

Rural Economic Note

Fonterra Milk Price Forecast Update & Interim Results

21 March 2018

The good, the bad, and the ugly

- Fonterra has lifted its 2017/18 milk price forecast by 15 cents to \$6.55/kg.
- Given that it is late in the season, we align our own forecast with Fonterra at \$6.55/kg.
- However, Fonterra’s half-year profits have taken a hit and the value of its Beingmate investment has been cut by a whopping \$405m.

2017/18 Milk price forecast update

Fonterra has lifted its 2017/18 milk price forecast by 15 cents to **\$6.55/kg**, largely in line with our expectations. Our forecast stood at \$6.50/kg prior to the announcement, although we noted that Fonterra could exceed that number as has proved the case.

Given that it is late in the season, **we move to align our milk price forecast with Fonterra’s \$6.55/kg**. If anything though, we note that if dairy auction prices hold near current levels, the milk price could edge higher to the vicinity of \$6.60/kg.

Generally global dairy prices, and in particular the prices important to NZ, remain firm. While NZ production is improving, the recovery from weak production earlier in the season is progressing only gradually. With global demand also firm, we expect the global dairy market will remain largely balanced for now and for prices to track sideways as a result.

This trend also bodes well heading into the 2018/19 season. At this early stage, we have pencilled in a similar milk price of \$6.50/kg for next season as well.

2017/18 Fonterra Interim Results

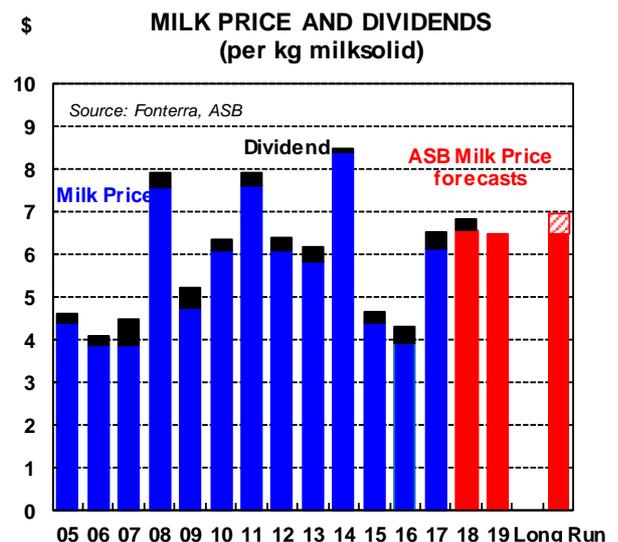
In contrast to the rosy milk price picture, **Fonterra’s half-year profits have taken a hit.** For example, its Normalised net profit after tax (effectively its underlying profit prior to the Danone and Beingmate adjustments) has fallen 36% from the same period of 2017 to \$248m. Fonterra pointed to high inventory levels, low milk collections and higher input costs (read higher milk price) as contributing to the fall in profits.

Moreover, taking into account the writedown in the value of its Beingmate investment and the Danone settlement

Farmgate Milk Price Forecasts

	2017/18		2018/19	Long Run
	Fonterra	ASB	ASB	ASB
Milk Price*	\$6.55	\$6.55	\$6.50	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).



Fonterra has actually posted a \$348m loss (in net profit after tax terms). Fonterra has written down the value of its Beingmate investment by \$405m, while the settlement with Danone cost around \$170m (after allowing for insurance).

Despite the fall in underlying profits, **Fonterra still intends to pay a cash dividend of 25 to 35 cents per share**. Notably, this dividend range is very close to the range to that Fonterra had planned to pay earlier in the year when profits were expected to be much higher. Effectively, this means that Fonterra will partly fund the dividend from its balance sheet as opposed to profits. Adding the revised milk price forecast to the dividend, farmer shareholders are forecast to receive between \$6.80/kg and \$6.90/kg cash in hand this season.

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