



## ZESPRI 2011 AGM - Speeches

### **ZESPRI Chairman John Loughlin**

In the year since we last met, the environment we operate in has changed considerably due to the confirmation of the presence of Psa in New Zealand last November.

I will address the enormous challenge of Psa shortly, but before I do I want to spend some time highlighting what our industry has achieved in the past year, and how the 2011 season has performed to date.

I feel it is important to firstly focus on our achievements, because in times of great uncertainty it is often easy to forget the positives.

Last year's achievements and this year's start to the season are what should give us all basis for knowing that we are part of an industry which is a real New Zealand success story.

The 2010 season was mixed. Among the challenges we faced were a two-paced global economy, demanding climatic conditions and the confirmation of Psa in New Zealand.

While among the positives, last year's great tasting fruit supported our marketing initiatives, there were increased returns for GREEN growers and the release of new varieties generated great enthusiasm in the industry.

It is significant that the challenges were in aspects that we could not control, whilst the positives were achieved where we did have influence.

In the face of the challenges, ZESPRI performed well in managing to hold total global kiwifruit sales steady at just over \$1.5 billion, while much of the impact of a significantly stronger New Zealand dollar was mitigated by currency hedging gains.

The 2010/11 result reflected a strong performance in Japan and across the rest of the Asia region. This was supported by very high levels of dry matter, which drove repeat purchases by consumers.

It also reflected a partial price recovery in most markets following the global financial crisis.

On the back of this, total fruit and service payments for New Zealand fruit, including the loyalty premium, increased from \$849 million in 2009/10 to \$883 million last season.

ZESPRI's net profit was sharply down, with a consolidated net profit after tax of \$7.3 million last season, compared to \$25.9 million in 2009/10.

The fall was due to four factors:

The first was a reduced effective corporate commission of \$9.8 million because of an agreed increase in the loyalty premium from 15 cents per Class 1 tray to 25 cents per Class 1 tray.

The second factor was the \$12.9 million directed to the New Zealand industry response to Psa.

The third factor was a fall in 12-month supply profitability from \$8.6 million to \$5.7 million.

The final factor was one-off organisational restructuring provisions of \$4.9 million.

We expect the corporate profit to rebound in 2012 with the strong volumes of fruit we have to sell. However, longer term a decrease in volumes as a result of Psa is likely to put pressure on future profitability.

The August forecast agreed by the Board yesterday shows that average per tray fruit and service payments across all pools are forecast to fall, although increased yields will offset this to some extent.

Total fruit and service payments are set to increase on last year by \$63.4 million to \$922.3 million.

This year has delivered us a bumper crop; with uncharacteristically high yields resulting in a total submit of 115.9 million trays, 14 percent up on last season. This represents a 40 percent increase in GOLD and a seven percent increase in GREEN.

The board was heartened to see the strong interest in demand for Gold3 New Variety Licences in June, and good level of interest in Green14 licences.

Given the level of anxiety in the industry over Psa, and some questioning as to whether new licences should be released at all, the fact the Gold3 allocation was over-subscribed underlines the importance of allowing growers to make their own choices as to how they want to develop their businesses.

It was noticeable that much of the uptake of new licences occurred in regions which were more remote from the Psa-V Priority Zone.

We see the demand for licences as a vote of confidence in the future of the industry.

The Board decided to release an extra 57 hectares of Gold3 because of the over subscription, and we are confident that this additional capacity will be manageable from a market perspective.

While Green14 was undersubscribed by around 50 hectares, we are confident that it has a very strong future in the ZESPRI portfolio. In-market feedback on Green14 has been very positive, particularly its ability to attract new customers to the kiwifruit category.

As previously communicated, ZESPRI will also consider releasing additional GOLD New Variety Licences in February 2012, following assessment of the findings of gold storage trials and trials into Gold9 shrivel.

Our markets remain highly sensitive to oversupply and price pressures across all categories.

This is because consumer confidence is uncertain in the face of continuing high unemployment rates in key Western economies, financial market volatility, and rising food and oil prices, which are fuelling global inflationary pressures.

While growth continues strongly in Asia, many of our traditional markets are struggling to achieve a convincing recovery from the Global Financial Crisis.

Most obviously, the European Union remains fragile, particularly with the precarious financial position of Greece, Ireland, Portugal and now Spain and Italy.

Political challenges remain in all these countries in terms of the austerity measures that are needed to address the fragile fiscal and debt positions.

In the United States key economic indicators are showing a gathering recovery, however the US economy is still wrestling with how to deal with huge Federal Government and State Government debts.

In Japan, the March 11 earthquake and subsequent tsunami have reduced domestic output and demand, and while a strong rebound is forecast once reconstruction begins, there is still uncertainty as to when the rebuild will be fully underway.

China, Southeast Asia and India are key growth markets for ZESPRI. But, while growth is strong in these markets, there are internal inflationary pressures and external pressures which may dampen their stellar growth rates.

In summary, while a global recovery is underway, it has risks, and could be stalled by lingering structural issues in developed economies, or by surfacing issues in key emerging markets.

In getting the most out of our markets we are heartened by the Government's ongoing free trade agenda. As a global company, improved market access and reducing barriers to trade can have significant impacts on grower returns and ultimately corporate profitability.

Improved market access is important for our industry. Eliminating tariffs on kiwifruit through the India and Korea free trade agreements would save growers somewhere in the vicinity of \$38 million per year.

The corresponding number will grow as we develop our market presence in India. We are also watching the Trans-Pacific Partnership negotiations closely.

This free trade agreement, while complex, has the potential to evolve into a genuine Asia Pacific wide deal – potentially bringing in Japan and other key markets for the kiwifruit industry.

I now want to turn to our most pressing challenge.

The confirmation of the presence of Psa in New Zealand last November has marked the start of a defining phase in the history of our industry.

The savage destructive potential of Psa-V is clear from the experience in Italy, and from what we are observing in Te Puke. How we face and manage the threat will obviously shape the future of not just the New Zealand kiwifruit industry, but in many ways the global kiwifruit industry.

The initial industry response to Psa was led by the Ministry of Agriculture and Forestry's Biosecurity New Zealand Unit and by ZESPRI, with strong support by Plant & Food Research, New Zealand Kiwifruit Growers Incorporated and post-harvest operators.

I want to recognise the outstanding focus and responsiveness of the Prime Minister John Key, Minister of Agriculture and Biosecurity David Carter, and the wider Government, throughout this initial period, and for their ongoing support.

This initial response focused on what might have been a limited incursion on a few sites within a confined zone. A strong attempt was made to confine it.

It was always recognised that this approach might not be able to succeed, but the wider benefit to the rest of the industry meant that an aggressive containment strategy had to be pursued.

The virulence of the bacteria, some extreme weather events and other factors ultimately resulted in this early strategy being unsuccessful.

The industry has since moved on to a long-term management strategy. This is being headed by Kiwifruit Vine Health Incorporated, in recognition that the management of Psa will be a permanent part of the landscape of our industry for some years to come.

The reality is we don't know what the long-term impact of Psa will be on the industry and therefore on ZESPRI, but all the signs are that it will be serious.

As a result the board has directed ZESPRI management to undertake scenario planning based on a number of possible outcomes.

The board has also directed that resources are dramatically re-prioritised where needed, particularly in the area of research and development.

ZESPRI has taken on the responsibility of leading a far reaching Psa research and development programme, and has actively recruited world-leading experts in the biological sciences to give oversight to the programme.

I am confident that we have secured among the best minds available to develop a solution to this disease.

Our re-prioritisation decisions are about deferring some constructive initiatives, rather than permanently abandoning them.

An example of such a re-prioritisation relates to the North American market.

At last year's Annual Meeting I indicated that we would not look to source fruit from Chile in the future without consulting shareholders.

Soon after that statement, ZESPRI management developed a concept to segment the North American markets into premium channels for ZESPRI-branded New Zealand fruit, and value channels which might involve using Chilean fruit packed under the Family brand.

At the time, management's strategy made a lot of sense when we were grappling with a long-term expectation of strong growth, but with a short-term supply dip as a result of grafting to new cultivars.

It was intended to bring this proposal to this meeting. However, Psa has changed all that for now as our supply is uncertain and our priorities are dramatically altered.

But that strategy may become desirable again when our Psa position changes for the better.

This example illustrates the challenge of Psa, which is to act with decisive urgency to ensure that we have a future, whilst ensuring that urgent actions do not compromise that future.

Psa may have significant impacts for shareholders and it is conceivable that appropriate responses may require shareholder approvals.

We are determined to do what is necessary and right and to do so in appropriate ways, which may involve consulting you again before the next Annual Meeting.

We are confident that a management solution to Psa will be found within the next two to four years and we want to position the company to be in good shape to quickly regain momentum toward the long-term goal of tripling export returns to \$3 billion by some date soon after 2025.

This long-term goal is still an attainable one. We expect the future environment will be good for New Zealand food producers, including kiwifruit producers, provided our industry can maintain control and ownership of our supply chains, and position in premium segments.

Among the global trends that give optimism are pressure on global food supplies, rising commodity prices, growing demand for healthy food, and rising affluent middle classes in India, Southeast Asia and China who are demanding better-quality food.

To take advantage of these trends, ZESPRI's overriding goal has been to grow the kiwifruit category globally by selling the health benefits of kiwifruit to consumers, introducing new consumers to the kiwifruit category through new kiwifruit products and developing markets.

We are still investing in developing and commercialising new kiwifruit products, although we have introduced a new attribute into our thinking on new cultivars - Psa resistance.

We have also been making greater investment in developing markets, particularly in China, Southeast Asia and, increasingly, India.

This is about ZESPRI remaining agile enough to take advantage of the dynamic world we operate in, and the complex choices this throws at us.

We are at a very dark hour with Psa. For some people this may be the end of their road in the industry. Yet at the same time, on so many other fronts the long-term potential of the industry remains very bright. We have a stunning offer for global fruit consumers and an offer that we can make even more exciting.

This statement is not to diminish the present threat that faces our industry.

We do have a very tough time ahead of us and I believe we must steel ourselves in order to weather it.

But as we work our way through these uncertain times I hope all of us, as hard as it will be at times, can on occasion lift our focus to remember the huge opportunities that sit ahead of us and the prize for those who can make the whole journey.

Now, more than ever, the value of our industry structure will prove its worth. In line with this, it is vital that growers' have an active and independent voice, who can make their views known to ZESPRI, KVH, the Government and other agencies who will form the backbone of the response to Psa.

For this reason I strongly encourage you to vote in the upcoming New Zealand Kiwifruit Growers Incorporated levy discussion to ensure your views are heard.

The only way this industry will survive Psa is if it stays together and works together to buy time, to support those who will lose orchards, to support those in the front line buffer zones, to develop, test and implement R&D solutions and to keep the industry on track to achieve its long-term goals.

The kiwifruit industry has survived tough times in the past through having a resilient belief that it can take on the world and be the best.

I know this resilience remains and it is ultimately this resilience which will carry the industry through.

Thank you.

## **ZESPRI CEO Lain Jager**

We all recognise that Psa has dramatically changed the New Zealand kiwifruit industry since November of 2010.

With this in mind I want to firstly recap our underlying strategy and how that strategy will be impacted by Psa at both grower and ZESPRI level in the medium term.

I then want to talk in more detail about the ZESPRI Executive restructure, last year's results, how this season is tracking and also look ahead to next year.

As John has noted our core strategy comprises three strands:

First, broadening the market base by developing high growth regions with an immediate focus on China and South East Asia and an increasing focus on India and other regions;

Second, to market the health properties of kiwifruit to grow repeat purchases in more developed markets - such as Japan, Taiwan, Korea, Spain and the Benelux.

Third, to grow the category by developing new products such as ZESPRI Gold. These premium higher yield products will support both stronger grower profitability and ZESPRI's position as the global market leader in kiwifruit.

This strategy has been consistent and successful. To name a few highlights:

- China alone has grown from 400,000 trays to over 10 million trays since 2003 with very significant growth yet to come;

- ZESPRI Kiwifruit consumption per person in Spain is three quarters of a kilogram and in Taiwan is almost one kilogram per annum compared with average global consumption of 50 grams per person. To give a sense of context, if we can grow kiwifruit consumption per person in China to one quarter of the levels of Taiwan this represents almost 90 million trays of consumption;
- This year we will sell over 28 million trays of ZESPRI Gold with OGR's forecast to exceed \$80,000 per hectare.
- The strategy has been a powerful driver of growth and value at orchard level with over 700 growers grafting or planting ZESPRI Gold and average returns across all pools increasing \$10,000 from \$32,000 to \$42,000 a hectare since 2003.

But challenges do remain, particularly for the Green business with per tray OGR's fluctuating below \$4.00 for much of the last decade.

We expect to be able to rebuild 10 year average OGR's above \$4.00 for Green on a sustainable basis and achieved \$3.94 at 10 year average rates last year.

Sustainable Green profitability will only be achieved through the disciplined application of our strategy, strong orchard productivity and efficient supply chain practices to ensure the viability of the Green business.

Prior to last November our strategy was clear and ZESPRI, growers and their post-harvest partners were planning for strong future growth.

ZESPRI is the marketing arm of the NZ Kiwifruit Industry and it appears Psa will challenge both orchard viability and ZESPRI's marketing strategy.

As John has said, the impact of Psa on the New Zealand Kiwifruit industry is still unfolding, but we must recognise and respond appropriately to the serious threat it poses.

While the future is unclear, I make the following observations about the current situation:

- Every week there are new reports of orchards with Psa-V both in the Te Puke Region and now beyond. We cannot expect this spread to slow down over spring and summer;
- The virulence of the disease on Hort16A is deeply concerning. There is clear evidence from Italy that Psa-V will kill Hayward vines over time but there remains the possibility that we will be able to farm through Psa-V with Hayward;
- It appears that there is a range of Psa tolerance across cultivars, with Hort16a at the more vulnerable end of the spectrum. More work needs to be done in this area before claims of tolerance can be made for any cultivar;
- It is not clear what impact Psa-LV will have on kiwifruit cultivars in New Zealand;
- As a bacteria that can be carried on airborne vectors and gets into the vascular system of vines, Psa is technically at the more challenging end of the spectrum in terms of finding controls;

- The expansion of the priority zone over the last two weeks suggests that keeping Psa-V out of the regions is very ambitious and it is prudent that we configure our businesses and risk management accordingly.

In this crisis situation the definition of success at both orchard and ZESPRI level is to survive Psa until growth is again possible.

Therefore, our immediate priorities at both ZESPRI and Orchard level are:

- To have the most complete technical, commercial and strategic understanding of the situation in order to respond appropriately;
- To focus all necessary resources on developing technical and management controls as rapidly as possible to mitigate the impact of Psa on our businesses;
- To configure our businesses at Orchard, Post Harvest and ZESPRI level to survive the unavoidable impact of the disease on volumes, revenues, and costs;
- To maintain and leverage our industry's cooperative unity to focus resources and management activity on the Psa response and mitigate the overall impact of Psa.

At ZESPRI our first priority has been to refocus ZESPRI R&D on to Psa. This effort is being led at Executive level by Dr David Tanner.

By the end of this financial year as well as its contribution to KVH, ZESPRI, the corporate will have committed \$2.8 million on Psa R&D and tech transfer management.

This is alongside a significant commitment of senior and middle management time to all aspects of Psa.

We will maintain investment as necessary in this area for the foreseeable future.

Beyond management overheads, the funding of the future Psa R&D program will likely continue to be a mixture of ZESPRI Corporate, KVH and Government funding.

It is likely there will be further industry discussions about funding for KVH over the coming year.

From a marketing and ZESPRI corporate perspective, we are committed to planning for a future with Psa.

In September, the Board will receive a range of volume scenarios covering such issues as market allocation, grower and corporate revenues, innovation and tech transfer investment levels, and of course ZESPRI overheads.

It is important to note in the ZESPRI Shareholder context that ZESPRI corporate revenues are very volume sensitive and the ZESPRI Balance sheet is of modest size in the context of the size of the industry P&L.

This volume sensitivity is of course exacerbated by ZESPRI commission arrangements.

Very simply, when ZESPRI had a 50 million tray business only 10 years ago, the ZESPRI commission was set at around 11 percent of net sales, today ZESPRI's net commission is closer to 7.5 percent of net sales.

For this reason ZESPRI must and will be very responsive in right sizing overheads relative to corporate revenues.

With regards to our marketing strategy, where we need to reduce volumes to markets, we will seek to both maximise grower returns while retaining future growth opportunities.

I now want to turn to 2010 results and issues

Last season was a year when, despite economic uncertainty in our traditional markets, rising costs and having to battle an ongoing volatile exchange rate, we more than held our own.

We achieved this due to a combination of growers once again delivering premium quality product, strong delivery from our Europe Green business in demanding economic conditions, and the key Asian markets of Japan and China delivering substantially increased revenue.

In Japan, great tasting fruit drove strong sales revenue. A particular highlight in Japan was an increase of almost 10 percent in ZESPRI GREEN sales to 9.5 million trays.

In China, both GREEN and GOLD categories continued their strong growth, and there was positive news in receiving organic certification for this market. Sales revenue from China grew by almost 27 percent last year, further underlining the rising importance of China.

Alongside China, our emerging markets in South East Asia and India continue to grow strongly and increasingly demand more attention from ZESPRI.

Returns from our 12-month supply business were down by around \$3 million to \$5.7 million last season due mainly to the impact of Psa on ZESPRI GOLD orchards in Italy.

The spread of Psa in Italy and France, particularly the devastating impact of the disease on Italian ZESPRI GOLD orchards, means 12 month supply volumes will decrease further, with French Gold volumes also expected to be heavily impacted.

Despite the impact of Psa on our growing operations in Europe we remain committed to the business as a key strategy in building a year-round ZESPRI brand presence to support the sale of New Zealand kiwifruit.

However, with the dramatic fall in Gold production, it is appropriate that we take stock of our 12 month strategy, with a particular focus on its strategic value to the New Zealand business. The Board will consider this review later in the year.

Prior to Psa I was heavily engaged with the Executive and Board around preparing ZESPRI for future growth.

Central to this was the importance of Executive focus in developing markets, making the most of our significant investment in marketing, and the need to adopt a genuinely global approach to the business, taking into account the strong growth ahead of us and the complexity implied by a multi-product future.

The outcome of these discussions was the need to implement a genuinely global sales and marketing team, which empowered country level managers to maximise customer responsiveness, rather than to run ZESPRI as a series of regional silos.

In our view this remains the correct direction, even with Psa.

Among the key changes, which took effect for the beginning of this season, were:

- Yujan Chen stepping into the role of Global President of Sales and Marketing with a specific focus on China and Japan;
- Daniel Matheson stepping into the role of Global Vice President of Sales and Marketing responsible for all markets outside of China and Japan;
- Carol Ward, reporting to Daniel Matheson, stepping into the role of General Manager of Marketing;
- Bert Barmans replacing Luc Clerx as General Manager of Europe, Kelvin Bezuidenhout stepping into the role of General Manager Asia including responsibility for Taiwan, Korea, SEA, and India, Tony Motion moving to the United States to be General Manager America.

I take this opportunity to thank Luc Clerx for his tremendous contribution to the industry over 20 years and he remains an important strategic contributor to the business as a Board member of our ZESPRI Europe subsidiary.

Each season is unique and 2011 is no different with its crop characteristics and seasonal challenges.

The August forecast is now out and it's clear per trays returns will be down on the back of the larger crop, but this will be significantly offset at per hectare level by higher orchard yields this year.

With the later start and the larger crop, our global weekly run rates are up for Gold on last year and in line with last year for Green. This will leave us with a slightly later finish in most markets with the final result highly dependent on storage performance particularly for Green.

I know many of you are looking forward to a more detailed discussion on how we are tracking for 2011. Can I suggest that we reserve more detailed discussion relating to this season to the more intimate ZESPRI grower meetings starting next Tuesday, which John and I will be attending.

The strength of the New Zealand dollar is an issue which has been in the headlines recently.

The integrated industry model supports an effective foreign exchange policy, which this year versus an unhedged position is worth approximately 96 cents per tray for Green and \$1.36 per tray for Gold.

However, hedging only smoothes the peaks and troughs of the dollar and the strength of the kiwi versus our major trading partners may eventually put the industry, particularly the Green business, under severe pressure.

To give you a sense of what we can expect at current exchange rate levels at the current crop

volume, the downside for 2012 will be approximately 30 cents per tray with a further 22 cents per tray downside in 2013. This is despite still strong hedging on the Yen.

Like all other NZ exporters we hope for some currency relief in coming seasons, and we do expect the potential downside for next year will be partially offset by a positive mix impact at a per tray level by a potentially smaller crop due to Psa and seasonal factors.

Except for Psa, foreign exchange is our most troubling headwind. To mitigate its impact addressing supply chain costs will be a vital component of supporting grower viability.

ZESPRI and Post Harvest Operators are currently discussing some aspects of our supply chain arrangements with the objective to reduce fruitloss and condition check and repack costs ahead of next season.

In conclusion, when we met this time last year we spoke about the industry being on the cusp of a hugely exciting growth phase.

Today, we meet in opposite circumstances. The advent of Psa presents the industry with its greatest challenge since the financial crisis of 1992, and the high NZ dollar will only exacerbate this challenge.

Having said this I remain an optimist with regards to the future of the New Zealand kiwifruit industry.

While the backdrop to our industry may have changed, the talent and commitment which got us to the highs of last year remain. For now though we must accept our resources will necessarily be directed toward overcoming Psa in the short term.

I believe it is important that we be unrelentingly honest about the gravity of the situation because this underpins our ability to respond appropriately.

I also believe on the other side of this crisis we have a bright future underpinned by the power of the SPE and a clear marketing strategy.

To reach this future we must focus the full resources and talent of our united industry to overcome the Psa challenge.

Thank you.