

Co-op status limits finance options

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FONTERRA is limiting its financial options by remaining a co-operative, Milford Asset Management director Brian Gaynor says.

Co-operatives are an ideal structure to raise capital to establish processing businesses such as dairy companies but a hindrance when future capital injections are needed. They, therefore, have a greater reliance on bank borrowing because they seldom get funds from shareholders, potentially starving them of capital.

Bank debt leading to other financial issues plagued Westland Milk and resulted in its sale to Chinese company Yili.

Fonterra owes more than \$7 billion and faces similar challenges of debt and accessing capital from its members, with claims shareholders want the maximum milk price, which can limit reinvestment.

"Outsiders see this as a flaw in



the co-operative model," he says.

While co-operatives are important to the economy, their tight shareholding structure limits investment from other funders.

"In the modern world the co-operatives all handcuff themselves. They have limited options."

That means Fonterra now relies on asset sales to strengthen its balance sheet rather than retaining earnings or seeking an equity investment from a cornerstone shareholder while meeting the financial expectations of shareholders.

Gaynor says that contrasts with the publicly listed a2 Milk Company, which is yet to pay a dividend despite being profitable and growing market capitalisation to nearly \$12 billion.

Fonterra is New Zealand's most important company and must

stay viable but its ownership structure can change, as happened to several of Ireland's dairy companies where the ownership model has evolved from being dominated by co-operatives to members becoming shareholders in those companies, some publicly listed, but which allow easier access to capital.

Kerry Group has split its structure so Kerry Co-operative Creameries owns a cornerstone shareholding in the publicly traded company, with the balance of investors being institutions and the public.

Carbery Group is an international food ingredients and cheese maker owned by four Irish co-operatives with its dairy division processing milk on behalf of farmer shareholders.

Gaynor says though it is costly and requires significant resources, value add is the correct strategy for Fonterra, unlike buying stakes in Chinese companies.

Westland made the wrong move building a processing plant in Canterbury under the nose



SPEND WISELY: Fonterra should invest the money from asset sales into big, value-add projects rather than repaying debt, financial adviser Brian Gaynor says.

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Brian Gaynor
Milford Asset Management

of Fonterra. The Westland plant does not operate to capacity and requires milk to be carted from the West Coast.

"Value add is still the way to go but doing it the right way is the key."

Selling assets like Tip Top will not be a setback for Fonterra provided it invests the proceeds correctly.

Gaynor would rather see the money invested in its new strategy than repaying debt.

"If it is being used to repay debt because the banks are telling them to, then that is not great.

"If they are doing it to put the money into capital, big value-added products then it could be good for them."

Co-op's problems run deep

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FONTERRA'S problems run deeper than debt and profitability, Lincoln University's agri-food systems expert Professor Keith Woodford says.

May's 10c/kg drop in the milk price, early forecasts next year's payout will be less than \$7/kg and a drop in the underlying forecast profit of 10c to 15c a share, the second decline this year, have captured the headlines.

"So, things are not going at all well. Can the big ship be turned around and if so, when?"

Those deeper issues start with this year's forecast operating profit before asset sales of about \$200 million. In September last year the operating profit was \$480m.

He believes Fonterra is caught between looking after its corporate needs and looking after its farmer shareholders who, facing new banking guidelines, are under cashflow pressure.

Woodford notes Fonterra goes into the new international dairy trade season with fundamentals the strongest for six years, with static production in Europe and the United States and declining output in Australia.

The only question is global demand, especially in China.

Fonterra's performance has



LOW: Fonterra's share price says its shareholders are uncertain about its future, Professor Keith Woodford says.

“ Can the big ship be turned around and if so, when? **”**

Professor Keith Woodford
Lincoln University

attracted the attention of Fitch Ratings.

In February Fitch downgraded Fonterra's outlook to negative after its

half year results, reflecting what it saw as structural issues that weaken the defensive traits underpinning its historically strong business profile.

It said assets sales are crucial for Fonterra to retain its A-negative rating though the negative outlook and lower earnings forecast will not immediately affect its rating, the agency advised.

Woodford says Fonterra's asset sales prompted by last financial year's \$196 million loss largely on the



back of asset write downs and burgeoning interest-bearing debt show non-farmer investors any financial turnaround is a long-term game.

They are also wary other assets are not selling as easily as Tip Top, which fetched \$380m.

Fonterra's stake in German nutritional business Goodminton AG sold for \$64m while the sale of its share in Corporacion Inlaca in Venezuela recorded a book loss of \$123m.

Similarly, the closure of the Dennington plant in Victoria, Australia, and the agreement with Beingmate to end a joint venture at the Darnum site, also in Victoria, will require funding.

Fonterra has agreed with Nestle to look at options on the future of Dairy Partners Americas Brazil and has launched a strategic review of its China farms.

Fonterra says it is on target to meet its \$800m in asset sales but shareholders are uncertain, evidenced by the share value.

"That tells us something about what the market thinks is happening to Fonterra's net assets," Woodford says.

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Tuesday 30/07/2019
Women's Enviro Evening – Connecting, Inspiring and Empowering
Speakers: Penny Clark-Hall, Kate Scott, Sinead Leahy and Janet Gregory
Time: 6.30-9.30pm
Venue: Clinton Town Hall, Clinton
Free event – Supper – Baffles – Cash bar
RSVP: By Friday 26 July to Libby, Clutha Development - libby@cluthanz.com

AWDT Understanding Your Farming Business
3 full-day workshops and an evening graduation ceremony run over four months. Equip and supports women involved in sheep and beef farming to lift business performance.
Registrations for 2019 programmes are now open, visit the website for more information and to register.
Locations and dates (3 modules & graduation):
Takaka: 21 Aug, 18 Sep, 16 Oct & 13 Nov
Kaikoura: 28 Aug, 25 Sep, 23 Oct & 20 Nov
Pukekohe, Hawke's Bay: 4 Sep, 2 Oct, 30 Oct & 27 Nov
Masterion: 5 Sep, 3 Oct, 31 Oct & 28 Nov
Clinton: 11 Sep, 9 Oct, 6 Nov & 4 Dec
Lawrence: 12 Sep, 10 Oct, 7 Nov & 5 Dec
Website: To register visit www.awdt.org.nz/uyfb/
Contact: keri@awdt.org.nz or 06 375 8180 for more information

Thursday 8/8/2019 – Friday 9/8/2019
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A two-day personal development programme for women involved in the primary sector or rural communities. Discover your true value, refocus on what is important, explore possibilities and create new networks. Visit the website for more information and to register for Blenheim
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