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Report Highlights: New Zealand's fluid milk production is forecast to rise 16 percent in the 1999/2000 season to a record 12,835,000 metric tonnes (985 million kilograms of milksolids). This is due to increased rainfall that sustained pasture growth throughout the season. Production of cheese, whey and milk powder products is forecast to increase, though butter is still constrained by the Russian market. Dairy export prices are also forecast to increase due to increased world commodity prices, lower subsidized competitor exports and a favorable exchange rate for New Zealand exporters. The proposed mega-merger, integrating New Zealand's marketing and manufacturing of dairy products, was called off in March 2000. Dairy leaders are now trying to decide the future of the dairy industry. The Minister of Agriculture has also rejected Government led deregulation of the industry.

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SECTION I. SITUATION AND OUTLOOK

New Zealand's fluid milk production is forecast to reach a record 12,835,000 metric tons, or 985 million kilograms of milksolids, in the 1999/2000 season. This results in a 16 percent increase in fluid milk production from the 1998/99 season which produced 11,070,000 metric tons or 850 million kilograms of milksolids. The 1999/2000 season was characterized by record rainfall in key dairying areas, such as Southern Auckland and Taranaki/Wellington, through the spring and summer months. This sustained pasture growth throughout the period, and also allowed farmers to make plenty of supplements to prepare for the late summer dry period.

The large increase in fluid milk production has greatly increased production of cheese, milk powder, whey and casein products for the 1999/00 season. Butter production is up slightly, but is still being impaired by the lack of demand for the product in Russia. Dairy export prices have also made a recovery from last season's low due to an upswing in world commodity prices and a favorable exchange rate for New Zealand exporters. New Zealand industry sources note that restrictions imposed under the GATT Uruguay Round (WTO) are also proving to be favorable for New Zealand dairy exports this season, as the EU and the U.S. are beginning to steadily reduce the volume of their subsidized exports.

The New Zealand Dairy Board (NZDB) has indicated that its estimated end-of-season payout for the 1999/2000 season will be NZ \$3.25-\$3.30 (U.S. \$1.59-\$1.62) per kilogram of milksolids. Forecast final dairy company payouts for the 1999/2000 season currently range between NZ \$3.70-\$4.00 (U.S. \$1.81-\$1.96) /kgMS.

The proposed mega-merger that was to merge all seven dairy companies with the Dairy Board in the hope of integrating marketing and manufacturing of New Zealand dairy products, was called off at the end of March 2000. The mega-merger failed because the two largest dairy companies, New Zealand Dairy Group and Kiwi Dairies, failed to merge. The mega-merger was to provide the dairy industry with gains of up to US \$150 million a year. With the failure of the mega-merger, leaders of the dairy industry are in negotiations to decide the future of the industry. Dairy Board leaders would like to see some of the benefits of the mega-merger captured in any future structure of the industry. The two dairy companies, which between them control 75 percent of the dairy industry, are more interested in pursuing options that would allow the companies to become independent players in the international market. The Minister of Agriculture, however, has recently announced his decision to reject a call for the industry to be deregulated in light of the failing merger. The future of the New Zealand dairy industry is at present, unclear. The two dairy companies are in the midst of plan making and have said they will reveal their plans to shareholders within the next month or two.

Meanwhile, the New Zealand Dairy Board is actively seeking alliances and partnerships with international dairy companies. A Heads of Agreement has been signed between the Board and Bonlac, Australia's second largest dairy company. The agreement outlines proposals under which, parts of each organization's operations will be merged and the New Zealand Dairy Board will take a minority role. The agreement is still subject to the approval by Bonlac's supplier shareholders and NZDB board of directors. The Board has also told European dairy industry leaders that the Board is investigating new partnerships, joint ventures and acquisitions with

Europeans.

SECTION II. STATISTICAL TABLES

PSD Table: Fluid Milk

PSD Table						
Country New Zealand						
Commodity	Dairy, Milk, Fluid		(1000 HEAD)(1000 MT)			
	Revised	1998	Preliminary	1999	Forecast	2000
	Old	New	Old	New	Old	New
Market Year Begin		06/1997		06/1998		06/1999
Cows In Milk	3270	3270	3285	3285	3295	3300
Cows Milk Production	11640	11640	11070	11070	12020	12835
Other Milk Production	0	0	0	0	0	0
TOTAL Production	11640	11640	11070	11070	12020	12835
Intra EC Imports	0	0	0	0	0	0
Other Imports	0	0	0	0	0	0
TOTAL Imports	0	0	0	0	0	0
TOTAL SUPPLY	11640	11640	11070	11070	12020	12835
Intra EC Exports	0	0	0	0	0	0
Other Exports	15	15	15	15	15	15
TOTAL Exports	15	15	15	15	15	15
Fluid Use Dom. Consum.	400	400	400	400	400	400
Factory Use Consum.	10774	10774	10250	10250	11125	11931
Feed Use Dom. Consum.	451	451	405	405	480	489
TOTAL Dom. Consumption	11625	11625	11055	11055	12005	12820
TOTAL DISTRIBUTION	11640	11640	11070	11070	12020	12835
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0

PSD Table: Cheese

PSD Table						
Country	New Zealand					
Commodity	Dairy, Cheese			(1000 MT)		
	Revised	1998	Preliminary	1999	Forecast	2000
	Old	New	Old	New	Old	New
Market Year Begin		06/1997		06/1998		06/1999
Beginning Stocks	41	41	41	41	13	13
Production	266	266	245	238	285	270
Intra EC Imports	0	0	0	0	0	0
Other Imports	1	1	0	0	0	0
TOTAL Imports	1	1	0	0	0	0
TOTAL SUPPLY	308	308	286	279	298	283
Intra EC Exports	0	0	0	0	0	0
Other Exports	232	232	240	240	245	245
TOTAL Exports	232	232	240	240	245	245
Human Dom. Consumption	35	35	33	33	33	26
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	35	35	33	26	33	26
TOTAL Use	267	267	273	266	278	271
Ending Stocks	41	41	13	13	20	12
TOTAL DISTRIBUTION	308	308	286	279	298	283
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	21	21	35	35	35	35

PSD Table: Butter

PSD Table						
Country	New Zealand					
Commodity	Dairy, Butter				(1000 MT)	
	Revised	1998	Preliminary	1999	Forecast	2000
	Old	New	Old	New	Old	New
Market Year Begin		06/1997		06/1998		06/1999
Beginning Stocks	88	88	86	86	87	93
Production	343	343	310	316	345	320
Intra EC Imports	0	0	0	0	0	0
Other Imports	0	0	0	0	0	0
TOTAL Imports	0	0	0	0	0	0
TOTAL SUPPLY	431	431	396	402	432	413
Intra EC Exports	0	0	0	0	0	0
Other Exports	315	315	279	279	320	300
TOTAL Exports	315	315	279	279	320	300
Domestic Consumption	30	30	30	30	30	27
TOTAL Use	345	345	309	309	350	327
Ending Stocks	86	86	87	93	82	86
TOTAL DISTRIBUTION	431	431	396	402	432	413
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	15	15	16	16	17	17

PSD Table: Non-fat Milk Powder

PSD Table						
Country	New Zealand					
Commodity	Dairy, Milk, Nonfat Dry (1000 MT)					
	Revised	1998	Preliminary	1999	Forecast	2000
	Old	New	Old	New	Old	New
Market Year Begin		06/1997		06/1998		06/1999
Beginning Stocks	60	60	67	67	54	54
Production	215	215	203	203	215	210
Intra EC Imports	0	0	0	0	0	0
Other Imports	0	0	0	0	0	0
TOTAL Imports	0	0	0	0	0	0
TOTAL SUPPLY	275	275	270	270	269	264
Intra EC Exports	0	0	0	0	0	0
Other Exports	197	197	205	205	210	205
TOTAL Exports	197	197	205	205	210	205
Human Dom. Consumption	11	11	11	11	11	11
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	11	11	11	11	11	11
TOTAL Use	208	208	216	216	221	216
Ending Stocks	67	67	54	54	48	48
TOTAL DISTRIBUTION	275	275	270	270	269	264
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	6	6	3	3	3	3

PSD Table: Whole Milk Powder

PSD Table						
Country	New Zealand					
Commodity	Dairy, Dry Whole Milk Powder (1000 MT)					
	Revised	1998	Preliminary	1999	Forecast	2000
	Old	New	Old	New	Old	New
Market Year Begin		06/1997		06/1998		06/1999
Beginning Stocks	47	47	54	54	40	40
Production	397	397	382	382	425	420
Intra EC Imports	0	0	0	0	0	0
Other Imports	0	0	0	0	0	0
TOTAL Imports	0	0	0	0	0	0
TOTAL SUPPLY	444	444	436	436	465	460
Intra EC Exports	0	0	0	0	0	0
Other Exports	359	359	362	362	380	380
TOTAL Exports	359	359	362	362	380	380
Human Dom. Consumption	4	4	4	4	4	4
Other Use, Losses	27	27	30	30	30	30
Total Dom. Consumption	31	31	34	34	34	34
TOTAL Use	390	390	396	396	414	414
Ending Stocks	54	54	40	40	51	46
TOTAL DISTRIBUTION	444	444	436	436	465	460
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	6	6	5	5	4	4

PSD Table: Dried Whey

PSD Table						
Country New Zealand						
Commodity Dairy, Dried Whey (1000 MT)						
	Revised	1998	Preliminary	1999	Forecast	2000
	Old	New	Old	New	Old	New
Market Year Begin		06/1997		06/1998		06/1999
Beginning Stocks	0	1	0	4	0	5
Production	0	21	0	22	0	25
Intra EC Imports	0	0	0	0	0	0
Other Imports	0	1	0	1	0	1
TOTAL Imports	0	1	0	1	0	1
TOTAL SUPPLY	0	23	0	27	0	31
Intra EC Exports	0	0	0	0	0	0
Other Exports	0	18	0	21	0	25
TOTAL Exports	0	18	0	21	0	25
Human Dom. Consumption	0	1	0	1	0	1
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	0	1	0	1	0	1
TOTAL Use	0	19	0	22	0	26
Ending Stocks	0	4	0	5	0	5
TOTAL DISTRIBUTION	0	23	0	27	0	31
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	0	5	0	7	0	8

TRADE MATRICES

Half year Trade Matrices for the 1999/2000 year can be found in report NZ006. To date there have been no more quarterly date export releases, but as soon as this data is made available it will be reported.

SECTION III. PRODUCTION, TRADE, MARKETING AND POLICY

PRODUCTION

Fluid Milk

Milk production for the 1999/00 season is forecast to reach a record 12,835,000 metric tons (985 million kilograms of milksolids). Of this 11,931,000 metric tons is estimated to be used for manufacturing purposes, and the rest for the domestic market. This is a 16 percent increase from the 1998/99 season and up from our last forecast (included in the 1999 NZ dairy annual), due to better than expected rains.

The 1999/00 season was characterized by record rainfall in key dairying areas, such as Southern Auckland and Taranaki/Wellington, through the spring and summer months. This sustained pasture growth throughout the period, and also allowed farmers to make plenty of supplements to prepare for the late summer dry period. The dry period hit the Waikato in late October and other key dairying areas late February, and many farmers began drying off mid April and are milking on a once-a-day cycle. The 1999/00 dairy season ends on 31 May, so current forecasts are not expected to change greatly.

The New Zealand milking cow herd is currently around 3.3 million head. This is a 1.2 percent increase from the 1998/99 season. The dairy herd is predicted to increase at the same rate over the next several years.

New Zealand's fluid milk production in 1998/99 totaled 11,070,000 metric tonnes. Of this 10,248,000 metric tons was used for manufacturing purposes, the rest being used for the domestic liquid milk market. Milk production for the 1998/99 season was down 5 percent from the previous season's then record production of 11,640,000 metric tons. New Zealand's dairy industry in 1998/99 was heavily affected by a La Nina-induced drought in several of New Zealand's key dairy areas. The volume of milk solids processed was 850 million kilograms, down 5 percent from the previous season's 893 million kilograms.

Cheese

1998/99 cheese production has been revised given the release of final year data from the New Zealand Dairy Board. Domestic consumption figures have also been revised according to industry estimates, as the domestic cheese market in New Zealand is declining. Cheese production in 1999/00 is forecast to increase 13 percent to 270,000 MT. Cheese stocks are currently low as supply has been tight, and the Dairy Board is selling almost everything that is being produced.

Butter

1998/99 butter and Anhydrous Milk Fat (AMF) production has been revised to 316,000 MT given final New Zealand Dairy Board data. 1999/00 butter and AMF production is forecast to be 320,000 MT. Butter production is only forecast to increase slightly as the weak Russian economy (Russia being New Zealand butter's largest market) is constraining sales due to low consumer demand. The majority of New Zealand butter is now taken by the EU, which only has a quota of 77,000 MT. Thus stocks are high, as product cannot be sold. Exports in 1999/2000 are still forecast to increase over last season's depressed level, when sales to Russia were at their bottom level.

Non-fat Dry Milk Powder

Non-fat dry milk powder production (includes buttermilk) is forecast to increase only 3 percent in the 1999/00, and exports are static.

Whole Milk Powder

Whole milk powder production (includes infant formula) is forecast to increase 10 percent in the 1999/00 year to 420,000 MT (including 35,000 MT of infant formula). Whole milk powder represents approximately 27 percent of total production by volume.

Dried Whey

1998/99 dried whey production has been revised to reflect final data from the New Zealand Dairy Board. 1999/00 production is forecast to increase 14 percent to 25,000 MT.

Casein

New Zealand casein production is forecast to increase 16 percent in the 1999/00 season, from 86,000 MT to 100,000 MT. Casein is an important product for New Zealand and represents 8 percent of total production.

Other (MPC)

New Zealand industry officials note that production and exports of MPC (milk protein concentrates) are growing sharply. Exports of MPC have grown 100 percent over the last year, including increased shipments to the U.S., as this product provides protein that can be added to cheese to extend production.

Farmgate Prices

Each season until the start of the 1998/99 season, the Dairy Board set a value for the components of manufacturing milk (a national farmgate value) which was used for the purpose of determining prices paid to dairy companies for products purchased by the Board for export. The actual payouts made by dairy companies to their suppliers are based largely on the Board's milk value but vary from company to company according to manufacturing cost efficiencies and other factors.

However, from 1 June 1998 a new system of payment from the Board to dairy companies was implemented. This is aimed at improving the alignment between dairy companies manufacturing plans and market requirements. Under the new system, companies will receive a price for standard products based on the international commodity price. They will also receive an additional payment relating to the value added products they produce. This new system aims to encourage dairy companies to focus on producing the products capable of returning the highest value from the market.

The New Zealand Dairy Board announced in the middle of February that it had raised its estimated 1999/2000 end-of-season pay-out from NZ \$3.10-\$3.15/kgMS at the start of the season to \$3.25-\$3.30/kgMS. There will be no more raises for this season from this estimate. The 1998/99 season payout ended at \$3.25/kgMS, with the weighted average Dairy Company pay-out at \$3.58 per kilogram. New Zealand Dairy Group and Kiwi Dairies, the two largest dairy companies in New Zealand, were initially conservative with their forecast end-of-season payouts, but have recently increased them to record levels. New Zealand Dairy Group has forecast a final

pay-out of \$3.60 - \$3.70 and Kiwi Dairies have forecast a pay-out between \$3.90-\$4.00. Final figures are due at the end of July. The current exchange rate is \$1NZ = 0.49 \$US.

TRADE

Gradual improvements in the world dairy market, due in part to the GATT Uruguay Round Agreement, which imposed steadily reducing limits on subsidized exports from Europe and the United States, is raising optimism that the New Zealand dairy industry is facing a cyclical upswing.

The Uruguay Round Agreement imposed a timetable under which Europe and the US agreed to proposals to steadily reduce the volume of their subsidized exports. Since October 1999 the European Union has reduced its subsidies for milk powder five times, and this is flowing on to higher world prices. These WTO commitments are also limiting the ability of the US to export subsidized product. The New Zealand Dairy board has also noted that the WTO restrictions will be applied more rigidly (starting on July 1) with subsidized U.S. exports of NFDM in 2000/01, limited to 68,000 MT compared to 100,000 MT in recent years.

Demand for New Zealand dairy products in Southeast Asia has recovered slightly in the 1999/2000 season, though not as much as expected. The Dairy Board is currently fighting an attempt by Japan to block imports through customs classifications of products. Certain products are being prevented from entering the Japanese market as they claim the products do not fit into customs classification criteria for the traditional dairy produce. This is causing some concern as Japan is an important market for New Zealand cheese, non-fat milk powder and whey products.

Another trade issue of major concern to the New Zealand dairy industry in Asia is the Thai market. Thailand has administered a tariff quota for skim milk powder, but it is causing time delays in issuing licenses. New Zealand, Australian and other dairy exporters have laid complaints to counter this action, and are currently awaiting a resolution. Thailand has also recently increased its tariff on whole milk powder imports from 5 percent to 18 percent which has the potential to hurt New Zealand dairy exports to Thailand considerably.

Due to the lack of demand in the Russian market, traditionally the largest importer of New Zealand butter, Egypt has become the Dairy Board's largest market in the Middle Eastern region with sales of around NZ \$200 million (U.S. \$100 million). The Russian financial crisis forced the Board to find another major market for its butter exports. Although Egypt does not take the same high quantities that were traditionally shipped to Russia, officials report that the country offers huge potential for growth due to both population and GDP growth and an economic upswing. Egypt is now the second largest export market for New Zealand butter, behind the United Kingdom and ahead of Russia. NZMP, the ingredients business of the Dairy board, will sell 23,000 tons of butter into the Egyptian market in the 1999/2000 year, up from 9,000 tons five years ago.

Trade Agreements

The New Zealand Government is currently going through a round of talks with Singapore concerning a free trade agreement which it hopes to conclude this year. An agreement with Singapore is seen as a stepping stone for New Zealand to join a major Asian trading bloc. The trading bloc involves a trillion-dollar trade deal spanning Australia, New Zealand, and nine South-

East Asian countries. Talks concerning the potential trade deal were held in New Zealand on April 27 and at this meeting delegates agreed to further study the proposal at meetings in other nations throughout the year. The proposal would unite Closer Economic Relations members Australia and New Zealand with the Association of Southeast Asian Nations, which comprises Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam.

The New Zealand Dairy Board has only limited interest in this agreement, as barriers to entry in Southeast Asian markets are not that high. Thailand is an exception, however, and the Dairy Board would hope to see benefits from this market, if the trade agreement went through.

POLICY

Domestic

The New Zealand dairy industry has experienced a major shake-up in the past two months. The dairy industry mega-company that was to integrate the manufacturing and marketing divisions of the industry was not formed due to lack of agreement between the two largest co-operatives. The mega-company had gone through two years of planning and was to provide the industry with gains of up to US \$150 million a year. The failure of the two largest co-operatives, New Zealand Dairy Group (NZDG) and Kiwi Dairies, to agree to merge (necessary for the mega-merger to form) has caused much discontent in the dairy industry. The failure between the two companies to merge was due to two main reasons: the lack of agreement on a valuation for the two companies, and the future position of New Zealand Dairy Foods, which would effectively be in competition to the mega co-op but would still be partly owned by Waikato dairy farmers. Differences in culture and business philosophies also kept the two co-ops apart. (For further details see NZ0017).

Leaders in the dairy industry are now trying to address the issue of uncertainty in the wake of the mega-merger talks collapsing and the issues relating to the merger. Leaders in the Dairy Board are very interested in trying to capture the benefits that the mega-merger would have offered. There is a lack of integration in the New Zealand dairy industry between manufacturing and marketing, and this discrepancy is causing the costs of production of processing milk in New Zealand to slowly rise. This is due to the fact that the Dairy Board is solely the export marketing arm of dairy products, and the dairy companies are solely the milk processors. The Dairy Board is unable to get the products, that they know the market is demanding, made in the factories that they want the products made in, at the right time, because the companies have different owners. The Board has had to put in place surrogate methods of getting exactly what they want made, at the right place. This is a laborious process for the Board, and one that could be eliminated by merging all the processing plants into one company and one driver. This is the area where the majority of the US \$150 million estimated savings were to be made from the mega-merger.

Due to the separation of the New Zealand dairy companies from the marketing of the dairy product, leaders of Kiwi dairies and NZDG are taking a different outlook on the failure of the merger. Both companies are actively trying to establish a way for their businesses to become independent players in the international market. There are some suggestions that the two big companies may continue separately and would try to absorb the NZDB's international marketing functions. This would however, require Government and farmer approval which would not be

easy as the Minister of Agriculture has rejected a call for the industry to be deregulated by the Government in spite of the failure of the merger plan. This decision was made as it would be contrary to the wishes of the majority of New Zealand's dairy farmers and also against current New Zealand government policy. For now the NZDB maintains its statutory export monopoly (and STE status) which could only be changed through legislation.

New Zealand dairy farmers are extremely unhappy over the failure of the mega-merger. The failure of the merger has left 14,000 farmers with an unsettled future. Many farmers are unhappy with their co-operatives leaders for not agreeing to merge, on what they think are political and communication failure problems, and for not acting in the best interests of their farmer/shareholders (The farmers own the dairy companies which in turn own the NZDB). A large group of New Zealand dairy farmers even formed an emergency meeting in mid-April, in which they proposed that farmers vote to exchange their shares in their co-operative for shares in the Dairy Board, thus putting the leadership and the initiative into the hands of the farmers. The Minister of Agriculture had previously indicated that he would consider this as legislation, if a credible plan was devised. Leaders of the dairy industry, both of the companies and the NZDB reportedly believe that this decision would be the downfall of the New Zealand dairy industry as farmers do not have the business knowledge to be able to pursue the type of change the industry requires. This proposal in effect did not go through, due to NZDG farmer/shareholders vetoing the vote.

Where the industry is headed in the near future is unclear. The two dairy companies are in the midst of plan making and have said they will reveal their plans to shareholders within the next month or two. Meanwhile, it is believed that the recent announcement of the Dairy Boards proposal to merge with Australian milk company Bonlac, is seen by some as an effort by the Board to pressure the two dairy companies to continue efforts towards increased co-operation in the industry. (For more details on the NZDB-Bonlac merger, see below).

Also, some industry analysts think that two of the smaller co-ops, Westland and Tasman, will likely be merged into one or both of the largest co-ops, leaving only 5 co-ops. NZDG is also proposing to cut the number of directors on its board from 15 to 10, in order to provide a more commercial orientation.

Biotechnology

A four-person Royal Commission to inquire over a twelve-month period, into genetic modification in New Zealand, was announced on 17 April 2000. The objective of the Commission is to inquire into and report on the strategic options available to enable New Zealand to address genetic modification now and in the future. A voluntary moratorium on all applications for the release of genetically modified organisms will be negotiated between the government and relevant industry and research groups for the period of the Commission.

The New Zealand Dairy Board is interested in making submissions to the Royal Commission. The Board would be concerned if the result of the Commission was to set up a moratorium on all field trials in New Zealand, or if the conditions of the field trials were so restrictive as to make any trials difficult or impossible. The Dairy Board's interest is to make sure a sensible and balanced approach is taken to GMO's in New Zealand. The Board has publicly announced that

they have an interest in biotechnology in New Zealand and in developing field trials on farm. The Board in 1999 made a decision to significantly increase its investment in biosciences. It noted that in order to defend its core advantage, the industry has set farmers and processors an annual 4 percent performance improvement challenge; a sustained 4 percent improvement in breeding and nutrition will not be possible without the tools of the newer biosciences.

For further information regarding the Royal Commission refer to NZ0023.

Genetics

The New Zealand Dairy Board has negotiated a deal with a US life sciences entrepreneur, Celera Genomics, to get access to the company's extensive expertise in using computers to analyze genetic information. An Auckland company set up by the Board is to work with Celera and its subsidiaries to try and pin down exactly which gene codes on the cattle genome control specific traits of interest to the dairy industry.

The NZDB has noted that in order to manage the industry's investment in bioscience and the associated intellectual property, a wholly owned NZDB subsidiary called ViaLactia, has been established.

ViaLactia will be a relatively small company comprising key scientific and business staff. It will initially out source appropriate research and development from organizations in New Zealand and around the world.

ViaLacita will manage its investment via three major research programmes:

1. The accelerated discovery of valuable bovine genes.
2. Forage biotechnology to overcome the limitations of NZ's traditional pasture systems.
3. Processing microbiology for enhanced dairy products.

MARKETING

The New Zealand Dairy Board's marketing arm for its ingredients business, NZMP, is experiencing rapid growth and sales. In 1998/99 NZMP showed a substantially higher profitability than the Board's consumer and food sales marketing division, New Zealand Milk. NZMP earned NZ \$264 million in 1998/99 compared to New Zealand Milk's NZ \$176 million. The reason for the increased profitability of the ingredients business is the increasing exposure of the Dairy Board in third world markets.

NZMP aims to profitably double its business in 5 years, equivalent of 15 percent growth per annum. The Board hopes to achieve this by: defending New Zealand's core low-cost position; improving existing business performance; leveraging its network beyond New Zealand dairy product; building global businesses; investing in biotechnology research; and creating competitive advantage through e-commerce. In order to achieve this, the ingredients group will have to make rapid progress in marketing non-New Zealand product; sourcing non-New Zealand product; investing in non-New Zealand milk processing and in partnerships, joint ventures and acquisitions.

International Mergers

Trans-Tasman

On April 28, the New Zealand Dairy Board and Bonlac Foods Limited (Australia's second largest dairy company and exporter with sales of NZ \$1.5 billion) announced plans to create the first Trans-Tasman dairy business. Directors of both organizations signed a Heads of Agreement outlining proposals under which parts of each organization's operations will be merged and the New Zealand Dairy Board will take a minority role. The agreement is still subject to the parties completing due diligence, finalizing commercial terms and the approval of regulatory authorities and shareholders.

The main elements of the proposed merger are:

1. The Australia consumer business of NZDB and Bonlac will be merged into a separate joint venture to be owned and operated on a 50/50 basis;
2. The NZDB will merge its Australian ingredients business into Bonlac;
3. The NZDB will take a 25 percent interest in Bonlac, with Bonlac supplier shareholders holding the remaining 75 percent of the shares.

Implementation of the alliance is dependent on approval by Bonlac's supplier shareholders and NZDB board of directors.

Both NZDB and Bonlac believe the proposal recognizes the power of regional alliances and will pave the way for establishing a vibrant trans-Tasman dairy vehicle. The new consumer products joint venture will combine the Australian consumer products and food service businesses of both organizations, marketing a portfolio of brands with leading market positions in cheese and spreads. The proposed alliance will also strengthen the combined international ingredients businesses in the face of increasing pressure from rapidly expanding global competitors.

Euro-Dairy Merger Possibilities

The New Zealand Dairy Board has told European dairy industry leaders that the Board is investigating new partnerships, joint ventures and acquisitions with Europeans. The Board already buys and markets European dairy products, including milk powder to Asia and the Middle East.

