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'International examples'

By Andrew Janes

Fonterra Co-operative Group is considering a full or partial listing on the stock exchange.

The drive behind listing it is to give the giant farmer-owned dairy co-operative, which is New Zealand's biggest single exporter, greater access to capital, and reduce the risk of ageing farmers leaving the co- operative and causing a run on the balance sheet.

A full or partial listing would be a huge boon for the New Zealand Exchange (NZX) and for regional areas, where farmers would on average hold shares worth an estimated $1 million per farm.

With an estimated value of $7.92 billion, Fonterra is comparable in size to current NZX behemoth Telecom, which has a market capitalisation of $9.47b. Fonterra has an annual turnover of $13b, outstripping Telecom's $5.8b.

Fonterra chairman Henry van der Heyden said all options were on the table but that retaining farmer control of the company would be non- negotiable.

Fonterra would launch a full review of its capital structure early next year with the aim of putting forward a proposal for its farmer shareholders to vote on before the end of 2007, he said.

Any big change to the capital structure would require the support of at least 75 per cent of farmers.

Fonterra has just conducted a series of 70 meetings with its shareholders around the country discussing changes to its capital structure.

"We have spoken to around 3500 farmers and there is overwhelming support from them to have capital structure on the agenda," van der Heyden said.

Fonterra Shareholder Council president John Monaghan said farmers' minds were definitely engaged on the issue, but it was too early to say whether they would support a listing or not.

"Being a co-operative doesn't mean staying the same, but you need reasons for it to change into something else," he said. "Farmers are not scared of change. If there are changes that would enhance our performance and profitability we would certainly want to look at those."

Monaghan said the council was setting up a project team that will work alongside board and management on the review.

Every step of the review process would involve getting agreement from the board, the council and the farmers, van der Heyden said.

"There will be options discussed and then we'll go out with a preferred option and that will be voted on."

One Fonterra director, who did not want to be named, told BusinessDay that farmers understood the rationale for change and were ready for it. "Farmers realise there's a finite period that the current capital structure can operate for and that we do need to change."

Van der Heyden said there were several reasons why Fonterra needed to change. These included better access to capital, addressing the risk of older farmers selling out and leaving the co-operative, increasing milk supply, giving farmers more diverse investment choices and attracting younger farmers. He said he was not concerned about older farmers leaving the co-operative and creating a run on the balance sheet in the short term, but that this was a concern in the medium to long term.

Currently farmers must hold one Fonterra fair value share for each kilogram of milk solids they produce.

Listing would lead to a massive 30% to 50% increase in shareholder value as institutions and smaller investors rushed to buy the shares, dairy industry commentator Tony Baldwin said.

The average dairy farmer currently produces 103,000kg of milk solids each year, meaning each farmer owns Fonterra shares worth around $712,000. If the shares listed at a 40% premium, each farmer would own shares worth around $1m.

It would also make Fonterra's balance sheet far more secure, he said.

"They've got a demographic problem because farmers are getting older and under the current system they're being asked to put in more money if they grow their milk supply.

"Farmers want money out, not money in, so at the moment they're at risk of having a run on the bank."

Baldwin said a dual listing on the NZX and a larger overseas exchange would also be an option.

But van der Heyden declined to comment on that issue.

Van der Heyden joined the board of the NZX last September.

International examples

Internationally there are examples of dairy co- operatives that have gone fully or partially public.

Irish dairy company Kerry did a full listing, but retained control of the company by setting up a co-operative group of farmers collectively holding more than half of the company's shares.

A variation on that model would be to fully list, but allow farmers to trade only 49% of their shares.

A third option would be to split the value-added part of the business and list it as a subsidiary, with Fonterra retaining a controlling stake.

A fourth option, used by Dutch company Friesland Coberco, would be to create two classes of shares -- one tradeable and one non- tradeable. Farmers would maintain control of the company as the non-tradeable shares would account for more than half.

Van der Heyden said it was too early to get down to the specifics of discussing options.

Dairy industry commentator Tony Baldwin, a long- time critic of Fonterra's co-operative structure, said there would be strong advantages for Fonterra in keeping the business as a single entity rather than splitting off the value-added part.

"It's quite difficult to find a demarcation point between value-added and the rest both in financial and operational terms.

"By retaining the business as an integrated operation you can capture value at various points."

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