FINANCIAL REVIEW

SE Market Wrap

HD **Scope for earnings upgrade**

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The collapse in global **dairy** prices could offset Fonterra's elevated spending on new plants and allow the **dairy** giant to pay bigger dividends, analysts say.

In 2013-14, Fonterra, which is listed in Australia and New Zealand, was forced to cut its dividend after the boom in **milk** powder prices put a rocket under the farmgate **milk** price.

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The **milk** price Fonterra pays its **dairy** farmers, the majority of whom are New Zealand-based, is regulated by reference to certain **dairy** product prices and is a cost of goods **sold**.

According to JPMorgan, global auction prices for a range of New Zealand's traded **dairy** products have fallen 40 per cent to 50 per cent since the peaks at the turn of the year.

Craigs Investment Partners analyst Adrian Allbon thinks the cooling in **dairy** commodities will help Fonterra and the lower **milk** price gives "scope for Fonterra earnings and dividend upgrades".

Fonterra is spending $NZ1.6 **billion** ($1.5 **billion**) on capital expenditures this year, raising concerns about its capital allocation policies and ability to increase its returns. But Mr Allbon expects 2014-15 to be the peak for capital spending and that Fonterra will become more transparent about return on capital requirements.

The **Chinese** retail **dairy** market is expected to grow at a compound annual rate of 10 per cent over the next five years to about $US140 **billion** ($165 **billion**) as **China**'s middle class grows and dietary habits change. But its **milk** production is expected to grow 3 per cent a year, resulting in a shortage of about 20 **billion** litres by 2020.

The big opportunity for Fonterra is expanding into higher-value **dairy** products to lift **group** returns. But there is some doubt in the industry that Fonterra can ever move away from being primarily a big producer of lower-returning commodities.

CO abncrg : Craigs Investment Partners Ltd. | foncop : Fonterra Co-operative Group Limited

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