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HD **Reduced margins pull Fonterra down**

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Fonterra's chief financial officer Lukas Paravicini said the **dairy** giant is investing heavily to protect itself from the market volatility that smashed the **group**'s earnings in 2013-14, as it eyes growth opportunities in **China**.

Fonterra, which is the world's biggest **dairy** exporter and the second-biggest processor in Australia, reported record revenue of $NZ22.3 **billion** ($20.3 **billion**) in the year ended July 31 as **dairy** commodity prices soared to record highs.

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But net profit dived 79 per cent to $NZ179 **million** as the high cost of **milk** crimped margins for the **group**'s other products such as **cheese** and casein.

"We want to increase our flexibility so that we can produce what we want, when we want," Mr Paravicini told The Australian Financial Review. "We are investing heavily to protect ourselves from volatility but the next stage is to leverage the volatility."

The **milk** price that Fonterra is mandated to pay its farmers is calculated off commodities such as **milk** powders. This means some products such as **cheese** saw a surge in input cost – **milk** – which could not be recovered.

The co-operative paid its farmers a record **milk** price of $NZ8.40 per kilogram of **milk** solids in 2013-14 and the co-op's cost of goods **sold** rose 27 per cent to $NZ19.8 **billion**.

In light of the extreme market conditions the co-operative declared a dividend of $NZ10¢ a share, two-thirds below last year. Fonterra said in August it is investing $NZ555 **million** to boost its processing capacity and improve flexibility at its plants.

Mr Paravicini said he expected margins will start to improve in the second quarter of the current year.

Alongside volatile markets, Fonterra has had to contend with the false health scare over a batch of its whey protein concentrate (WPC80) which prompted widespread product recalls and shut Fonterra out of some markets.

Fonterra's WPC is still banned in **China**. Despite the fallout, sales in **China** grew 6 per cent to $NZ5.5 **billion** and demand in Sri Lanka is back to normal after Fonterra's products were locked out during the health scare.

"For us WPC80 is a very significant event. We are focused to go on building trust and leading food safety in the industry," Mr Paravicini said.

"We don't want to play the victim here. WPC80 is not an excuse for not delivering earnings. We recognise that you can't just export product into a market, you have to embed yourself and be a corporate citizen."

On a conference call on Wednesday Fonterra chief executive Theo Spierings said the partnership with **Chinese** infant nutrition **company** Beingmate was crucial to drive growth in the world's second-biggest economy.

"You cannot do **business** in **China** without local partnerships and fresh local **milk**," he said.

Fonterra operates in 93 markets with more than 60 brands. Mr Spierings said the plan is to focus primarily on eight core markets under five global brands: NZ **Milk** Products, Anchor, Anlene, Anmum and a new **brand** to be unveiled next week.

Fonterra expects volatility to continue and it forecast a farmgate **milk** price of $NZ5.30 per kilogram of **milk** solids and a dividend of NZ25¢ to NZ30¢ for 2014-15.

Earlier this year the **Business** Council of Australia issued a report highlighting Fonterra as an example of successful government involvement to augment **business** competitiveness.

CO	foncop : Fonterra Co-operative Group Limited
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