were the principal benefits arising from the creation of Fonterra?

Acquisition of Warrnambool Cheese and Butter (WCB) by a third party

6 To what extent and in what ways might there be parallels between the benefits that were realised as a result of the creation of Fonterra and a merger of WCB and Murray Goulburn?

7 What benefits might flow upon a merger as between WCB and:

(a) Murray Goulburn;

(b) Saputo; and

(c) Bega?

In answering these questions, please have regard to the degree of likelihood of such benefits arising and how quickly they may be realised. In addressing each question please consider matters including: the relative productive capacity of the various entities and their product mix; any synergies that may be available; the growth potential in the global dairy industry for particular products and the suitability of WCB's assets to be deployed to service same; the most likely utilisations of WCB's assets by the potential acquirers; and the ability to increase prices for sale of product produced internationally by WCB.

8 When Australian dairy companies participate in the global dairy market, what are the characteristics of the leading competitors they confront? What makes those entities effective competitors? Does the scale of their operations provide an advantage, including being 'relevant' to international customers?

HERBERT SMITH FREEHILLS

Attachment 4

List of parties to the Proceedings

Murray Goulburn's merger authorisation application in respect of its proposed acquisition of Warrnambool Cheese & Butter Factory Company Holdings Limited.

The applicant in the Proceedings is:

1 Murray Goulburn.

Other interested parties in the Proceedings are likely to be:

2 The Australian Competition and Consumer Commission;

3 Warrnambool Cheese & Butter Factory Company Holdings Limited

4 Bega Cheese Limited

5 Saputo Inc

6 Lion Pty Ltd / Kirin Holdings

7 Fonterra