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Report Highlights: The New Zealand Government moves toward a free trade agreement with Thailand. Forestry: Fifteen percent of NZ's forests available for sale. Biotechnology: Increased government funding for biotechnology in 2003/2004 budget. Biotechnology report makes recommendations to create a US $6 billion industry by 2013. Dairy: Fonterra increases its stake in Australia's dairy sector.

Includes PSD changes: No
Includes Trade Matrix: No
Unscheduled Report
Wellington [NZ1], NZ

GENERAL

New Zealand Evaluates Potential Free Trade Agreement with Thailand

The New Zealand and Thai Governments have agreed to initiate a feasibility study for a bilateral free trade agreement between the two countries. The New Zealand Government is aware that Thailand and Australia have already initiated negotiations on a closer economic partnership agreement and is concerned that a successful conclusion may displace New Zealand exports in the Thai market. The current trade balance favors Thailand by more than NZ $100 million[1], due in part to significant tariff barriers and import restrictions on New Zealand dairy products as well as complex Thai customs procedures. The feasibility study is expected to be completed by December 2003.

FORESTRY & PRODUCTS

Fletcher Challenge Forests Plans to Sell Its Forest Assets

Fletcher Challenge Forests (FCF) has announced plans to sell by the end of 2003 its entire New Zealand forestry estates estimated at approximately 106,000 hectares. The announcement comes after a recent sale of 8 percent of its forests to UBS Timber and indications earlier this year that it would separate its forest operations from other wood processing activities (see: NZ3008). The proposed sale of FCF's forestry estates and the availability of an additional 165,000 hectares under the CNIFP means that 15 percent of New Zealand's total plantation forests are now available for sale. Some analysts predict that if FCF is determined to sell its forest plantations within this time period, it may be compelled to sell at prices which fail to reach asset values shown in FCF's financial statements. This supports the view of many in the industry that New Zealand's forests are overvalued. A portion of FCF's sales proceeds will be utilized to provide additional working capital and investment for FCF's processing operations. The remainder will be returned to FCF's shareholders.

Fletcher Challenge Forests Announces Final Settlement of CNIFP Issues

Fletcher Challenge Forests (FCF) has relinquished its interests in the Central North Island Forest Partnership's (CNIFP) 165,000 hectare forest estate (see: NZ3008). FCF announced in May that it had signed an agreement with the receivers of the CNIFP and the CNIFP banking syndicate to settle a range of outstanding legal and financial issues. Under the terms of the settlement, FCF will make a net payment of NZ $7.5 million to the CNIFP receivers to settle all disputes and loans. This includes a payment of NZ $1.5 million to the Chinese-government investment company Citic to settle litigation brought against FCF by Citic and a payment of NZ $8.5 million to the CNIFP receivers to settle a FCF Group intercompany debt. While FCF will lose its contract with the CNIFP receivers to manage the CNIFP estate to the newly-formed Timber Management Company, FCF will receive NZ $2.5 million from the CNIFP receivers for costs related to the cancellation of its management contract. FCF has agreed with the CNIFP receivers to buy 500,000 cubic meters of sawlogs from CNIFP every year. This final settlement with the CNIFP leaves FCF in a position to focus on its more profitable downstream wood processing and

[1] Exchange rate: U.S. $0.58 = NZ $1

distribution businesses.

The cutting rights to the CNIFP forests were originally sold by the Crown's Forestry Corporation to a consortium consisting of Fletcher Challenge, Brierley Investments and Citic for NZ $2 billion in 1996. The partnership, however, was put into receivership in February 2001, by the financial institutions which financed the partnership's forest cutting rights purchase. While FCF and Citic tried to buy back the cutting rights from the CNIFP receivers in late 2002, the proposed deal did not find sufficient FCF shareholder support due to concerns over high debt levels associated with such a purchase. With the failed attempt to buy back the cutting rights, FCF had hoped to retain an annual NZ $10 million (after tax) management contract for the forest estate. However, the CNIFP receivers established their own Timber Management Company (TMC) in early 2003 to assume management responsibility for its forests.

DAIRY & PRODUCTS

Fonterra Reaches Tentative Merger Agreement with Australia's Bonlac Foods

The Australian dairy cooperative Bonlac Foods, Australia's fourth-largest dairy company, and Fonterra have agreed in principle to allow Fonterra to raise its stake in Bonlac Foods from 25 percent 50 percent. Under a new partnership agreement, Bonlac Foods will focus on milk collection and processing while Fonterra will purchase Bonlac Foods' products and market them internationally. Once the merger is concluded, Fonterra will have a role in Bonlac Foods' processing activities and management. Bonlac expects to put the merger proposal to its supplier shareholders for vote at the end of July. Bonlac's Board seeks to gain approval from three quarters of its shareholders before it will proceed with the merger.

Bonlac Foods is Australia's largest dairy ingredients business (supplying Japan, the Middle East and Asia) but has recently incurred significant financial losses and was forced to sell some of its assets. Through its 25 percent shareholding, Fonterra was exposed to Bonlac Foods' financial losses. Fonterra's decision to increase its stake in Bonlac Foods follows the collapse of merger negotiations between Bonlac Foods and Australia's Murray Gouldburn dairy company in March 2003. Fonterra's marketing strategy calls for the creation of a New Zealand-Australian home market. Fonterra already has a well-established presence in Australia through its ownership of Australasian Food Holdings, a stake in National Foods and its New Zealand Milk subsidiary in Australia.

Fonterra Increases Fair Value Share Price 14 Percent

Fonterra dairy farmers will have to purchase Fair Value shares in Fonterra at NZ $4.38 (up 14 percent) for every additional kilogram of milksolids (MS) they supply beyond existing supply rights already owned for the 2003/2004 (June to May) season. The Fair Value share price also represents the value of Fonterra's business on the basis of its total milk solids production. Fonterra commented that an independent valuation by Standard & Poor, which was used to set the new Fair Value share price, recognized that Fonterra had achieved operational cost reductions and made sound investment decisions in the past season. The steady increase in the Fair Value Share price over the past few seasons, along with significantly lower milk payouts in 2002/2003 and again in the current season, will prompt farmers to consider carefully the return on their investment when making production expansion decisions. Producer return on investment declined in 2002/2003 and is set to fall again in the current season. This points to a slower growth in New Zealand's milk production for 2003/2004. Some farmer representatives, however, comment that the Fair Value share price of NZ $4.38 may be considered relatively cheap in years to come.

NZ Breeding Company Develops Breeding Index for "Once-A-Day Milking" Dairy Herds
The New Zealand breeding company Livestock Improvement (LI) has developed an exclusive Breeding Index (BI) which enables it to identify Artificial Breeding bulls to sire cows suited to once-a-day milking. The BI also enables the identification of cows with the appropriate traits so that dairy farmers can rank their herd and identify cows with the most advantageous characteristics. LI's on-farm research has shown that while per cow milk volume is somewhat reduced under a once-a-day milking regime, it is possible to compensate for lower per cow production by increasing the farm stocking rate 15 percent. The BI provides a critical tool for dairy farmers to identify and breed a dairy herd that maximizes milksolids production under the once-a-day milking regime at lower milk volumes. Jersey cows are most suited for once-a-day milking since their milk has a higher protein and fat content, which represent the main raw milk components on which New Zealand dairy companies base their payments to producers. Jersey cows represent a quarter of New Zealand's national dairy herd and producers are introducing more Jersey genetics into their dairy herds.

Apart from the obvious convenience for dairy farmers and the lower operating costs associated with once-a-day milking, there are also advantages in terms of animal health, farm management and grazing practices, and pasture utilization. Increased pasture utilization is the critical factor which enables dairy farmers to raise stocking rates. LI has developed the BI on the basis of the animal's physical characteristics, but BI selection will utilize ongoing research on gene-trait linkages tied to the bovine genome map. This knowledge will help to identify animals with genes responsible for increased fat and protein production. Livestock Improvement in conjunction with ViaLactia Biosciences (a Fonterra subsidiary which conducts R&D focused on biotechnology) is currently undertaking this work.

BIOTECHNOLOGY

Increased Funding for Biotechnology in Government's 2003/2004 Budget
In the New Zealand Government's 2003/2004 budget (released in May) funding for "operational investment" under the broad category of Research, Science and Technology (RST) is set to increase nearly 9 percent to a record NZ $545 million. The Government will also introduce a new funding category to support the commercialization of publicly-funded research. The increased funding is targeted at the NZG's Growth and Innovation Framework (GIF) initiative which is the basis for the Government's economic strategy to promote economic growth through targeted investments in biotechnology, information technology, and creative industries sectors. It is anticipated that biotechnology will be allocated the lion's share of this year's additional RST funding, which could direct almost NZ $170 million to the biotechnology sector. This will assist

the NZG in achieving its biotechnology goals which are identified in a national Biotechnology Strategy document released in May (see: www.morst.govt.nz).

Industry Biotechnology Report Aims For NZ $10 billion Biotechnology Industry

A Biotechnology Taskforce, convened by the New Zealand Government (NZG), with representatives from industry, academia and the government's Crown Research Institutes issued in May its action plan for promoting the development and international competitiveness of New Zealand's biotechnology sector. The taskforce's recommendations were published in a comprehensive report, "Growing the Biotechnology Sector in New Zealand - A Framework for Action" (see: www.morst.govt.nz). The report identifies three primary areas in which the NZG and the biotechnology industry should take action: (1) the need to build a biotechnology industry which reaches critical mass, (2) regulatory reforms needed to create an enabling environment, and (3) the creation of an international network to attract foreign direct investment into the industry. The report also recommends solutions to six problem areas that will permit New Zealand to develop into a viable participant in the global biotechnology marketplace within the next ten years. According to the taskforce's report, following these recommendations will ensure that the number of biotechnology companies in New Zealand with a core biotechnology focus will increase from 40 to more than 200 and that the number of biotechnology organizations will expand from 300 to more than 1,000. Achieving this will create a NZ $10 billion biotechnology industry in New Zealand which will generate exports of goods & services valued annually at NZ $1 billion. The taskforce report highlights the need for: (1) a highly skilled workforce, (2) a more effective approach to attract investment (including tax incentives), (3) more effective partnerships between government, research institutions and industry organizations which will enhance research and drive commercialization efforts, (4) a stronger industry network to establish a unified industry, (5) a more streamlined regulatory framework, and (6) more effective participation in the global biotechnology industry. The taskforce's report served as input to the Government's Biotechnology Strategy which broadly outlines a vision for the development of biotechnology in New Zealand.