

USDA Foreign Agricultural Service

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Global Agricultural Information Network

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High Pasture Growth Fuels Surge in New Zealand Milk Production

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Report Highlights:

Increased Cow Numbers and a great 12 months of pasture growth have combined to create a “super flush” of milk which surpassed all previous peaks of daily production. Milk production in 2012 is projected to reach 19.9 MMT, 5% higher than last year’s record production level.

Executive Summary

“A Super Flush Occurs”

A combination of pent up capacity to produce and an incredible period of pasture production has given rise to what some have called a “super flush of milk production”. From March 2011 right through to April 2012 pasture production has been above normal over much of New Zealand. A La Nina weather pattern has contributed to a distribution of rain which was frequent and even. Air temperatures were cooler than normal which improved pasture quality.

Benefiting from the latter half of the golden production season, 2012 milk production is now projected to reach 19.9 million metric tons (MMT). This would put 2012 milk production 5% ahead of 2011’s estimated record production level of 18.97 MMT, which in turn was 10.4% higher than the previous year.

As a direct consequence of the projected increase in milk production, dairy product production is also expected to increase. There are no government intervention schemes and commercial processors don’t generally accumulate stocks to short the market. So, as production increases so too do exports. Because New Zealand has such a small domestic market, 96% of total milk production in 2012 is likely to be processed into products for export.

For the PSD categories Whole Milk Powder (WMP), Non Fat Dry Milk/Skim Milk Powder (SMP), Cheese, and Butter, 2012 production is expected to reach a total of 2.37 MMT, up 7.8% from the estimated 2011 production level of 2.19 MMT. Total exports of the above product categories are forecast at 2.3 MMT in 2012. Closing stocks are projected to increase by 13% to close at 260,000 MT as processors adjust to the logistics required for the increase in production. This level of exports would be 6% ahead of the 2011 total of 2.17 MMT.

As has been the case in the recent past, WMP production is likely to be the big mover. For 2012, WMP production is forecast at 1.24 MMT, 10% higher than the 2011 production level estimated at 1.125 MMT. Exports of WMP will similarly increase in 2012, and are forecast at 1.22 MMT, 10% ahead of 2011.

On the trade front, China has become a cornerstone market especially for the burgeoning WMP exports. An estimated 302,261 MT of WMP was shipped to China in 2011, accounting for 93% of China’s total WMP imports for the year. WMP made up 65% of NZ’s total volume of dairy product shipments to China in 2011. While the growth trend for WMP exports to China appears to have leveled off somewhat, exports of other product categories such as fats, Cheese, Liquid Milk, and SMP are still showing impressive upwards trajectories.

Exports to the US continue to be focused on protein ingredient products such as Milk Protein Concentrates, and Casein with fat shipments at useful levels. The US continues to be the second most valuable export destination for NZ dairy products, accounting for 6.6% of total export receipts in 2011, with 2011 export revenues up 31% compared to sales in 2010. This reflected the strength of dairy markets all round the world in 2011.

In 2012, the New Zealand policy and regulatory fields were dominated by the impending passage of amendments to the Dairy Industry Restructuring Act (DIRA) which sets the ground rules for the dominant player at processor level, the Fonterra Cooperative.

In addition, Fonterra is attempting to complete the third leg of its capital restructuring plan entitled "Trading Among Farmers" Implementation of the plan is dependent upon enactment of some of the changes proposed for DIRA. "Trading Among Farmers" would see Fonterra relinquish the onus of having to redeem or issue shares to farmers as their production falls or rises. Instead farmers would trade shares on an exchange among themselves as and when they chose.

(Note: For Dairy GAIN and PSD reports the Calendar year is the Marketing Year)

Commodities:

Dairy, Milk, Fluid

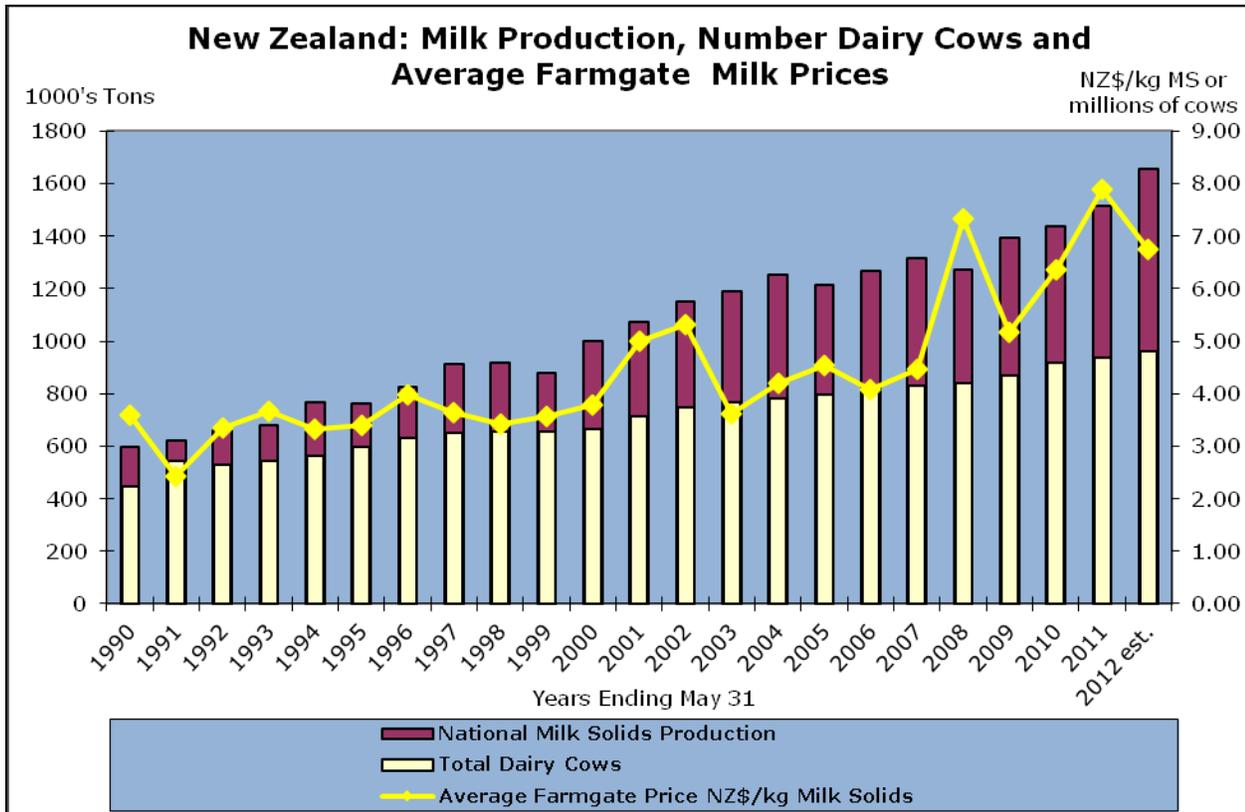
Dairy, Butter

Dairy, Cheese

Dairy, Dry Whole Milk Powder

Dairy, Milk, Nonfat Dry

Milk Production



Sources: Livestock Improvement Corporation (LIC), DairyNZ, StatsNZ, Ministry of Agriculture and Forestry (MAF), Post Estimates

2012

Post's forecast of 2012 milk production is increased (4.5%) to 19.9 MMT, up just under 5% from the estimated 2011 production level.

Favorable weather conditions experienced in Q4 2011 were continued into the first half of 2012. Q1, 2012 production is provisionally estimated at 9.8% above that of the previous year owing to the cool summer temperatures, sufficient rainfall which has ensured high pasture growth rates, and better than average pasture quality. The impressive rate of growth in milk production will likely be sustained through Q2, 2012.

For the 2nd half of 2012, Post is estimating production gains of 1% over 2011 based on:

- Normal weather patterns (some long term models are suggesting a return to El Nino conditions which often causes dry conditions on the East Coast)
- 80,000 extra cows (+1.8%) spread over 70 to 80 new conversions and some increases to existing herds.
- Even though cows will be in generally good condition and there will be above average levels of supplementary feed on hand especially in the North Island it is unlikely the super flush conditions of equable weather and sustained high pasture growth rates observed in October to December 2011 will be repeated over the whole of the North Island again in 2012.

2011

With La Nina weather patterns giving all of New Zealand except Southland excellent growing conditions late in 2011 final milk production finished at 18.97 MMT up 10.4% from 2010. This is 1.5% higher than Post's previous forecast of 18.68 MMT. The main reasons for this enormous production jump are:

- There has been latent capacity to increase production owing to the increase in cow numbers and general farm productivity improvements over the last 4 to 5 years, which has not been realized until the 2011 year.
- Very good weather conditions: enough rainfall and generally cooler conditions over most of the country for 10 months of the year meant pasture growth and quality has been well ahead of expected levels.
- Cow numbers were up by 130,000 head.
- Cows commenced milking in spring 2011(August/September) in generally better condition than previous years.
- There was enough supplemental feed on hand or available to purchase to ensure satisfactory cow nutrition at all times.

Dairy Product Production

CY 2012

In response to the greater availability of milk, total production of PSD dairy products in 2012 is forecast at 2.37 MMT, 3% higher than Post's previous forecast, and a 7.8% increase over the previous year.

Whole Milk Powder (WMP)

Once again production of WMP is expected to surge, and is forecast at 1.24 MMT in 2012, 12 percent higher than Post's previous forecast, and 10% higher than the estimated 2011 production level. A major powder drying processing facility will be commissioned during the year and a smaller processor will complete its first full 12 months of operation in 2012. WMP is still seen as the growth format. Although for 6 months (March through Aug) of 2011 the sales of the SMP/fat combination valued protein higher than WMP, this advantage has been eliminated and presently the outlook for SMP is not as good with surpluses of this product available from other origins. Therefore it is assumed that production of WMP will be maximized to continue the trend established over the last 10 years. This format is the most cost effective for NZ processors to manufacture, ship, and market.

Butter, Anhydrous Milk Fat (AMF) and other Fat Products

Post forecasts 2012 butter production at 482,000MT, 1.6% lower than Post's previous estimate, and 5% higher than the estimated 2011 production level. It is expected that most of the increased supply of milk in will go into WMP production. However, it is quicker to manufacture Anhydrous Milk Fat (AMF) and SMP, consequently during the peak milk-flows of spring (Oct to Dec), AMF and SMP will be produced in order to process the daily tidal wave of milk, even if they are not as valuable as WMP. (Note the PSD total adjusts AMF volume to a butter equivalent by multiplying the AMF tonnage by 1.22).

Non-Fat Dried Milk/Skim Milk Powder (SMP)

For SMP Post has revised the 2012 production forecast down to 380,000MT a decline of 13.6% from our earlier forecast. However this will still be 5.6% higher than the revised estimate for the 2011 level. The same factors that drive butter and fat production drive SMP production.

Cheese

Total cheese production in 2012 is forecast at 265,000MT, up marginally (1.9%) from the previous forecast. While this would be a 15,000MT increase on the 2011 production level it is more a manufacturing necessity than a preference. Cheese is not a favored format at present because: the price/cost relationship heavily favors WMP; as a rule it needs to be stored onshore longer; and the market outlook is weaker than for the powders. At present the cheese plants in NZ are only put to work to deal with the seasonal peak flows in the spring early summer. However it should be noted that Whey protein products (a by-product of the cheese making process) are in demand and selling at good prices.

CY 2011

Total Production of WMP, SMP, cheese, and butter in 2011 is estimated at 2.19MMT up marginally (5,000MT) from Post's previous estimate.

Whole Milk Powder (WMP)

Whole milk powder production in 2011 is now estimated at 1.125MMT, 12.5% higher than the previous estimate.

Butter, Anhydrous Milk Fat (AMF) and other Fat Products

As a result of lower than expected total exports and smaller than anticipated closing stocks, 2011 production is estimated at 459,000MT, 6.7% lower than Post's earlier estimate.

Non-Fat Dried Milk/Skim Milk Powder (SMP)

SMP production varies in tandem with fat production. So for the 2011 year there is a corresponding reduction in the revised estimate for SMP, which is estimated at 360,000MT. This is a change of 80,000MT or 18%.

Cheese

For 2011, cheese production is estimated at 250,000MT just under 3% less than the previous estimate.

New Zealand: Overview of Dairy Processors (other than Fonterra)						
Company Name	Date Established & Description	Company Type	Estimated Total Milk Processed 2011/12 Season 1/	Estimated Milk Accessed under DIRA 2011/12 Season	Estimated Milk Processed 2012/13 Season	Product Focus
			Millions of kilograms of milk solids			
North Island						
Tatua	1919	Cooperative	17.5	4.3	17.5	Caseinates, AMF, Specialty Products
Goodman Fielder		Corporate	24	24	24	Yogurt and Fluid Milk
Open Country Dairy	2007	Corporate	48	4.3	48	Cheese, Whey (low protein), WMP, SMP, AMF
NZ Dairy Processing Ltd	2010	Corporate	0	0	5	UHT liquid milk
Miraka Milk	completed & in operation	Corp/Iwi	13.5	4.3	17.5	WMP/SMP AMF
Arapuni Milk Coy (Zoagn Ltd)	Planning Capital Raising, Consents granted	Corporate. Won't be built in time for 12/13 season	0	0	0	WMP
Dairyland	in planning stages	Corporate integrated farming & processing	0	0	0	WMP/SMP AMF
Est. N.I.			103	36.9	112	
South Island						
Westland Milk Products	1937	Cooperative	56	4.3	57	Milk Powder, Butter, AMF, Caseins, Caseinates etc.
Open Country Dairy	2007	Corporate	25	0	25	Whey (low protein), WMP, SMP, AMF
NZ Dairies	2007	Corporate	18	3	18	WMP and Child Nutrition Products
Synlait	2008	Corporate	39	4.3	42	WMP, AMF, SMP, Infant formula & Nutritional Products
Cadbury		Corporate	2.2	2.2	2.2	Confectionary
Mataura Valley Milk	In process of raising capital	Corporate	0	0	0	WMP
Oceania Milk	site purchased by Synlait	Corporate	0	0	0	WMP

Gardians	2011	Corporate. opening Aug 2012.	0	0	7	Nutritional powders.
Est. S.I.			140.2	13.8	144.2	
Other Small Processors			3	3	3	Various, artisan cheeses etc
Total NZ			246.2	53.7	259.2	

Source: Post estimates

PSD Tables

Dairy, Milk, Fluid New Zealand (1000 Hd, 1000MT)	2010 Market Year Begin: Jan 2010			2011 Market Year Begin: Jan 2011			2012 Market Year Begin: Jan 2012		
	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Cows In Milk	4680	4680	4680	4820	4820	4810	4930	4930	4890
Cows Milk Production	17173	17173	17173	18681	18681	18965	19023	19023	19874
Other Milk Production	0	0	0	0	0	0	0	0	0
Total Production	17173	17173	17173	18681	18681	18965	19023	19023	19874
Other Imports	2	2	2	2	2	2	2	2	2
Total Imports	2	2	2	2	2	2	2	2	2
Total Supply	17175	17175	17175	18683	18683	18967	19025	19025	19876
Other Exports	123	123	123	120	120	123	125	125	125
Total Exports	123	123	123	120	120	123	125	125	125
Fluid Use Dom. Consum.	300	300	300	300	300	300	300	300	300
Factory Use Consum.	16702	16702	16702	18213	18213	18494	18550	18550	19401
Feed Use Dom. Consum.	50	50	50	50	50	50	50	50	50
Total Dom. Consumption	17052	17052	17052	18563	18563	18844	18900	18900	19751
Total Distribution	17175	17175	17175	18683	18683	18967	19025	19025	19876
CY Imp. from U.S.	0	0	0	0	0	0			0
CY. Exp. to U.S.	0	0	0	0	0	0			0
TS=TD			0			0			0

Dairy, Dry Whole Milk Powder New Zealand (1000 MT)	2010 Market Year Begin: Jun 2010			2011 Market Year Begin: Jun 2011			2012 Market Year Begin: Jun 2012		
	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post
Beginning Stocks	100	100	100	100	100	100	49	99	115
Production	947	947	947	1,000	1,000	1,125	1,110	1,110	1,239
Other Imports	2	2	2	0	0	1	0	0	1
Total Imports	2	2	2	0	0	1	0	0	1
Total Supply	1,049	1,049	1,049	1,100	1,100	1,226	1,159	1,209	1,355
Other Exports	948	948	948	1,050	1,000	1,110	1,093	1,093	1,222

Total Exports	948	948	948	1,050	1,000	1,110	1,093	1,093	1,222
Human Dom. Cons.	1	1	1	1	1	1	1	1	1
Other Use, Losses	0	0	0	0	0	0	0	0	0
Total Dom. Cons.	1	1	1	1	1	1	1	1	1
Total Use	949	949	949	1,051	1,001	1,111	1,094	1,094	1,223
Ending Stocks	100	100	100	49	99	115	65	115	132
Total Distribution	1,049	1,049	1,049	1,100	1,100	1,226	1,159	1,209	1,355
CY Imp. from U.S.	0	0	0	0	0		0		
CY. Exp. to U.S.	1	0	0	1	1	2	0		2
TS=TD			0			0			0

Dairy, Milk, Nonfat Dry New Zealand (1000 MT)	2010 Market Year Begin: Jan 2010			2011 Market Year Begin: Jan 2011			2012 Market Year Begin: Jan 2012		
	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post
Beginning Stocks	50	50	50	50	50	50	80	80	47
Production	344	344	344	440	440	360	430	440	380
Other Imports	3	3	3	3	3	2	3	3	2
Total Imports	3	3	3	3	3	2	3	3	2
Total Supply	397	397	397	493	493	412	513	523	429
Other Exports	344	344	344	410	410	362	450	460	376
Total Exports	344	344	344	410	410	362	450	460	376
Human Dom. Cons.	3	3	3	3	3	3	3	3	3
Other Use, Losses	0	0	0	0	0	0	0		
Total Dom. Cons.	3	3	3	3	3	3	3	3	3
Total Use	347	347	347	413	413	365	453	463	379
Ending Stocks	50	50	50	80	80	47	60	60	50
Total Distribution	397	397	397	493	493	412	513	523	429
CY Imp. from U.S.	0	0		0	0		0		
CY. Exp. to U.S.	0	0		0	0	1	0		1
TS=TD			0			0			0

Dairy, Butter New Zealand (1000 MT)	2010 Market Year Begin: Jan 2010			2011 Market Year Begin: Jan 2011			2012 Market Year Begin: Jan 2012		
	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post
Beginning Stocks	56	56	56	50	50	50	70	70	45
Production	441	441	441	492	492	459	490	490	482
Other Imports	1	1	1	1	1	1	1	1	1
Total Imports	1	1	1	1	1	1	1	1	1
Total Supply	498	498	498	543	543	510	561	561	528
Other Exports	428	428	428	453	453	448	481	481	458
Total Exports	428	428	428	453	453	448	481	481	458

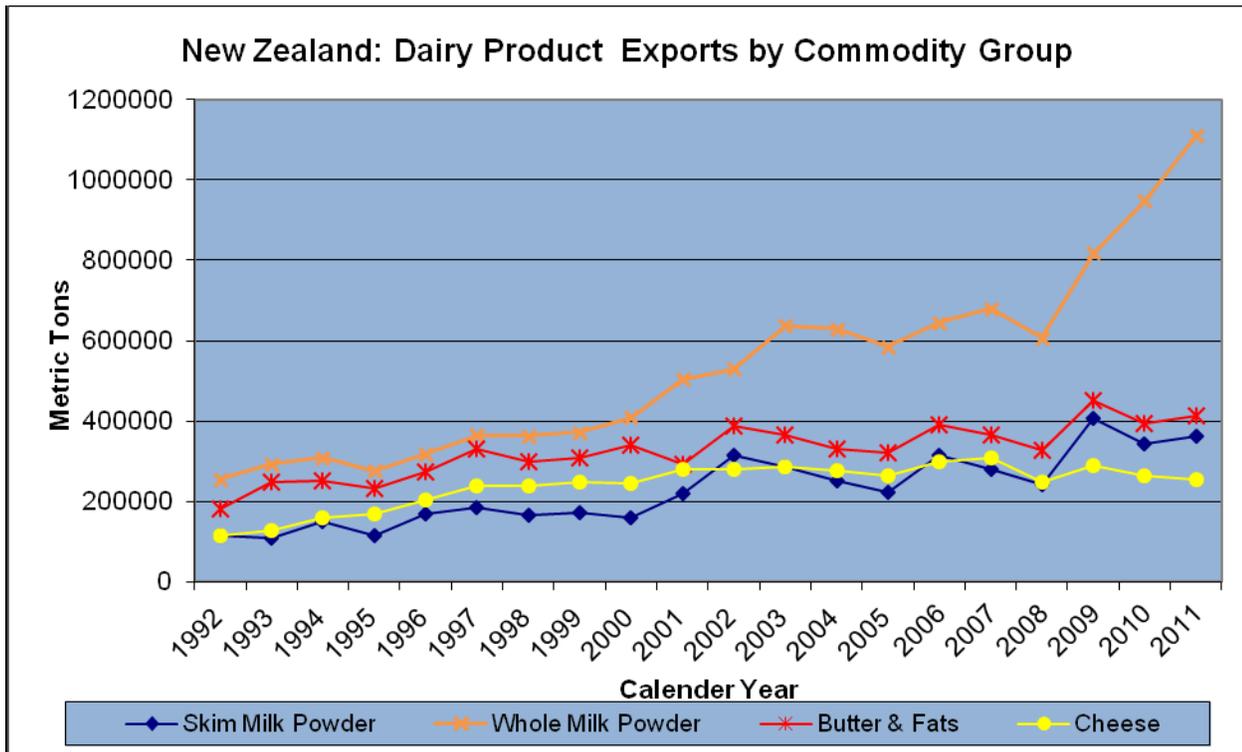
Domestic Cons.	20	20	20	20	20	17	20	20	20
Total Use	448	448	448	473	473	465	501	501	478
Ending Stocks	50	50	50	70	70	45	60	60	50
Total Distribution	498	498	498	543	543	510	561	561	528
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	35	22	22	12	12	22	15	15	17
TS=TD			0			0			0

Dairy, Cheese New Zealand (1000 MT)	2010 Market Year Begin: Jan 2010			2011 Market Year Begin: Jan 2011			2012 Market Year Begin: Jan 2012		
	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post
Beginning Stocks	55	55	55	40	40	40	25	40	22
Production	268	268	268	257	257	250	280	260	265
Other Imports	6	6	6	3	3	5	3	3	5
Total Imports	6	6	6	3	3	5	3	3	5
Total Supply	329	329	329	300	300	295	308	303	292
Other Exports	265	265	265	255	240	253	250	238	245
Total Exports	265	265	265	255	240	253	250	238	245
Human Dom. Cons.	24	24	24	20	20	20	25	25	20
Other Use, Losses	0	0	0	0	0	0	0	0	0
Total Dom. Cons.	24	24	24	20	20	20	25	25	20
Total Use	289	289	289	275	260	273	275	263	265
Ending Stocks	40	40	40	25	40	22	33	40	27
Total Distribution	329	329	329	300	300	295	308	303	292
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	7	5	5	2	2	2	2	2	2
TS=TD			0			0			0

Note 1: Non butter fat products such as AMF are brought up to a butter equivalency by multiplying by 1.22.

Note 2: These tables are not official USD forecasts.

Exports/Ending Stocks



CY 2012

For 2012 the main four commodity groups are forecast to see a total of 2.3 MMT exported from NZ, which is 1.3% higher than Post's initial forecast and 6% greater than estimated exports in 2011. The projected increase in exports is attributed to increased milk flows. Ending stocks are also expected to increase, and are projected at 259,000 tons (up 13% for the 2011 level). Generally, Kiwi milk processors aim to minimize stock holdings and don't aim to short the market by building up inventories as the sector is far too transparent now for that to have a material benefit to overall average product prices.

Ending stocks are generally rising in line with increases in production. However, product is normally held on shore for one to six months, and during the peak milk flow months (October through December) there are logistical bottlenecks which are likely to see the calendar year inventories increase at a higher rate than the average milk flow percentage increase.

WMP

WMP exports in 2012 are forecast at 1.22 MMT, 12% higher than Post's previous forecast, but in line with recent trends. In addition it is likely that year-on-year ending stocks will increase by 17,000MT to 132,000MT.

SMP

With the anticipated increase in the production of fat and SMP it is forecast that this will translate into an increased year on year export tonnage of SMP, which is forecast at 376,000MT. This is significantly (18%) lower than Post's previous forecast because SMP pricing has now fallen back

into line with WMP and there is no incentive to produce extra AMF/SMP at the expense of WMP production.

Butter, Anhydrous Milk Fat (AMF) and other Fat Products

Total fat product exports are now forecast to reach 458,000MT (all products adjusted to butter equivalent) which is 5% less than Post's previous forecast. AMF prices peaked in February/March 2011 and have been trending down ever since. There is no incentive now to increase fat production over and above regular customer demand except when manufacturing constraints dictate AMF/SMP production to speed raw milk through the processing system.

Cheese

The gradual decline in cheese exports is expected to continue, with exports in 2012 forecast at 245,000MT, which is 7,000MT better than previous forecasts but still 8,000MT less than exports in 2011.

CY 2011

In 2011, New Zealand exported an estimated total of 2.17 MMT of dairy products from the main four commodities (WMP, SMP, Fat, and Cheese), which is about 3% higher than Post's earlier estimate and 9.5% higher than exports in 2010. The increase in exports is broadly in line with greater milk production (up 10.4%) in 2011. Ending stocks are estimated at 229,000MT which would be 11,000MT less than the previous year but is not regarded as a significant change.

WMP

Total exports of WMP in 2011 are estimated at 1.11 MMT, 13% higher than the earlier estimate and 17% higher than 2010 exports. For the period 1992 through 2011, an exponential trend best fits the progression for the volume of WMP exports. This is exceptional but won't be able to be continued indefinitely.

SMP

SMP exports during 2011 totaled an estimated 362,000 MT, 12 % lower than Post's previous estimate, but 5% higher than 2010 exports. SMP prices peaked during mid 2011 which was likely too late for the processors to fully exploit and for the 2nd Half, 2011 SMP and WMP prices were more aligned which resulted in production and exports of WMP being emphasized.

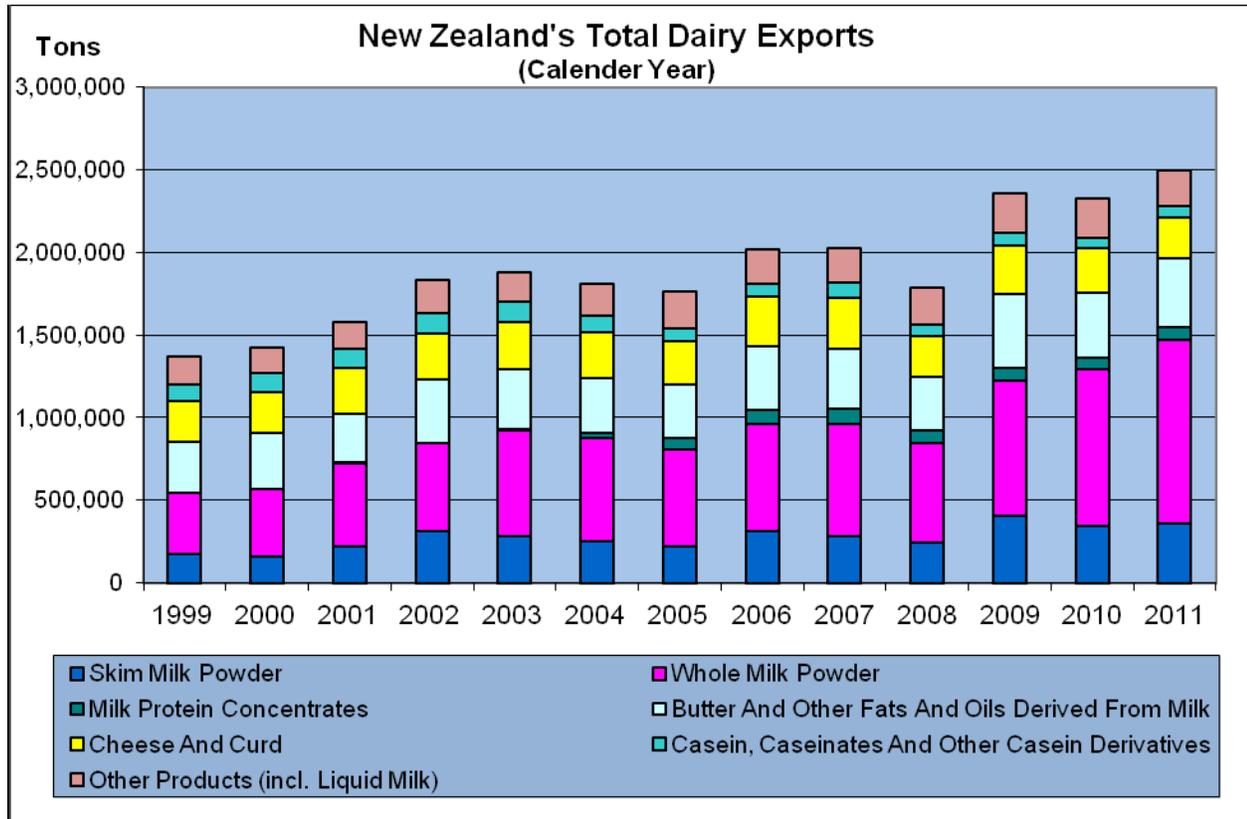
Butter/AMF

Total fat product (in tons butter equivalent) exports reached an estimated 448,000 MT in 2011 which was 4.7% higher than 2010 but 5,000 MT less than previously expected. Fat and SMP prices peaked in February/March 2011 which supported export increases but probably came a bit late in the 2010/11 milk supply season to alter production significantly.

Cheese

Cheese exports in 2011 totaled an estimated 253,000 MT, which was a 12,000 MT year on year reduction (-4.5%) but not as great as previously expected. However this result still falls in line with trends to minimize cheese production and exports from NZ.

Trade



Source: Global Trade Atlas (GTA)

New Zealand Dairy Product Exports Annual Series: 2006 - 2011

Destinati on Country	United States Dollars						% Chan ge 2010 to 2011	% Mark et Share 2011
	2006	2007	2008	2009	2010	2011		
China	280,300,053	317,730,448	374,212,476	667,100,797	1,387,668,441	1,788,885,585	28.9%	17.5%
United States	528,417,652	621,199,667	705,889,142	541,790,684	514,622,520	673,265,041	30.8%	6.6%
Japan	287,210,259	379,975,130	486,583,886	315,095,640	404,797,950	469,192,189	15.9%	4.6%
Australia	219,069,993	275,360,652	366,541,558	259,414,036	396,888,017	426,393,143	7.4%	4.2%
Philippin es	234,286,992	384,007,272	386,339,329	260,750,453	389,398,486	414,122,031	6.3%	4.1%
Algeria	129,897,906	168,175,638	212,607,508	156,116,122	164,667,795	389,919,087	136.8%	3.8%
Saudi Arabia	196,323,233	292,797,438	370,671,896	191,141,262	286,994,438	389,862,485	35.8%	3.8%
Venezuel	109,767,18	261,790,08	466,664,81	224,827,72	334,980,02	378,373,32	13.0%	3.7%

a	3	5	5	5	5	6		
Malaysia	151,115,93 6	273,092,77 9	370,767,50 6	222,863,84 6	286,114,71 4	366,393,50 6	28.1%	3.6%
UAE	81,049,081	75,873,247	89,628,872	150,276,69 0	196,673,98 7	323,558,63 0	64.5%	3.2%
Rest of World	2,452,234, 600	3,311,163, 291	3,540,206, 610	2,737,478, 761	3,782,844, 295	4,580,433,2 43	21.1%	44.9%
Total Exports	4,669,672, 886	6,361,165, 652	7,370,113, 600	5,726,856, 013	8,145,650, 665	10,200,398, 270	25.2%	100.0 %

Source: Global Trade Atlas (GTA)

New Zealand: Dairy Products to Top Five Markets						
(CY2011/metric tons)						
	China	USA	Japan	Australia	Philippines	World Total
Liquid Milk (T)	18,747	0	0	8,204	38,454	123,280
SMP	77,474	513	5,021	5,395	33,712	361,625
WMP	302,261	2,399	1	11,660	27,661	1,109,636
Consumer Products	2,451	33	3,791	2,983	8,826	45,573
MPC	1,785	46,353	2,631	1,381	1,290	77,953
Butter & Fats	34,451	18,931	5,246	16,946	11,303	413,490
Cheese	13,535	1,875	61,174	46,472	10,186	252,839
Casein	6,336	29,456	8,472	990	905	65,656
Whey Products	10,510	4,628	4,498	2,758	188	29,995
Other Products inc Lactose	261	137	3,769	2,106	0	19,294
Total Volume	467,811	104,325	94,603	98,895	132,525	2,499,341
Total Value in 1000's USD	\$1,788,886	\$673,265	\$469,192	\$426,393	\$414,122	\$10,200,398
Price per Metric Ton in USD	\$3,824	\$6,454	\$4,960	\$4,312	\$3,125	\$4,081

Source: Global Trade Atlas (GTA)

New Zealand Dairy Product Export Statistics To United States						
(Quantity (T), USD, USD/T)						
Calendar Years	2006	2007	2008	2009	2010	2011
Liquid Milk (T)	0	512	931	582	120	0
SMP	200	204	86	178	203	513
WMP	2919	1830	693	3233	328	2399
Consumer Products	14	30	173	81	60	33
Milk Protein Concentrates	48209	50289	47752	41850	43654	46353
Butter & Fats	24439	27851	20497	31496	18502	18931

Cheese	29421	26356	16549	17465	5291	1875
Casein	34881	43947	37628	32022	22999	29456
Whey Products	4821	5635	4367	6674	5179	4628
Other Products incl Lactose	130	44	111	99	103	137
Total Quantity (T) Exported	145034	156698	128787	133680	96439	104325
Total Value in millions USD	528.4	621.2	705.9	541.8	514.6	673.3
Average Price in USD/Ton	3643	3964	5481	4053	5336	6454

Source: Global Trade Atlas (GTA)

New Zealand Dairy Product Export Statistics To China						
(Quantity (T), USD, USD/T)						
Calendar Years	2006	2007	2008	2009	2010	2011
Liquid Milk(T)	1962	3084	4611	5585	8168	18747
SMP	34709	16021	19275	50199	50790	77474
WMP	61542	51237	44800	171491	294181	302261
Consumer Products	258	181	168	3874	2987	2451
Milk Protein Concentrates	802	2141	1258	1715	1383	1785
Butter & Fats	12093	10886	11146	26720	19351	34451
Cheese	4188	6209	6259	9222	11702	13535
Casein	2580	1895	1549	3199	4872	6336
Whey Products	6260	5254	8271	8889	7806	10510
Other Products incl Lactose	1818	244	1316	4103	328	261
Total Quantity (T) Exported	126212	97152	98653	284997	401568	467811
Total Value in millions USD	280.3	317.7	374.2	667.1	1387.7	1788.9
Average Price in USD/Ton	2221	3270	3793	2341	3456	3824

Source: Global Trade Atlas (GTA)

China has become a very important market for the New Zealand Dairy industry: it has been the leading market by value for the last three years and is also the market which takes the largest volume. New Zealand supplied 93% of the total WMP imported in to China in 2011 up from 89% in the previous two years.

Interestingly New Zealand has a FTA with China but in 2011 only 29% of the total volume of milk powders shipped by New Zealand to China was at the lower tariff rate of 6.7%. The rest of the volume was at the WTO, MFN (most favored nation) tariff level of 10%, which gives an effective average tariff rate of 9%. This would amount to approximately \$35-38/MT of savings. The tariff on WMP and SMP is reduced each year, from 10% in 2008, to 6.7% in 2011, to 5.8% in 2012 through to zero in 2019. However there is a safeguard whereby once a trigger volume for imports of powders is reached the tariff for any additional imports reverts back to the WTO, MFN tariff level. For 2011, the trigger tonnage was 109,974 tons of powders, which was reached by the end of March 2011. In 2012 the trigger level will increase by 5% again to 115,474 tons which was been reached in March. Even though the official tariff will be zero by 2019 the trigger volume mechanism still be in play right through to 2023 when the trigger volume will be 197,498 MT.

It is thought that it is not the small reduction in overall tariffs that makes the FTA advantageous but the forum the FTA provides to address SPS issues and other non-tariff barriers.

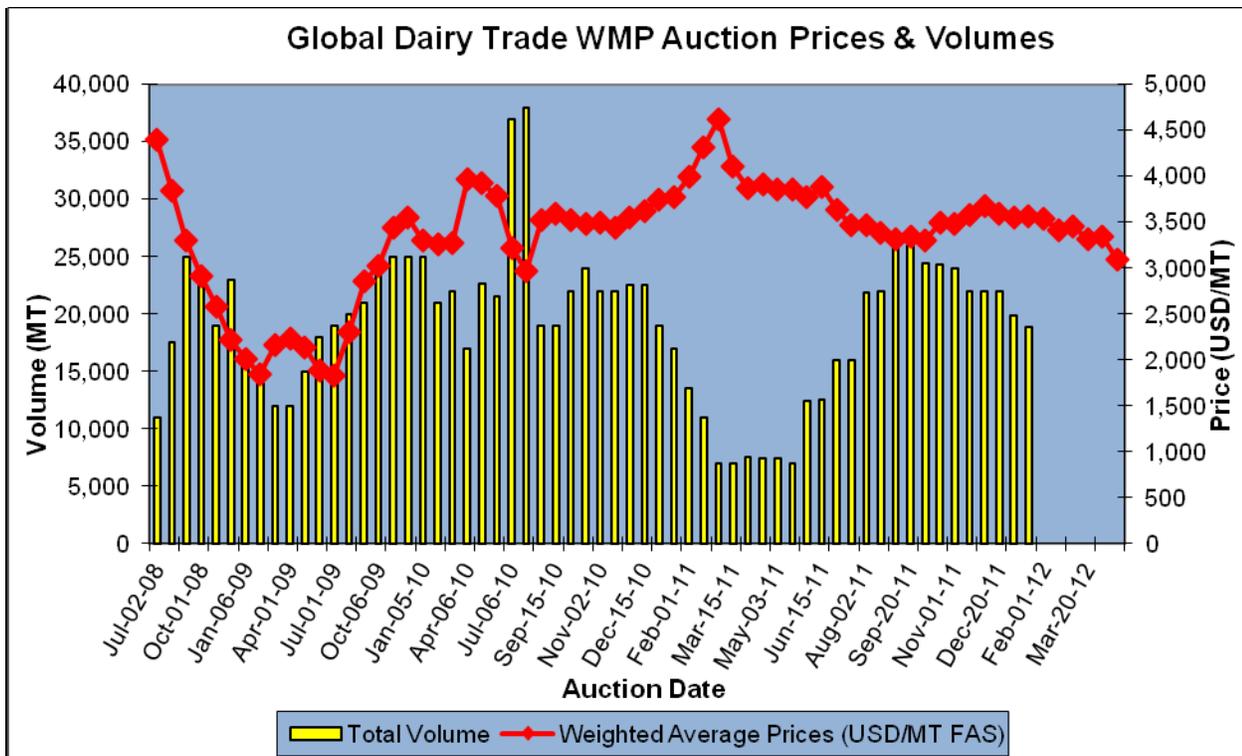
When comparing exports to the US to those to China it is obvious that the average prices achieved in the two markets are very different. Primarily the product mixes are very different with the casein and MPC products being very much more costly to produce and achieving very much higher prices on world markets than WMP does.

Global Dairy Trade – Electronic Auction Platform for Dairy Products

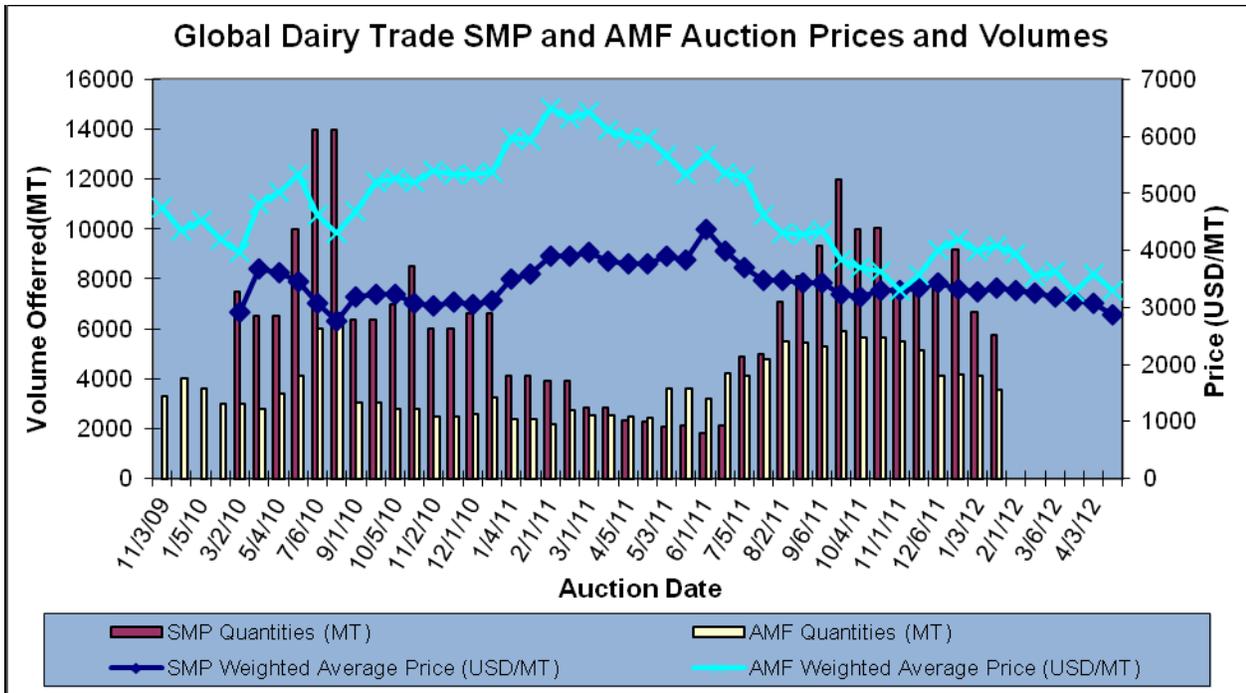
Fonterra developed and began selling WMP via the electronic auction platform in mid 2008. Initially auctions were held monthly but by September 2010 the frequency was doubled to two auctions each month. Having started as a regional Oceania trade avenue the auction platform has become an international forum for dairy product trade. Now there are four vendors: Arla (EU); Murray Goulburn (Aus); Dairy America/California Dairies (US); and Fonterra (NZ and Aus) and purchasers from right around the globe.

Having started with WMP as the single category being sold, there are now eight commodity groups sold comprised of: WMP, SMP, AMF, Milk Protein Concentrate, Rennet Casein, Lactose, Cheddar Cheese, and Butter Milk Powder. Each auction event runs for 4 delivery periods (contracts 1 to 4) for each commodity which as the year progresses gives purchasers many opportunities to purchase product for a targeted delivery month. In addition Fonterra publishes forecasts for the volumes of each product it intends to sell. The Global Trade Dairy auction has now become a leading method of price discovery for the sector.

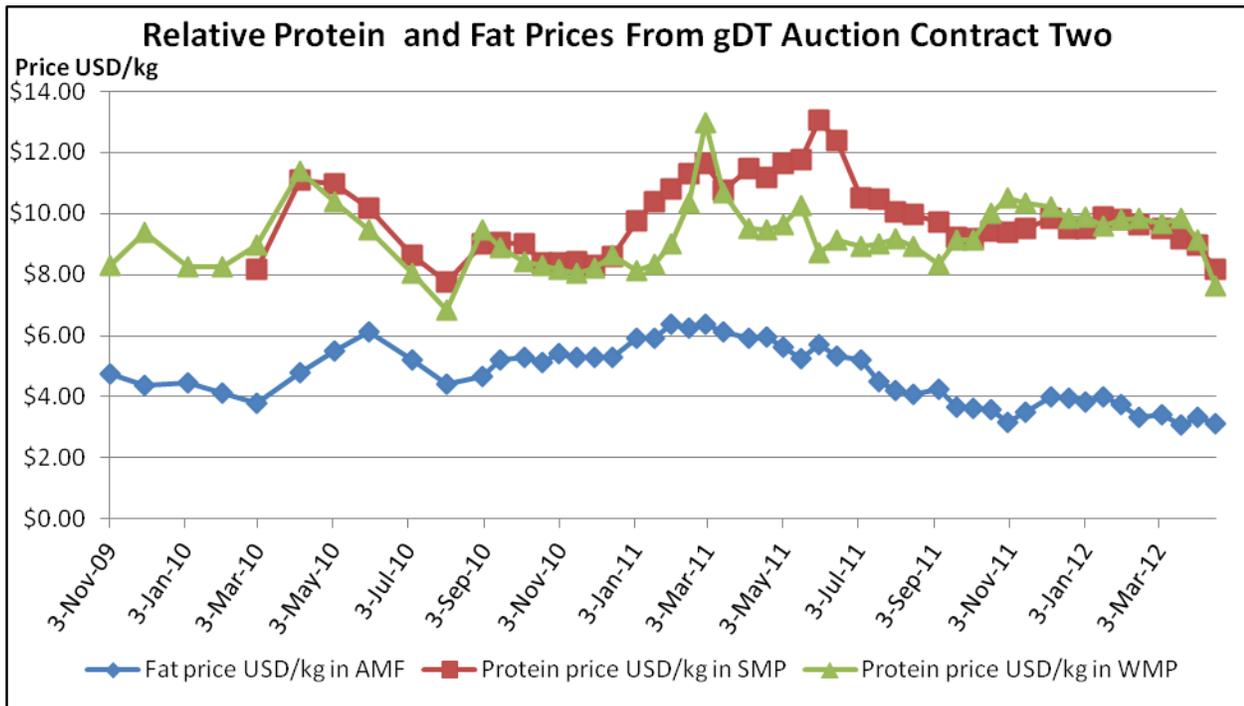
For Fonterra the gDT has become a significant sales channel. For example in 2011, 395,546 MT of WMP was sold via gDT which was equivalent to approximately 35% of total NZ production of WMP. In 2010 377,200 MT of WMP was sold via gDT which was nearly 40% of total NZ production.



Source: gDT



Source: gDT



Source: gDT

The chart above tracks the relative pricing for the protein component in WMP (regular grade, contract period two) and SMP (medium heat, contract period two) for Fonterra product sold in the gDT auction. The fat component in AMF is used to price the fat components in the WMP and SMP sold at the same auction. The AMF is regular 210 kg drum specification sold in contract period two.

For many years now cow breeding in New Zealand has focused on increasing the protein component of the raw milk, it is easy to see why.

It would seem reasonable to assume that purchasers would tend to price SMP and WMP to equalize the protein component costings and for the most part it appears they do. However during the middle of 2011 the prices for the protein components in WMP and SMP diverged significantly. Industry commentators recognized this but were at a loss to explain the reasons. The volumes of SMP sold on gDT were relatively low during the period in question and it is likely the end-users such as Fast Moving Consumer Goods Manufacturers in Asia who were experiencing very strong demand and could afford to pay the increased prices and not change their input mixes for a short period of time.

Policy

Dairy Industry Restructuring Act (DIRA)

In 2011, the Minister of Agriculture determined that the DIRA would be reviewed and proposals for amendment to the Act be developed by the then Ministry of Agriculture and Forestry (now the Ministry for Primary Industry-MPI). This was in response to pressure from several quarters:

- The Minister and the then MAF were thinking that the DIRA was 10 years old and the regulatory environment and sector structure had developed/changed since the inception of the Act and it was time to refresh it;
- Fonterra itself was desirous of change;
- Implementation of Trading Among Farmers (TAF* see below) would require regulatory change;
- Other parties directly affected by the raw milk regulations have agitated for change;
- Various consumer groups and NGO's have lobbied the government to review how the milk price to consumers comes about as they think consumers in NZ are paying too much for milk.

The DIRA Amendment Bill of 2012 was placed before the Parliament in March 2012 and it has survived its first reading and vote. It is now before the Primary Sector Select Committee which will hear submissions and determine whether to recommend changes to the bill. The main proposals put up by MPI and incorporated into the bill include:

For the Fonterra Farm gate milk price:

- embedding Fonterra's current milk price governance arrangements in legislation;
- requiring Fonterra to publicly disclose information in relation to its milk price setting scheme; and;
- Introducing a milk price monitoring/oversight regime. This would involve the Commerce Commission undertaking and publishing the results of an annual qualitative assessment of Fonterra's milk price setting scheme. This assessment would focus on Fonterra's underlying assumptions, inputs and processes, rather than Fonterra's milk price itself, measured against the outcomes that would have arisen in a competitive market for farmers' milk.

Fonterra share price and TAF formation:

- a minimum fund size of \$500 million as a pre-condition to launch of TAF;
- a further pre-condition that Fonterra shares and fund securities be listed on a registered exchange at all times;
- locking-in key structural features of TAF in legislation to ensure that they are maintained post launch, such as the presence of Registered Volume Providers;
- prohibiting Fonterra from engaging in behavior with the purpose of hindering liquidity and fungibility (i.e. exchangeability of shares and units) of the TAF share and fund markets; and

- Imposing obligations on Fonterra to ensure that fund investors have the ability to appoint/remove a fund manager, and the ability to wind up the fund.

And in relation to the Raw Milk regulations:

- independent processors, who source some of their raw milk directly from farmers, only being able to access raw milk under the Raw Milk Regulations for three seasons;
- The total quantity of raw milk available under the Raw Milk Regulations to be increased to approximately five percent of Fonterra's milk supply. The Act sets the maximum quantity at five percent but the Regulations currently limit the total volume to 600 million liters (approximately 4 percent of Fonterra's total milk supply);
- the October Rule, governing the volumes of milk that can be taken each month, will be removed and replaced with a series of maximum quantity limits set, restricting how much milk independent processors can take under the Raw Milk Regulations in different months of the season, based on the seasonal supply curve; and
- the price for regulated milk to be changed by removing the \$0.10 margin, which is currently added to the farm gate milk price to compensate Fonterra for providing independent processors with the opportunity to take regulated milk on a flatter curve than that which Fonterra receives from its farmers.

Some participants in the sector see the main issues of contention surrounding the notional milk pricing model and the milk pricing manual as used by Fonterra; and power(s) that may be given to the Commerce Commission to review raw milk pricing methodology are perceived as too vague and provide no real protection for startup processors to get well established. This is an infant industry argument for protection which others in the sector would say is not needed given the Dairy sector in New Zealand is well established, successful, and competitive on a world stage.

The parliamentary process has been fast tracked so that the bill should be law by midyear.

Fonterra Restructuring – Trading Among Farmers (TAF)

The Trading Among Farmers (TAF) proposal was approved by farmers in June 2010, and is the final leg in a wide range of restructuring measures of the Fonterra Co-operative. Under the TAF, Fonterra would no longer be required to redeem and issue farmer supply shares on demand, instead Fonterra would set up an exchange for farmers to trade shares among themselves. The TAF has yet to be implemented as there are several issues which still need to be resolved, principally they are:

The proposal for the Fonterra Shareholders Fund would allow for investments from the general public and financial institutions, which is proving contentious for some farmers. The fund investors would be able to reap economic benefit from Fonterra Coop shares (i.e. dividend flow and capital gains/losses); however they would not have any voting rights. The establishment of a NZ\$500m fund (approximately 8-10% of the total Fonterra share capital) has been proposed. Even though this equity capital fund would not have direct voting rights some industry participants think the proposal could over time have far reaching effects on complete, farmer-only control of the Co-op. The Co-op would still have to issue additional shares as production grows as generally production must be backed by share capital (at the rate of 1 share per kg of milk solids). However, they would not have to redeem shares if production fell in any one year, which would in effect give the

Co-op a steadily increasing pool of permanent capital (equity) with no redemption risk for the Co-op which has been one of the goals of the restructuring process.

The Dairy Industry Restructuring Act (DIRA) has to be amended before TAF can be implemented. The formation of Fonterra was established (from the single desk Dairy Board and the farmer-owned processing co-ops (bar two)) under the DIRA in 1999/2000. This was done without Commerce Commission examination and approval. The DIRA set up various controls on Fonterra to limit the potential for anti-competitive behavior either at the farm gate or the processor level. Specifically freedom of entry and exit from the Co-op for farmers without any undue consequences was a key part of the controls on the Co-op. The Ministry for Primary Industry's (MPI's) view is that without some safeguards, TAF could impinge on this key part of the regulations which have governed Fonterra's existence so far. The MPI has proposed new conditions to be observed and implemented by Fonterra in order for TAF to be implemented. The regulatory conditions for TAF include: the shareholders fund; and Commerce Commission evaluation of how the farm gate raw milk price (for Fonterra suppliers) is calculated each year.

There are some who see the political processes and additional policy and regulations taking control away from farmers of their own Co-op, and putting parts of the Co-ops internal workings into the hands of bureaucrats. However the degree to which this happens will be determined over the next few months as the bill containing the amendments passes through the parliament and becomes law.

A final vote on the TAF will be taken by the Fonterra shareholders at an extraordinary meeting on 25th June, 2012.

Free Trade Agreements

The following agreements are in force:

- [New Zealand-Hong Kong, China Closer Economic Partnership](#) (NZ-HK CEP entered into force on 1 January 2011)
- [New Zealand-Malaysia Free Trade Agreement](#) (MNZFTA entered into force on 1 August 2010)
- [ASEAN-Australia-New Zealand Free Trade Agreement](#) (AANZFTA) - 2010
- [New Zealand-China Free Trade Agreement](#) (NZ-China FTA) - 2008
- [Trans-Pacific Strategic Economic Partnership](#) (P4) - 2005
- [New Zealand-Thailand Closer Economic Partnership](#) (NZTCEP) - 2005
- [New Zealand-Singapore Closer Economic Partnership](#) (NZSCEP) - 2001
- [Australia-New Zealand Closer Economic Relationship](#) (CER) - 1983
- [New Zealand-Australia Closer Economic Relations Investment Protocol](#) (CER IP) (Subject to Parliamentary Treaty Examination, expected to enter into force in the second half of 2011)

In addition, the New Zealand Government is currently negotiating the following FTAs:

- [Anti-Counterfeiting Trade Agreement](#) (ACTA signed; yet to be ratified)
- [New Zealand-Gulf Cooperation Council Free Trade Agreement](#) (NZ-GCC FTA negotiations have been concluded but not yet signed)
- Expansion of the [Trans-Pacific Strategic Economic Partnership](#) (TPP)
- [New Zealand-Korea Free Trade Agreement](#) (NZ-Korea FTA)
- [New Zealand-India Free Trade Agreement](#) (NZ-India FTA)

- [New Zealand-Russia-Belarus-Kazakhstan Free Trade Agreement](#) (NZ-RBK)
- [New Zealand-Hong Kong, Closer Economic Partnership Investment Protocol](#) (CEP IP)

While exporters report that FTAs do not drive business decisions, they do provide a framework to work out trade-related issues, especially SPS and non-tariff barriers, and, in some cases, convey significant market access advantages.