Fonterra proposes big milk shake-up

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By BERNARD HICKEY

Fonterra has proposed the biggest shake-up in the dairy industry since the creation of Fonterra in 2001.

Chairman Henry van der Heyden provided options yesterday for reforming the cooperative's capital structure that ruled out a public float, as expected, but proposed a system of contract of supply as early as 2006-07.

This will allow some Fonterra shareholders to simply sell milk to Fonterra at a contract price agreed yearly, without having to buy Fonterra shares. At present a farmer joining the cooperative must pay about $500,000 on average to buy the Fonterra "fair value shares" needed to supply milk.

Mr van der Heyden said the contract supply proposal would ease some of the tensions about the fair value share system, under which some existing farmers had decided against increasing supply because of the cost, and young farmers might have been put off joining the industry.

Earlier this week Fonterra announced the fair value shares would be worth $5.11 this season, up 9 per cent from a year ago.

The rising price of the shares had also increased the "redemption risk" that some farmers would sell the shares and leave the cooperative, Mr van der Heyden said.

"Some people were saying if it gets up to $6 or $7 or $10 they're going to cash in their shares and go into something else."

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The contract supply option would allow those reluctant to buy more shares to supply some milk on a contract basis. "It helps young farmers or new farmers coming in."

Fonterra needed to keep increasing milk production to meet global demand and the contract supply option would ensure growth.

Fonterra is proposing a tender system in which farmers will bid to supply up to 2 to 3 per cent of total supply or about 36 million kilograms of milkfat in the first year - three times the output of tiny rival Tatua. This would rise to between 6 and 9 per cent within three years.

Fonterra also outlined much more significant structural reform options - including listing or selling its NZ Milk consumer products arm - but said it would not propose them in the current reforms. It will instead legally separate NZ Milk, give it its own balance sheet and profit and loss statements, and make it sign "arm's-length" agreements to buy ingredients from Fonterra so its performance can be judged more clearly. Mr van der Heyden agreed that the sale or float of NZ Milk might be longer-term options once its performance was more transparent.

Fonterra will publish more details on the contract supply proposal in February or March and aims to hold a special general meeting to vote on the plan in April, with the aim of holding the first tender for the 2006-07 season in February 2006.

Fonterra will also re-propose the replacement of the peak notes system with a a buffer system to reduce the impact of one-off seasonal supply shocks. It said it would contribute a "modest amount" to help farmers in the transition.

Farmers cautiously welcomed the proposal, saying it was "sound", but that more detail was needed. Dairy Farmers New Zealand, which is part of Federated Farmers, said it was generally positive about the plan. "The concept would appear to help relieve some of the tensions in the cooperative," chairman Kevin Wooding said.