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Dairy venture to take on Fonterra

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It's the mother of all dairy ventures. Former finance minister Ruth Richardson - who delivered the "Mother of all Budgets" in 1991 that unveiled broad changes to the welfare system - is part of a breakaway dairy operation ditching Fonterra to set up its own shop.

Synlait Investments, a privately owned farmer-based company in rural Canterbury, will stop supplying milk to Fonterra from the 2007 dairy season.

Instead, it will build a factory west of Christchurch and begin manufacturing and exporting high value milk products. Between now and then Synlait plans to more than double milk production to 100 million litres a year.

Fonterra has shrugged off the move as an "ambitious venture", but analyst Tony Baldwin said it exposed cracks in the industry heavyweight's cooperative structure that would be worrying to it.

"It's an example of larger, more innovative and progressive farmers believing that they can achieve stronger returns by cashing up their capital in Fonterra and using it elsewhere."

Synlait's 8500-strong herd at present accounts for only about 0.25 per cent of Fonterra's total, but it is looking to expand this to 40,000 within 10 years, using its farms or contract farms.

On current production levels, Synlait stands to make just over $19 million from its Fonterra shares in 2007. Any expansion before then would involve buying more shares in Fonterra that would then have to be sold back.

One subsidiary, Synlait Farms, will produce the milk and another, Synlait Milk, will process and market it. It is looking to export high value milk products, and aims to become a major niche player.

Chairman John Penno said it would investigate raising capital by an offer of securities, but the company was comfortable with its present financial arrangements.

Dr Penno would not be drawn on how much the 200-million-litre-capacity factory would cost to build.

In addition to the 100 million litres produced by its farms, Synlait would look to invoke a clause in the Dairy Industry Restructuring Act that requires Fonterra to supply it with 50 million litres of milk a year.

Fonterra's only competition to date has been from two other cooperatives, Waikato-based Tatua and Westland Milk Products in the South Island.

Mr Baldwin said the Synlait move exposed a core weakness in the Fonterra capital structure -- the requirement for it to buy out shareholders who wish to leave.

"This will confirm their fears that redemption risk is a material factor for Fonterra.

"If the numbers stack up for Synlait, from an investor's point of view, then there will be a growing group of suppliers in that area who will decide to take their money out of Fonterra."

Synlait Investments has five member farms covering 2800 hectares and two more set to join.

The company has no plans to expand beyond Canterbury.

Dr Penno said Synlait would look to gain a cost advantage over other farming operations by having the best management expertise in the country. Controlling the entire "cow to customer" process would also bring savings.

The company was formed in 2000 by Dr Penno, Ben Dingle and Juliet Maclean. Ms Richardson is a non-executive director.

Dr Penno said Synlait Investments immediately began pursuing a growth strategy, and described the 45 million litre production capacity it has now reached as the critical mass it was looking for in its decision to split from Fonterra.