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HD **Murray Goulburn changes tack**

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When Agriculture Minister Barnaby Joyce came out this week and fired both barrels at the competition watchdog over its treatment of dairy co-operative Murray Goulburn, it reopened the contentious issue of national champions.

It is an issue that has flushed out groups including the Business Council of Australia to come out recently in favour of Australia backing national champions in certain industries, including dairy.

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Murray Goulburn boss Gary Helou put the issue firmly on the map last year when he tried to buy Warrnambool Cheese & Butter but was frustrated by competition concerns from the ACCC. He tried to play the national champion card as an attempt to get round the competition law, but withdrew from the bid due to the time it would have taken in the competition review process.

It has prompted debate about the competition law, with Mr Joyce reiterating this week the need for changes to the competition law to support the creation of national champions.

While the pros and cons of such an approach will be debated in the months to come as the root-and-branch inquiry into competition policy kicks into gear, in respect to dairy, it would seem the horse has already bolted.

Most of the country's key dairy assets have been sewn up, with Canada's Saputo winning the bid for Warrnambool and New Zealand's Fonterra building a blocking stake in Bega Cheese.

For Murray Goulburn, the changing landscape in dairy triggered by the presence of Saputo and Fonterra leaves few options but to rebalance its portfolio and focus on its organic strategy. To this end it has announced it will expand into fresh milk domestically as well as continuing to expand its international business.

In a document released in March, the co-operative estimated its strategy would require capital investments of between $400 million and $500 million over the next three to five years.

Next month it will embark on one of a number of supplier roadshows to discuss its plans to raise up to $500 million. If its farmer investors give the green light, Murray Goulburn will go to the listed equities market early next year and raise the money with external parties.

To enshrine its co-operative structure, the raising will be in the form of a notes issue, to be held by a unit trust listed on the Australian Securities Exchange. The structure will maintain 100 per cent farmer control.

But before it goes to the market with a proposal to attract external investors, it will need to be in a position to convince them that its domestic strategy will not be a drag on earnings and a distraction from success in the international marketplace.

The central platform of its domestic strategy is a private label deal struck with Coles last year. This involved building plants in Victoria and NSW at an initial cost of $120 million.

The cost has blown out by $40 million to $160 million due to various factors including the scope and build and a decision to increase automation.

Against this backdrop, it has missed the start date for the contract with Coles, something which resulted in the supermarket chain being without supply of some private milk, and having to go cap in hand to previous suppliers to fill the gap.

Not surprisingly, it prompted speculation that this miss would come with financial penalties to fill the gap. Mr Helou denies this and downplays it as being a delay in one state over a four-week period. "No penalties attached," he says.

Investors considering investing in Murray Goulburn will want clear optics around the deal with Coles, given the talk at the time it was struck was it had undercut existing suppliers by a rumoured 10¢ a litre. Those contracts were already close to break-even for the existing players. While Murray Goulburn would be able to produce the milk more cheaply given the greenfields automated plants, Mr Helou will need to convince potential investors the blowout in costs hasn't made the contract an albatross around its neck.

For now, Mr Helou says, it is a "simple contract" based on farm gate price plus cost plus a guaranteed return on investment for 10 years. "It was profitable from day one," he says.

Investors will also study the industry implications of the deal, which arguably locks in low-priced milk for up to a decade by adding even further excess capacity to the nation's fresh milk base. An industry estimate is that post-commissioning of Murray Goulburn and Norco's new plants there will be excess capacity in white milk production in Australia of about 1.2 billion litres.

As Murray Goulburn juggles its domestic and international strategies, it will continue to call for free trade agreements. "We desperately need FTAs in place - with China certainly, but also Korea and Japan - so that we can compete on an even playing field with other major global dairy exporters, particularly our New Zealand neighbours, who have had an FTA with China for some time," Mr Helou has said.

He is not alone in that.

CO bucoau : Business Council of Australia | maryglb : Murray Goulburn Co-operative Company Limited

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