

Monday, 9 April 2007

## ***Henry van der Heyden:*** **Fonterra's four-step plan to stay ahead of the world**

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Confidence is rising in dairying - international commodity prices are at record highs and the longer term outlook is the best I have seen in my 20 years in the industry.

As the world becomes more and more health conscious, dairy producers are increasingly being recognised as an important part of the diet for people of all ages.

They are a low-cost source of nutrition - important in developing countries - and provide the answers to some of the big global health issues, such as osteoporosis and obesity.

They are versatile, being used in everything from sports drinks and nutrition bars to snack meals, luxury desserts and even cosmetics and pharmaceuticals.

The growth opportunities are many and Fonterra has the global business strategy to capitalise on them. We have recently been refreshing our farmer shareholders on our strategy and how it will grow Fonterra and their wealth.

The strategy is not new but it recognises that the world dairy market is different to what it was even five years ago. Then, subsidised European farmers were the leading international suppliers. Today, it's New Zealand and Australia.

We are both efficient, low cost producers, but as world demand accelerates, it is unlikely that we will be able to keep up with demand.

That will open the door for new exporters and increased competition. Meanwhile countries such as China are developing their own dairy industries to meet their rapidly growing domestic demand for fresh milk.

These changing dynamics mean Fonterra has a choice - to sit back and watch them develop or to aggressively compete and invest in other countries to benefit our farmers.

If we stay on the sidelines, New Zealand could fall back into being a regional commodity trader and that will be bad for the New Zealand dairy industry and bad for the New Zealand economy which relies on dairy for 20 per cent of its exports.

It would mean missing out on the opportunities in dairy consumption growth that we are forecasting will average 2.7 per cent a year.

That is the equivalent of one whole New Zealand dairy industry opening up every year for the next 10 years.

We predict that the biggest growth will be in fresh, liquid dairy at 3 per cent. Cross border trade - the traditional market for dairy commodities such as powders, cheese and butter - is expected to grow at around 1.2 per cent a year.

We want to capture the growth opportunities in both segments and the Fonterra strategy is clear on how we can achieve this.

Our strategy has four platforms. First, we must ensure that New Zealand farmers and Fonterra remain among the lowest-cost, sustainable suppliers of milk in the world.

As new low-cost producers emerge, we must aggressively defend our competitive advantage. Our first priority is to retain supply in New Zealand by paying New Zealand farmers a competitive price for their milk and retaining shareholders' loyalty by providing the best possible returns over and above this milk price.

Second, we are making Fonterra indispensable to customers, by augmenting New Zealand supply with products from other countries to ensure continuity of supply.

In the past, our large multinational customers have limited contracts with Fonterra to 30 per cent of their needs because all our milk came from New Zealand - and there is always risk in having only one source.

Today, Fonterra has diversified its milk sources and now has contracts with its largest customers to supply up to 70 per cent of their requirements. Our farmers are benefiting.

That 70 per cent is made up of 60 per cent New Zealand milk - twice what we once supplied - and our increased revenue reflects these larger contracts.

Our third platform aims to increase returns to our shareholders from markets we cannot supply from New Zealand.

These are markets where high tariffs make it impractical to use New Zealand milk, or where the demand is for fresh milk. They include China, India and Brazil and they share something in common - strong demand and a new breed of more sophisticated, more affluent consumers.

Where consumers in developing countries once went from powdered milk to condensed milk and then to fresh, we are seeing a much faster transition to fresh milk.

In China, for example, demand for fresh milk is forecast to grow by 22 per cent over the next five years and for yoghurt by 31 per cent.

This is why Fonterra is investing in China, has a partnership with Nestle in South America and is looking at opportunities in countries such as Brazil and Venezuela.

These markets offer opportunities to use the expertise we have built up in other countries and increase returns to our farmers.

Few co-operatives or companies in the world have capabilities that start at the farm gate and extend through the supply chain covering milk collection, processing, product manufacturing, demand forecasting, distribution and marketing expertise in dairy ingredients and consumer-branded dairy products.

It is Fonterra's cow to consumer skill we are replicating in countries where we cannot supply liquid New Zealand milk, opening up new growth and earning opportunities.

The fourth platform of our strategy is to make Fonterra products the first choice of customers and consumers wherever we do business. This aims to increase our value-added returns, taking advantage of our brand portfolio - with international household names such as Anchor, Anlene and Mainland to help reduce the effects of any volatility in the commodity market.

The Fonterra strategy is designed to optimise the milk price we pay our farmers, increase profits and increase farmer shareholder wealth.

It ensures there will always be a market for New Zealand farmers' milk, so the next generation of farmers has a good future in dairying.

It ensures that our earning potential and our returns to shareholders and New Zealand are not limited to New Zealand farmers' capacity to increase production.

It capitalises on our core strengths - the ability of New Zealand farmers as efficient, low cost producers and Fonterra's deep knowledge of all aspects of dairying.

Using these strengths we want to build the most successful, profitable dairy co-operative in the world.

The strategy sees Fonterra not only as the world's leading dairy exporter - as it is today - but also as a true multinational business earning revenue from fresh milk opportunities as well as traditional exports.

Confidence in dairying is rising. Prices are good, demand is growing and Fonterra has a clear strategy to take advantage of higher demand. There's every reason for our farmers to be optimistic as Fonterra works to secure the future of dairy, so new generations of farmers can contribute to New Zealand's economic performance, just as the current generation does today.

*\* Henry van der Heyden is chairman of the Fonterra Co-operative Group*