

AGRIBUSINESS

FIELD NOTES

Weekly news update from the KPMG Agribusiness network



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AGENDA 2013 VOLUME 4**

18 December 2013

From the KPMG Field Notes team we would like to wish you all, a happy and safe holiday season. Field Notes will return 15 January 2014.

Organisations referenced in this week's Field Notes include:

Alliance Group	Lion Beers, Spirits and Wine (NZ)
ANZ New Zealand	Macrofertil Australia
Arla Foods	Ministry for Primary Industries
ASB Bank	New Zealand Wool Services International
Commerce Commission	Oceania Dairy
Dairy NZ	Pernod Ricard New Zealand
Federated Farmers	Peterson Farm Brother
Fonterra Co-operative Group	PlusGroup Horticulture
Greenshell New Zealand	Ravensdown
Inner Mongolia Yili Industrial Group	Silver Fern Farms
Irrigation New Zealand	University Waikato
Korda Mentha	Westpac New Zealand
Lincoln University	

This week's headlines

Fishing and aquaculture	Mussel farmer goes from winner to loser [14 December/ New Zealand Herald]
Dairy	Fonterra price slump on dividend cut [11 December/ New Zealand Herald]
Meat	Meat reformers score win [13 December/ Business Day]
Rural infrastructure	ASB, ANZ, Westpac face legal action over interest rate swaps [17 December/ NZ Herald]
Food safety	Ministers' WPC inquiry report out [12 December/ Rural News]

Viticulture

Lion, Pernod battle illuminating [16 December/ Business Day] A dispute over a breach of a warranty made when Lion Beer, Spirits and Wines (NZ) purchased some of the Pernod New Zealand wine brands in 2010 has cast light on the way that supermarket chains manage the price of wine. Lion acquired a range of Pernod brands, including Lindauer, for \$88 million and alleged that Pernod breached a warranty by failing to disclose the existence of a general margin agreement (GMA) it had with Progressive Enterprises. The GMA stipulated that Progressive would receive a specified overall average margin across all the Pernod wines it stocked and sold, with the essence of the agreement being that if the margin was below the stipulated level (which has been withheld due to commercial confidentiality) a payment would be made to make up any shortfall. Lion only found out about the GMA when it was informed by Progressive the day after the deal to buy the Pernod brands was signed, which Lion claimed meant it had overestimated their value and paid an inflated price. Lion sought damages of between \$6m and \$9m. A high court decision found a breach of warranty had occurred but Lion had not suffered a loss as a result. The Court of Appeal dismissed the appeal as it found the GMA had applied to Pernod and was not binding on Lion and each agreement was usually in force for a relatively short period of time. It also noted that Lion had other sources of information, including its existing business, which should have indicated to it what Progressive's margin expectations were.

Poultry

Battery hen deadline extended [13 December/ Radio New Zealand Rural] Primary Industries Minister, Nathan Guy, has announced changes to the Layer Hens Welfare Code to enable the egg industry to meet the criteria for phasing out battery cages. The transitional period to shift from battery cages to larger colony cages will be extended by two years, meaning the oldest cages need to be replaced by 2018 and all cages will need to be transitioned by 2020. The industry has said the original timetable would not work thus the National Animal Welfare Advisory Committee had recommended changes to the code. The chair of the Egg Producers Federation, Michael Guthrie, said that it was physically impossible for many producers to meet the conditions, particularly the early deadline. Mr Guthrie said the Egg Producers Federation will report annually to the Minister on the progress being made in phasing out battery cages.

Fishing and aquaculture

Mussel farmer goes from winner to loser [14 December/ New Zealand Herald] Receivers have been appointed to Greenshell New Zealand and an associated company Ikana, by the main secured creditor, Rabobank. The mussel exporter is continuing to trade and the receivers are working to sell the business as a going concern. Receiver, Brendan Gibson of KordaMentha, said that Ikana, the retail arm of the business selling frozen and chilled mussels, had been unprofitable and had ceased trading, with four or five job losses. The company holds leases and licenses on several Coromandel Mussel farms from which its website suggests it farms around 10,000 tonnes of mussels each year. Greenshell and Ikana were both owned by Peter Vitasovch. The company had spent more than two years developing the Ikana packaging to sell live mussels in retail-ready packs with a 10 day shelf life. Greenshell had received a number of awards in recent times including Export NZ's Food and Beverage Exporter of the Year and the Supreme Award and Exporter of the Year at the American Chamber of Commerce Success and Innovation Awards.

Dairy

Fonterra price slump on dividend cut [11 December/ New Zealand Herald] Warnings from Fonterra of a cut in dividend and a sharp fall in earnings sent the prices of Fonterra Shareholder Fund units down almost 10% to a new low price. The fall came as Fonterra held its forecast farmgate milk price payout at \$8.30 per kilo milk solids and announced a cut in the dividend forecast from 32 cents to 10 cents (as EBIT is forecast to fall from \$1 billion to between \$500 million and \$600 million). Economists had expected an upward revision in the forecast due to the very high Global Dairy Trade auction prices but the announcement represents a reduction in the forecast cash payout to farmers of 22 cents. Fonterra Chair, John Wilson, said that milk powders were still selling at very high prices due to strong demand and limited supply but prices for the other key product streams that Fonterra produces due to production footprint, particularly cheese and casein, were dropping creating an extraordinary gap in prices. This was resulted in the milk price calculated by the manual (which is based on powders) being higher than the price Fonterra is able to pay based on its actual asset base (which includes cheese and casein). Mr Wilson said the board had exercised its discretion to pay a lower farmgate milk price than that specified under the manual, which is currently calculated at \$9 per kg milk solids. Fonterra CEO, Theo Spierings, said that Fonterra would maintain its financial discipline and not pay the milk price out of borrowings. Mr Spierings added that Fonterra had devoted the maximum possible volume of milk to powders to maximise payouts to farmers but the co-op has not been able to lift production of powder over 70% of total volume due to the existing production facilities that the co-operative has in New Zealand.

Fonterra to build milk powder plant in Pahiatua [12 December/ Radio New Zealand Rural] Fonterra has announced that it has started work on a new milk powder plant at Pahiatua in the lower North Island to grow its processing capacity. The announcement follows a spring season where the volumes of milk supplied has seen Fonterra dumping low value products as it was unable to process all milk supplied at peak. The new \$235 million plant will help to deal with the increased volume of milk production which is growing at 3% a year. Fonterra chair, John Wilson, says the dryer has been planned for some time but it has now been confirmed given the increased demand for processing capacity. The new dryer will be operating in spring 2015 and will process around 2.4 million litres of milk a day. Operations Director, Robert Spurway, said that the extra capacity will assist the company in processing all the milk it receives and enable production to be optimised to meet the growing demand for whole milk powder to maximise returns. The new dryer will be the first in the country to reuse its own condensate, while the wastewater will also be treated and used for irrigation.

Oceania Dairy signs first milk supply agreement [13 December/ Otago Daily Times] Oceania Dairy has signed its first milk supply agreement for the \$214 million dairy factory being constructed in Glenavy for its parent company, Inner Mongolia Yili Industrial Group. The deal was signed with Aad and Wilma van Leeuwen representing a foundation group of suppliers covering 20 individual dairy farms with supply expected to commence in August next year. Oceania Dairy will contract up to 40 local farmers for the 2014/15 season to deliver 130 million litres of milk. The factory will process 300 millions of milk at full capacity in 2016/17 producing 47,000 tonnes of milk powder for export to China for use in infant formula. Mr van Leeuwen said the company offered local farmers choice. Oceania Dairy is currently employing 11 staff with the number expected to ramp up rapidly in the new year.

Operating costs eat into milk payout [13 December/ Business Day] Canterbury farmers are looking at total farm operating costs off close to \$5 a kilogram milk solids according to the latest figures from Dairy New Zealand. Operating costs rose rapidly in the last high payout season (2007/08) when costs rose around \$1 per kilo of production, an increase which has remained with farmers since. Dairy NZ CEO, Tim Mackle, said the latest predictions were farmers were heading for operating expenses towards \$5/kg with farm working expenses at about \$4.40/kg, which given the current payout forecast still leaves a good margin. Mr Mackle noted the average debt in Canterbury is similar to other regions at \$18 to \$19/kg but with higher prices pushing up farm values there is a risk that debt levels might increase again. At current debt levels, the cost of service debt is around \$1.40 per kilogram milksolids which is on top of the operating expenses. He stressed it was important that farmers do not take their eye of the ball in respect of farm cost inflation in the current high payout environment, and should work hard to protect their cost structure to be in a strong position when the milk price drops again. Canterbury farmers are facing the added difficulty of irrigation damage experienced in September and should be aware of external factors in preparing budgets, with a strong expectation that supply from the US will increase putting pressure on prices.

Exporters need right formula [15 December/ Business Day] Although the first stage of the Government inquiry into botulism has exonerated New Zealand's food safety system, it is apparent that infant formula exporters were worried about being on the back foot in China, despite high demand for the products and a good reputation for safety. The industry has been impacted by a series of events over the last five years (the melamine scare, a grey trade in NZ infant formula through Hong Kong which has placed a shadow over legitimate products, the DCD scare and the recent botulism scare) which has taken the gloss off the reputation of NZ products. The biggest challenge may still be to come with the Chinese government announcing new draft regulations for dairy imports in the months before the botulism scare which have been difficult for smaller industry players to translate and the general impression of these companies is that the Ministry for Primary Industries was caught out by their release. The regulations demand more testing yet it took some months for the Ministry and the exporters to engage fully over the changes and while the rules remain draft this can create issues at different ports where interpretations of the rules can vary. China is expected to firm up the import rules by the middle of next year with minimum requirements expected to involve registration of exporters and audits of manufacturing facilities. One exporter views China's demands for greater traceability positively however the challenge will be in the detail of the rules and how accountable exporters need to be across the whole supply chain, including the manufacturer of the base product (often Fonterra or one of the other large processors). Professor Keith Woodford of Lincoln University says that the Chinese will probably frown on the many exporters who have no presence in their home market, suggesting that if a product is manufactured here specifically for China it is unlikely to have a long term place in the Chinese market – they want the same products that are being consumed in our domestic market.

Commerce Commission to look into Fonterra milk pricing [16 December/ Radio New Zealand Rural] The Commerce Commission says that it will look into the implications of Fonterra's decision to its milk price below the price calculated under the milk price manual. Fonterra announced a forecast milk price of \$8.30 a kilogram milk solids despite the manual price being \$9 a kilo. The Commerce Commission monitors compliance with the milk price manual and the way it is applied and as a consequence the Commission's deputy chair, Sue Begg, says it will be looking at the implications of Fonterra deviating from the pricing model in a more detailed review next year. Ms Begg said that Fonterra will provide an explanation of why its setting price below the level that is calculated by the model. Ms Begg also noted that the Commission has just completed a review of the milk price manual and found that it is largely consistent with the DIRA regulations, however added that there is a concern about the lack of prescription in some rules in the manual which makes it unclear how Fonterra is applying the rules in a couple of areas.

Meat

Meat reformers score win [13 December/ Business Day] The candidates put forward by the Meat Industry Excellence Group has scored a pair of wins at the Annual General Meeting of Alliance Group. Don Morrison has been elected to the board of the Alliance Group, having resigned from the board of MIE on being nominated for the Alliance elections. Mr Morrison won one of the contested seats, the other being retained by Alliance Group chair, Murray Taggart. Alliance shareholders also passed a resolution that the co-operative should appoint MIE candidate and Fonterra director, John Monaghan, to the board as an independent director. The unsuccessful candidate was Jason Miller, who was first elected to Alliance board in 2007. The results were announced at the co-operative's annual meeting in Dannevirke and showed a shareholder turnout of 49%, significantly higher than recent years. Mr Taggart said the board is currently looking for an independent director with the right skills and expertise, but they would take the views of the farmers voting on the resolution into account.

Peasants warning issued as candidates elected to Silver Fern board [16 December/ Radio New Zealand Rural] Silver Ferns Farms shareholders have elected Richard Young and Dan Jex-Blake to the co-operatives board. Both candidates are supportive of meat industry reform but are strongly supportive of the co-operative model, suggesting that farmers could end up as peasants if the co-operatives influence is undermined. David Shaw, a sitting Director that was standing for re-election lost his seat. Mr Young said the next step is to get the boards of the two co-operatives talking as bringing the co-op's together must be the first part of consolidation for the industry. He added that it is imperative that the co-op's remain the cornerstone to any solution because farmers cannot afford to lose ownership of the value chain.

Wool

Wool prices continue to unravel [13 December/ Radio New Zealand Rural] Wool prices continue to fall reversing the gains made through most of the selling season. At the most recent North Island sale, prices for most wool types continued to decline, with strong cross bred wools selling for 9% below the previous sale level. New Zealand Wool Services International described the fall as part of a continuing market correction. The clear rate was also much lower than usual, with only two thirds of the 6,200 bales up for auction being sold. The current market conditions provide a striking contrast to the position earlier in the selling season when returns rose steeply on the back of demand from international buyers.

Rural infrastructure

Ravensdown sells Macfertil Australia [16 December/ Otago Daily Times] New Zealand based fertiliser co-operative, Ravensdown, said it has completed the sale of its entire Western Australian operation to Macfertil Australia. The purchaser is a subsidiary of Louis Dreyfus Commodities. Ravensdown had announced in July that it intended to sell its Western Australian operations as part of a strategic refocusing exercise. Ravensdown has not disclosed details of the transaction.

ASB, ANZ, Westpac face legal action over interest rate swaps [17 December/ NZ Herald] The Commerce Commission has said that it intends to file proceedings against the ASB Bank, ANZ New Zealand and Westpac New Zealand over breaches of the Fair Trading Act in respect of the sale of interest rate swap contracts. The Commission Chair, Mark Berry, said that the banks have been told that the Commission believes that there is sufficient evidence of breaches in the Act, over areas such as misleading or deceptive conduct and false or misleading representations. Mr Berry added that he expected to have further talks with the banks over the coming months. The Commission started probing the sale of swap contracts to rural and commercial clients of the banks in August last year and has received 42 complaints relating to concerns over how the swap contracts were sold. The ANZ said that the swaps were largely sold by the National Bank prior to the Global Financial Crisis and a spokesman noted that they have been working with customers who subsequently found themselves in challenging financial circumstances, something it remained committed to doing. The ASB said in a statement it would continue to co-operate with the ongoing investigation while Westpac said it would be seeking details of the specific concerns of the Commission, noting the generality of the statements made to date.

Environment and emissions

Water quality tops public concerns [16 December/ Business Day] The Triennial Public Perceptions on New Zealand's Environment survey recently completed by Lincoln University highlights that water issues are considered to be the top priority problem facing the environment in the minds of the New Zealand public. The survey which asked 2,200 people questions about a wide range of environmental categories highlighted public concerns that growth in production and consumption, as well as intensification of farming and forestry activities were putting increased pressure on the environment. The perception was that rivers, lakes and groundwater were the worst managed environments due to negative perceptions over farm effluent and run off, with 56% of respondents believing that farming was the main cause of fresh water damage. Federated Farmers President, Bruce Wills, said that there is no question that farming has an impact on the environment but added that farmers are absolutely stepping up to these concerns and finding better solutions to keep farming profitably but with a smaller environmental impact. The report found that most New Zealanders considered the state of the natural environment to be adequate or good and that New Zealand continues to be perceived as 'clean and green'. The research team noted that science backed up perceptions on freshwater but ideas about the state of the country's biodiversity were not backed up in reality, with reports from DOC and MFE suggesting we could be doing much better in these areas.

Water

Tensions rise as farmers wait on repairs [15 December/ Business Day] The wind storms through Canterbury in September have left some farmers with repair bills of around \$500,000 with many farmers still waiting for parts to arrive to get their irrigation systems back on line. Repair crews who have been working overtime, in general expect more than 80% of the repairs will be completed before Christmas all though it may take until March for the worst hit arable farmers to get fully back up and running. Andrew Curtis, CEO of Irrigation NZ, said that overall most people have some form of irrigation operating on their properties although there are a small number that have nothing (10 to 15 farmers), adding that life is getting particularly tense for these people. While pastoral farmers are coping by buying in feed, the cropping farmers are finding life very difficult although recent rain would have helped to some extent. Mr Curtis said that good progress has been made with the repairs, considering the scale of the damage, but this is cold comfort to those still waiting. He also noted that farmers had reported insurers dealing with the claims quickly, although as always there have been a few situations where people have not been as helpful as they could have been, particularly when the irrigation providers are having to outlay millions of dollars to bring the parts shipments in.

Research and development

Firms want robotics study to bear fruit [11 December/ Bay of Plenty Times] Twenty three companies in the Waikato and Bay of Plenty have joined a study being led by the University of Waikato Agritech Group and co-funded by Priority One, to identify research programmes that are responsive to the practical problems being faced by businesses in primary sector. The primary sector has some very complex robotics challenges operating in forests and farms but also operates on low margins, so while researchers may have great ideas the economics often do not work for the industry. Steve Saunders of PlusGroup Horticulture whose company has developed robotic solutions for the primary sector noted it is important to work back from what the farmer could use to increase efficiency and save money rather than starting with a solution that might not work in the real world. Mr Saunders highlighted that whatever is developed needs to be affordable for the end user so it can generate a return for the investor. The preliminary research findings noted that there are many potential projects that did not require complex robotics but were more about automating simple tasks that are currently done manually. The key issues facing the sector – rising labour costs and the long run increases in input costs – highlights a real opportunity in doing things smarter, quicker and more efficiently.

Biosecurity

Govt and primary sectors to form formal biosecurity partnerships [13 December/ Radio New Zealand Rural] The Cabinet has confirmed the structure to enable the Ministry for Primary Industries to start to enter into formal biosecurity agreements with industry sectors. The Government Industry Agreements (GIA's) will allow the ministry and agricultural sectors to work together in developing biosecurity plans and incursion responses. The industry sectors will gain influence but will be required to share some of the costs. Primary Industries Minister, Nathan Guy, noted that he was aware a lot of industry groups are keen to sign up but highlighted that biosecurity protection remained his number one priority. The Labour Party Primary Industries spokesperson, Damien O'Connor, believes that the industry and government working together is a sound idea but thinks the GIA structure may be too expensive for small sectors to sign up to. Mr O'Connor also predicts problems down the line as industries look to influence what is coming over the border.

International

Agriculture the most promising market for drones [15 December/ New Zealand Herald/ AP] Farmers in the US are not waiting for Federal Aviation officials to set the rules for the use of drones in agriculture and are getting on with using the lightweight aircraft to get a bird's eye view of their properties. One farmer from Idaho, Robert Blair, notes it provides information to make better decisions and has huge potential on large scale properties where privacy and safety issues are less of a concern. Drones can be fitted with cameras and sensors to survey crops, monitor for disease or precision spray pesticides and fertilisers and have already been adopted in agriculture in Brazil and Japan. Some experts suggest the range of uses in agriculture (bird scaring, pollination, water surveys, irrigation monitoring, harvesting support) make the sector the most likely to adopt drone technology on a large scale with a potential to make a significant contribution to production yields and lower costs. Currently commercial use of drones is not permitted although special experimental airworthiness certificates are available. Concerns around privacy and government surveillance has led legislators in many states to introduce rules to limit the use of drone surveillance focusing manufacturers on other commercial opportunities, such as agricultural. The US Congress has directed the FAA to grant access to unmanned aircraft in US skies by September 2015 and the rules are currently being developed. Researchers however are exploring the uses of the technology; at the University of Oregon drones have been trialled to monitor for disease in potato fields, in Florida drones are being trialled with infrared cameras to monitor for the deadly citrus greening disease while the University of California Davis is using the technology to spray vineyards and orchards. Mr Blair notes that drones support surgical agriculture, allowing farmers to be more precise and more environmentally friendly in their activities.

UK butter eaters lose taste for Anchor after dairy giant cuts NZ ties [16 December/ New Zealand Herald] Arla Foods have recently changed the sourcing for Anchor butter which has upset some British consumers. Arla Foods uses the famous New Zealand brand in Britain, having bought Fonterra out of the AFF joint venture in 2009. Until recently Arla continued to source the butter used in the product from Fonterra but has now switched to using product made in a British factory. The Arla logo has been added to the block butter packs but complaints have been received from disgruntled customers some of whom say they will not be buying the product again. An Arla spokesman could not be reached for comment, but the company has previously said that the vast majority of shoppers were happy with the change. AFF (Arla Foods Fonterra) was established in 2002 to market block butter, spreads and aerosol creams in Britain.

Peterson Farm Bros continue roaring success [16 December/ FW Plus] Farmers on Twitter are embracing three farming brothers, The Peterson Farm Bros, whose music parody videos are educating the wider public about farming life. The most recent, a parody of Katie Perry's "Roar" called Chore shows the activities that the brothers do on their family farm in Kansas where they run beef cattle, grow wheat, corn, alfalfa and soybeans. Gregory Peterson created their first farming themed video in June 2012, when he was an ag-comm major at Kansas State University and was looking at ways to promote agriculture. The initial video achieved more than 6 million views on YouTube in the first two weeks of posting and the brothers are now being invited to perform at agricultural conferences and events in the US and around the world. Gregory Peterson says he has made a sub career out of the video's between farming and notes that some of the mainstream media does a good job at representing farmers but most doesn't, given the media is mainly city based and does not understand farming or who farmers really are. He says that the message he and his brothers want people to take away about farmers and agriculture is that it is important to each and every person – without agriculture people would be starving and without clothes. They also want to portray farmers as extremely intelligent, technically savvy, environmental aware operators.

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Food safety

Ministers' WPC inquiry report out [12 December/ Rural News] The Government has accepted in principle all the recommendations from the first stage of the Ministerial inquiry into the dairy food safety system in New Zealand. The review found that the system is consistent with international principles and is among the best in the world, a finding that Primary Industries Minister, Nathan Guy, and Food Safety Minister, Nikki Kaye, said is of fundamental importance to reassuring off shore markets. The report had been peer reviewed by Professor Alan Reilly, the head of the Food Safety Authority in Ireland, who confirmed he was satisfied with the quality and integrity of the inquiry's report. Ms Kaye said the report makes recommendation about strengthening the food safety system to cope with the growth in exports and the different markets that we are now supplying. The government has confirmed it will allocate funds to strengthen capability in export markets (particularly China), establishing a centre of food safety science and research which will bring together existing capability in New Zealand allowing for collaboration, increasing dairy processing regulatory capability and establishing a food safety and assurance advisory council. The inquiry also recommended a revision of New Zealand regulatory requirements for the manufacture of infant formula, a project which is already underway.

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Field Notes presents a summary of some of the media comment on the Agribusiness sector in the last week. The views expressed do not necessarily represent the views of KPMG but are summaries of the articles published.

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