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Report Highlights: General: Negotiations on a free-trade agreement with Hong Kong have stalled. New Zealand's competitiveness remains in agriculture. Horticulture: Guiness Peat Group unveils plans for Enza and Turners & Growers merger. Dairy: Fonterra's financial position deteriorated in the six months to March 2002. Forestry: Fletcher Forests' proposal to purchase Central North Island Forests Partnership assets is rejected by shareholders.

Includes PSD changes: No
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GENERAL

Hong-Kong free-trade negotiations stall

The much anticipated free-trade agreement with Hong Kong has stalled – possibly permanently – because of a lack of agreement over rules of origin. The deal that NZ officials had talked confidently about since the Prime Minister's visit to Hong Kong in April 2001 was always dependent upon the critical issue of the parties agreeing to rules covering the origin of Hong Kong-goods destined for New Zealand. As the negotiations went on, NZ officials became increasingly concerned that New Zealand could become a conduit for low-cost goods from mainland China through the misuse of a Hong Kong tariff preference. The problem is complex and unique to the region because much of Hong Kong's manufacturing base has been transferred to the mainland where wage rates and costs are substantially lower than in the territory. Many goods produced in the territory are in many cases sent to the Guang-dong province for finishing because Hong Kong exporters want to ship them from Chinese ports where freight and port costs are considerably lower. In addition to the customs verification issue, the Government faces pressure from unions in New Zealand to protect manufacturing jobs from unfair competition. The NZ Trade Negotiations minister has publicly ruled out a free-trade agreement with Hong Kong that would allow Hong Kong-products free entry from Chinese ports.

Trade New Zealand and Industry New Zealand to merge

Trade New Zealand, which was set up in 1988 by the government in order to expand NZ's foreign exchange earnings will soon be merged with Industry New Zealand, another government organization. Trade New Zealand focuses on small to medium-sized exporting businesses, which struggle to gain a foothold in foreign markets. It offers advice and research, arranges trade fairs and promotions for specific industries and works with larger New Zealand exporters, such as the large dairy company Fonterra, to develop new markets. Industry New Zealand was set up to promote domestic industrial and regional development during the Government's last term. Investment New Zealand, Trade New Zealand's inward foreign investment branch, has already been taken over by Industry New Zealand's investment branch. Industry New Zealand also has a strong private sector focus and is more politically sensitive than Trade New Zealand. Trade New Zealand's budget for 2002-03 is NZ$ 73.6 million (US$ 34.6 million), most of which is funded by the state. Industry New Zealand, formed in October 2000, plans to spend more than NZ$ 100 million (US$ 47 million). This will consist of NZ$ 57 million (26.8 million) allocated for service delivery, NZ $ 38 million (US$ 17.9 million) for business and regional grants and awards, and NZ$ 10 million (US$ 4.7 million) for newly acquired Investment New Zealand.

New Zealand's competitiveness remains in primary production

According to a study by the New Zealand Institute of Economic Research (NZIER), New Zealand's competitive advantage continues to be focused on agriculture, horticulture, and forestry-based products. The study suggests that to improve New Zealand's export competitiveness and thus economic growth, New Zealand needs to place more emphasis on improving efficiencies and on encouraging innovativeness in those industries in which New Zealand already has a competitive advantage. A leading economist suggests that rather than searching for solutions in industries in which New Zealand will not be competitive it should continue to do what it already does, but do it smarter and better. The NZIER analysis did show that between 1985 and 1999 New Zealand benefitted from the continued growth in downstream processing of primary products. Best performing industries during this period included: horticultural products, wine, dairy products, fish, sugar and syrups, wood and paper products, and metal products.

LIVESTOCK & PRODUCTS

Export meat production

As of mid-August, the number of lambs slaughtered for export reached an accumulative total of 22.865 million down 7.5 percent compared with the same period a year earlier. Hogget production totaled 11,229 down 32.1 percent; mutton production totalled 3.893 million down 13.7 percent; steer production totaled 384,030, down 17.7 percent; heifer production totaled 163,002 up 4 percent; cow production totaled 642,541 up 14.3 percent; bull production was similar at 606,056; bobby veal production totaled 663,990 up 20.5 percent. Total beef slaughter for export was up 0.3 percent at 1,770,517 head compared with the same period last year. Goat slaughter was down 13.7 percent at 105,886.

HORTICULTURE & PRODUCTS

Guiness Peat Group unveils plan for Enza and Turners & Growers merger

Guinness Peat Group (GPG), which owns 100 percent of Enza and 46 percent of Turners & Growers, will keep the names Enza and Turners & Growers in its plan to merge the two companies. Enza used to be a grower-owned cooperative mainly involved in apple and pear production and export with an extensive overseas distribution network. Turners & Growers is a well established national wholesaler, auctioneer, importer, and exporter of fresh fruit and vegetables. GPG, which is known as a ‘corporate raider’, has indicated it would not exit the new company. The merged company is expected to generate annual revenues of NZ$ 1 to 1.2 billion. The merger is expected to provide significant synergies in shipping, transport, container management, overseas importer networks, warehouse facilities, cool stores and shared services, such as finance and information technology. If the merger is approved by shareholders at Turners and Growers annual meeting in November, as well as by government regulators, the new company will seek a full stock exchange listing and a capital raising of NZ$ 50 to 100 million (US$ 23.5 - 47 million) in the first quarter of 2003. All grower suppliers of both companies will be offered a preferential entitlement to shares in the capital raising. Industry insiders predict that the new company may plan to enter into the kiwifruit market, which is currently legally controlled by Zespri International (except for kiwifruit to Australia).

NZ$ 15 million promotional investment in gold kiwifruit

Zespri has backed its new gold kiwifruit variety by investing considerable resources on promotional activities in the Asian region this year. Zespri spent NZ$ 15 million (US$ 7 million) on what it described a 'risky' campaign including TV advertising. Correspondingly, sales in Japan, Korea and Taiwan were unexpectedly strong and only constrained by this year's smaller gold crop. A long-time kiwifruit critic commented that while gold kiwifruit commanded a premium of more than NZ$ 5 (US$ 2.35) a tray, none of this benefit was going back to growers because up to NZ$ 3.50 (US$ 1.65) per tray was going towards defraying promotional costs (as opposed to green kiwifruit which is NZ 50 cents or US 23.5 cents per tray). Zespri is, however, forecasting another record payout for the year (ended March 2003), with a projected return of NZ$ 488.8 million (US$ 230 million up 2.6 percent) on a volume of 59.7 million trays (down 8 percent). The forecast payments for kiwifruit (per tray equivalent) are: green NZ$ 7.91 (US$ 3.72 up 10.6 percent), organic NZ$ 9.86 (US$ 4.63 up 20 percent, which includes a NZ 50 cents or US 23.5 cents per tray top-up payment from green growers to encourage organic growers to maintain and increase organic production), and gold NZ$ 9.21 (US$ 4.33 down 1.8 percent).

By week 33, global sales had reached 33.4 million trays (4.6 million trays ahead of the same time last year). Japan was driving the good performance and had reached 8.5 million trays (up 3.7 million trays). Sales to Europe had reached 19.2 million trays, which was at similar levels to last year despite recent price increases for all products.

Maori kiwifruit group wants freedom from Zespri monopoly

A group of Maori kiwifruit growers, which produces about 5 percent of NZ's annual crop, is lobbying politicians and foreign buyers for the freedom from Zespri's statutory export monopoly in order to export their own fruit. The group wants that either Maori growers are allowed to form a brand and export worldwide themselves or that Maori packhouses are allowed to set up their own export channel independent of Zespri. How far the group will take this issue is unclear at this stage but as far as Zespri is concerned the issue had previously been dealt with in a similar case. Then the Waitangi Tribunal refused the Maori company Aotearoa the right to export its own fruit and ruled that industry regulations applied equally to all growers. The Maori group is raising these issues at a time when Zespri is trying to prevent illegal kiwifruit exports from New Zealand to Asian markets via transhipments through Australia, to which kiwifruit can be legally exported.

Kiwifruit volumes down in 2003

HortResearch scientists are warning that this winter is not cold enough and that bud break on Hayward kiwifruit could be as late early October in Te Puke and Kerikeri. The number of flowers could be low and similar to levels last seen in 1998. Growers can apply hydrogen cyanamide (HiCane) to break dormancy. The compound has been shown to increase the number of flowers/bud by 0.3 at cool sites and 0.6 at warm sites. In the Bay of Plenty and Kerikeri, for example, HiCane is equivalent to lowering the winter temperature by 1 degree Celsius.

Baby Kiwifruit

A Bay of Plenty fruit exporter plans to boost the marketing of the small kiwifruit variety, Arguta, throughout New Zealand and internationally. Arguta is a different fruit to the commercial kiwifruit varieties marketed internationally by Zespri. It produces red, pink and green fruit, has the size of a large cherry and a smooth surface. The company is aiming to expand sales of the 'baby' kiwifruit through supermarket chains in Japan, Taiwan, the U.S. and the UK.

New Zealand scientists develop technology to stop browning of apple slices

HortResearch scientists claim to have worked out how to stop sliced apples from browning and going mushy. The new technology is to be licensed to U.S. fruit processors who want to take advantage of the fast growing segment in the US$ 100 billion fresh produce market. The method will extend the fridge-life of sliced apples to three weeks. Other fruit and vegetables such as as cucumber, tomatoes and lettuce, may be adapted to the same method. The method involves washing damaged cells and cleaning bacteria from the surface of apple slices and adding vitamin C and does not involve preservatives in the process.

DAIRY

Fonterra first year financial results

Fonterra's financial position deteriorated in the last six months of its financial year, to May 31. Total assets declined by NZ$ 818 million (US$ 384.5 million) from NZ$ 12.618 billion (US$ 5.93 billion). Equity declined from NZ$ 5.188 billion (US$ 2.44 billion) to NZ$ 4.485 billion (US$ 2.11 billion), and borrowings increased from NZ$ 3.855 billion (US$ 1.81 billion) to NZ$ 4.555 billion (US$ 2.14 billion). The cash balance declined from NZ$ 497 million (US$ 233.6 million) to NZ$ 37 million (US$ 17.4 million). The cash operating surplus was NZ$ 855 million (US$ 401.9 million) for the first six months but minus NZ$ 501 million (US$ 235.5 million) for the second six months. Intangibles (mainly the value of brands) declined from NZ$ 1.859 billion (US$ 874 million) to NZ$ 1.587 billion (US$ 746 million). The first official valuation of the Fonterra brands disclosed just over NZ$ 1 billion (US$ 470 million) increase in intangible assets, when compared with those of their founding entities. The report also indicates a NZ$ 400 million (US$ 188 million) decline in dairy product inventory levels.

Fonterra chairman quits after one year into a three year term

John Roadley, farmer director of Fonterra, has resigned from his post after less than one year into his three year term. The resignation comes after Roadley claimed that he met his three major goals since the dairy industry merger: to ensure shareholders agreed to the merger, to see the Fonterra co-operative through the risky transitional first year, and to achieve consensus among the board and management on Fonterra's future business strategy. He believed the goals had been achieved or would be achieved by the end of this year. According to insiders, his resignation appears to have been hurried by a shareholders decision to reduce the number of farmer directors from ten to nine (and increase appointed directors from 3 to 4). Had he not resigned, a costly by-election would have been held. Roadley is replaced by a commercial director, van der Heyden, who has been in the dairy industry for some time.

Fonterra's year in review

Fonterra has had a difficult first year in operation. Shareholders and Dairy Farmers of New Zealand are taking issue with several events dsicussed below. The dairy industry is being compelled to acknowledge that international dairy commodity prices continue to be the main factor in local dairy farmer returns. The final payout forecast for the 2002-03 season whas been revised downwards on several occasions over the last half year with some analysts now predicting more downside payout risk to as low as NZ$ 3.30 to 3.40 (US$ 1.55 - 1.60) per kg milksolids. Fonterra has been plagued by a run of unfavorable publicity.

Fonterra's accounting accuracy is being closely scrutinized after a NZ$ 34 million (US$ 15.98 million) discrepancy emerged between figures reported a month ago and those in Fonterra's annual report. Originally, earnings for Fonterra's subsidiary, NZ Milk, before interest and tax were NZ$ 336.2 million (US$ 158 million) on sales revenue of NZ$ 5.604 billion (US$ 2.63 billion). But in Fonterra's annual report, posted to farmers in mid-August, NZ Milk earnings before tax and interest were NZ$ 34.2 million (US$ 16.1 million) lower at NZ$ 302 million (US$ 142 million), and sales revenue was down slightly at NZ$ 5.583 billion (US$ 2.62 billion). Fonterra's CFO reportedly told media that the error arose because Fonterra's result had been audited by July 19 but NZ Milk's audit was not completed until later. However, Fonterra's auditor, KPMG, reportedly told the press that they did not audit NZ Milk at all. Under the Companies Act, companies can choose whether to audit wholly owned subsidiaries.

Further issues are: Fonterra's NZ$ 50 million maiden year loss, early-season on-farm milk collection problems, high domestic milk prices despite low international commodity prices, the strategic 'fit' of Fonterra's numerous joint ventures and acquisitions worldwide, on-going MAF investigations over illegal milk powder exports which occurred prior to the industry merger, NZ$ 3 million (US$ 1.41 million) of spending on top of directors' fees indicating high corporate costs and a general lack of accounts' transparency, and worse than expected cashflow than previously forecasted. A cashflow forecast from October 2001, in an investment prospectus, showed cashflow of NZ$ 879 million (US$ 413 million), however, this had deteriorated to NZ$ 354 million (US$ 166.4 million) in Fonterra's annual report, reflecting plunging international commodity prices and the company's investments, mainly factory expansions, and the situation in the marketplace with Fonterra holding more inventory than they would have liked to.

The Shareholders Council was also concerned about Fonterra's subsidiary, NZ Milk Products, which produced more than NZ$ 37 million (US$ 17.4 million) worth of product that was not fit for purpose and another NZ$ 7.2 million (US$ 3.38 million), which was downgraded. Five events caused NZ$ 19.3 million worth of losses but this was offset by 17 plants that exceeded grading targets.

Reportedly, plant overcapacity was another concern for the Shareholders Council. According to estimates, Fonterra had nearly twice the amount of plant capacity that an efficient milk processor should employ. Credit rating agency Standard & Poor was reported as saying that an efficient milk processor would have NZ$ 2.2 billion (US$ 1.03 billion) tied up in fixed capital, but Fonterra had NZ$ 3 billion (US$ 1.41 billion) at the end of last season. Furthermore, a hypothetical competitor would have NZ$ 1.5 billion (US$ 0.71 billion) in working capital compared to Fonterra's NZ$ 3 billion US$ 1.41 billion). However, Fonterra is said to address this issue in its current business plan. On the upside, Fonterra reported that it had realized merger synergies of NZ$ 74 million (US$ 34.8 million).

Fonterra sells Korean joint venture

Fonterra is selling its 50 percent shareholding in the Korean-based Maeil New Zealand Cheese Company (MNZCC) to Maeil Dairy Industry Co Ltd. MNZCC is recognized for quality cheese products, such as high calcium cheese, which it also exports to McDonalds in Japan. The joint venture, which was set up 13 years ago was aimed to establish a strong position in the Korean cheese market. Korea is now Fonterra's second largest cheese market in Asia, and MNZCC is the market leader. Fonterra agreed to sell its share to Maeil so that each partner could pursue other opportunities but Fonterra will continue to cooperate and remain in the Korean market.

New Zealand Dairy Foods Holdings Limited raises funds

New Zealand Dairy Foods Holdings Limited has proposed a capital notes offer for public subscription to raise funds in order to cover repayments in connection with its takeover of New Zealand Dairy Foods Limited earlier this year. The notes will be unsecured subordinated and fixed-rate debt obligations. These will be issued to New Zealand investors in two forms: five-year and ten-year capital notes. The offer is for NZ$ 100 million (US$ 47 million), with up to NZ$ 50 million (US$ 23.5 million) in oversubscriptions at the issuers discretion. Application has been made to the New Zealand Stock Exchange for permission to list securities.

Tatua develops specialized products

The Tatua Co-op Dairy Co, one of the two small independent dairy companies with the highest payouts in the New Zealand dairy industry said that it was concentrating on specialized protein products extracted from milk. Tatua also conducts research into tracing the linkages between specific gene sequences in cattle and particular traits, such as the production of valuable proteins. Such linkages could enhance selective breeding of animals able to produce milk high in such proteins. Tatua had also taken out the intellectual property rights over research to break down milk into smaller peptides. Such work has the potential for the development of a milk to control blood pressure and cash-in on the growing market for natural alternatives to drugs. Tatua indicated that the business it was in was essentially different from Fonterra's large-scale commodity production.

Transfer of shares to sharemilkers approved

Fonterra shareholders have approved that shares in Fonterra could now be transferred to sharemilkers. Even tough the Dairy Industry Restructuring Act already allowed for such transfers the resolution is now established in the constitution. The resolution allows sharemilkers and shareholding farm owners to transfer some of the farm's shares into the ownership of the sharemilkers for the length of their contracts. This is seen as a significant step toward recognition of the importance of sharemilkers in the dairy industry.

FORESTRY

Fletcher Forests proposal to buy CNFIP failed

In a vote on August 13, Fletcher Forests' shareholders have rejected the company's proposal to buy the assets (162,000 hectares of forests and sawmills) of the Central North Island Forests Partnership (CNIFP) for NZ$ 1.44 billion (US$ 677 million). Shareholders were suspicious about the motives and role of the 35 percent Chinese Government investor, Citic (the same partnership had failed before), and spooked by Fletcher Forests rising debt levels (five fold to NZ$ 1.3 billion or US$ 611,000) to finance the deal. The deal was also considered high-risk because a fall in log prices could have potentially forced Fletcher Forests into receivership. In response to the vote outcome Citic indicated that it might consider buying the CNFIP alone.

According to industry insiders, the CNFIP deal would have meant a much needed consolidation of the NZ forestry industry. For now, this is not going to happen. However, there are unofficial reports that a mega-company may be created, consisting of major forestry firms. Fletcher Forests, Carter Holt Harvey, and the CNFIP currently control the lion's share of New Zealand's log exports.

FISHERIES

New fishing company 'Aotearoa Fisheries Ltd' proposed

The Treaty of Waitangi Fisheries Commission has proposed the establishment of a new fishing company to provide a vehicle for Maori to strengthen their influence within the industry. Through assets held by the Fisheries Commission, Maori already own or control more than a third of New Zealand's commercial fishing quota. According to proposals by the commission's chairman, Aotearoa Fisheries Ltd would initially account for almost 39 percent (NZ$ 600 million or US$ 282 million) of the total industry's earnings of NZ$ 1.5 billion (US$ 705 million). The Fisheries commission currently owns a 50 percent stake in the Sealord Group, 84 percent in Moana Pacific Fisheries Ltd, and 50 percent in Prepared Foods Ltd, and wholly owns Chatham Processing Ltd and Pacific Marine Farms. Aotearoa Fisheries Ltd would rank in the top 10 largest primary procures in New Zealand. The Commission will consult with iwi (ie. officially recognized Maori tribal groups) and other interested Maori groups until early October. It is understood that not all Maori representative groups are happy with the proposal.