Fonterra could be forced to float NZ Milk

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Capital-raising needs might drive Fonterra Co-operative Group to hive off its consumer products subsidiary, New Zealand Milk.

Fonterra chief executive Craig Norgate acknowledged to an international dairy forum in Paris that not all of his 13,000 farmer-shareholders shared the same appetite for investment.

"Like other co-operatives, we will continue to grapple over the next few years with the question of our capital structure," he said.

"Whether we should provide an alternative channel for shareholders who would prefer to increase, for example, their investment in our international consumer business."

Mr Norgate echoed the 1999 dairy industry global strategy, written by McKinsey & Co, which recommended corporatising all international consumer product operations, plus some dairy ingredients supply businesses, if the megamerger was to proceed, and to succeed in its aim of becoming a dairy industry player of world stature.

It said new capital of $12 billion would be needed to help the industry grow 15% a year to reach $30 billion turnover by 2010.

Dairy industry leaders later obtained approval for the merger from the government and shareholders without the standalone consumer product operations being corporatised.

Since then Mr Norgate has confined the future investment option to existing farmer-shareholders. But analysts doubt this would give Fonterra anything like the capital needed to pursue a strategy of global domination in categories of internationally traded dairy products, substantial within-market investment and the $30 billion-a-year turnover target.

Whether that target remains in the industry strategy will not be known until Fonterra completes its Project Galileo, which, judging by the name, must address global business directions.

If Galileo were to depart significantly from the major elements of the 1999 strategy, many regulators and commentators would want to know why.

Clearance for the giant merger as a response to dairy industry deregulation was given by the government, along with exemption from some Commerce Commission scrutiny, partly on the basis of the 1999 plan and its arguments.

"What was wrong with the 1999 strategy and what has Fonterra been following in the interim?" former policy adviser and merger critic Tony Baldwin asked. "Is Fonterra going to remain an 80% commodities business or is it going to tackle added-value products in a major way? Fonterra as we have it is a greatly watered-down version of strategy and structure presented to justify the megamerger.

"The question is why was it watered down, and are those influences and conflicts still at work within Fonterra?"

(Mr Baldwin was a policy adviser to the Department of Prime Minister and Cabinet during the 1990s and leader of the producer board project team in 1998-99.)

The contrast between the two Fonterra divisions, NZMP and New Zealand Milk, was quite marked in the 2001-02 annual results and report.

NZMP managed only 3% return before tax on shareholders' equity, and was burdened with performance issues, too much working capital and processing overcapacity, which Mr Norgate says cost more than $200 million.

New Zealand Milk had revenue of $5.583 billion and earnings before tax and interest of $302 million.

Most significantly, its profit was almost $80 million above budget, in a year in which commodity prices were at historical highs for a significant part of it.

"In the year ahead we are expecting its results to be simply outstanding," Mr Norgate said at the recent Fonterra annual meeting.

New Zealand Milk now has a portfolio of 96 brands added value to milk in more than 30 countries, says Mr Norgate.

In Latin America 23% of revenues came from products introduced to the market within the past five years, while in Southeast Asia the equivalent figure was 53%.

New Zealand Milk has 12,500 employees and NZMP just under 7000.

New Zealand Milk has high-profile global brands Anchor, Anlene, Fernleaf and Chesdale and strong regional brands such as Soprole, Mainland, Peters and Brownes, Bega, Tararua, Meadowfresh and Tip Top.

These brands collectively were valued at $1.5 billion on the May 31 balance date.

The business of New Zealand Milk is primarily in sales, marketing and distribution, with some additional plants in Latin America and Asia which pack bulk dairy and non-dairy products into branded consumer presentations.

The business of New Zealand Milk tends to be counter-cyclical to the rest of Fonterra's business; it is more profitable when payout is low and less profitable when payout is high. This is because New Zealand Milk buys its raw materials, which are bulk dairy products, at prevailing international dairy prices but sells into retail markets which tend to react more slowly to changes in international prices.

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