



Submission to;

Senate Select Committee

On

Australia's Food Processing Sector

Submitted by McCain Foods Australia/New Zealand, April 12, 2012

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McCain Foods welcomes this opportunity to address important issues with the Senate Select Committee on Food Processing Sector in Australia.

McCain Foods believes that Australia's potato growers are increasingly uncompetitive, and unless major reform is undertaken, the industry will source from countries providing a more cost effective base.

McCain Foods would like to retain its presence in Australia, but can only do so in the longer term if the operations are economically viable. This means that potato prices must be sustainable in the long term.

Moreover, McCain Foods believes that Federal and State Governments both should invest more resources to help growers find more efficient and productive approaches to harvesting potatoes not only in Tasmania, but also in Victoria and South Australia.

Quite clearly, the current modes of farming operations are inefficient and if growers are to compete with imports, more research, business advice and benchmarking against global competitors is required if potato growers are to survive.

Also, globally competitive potato growers in Tasmania, Victoria and South Australia will ensure that food processing has a future in Australia.

Background - McCain Foods Australia/New Zealand

McCain Foods Limited is an international leader in the frozen food industry, employing 20,000 people and operating 50 production facilities on six continents. A privately owned company headquartered in Toronto, Canada, McCain generates annual sales in excess of CDN\$6 billion.

McCain is the world's largest manufacturer of frozen potato specialties, and also produces other food products, including pizza, appetizers, oven meals, juice and desserts. The company's products can be found in thousands of restaurants and supermarket freezers in more than 160 countries around the world. McCain also owns The Day & Ross Transportation Group, which is based in Hartland, New Brunswick and is one of the largest transportation companies in Canada.

The company commenced operations in Australia in 1968 by selling imported French fries.

Within two years, the Company had purchased a small production facility at Daylesford, and began processing locally-grown potatoes into French fries.

To satisfy increasing demand, a brand new production facility was required - one which was capable of at least doubling the capacity of the Daylesford plant. The climatic conditions of

Ballarat were considered ideal for growing quality potatoes, and the district already had a good reputation, so Ballarat became the location of the new plant.

A seven-hectare lot was purchased in Ballarat, and construction of the new plant began in 1974 with operations commencing at the plant in August, 1975.

Through acquisitions and expansions detailed in the timeline, McCain Foods (Australia) Pty Ltd now produces French fries, pizzas, meals and potato specialty products in plants located in Victoria (Ballarat), Tasmania (Smithton) and South Australia (Penola) for both the retail and Foodservice markets.

In both Australia and New Zealand, McCain Foods is a significant player in the retail and food service markets, and is the market leader in several of its categories. McCain Foods has around a 1,200 employees in its operations in Smithton, Tasmania; Ballarat in Victoria; Penola in South Australia; Timaru in the south island, and Hastings in the north island in New Zealand.

1. Introduction – the issues and challenges

With respect to the Terms of Reference, McCain Foods Australia/New Zealand would like to focus particularly on (1) (a) the competitiveness and future viability of Australia's food processing sector in global markets. With respect to section (1) (b) sections (i) to (VI), McCain Foods will make some comments where appropriate.

McCain Foods supports the overall position of the Australian Food and Grocery Council (AFGC) on all other matters referred to in their submission on behalf of the industry addressing the terms of reference 1 (b) and (c).

As a food processor in Australia and New Zealand, McCain Foods has seen Australia's competitive position eroded over the last decade through higher input costs particularly with potatoes and vegetables. A decade ago, Australia was largely import resistant, but this is no longer the case.

Australia now has the highest cost of processing potatoes in the world, and low cost imports are increasing each year, which will affect the livelihoods of all potato growers and processors, such as McCain Foods and Simplot.

In 2004/05, total imports were worth \$20.9 million, and in just four years, they jumped to \$109 million in 2008/09, and continue to rise (Source: Potatoes Australia).

In 2010, 90,000 tonnes of potatoes were imported from Europe, New Zealand and North America. This has blown out to 93,829 tonnes in just six months from July 2011 to January 2012, putting more pressure on prices.

The French fry market is a global market so there is a lot of pressure to compete internationally for customers with lower prices. Australia is not shielded by its distance from the global markets of Europe and North America, and growers need to have similar global perspective as their counterparts in New Zealand, Europe and North America.

Closing of Smithton vegetable plant

McCain closed its Smithton vegetable plant in November 2010 because of a combination of the significant capital investment required to upgrade the plant to global standards, and consistently high raw material costs.

The decision to close the 60 year-old vegetable plant was made on the basis that it could not be economically justified.

McCain Foods has to be commercially viable to compete in a global economy and the decision to relocate to Hastings and invest in plant upgrades was based on New Zealand providing flexible working conditions, lower labour costs, consistently lower raw material costs, and quality clean and green products.

2. Overview

McCain Foods realized that Australia's competitiveness was declining with no respite in 2009. With the drought of 2008-09, potato prices reached an all-time high.

McCain Foods decided to commission Dr. David McKinna, an agricultural economist, to review Australia's competitiveness to other key players in the sector to assess what needed to change. The McKinna study, commissioned in 2010, looked at Australia's competitiveness in the global French fry markets across New Zealand, Canada, Europe and the United States. French Fries are a globally traded commodity.

Ultimately, this study concludes that the cost of processing potatoes in Australia is more expensive than these other markets.

Over time, price per tonne for potatoes in Australia has risen from \$230 in 2005 to \$330 in 2009 (the peak of the drought), to an expected \$310 in 2012.

One of the major demand points for product is the Quick Service Restaurants (QSR) and food service outlets, which purchase 80% of French fries.

McCain, Simplot and Lamb Weston compete aggressively for global QSR contracts and the threat of imports is used to negotiate lower prices. Quick Service Chains are already importing directly.

McCain Foods sources potatoes from four different markets, including New Zealand.

Potato processors cannot ignore global price trends in the French fry market, which has in recent times trended down - not up. Australian growers are getting up to \$AUD 100 a tonne more than their nearest international competitor - well above the market price.

This places greater pressure on processing factories in Smithton in Tasmania, Ballarat in Victoria, and in Penola, South Australia. In response, McCain Foods has implemented efficiency programs, making these plants strong performers in the McCain network.

But what is at stake, if reforms are not undertaken, is the risk of losing hundreds of jobs and destroying local communities in these areas. Most importantly, there will be the loss of \$1.2 billion in direct economic benefits if reform is not progressed quickly. The private sector can only initiate so much, and the rest remains in the hands of the growers, their peak bodies, and State and Federal Governments.

All relevant State and Federal Governments have been briefed on this issue over the past 18 months.

3. Tasmania

McCain's Smithton plant contributes over \$114 million to the local economy, according to the McKinna report. Importantly, the crop value to the 55 local growers is worth \$28 million with over 250 jobs at stake in North West Tasmania. Processed potato output is worth \$76.1 million with over \$54 million in potato production.

Tasmanian grower costs, as an average of all the regions surveyed, is around \$260 per tonne – the highest in the world. It mainly suffers through high land costs (145%), seed costs at (162%), fertilizer (155%), water at (195%), chemicals at (82%) and operations at (114%).

Local growers have shown strong interest in looking at co-operative models to purchase chemicals, fertilizer and seed, and sharing of equipment to find reductions in the cost base.

The State Government at the time of writing has not committed any funds or staff to directly help the growers.

4. Victoria

Victoria's potato processing industry is at extreme risk, says the McKinna report. Ballarat has the highest water costs due to pumping, high land costs, inefficient small farms and high operating costs. Growers do not co-operate to reduce their own costs to find more efficient models.

There are around 40 growers in the Ballarat region with a crop value of \$41 million. Potato production expenditure is around \$225 million.

Victorian grower costs, as an average of all the regions surveyed, is around \$240 a tonne. It also suffers through high land costs – 117%, seed costs at 94%, fertilizer at 115%, water at 321% chemicals at 27% and operations at 91%.

What's at stake is \$253 million in economic flow-on effects to the local economy, and over 1,100 jobs in Ballarat and the region. Processed potato output is \$168.4 million

McCain Foods lobbied to have a working party to be set up to benchmark costs against other grower groups in Australia, and after a year the working party has started to look at the issue, but progress is slow.

To date, the Victorian State Government has committed \$32,000, McCain Foods \$16,000 and Ballarat growers \$16,000 to fund benchmarking studies.

5. South Australia

According to Dr. McKinna, South Australia has the best prospects of any area to survive.

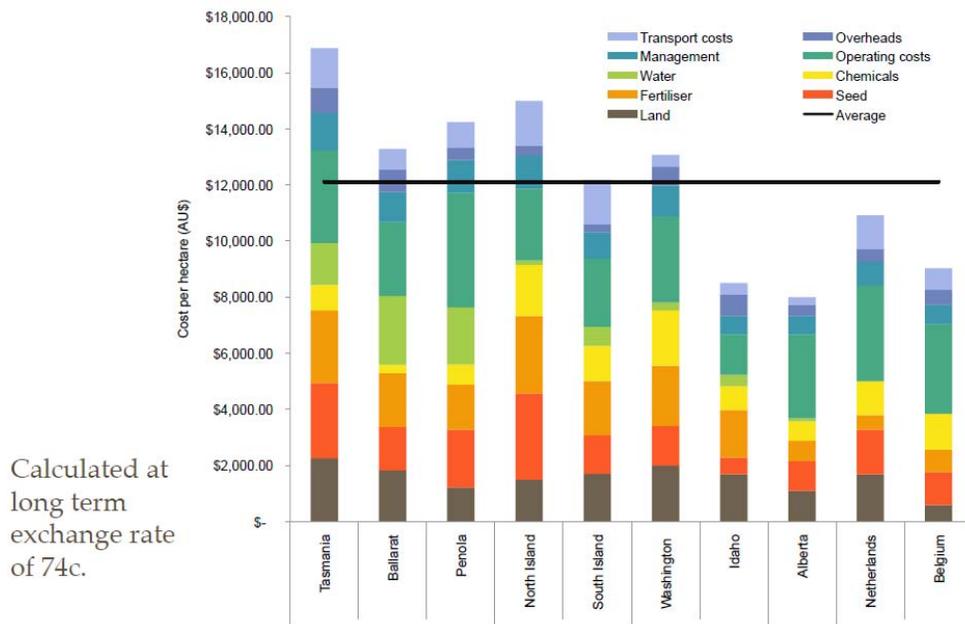
But at this point, South Australia has the highest operating costs, mixture of soil types with heavy stones, second highest water costs, and an inability to install pivot irrigation, which is adding to water costs.

There are around 17 growers in the Penola region with a crop value of \$33 million. Processed potato output is around \$102 million and production expenditure is around \$52 million with 100 employees.

South Australian grower costs, as an average of all the regions surveyed, is around \$255 a tonne. It suffers through high seed costs – 124%, land costs at 78%, fertilizer at 96%, water at 266% chemicals at 66% and operations at 140%.

The State Government has set up a working party with local growers and McCain Foods to look at reducing costs of growing potatoes, but in twelve months progress is also slow.

Top line findings

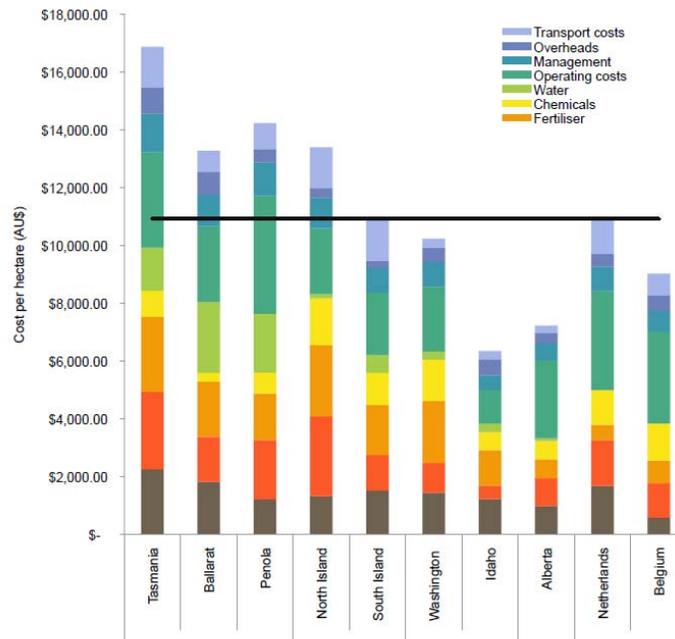


There is much discussion of the impact of a high Australian dollar. Dr. McKinna calculated the impact of the Australian dollar at 99c – see graph below. But even at 74 cents to the dollar, Australia’s potato growers are still uncompetitive.

McCain Foods shared the findings of the McKinna report with growers in each region, State and Federal Government representatives, and industry groups to stimulate debate into the issues.

The scenario at current exchange rates

At 99.2c the average cost is now even lower at \$11,000.



6. How can Federal and State Governments help?

The Federal Government can assist by providing funds and/or resources to State Governments to tackle analysis of the cost base with the aim of finding ways to reduce costs, and becoming globally competitive.

State Governments, that are yet to commit, should establish working parties with growers and industry with the aim of finding ways to improve competitiveness.

With \$1.2 billion at stake, it is incumbent upon all parties to find ways for Australia's potato growers to become more competitive. Failure to act will mean more imports, less growers, and processors moving production to more countries.

Federal Government can assist State Governments by adopting a Federal coordinating role and providing specialized resources to assist growers.

7. Regulatory Environments

McCain Foods has outlined some of the regulatory barriers and costs that confront growers and the company in the McKinna report. It also believes continuous regulatory reform is vital to create business conditions that allow companies to compete and supports the Australian Food and Grocery Council submissions to the Senate Select Committee.

The AFGC has a very comprehensive discussion of the issues, and McCain Foods supports those recommendations.

8. Costs of production including raw materials, labour, energy and water

We have documented earlier in this paper some of the raw material costs and in each of the processing plants the raw material costs particularly potatoes make up the largest cost factor towards the end product.

Raw material costs

Potato growers received much higher prices during drought years of 2007-08, and while prices rose on average at around 8 per cent over the past six years - higher than inflation.

During the drought, potato prices increased a staggering 40 per cent over two years in Ballarat.

Potato growers in Tasmania, South Australia and Victoria are also facing competition from lower-priced imports, which are cheaper from the US and from Europe before freight.

Energy

Energy costs particularly electricity is rising and will continue to do so.

Energy costs in Penola are around 5% of total operating costs, at Smithton they are around 7%, and Ballarat with Ready-made meals and a French fry plant at around 3% and rising.

McCain Foods has a number of programs in place to save energy and water particularly in its Ballarat plant working closely with Central Highlands Water.

From July of 2010 to June 30 of 2011, McCain reduced its energy use by around 25%, used 33% less water, and increase the amount of re-used and recycled waste by around 26%.

Food labeling

With respect to Terms of Reference 1 (b) (iii) Food labeling, McCain Foods would like to make a number of points.

- McCain Foods endorses the recommendations provided by the AFGC with regards to the Blewett Review. In particular McCain Foods believes that the best available solution to date for Front of Pack labelling is outlined in the Front of Pack Labelling Code of Practice. The thumbnails are clear to those consumers seeking to understand the nutritional characteristics of the purchased food.
- There is a fear that, with an ever growing focus on food content and food labelling, significant costs will be incurred as a result of ongoing compulsory changes to food labels. With the potential cost of a single pack change being up to \$3000 or more (not including labour) the impact on McCain could easily reach in excess of \$1 million. The Blewett Review has done little to guide the development of policy in the area of a streamlined food labelling regulation.
- McCain believes that whilst food labels should contain critical nutritional information, technology is also providing opportunities for the food industry to provide all encompassing information to consumers. Manufacturers can utilise websites and other medium for providing transparency of product information to consumers. With many independent, non-regulated tools starting to surface, some control should be placed. The food industry, through the AFGC, is developing the tools to be able to ensure the most accurate, up-to-date information is made available through GS1 and Go Scan. This should be endorsed and supported by Government.

Conclusion

McCain Foods Australia/New Zealand is a proud member of the food processing sector and has been so for over forty years. We have raised the issue of competitiveness of Australia's potato growers so that reforms can be undertaken before costs hit a level where companies will be forced to make decisions about moving their operations offshore.

McCain Foods is looking for sustainable potato prices and business certainty to ensure its operations in Australia continue to survive and prosper.

Australian potato growers need to be competitive with their global counterparts to survive. And in doing so they will have to work together to become a viable business unit that is productive

and efficient. If this goal can be reached then food processors such as McCain Foods will continue to operate in Tasmania, and the rest of Australia.

McCain Foods is also major employer and plays an important economic and social role in regional communities. The company is a major contributor to local social and community organizations that make up the fabric of our society.

The company also donates food worth hundreds of thousands of dollars to charities and community organizations each year.

In the end, all McCain Foods is seeking to achieve is a sustainable potato price structure so the company can effectively compete and provide the popular range of products to the Australian community.