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"Co-op fails to add value"

By Andrew Janes

In the latest of The Press's series on stars and lacklustre performers in the New Zealand sharemarket, ANDREW JANES looks at dairy giant Fonterra.

Fonterra came under fire during 2006 from its disappointed farmer shareholders. Although not publicly listed, Fonterra does have a significant presence on the New Zealand Exchange's debt market.

Fonterra's inability to lift its value-added performance in the last five years while dairy consumption in Asia has risen steadily and the Fonterra Shareholders Council's decision not to endorse the co- operative's statement of intentions for the 2005-06 year made it worthy of underperformer status.

One of the main reasons Fonterra was formed in 2001 was to help the New Zealand dairy industry to generate more returns from branded value- added products, as opposed to simply selling commodities such as milk powder.

But Fonterra has failed to live up to its promise in value- adding. The value-added contribution to milk payout, a key indicator in assessing the value- added contribution to profitability, has hardly changed in the last five years.

It was 47 cents for the 2002-03 season, 48c in 2003-04, 45c in 2004-05 and 48c in 2005-06. According to Fonterra's latest payout forecast, issued in mid-December, the value-added contribution for 2006-07 is likely to be 45c.

The static value-added contribution was one of the main reasons the Fonterra Shareholders Council refused to endorse Fonterra's statement of intentions for 2005-06.

In its annual report, released in September, the council said the value-added performance was a "serious concern", and noted Fonterra's total shareholder returns for 2005-06 put in the bottom half of similar benchmark companies around the world.

"There is an air of frustration around the 2005-06 season," council chairman John Monaghan told The Press in September.

"Heading into its fifth year of operation and with solid foundations, we saw no evidence (during the 2005-06 season) of a significant lift in the co-operative's performance against the previous season and no indication that the assets of the business were being adequately utilised. Fonterra must deliver returns that outweigh alternatives to ensure it is the first choice for New Zealand dairy farmers."

It also looks as if Fonterra will be unable to take advantage of the current surge in world milk-powder prices because of the high New Zealand dollar, a factor that is out of the co-operative's control.

An indication of how keen Fonterra is to increase production to take advantage of the high prices was the announcement in mid-December that it would pay a one-off autumn premium to farmers for milk produced in the last few months of the season.

Realising its co-operative structure is holding it back, Fonterra's board recently announced it would look at a full or partial stock-exchange listing next year, and aims to put a proposal to a shareholder vote before the end of 2007. But whether more than 75 per cent of its farmer shareholders will vote to relinquish total control of the co-operative remains to be seen. Next year will definitely be an interesting one at the dairy giant.

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