

Results announcement Six months ended 31 December 2009

Half-year earnings reflect growth and improved operating conditions

Key points

- 42 percent increase in Revenue, to \$US10.9 million
- 50 percent reduction in Operating Loss, to \$US2.5 million
- Milk prices recovering, to US 29c per litre at the farmgate in December 2009
- 70 percent increase in milk production, to 42.1 million litres
- 15 percent reduction in farm operating costs despite increased production
- Five new milking sheds on target for autumn commissioning

Results for the December 2009 half-year reflected continued growth in the farming operations, improved operating conditions and the success of measures taken to reduce expenditure.

The Chairman, John Parker, said: "The company has established good momentum after the difficulties experienced in the previous year. Milk prices have improved, and tight cost control has resulted in a much improved performance.

Given the extent of the land banking undertaken we are understandably still a long way from steady state production on most of our existing farms, and still have many farms to develop. Our longest established farms indicate that our steady state goal of an average of 940 kilograms of milk solids per hectare is realistic, although was originally somewhat ambitious in terms of the time it would take to reach those goals.

Last year's drought, poor prices and a lack of funds have been, or are being addressed to the satisfaction of directors. While it is impossible to fully drought-proof a pastoral farming operation, we are moving as rapidly as we can to have significant portions of all farms irrigated. The ramp-up in irrigation has been hampered by the availability of sufficient electricity reticulation and sufficient capital, but both issues are in the process of resolution."

Overview

Revenue increased to \$US10.9 million in the period under review, from \$US7.7 million in the 2008 half year.

Milk volumes were substantially higher, with milk sales contributing \$US10.2 million of revenue net of charges (up from \$US6.2 million in the previous comparable period), and livestock sales \$US0.7 million (primarily beef animals and dairy cull cows). Natural growth in the livestock herd was valued at \$US0.8 million, but there was no requirement for fair value adjustments in the total value of the herd at the end of the period.

The Operating Loss from Farming Activities before fair value adjustments¹ and other one-off items was \$US2.5 million, compared to a \$US5.1 million loss for the previous comparable period.

Consistent rainfall patterns in the first quarter were followed by good rains throughout the second and into the early summer. This allowed pastures to recover from the prolonged and debilitating drought over the previous summer and autumn.

Milk production for the half-year totaled 42.1 million litres, an increase of 70 per cent on the 24.6 million litres produced in the comparable period in 2008. The increase reflected a production curve consistent with the growth of farming operations – during the first half year the company had an average 10,950 hectares of land in dairy production, compared with 6,400 hectares one year earlier.

The first-half production level was consistent with the lower end of the 80-85 million litres forecast for the full 2010 financial year.

Despite the production growth, farm working expenses were about 15 per cent lower than for the previous corresponding period, at US\$9.8 million, with a marked reduction in pasture and supplementary feed costs.

Operating conditions

The company received an average milk price of US25.0 cents per litre for the December half-year, compared with US26.8 cents in the December 2008 period. The previous comparable period benefited from peak dairy prices in mid-2008 calendar year, whilst the January to June 2009 period subsequently achieved only US22.0 cents per litre. Prices trended upward during the current half year, with average prices moving up from US24 cents to US29 cents per litre over the October to December period. The weather, which caused severe stress in the previous summer, has been more favourable throughout and beyond the period under review with rainfall extending into January 2010. Caution remains, as climatic conditions can change quickly.

Favourable weather conditions have resulted in substantially better pasture growth and therefore substantial savings on supplementary feed compared with last year. Irrigation, where installed, has been used to maintain moisture levels and grass growth following rainfall. The company now has 1,240 hectares of dairy land under irrigation, with a further 700 hectares awaiting final connections over the next few months. Steady progress is being made although the total irrigated area is well short of the eventual goal of 50% of dairy area (approximately 10,000 hectares). Irrigation dams are full following the regular rainfall.

Better weather has allowed good volumes of silage and supplementary feed crops to deliver satisfactory yields.

Livestock are in good condition, with the autumn calving herds in optimum condition and the climate this year allowing body condition to be substantially improved following the end of last summer's drought. Calves born in 2010 will again be cross-breds, as the company builds the future milking herd based on NZ genetics.

Operating performance

Milk production improved over the course of the half-year with the rolling 12 months to December achieving 62 million litres, up from 45 million litres in the 12 months to June 2009. The spring peak was 8.5 million litres, for the month of October.

Milking numbers peaked for the spring season at just on 20,000 during November. Peak milk production was in line with guidance previously issued, but was lower than expected as the cows' body condition had not fully recovered from the previous summer's drought. Accordingly, peak milk production per cow can be expected to improve in future years.

¹ Fair value adjustments were nil in the December 2009 half year, but previously have included price changes for livestock and farm properties. Other one-off items include gains or losses on farm sales, and discount on VAT receivable.

At the end of December, 19,600 cows were being milked, with an average daily yield of 10.4 litres. Many cows are now near the end of their seasonal lactation as over half of the herd is autumn calving.

As noted above, costs were down significantly, with a reduction in fertiliser prices, reduced use of supplementary feed and a focus on efficient on-farm expenditure. This was a commendable achievement by the manager and staff, as the area in production and the size of the milking herd continued to increase.

Development and funding

The strong support of Uruguayan institutions for the \$US30 million bond issued by the company in July enabled a rapid increase in the area irrigated, the construction of a further five dairies and the restitution of pastures impaired by last summer's drought.

The area under irrigation tripled, to 1,240 hectares currently. Further irrigation gains will be enabled by the installation currently underway of new power transmission lines to farms in the Eastern hub by Uruguay's electricity distributor. The bond issue has provided sufficient funding for a total of nearly 3,200 hectares of irrigation, including the current area. In addition to the current 1,240 hectares there is some 700 hectares awaiting final connections over the next few months, and a further approximately 1,200 hectares of pivots having been ordered.

The company initiated a programme to dispose of a small number of undeveloped properties to optimise land use and operations, and to free up cash. The sale of one farm of ~2,000 hectares was completed in October 2009 for \$US6.85 million before sales commissions, which was 7.5% below the June 2009 valuation. It would have been some time before the property was developed, so although the sale was at a modest discount to valuation, we preferred to realize the cash. The company is also working with prospective investors on the sale and leaseback of some developed properties and other capital raising initiatives that will enable it to complete the development of its farms in 2011/12 and meet its other financial commitments. These initiatives include a second bond issue.

Personnel

The management team was further strengthened by the appointments of Brent Boyce as New Zealand General Manager in September 2009, and Sue Hagenson as Technical Manager, effective early March. Both Brent and Sue bring a strong NZ farm consultancy background, and will be based with their families in Uruguay.

Keith Smith retired as chairman in December 2009, having taken up the chairmanship of PGG Wrightson and deciding that chairing both companies was inappropriate. Keith has been chair of NZS since inception and the board is grateful for the time, effort and experience he brought to the role and is pleased he is staying on as a director of NZS.

Uruguayan economy

Senator Jose Mujica, of the Frente Amplio party in the current centre-left ruling coalition, won the Presidential election held on 29 November 2009. Amongst his initial comments, President-elect Mujica said his government would continue with existing policies established by current President Vazquez. His running mate and ex Minister of the Economy Danilo Astori will be Vice President, with oversight of the economy, when the new government takes office in March 2010. President-elect Mujica was previously Uruguayan Minister of Agriculture, and supportive of the establishment of NZ Farming Systems Uruguay.

Uruguayan Gross Domestic Product grew by 2.5 percent in the third quarter of 2009. A survey of public and private analysts predicts growth of 1.8 percent for calendar 2009 and 3.7 percent for 2010. Inflation has been running at just under six percent, and the Government has tightened its target range to 4-6 percent. Analysts are forecasting inflation of six percent for 2010.

The Uruguayan peso continued its steady appreciation, closing at 19.6 to the US Dollar at the end of December, compared with 24.3 at 30 June 2009. This has put pressure on peso-denominated expenses such as labour costs.

Outlook

The outlook for milk prices remains somewhat uncertain for the balance of the year, with ongoing volatility in prices struck by the Fonterra online auction system; however, a positive underlying trend is expected to continue as economies in key international dairy markets improve.

Currently, Conaprole has lifted its milk price to the equivalent of US29 cents per litre. At the 31 December 2009 NZD:USD exchange rate of 0.725, this is equivalent to \$NZ 5.80 per kilogram of milksolids.

Our internal financial projections (including those stated below) reflect an average milk price of US25 cents per litre for the 2009/10 season. The assumed milk price is slightly above the average of 23.9 cents per litre received in the 2008/09 financial year (during which prices ranged between US19 cents and US40 cents per litre) but in line with the average price for the December half-year. We believe US25 cents to be a conservative long-term expectation given the high level of production costs in many dairy-producing countries.

At the forecast production level of the lower end of the 80-85 million litres range for the 2010 financial year, projected loss at the EBIT level (Earnings Before Interest and Taxation) remains consistent with the maximum US\$10 million outlined in the 17 December 2009 update.

At the forecast production level of 100-110 million litres for the 2010/11 financial year, projected EBIT would be a small loss as previously stated. On that basis, the company would expect operations at the EBIT level to be profitable in the 2011/12 financial year.

Achievement of the full-scale production target of 940 kilograms of milksolids per hectare per year by 2014/15 would imply positive EBIT of \$35-40 million at that point. Although the company expects a number of farms to achieve steady state prior to this, on average it is expected to take until 2014/15 year for steady state to be achieved.

The combination of drought, milk price and capital shortages made last year unmemorable. This year to date has been much better however your directors are far from satisfied. We have progressed well but still are short of where we would wish to be. That's the negative. The positive is although there is still much hard work to do, the last half year has greatly increased confidence that we will achieve success for NZ Farming Systems Uruguay.

Key statistics

| | Jun 09 | Dec 09 | Expected Jun 10 |
|---|--------|--------|-----------------|
| Total livestock numbers (period end) | 53,000 | 54,300 | 55,000 |
| Milking cow numbers (period end) | 11,300 | 19,600 | 20,000 |
| Milk production Kgs MS per cow per year Dec 09 is rolling 12 months | 290 | 290 | 290 |
| Dairy hectares in production (period end) | 10,500 | 11,100 | 13,000 |
| Milk production Kgs MS per hectare per year Dec 09 is rolling 12 months | 420 | 430 | 480 |
| Milking sheds (period end) | 26 | 27 | 31 |
| Capital expenditure for period (Excluding livestock – Dec 09 is six months only) | 28 | 6 | ~12 |

Notes

- Livestock / milking cows / dairy hectares / milking shed figures are as at the date specified. Milk production figures are for the 12 mths ended on the date specified. Capital expenditure figures are for the 12 mths ended on the date specified, except for Dec 2009 which is for the 6 mths to that date.

- Milk production per hectare figures are calculated based on dairy hectares in production each month and thus are weighted for conversion progress.

Key operating performance statistics

| | Q1 (Jul-Sep) | Q2 (Oct-Dec) | YTD Dec 09 (6 mths) | Full yr projection Jun 10 (12 mths) |
|---|-----------------|-----------------|---------------------------|---|
| Milk price (US cents/lit average) | 22.4 | 26.9 | 25.0 | 25.0 |
| Milk volume (Million litres) | 19.9 | 22.2 | 42.1 | Low end of 80-85 |
| Farm working expenses (USD Millions) | 5.4 | 4.4 | 9.8 | 22-23 |

Notes

- Farm working expenses include all on-farm operating expenses, except depreciation.

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