

**THE UNIQUE CHALLENGES OF CAPITALISATION AND FINANCING  
FACED BY COOPERATIVE AND MUTUAL BUSINESSES:  
FONTERRA'S TAF**

**Presentation NZASCM Conference**  
Onno van Bekkum, 22 June 2012

- Research 
- Advisory
- Courses
- Cooperative Strategy
- Capitalization
- Governance
- Member engagement

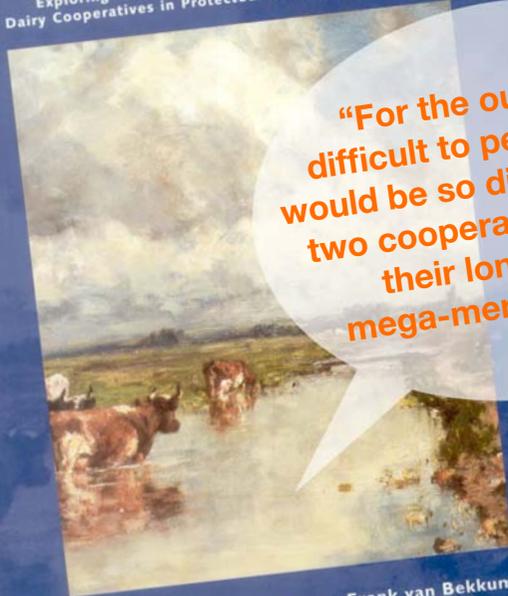


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**Cooperative Models and  
Farm Policy Reform**

Exploring Patterns in Structure-Strategy Matches of  
Dairy Cooperatives in Protected vs. Liberalized Markets



*“For the outsider it is difficult to perceive why it would be so difficult for these two cooperatives to realize their long-debated mega-merger.” (Dec'00)*

Onno-Frank van Bekkum

**World Dairy Co-ops**

Update: 22May12

EUR m

Dairy#	W#	Company name	Country	Date	Revenues	Δ	Net profit	Profit/ Reven	10yr growth
D1	W3	Fonterra	NZ	Jul11	12128	31%	549	4.5%	72%
D2	W4	Dairy Farmers of America	USA	Dec11	10039	36%	31	0.3%	63%
D3	W5	Land O'Lakes	USA	Dec11	9922	18%	142	1.4%	78%
D4	W6	FrieslandCampina	NL	Dec11	9626	7%	216	2.2%	104%
D5	W9	Arla Foods	DK	Dec11	7384	12%	176	2.4%	39%
D6	W22	DMK	DE	Dec10	4175	-6%	2	0.1%	82%
D7	W24	Sodiaal	FR	Dec10	4021	62%	23	0.6%	113%
D8	W31	Glanbia	IR	Dec11	2735	26%	120	4.4%	18%
D9	W33	Agropur	CA	Oct11	2600	11%	31	4.1%	118%
D10	W34	Tine	NO	Dec11	1960	11%	38	4.1%	33%
D11	W35	Chico	FR	Dec11	1800	11%	38	3.0%	134%
D12	W40	Dairy Farmers of America	USA	Dec10	2236	28%	2	0.1%	25%
D13	W44	Irish Dairy Board	IR	Dec11	1881	4%	2	0.1%	5%
D14	W46	Valio	FI	Dec11	1604	7%	27	1.6%	47%
D15	W47	Valio	FI	Dec11	1604	7%	27	1.6%	47%
D16	W48	Valio	USA	Dec11	1544	20%	2	0.1%	65%
D17	W60	Amul	IN	Mar11	1527	16%	?	?	?
D18	W61	Darigold / Westfarm Foods/	USA	Mar11	1468	20%	36	2.5%	-1%
D19	W68	Maitres Laitiers du Cotentin	FR	Mar11	1300	-0%	14	1.1%	?
D20	W73	Laïta	FR	Dec11	1159	7%	?	?	251%

**The World's No.1  
Dairy Cooperative**

# DAIRY NEWS

LEGAL PITFALLS  
MAY 2012 DEBATE  
PAGE 97

“For an overseas observer it is difficult to understand why TAF and TAF only should be considered as a solution to Fonterra’s redemption problem.”

## CRUNCH TIME

“I’ve just seen many cooperatives going down the drain when investor interests start prevailing over producer interests.”

- Dutch co-op expert Onno van Bekkum

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TAF debate pages 3-6



## A COOPERATIVE?

- “A normal **business** that competes in the **same markets** just like any other business, but at yearend it **distributes returns** to a particular class of owners we call “**members**” who also **supply** to the business.”
- A business with “**100%** farmer control and ownership” and where “**75%** of shareholders decide on any changes to key features”.

## 4 NEWS

### Front foot it!

ANDREW SWALLOW

“LICENSE TO operate: regulatory barrier or market opportunity?”

That was the title four guest speakers spoke to at Agmand’s annual agribusiness breakfast, preceding the practical day of the Young Farmer Contest.

Fish and Game chief executive Bryce Johnson said five years ago the topic would have been “heresy” in such a setting but now it’s time has come.

“What agriculture needs to do is take the lead... The trick is to stay ahead of the game. You’ve got to collaborate with the policy makers.”

Revamping the Clean Streams Accord is “a huge opportunity” and as Land and Water Forum (LAWF) progress has shown, all New Zealanders want more or less the same outcomes.

Environmental NGOs (which F&G is not), rather than being the enemy, are “really part of your strategic opportunity”.

Johnson’s presentation followed Lincoln University vice chancellor Andy West’s, who gave a “big picture” personal view that world agriculture – New Zealand included – needs to intensify production, not just to feed the predicted 10 billion population of 2050, but to protect the environment.

“What we’re doing right now is sending an awful lot of species extinct. We’ve got to intensify our use of land. The question is: does New Zealand want to be a part of that?”

Intensification, for example through partially housed dairy systems, offers a win-win to increase production and reduce environmental impact, he said, declaring he has an interest in the Herd Home company.

“We could double our [dairy] production just by



Bryce Johnson

## TAF sceptics seek second opinion

ANDREW SWALLOW

A GROUP of Fonterra shareholders has commissioned a report on hybrid cooperative models because they’re concerned they’re not getting the full story from their own board and management.

“We have been forced to do this because, to date, we’ve not been allowed access to the official due diligence that we as farmers have all paid for,” group spokeswoman Leonie Guiney told Rural News last week.

At their own expense Guiney and others commissioned Dutch co-operatives analyst Onno van Bekkum to look at the success or otherwise of cooperatives elsewhere in the world that have pursued models that involve non-farmer equity in cooperatives.

“Part of the problem is there’s nothing to compare TAF with. But it is



Leonie Guiney

### About van Bekkum

ONNO VAN Bekkum describes himself as a cooperative strategist. He has an MSc in agricultural economics from Wageningen University and a PhD in economics from Nyenrode Business University, Holland. He has worked as a consultant for cooperatives including Rabobank, FrieslandCampina, Fonterra, Tine, and Dairy Farmers of Britain, among others.

• See [www.coopchampions.com](http://www.coopchampions.com)

Couper about his reasons for standing down from the Shareholders Council were not.

“Couper was our elected representative who has seen the detail behind this and he’s stood down on principle because he doesn’t believe 100% ownership and control can

sent by an area manager following farmer feedback expressing interest in independent reviews and comments on TAF. It is doing everything it can to ensure all the information is available to shareholders in time to be read, discussed and questioned, the co-op says.

## A COOPERATIVE IS:

- A trusted **business**
- serving (nothing but) the best, long-term and collective **interests**
- of a single class of owners: (milk) **producers**

# FONTERRA:

- Is a NZ dairy **business**
- that requires
- for farmers to “control [their] own destiny”
- a “unifying **vote**” of over 50% (60%?)
- in favor of **TAF** (and TAF only: “no plan B”)
- as the ‘governmentally enforced’ solution
- to the problem of an **unstable** capital base
- with “possibly as much as **\$1 billion** to cover the potential cost of redemption risk”
- resulting from a (deficient) **fair value** share structure
- that otherwise may not be changed.

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# FONTERRA'S FAIR VALUE SHARE

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## FAIR VALUE SHARE RAISED CAPITAL

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Sum
<b>Value shares issued</b>	403	549	552	495	634	1,644	1,142	750	617	404	<b>7,190</b>
<b>Redeemed</b>	189	322	403	535	440	1,750	1,425	506	158	159	<b>5,887</b>
<b>Net contributed</b>	214	227	149	-40	194	-106	-283	244	459	245	<b>1,303</b>
<b>Cumulative net contr.</b>	214	441	590	550	744	638	355	599	1,058	1,303	

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## \$3 NOMINAL SHARE WOULD'VE RAISED \$s **T00**

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Sum
<b>Value shares issued</b>	403	428	378	317	350	752	505	404	410	268	<b>4,213</b>
<b>Redeemed</b>	189	251	276	342	243	800	630	273	105	106	<b>3,214</b>
<b>Net contributed</b>	214	177	102	-26	107	-48	-125	131	305	163	<b>999</b>
<b>Cumulative net contr.</b>	214	391	493	467	574	526	401	532	837	999	

Note: A cheaper share would have taxed production growth less and hence raised more capital

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## CONCLUSION: EXTRA CAPITAL RAISED BY FVS WAS VERY LIMITED

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Cumulative net contr.</b>	214	441	590	550	744	638	355	599	1058	1303
<b>Idem \$3</b>	214	391	493	467	574	526	401	532	837	999
<b>Extra capital raised</b>	0	50	97	83	170	112	-46	67	221	304

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## SUMMARIZING THE ISSUE

- ‘Fair’ valuation of shares: brings in **little extra capital** (compared to \$3 nominal valuation) but leaves behind a **massive redemption claim** (not just a ‘risk!’).

➔ The fair value share is **deficient**.

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## FAIR VALUE SHARE CREATED REDEMPTION CLAIM

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Milk solids</b>	1,111	1,148	1,201	1,160	1,210	1,243	1,183	1,227	1,256	1,320
<b>Share price</b>	3.00	3.85	4.38	4.69	5.44	6.56	6.79	5.57	4.52	4.52
<b>Outstanding redemption claim</b>	3,333	4,420	5,260	5,440	6,582	8,154	8,033	6,834	5,677	5,966
<b>Excess claim (over \$3 value)</b>	0	976	1,657	1,960	2,952	4,425	4,484	3,153	1,909	2,006
<b>Idem over equity book value</b>	833	95	-647	-712	-1,565	-3,274	-3,807	-2,069	-46	537

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## WHY, THEN, A FAIR VALUE SHARE?

- 2001: To **allocate** the (full) value of the NZ Dairy Board to **farmers**, rather than to companies, which they would then take out from Fonterra when leaving (‘free exit’).
- Is value **change** at Fonterra **today** (e.g. Anker whey deal in NL) still in any way **related** to the Dairy Board?
- (It’s fair in a cooperative that **entrants** pay their way in.)
- “The select committee has changed the legislation [Clause 77a] to ensure the fair value share price must reflect a price related to the cooperative share, which is currently redeemed by Fonterra and is currently discounted to reflect that limited trading.” Media Release, Damien O’Connor, 19 June 2012

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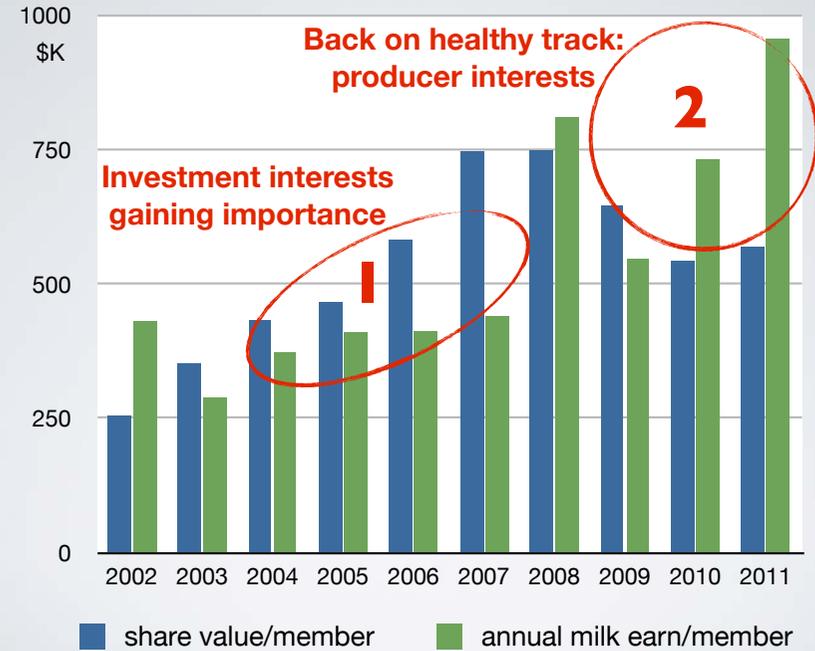
IN TERMS OF **VALUE** CREATION,  
MEMBERS' **TRUE** INTEREST IS IN  
LONG TERM RETURNS ON **MILK**

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**TAF THE SOLUTION?**  
THE **BROAD** PICTURE  
& SOME **DETAILS**

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Fonterra's value creation



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DOES **TAF** SOLVE/REMOVE  
THE REDEMPTION **CLAIM?**

*"this major deadweight [on] the co-op's back"*

- **No**, it says: "Farmers, it's now **yours** - you may ask other **farmers** to 'redeem'/buy your shares. You might also ask public **investors** to buy units of these shares."
- (So what?)

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## WHAT IS THE FUNDAMENTAL PROBLEM WITH TAF?

- You can't just **strike out** the redemption claim, say you "removed" it, and believe it just disappeared.
- **Where did it go?**
- To the current generation of farmer shareholders: by transferring the redemption claim, the **co-op is sold** to individual farmer shareholders.
- The Co-operative share is transformed into a **derivative** and Fonterra Co-op into a '**farmer owned business**'.
- (So what?)

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## TAF WEAKNESSES & THREATS

- Introduces **stock market thinking** into Fonterra;
- Grants legal **rights** to external financial owners;
- **Drains** up to 20% of dividends;
- (Partially) **delinks** investments from milk supplies (max 3:1 dry:unbacked);
- **Taxes** production through high(er) share price, set by the public; *(what if the public systematically offers higher prices?)*
- **Locks** members in: delivery obligation on wet shares (vouchers);
- Complicates **raising** fresh capital;
- Tightens **governmental** controls and intensifies **public** scrutiny;
- Risks dividend **tax**?
- Complicates international **cooperative** approaches;
- Difficult and costly to **reverse**.

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## A FARMER OWNED BUSINESS

- **Rationale:** securing market access under sound commercial terms.
- **Thinks differently:** maximizing **investor** returns.
  - Shareholders: shareholder perspective ('cashing in').
  - Board: shareholder interests
  - Management: share price incentives
- Induces **free riding** ("adding flexibility"): farmer **solidarity** erodes and disappears

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## ENTRENCHING 100% FARMER OWNERSHIP

- "It will entrench for the **first time** 100% **farmer** control and ownership of our Co-operative."
- Really? 2001 Constitution, section 2: "The Board may not issue Co-operative Shares to any person (b) who is not the owner of the Milk supplied to the Company"
- No, what it does is privatizing the cooperative for the first time into 100% **individual** farmer ownership.

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# CREATION OF THE FUND

- “To achieve a minimum launch size of **\$500 million**, farmer shareholders will be **invited** to participate in a supply side book build”.
- **Unprecedented** to invite members of a cooperative to sell their shares to external investors.
- What do you **build up** while breaking down?

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# WILL THE FUND WORK?

- Limits on # dry shares (+25%) and # Shareholders Fund (20%) of shares may be tight and **stagnate** the market!
- ‘Uncertain’ outcomes of **stress testing**: milk drop, milk flush, (hostile) takeover bid, acquisition opportunity
- Breaches test the Board’s budget (buying back units **≈redemption**) & build up pressure to relax controls.

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# IS TAF REALLY NECESSARY?

“The harsh reality is that we need to set aside large amounts of capital – possibly as much as **\$1 billion** – to cover the potential cost of redemption risk.”

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Sum
<b>Value shares issued</b>	403	549	552	495	634	1,644	1,142	750	617	404	<b>7,190</b>
<b>Retentions</b>	-50	257	7	191	0	165	235	19	438	487	<b>1,749</b>
<b>1% Milk earnings</b>	56	36	45	48	47	48	87	58	77	100	<b>602</b>

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# A “NO” VOTE: THE DOWNSIDE

- Three-five years of **work** is ‘wasted’.
- Instability: position of the **Board** under question?
- Two **more** years (?) to be invested ‘going back to the drawing board’ for a new proposal, government approval (?) and another member vote.
- Woud this damage Fonterra’s ‘**Strategy Refresh**’ implementation?

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## CONCLUSION

- Fonterra's **fair** value share is **deficient**: raises little extra capital & creates an outstanding claim (not just a risk).
- TAF *removes* transfers that claim to current farmers, **privatizing** the co-op into a '**farmer owned business**'.
- There are **risks** associated with TAF and the **investor** orientation it imports into the system.
- Solving the problem doesn't necessarily require TAF; might it not be solved in a much **easier way**?

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# COOP CHAMPIONS

LEARNING & LEADERSHIP



## All the best!

### CO-OP Champions

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