Rural Economic Note

2018/19 Fonterra Annual Results

26 September 2019

The wrong records tumble

- Fonterra has posted a record loss for a second successive year.
- Despite the earnings result being largely as expected, we find very little to be rosy about.
- On paper, Fonterra has a new simplified and sensible strategy, but we remain healthily sceptical given the string of poor results.

Summary

Fonterra's financial performance has gone from bad to worse. This financial year it posted its largest ever loss of $605m on top of the $196m loss last year.

We find very little to be rosy about in the results despite knowing what to expect. Underlying profit continues to worsen, while what previously looked like one-off hits to the business (think Danone, Beingmate) are now becoming regular.

On paper, Fonterra has a new simplified and sensible strategy. But we remain healthily sceptical. After a string of poor results, only a subsequent string of strong results will make us believers.

Annual Results

Fonterra has announced poor financial results for the 2018/19 financial year, highlighted by a $605m net loss after after tax. The 2018/19 loss is the worst on record, and compares to the 196m loss in 2017/18, which itself was a record loss at that time.

The loss was driven by asset writedowns totalling $826m. These writedowns were expected (previously announced by Fonterra) and included $200m shaved off the values of Fonterra's China Farms, DPA Brazil, the NZ consumer businesses, respectively, and a $70m writedown to its Australian assets.

2018/19 Financial results

	2018/19	2017/18	*Change*
Revenue	$20.1bn	$20.4bn	*-2%*
Normalised EBIT	$0.8 bn	$0.9 bn	*-9%*
Net profit/loss after tax	-$605m	-$196m	*-409%*
Return on capital	5.8%	6.3%	*-0.5 pts*
Debt	$5.7bn	$6.1bn	*-7%*
Gearing ratio	48.2%	48.4%	*-0.2 pts*
Earnings per share	$0.17	$0.24	*-29%*
Cash payout (per kg MS)	$6.35	$6.79	*-6%*
Farmgate milk price	$6.35	$6.69	*-5%*
Cash dividend per share	$0.00	$0.10	*-10c*

Looking at the profit trend, normalised EBIT fell 9% from 2017/18 to $819m. EBIT has now fallen for three years in a row, with Fonterra's underlying profitability falling by around 40% (ca. $540m) over this period. Fonterra's return on capital also fell to 5.8%. Notably and for comparison, this sat as high as 12.4% back in 2015/16.

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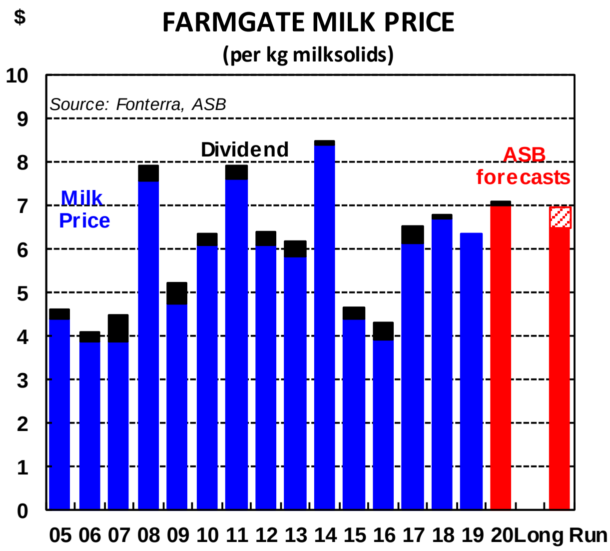
While Fonterra reported lower debt levels, this was largely due to selling assets and lower capital expenditure. And while asset sales such as Tip Top ($480m) and DFE Pharma ($633m) generated cash for repaying debt, these businesses in particular were also profitable arms of the wider business. For the record, debt fell $0.4 billion to $5.7 billion, while Fonterra's gearing ratio also fell 0.2 percentage points to 48.2%.

The cash payout for farmers was also down on last year. All up and with no dividend paid, the cash payout came in at $6.35/kg. This payout was down 44c on last season (the 2017/18 cash payout included a $6.69/kg milk price and a 10c/kg dividend). Meanwhile, Fonterra reconfirmed its 2019/20 milk price forecast range of $6.25/kg to $7.25/kg.



Fonterra is hoping for an improved performance over 2019/20. It has signalled an earnings-per-share range of 15 to 25 cents. However, in an acknowledgement of weakening in its business and balance sheet, it has changed its dividend payment policy from 65%-75% to 40%-60% of net profit after tax.

Implications

Fonterra's financial performance has gone from bad to worse. Moreover, its underlying business profit has fallen year-on-year for three years and one can no longer ignore the pattern of one-off events such as Beingmate, Danone and more recently the asset writedowns to China Farms and other businesses mentioned above.

Season end farmgate milk price forecasts

	2018/19	2019/20	
	Final	Fonterra	ASB
Milk Price*	$6.35	$6.25-$7.25	$7.00

* per kg of milk solids (excluding dividend).

With this in mind, we take Fonterra's profit expectations with a large grain of salt. The refreshed strategy sounds sensible on paper, but Fonterra has no clear track record of executing its strategies or meeting its profit expectations. Accordingly, we continue to see downside risks to its 2019/20 dividend forecast.

Finally, as a major player in the New Zealand economy, Fonterra's ongoing underperformance has been disappointing. **Better performance can make a significant difference to the broader performance of the New Zealand economy.**

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