

# **NZ's Dairy Sector Institutions**

**LEANZ**

Bell Gully, Auckland  
April 30, 2019

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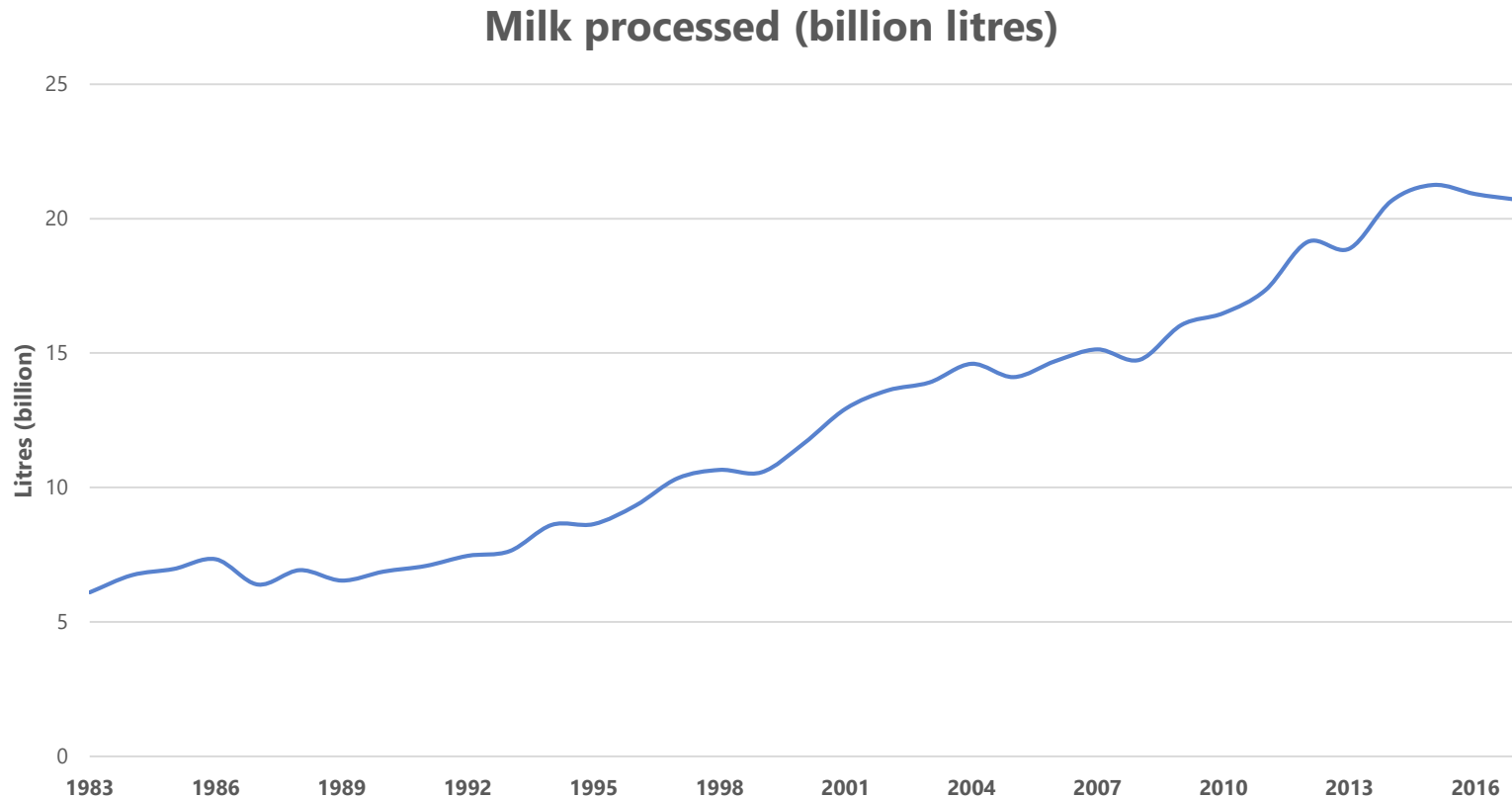
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1. What did DIRA do?
2. Has DIRA worked?
3. Is DIRA still needed?

# 1. What Did DIRA Do?

1. Created a near-monopsony for Fonterra at the farm-gate
2. Removed the monopsony of the Dairy Board at the factory-gate
3. Preserved competition in the domestic dairy-products market

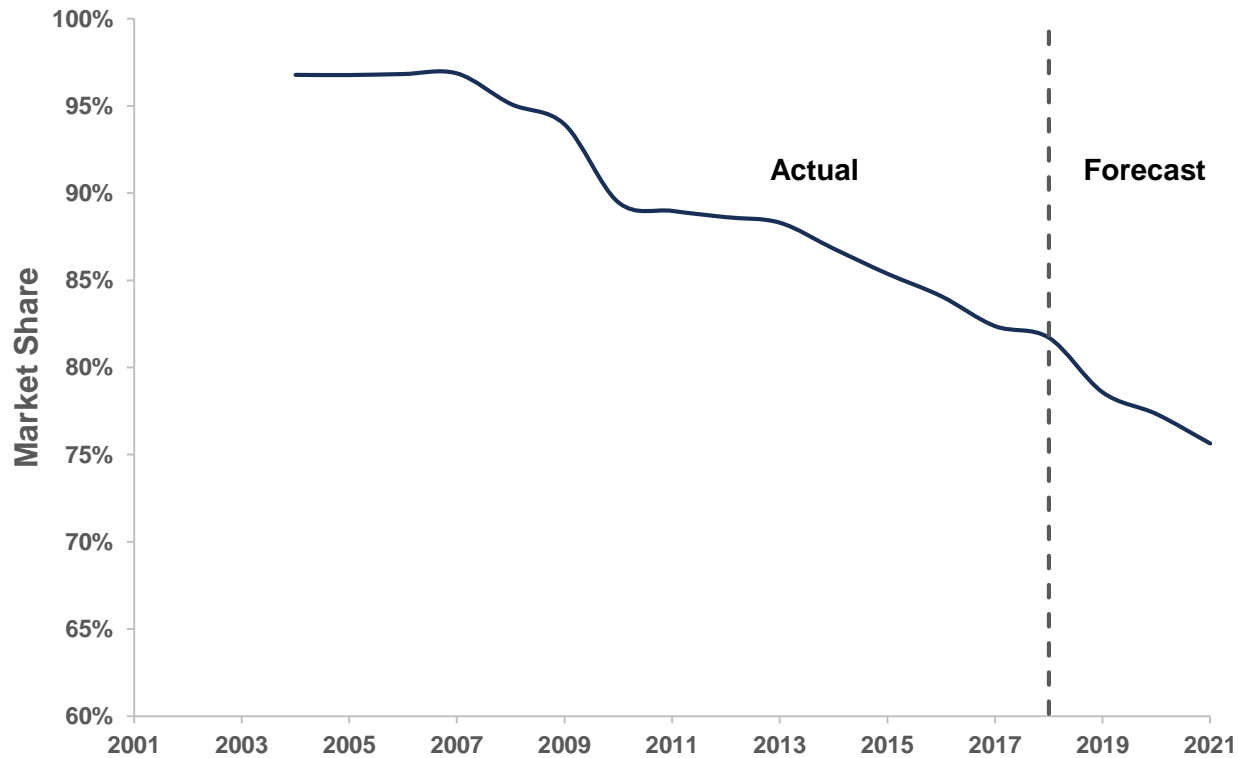
## 2. Has DIRA Worked?



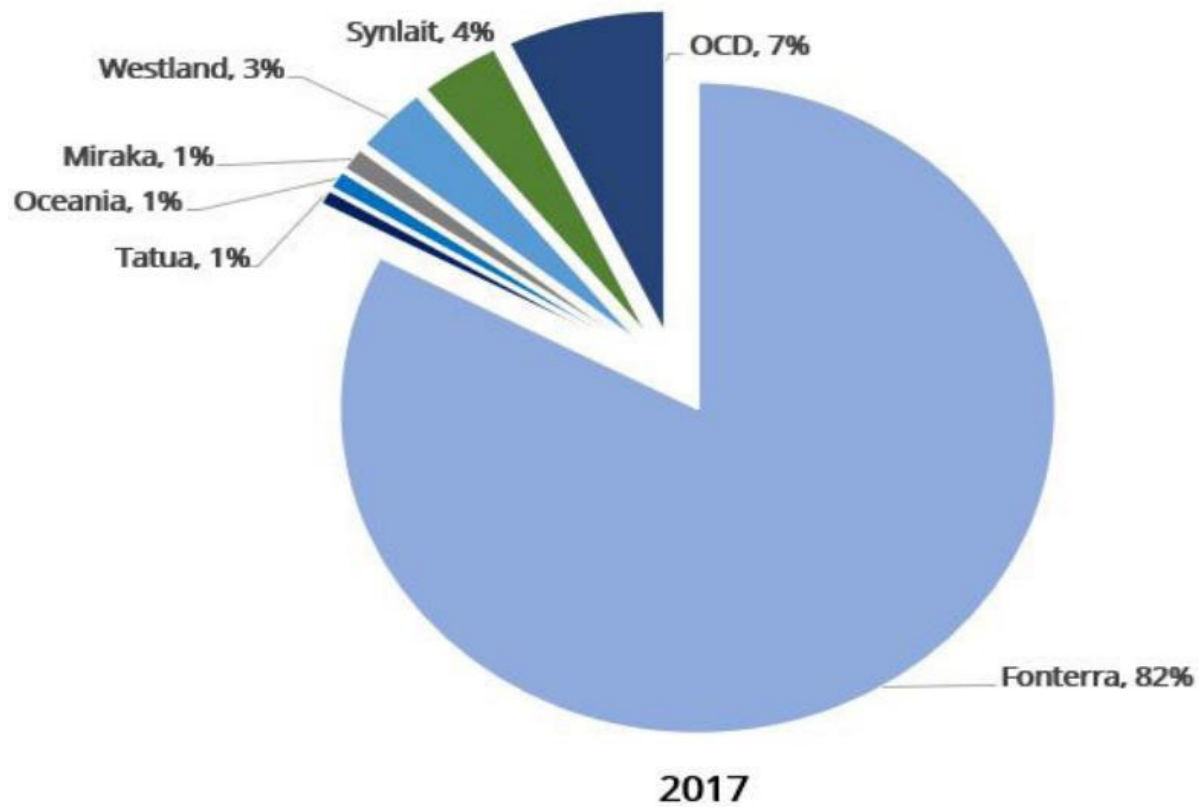
Growth in the sector until reaching peak-cow in approx. 2015-16

# Fonterra's Place in the Sector

## Fonterra's Farmgate Market Share

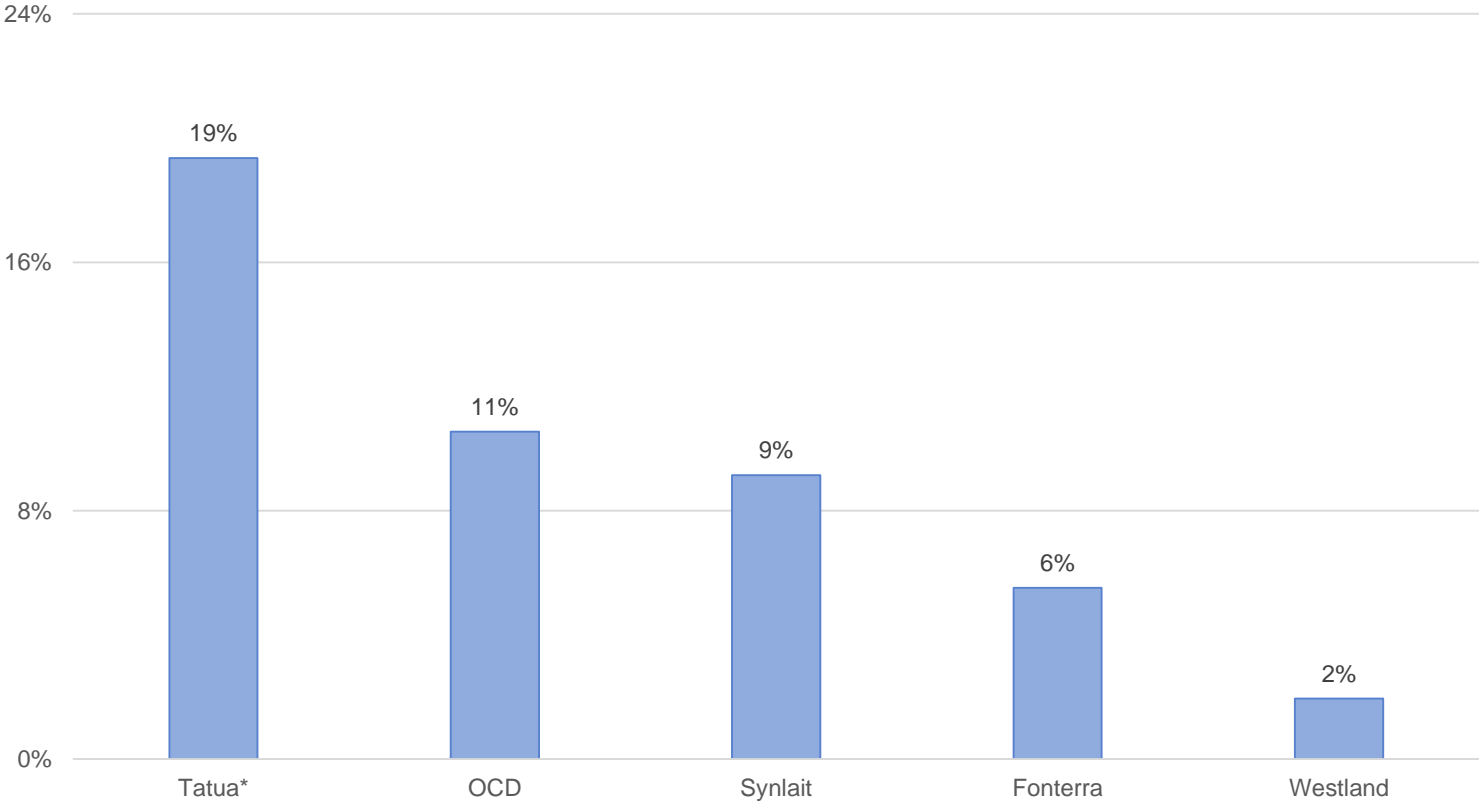


# Increasing Competition

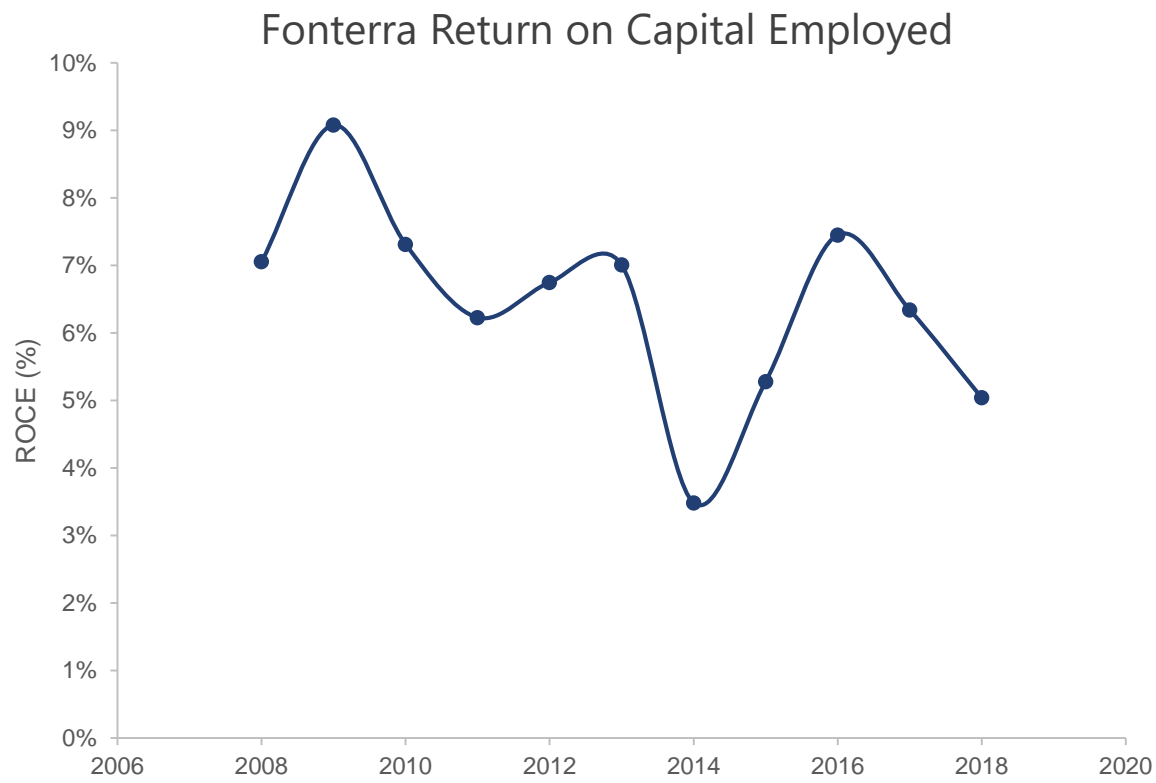


# Dairy Processors' Performance

**Average Return on Capital Employed, 2014-2018**



# Fonterra's Financial Performance

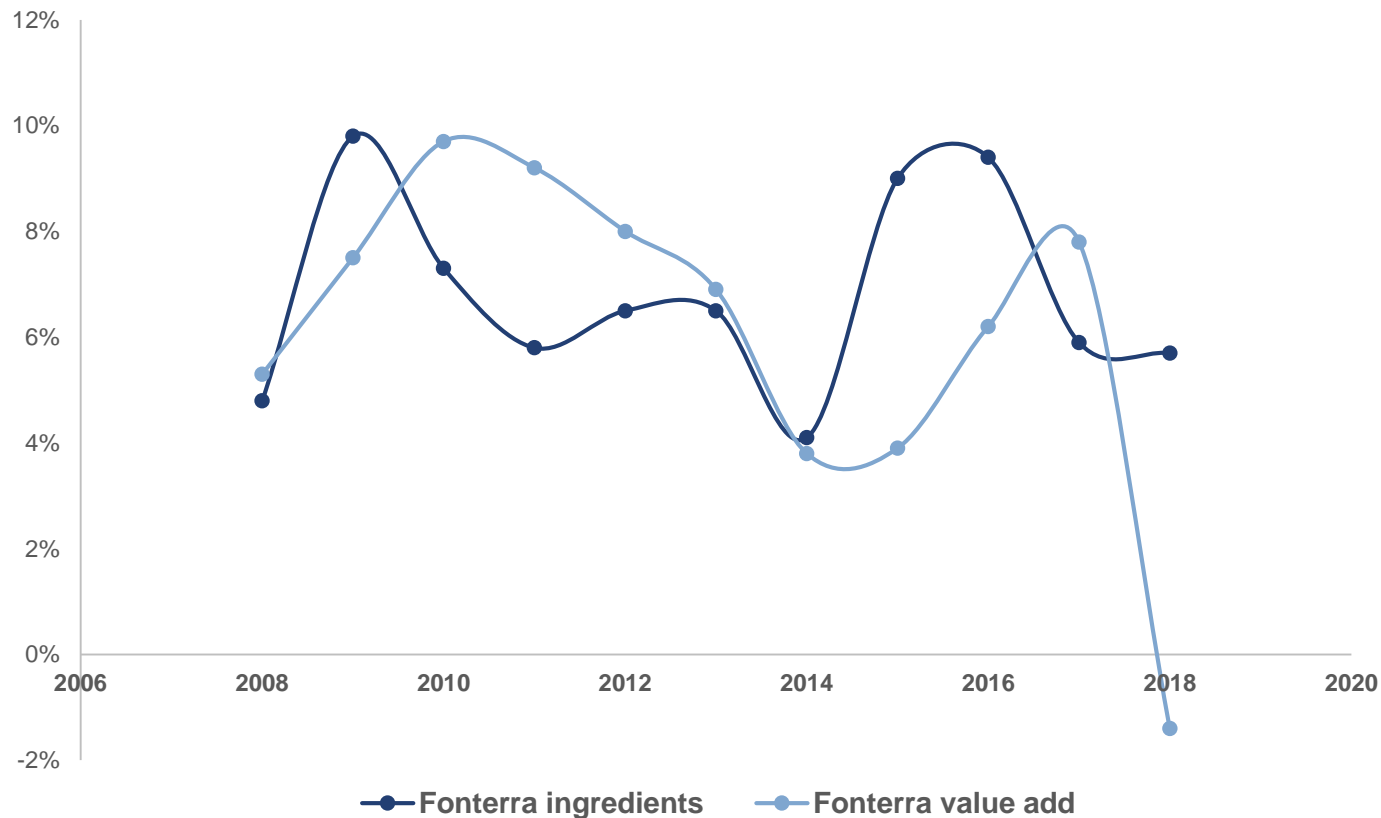


- Downward trend in performance



# Fonterra: Commodities vs "Value Add"

## Return on Capital Employed



Source: Northington Partners and TDB Advisory analysis

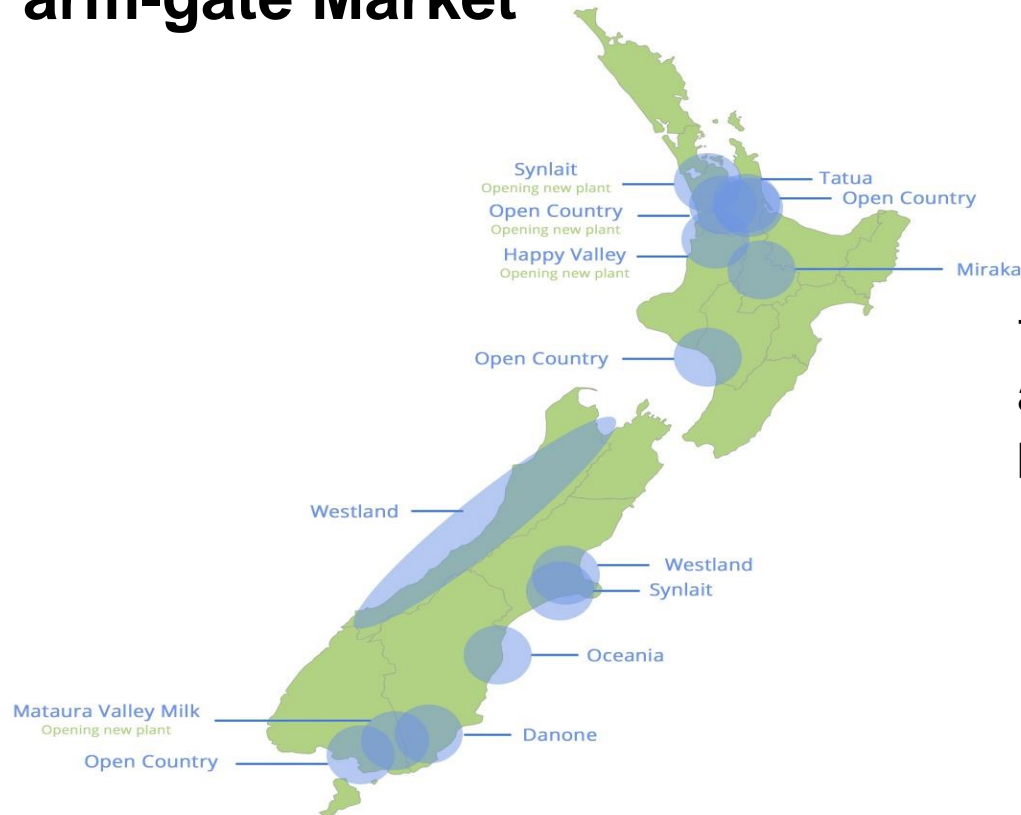
[www.tdb.co.nz](http://www.tdb.co.nz)

# What went wrong at Fonterra?

- Structure or Strategy?
- Co-op structure not inherently flawed: but sources of capital limited: debt & retained earnings
- Was there a clear strategy? volume/commodity and “value-add”
- Both strategies need capital

# 3. Is DIRA Still Needed?

## Farm-gate Market



74% of milk collected has access to more than one processor

# 3. Is DIRA Still Needed?

## Farm-gate Market

Dairy Region	Total production (millions kgMS)	Percentage of national market (kgMS)	No. of processors
Waikato	503	27%	3
Whanganui / Manawatu	81	4%	2
Westland / Nelson / Tasman	85	5%	2
Canterbury	385	21%	4
Otago	101	5%	2
Southland	223	12%	3
Rest of NZ (5 regions)	483	26%	1

ComCom Part IV regulation typically applied where one supplier

# 3. Is DIRA Still Needed?

## Domestic Dairy Products Market

- Under DIRA, Goodman Fielder has guaranteed access to 250M litres of raw milk p.a. at a regulated price
- The Commerce Commission has estimated that if the DIRA Regulations were removed, the domestic raw milk price would increase by around 25%
- Leading to an estimated:
  - transfer of wealth from New Zealand consumers to suppliers of \$51M to \$92M p.a.; and
  - an efficiency (deadweight) loss to the economy of around \$6M p.a.

# Conclusions

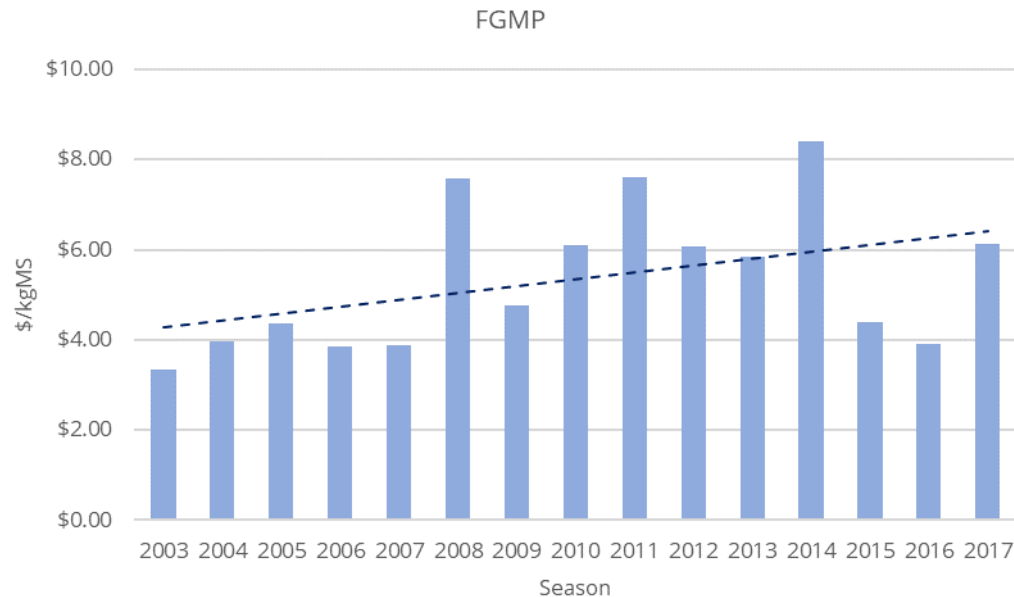
- Under DIRA:
  - The dairy sector overall has fared well; but
  - Fonterra has struggled
- With increased competition there are valid questions whether DIRA is still needed at the farmgate
- Given the domestic presence of Fonterra, regulation is still needed for the domestic dairy products market



**TDB**  
ADVISORY

# Over Paying for Milk?

- The Farm-Gate Milk Price shows a general increasing trend
- Fonterra's constitution states that it's goal is to maximise pay-out for milk to farmers, this has incentivised farmer volume production, requiring investment in processing capacity and not value add business





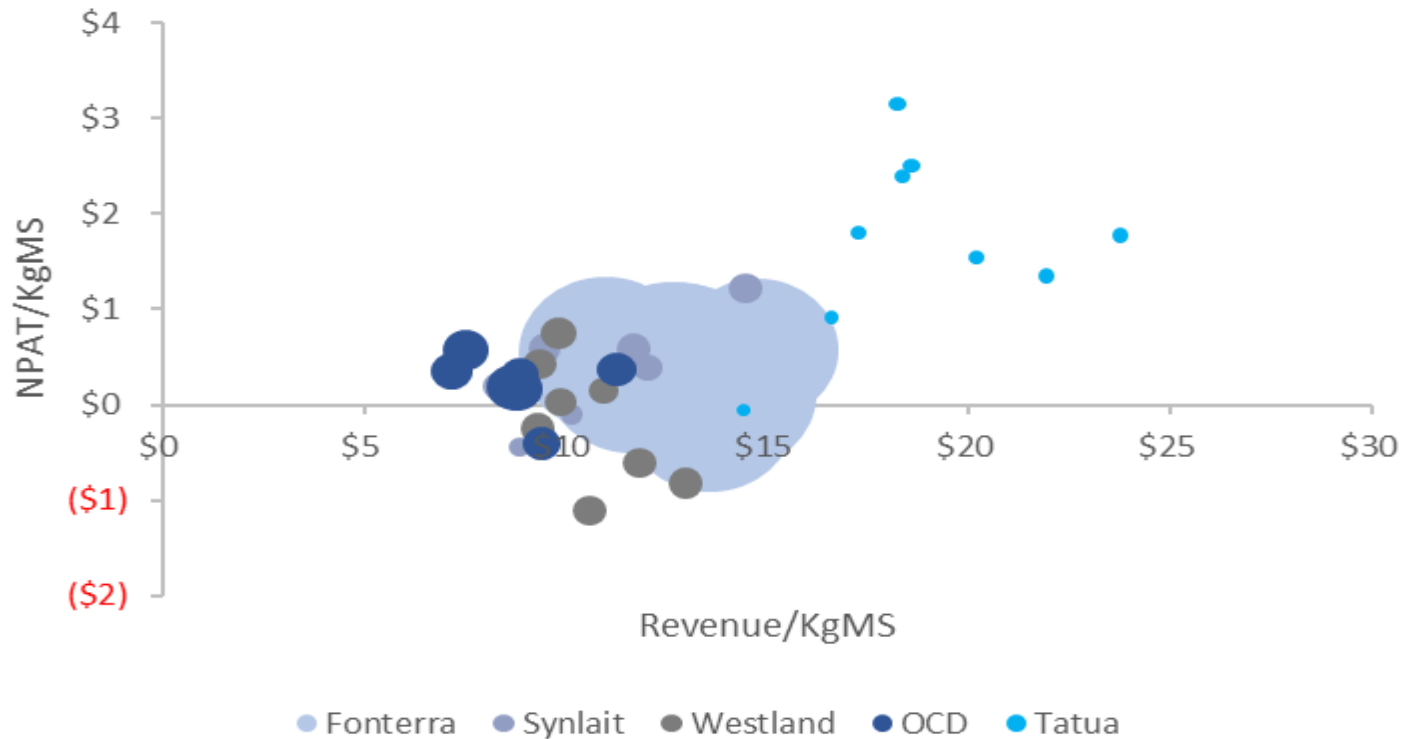
# Over Investing in Processing?

- Fonterra has out-spent competitors



# NPAT and Revenue per kgMS

2010-2018



# Debt to debt plus equity, 2018

