Capital Structure Consultation

Alternative Farmer Proposals – July 2021

Proposal	Brief description	Some initial thoughts
Allow milk supply on an unshared basis (with a retention that would fund share buy-backs)	• Farmers would be able to ask that some (or all) of their shares are bought back by the Co-op, subject to funding being available. • The share buy-backs would be funded by a retention from the Milk Price from all suppliers, plus an amount of money equal to the dividends that would have been paid if unshared suppliers had held shares. The proposal suggests starting the Milk Price retention at 10c per kgMS and reducing it to 4c per kgMS in year nine. • The share buy-back would allow the dividend pool to be concentrated and paid on fewer shares. • New suppliers could supply milk on an unshared basis earning the full Milk Price, minus the retention for buy-backs.	• This proposal would provide farmers with the flexibility to sell shares below a 1:1 Share Standard. • Share buy-backs would reduce the total number of shares on issue. • An equitable mechanism for distributing unshared supply would be required i.e. what % of supply would be able to be unshared, and who would be able to access unshared supply? • Unshared suppliers would be a separate, and potentially significant, group of stakeholders. • A Milk Price retention may mean that Fonterra's Milk Price would be less competitive.
Share leasing or financing	• Farmers could lease dry shares from other farmers to meet their minimum shareholding requirements instead of having to own shares. This would require farmers to pay an annual lease fee to the leasing farmer rather than investing capital in the Co-op. • Alternatively, exiting farmers could sell shares to new farmers over a number of years via a farmer-to-farmer financing facility, with the Co-op, or a group company, acting as intermediary.	• Both proposals would create an alternative income stream (i.e. a lease fee and/or interest) for retiring farmers or those with dry shares. • The proposals would likely involve the establishment of a managed lease market or the Co-op acting as a financial intermediary (with potential regulatory/compliance implications).
A buy-back or a consolidation of Co-op shares	• All shares would be equally subject to a mandatory buy-back or consolidation (e.g. the Co-op would buy back one out of every 10 shares, or consolidate every five shares into four shares). • An alternative would be that the Co-op buys back shares directly within the Fonterra Shareholders' Market. • Another proposal was to buy back all of the dry shares currently held by farmers and retain the Fonterra Shareholders' Fund in a permanently capped state.	• These proposals would reduce the number of shares on issue. • If farmers were still required to hold 1 share for every 1 kgMS supplied, some farmers might need to buy more shares as a result and the proposal would not provide flexibility going forward. • Further buy-backs or consolidations might still be needed if the number of dry shares increases again.

Ease of entry	• One proposal suggested allowing new farmers up to 10 years to fully pay the Co-op for their shares, while receiving full dividends, which could be used as payment for the shares. The proposal also suggested that farmers who exit could be paid by the Co-op equally over seven years for their shares, with the share price being fixed at the time of entry or exit. • Another submission proposed deducting a set amount from each new entrant's Milk Price to be used for the sole purpose of the new entrant buying new shares.	• These proposals could make it easier for new farmers to join the Co-op, but could reduce flexibility when they come to exit. • The first proposal could mean a return to the Co-op needing to issue and redeem shares as was the case before TAF, or the Co-op lending money to new farmers (with potential regulatory/compliance implications). • Providing new farmers with the benefit of full dividends on shares that are not fully paid for could be seen as preferential treatment to new farmers.
Differential Milk Price payments	• New entrants would have five years to fully share up to a 1:1 Share Standard. • Beyond that time, any farmers not fully shared up would be subject to a discount off the Milk Price. • Existing farmers would be able to sell below a 1:1 Share Standard, but any unshared milk supply would also be subject to the same discount off the Milk Price.	• This proposal would provide a way for farmers to supply the Co-op without being required to hold 1 share for every 1 kgMS supplied. • The most likely farmers to be under shared could be those under financial pressure, therefore the Milk Price discount may put even more pressure on this group of farmers.
Conversion of the Fonterra Shareholders' Fund	• Units in the Fonterra Shareholders' Fund could be converted into bonds or other mainstream capital securities.	• This proposal would be complex to implement and need the approval of unit holders. It would likely involve buying back the Fonterra Shareholders' Fund and issuing a new class of securities to replace it.
Nominal shares	• Each farmer would be required to hold a nominal share (values of $1 or $3 have been proposed) for each kgMS supplied, with the current capital structure being unwound. • Existing share capital would be returned to farmers at a set rate. • An investment/superannuation fund could be created for retiring farmers.	• A nominal share structure was considered by the Board and not prioritised. • While this would significantly reduce the barriers to entry and incentives to leave for all farmer owners, we did not prioritise this because transitioning to a nominal share would require all current shares on issue to be bought back. This would require significant capital to be returned to farmer owners, which would be unaffordable. We also do not think this would be achievable under the current regulatory environment in New Zealand.
Split the Co-op into value-add and processing assets	• Divide the Co-op into a core dairy processing company and a separate value-add business, with farmers only being required to hold shares in the core dairy processing company.	• This option was considered by the Board and not prioritised. • We removed this option from further consideration because of the operational and transitional complexity it would introduce, and because of the potential for misalignment between external equity and farmer interests, and pressure to sell down the farmer stake in the value-add entity over the long-term.