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## "Fonterra's near future Enter Henry van der Heyden. Exit Craig Norgate?"

By Fiona Rotherham

Remember arguing with the teacher about comments she made on your school report? It happens in business, too. Just-retired Fonterra chairman John Roadley blew his stack when he saw the first draft of the Shareholders' Council report reviewing the company's first-year performance. He warned legal action could be taken against the council, which represents 14,000 supplying farmers, unless it fixed "inaccuracies" and toned down the report's criticisms. Roadley insists he wasn't heavying the council, but that it was essential it got things right.

The council stood firm. One farmer says they tried hard not to be overly negative, but it wasn't easy.

Fonterra was formed a year ago by merging NZ Dairy Group, Kiwi Dairies and the Dairy Board. Hailed as an icon of the country's economic transformation, Fonterra proceeded to report a $50 million loss in May. Fonterra musters 20% of our export receipts, so this matters.

Fonterra then grabbed $50 million from reserves to make a record payout to farmers — $5.33 per kg of milk solids, including a $5.06 payment for the milk component and various additional payments. Nutty? Scary, more like, and another sign Fonterra just isn't performing. According to two international benchmarks from the shareholders report, if the newly merged company was the world-beater it said it was going to be, the payout should have been even bigger.

First, using the Economic Value Added financial performance methodology and given the cost of capital invested, the payout wasn't enough to represent value for farmer shareholders. Second, if you use Standard & Poors' international figure for the commodity milk price (a theoretical benchmark to compare dairy companies) an efficient Fonterra should have paid farmers $5.45 a kg just for the milk part of the payout rather than $5.06. If that's not bad enough, declining world commodity prices mean next year's farmer payout will be lower, resulting in a $130,400 drop in average farmer income.

The council's report raised a wide range of concerns, from the payout to governance to financial performance, and complained company information it received was "late, incomplete and subject to change". The company had a weaker-than-forecast balance sheet, a $64 million blow-out on corporate overheads, a $200 million salary bill for top executives, and interest-bearing debt of $903 million above budget. The council was "not satisfied the company has a strong focus on minimising cost".

Net cash flow from operations is also a worry. Fonterra generated only $354 million net cash flow from operations — some $525 million under the October forecast. It is also understood to have spent more than $70 million on consultants' fees. Then there was the resignation of independent director Mike Smith citing governance concerns, milk collection hassles and a $34 million mistake in Fonterra's end-of-year financial reporting.

Chief executive Craig Norgate partly blames inherited capital structure problems. He also disagrees with the report, rating Fonterra's first year as above average. Operating profit is more than $100 million ahead of the legacy companies' budget, he says, and forecast merger benefits over three years have risen from $332 million to $400 million. The industry is processing more milk than ever, there have been joint ventures including a multibillion-dollar deal with Nestlé, and efficiency gains at the factory level.

Here's the key problem: management is saying "we've done good" and shareholders beg to differ. Fonterra needs a smart go-between. Enter Fonterra chairman Henry van der Heyden, former NZ Dairy Group chairman. Farmers have faith in this hard-nosed businessman. Good. He needs to make some hard-nosed decisions. There are differences between shareholders and management, a schism between staff formerly from dairy rivals Kiwi and Dairy Group, and the Powdergate illegal dairy export scandal tainting Norgate and deputy chairman Greg Gent and still under investigation by the NZ Food Safety Authority.

The appointment of a tough new chairman to an underperforming company has fuelled speculation Norgate's reputed $2 million-a-year contract won't be renewed next July. Norgate isn't doing much to dispel that notion, saying the first two years of the merger are the most critical anyway. In that case, he really doesn't have long to get it right. Nor does his new boss.

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