



Tasmanian Freight Assistance Arrangements Productivity Commission Draft Report

Simplot Australia Response

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1.0 Executive Summary

The TFES scheme is critical to leveling the playing field between States, and is critical to ensuring an equitable competitive platform for Tasmanian manufacturers. TFES does not remove the motivation for rigorous and ongoing efficiency improvements. The rationale for TFES is as applicable today as it was upon its introduction in 1976.

In 2006 Simplot plan to move over 16,000 TEU to Melbourne, Perth, Brisbane, and Newcastle ex Tasmania. Toll Shipping manages the door-to-door movement of containers ex Tasmania to Simplot's mainland warehouses and some select customers. Simplot's freight is moved to a small number of specific destinations where exact freight costs are easily quantified.

Simplot have made the freight movement between Tasmania and the mainland as efficient as possible by:

- a) Maximizing the container utilization to greater than 99%
- b) Loading containers directly from the production line at Ulverstone

With the TFES assistance, it is 3.5% more expensive per tonne/kilometre to freight between Burnie and Melbourne versus Simplot's average cost per tonne/kilometre between mainland eastern seaboard states.

Without the TFES assistance, it is 173% more expensive per tonne/kilometre to freight between Burnie and Melbourne versus Simplot's average cost per tonne/kilometre between mainland eastern seaboard states.

The stability of Simplot is crucial to the well being of some 500 vegetable growers, to the communities of Northern Tasmania, and to the Tasmanian economy as a whole. Simplot directly employ over 580 Tasmanians. To support Simplot production it is planned that during 2007 approximately 365,000 tonnes of vegetables, with a gross value of approximately \$96.0 million at the farm gate, will be produced on 13,000 hectares of land.

Simplot is competing against global supply chains where low labour costs generate reduced farming and processing costs. Simplot's strategic weapon against cheap import product includes:

- Investment in modern plant equipment and processes
- The elimination of supply chain waste and inefficiency
- Proximity to the Australian market (lower freight costs)

Simplot operate in a low margin, competitive business where freight costs form a significant cost. Any decrease in the TFES assistance is a direct incentive for Simplot to source product from the mainland, or more probably, from overseas. TFES is not so much about freight as it is about the viability of the Tasmanian economy.

The TFES system has been in place for thirty years and Tasmanian industry have come to accept it as an integral part of the regulatory infrastructure that governs their trade links with the rest of Australia. Simplot have assumed that the TFES will remain in place and will continue to provide support broadly in line with the historical record. Investment decisions have reflected this



assumption. The outcome of this review will influence Simplot's future investment and the degree to which Simplot continue current operations in Tasmania.

Simplot are familiar and comfortable with the current TFES assistance mechanism, and believe it is an adequate mechanism moving forward. Perhaps due to the bulk nature of Simplot movements, Simplot find the current application of the assistance easy to administer.

Simplot see the TFES methodology as an adequate and direct method for addressing the competitive gap between mainland and Tasmanian processing caused by the need to transport across Bass Strait. Funding freight is Simplot's preferred option for Government assistance to Tasmania as Simplot can be certain all the intended benefit flows to the assistance of actual freight costs versus the possible benefit dilution with less direct assistance.

Simplot do not endorse rorting in any form, and support the application of penalties for anyone found to be rorting the TFES scheme. However, caution must be exercised not to unfairly minimize the benefit to those recipients acting within the spirit of the assistance program simply as a way to eliminate all possibility of rorting.

The fundamental issue in any proposed TFES mechanism is the clear and accurate identification of the freight cost disadvantage for shippers across Bass Strait. Simplot welcomes the annual review of the parameters used in defining the freight cost disadvantage – and promotes the annual adjustment (either up or down) of the genuine disadvantage to shippers.

Simplot do not support "flat rate" assistance. Flat rate assistance:

- Is not related to the size of the freight cost disadvantage experienced
- Does not allow for the differences in freight services provided (treating transport service as a homogeneous product to all users)
- Does not recognize the differences in product characteristics

Furthermore, the \$400 proposed in the Productivity Commission's draft report is inadequate assistance. Simplot would be approximately 50% worse off under this arrangement than with current assistance levels.

1.0 TFES Rationale

Department of Transport and Regional Services (DOTARS) regional development goal:

*“The scheme assists in alleviating the comparative **interstate freight cost disadvantage** incurred by shippers of eligible non-bulk goods carried between Tasmania and the mainland. Its objective is to provide Tasmanian industries with equal opportunities to compete in mainland markets, recognizing that, unlike their mainland counterparts, **Tasmanian shippers do not have the option of transporting goods interstate by road or rail.**”*

In clarifying the rationale for TFES, Simplot endorse the following comments made by the Tasmanian Chamber of Commerce and Industry¹:

- The rationale for TFES is equitable treatment of industry with respect to interstate trade and specifically, access to production inputs, and the markets for goods produced. To achieve this, neutrality in terms of access to transport infrastructure is essential.
- The Australian Government has been actively engaged in pursuing this equity between mainland States on a number of fronts. These include identification and improvement of national highway infrastructure and the removal of barriers to trade such as the conflicts in rail gauge that existed at the time of federation. In Tasmania’s case the barrier to trade is Bass Strait, and without the equity provided through TFES, access to mainland markets by Tasmanian producers would be severely compromised.
- The TFES is an equity measure to ensure that one State of the Federation is able to compete with other States and is not disadvantaged because it is an island.
- The TFES is an efficient way to ensure Tasmanian business and industry competes on a level playing field as it only assists those businesses which send their product to other States.

The TFES scheme is critical to leveling the playing field between States, and is critical to ensuring an equitable competitive platform for Tasmanian manufacturers. TFES does not remove the motivation for rigorous and ongoing efficiency improvements. The rationale for TFES is as applicable today as it was upon its introduction in 1976.

Simplot welcomes the Prime Minister’s statement on the 7th September, 2006:

“The Government will not be phasing out the Tasmanian Freight Equalisation Scheme... The Scheme remains an important element of Australian government programmes that equalise cost disadvantages between the States and Territories”.

¹ TCCI Comment on TFES Draft Report (October 2006)



2.0 Simplot Tasmanian Freight Task

In 2006 Simplot plan to move over 16,000 TEU to Melbourne, Perth, Brisbane, and Newcastle ex Tasmania (Ulverstone and Devonport) with Toll Shipping. This is greater than 200,000 tonnes of finished goods. Seventy five per cent of finished goods are produced at Ulverstone's specialized potato manufacturing plant – with the remainder produced at Devonport's vegetable processing plant. In addition, approximately 900 TEU of raw material ingredients will move from the mainland to Ulverstone.

Simplot have made the freight movement between Tasmania and the mainland as efficient as possible by:

- c) Maximizing the container utilization to greater than 99%
- d) Loading containers directly from the production line at Ulverstone

To ensure maximum freight optimization on Bass Strait, Simplot have designed the Ulverstone factory to flow product directly into containers on slip sheets. The containers are then moved directly from Ulverstone to mainland warehouses via road, ship, and rail – where mainland warehouses unload containers at specialized receiving docks. Devonport production is stored in Simplot's on-site warehouse, and movements from Devonport to mainland warehouses are also done in optimized container movements. **Hence, Simplot's Tasmania-to-mainland supply chain is fully optimized.**

Simplot's freight is moved to a small number of specific destinations where exact freight costs are easily quantified. Furthermore, Simplot's significant Bass Strait volume helps lower the overall freight price for other industry volume as Simplot absorb a proportionate amount of Toll Shipping's largely fixed service costs.

The service from Toll Shipping is adequate. Simplot's major operational concern is dealing with shortages in Toll Shipping's equipment pool during peak periods – thus requiring the de-stuffing of containers in Melbourne and re-loading upon road transport for interstate deliveries when containers are urgently needed back in Tasmania to meet Ulverstone production.

3.0 Logistics Cost Comparison

Simplot is one of the largest buyers of refrigerated transport in Australia and has good buying power. It is difficult to compare the rates for mainland interstate (linehaul) transport to the rates for Tasmania to mainland transport because transport has different rates depending on which direction traveled. This is caused from an imbalance in freight volume between States. However, for the purpose of comparing transport rates ex Tasmania versus mainland transport the following calculations have been made:

- a) Comparison between Melbourne to Brisbane tonne/kilometre rate versus Burnie to Brisbane tonne/kilometre rate (as this is the same directional flow and is a close direct comparison)
- b) Average rate per tonne/kilometre on Simplot's major Eastern Seaboard freight lanes versus Burnie to Melbourne tonne/kilometre rate (as this is a good indication of mainland transport cost versus Tasmania to mainland cost).

3.1 Melbourne to Brisbane versus Burnie to Brisbane

With the TFES assistance, it is 2.5% more expensive per tonne/kilometre to freight between Burnie and Brisbane versus between Melbourne and Brisbane. This also assumes direct container movements between Burnie and Brisbane is occurring. Approximately 10% of all containers ex Burnie to Brisbane require de-stuffing in Melbourne onto road transport to enable the quick return of containers to Ulverstone during peak production periods. The impact is an additional 20% per tonne/kilometre for the freight affected.

Without the TFES assistance, it is 34.6% more expensive per tonne/kilometre to freight between Burnie and Brisbane versus between Melbourne and Brisbane. Once again, this comparison does not factor any de-stuffing required in Melbourne en-route to Brisbane.

3.2 Simplot's Major Eastern Seaboard Freight Lane Rates versus Burnie to Melbourne Rate

With the TFES assistance, it is 3.5% more expensive per tonne/kilometre to freight between Burnie and Melbourne versus Simplot's average cost per tonne/kilometre between mainland eastern seaboard states.

Without the TFES assistance, it is 173% more expensive per tonne/kilometre to freight between Burnie and Melbourne versus Simplot's average cost per tonne/kilometre between mainland eastern seaboard states.

3.3 Additional Logistics Costs

There are additional logistics costs associated with Simplot's Tasmania-to-mainland freight requirements that are not included in the freight rate. These include:

- a) Our Tasmania-to-mainland supply chain is highly geared towards optimizing the flow of product from production facility to mainland warehouse. Fundamentally, this means ensuring the efficiency of container movements.

- Investment has occurred in specialized factory dispatch processes to flow slip-sheeted product into containers.
 - Receipting costs at mainland warehouses are higher for Tasmanian products as slip sheet quantities must be de-stuffed from containers and re-configured to pallet quantities as slip sheet quantities are not in pallet configurations, but are configured for best container utilization. This process takes more time than unloading full pallets from refrigerated pan-tech mainland transport.
 - Simplot incur warehouse overtime costs or container demurrage costs (or both) during times of peak production as Ulverstone do not have a warehouse facility to smooth the volume flow across Bass Strait.
 - Just in Time (JIT) production processes are less attractive for Tasmanian production as bulk volume better optimizes containers. JIT production would lower the finished goods inventory required.
 - In using slip sheets to optimize container usage, Simplot incur greater incidence of product damage versus more “product protected” mainland transport modes.
- b) Although Toll Shipping provides a daily service ex Tasmania to Melbourne, Simplot carry greater inventory safety stocks to offset the risk of service failure between Tasmania and mainland warehouses.
- c) Not only is there a planned requirement to transport specific raw materials from the mainland to Tasmania at a higher transport cost versus mainland delivery (such as frying oil in tankers that return empty to the mainland), but when raw material supply from Tasmania is compromised Simplot incur additional transport penalties in moving raw material from the mainland.
- d) With specialized equipment in use, there are poor back-loading opportunities from the mainland to Tasmania versus the more “general” equipment employed on the mainland – which is usable across a greater volume of mainland industry freight.
- e) Simplot spend a significant amount on slip sheets for loading product into containers in Tasmania. Simplot use slip sheets versus wood pallets so that more net tonnes can fit into containers. Slip sheets are a more cost efficient method than using wood pallets. If Simplot reverted to wood pallets and eliminated the slip sheet cost, the transport cost per net tonne ex Tasmania would increase.
- f) After traveling north with work-in-progress vegetables, approximately 5,000 empty bins travel south from Bathurst to Devonport for re-filling.
- g) Containers moved between Tasmania and Perth (approximately 1,750 TEU per annum) travel on international vessels. The containers are a different size and do not fit two rows of standard Australian pallet footprints. Hence, Perth-bound product requires hand stacking into containers after being moved from the Ulverstone production facility to an off site warehouse.

While the TFES may provide equalization of a kind, it does not provide equalization for the additional logistics costs consequential in doing business between Tasmania and mainland Australia.



4.0 Simplot's Impact within Tasmania

The stability of Simplot is crucial to the well being of some 500 vegetable growers, to the communities of Northern Tasmania, and to the Tasmanian economy as a whole. Simplot directly employ over 580 Tasmanians.

To support Simplot production it is planned that during 2007 approximately 365,000 tonnes of vegetables, with a gross value of approximately \$96.0 million at the farm gate, will be produced on 13,000 hectares of land.

The great bulk of this vegetable production goes into processing by Simplot - overwhelmingly for consumption on the Australian domestic market. Approximately 99% of all production is shipped across Bass Strait.



5.0 Competitive Pressure

The products Simplot manufacture in Tasmania are predominately frozen potato and frozen vegetable “commodity” products. The competition against Simplot’s Tasmanian production is largely comprised of:

- Simplot’s mainland production
- Tasmanian production by competitors
- Mainland production by competitors
- Simplot purchased imported product
- Competitor purchased import product
- Retailer purchased “private label” product (domestic & imported)

Historically, Simplot Tasmania has competed predominately against mainland production. However, the competitive pressure from imported product is more substantial than ever before. Faced with cheap imported finished goods from China, Thailand, and New Zealand there is constant financial pressure for Simplot to:

- a) Reduce Tasmanian production and increase the import of Simplot finished goods from Asia
- b) Constantly refine Tasmanian production processes for efficiency improvements

The difficulties facing the Australian vegetable industry (particularly the processed sector) through increasing import pressure is well recognized and has been the subject of several reviews - initiated by both the State and Federal Government.

Simplot is competing against global supply chains where low labour costs generate reduced farming and processing costs. Simplot’s strategic weapon against cheap import product includes:

- Investment in modern plant equipment and processes
- The elimination of supply chain waste and inefficiency
- Proximity to the Australian market (lower freight costs)



6.0 Simplot's Reliance on TFES

Simplot operate in a low margin, competitive business where freight costs form a significant cost. Any decrease in the TFES assistance is a direct incentive for Simplot to source product from the mainland, or more probably, from overseas. TFES is not so much about freight as it is about the viability of the Tasmanian economy.

Already facing significant competitive pressure, numerous initiatives exist to maximize the efficiency of the Simplot Tasmanian supply chain – including the processes for farming raw materials within Tasmania. Simplot suspect there is limited room to pass on the cost impost of reduced TFES subsidies to Tasmanian farmers without a severe (and possibly terminal) effect on supply. Consequently, processing activity within Tasmania may cease as mainland and/or imported product becomes the only sustainable option.

The TFES system has been in place for thirty years and Tasmanian industry have come to accept it as an integral part of the regulatory infrastructure that governs their trade links with the rest of Australia. Simplot have assumed that the TFES will remain in place and will continue to provide support broadly in line with the historical record. Investment decisions have reflected this assumption. The outcome of this review will influence Simplot's future investment and the degree to which Simplot continue current operations in Tasmania.

7.0 TFES Mechanism

Simplot are familiar and comfortable with the current TFES assistance mechanism, and believe it is an adequate mechanism moving forward. Perhaps due to the bulk nature of Simplot movements, Simplot find the current application of the assistance easy to administer.

There may be other forms of assistance that achieve the DOTARS regional development goal, but Simplot see the TFES methodology as an adequate and direct method for addressing the competitive gap between mainland and Tasmanian processing caused by the need to transport across Bass Strait. Funding freight is Simplot's preferred option for Government assistance to Tasmania as Simplot can be certain all the intended benefit flows to the assistance of actual freight costs versus the possible benefit dilution with less direct assistance.

Simplot see any capping of the TFES benefit as an inadequate approach – as this will promote Simplot to source finished goods from other supply points once a capping threshold is reached.

Simplot do not endorse rorting in any form, and support the application of penalties for anyone found to be rorting the TFES scheme. However, caution must be exercised not to unfairly minimize the benefit to those recipients acting within the spirit of the assistance program simply as a way to eliminate all possibility of rorting. Simplot are not aware of any actual incidents of rorting, and would like some evidence into the magnitude of the problem. Simplot regularly employ independent auditors to review the Simplot processes for claiming TFES assistance.

The fundamental issue in any proposed TFES mechanism is the clear and accurate identification of the freight cost disadvantage for shippers across Bass Strait. Simplot welcomes the annual review of the parameters used in defining the freight cost disadvantage – and promotes the annual adjustment (either up or down) of the genuine disadvantage to shippers.

Simplot do not support “flat rate” assistance. Flat rate assistance:

- Is not related to the size of the freight cost disadvantage experienced
- Does not allow for the differences in freight services provided (treating transport service as a homogeneous product to all users)
- Does not recognize the differences in product characteristics

Furthermore, the \$400 proposed in the Productivity Commission's draft report is inadequate assistance. Simplot would be approximately 50% worse off under this arrangement than with current assistance levels.