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Dairy and Products

Dairy Industry Update

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Report Highlights:
NZ Dairy Board Lifts Forecast for Milk Payout
New Zealand Dairy Companies Find Solutions for Milk Flood
New Zealand Dairy Board and Bonlac Australia Merger Delayed
New Zealand Domestic Structure

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

New Zealand Dairy Board Lifts Forecast for Milk Payout

In it's second seasonal review of the milk price paid to dairy farmers, the New Zealand Dairy Board has announced an increase in the forecast payout for the 2000/01 season by NZ$700 million (US$301 million) for dairy companies and NZ$1 billion (US$430 million) extra in export earnings. The board estimates that its end-of-season milk payment to dairy companies will be between NZ$4.15 - NZ$4.25 cents/kg milksolids, up on the earlier estimated payout of NZ$3.65 - NZ$3.75, and the highest payout ever achieved.

This forecast, which the board said was largely based on record world prices for some products and the very weak Kiwi dollar, would lift the dairy industry's export earnings for 2000/2001 to more than NZ$9 billion (US$3.87 billion). Some industry officials say that given the exchange rate and world market prices, the premiums should take the payout to NZ$5 per kilogram of milksolids. However, it is expected that the board will hold back some of the money to finance overseas acquisitions and mergers.

New Zealand Dairy Companies Find Solutions for Milk Flood

The two largest New Zealand dairy companies are in the process of establishing solutions to New Zealand's "milk flood" problem. The milk flood is created by the fact that processors, in the regulated environment in which they operate, are required to accept all milk from their suppliers. As a result, processing co-operatives have been forced to build ever-bigger factories to cope with a 60-day flood, based on the differing times when individual farmers' production peaks in the North and South Islands.

As reported in the New Zealand Dairy Annual (NZ0052), New Zealand's largest co-operative, New Zealand Dairy Group (NZDG) has introduced a peak milk rights system to deal with the problem. Under the plan, existing milk suppliers will be allocated peak rights for the October seasonal peak, based on historical production. The peak rights will cost NZ$30 per "peak standardized litre" initially and will be tradable among farmers or shareholders. For new milk, they will be on top of the normal NZ$2/kg milksolids share prices charged by the co-operative to enter the industry.

Kiwi Dairies, New Zealand's second largest co-operative, has recently announced how it intends to tackle the problem. Kiwi's plan involves the issue of capital notes, which could be bought by non-Kiwi farmers through the Stock Exchange and other trading desks. Kiwi's "fair share" package also proposes setting a fair value for shares in Kiwi each year based on the value of the company; requiring all existing and new shareholders who produce additional milk to pay for additional shares at their value when the milk is produced; resuming shares from farmers who cut their production or leave the industry and exchanging them for tradeable capital notes. The standard would determine the number of $1 shares needed, and as the value of the company increased, a higher number of shares would need to be bought from the company to produce extra milk. The standard would also determine the price farmers will get for their shares when selling up. For this it plans to persuade farmers that instead of continuing to get cash in the hand when they surrender their Kiwi shares, they should instead accept capital notes. The market value of these notes would not necessarily be their face value, but would fluctuate, and farmers would be able to buy and sell them on the Stock Exchange or privately on Kiwi's website. Kiwi still has to consult its farmers on its proposal, and shareholders are expected to vote on the proposal March 2001.

New Zealand Dairy Board and Bonlac Merger Delayed
The merger between the New Zealand Dairy Board and Australia's Bonlac Foods has been delayed until early next year by licensing talks going on between Bonlac and it's leading cheese brand Bega. The cheese brand Bega is owned by 125 shareholders of the tiny Australian dairy co-operative, Bega Cheese. It is these shareholders that own the brand to which Bonlac Foods holds the marketing rights. The farmers have bid to Bonlac to maximize the value placed on their brand if a merger goes through between the Dairy Board and Bonlac, and they are prepared to wait for Bonlac to give them the deal they want. The Bega brand is part of the deal which the Dairy Board is buying into, so issues of ownership and payment have to be sorted out before Bonlac can sign the deal with the Dairy Board. Bonlac is understood to be negotiating a franchise or lease of the Bega brand, or failing that, an outright purchase, which could allow more value to be added to New Zealand cheese.

New Zealand Domestic Structure
The two largest co-operatives in New Zealand, Kiwi Dairies and New Zealand Dairy Group (NZDG) have been negotiating since April on how to proceed with the integration of New Zealand's manufacturing and marketing operations. Formal negotiations to merge the two operations fell through in April, when the two companies could not agree to merge their operations. Reasons behind the failed merger were reported to be Commerce Commission requirements that were considered, by both co-operatives, as being unfavourable to the dairy industry.

Industry sources now suggest that the two companies may be able to reach an agreement to merge by Christmas this year, but that reaching the goal of the integration of New Zealand's manufacturing with the Dairy Board could still prove to be a problem. It has been reported that there is increasing consensus among industry leaders that integration of the manufacturing companies with the marketing Dairy Board was the only way forward. It is expected that the two companies will be able to achieve a deal at some point but whether or not the structure can make it through the Government and the Commerce Commission remains to be seen. Industry officials have said that the constraints that the Commerce Commission placed on the merger last time would have to be reviewed as it would be pointless taking any structure to the commsission if the constraints still existed. New Zealand's Agriculture Minister had signaled some accommodation but the industry has had no indication of the details. The companies have done some changing to meet the commission requirements, such as meeting a fair value entry and exit system from the co-operatives. It is thought that Kiwi's proposed share structure could be joined with Dairy Group's peak rights proposal quite easily.

Kiwi Dairies Mergers With Marlborough Cheese Co-operative
The small Marlborough Cheese dairy company, with 81 suppliers, and Kiwi Dairies have announced plans to merge. This merger now leaves only four dairy companies in New Zealand, NZDG, Kiwi, Tatua and a Westland company. Marlborough had maintained that it was likely to remain outside the two dairy giants, but there was some scepticism that the stance was more of a bargaining ploy than a real intention. Industry top performer Tatua, on the other hand, is not expected to change its position of fierce independence. Marlborough has a sound manufacturing

operation, its cheese is well respected and the company has historically performed well on the domestic market.