	ZESPRI GROUP LIMITED **GOLD ORGANIC POOLING REVIEW – NOVEMBER 2019**

Purpose

Zespri Management intends to recommend to the Zespri Board the establishment of an own pool for SunGold Organic in 2020/21.

The purpose of this paper is to outline information relevant to this decision, and for growers to provide feedback prior to tabling the paper to the Board in December 2019.

Background

The $2.00/TE Gold Organic Purchase Premium mechanism was established in 2007 for a rolling 3-year term with the premium rates to be reviewed annually thereon. The objective of the payment mechanism was to smooth fluctuations in actual market returns on a year-to-year basis. With the historical small volumes of Gold Organic, there has been a high risk of returns being disproportionately impacted by small changes in market mix.

A paper circulated to Gold Organic growers in 2018 indicated that SunGold Organic meets the pooling guideline criteria (See Appendix 1) to create a separate pool, however there remained a degree of risk due to small volumes. A subsequent consultation on moving to a separate pool was held with SunGold Organic growers. Feedback received indicated a view that moving to an own pool was inevitable, however preference was to wait for larger volumes to mitigate the impact of small changes in market/profile mix. The Zespri Board were guided by growers and supported continuing the combined pool structure, indicating when volumes reach 2M trays would be an appropriate point to create a separate pool.

SunGold Organic volumes are set to increase significantly over the coming years as growers respond to market demand signals, increasing from 990k TE in 2019 to approx. 1.6m TE in 2020 and 2.4M TE in 2021[1]. Volumes are expected to rise to 4M TE by 2024 taking into account the annual release of 50ha SunGold Organic licence until 2022, and conversions from conventional.

Gold Organic historical performance

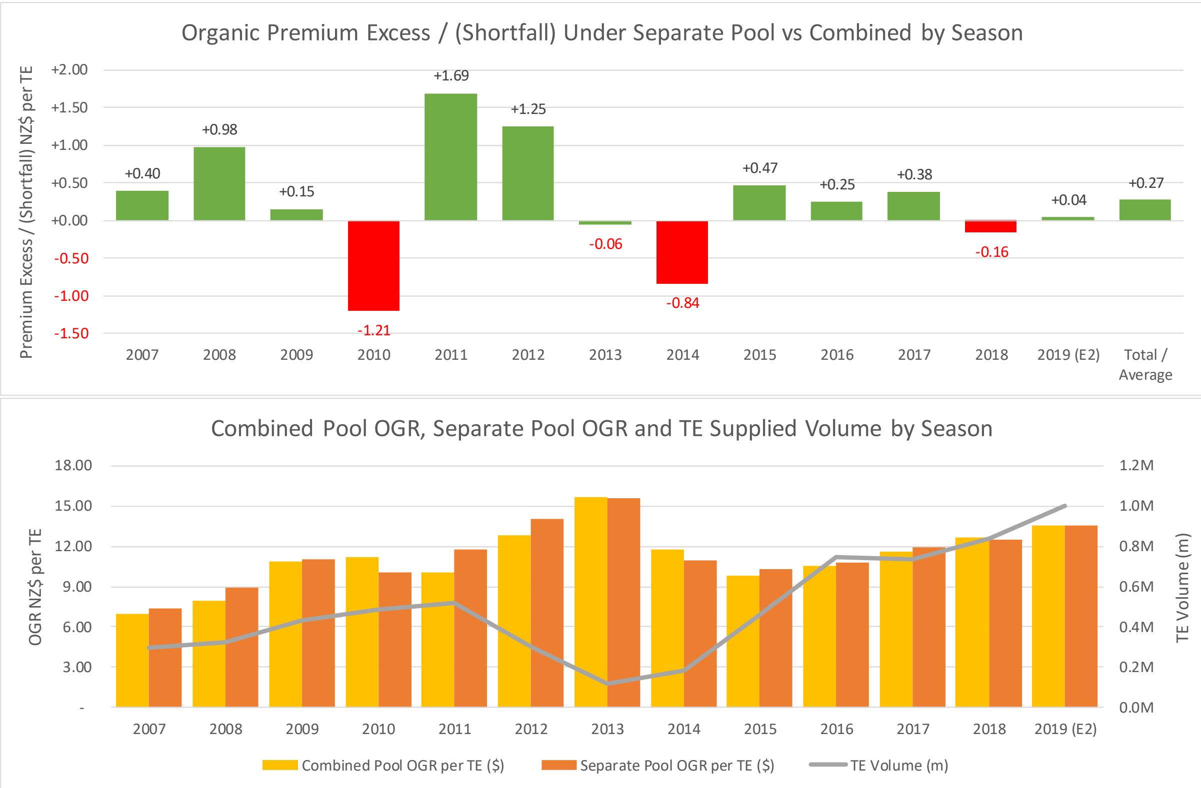
The chart below shows Gold Organic returns in a combined versus separate pool since the establishment of the purchase premium in 2007. In the top chart, where the variance is positive the organic premium has been achieved ($2.00/TE from 2007 – 2018; $2.20/TE for 2019) and where the variance is negative the premium has not been achieved. The lower chart shows the total OGR figures in each pool together with the Gold Organic volumes in each year.

Looking back over the last 12 seasons (2007-2018), Gold Organic has earned more revenue for the combined pool than the $2.00/TE premium paid to growers in nine of the 12 years. Over this horizon $1.55m of additional returns (or $0.28/TE of Organic SunGold) have been returned to the Total Gold Pool (over and above the purchase premium).

[1] Based on Zespri 5 year plan, February 2019

Whilst fluctuations in actual market return are apparent from 2007-2014, over the last five seasons these fluctuations have become smoother, with returns above the premium consistently achieved, with the exception of 2018.

Chart 1 & 2



Note: Organic Premium was set at $2.00/TE from 2007 – 2018. For the 2019/20 season the premium was set at $2.20. Therefore the variance shown for 2019 is against $2.20/TE.

SunGold Organic Outlook

Organic sales have been anchored with long-term customers in Europe and Japan, and combined with North America represent around 85% of total SunGold Organic volumes. A similar allocation strategy is expected in coming seasons, with growth prioritised based on distinct organic demand and the market opportunity to deliver a strong and stable return. A focus will be on building capability and lifting value in Europe and USA, where there is strong demand for SunGold Organic. Volumes to Japan will also continue to grow, reliant on meeting market access requirements, although will drop slightly as a proportion of market mix.

There is an opportunity to build volumes into high value markets including Korea and Taiwan, which is also reliant on meeting market access requirements around scale.

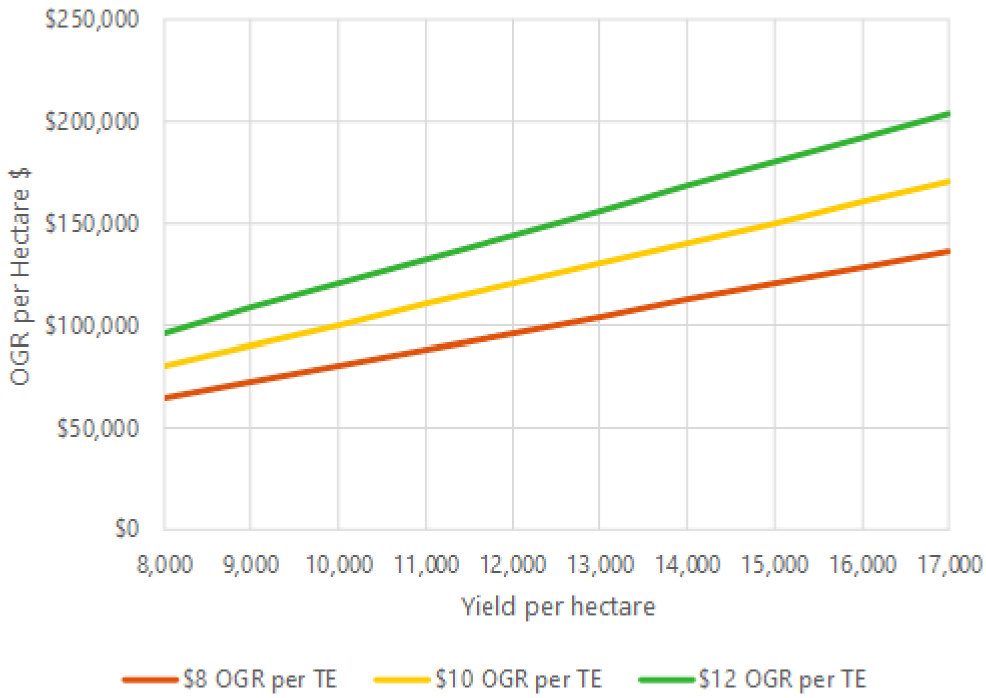
Volumes to China will increase over time, however are not expected to increase as a proportion of total volume.

The overall drive for value will be supported by clearly differentiated packaging, that increases awareness of Zespri SunGold Organic and reinforces a premium position.

Based on current available planning figures, Zespri expect a premium range of $1.40 - $2.20/TE above conventional over the coming five years. Using the long term Sun Gold conventional OGR range of $7- $9 (as published in the Zespri 5 Year Outlook, March 2019) and adjusting for this premium range, would give an OGR range for Organics of $8.40 - $11.20/TE. [2]

Chart 3 below presents yields vs. OGR/TE as an indication of the variability growers could be faced with depending on orchard yields and returns. OGRs per tray of $8, $10 and $12 dollars have been used for illustrative purposes only.

Chart 3: Yield vs. OGR per hectare



If the appropriate market mix cannot be achieved, due to market access, it will be difficult to reach the upper end of this range (See Appendix 2 for OGR impact of not meeting Japan supply over past four seasons). A further factor that will have a material impact on the outcome is the relativity of organic and conventional if

[2] The Five Year Outlook document scheduled for distribution in March 2020 will include a full outlook for SunGold Organic.

conventional value keeps rising, in which case there is a risk in the ability to achieve a price premium for organic.

Summary

- Zespri Management intend to recommend to the Board the establishment of an own pool for SunGold Organic in 2020/21.

- Organic SunGold volumes are expected to reach 1.6M trays in 2020/21 and exceed 2M trays in the 2021/2022 season.

- The risk of reduced returns or negative impacts from market mix are considered relatively low based on performance over the last four seasons.

- Zespri seek feedback from growers on the intention to create a separate pool for SunGold Organic in 2020/21 season.

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Appendix 1 – Pooling Framework

The Pooling Framework developed in 2009 outlined the factors to be considered when making decisions regarding combining, or not, varieties into pools. These were: product attributes, market differentiation, market allocation strategy and supply strategy. These are considered in turn:

- **Product attributes:** SunGold Conventional and Organic fruit is not distinctly different to each other in either appearance or flavour. From a production perspective SunGold Organic yields are lower on average than Conventional, with a lower average size profile.

- **Market differentiation.** The branding of the organic and conventional fruit is currently aligned – Zespri™ SunGold, Zespri™ SunGold Organic. SunGold Organic generally achieves incremental shelf space alongside conventional, with a differential pricing strategy that delivers a premium across all markets. Customers and consumers are aware SunGold Organic is a different proposition to Conventional.

- **Market allocation strategy.** The market allocation strategy for SunGold Organic is based upon distinct market demand for organic kiwifruit. Sales have been anchored with long-term customers in Europe and Japan and combined with North America represent around 80% of total Gold Organic volumes. A similar allocation strategy is expected in coming seasons, with growth prioritised based on distinct organic demand and the market opportunity to deliver a strong and stable return.

- **Supply strategy.** Shipping of SunGold Organic for the 2019 season reflected the fruit having its own distinct market segments and not being significantly constrained by its storage properties. Shipping of this nature is expected to be the case in future Seasons.

Appendix 2 – Impact of not meeting Japan demand

The current main risk that exposes organic growers to disproportionate swings in returns is the risk of not meeting Japan demand, which can have a material impact on grower returns.

Table 1 below shows the impact not meeting Japan demand has had on OGR over the past four seasons. This highlights the risk to returns from variability of supply to Japan in particular, and other high returning markets such as Korea and Taiwan which is more evident under the (current) low supply volumes.

Table 1: Historical impact of not meeting Japan demand

	2019	2018	2017	2016
Total cost of missing JP supply	-$41,525	-$130,376	-$336,676	-$114,612
Cost/TE GoldOB	-$0.04	-$0.16	-$0.48	-$0.19