

# Wilson, Spierings argue valid com

For the Fonterra Scorecard series *Farmers Weekly* sought an interview with chairman John Wilson and chief executive Theo Spierings, now in his last year at the top of the world's second-largest dairy processor and trader. Aspects of Fonterra's historical performance, Spiering's strategies, the dairy industry review and Fonterra's most-recent downgrade in earnings and dividends were discussed. It was their only joint interview with rural media during the past seven years. **Hugh Stringleman** reports.

## Fonterra's performance

NEW Zealand dairy farmers who supply Fonterra now receive better payouts than their counterparts almost everywhere in the world, chairman John Wilson and chief executive Theo Spierings say.

In the past decade the average farmgate milk price paid here has been at least \$1/kg higher than the average of Fonterra's first decade or \$1.50 higher if you back out the two recent disastrous seasons caused by geopolitical problems.

Valid comparisons over Fonterra's lifetime should also include exchange rates, as a couple of the high payouts in the first decade were achieved on a NZ dollar worth around US40c, Wilson said.

Whereas in the \$4 seasons following Russia's invasion of Crimea the NZD was up at US70c. That is \$3/kg difference on exchange rate alone.

"As recently as 10 years ago our farmers were 30-40% behind and now they are paid the same or better.

"So any assessments of Fonterra's performance must take into account the value created on NZ dairy farms."

The co-operative is an extension of the farm and the



farmers have the most efficient, pasture-based milk production model on the planet.

Fonterra's assets were built to accommodate the pasture curve and the giant stainless-steel machine is strongly competitive with anywhere else in the world, Spierings said.

"We have a spring peak of 80-85m litres/day and a winter trough of 1m/day – our global competitors don't have that," Wilson said.

"Right across the footprint those assets deliver a 7% weighted average cost of capital but individual plants used for short periods are not making that return.

"We enable our farmers to maximise their own businesses and produce as much milk as they are able through the peak.

"We could make our figures



look a whole lot better, hypothetically, by incentivising farmers to produce milk across the winter but the productivity and profitability of the NZ dairy industry, impacting the entire NZ economy, would diminish dramatically.

"So that needs to be included in any understanding of our performance," Wilson said.

## Capital structure

TRADING Among Farmers has delivered permanent capital through some tough years and seasons and Fonterra has stayed on strategy, which is fantastic, Wilson said.

"We invested in stainless steel for the growth milk and those returns go into the milk price.

"Through good capital management we have also built food service capacity, funded internally or by debt.

"Our balance sheet has very conservative valuations such as the plants and land they are on when Fonterra was formed which have never been revalued.

"But \$7 billion debt is at the higher end of our comfort level so we would like to bring it down.

"Capital is not going to be a constraint on growth in the future.

"We could sell some global

assets, make more joint ventures and use the flexibility that comes from permanent capital.

"Some farmers from time to time want to free up share capital. "Personally, I don't agree because if you have up to \$50/kg of money tied up in land, cows and shares it makes sense to stay invested in a strong co-operative in which every employee every day tries to maximise your total farmgate returns.

"We are talking to our farmers at present about share standard and capital, particularly about farm and business succession and how to provide more flexibility.

"They tell us they want to remain in the co-op and they know the value proposition but they may have to come up with a solution to a capital need short-term."

## DIRA review

COMPETITION now exists in most dairying regions and the universal open entry requirement on Fonterra sends entirely the wrong signal to farmers, Wilson said.

"It means that with even the thought of more milk production we have to build the processing capacity.

"It makes it difficult to drive a strategy to add value with that sitting in the background.

"We think that is widely accepted now but we need the relevant regulation change."

Fonterra also needs to be free of

the obligation to provide milk to start-ups that are exporting.

It will always respect and guard the domestic milk market – right from Goodman Fielder down to niche cheese makers.

"The milk market needs the right incentives," Wilson said.

"Fonterra will always want to pick up milk and farmers must produce the right quality, with environmental and animal welfare standards. These things should drive the farmer-Fonterra relationship, not regulation.

"It has been an indictment on regulators that Fonterra was forced to pick up milk from environmentally sensitive areas over the past decade when we have been quite clearly against it."

## Spierings' strategy and achievements

THEO Spierings was reluctant to talk about any legacies because he insists all the company's people share in its successes.

"We all should be very proud that Fonterra is the most trusted source of dairy nutrition in the world.

"Moving up the value curve has been a big achievement – revenue is now \$1/LME (liquid milk equivalent) whereas it used to be 60-70c.

"I am also proud of the \$5b China enterprise value we have created, which is a 27% increase over the past three years.

"We changed from a very siloed organisation to this open and

## True Blue Aussie!

Explore the real Australia!



BE QUICK!

- **Western Australia** Sept - Wildflowers, farming, dramatic landscapes
- **Tasmania** Nov - A fantastic way to discover this unique island state



**Farm To Farm Tours**  
PO Box 239, Victoria St,  
Rangiora, 7440  
info@farmtofarm.co.nz  
Ph: 03 313 5855

Discover some of the  
world's best farming,  
scenery and experiences  
in the company of like  
minded travellers.

Ph: 0800 3838 747 [www.farmtofarm.co.nz](http://www.farmtofarm.co.nz)



# parisons, value-add



**HAPPY TOGETHER:** Fonterra chief executive Theo Spierings, left, and chairman John Wilson have given their views on Fonterra's performance and its results for farmers and investors.

transparent company, attractive for young people, some doing disruptive start-ups in the company."

His Volume-to-Value-at-Velocity (V3) strategy will continue to reap the benefits from the unconstrained demand for higher dairy categories.

"This is not just my story about V3 and Disruption but a company-wide story.

"In the next five years will see much more dramatic changes than the last 10 years.

"That is why we have our Disruption strategy, the New Ventures and the Co-Labs."

## Earnings downgrade

THE shock earnings downgrade on May 23, from 35-45c to 25-30c, was a result of dairy prices rising late in the season on top of one-off deductions, Spierings said.

The one-offs were the Danone settlement and the Beingmate impairment, which was not write-off.

Farmer-shareholders and Fonterra Shareholder's Fund unit investors were rightly concerned about the volatility in annual dividends. This financial year's dividend guidance is now 15-20c/share, compared with 25-35c made in March.

The company's units and supply shares have lost 60c or 10% of value.

"I talked to investors after the latest announcement and they

were balanced, understanding the short-term issues and wanting to know what it means for next year," he said.

The FY2019 earnings forecast will be made in late July after the budgets have been written and approved.

"I told investors that we still see strong demand that will generate 11-12% return on capital and 7% dividend yield and these are still our target numbers."

Wilson said the higher milk prices are great news for farmers but not so good for earnings.

"The mindset of our people is to maximise total available for payout but the rapidly rising milk prices impacted gross margins in our consumer, food service and specialty ingredients businesses."

Spierings said with milk prices in the range \$5.50 to \$7.50/kg persisting over 12 to 18 months his team will be able to create earnings above that.

"If the milk price products rise late in the season with limited volumes still available and we have to absorb that in cost of goods sold it will have a temporary effect on earnings.

"Below \$5.50 and we get issues of supply and above \$7.50 issues of demand.

"Within that range, over a long period, profitability should not be affected – the consumer will pay and can afford those prices.

"Chinese demand at current

milk prices is not slowing down."

Wilson said the co-operative sets out to maximise the total available for payout and the 87-page Milk Price Manual says where the cut occurs between milk price and earnings.

"We have a totally transparent milk price, which nobody else in the world has.

"It provides clear signals to Theo and his team to drive performance and to our farmers.

"But we have a margin squeeze right at the end of a season on top of the impact of Danone, on a matter that goes right back to 2013.

"We expect this year will be an anomaly and we will go through the business plans, sign off the budget and have an earnings view in July."

Spierings said the FY2017 season began with a \$4.25 milk price that kept on rising and ended 50% higher at \$6.12 but profitability was hardly affected.

"We had the whole season to implement those higher milk prices through consumer/food service products and advanced ingredients and we delivered earnings that were comparable to the year before (a low milk price year)."

Wilson said 46c had migrated from earnings to milk price over the years and been baked in but there is nothing inherent in the

Continued page 20

# Decisions made. More informed.



## My farm

- Track farm events over time
- Upload your farm map - specify vegetation, soil type, topography, draw blocks and management zones

HawkEye's farm information tool enables you to see farm data at a glance.

See more. Visit us for an onsite demo at National Fieldays, Hamilton - Ravensdown, Site D66.

Go to [hawkeye.farm](http://hawkeye.farm) or call 0800 73 73 73

**HawkEye**  
INSIGHT TO ACTION



Continued from page 19

Milk Price Manual that means only 10c, 20c or 30c will always be left over for dividend.

If non-milk price products, like cheese and casein, rise in price and milk price products fall then earnings will benefit relative to the farmgate milk price.

Commenting on the new adverse factors of falling sales in NZ and lower volume growth in food service, Spierings said Fonterra Brands NZ has already been reformed by bringing in the best people available globally.

It has the right products and brands, many of them iconic like Mainland and Tip Top, but those brands need more linkage with Fonterra, Anchor and Trusted Goodness.

The food service growth target has been 20% a year since inception but has regularly exceeded that.

“Now, because of strong fat prices, European competition in China has increased.

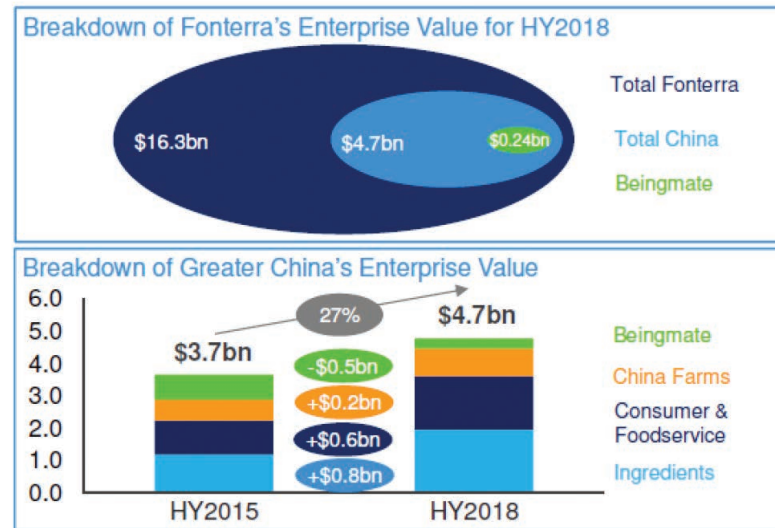
“Our marketing model and products are still superior so I see no reason to adjust the T20 target.

“It has been a temporary slowdown this year, but China in the third quarter was still 12% growth.”

The ambition

FONTERRA’S ambition for 2025 is to use 30b litres of milk from

Greater China operations are a substantial business



1. Enterprise value (“EV”, being market value of equity plus net economic debt) is based on Fonterra’s share price and shares outstanding as at 31 January, plus average net debt for the respective half year period. 2. Greater China’s share of EV is calculated as a sum of book value of Farms, plus Fonterra’s carrying value of its investment in Beingmate as at 31 January 2018, plus a pro-rata share of EV (excluding Beingmate and Farms) on the basis of gross margin (16% HY15, 23% HY18)

- Based on our current share price, Fonterra’s Enterprise Value (EV)<sup>1</sup> exceeds \$16bn
- Greater China’s share of EV estimated to be \$4.7bn Beingmate and China Farms included at current book value and balance based on pro-rata share of gross margin
- Conservative estimate relative to valuation of similar China businesses, plus upside potential of China Farms
- Since 2015 the EV of Fonterra’s business in Greater China has grown by \$1.0bn or 27%

“It has been an indictment on regulators that Fonterra was forced to pick up milk from environmentally sensitive areas over the past decade when we have been quite clearly against it.”

John Wilson  
Fonterra

return favourably to Friesland Campina (Spierings’ old company) at 8.8% and the Danish company Arla at 7.4%.

“We use \$1.2b of assets, without brands and goodwill, and we achieve \$600m EBIT,” Spierings said.

“It is only the dedicated assets, not those used to make the ingredients in the first place, eg cream, or the related assets, like whey from mozzarella cheese, which go into the ingredients category.

“We are also using like-for-like basis when comparing ourselves with Arla and Friesland Campina although they have different financial years so it gets a little harder when prices are moving around.”

five or six milk pools and derive revenue of \$1.20/LME, generating a \$35b turnover.

How realistic are those components?

Spierings said they already know unconstrained demand will account for 30b LME much earlier than 2025.

“The NZ milk pool will not grow to 30b so we look elsewhere.

“Perhaps we sell some legacy assets and invest the money elsewhere in milk pools where we can make a difference.

“Europe has turned right around for us through new joint ventures and partnerships gaining 2b litres of milk.

“We have the Dairy Crest UK agreement over demineralised whey powder, tapping into almost 1b LME.

“Investments have been made in the Netherlands, Lithuania, Russia based on our knowledge, IP and the abilities of sales machine worldwide.

“We have also invested in a German start-up called

Foodspring, which is using whey protein in active nutrition products.”

All the steps taken in Europe now give Fonterra access to roughly 4b litres of milk, he said.

Comparisons

FONTERRA reported a 47% return on capital for its consumer and food service division, which is a big help in generating the full company’s 11.1% return on capital.

Fonterra then compared its

# FIELDAYS® DEALS

Offers available until 31 July 2018

## POLARIS RANGER 500

Ranger 500 – your introduction to the hardest working side-by-side on the market. Whether you’re looking to do more around the property, haul your gear for a hunt or just enjoy a day on the trails, Ranger will get you there.

- Full size features at entry-level price
- Power - 32HP
- On Demand true AWD
- Independent rear suspension
- Electronic Fuel Injection

**\$10,995 + gst**  
SAVE \$1,175



## EXCLUSIVE OFFER

## POLARIS RANGER 570 FULL SIZE

Ranger - the superior utility recreational vehicle... from the back yard to the bush, Ranger has been the #1 trusted partner for more farmers, hunters and home-owners for 10 years straight.

- Power - 40HP
- Towing 680 kg
- Ground Clearance 25cm

**\$12,995 + gst**  
SAVE \$914



## EXCLUSIVE OFFER

# FIND US AT FIELDAYS®

- See the **NEW 2018 models** up close and side by side
- Hot deals on merchandise & accessories
- Watch Simmo (from CARNZ) taking our vehicles around the extreme trail on site
- See you at Stand G76



## YOUR CHANCE TO WIN!

Sign up for a test drive and be in to win one of four awesome prizes.\*

\*Terms and conditions apply.



WARNING: Polaris® off-road vehicles can be hazardous to operate and are not intended for on-road use. Driver must be at least 16 years old with a valid driver's license to operate. Passengers, if permitted, must be at least 12 years old. Check your local laws regarding usage and riding regulations for minors and restrictions. All riders should always wear helmets, eye protection, and protective clothing. Always use seat belts and cab nets or doors (as equipped). Never engage in stunt driving, and avoid excessive speeds and sharp turns. Riding and alcohol/drugs don't mix. All riders should take a safety training course. Check local laws before riding on trails. ©2018 Polaris Industries Inc.