

Annual Report

2002 - 2003



Annual Report 2002-2003

The Directors are pleased to present the annual report of Livestock Improvement Corporation Limited for the year ended 31 May 2003.

For and on behalf of the Board of Directors.



DJ Milne, Chairman
August 2003



SB Bay, Deputy Chairman
August 2003

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Overview

Mission

Leading the world with genetics and knowledge to create wealth for pastoral dairy farmers

Vision

Creating solutions for the world's best dairy farmers

Strategic objectives

By 2005

- | | |
|-----------------------|--|
| Innovation | - increase real revenue to \$140 million |
| Performance | - return on capital of 10% after tax |
| Customer focus | - achieve Silver Business Excellence Award |

Core values

- | | |
|-----------------------|---|
| Integrity | <i>Expressed by being ethical; honest; trustworthy; fair; responsible and accountable; responsive and reliable.</i> |
| Customer focus | <i>Expressed by the above, and by putting the client first; demonstrating empathy with dairy farming; providing solutions to our farming clients and consistently providing a quality service.</i> |
| Innovation | <i>Expressed through innovative solutions which add value to our clients' business; consistently looking for better ways to do things, and a focus on quality and excellence in everything we do.</i> |
| Teamwork | <i>Expressed through leadership; professionalism – consistently demonstrating standards of excellence; balancing work and home life, and empathy and support for colleagues.</i> |

Company structure

Operational Divisions

Genetics • Information • International

Support Divisions

Research and Development • Strategic Development • Corporate Services • Computer Services

Divisional highlights

Genetics

Activities

- Sire Proving Scheme
- Artificial Breeding - PREMIER SIREs, Alpha Nominated
- Artificial Breeding Technician Service
- National sales force.

Highlights 2002 - 2003

Sire Proving

- Evaluations calculated for first graduates of (2001) Short Gestation Length Sire Proving Scheme
- Sire Proving Scheme gains ISO accreditation.

Innovations

- Once-A-Day milking index
- Design and launch of software to optimise contract mating and sire allocation
- Licensing of two genes (Optimum and Quantum) discovered by BoviQuest (Livestock Improvement's joint venture with ViaLactia Biosciences Ltd)
- First bull dams selected as donors for GENERate in vitro production (IVP) programme
- Development of Soft Fat Breeding Value
- Trial of sexed semen technology.

Bull team performance

- Livestock Improvement bulls continued to dominate the Ranking of Active Sires (RAS) list
- Significantly grew Artificial Breeding market share (third time in last four years) in a flat market
- Top five Jersey bulls with daughters in Australia bred by Livestock Improvement
- 2002 Holstein-Friesian PREMIER SIREs team of 20 bulls sired by 18 different sires
- 2002 Jersey PREMIER SIREs team of 18 bulls sired by nine different sires
- SRD Collins Royal Hugo the most popular bull with New Zealand farmers for a third consecutive season. The bull also achieved a Livestock Improvement record yielding more than 21,000 straws from a single ejaculate
- Glenmead RE Holiday-ET (bred by Kevin and Felicity Clark of Waimana) was awarded the Mahoe Trophy by the New Zealand Holstein-Friesian Association
- Dayshs Landmark GR (bred by Neil and Elaine Daysh of Pahiatua) was awarded the JT Thwaites Trophy from Jersey New Zealand
- Kilfennans Challenge (bred by S Macky) was ranked the highest Breeding Worth New Zealand proven Ayrshire bull of all time. This Semayr Bull is available exclusively through Alpha Nominated.



World records

- SRB Collins Royal Hugo set world record for youngest bull to achieve one million inseminations
- Hugo's domestic lifetime tally, at the time of publication of this Annual Report, is 1,131,500 – just 137,000 inseminations short of Kingsmill PA Walesa's record
- In acknowledgement of his extraordinary achievements, SRB Collins Royal Hugo was inducted into the Livestock Improvement Hall of Fame
- Van der Fits Fjord (now in his 6th consecutive season as a member of the PREMIER SIREs team) extended his world record for a Jersey bull to 652,000 domestic inseminations.

Artificial Breeding (AB) Technician service

- Introduction of Submission Rate and Non Return Rate (NRR) data to farmers via DataMate
- Management of lethal genetic defect (CVM) via DataMate
- Yearling mating management via DataMate
- Geographic Information System trialled to improve efficiency of AB Group make-up.

Plans 2003 - 2004

- First KiwiCross™ bulls (19 from 2000 Sire Proving Scheme (SPS)) will receive progeny test evaluations
- Genotyping of the Quantum gene will be used in bull breeding and acquisition
- Completion of Livestock Improvement initiative with breed associations to establish new breeding relationship replacing the historic bull nomination system
- Technology will be advanced to generate multiple bulls from elite cows
- Semen allocation system will be modified to allow use of one SPS bull per day (enables large herds to participate in SPS)
- Continue trial of UMF honey as mastitis treatment
- Use of SuperMate hand held computers to assist field supervision of AB Technicians.

Information

Activities

- FarmWise nationwide farm consultancy service
- MINDA
- Protrack
- Herd Testing
- Animal Health.

FarmWise

Highlights 2002 - 2003

- 21 consultants maintained FarmWise's position as the premier national dairy consultancy business
- FarmWise operated a national consultancy contract for LandCorp and assisted other Livestock Improvement divisions with new business opportunities.

Plans 2003 - 2004

- Continue operation of nationwide dairy consultancy
- Regular input into development of new business for Livestock Improvement and enhancement of existing products and services
- Develop suite of software tools for use by FarmWise consultants
- Develop expertise in the establishment and management of Once-A-Day milking systems.

MINDA

Highlights 2002 - 2003

- More than 3.8 million dairy cows and 1.6 million dairy young stock recorded in 11,850 herds
- MINDApro and M-NOTE launched in October 2002 and achieved steady uptake during the season to a final total of 1,600 users. DairyWIN usage fell on previous seasons to 1,000
- Sales of chargeable reports grew strongly during the season
- The MINDA Contact Centre performed to a consistent and very high level exceeding contact centre industry standards for service.

Plans 2003 - 2004

- MINDA will continue to be the preferred herd management system for New Zealand dairy farmers
- Continued growth in the use of MINDApro and M-NOTE
- Release of upgrade to MINDApro and M-NOTE
- Increasing use of health recording in MINDA, and management reports that use health records.

PROTRACK

Highlights 2002 - 2003

- The Protrack Farm Automation system was extensively trialled on five dairy farms around New Zealand.

Plans 2003 - 2004

- Launch of Protrack for rotary farm dairies in June 2003
- Development of herringbone and stand-alone drafting using electronic identification (EID)
- Development of software linking Protrack and MINDApro
- Forward enquiries indicate continued farmer uptake, particularly in large herds.

Herd Testing

Highlights 2002 - 2003

- More than 35,000 visits carried out to 9,600 herds
- Livestock Improvement's Testlink Milk Analysis Laboratory analysed 9.15 million milk samples
- A new Testlink Milk Analysis Laboratory was established in Christchurch to service the growing needs of the South Island
- Both North and South Island Testlink Laboratories achieved ISO 17025 accreditation required under the Herd Test Regulations.

Plans 2003 - 2004

- Commercial trial of new Herd Testing systems utilising handheld data recorders and electronic meters in Waikato (both systems) and Canterbury (handheld data recorders only)
- Focus continues on delivering a high quality, accurate, speedy service to farmers
- Installation of robotic equipment will continue to maximise accuracy and speed of sample handling and analysis.

Animal Health

Highlights 2002 - 2003

- Livestock Improvement continued to administer the dairy industry Enzootic Bovine Leucosis (EBL) Control Scheme, funded by Dairy InSight, using milk and blood samples to screen for the disease
- The season ended with 46 (see Table 2) herds with a positive status for EBL, down from 110 at the start of the season
- The Leptosure Quality Assurance (QA) programme (jointly developed by Livestock Improvement and the NZ Veterinary Association) was launched and rolled out to veterinarians and dairy herds across New Zealand. Approximately 700 dairy herds are currently using the QA programme.



Figure 1: The number of EBL positive herds has reduced dramatically from July 1998 to June 2003

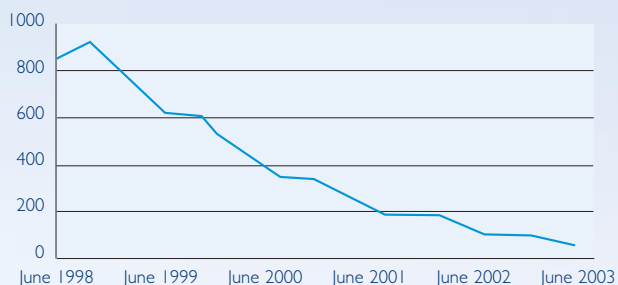


Table 2: EBL status summary for dairy herds at the end of the 2002/2003 season

EBL Free	10,474
Negative	1,794
New Locations	203
Suspect	127
Milk Positive	3
Blood Positive	43
	12,644

Plans 2003 - 2004

- Continue progress to eradicate EBL from the New Zealand dairy industry in partnership with Dairy InSight and dairy companies
- Investigate potential for disease control programmes through analysis of milk or blood samples
- Uptake of Leptosure™ expected to continue.

Research and Development

Activities

- GeneMark
- Scientific Research
- Product and Service Development
- Genomics (Gene Discovery)
- Reproductive Technologies.

Highlights 2002 - 2003

GeneMark

- The GeneMark Laboratory was opened by the Minister of Agriculture Hon. Jim Sutton in May 2002 as part of the Testlink Laboratory network in Hamilton
- GeneMark set up the BLAD and CIT Lethal Gene tests; Tru-Parent Parentage Testing; and the four Protein and the Optimum Production Genes in-house, all previously out-sourced. This, together with a new DNA extraction system, will reduce costs and improve turnaround time
- GeneMark designed and implemented two new software programmes, the Nautilus Laboratory System and the Aquarius Business System, leading to improved customer service, improved accuracy and turnaround
- The Optimum gene, which affects protein, fat and milk volume, was commercialised
- Tru-Parent was launched, a more cost effective and user friendly parentage test that automatically uses the National Database to search for parents and, with increased 'second marker set' technology, is the most powerful and accurate bovine parentage test in New Zealand
- GeneMark successfully bid for and was awarded several large research genotyping contracts for completion over the next two years
- First international sale of GeneMark services.



Plans for 2003 - 2004

- Launch the second gene discovered by BoviQuest, Quantum
- Build GeneMark's international business
- Continue to grow sales in the stock buying and selling market
- Reduce turnaround time for parentage and gene testing
- Increase volumes of service to the research programmes of Livestock Improvement and BoviQuest.

Highlights 2002 - 2003

Scientific Research

Product and Service Development

Genomics (Gene Discovery)

Reproductive Technologies

- Tools to control inbreeding in Livestock Improvement's breeding scheme were developed and implemented operationally
- A Once-A-Day milking breeding index was developed and delivered to the Genetics Division for operational deployment
- Under a revised business model for BoviQuest, Livestock Improvement took over ownership of, and funding for, gene discovery research for animal productivity traits
- In the Friesian-Jersey Crossbred gene discovery trial, rising 2 year old F2 heifers of the second cohort were relocated from Tokanui to Whareroa for calving. The first cohort will start second lactation shortly
- The Economic Value for Somatic Cell Count (SCC) has been developed and a recommendation made to the National Animal Evaluation Committee that it be incorporated in animal evaluation
- Livestock Improvement's female reproductive technologies programme, GENERate, (in collaboration with Animal Breeding Services Ltd), has delivered a functioning platform for oocyte collection (OPU), in vitro production of embryos (IVP), embryo transfer (ET) and foetal sex determination
- Animals in the Holstein-Friesian Strain trial completed their second lactation. Data will be analysed in combination with results from a parallel trial at Moorepark (Ireland).

Plans 2003 - 2004

- Undertake a fertility gene discovery project using DNA pooling
- Complete genotyping of Friesian-Jersey Crossbred trial animals and genome scan for DNA pooling project
- Livestock Improvement will continue to implement the very demanding science plan for the Friesian-Jersey Crossbred trial as scheduled, generating valuable phenotypic data and collecting biological samples for further analysis
- First round of Quantitative Trait Loci (QTL)/gene discovery research for traits for which sufficient phenotypic data have been collected from the Friesian-Jersey Crossbred trial
- Continue work on implementation of gene discovery output within Livestock Improvement's core business
- Implement Somatic Cell Count Breeding Value (BV)
- Estimate BV for Condition Score. Develop a prototype system and analyse the contribution of condition score to the fertility BV and Breeding Worth (BW). Develop recommendations for a BV for Condition Score and present to the National Animal Evaluation Committee
- GENERate bulls by OPU/IVP to enter Sire Proving Scheme in 2005
- Develop an embryo genotyping system within GENERate
- Provide first commercial OPU/IVP service through Animal Breeding Services Ltd.



International

Activities

- International semen sales
- Fully owned subsidiaries in Australia and United Kingdom
- Joint Venture (50/50) marketing semen in Ireland.

Highlights 2002 - 2003

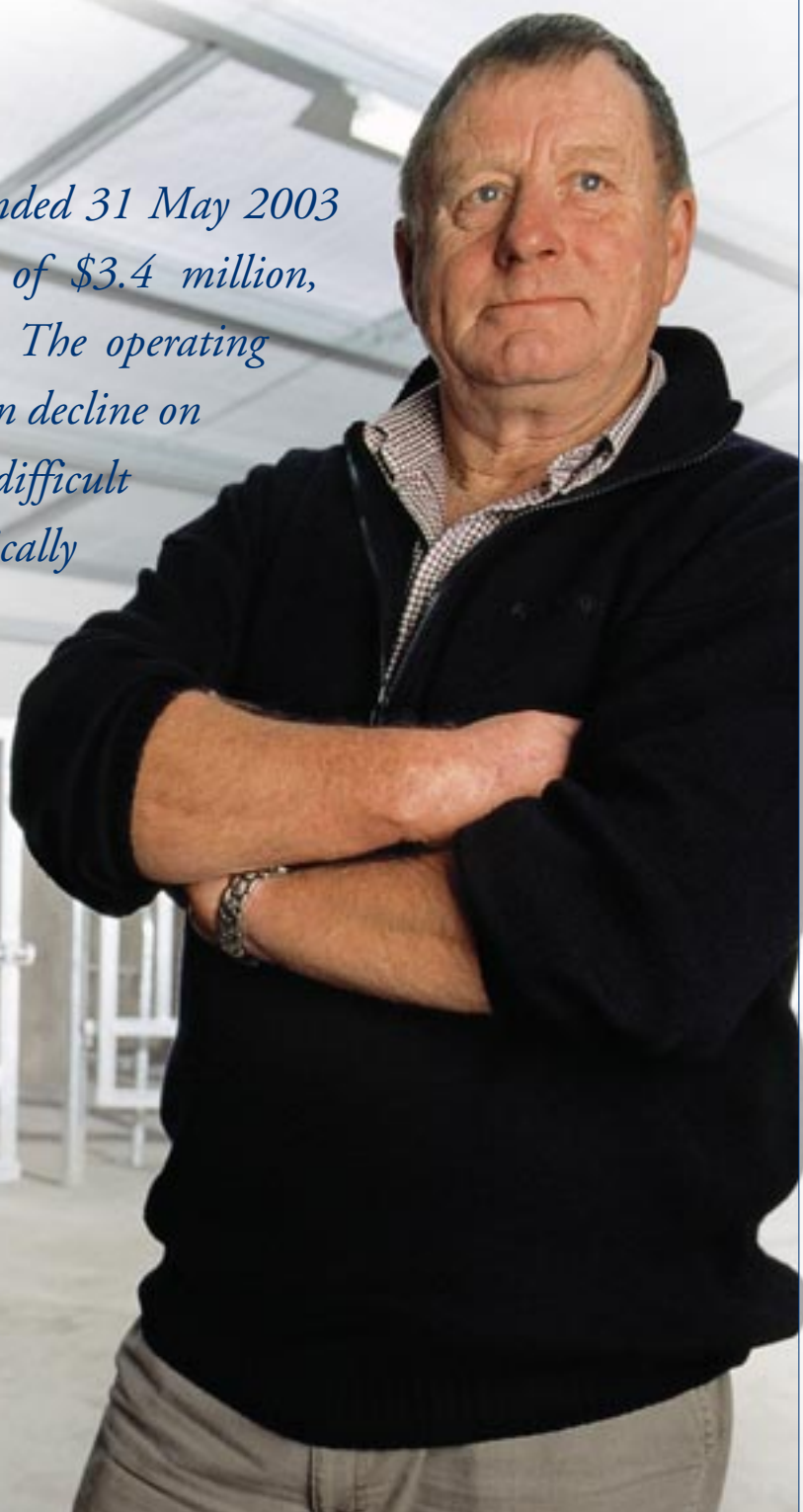
- Sales to more than 15 countries
- Australia: Livestock Improvement's Australian subsidiary, New Zealand Genetics (Australia) Pty Ltd, has experienced a very difficult trading year as a result of drought in Australia
- United Kingdom: Slightly increased unit sales over last year. Operational restructure completed to reduce fixed cost and improve long-term viability
- Ireland: Livestock Improvement's joint venture has continued to grow sales despite an overall decline in the market
- United States: In conjunction with agent, Taurus Service Inc, sales increased again and are now at an all time high
- Brazil, Chile and South Africa: Positive environment for growth in sales with excellent market partners NZBrasil Producao Animal Ltd, Cooprinsem Ltd and Genimex.

Plans for 2003 - 2004

- Consolidate and grow operating companies in Australia and United Kingdom
- Implement growth strategies for the Irish market
- Expand progeny testing programme in Australia
- Work with agents and representatives in other key markets to develop and implement strategies and plans
- Work with GeneMark to develop business plan for marketing GeneMark products to overseas semen companies and breed societies
- Continue to position Livestock Improvement New Zealand Genetics™ as the world's leading pasture based genetics.

Chairman's report

The financial result for year ended 31 May 2003 was a net surplus after tax of \$3.4 million, on revenues of \$92.4 million. The operating surplus represented a \$2 million decline on the prior year, as the result of difficult market conditions both domestically and internationally.



Financial performance

Lower payout seriously impacted the uptake of PREMIER SIREs, nominated semen, KAMAR detectors and Herd Testing, as New Zealand farmers endeavoured to reduce their costs to a minimum.

In addition to being adversely affected by the prevailing financial conditions, Herd Testing had to contend with drought, continuing herd amalgamations and the onset of competition.

Revenues for Livestock Improvement's International Division were \$1.1 million below those of the previous year reflecting conditions in primary markets: Australia suffered severe drought; South America, financial instability; and the United Kingdom the after-shocks of foot-and-mouth.

Livestock Improvement's management made strenuous efforts to mitigate the effects of revenue declines, and total expenditure within the parent company was restricted to the level of the previous year. It was not possible, however, to eliminate the effects of market contraction altogether.

Shareholding

As at 31 May 2003, 2,938,325 nominal shares have been issued to 12,323 shareholders and 62,269 shares have been converted into User Redemption Rights.

Proposed change to share structure

Following 18 months of extensive research, the Livestock Improvement Board began a consultation process with shareholders and interested parties on a change to the co-operative's share structure.

The proposed dual share structure is unique. It provides shareholders with some recognition of the value they have built in the organisation through their purchase of products and services, and provides a mechanism to invest in its future.

Key considerations in developing the proposal were :

- Maintaining the co-operative base
- User ownership and control
- Easy entry for new shareholders
- No risk of capital run on the co-operative
- Maintaining value of integration
- Maintaining focus on innovation
- Maintaining the core database.

The proposal provides shareholders with choice in their degree of investment in Livestock Improvement by trading investment shares on a closed market – and ensures the co-operative remains owned by the dairy farmer users of Livestock Improvement products and services.

The proposal signals an exciting leap forward for Livestock Improvement as it comes to terms with a truly commercial operation in place of the historic 'industry good' perception that governed earlier thinking.

Should the dual share proposal be endorsed by shareholders and the Minister of Agriculture, nominal shares currently held by shareholders will be subdivided into 11 shares – one co-operative control share (similar to the current nominal share), plus 10 investment shares.

The co-operative control share will retain the value of today's nominal share, \$1, and the investment shares will be traded within a range of two per co-operative control share up to a maximum of 30 per co-operative control share.

The basis for ownership of co-operative control shares will remain at 4% of shareholder's annual spend on qualifying products and services from Livestock Improvement.

Dividend

The Livestock Improvement Board was pleased to announce a distribution for dividend of 60 cents per share, which equates to 50% of the after tax profit.

Governance

In accordance with the constitution, Directors Murray Jagger (Region 1), Ron Jackways (Region 2) and Bryan Guy (Region 7) retired by rotation as elected Directors. However, they were eligible for re-election and were subsequently nominated and re-elected unopposed.

The constitution allows for the appointment of three independent directors. In accordance, the appointment of Graham Fraser and Phillip Lough as independent Directors was ratified by shareholders at the 2002 Annual Meeting. Shareholders attending the 2003 Annual Meeting will be asked to ratify the appointment of Barry O'Donnell as an independent Director. His nomination is recommended by the Livestock Improvement Board and has the endorsement of the National Council.

Concerned Dairymen's Association

Most shareholders will be aware of longstanding legal action by the Concerned Dairymen's Association against NZ Dairy Board as first defendant and Livestock Improvement as second defendant.

Defence of the case, which began five years ago, has demanded a huge amount of time and money from the co-operative. At the time of publication of this Report, the hearing has concluded with judgement reserved.

Core Database

The deregulation and restructuring of the New Zealand dairy industry, of necessity, introduced a regime to ensure that Livestock Improvement's ownership and management of the core database continued to serve the interests of the dairy industry, fairly, impartially and efficiently.

Regulations were defined under the Dairy Industry Restructuring Act 2001 requiring Livestock Improvement to

- 1 Enter data from all herd testers into the core database at Livestock Improvement's expense.
- 2 Not enter into exclusive arrangements with other parties for access to the core database.
- 3 Comply with the decisions of the Core Database Access Panel (appointed by Government to oversee administration of the core database).
- 4 Operate and publish procedures for compliance with the Panel's decisions, confidentiality and pricing methodology for access.
- 5 Be audited at Livestock Improvement's expense for compliance with the Regulatory requirements.
- 6 Pay a levy to cover the cost of the Access Panel.
- 7 Apply to the Access Panel for core data which will be used by a Livestock Improvement partnership, joint venture or other business arrangement.

The deregulated environment saw, for the first time, competition in the field of herd testing. All providers of herd testing services are required to

- a obtain certification
- b comply with rules and standards defined in the Herd Testing Standards, and
- c supply herd testing data to the core database.

In addition Livestock Improvement must provide a nationwide herd testing service to which it consistently applies one pricing methodology.

The first 12 months in this new competitive environment has enabled Livestock Improvement and others to come to grips with the regulations, and it is expected that compliance will improve as understanding grows.

There is no question that Livestock Improvement has led the world in genetic gain, one contributor being the core database, and it is essential that all dairy breeding interests remain committed to ensuring these benefits continue for everyone involved in the industry.

A perception held by a small group, that the industry would be better served by relocating the core database to an 'industry good' organisation, suggests that NZ dairy farmers are happy to significantly increase the cost of breeding and undermine herd improvement.

Rigorous regulations are in place which ensure fairness, efficiency and impartiality in the management of an asset which has delivered unparalleled benefits to the industry, something Livestock Improvement is committed to ensuring continues into the future.

Farmer representation

Last year's Annual Meeting saw the structural separation of the National Council and Livestock Improvement Board. This autonomy has seen the National Council flourish and become an influential body in its own right.

The National Council is a more accessible and most effective sounding board for shareholder concerns and already this group has shown it is capable of providing useful feedback to the Livestock Improvement Board on a wide range of matters.

The National Council has assisted the Board over the last 12 months with constitutional matters and has actively participated in the development of the dual share proposal.

Vision for the future

Livestock Improvement continues to make significant investments into the products and services farmers will need in the future. This affirms a focus on innovation more important today than it has ever been in the past. There is, for example, a growing demand from the farm for solutions relating to large herd management and considerable progress can be reported in this area.

It is also clear that customised products, which add value on-farm, are a necessity in an environment that is constantly challenged to arrest falling revenues.

Livestock Improvement's investment in biotechnology is now bringing products to market, providing products that either reduce costs or add value for our shareholders.

The ability of farmers to embrace new technology is well proven as evidenced by the uptake of MINDAlink, and ongoing development of electronic recording systems will continue.

Livestock Improvement's traditional products will remain but the financial pressure on-farm means continual review to deliver more cost-effectiveness. The co-operative is well equipped to meet this demand through people and systems which are recognised as world leading.

Creating solutions for the world's best farmers is a fact.

Appreciation

There is no question that, as a herd improvement company, Livestock Improvement sets the standards internationally. This is largely due to the skill, dedication and loyalty of a large number of people – staff, Liaison Farmers, National Councillors, shareholders, Directors – all committed to the highest standards in all they do.

On behalf of the Livestock Improvement Board, I congratulate Chief Executive, Stuart Gordon, on the way he has molded Livestock Improvement and on his leadership in achieving staff commitment to achieving the co-operative's strategic goals.

To staff, whether in New Zealand or overseas, thank you for continuing to lift levels even further and to being the success factor in Livestock Improvement's continued success in all we do.

To the shareholder representatives, whether Liaison Farmers or National Councillors, your efforts are applauded.

To my fellow Board members, thank you for a big effort in a very busy year; the counsel and support you have given me is greatly appreciated.



David Milne
Chairman

Appreciation

Chief Executive's report

The prosperity of the New Zealand dairy industry depends on the level of payout. The decrease this season saw belts tighten, not only on-farm but within Livestock Improvement.



In response to the flat market, management conducted rigorous reviews of expenditure and made cuts wherever possible to ensure we could reach year-end returning a profit to our shareholders.

Reduced payout was not the only challenge in the market. For the first time Livestock Improvement faced competition in herd testing and herd recording, while in artificial breeding, competition remained intense.

It is therefore pleasing to report that losses of herd testing market share were minimal and, for the third year out of four, Livestock Improvement's share of the artificial breeding market has grown.

Livestock Improvement is thriving in the deregulated environment. We have grown the business during 2002-2003 and are well positioned to achieve our strategic objectives.

Innovation

Our first strategic objective is to increase real revenue through innovation.

MINDA

MINDA and its suite of products stands out as one of the most innovative programmes to be offered to farmers, echoed by the fact that more than 93% of New Zealand dairy farmers rely on MINDA for their herd recording.

MINDApro is an enhancement to MINDAlink providing farmers with highly sophisticated interactive herd recording. This software enables farmers to design herd reports uniquely suited to their individual operations. It has added another dimension of ease to the area of herd recording and farmers have been enthusiastic in their use and appreciation for all it offers.

Gene discovery

Livestock Improvement's commitment to discovering and commercialising genes which benefit New Zealand dairying, advanced to a higher level through BoviQuest, our joint venture with Fonterra owned ViaLactia Biosciences.

During the 2002-2003 season BoviQuest discovered two genes which affect milk production and Livestock Improvement was successful in obtaining the licensing rights.

Livestock Improvement artificial breeding bulls are genotyped for the Optimum and Quantum genes and a genotyping service is available from our GeneMark DNA Analysis Laboratory.

These discoveries, so soon after our collaboration with ViaLactia, reward shareholders' faith in our commitment to biotechnology and investment in pursuing the science to give New Zealand farmers an edge on the world market.

Electronic identification - Protrack

Improving identification of cows has been a challenge which has grown along with the scale of dairying. Effective animal identification in large herds is a real problem and it is with considerable satisfaction that we launched the Protrack farm automation system during the 2002-2003 season.

Protrack brings a new era of efficiency and simplicity to the identification and handling of cows, no matter the size of the herd. It enables farmers to identify and draft cows without moving from the pit of the farm dairy. Large herd owners in particular have been quick to see the advantages it brings in terms of the efficiency, accuracy and ease it brings to stock handling and sales are exceeding expectations.

Once-A-Day

The prospect of Once-A-Day milking has tantalised dairy farmers for years and Livestock Improvement's breakthrough research on a Once-A-Day Breeding Index finally brings that reality one step closer.

This breeding index, developed by, and exclusive to, Livestock Improvement enables us to identify the bulls which will sire cows suited to once-a-day milking and also enables farmers to identify the cows most suited to make the change to once-a-day milking.

Animal Breeding Services

Midway through the 2002-2003 season, Livestock Improvement acquired a majority shareholding in the reproductive technology company, Animal Breeding Services Ltd (ABS), based in Hamilton.

The four-way deal also saw specialist beef and sheep breeding company, Rissington Breedline, Animal Breeding Services General Manager John Hepburn and Veterinary Enterprises with minority interests.

This acquisition is already delivering value to Livestock Improvement in terms of profits and in ABS's acknowledged expertise in the field of embryo technology and artificial breeding across various species.

Intellitech Automation

This joint venture business which specialises in process automation robots, enjoyed some significant milestones during 2002/2003 –

- Patent granted on one robot from the range
- Developed a manufacturing system for the main robot model
- Won \$80,000 grant from Technology NZ for research and development
- Sold ILAS 3000 robots into Belgium and Denmark.

Performance

The second of our strategic objectives is to make a return on capital of 10% after tax through performance. Translated, this means maintaining or growing our market share, applying expert financial management and ensuring our processes are efficient and effective.

As mentioned at the start of this report, Livestock Improvement has retained or grown market share.

We have responded to the financial signals from the market and tightened our belts so we could meet budget and deliver a dividend to shareholders of \$1.7 million.

Livestock Improvement extended its South Island bases during the 2002-2003 season in recognition of the growth of the industry and the desire to provide South Island dairy farmers with the same levels of service enjoyed by their North Island counterparts.

The Invercargill base was enlarged and a Testlink Milk Analysis Laboratory opened in Christchurch to provide the South Island with a service infrastructure which will surpass farmer expectations in terms of speed, accuracy and efficiency of all services, in particular Artificial Breeding servicing and herd test turnaround times.

International

The profile of Livestock Improvement New Zealand Genetics™ is growing in our major markets of Ireland, United Kingdom and Australia, as farmers gain greater awareness and appreciation for the value of cows which turn grass into profit.

Customer focus

Our third strategic objective is captured in the term 'customer focus' which means setting and achieving the highest standards of business excellence for the co-operative.

Customer Satisfaction

Independent market research conducted during 2002/03 showed a continued significant improvement in overall customer satisfaction with Livestock Improvement.

Quality standards

The Livestock Improvement Sire Proving Scheme gained ISO9001 certification during the year.

Both Testlink Milk Analysis Laboratories achieved the rigorous ISO17025 quality standard.


Business excellence

Livestock Improvement's commitment to business excellence was rewarded with a Bronze Award in the New Zealand Business Excellence Awards, the first dairy industry organisation to win such an award. Our goal is to be awarded Silver in 2005.

The Baldrige Quality Criteria which apply to these awards are considered to be among the most rigorous in the world and shareholders can have confidence that their co-operative possesses standards, business operations and personnel which are, quite simply, world class.

Our success in these Awards, and in all we achieve, comes down to the quality of our people. Livestock Improvement has always attracted the best of the best, and I want to pay tribute to the efforts of our staff over the last year. Despite our geographical distribution and, often, isolation from each other, the Livestock Improvement team is like no other – united and committed to working towards improving the profitability of New Zealand dairy farmers.

That commitment is evident in this Annual Report.



Stuart Gordon
Chief Executive

Board of Directors



David Milne
Chairman, Elected Director



Stuart Bay
Deputy Chairman, Elected Director



Ronald Jackways
Elected Director



Peter Lynskey (John)
Elected Director



Murray Jagger
Elected Director



Bryan Guy
Elected Director



John Bicknell
Elected Director



Edward Coats (Ted)
Elected Director



Alvin Reid
Elected Director



Graham Fraser
Appointed Director



Phillip Lough
Appointed Director

(Shareholders will be asked to ratify the appointment of Barry O'Donnell as an appointed Director, at the Annual Meeting.)

National Council report

Since October 2002, the governance (Livestock Improvement Board) and representation (National Council) roles of the co-operative have been separate. The National Council has, in that time, developed systems and processes to enable it to fulfil its constitutional and representational duties.

Monitoring the Board

The Council has worked with Board and Management to ensure it has clear guidelines for its monitoring function and appreciates the receptiveness of both groups to its requests. All groups continue to work together to improve reporting as the co-operative evolves.

Communication/Liaison Farmers

The Council is identifying ways of communication with shareholders that will generate maximum opportunities for farmer involvement. Liaison Farmers have been surveyed and management is being consulted. Representation is taken very seriously and the Council always welcomes contact from its members.

Ward Boundaries

The Council has consulted Liaison Farmers to design an appropriate number of wards for effective representation. Shareholders will, at the Annual Meeting, be asked to support a resolution to reduce the current 36 wards needed when Board members were also National Councillors.

Council Meetings

This year two additional Council meetings were held to enable the Board to consult on the proposed new share structure. The Council appreciated the depth of information that was presented, and the number of people prepared to spend time with it to ensure queries were answered and understanding was comprehensive. A number of minor adjustments were made as a result of Council input.

In Summary

As you will have noted in this 2002-2003 Annual Report, this year has been disappointing for Livestock Improvement financially. Returns have been down on expectations mainly due to economic changes in the local industry and overseas. The Council shares that disappointment.

Councillors are excited by many new developments in Livestock Improvement. Gene discovery is one example from a list of innovations that will enhance the future of the co-operative.

It has been a pleasure to chair the Council this year. I lead a very committed team of farmer/shareholder Councillors who work hard on your behalf.



Barbara Kuriger
Chairman



National Council Representatives

Director Region One:

Roger Hutchings	09 401 9678
Jim Galloway	09 439 6007
Alan Davie-Martin	09 425 7663

Director Region Two:

Barry Shuker	09 235 2745
Neil Bateup	07 828 5832
Rick Matthews	07 829 8888

Director Region Three:

Vacancy	
Ross Goudie	07 863 6151
Gerard Van den Heuvel	07 884 5711

Director Region Four:

Wayne Berry	07 824 1617
Jeanette Quin	07 872 7978
Alan Morris	07 549 4625

Director Region Five:

Tom Williams	07 533 3502
Vacancy	
Brian Aspin	07 333 9386

Director Region Six:

Barbara Kuriger (Chairman)	06 763 8514
Gordon Glentworth	06 764 6704
Diane Jellyman	06 273 4278

Director Region Seven:

Noel Johnston	06 324 8628
Harvey Ebbett	06 376 6472
Bryan Weatherstone	06 307 7773

Director Region Eight:

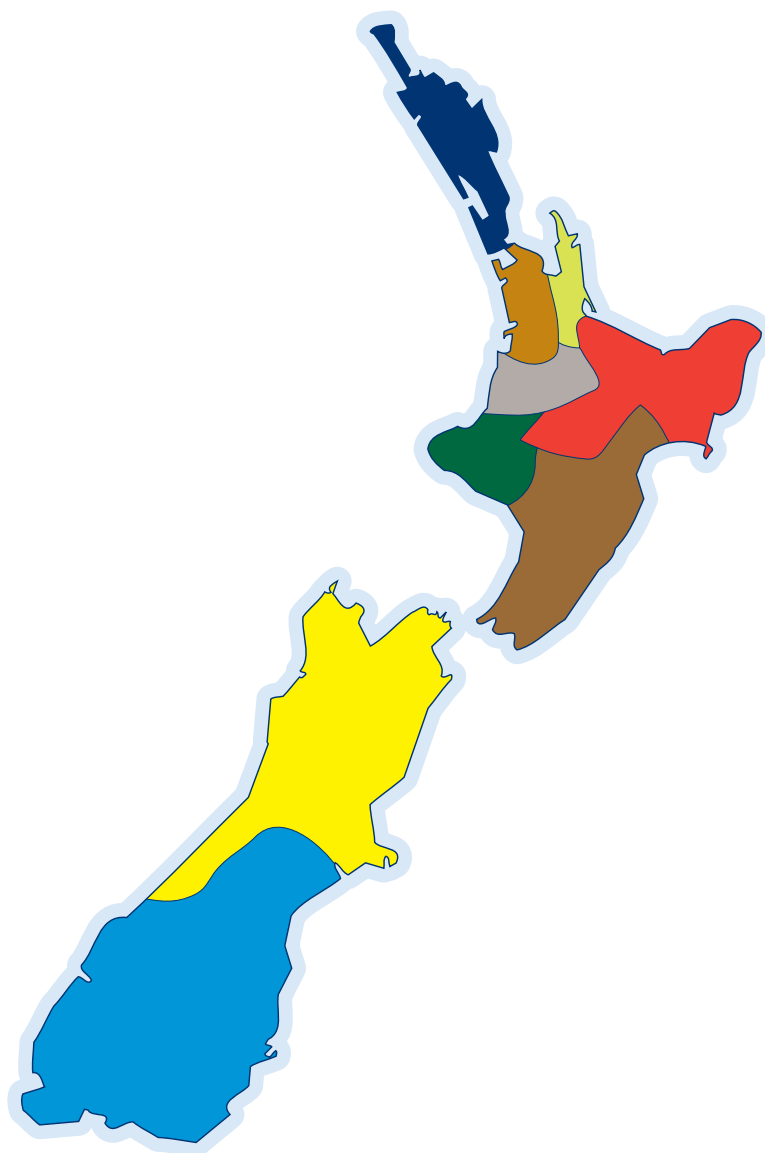
Kevin Straight	03 574 2259
John Vlaming	03 524 8179
Geoff Stevenson	03 302 7997

Director Region Nine:

John Van Polanen	03 302 4878
Hamish Anderson	03 418 2806
Lloyd McCallum	03 221 7297

Dairy Company Representatives:

Tatua:	Kevin Old	07 889 3901
Fonterra:	Brian Power	07 308 4846
Westland:	Jim Wafelbakker	03 755 4136



Corporate governance

Role of the Board of Directors

The Board is responsible for the direction and control of Livestock Improvement's activities. This responsibility includes such areas of stewardship as the identification and control of the company's business risks, the integrity of management information systems and reporting to shareholders.

Role of National Council

Livestock Improvement's National Council's primary role is to represent the voice of farmer shareholders expressed through the Liaison Farmer network or directly to members of the National Council.

Membership of the National Council comprises 27 farmer members plus four dairy company representatives in 36 Wards across New Zealand. National Councillors are elected by farmer shareholders within Wards.

Appointment and Retirement of Directors

Each of the elected Directors holds office as a Director for a period of three years. One third of elected directors retires from office each year. A retiring director is eligible for re-election as a director of the company.

The following directors retired by rotation in 2003 and were re-elected unopposed:

Murray Jagger	Region 1
Ron Jackways	Region 2
Bryan Guy	Region 7

Barry O'Donnell was appointed an Independent Director on 13 February 2003. In accordance with the constitution, shareholders will vote to ratify his appointment at the Annual Meeting.

Audit, Finance and Risk Committee

This is a sub-committee of the Board comprising five Directors. It liaises with the Co-operative's auditors to determine the extent and scope of the audit programme. It is responsible for establishing a framework of internal control mechanisms to ensure proper management of the Co-operative's business affairs and risk profile.



Financial statements

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for the year ended 31 May 2003

		Consolidated		Parent	
		2003	2002	2003	2002
	Note	\$'000	\$'000	\$'000	\$'000
Total operating revenue	1	92,434	92,343	87,787	88,291
Total operating expenses	2	(88,892)	(86,913)	(83,391)	(83,291)
Operating surplus before income tax		3,542	5,430	4,396	5,000
Income tax	3	(107)	(46)	-	-
Net surplus for the year		3,435	5,384	4,396	5,000
Net surplus comprises					
Parent interest		3,385	5,384	4,396	5,000
Minority interest		50	-	-	-

for the year ended 31 May 2003

	Consolidated		Parent	
	2003	2002	2003	2002
	\$'000	\$'000	\$'000	\$'000
Total recognised revenues and expenses				
Net surplus for the year:				
parent interest	3,385	5,384	4,396	5,000
minority interest	50	-	-	-
Translation difference	24	(5)	-	-
	3,459	5,379	4,396	5,000
Contributions from Owners				
Shares issued	448	-	448	-
Contributions from minority shareholders	295	-	-	-
	743	-	448	-
Distributions to owners				
Dividends:				
parent interest	(1,769)	(2,692)	(1,769)	(2,692)
minority interest	-	-	-	-
Repurchase of shares	(341)	(43)	(341)	(43)
	(2,110)	(2,735)	(2,110)	(2,735)
Movements in equity for the period	2,092	2,644	2,734	2,265
Equity at beginning of year	90,944	88,300	89,228	86,963
Comprising:				
parent interest	90,944	88,300	89,228	86,963
minority interest	-	-	-	-
Equity at end of year	93,036	90,944	91,962	89,228
Comprising:				
parent interest	92,691	90,944	91,962	89,228
minority interest	345	-	-	-

Livestock Improvement Corporation Limited **Statement of Financial Position**
as at 31 May 2003

	Note	Consolidated		Parent	
		2003	2002	2003	2002
		\$'000	\$'000	\$'000	\$'000
Current Assets					
Cash balances		19,903	26,511	19,165	25,542
Intra-group receivables		-	-	3,146	1,068
Trade receivables		9,105	8,228	6,136	6,496
Inventories	8	4,102	3,514	3,412	3,432
Other current assets		1,254	1,513	1,173	1,502
		34,364	39,766	33,032	38,040
Non-current Assets					
Investments	4	448	701	1,965	620
Bulls and database		22,500	22,500	22,500	22,500
Fixed assets	9	50,165	47,972	49,669	47,903
Goodwill	10	708	-	-	-
Development costs	11	233	-	233	-
		74,054	71,173	74,367	71,023
Total Assets		108,418	110,939	107,399	109,063
Current Liabilities					
Intra-group payables		-	-	3,146	1,068
Trade payables		6,509	10,142	3,523	9,012
Provisions	15	4,596	5,457	4,530	5,359
Prepaid receivables		291	817	291	817
		11,396	16,416	11,490	16,256
Non-current Liabilities					
Provisions	15	3,947	3,579	3,947	3,579
Other non-current liabilities		39	-	-	-
		3,986	3,579	3,947	3,579
Total Liabilities		15,382	19,995	15,437	19,835
Net Assets		93,036	90,944	91,962	89,228
Equity	6	93,036	90,944	91,962	89,228


DJ Milne, Chairman
 9 July 2003


SB Bay, Deputy Chairman
 9 July 2003

for the year ended 31 May 2003

	Note	Consolidated		Parent	
		2003	2002	2003	2002
		\$'000	\$'000	\$'000	\$'000
Net cash from/(used in) operating activities					
<i>Cash provided from:</i>					
Receipts from customers		90,694	88,485	84,543	84,345
Interest income received		1,230	1,754	1,237	1,765
		91,924	90,239	85,780	86,110
<i>Cash applied to:</i>					
Payments to suppliers and employees		(81,848)	(78,589)	(76,089)	(75,116)
Interest expense paid		(28)	(6)	(4)	(6)
Income tax paid		(367)	(168)	-	-
		(82,243)	(78,763)	(76,093)	(75,122)
	12	9,681	11,476	9,687	10,988
Net cash from/(used in) investing activities					
<i>Cash provided from:</i>					
Proceeds from sale of other non-current assets		335	236	335	236
		335	236	335	236
<i>Cash applied to:</i>					
Acquisition of shares		(1,484)	(350)	(1,484)	(350)
Acquisition of other non-current assets		(12,568)	(17,447)	(12,344)	(17,188)
		(14,052)	(17,797)	(13,828)	(17,538)
		(13,717)	(17,561)	(13,493)	(17,302)
Net cash from/(used in) financing activities					
<i>Cash provided from:</i>		448	-	448	-
Shares paid up		448	-	448	-
<i>Cash applied to:</i>					
Repurchase of shares		(341)	-	(341)	-
Dividends paid to shareholders of the Group		(2,678)	-	(2,678)	-
		(3,019)	-	(3,019)	-
		(2,571)	-	(2,571)	-
Net increase (decrease) in cash balances		(6,608)	(6,085)	(6,377)	(6,314)
Cash balances at beginning of year		26,511	32,596	25,542	31,856
Cash balances at end of year		19,903	26,511	19,165	25,542

for the year ended 31 May 2003**(a) ACCOUNTING ENTITY**

Livestock Improvement Corporation Limited (the Parent) is a company registered under the Companies Act 1993 and the Co-operative Companies Act 1996.

The Parent is a reporting entity for the purposes of the Financial Reporting Act 1993. The financial statements of the Parent have been prepared in accordance with the Financial Reporting Act 1993.

The Parent was previously a wholly owned subsidiary of the NZDB. As part of the dairy industry restructuring, the Parent's ownership was transferred to the farmers who utilise its services on 1 March 2002.

(b) GENERAL ACCOUNTING POLICIES

The general accounting policies for the measurement and reporting of earnings and financial position on an historical cost basis have been followed in the preparation of these accounts. The financial statements have been prepared based on the going concern concept.

(c) PARTICULAR ACCOUNTING POLICIES

The following particular accounting policies which materially affect the measurement of earnings and financial position have been applied.

(i) Foreign Currencies

Transactions involving foreign currencies are translated at rates of exchange ruling at the date of the transaction. Monetary amounts outstanding at balance date are converted using the year-end rate. All exchange differences are taken to the Statement of Financial Performance. Short-term transactions covered by forward exchange contracts are translated at the exchange rates specified in those contracts.

Translation of the financial statements of independent foreign operations

The assets and liabilities of the Group's and associate's overseas operations, being independent foreign operations, are translated at the exchange rates ruling at balance date. The revenues and expenses of these entities are translated at rates approximating the exchange rates ruling at the dates of the transactions. Exchange differences arising on the translation of independent foreign operations are recognised directly in the foreign currency translation reserve.

(ii) Fixed Assets and Depreciation

All owned items of property, plant and equipment are initially recorded at cost, and, except for land, depreciated. Initial cost includes the purchase consideration, or fair value in the case of donated asset, and those costs directly attributable to bringing the asset to the location and condition necessary for its intended use. Costs cease to be capitalised when substantially all the activities necessary to bring an asset to the location and condition for its intended use are complete. All feasibility costs are expensed as incurred. The useful economic lives of depreciating assets have been assessed as:

Buildings	40 years
Plant and Equipment	5 years
Vehicles	5 years
Office Equipment	5 years
Personal Computers	4 years
Other Computer Equipment	5 years
Computer Software	4 years

Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Assets acquired by way of finance lease are stated initially at an amount equal to the present value of the future minimum lease payments, and are depreciated as described above.

(iii) Bulls and Database

These assets are comprised of the pool of Breeding Bulls and the Parent's database.

Breeding Bulls

The pool of Breeding Bulls was acquired in May 1988 and it is the Parent's policy to maintain this pool. The composition of the pool constantly changes with the average bull having a productive breeding life of three years. All costs incurred in maintaining the pool including the costs of replacement bulls are expensed as they are incurred.

Accordingly, on the basis that the pool will be maintained, there is no defined economic life of this asset. Thus it is not considered appropriate to amortise the cost of this asset unless there is a permanent impairment in its value.

Livestock Improvement database

In May 1988, the Parent acquired the Livestock Improvement database as part of its acquisition of the net assets and operations of the Livestock Improvement Division of the NZDB and the six Livestock Improvement Associations. Under the Dairy Industry Restructuring Act 2001, the core database, covering some 40 fields of animal data, was defined. While the Livestock Improvement database includes these defined fields, no value is attributed to the core database.

All costs of maintaining and enhancing the Livestock Improvement database are expensed when incurred as a period cost. Accordingly there is no defined economic life of this asset.

Thus it is not considered appropriate to amortise the cost of this asset unless there is a permanent impairment in its value.

(iv) Inventories

Inventories are valued at the lower of cost or their net realisable value on a first in first out basis. The cost of frozen semen includes the direct cost of production.

(v) Accounts Receivable

Accounts Receivable are stated at estimated net realisable value.

(vi) Taxation

In accordance with the Dairy Industry Restructuring Act 2001, the Parent became taxable on 1 June 2001.

Income tax expense is recognised on the operating surplus before taxation adjusted for permanent differences between taxable and accounting income. Deferred tax is calculated using the comprehensive basis under the liability method. This method involves recognising the tax effect of all timing differences between accounting and taxable income as a deferred tax asset or liability in the statement of financial position. The future tax benefit or provision for deferred tax is stated at the income tax rates prevailing at balance date.

Future tax benefits are not recognised unless realisation of the asset is virtually certain.

Future tax benefits and provisions for deferred tax are not offset if they arise in different tax jurisdictions.

Any income tax effect of movements in reserves is recognised directly against the related reserve and allocated to deferred or current tax.

(vii) Basis of Preparing Consolidated Financial Statements

Subsidiaries

Subsidiaries, including in-substance subsidiaries, are those entities controlled, directly or indirectly, by the Parent. The financial statements of subsidiaries are included in the consolidated financial statements using the purchase method of consolidation.

Associates

Associates are entities in which the Group has significant influence, but not control, over the operating and financial policies. The Group's share of the net surplus/net deficit of associates is recognised as a component of operating revenue/expense in the statement of financial performance, after adjusting for the amortisation of goodwill arising on acquisition. Dividends received from associates are credited to the carrying amount of the investment in associates. The unamortised balance of goodwill arising on acquisition is included in the carrying amount of the associate.

Partnerships

Partnerships are those relationships that the Group has with other persons whereby the partners carry on a business in common with a view to profit. Where the Group has a controlling interest in a partnership it is accounted for in the consolidated financial statements as a subsidiary. Where the Group has significant influence over the operating and financial policies of the partnership it is accounted for in the consolidated financial statements as an associate.

Joint Ventures

Joint ventures are joint arrangements with other parties in which the Parent has several liability in respect of costs and liabilities, and shares in any resulting output. The Parent's share of the assets, liabilities, revenues and expenses of joint ventures are incorporated into the Parent and consolidated financial statements on a line-by-line basis using the proportionate method.

Goodwill Arising on Acquisition

Goodwill arising on the acquisition of a subsidiary or associate represents the excess of the purchase consideration over the fair value of the identifiable net assets acquired. Goodwill is amortised to the Statement of Financial Performance on a straight-line basis over the period during which benefits are expected to be derived - a period of 5 years.

(viii) Derivative Financial Instruments

The Group uses derivative financial instruments within predetermined policies and limits in order to reduce its exposure to fluctuations in foreign currency exchange rates and interest rates.

Derivative financial instruments that are designated as hedges of specific items or economic exposures are recognised on the same basis as the underlying hedged items. Where a hedge of an anticipated purchase or sale transaction is undertaken the exchange difference on the hedging transaction up to the date of the purchase or sale transaction, and any costs associated with the hedge transaction to that date, are deferred and included in the measurement of the purchase or sale transaction.

Derivative financial instruments that do not constitute hedges are stated at market value and any resultant gain or loss is recognised in the Statement of Financial Performance.

Where a derivative financial instrument, which is a hedge of an anticipated transaction, is terminated early but the anticipated transaction is still expected to occur, the deferred gain or loss that arose prior to termination continues to be deferred and is recognised as part of the transaction when it occurs. If the transaction is no longer expected to occur, the deferred gain or loss is recognised in the Statement of Financial Performance immediately. The Group does not engage in speculative transactions or hold derivative financial instruments for trading purposes.

(ix) Research and Development

Expenditure

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding. Development expenditure is expenditure on the application of research findings or other knowledge to a plan or design for the production of new or substantially improved products or services.

All research expenditure is recognised in the Statement of Financial Performance as incurred. Development expenditure is recognised as an asset when it can be demonstrated that the commercial production of the product or service will commence.

Development expenditure recognised as an asset is stated at cost and amortised on a straight-line basis over the period of expected benefits (5 years). Amortisation begins at the time that commercial production commences. All other development expenditure is recognised in the Statement of Financial Performance as incurred.

(x) Operating Leases

Payments made under operating leases are recognised in the Statement of Financial Performance on a basis representative of the pattern of benefits expected to be derived from the leased asset. Lease incentives received are recognised as an integral part of the total lease payments made.

(xi) Cash and Cash Equivalents

For the purpose of the Statement of Cash Flows, cash comprises cash balances (net of bank overdrafts) and demand deposits. Cash excludes bank bills that are not used as part of the Group's day-to-day cash management.

(xii) Changes in Accounting Policies

In the current year the Group changed its policy of accounting for investments in associates and subsidiaries in accordance with FRS-36 *Accounting for acquisitions resulting in combinations of entities or operations*, FRS-37 *Consolidating investments in subsidiaries*, and FRS-38 *Accounting for investments in associates*. The implementation of the new accounting policies has not had a material impact on the consolidated financial statements in the current year.

With the exception of the above changes in accounting policies, uniform accounting policies have been applied throughout the Group on a consistent basis with those of the previous year.

(xiii) Comparative Information

Certain comparative information has been reclassified in order to provide a more consistent basis for comparison.

for the year ended 31 May 2003

		Consolidated		Parent
	2003	2002	2003	2002
	\$'000	\$'000	\$'000	\$'000
1. Operating Revenue				
Operating revenue comprises				
Related-party sales revenue	-	-	1,510	1,083
External sales revenue	91,241	90,795	85,077	85,648
Interest income	1,193	1,548	1,200	1,560
Total Operating Revenue	92,434	92,343	87,787	88,291
	2003	2002	2003	2002
	\$'000	\$'000	\$'000	\$'000
2. Operating Expenses				
Operating expenses include:				
Interest expense	28	6	4	6
Equity accounted losses of associates	255	121	-	-
Depreciation of fixed assets:				
Buildings	512	374	512	374
Plant and equipment	3,006	2,724	2,918	2,714
Furniture and fittings	202	161	199	156
Vehicles	1,381	1,336	1,358	1,310
Computers and software	2,749	2,224	2,738	2,210
Amortisation of goodwill	109	-	-	-
Amounts incurred and expensed for research and development	7,199	5,923	7,322	5,923
Doubtful debts:				
Written off	37	107	32	62
Increase/(decrease) in provision	-	-	-	-
Provisions				
Employee entitlements	62	(27)	62	(27)
Employee retirement allowances	79	1,269	79	1,269
Operating lease expenses	490	306	363	292
Net foreign exchange loss	88	83	-	-
Loss on disposal of fixed assets	48	183	47	183
Employee remuneration:				
Fees to Directors	319	254	319	254
Staff salaries and wages	41,206	39,406	39,425	38,386
Auditor's remuneration:				
KPMG - audit services	37	34	37	30
KPMG - other services	97	79	97	79
I A Anderson & Co - audit services	9	10	-	-
Donations	-	-	-	-

		Consolidated		Parent
	2003	2002	2003	2002
3. Taxation	\$'000	\$'000	\$'000	\$'000
(a) Income Tax Expense				
Operating surplus before income tax	3,542	5,430	4,396	5,000
Permanent differences:				
Tax loss offset	-	-	-	383
Deductions arising from change in tax status	(11,505)	(29,386)	(11,505)	(29,386)
Other	1,129	1,597	856	1,523
Timing differences not recognised	(2,567)	7,415	(2,648)	7,414
Tax loss not recognised	9,724	15,148	8,901	15,066
	(3,219)	(5,226)	(4,396)	(5,000)
Taxable income	323	204	-	-
Tax expense @ 33%	107	67	-	-
Income tax over provided in prior year	-	(21)	-	-
Total income tax expense:	107	46	-	-
Current taxation	107	46	-	-
Deferred taxation	-	-	-	-
(b) Imputation Credits				
Balance at beginning of year			-	-
Income tax paid			-	-
Balance at end of year			-	-
The imputation credits are available to shareholders of the parent:				
Through the parent	-	-		
Through subsidiaries	651	284		
(c) Deferred Taxation				
The income tax benefit of timing differences that are not recognised are \$1.607 million (2002 : \$2.454 million)				
(d) Tax Losses				
Unrecognised tax losses available for offset against future assessable income:				
Tax losses	24,871	15,148	23,967	15,066
Tax saving thereon	8,207	4,999	7,909	4,972

A future tax saving will also arise over approximately five years from the ability to depreciate certain fixed assets from a higher cost or book value for tax purposes than applies for accounting purposes. The associated contingent tax benefit has reduced the current year's tax by \$3.797 million (2002 \$8.553 million) and the balance, which has not been recognised in the financial statements, is \$3.378 million (2002 \$7.175 million).

The ability to utilise these tax losses depends on the generation of sufficient assessable income in the respective tax jurisdictions.

		Consolidated		Parent
		2003	2002	2003
		\$'000	\$'000	\$'000
4. Investments				
Non-current investments				
Shares in listed companies	4	4	4	4
Shares in unlisted companies	37	35	37	35
Investments in subsidiaries	-	-	1,788	307
Investment in associates	407	662	136	274
	448	701	1,965	620
(a) Carrying amount of associates	662	783		
Carrying amount at beginning of year	(255)	(121)		
Share of total recognised revenues and expenses				
Equity accounted value of investment	407	662		
(b) Included within the above carrying value is goodwill relating to investment in associate				
Goodwill arising on acquisition of associate	271	271		
Accumulated amortisation	(144)	(90)		
Net carrying amount	127	181		
(c) Results of associates				
Equity accounted earnings comprise:				
Share of surplus (loss) before income tax	(201)	(67)		
Income tax	-	-		
Share of net surplus (loss)	(201)	(67)		
Amortisation of goodwill	(54)	(54)		
Total recognised revenues and expenses	(255)	(121)		

In December 2001 the Parent acquired a 50% holding in Intellitech Automation Limited. The Group has equity accounted the result of Intellitech Automation Limited for the year. The Group has also equity accounted the unaudited result of NZ Genetics (IRE) Limited for the year.

5. Acquisiton of Subsidiary

On 1 October 2002 the Parent acquired 70% of the shares of Animal Breeding Services Limited, a company specialising in livestock reproductive technologies. The contribution of *Animal Breeding Services Limited* to the consolidated net surplus for the period 1 October 2002 to 31 May 2003 was \$139,483 (after the elimination of intra-group transactions).

The acquisition was accounted for using the purchase method with the resulting goodwill being amortised in accordance with the Group's policy.

The acquisition had the following effect on the consolidated financial position at acquisition:

	2003 \$'000
Current Assets	
Receivables	885
Inventories	316
Other current assets	29
	1,230
Non-current Assets	
Fixed assets	310
	310
Current Liabilities	
Trade creditors	294
Provisions	202
Other current liabilities	34
	530
Non-current Liabilities	
Other non-current liabilities	49
	49
Net Assets	961
Minority interest	295
Net assets acquired	666
Cash paid	1,483
Goodwill arising on acquisition	817

6. Capital

The Parent had 2,938,325 shares on issue at balance date. The shares have a nominal value of \$1 each. All shares confer identical rights, privileges, limitations and conditions on the holders of the shares. The Parent also had 62,269 User Redemption Rights on issue. These confer the right to convert to shares should the holder be required to purchase additional shares in the future, and have a nominal value of \$1 each. User Redemption Rights do not confer voting or dividend payment rights.

		Consolidated		Parent	
	2003	2002	2003	2002	
7. Foreign Currency Translation Reserve	\$'000	\$'000	\$'000	\$'000	
Balance at beginning of year	(11)	(6)	-	-	
Difference arising on translation of independent foreign operations	24	(5)	-	-	
Balance at end of year	13	(11)	-	-	

		Consolidated		Parent	
	2003	2002	2003	2002	
8. Inventories	\$'000	\$'000	\$'000	\$'000	
Semen	1,361	1,390	1,323	1,390	
Artificial Breeding tradeable products	639	673	639	673	
Livestock	516	458	389	458	
National Milk Analysis Centre	212	170	212	170	
Herd Testing Brackets and Bolts	120	59	120	59	
Equipment	745	759	724	677	
Sundry	5	5	5	5	
Drugs and consumables	125	-	-	-	
Stockfeed	67	-	-	-	
Embryos	312	-	-	-	
	4,102	3,514	3,412	3,432	

Only that semen projected to be sold in the next financial year has been valued at cost and included in the accounts on the assumption that it is fully usable. All other semen stock has been included at nil realisable value.

		Consolidated		Parent
	2003	2002	2003	2002
9. Fixed Assets	\$'000	\$'000	\$'000	\$'000
Land				
At cost	6,821	6,829	6,821	6,829
Buildings				
At cost	20,616	19,991	20,616	19,991
Accumulated depreciation	(4,147)	(3,633)	(4,147)	(3,633)
	16,469	16,358	16,469	16,358
Plant and Equipment				
At cost	23,992	23,270	23,515	23,208
Accumulated depreciation	(13,346)	(12,745)	(13,177)	(12,695)
	10,646	10,525	10,338	10,513
Furniture and Fittings				
At cost	2,397	2,192	2,336	2,140
Accumulated depreciation	(1,867)	(1,684)	(1,819)	(1,634)
	530	508	517	506
Vehicles				
At cost	8,676	8,369	8,493	8,274
Accumulated depreciation	(5,308)	(4,945)	(5,272)	(4,879)
	3,368	3,424	3,221	3,395
Computers and Software				
At cost	23,282	19,467	23,170	19,362
Accumulated depreciation	(10,951)	(9,139)	(10,867)	(9,060)
	12,331	10,328	12,303	10,302
Total net carrying amount	50,165	47,972	49,669	47,903

At 31 May 2003 the Directors consider the fair value of land and buildings to be approximately \$30 million in respect of the Group and the Parent. The Directors have made their assessment based on the last independent valuations carried out during June 2001 plus the cost of additional buildings completed since.

		Consolidated		Parent
	2003	2002	2003	2002
	\$'000	\$'000	\$'000	\$'000
10. Goodwill				
Balance at beginning of year	-	-	-	-
Goodwill arising on acquisition	817	-	-	-
Amortised	(109)	-	-	-
Balance at end of year	708	-	-	-

11. Development Costs

Development costs arise from the Group's activities in developing new products and services. Only those costs relating to products on services which are to be marketed are capitalised. These costs are amortised over five years.

		Consolidated		Parent
	2003	2002	2003	2002
	\$'000	\$'000	\$'000	\$'000
Balance at beginning of year	-	-	-	-
Costs capitalised	233	-	233	-
Amortisation	-	-	-	-
Balance at end of year	233	-	233	-

12. Net Cash Flow From (Used In) Operating Activities

The following is a reconciliation between the surplus after income tax shown in the Statement of Financial Performance and the net cash flow from/(used in) operating activities.

	Consolidated		Parent	
	2003	2002	2003	2002
	\$'000	\$'000	\$'000	\$'000
Surplus after income tax	3,435	5,384	4,396	5,000
Items classified as investing/ financing activities				
(Gain)/loss on sale of other non-current assets	48	183	47	183
Non-cash items				
Depreciation	7,850	6,819	7,725	6,764
Equity accounted losses	255	121	-	-
Goodwill	109	-	-	-
Movement in working capital				
(Increase)/decrease in inventories	(299)	(29)	20	53
Decrease/(increase) in other receivables	270	(2,111)	(1,389)	(2,394)
Increase/(decrease) in income tax payable	(66)	(123)	-	-
(Decrease)/increase in other payables	(1,921)	1,232	(1,112)	1,382
Net cash from/(used by) operating activities	9,681	11,476	9,687	10,988

13. Operating Lease Commitments

The Group has the following future operating lease commitments:

	Consolidated		Parent	
	2003	2002	2003	2002
	\$'000	\$'000	\$'000	\$'000
Non-cancellable operating lease rentals are payable as follows:				
Not later than one year	521	253	410	240
Later than one year but not later than two years	455	141	355	141
Later than two years but not later than five years	1,159	334	951	334
Later than five years	1,152	270	1,152	270
	3,287	998	2,868	985

14. Financial Instruments

Exposure to currency, interest rate and credit risk arises in the normal course of the Group's business. Derivative financial instruments are used as a means of reducing exposure to fluctuations in foreign exchange rates and interest rates. While these financial instruments are subject to the risk of market rates changing subsequent to acquisition, such changes would generally be offset by opposite effects on the items being hedged.

(a) Foreign Currency Risk

Foreign currency risk is the risk that the value of the Group's assets and liabilities will fluctuate due to changes in foreign exchange rates. The Group is exposed to currency risk as a result of transactions that are denominated in a currency other than the respective Parent's functional currency. Such transactions which would typically expose the Group to foreign currency risk include exported sales, imported purchases, purchases of certain plant and machinery and offshore investments, which include subsidiaries and associates. The currencies, giving rise to currency risk, in which the Group primarily deals are Great British Pounds, United States Dollars, Australian Dollars and Euros.

The Group's policy is to hedge 100% of all existing foreign currency exposures. The Group hedges its exposures by using forward exchange contracts.

(b) Interest Rate Risk

Interest rate risk is the risk that the value of the Group's assets and liabilities will fluctuate due to changes in market interest rates. The Group is exposed to interest rate risk primarily through its cash balances and advances.

(c) Credit Risk

Credit risk is the risk that the counterparty to a transaction with the Group will fail to discharge its obligations, causing the Group to incur a financial loss. The Group is exposed to credit risk through the normal trade credit cycle, advances to third parties and through the use of derivative financial instruments. No collateral is required in respect of financial assets. Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit over a certain amount. Reputable financial institutions are used for investing and cash handling purposes. A sum of \$19.20 million is deposited with Westpac (2002 \$25.55 million). At balance date there were no other significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying value of each financial asset in the Statement of Financial Position. The maximum exposure to credit risk arising from amounts receivable under forward exchange contracts is \$0.453 million (2002: \$0.323 million) and for amounts payable under forward exchange contracts is \$0.552 million (2002: \$1.680 million).

(d) Fair Values

The fair values of the Group's financial instruments do not differ significantly from their carrying values shown in the Statement of Financial Position.

		Consolidated		Parent
	2003	2002	2003	2002
15. Provisions	\$'000	\$'000	\$'000	\$'000
Current				
Employee Entitlements	1,748	1,592	1,682	1,561
Sire Proving Rebates	1,065	1,106	1,065	1,106
Taxation	-	67	-	-
Dividends	1,783	2,692	1,783	2,692
	4,596	5,457	4,530	5,359
Non Current				
Employee Entitlements	1,289	1,269	1,289	1,269
Sire Proving Rebates	2,658	2,310	2,658	2,310
	3,947	3,579	3,947	3,579

		Consolidated		Parent
	2003	2002	2003	2002
16. Provision for Employee Entitlements	\$'000	\$'000	\$'000	\$'000
Balance at beginning of year	2,861	1,542	2,830	1,520
Additional provision made	3,250	3,033	3,190	3,002
Amount utilised	(3,074)	(1,714)	(3,049)	(1,692)
Balance at end of year	3,037	2,861	2,971	2,830
Current	1,748	1,592	1,682	1,561
Non-current	1,289	1,269	1,289	1,269

The provision for employee entitlements relates to employee benefits such as accrued annual leave and retirement allowances. The provision for retirement allowances is affected by the estimate of eligibility for the allowance (the employee must continue in employment until eligible for National Superannuation). The retirement allowance portion extends out over the next 30 years.

		Consolidated		Parent
	2003	2002	2003	2002
17. Provision for Sire Proving Rebates	\$'000	\$'000	\$'000	\$'000
Balance at beginning of year	3,416	3,121	3,416	3,121
Additional provision made	1,614	1,533	1,614	1,533
Amount utilised	(1,307)	(1,238)	(1,307)	(1,238)
Balance at end of year	3,723	3,416	3,723	3,416
Current	1,065	1,106	1,065	1,106
Non-current	2,658	2,310	2,658	2,310

The provision for sire proving rebates relates to the (rebated) cost of herd testing daughters resulting from sire proving inseminations. The provision is affected by a number of estimates including the expected number of heifer calves born and raised, and the herd testing options used. The non-current portion is payable within 2 years.

		Consolidated		Parent
	2003	2002	2003	2002
18. Provision for Dividends	\$'000	\$'000	\$'000	\$'000
Balance at beginning of year	2,692	-	2,692	-
Additional provision made	1,769	2,692	1,769	2,692
Amount utilised	(2,678)	-	(2,678)	-
Balance at end of year	1,783	2,692	1,783	2,692
Current	1,783	2,692	1,783	2,692
Non-current	-	-	-	-

The provision for dividends relates to the Directors' declaration on 20 May 2003 of a dividend payment representing approximately 50% of the consolidated after-tax profit. Payment date is 31 July 2003.

19. Contingent Liabilities

In the normal course of business the Parent is subject to claims against it. A claim has been made by the Concerned Dairyman's Association in relation to the Animal Evaluation Model. The Parent has been named as second defendant in an action for damages, which have yet to be fully quantified in the plaintiffs' statement of claim. This and other claims are being contested and defended. Having received legal advice and made their own enquiries, the Directors do not expect that the financial outcome will have a material adverse effect on the Group's financial position. No provision has been made in the financial statements.

20. Group Investments

The Group has the following significant subsidiaries and associates:

Name	Country of Incorporation	Class of Share	Voting Interest Held		Balance Date	Principal Activity
			2003 %	2002 %		
Subsidiaries						
LIC (NZ) Ltd	NZ	Ordinary	100	100	31 May	Semen sales
LIC (UK) Ltd	UK	Ordinary	100	100	31 May	Semen sales
NZ Genetics (Aust) Pty Ltd	Australia	Ordinary	100	100	30 June	Semen sales
LIC Bovine Ltd	NZ	Ordinary	100	100	31 May	Research
Animal Breeding Services Ltd	NZ	Ordinary	70	0	31 May	Reproductive Technologies
[Animal Breeding Services Ltd has a 55% interest in Equine Fertility Services Ltd which specialises in reproductive technologies for horses]						
Associates						
NZ Genetics (IRE) Ltd	Ireland	Ordinary	50	50	31 August	Semen sales
Intellitech Automation Ltd	NZ	Ordinary	50	50	31 May	Robot sales

21. Segmental Information

The Parent and Group predominantly provides goods and services to the New Zealand pastoral farming sector:

Any operations conducted outside of New Zealand, only facilitate export sales from domestic operations and are therefore not deemed to be separate geographical segments.

22. Capital Commitments

No capital commitments exist at balance date.

23. Related Party Transactions

(a) Parent Company

The Parent was previously a wholly owned subsidiary of the New Zealand Dairy Board (NZDB). As part of the dairy industry restructuring the Parent's ownership was transferred on 1 March 2002 to the farmers who utilise its services.

(b) Identity of related parties with whom material transactions have occurred

Note 20 identifies all entities in which the Group has an interest. All of these entities along with the elected Directors are related parties of the Parent.

(c) Types of related party transaction

The Parent enters into transactions with its subsidiaries in the ordinary course of business as follows:

- Treasury; and
- Sales and services.

All directors, excluding Messrs Lough, Fraser and O'Donnell, are customers of Livestock Improvement and purchase products and services for their farming activities on an ongoing basis.



Audit Report

To the shareholders of Livestock Improvement Corporation Limited

We have audited the financial statements on pages 22 to 42. The financial statements provide information about the past financial performance and financial position of the company and group as at 31 May 2003. This information is stated in accordance with the accounting policies set out on pages 26 to 29.

Directors' responsibilities

The Directors are responsible for the preparation of financial statements which give a true and fair view of the financial position of the company and group as at 31 May 2003 and the results of their operations and cash flows for the year ended on that date.

Auditors' responsibilities

It is our responsibility to express an independent opinion on the financial statements presented by the Directors and report our opinion to you.

Basis of opinion

An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. It also includes assessing:

- the significant estimates and judgements made by the Directors in the preparation of the financial statements;
- whether the accounting policies are appropriate to the company's and group's circumstances, consistently applied and adequately disclosed.

We conducted our audit in accordance with New Zealand Auditing Standards issued by the Institute of Chartered Accountants of New Zealand. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to obtain reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Our firm has also provided other services to the company and certain of its subsidiaries in relation to taxation and general accounting services. Partners and employees of our firm may also deal with the company and group on normal terms within the ordinary course of trading activities of the business of the company and group. These matters have not impaired our independence as auditors of the company and group. The firm has no other relationship with, or interest in, the company or any of its subsidiaries.

Unqualified opinion

We have obtained all the information and explanations we have required.

In our opinion:

- proper accounting records have been kept by the company as far as appears from our examination of those records;
- the financial statements on pages 22 to 42:
 - comply with New Zealand generally accepted accounting practice;
 - give a true and fair view of the financial position of the company and group as at 31 May 2003 and the results of their operations and cash flows for the year ended on that date.

Our audit was completed on 9 July 2003 and our unqualified opinion is expressed as at that date.

Hamilton

for the year ended 31 May 2003**Activities**

The Parent is primarily involved in the development, production and marketing of artificial breeding and herd testing services to the New Zealand dairy industry, the control and maintenance of the Livestock Improvement Dairy Herd Improvement Database, and the execution of research relating to dairy herd improvement.

The Parent was previously a wholly owned subsidiary of the New Zealand Dairy Board (NZDB). As part of the dairy industry restructuring, the Parent's ownership was transferred to the farmers who utilised its services on 1 March 2002. The Parent continues the Dairy Herd Improvement activities previously provided by the six Livestock Improvement Associations and the Livestock Improvement Division of the NZDB.

During the financial year, the Parent acquired a 70% holding, Animal Breeding Services Ltd, a company specialising in animal reproductive technologies.

Directors and Remuneration

Directors of the Parent received the following remuneration:

	<i>Fees</i>
	<i>\$000</i>
D J Milne	63
S B Bay	38
J E Bicknell	24
E G Coats	24
B R Guy	24
R D Jackways	24
M E Jagger	24
P J Lynskey	24
A J Reid	24
G A Fraser	20
P V Lough	20
B J O'Donnell	10
	<u>319</u>

Directors of the subsidiary companies were not paid fees.

Entries Recorded or to be Recorded in the Interests Register

A Directors' Interests in Transactions During the Financial Year

S Bay: reaffirmed earlier disclosures that he has been a Director of:

- ViaLactia Biosciences Limited - Director since March 2000, ceased in December 2002
- South Auckland Independent Testing Society Ltd – Director October 1993, ceased in July 2002

and was therefore interested in all transactions between these companies and Livestock Improvement Corporation and/or its subsidiaries, until December 2002.

S Bay: declared that he had sold one bull calf to the Company under the Contract Mating Scheme for \$2,500.

A Reid: reaffirmed earlier disclosures that he has been, and remains, a Director of:

- Dexcel Holdings Limited - Director since March 2001
- Dexcel Limited - Director since March 2001

and will therefore be interested in all transactions between these companies and Livestock Improvement Corporation and/or its subsidiaries.

A Reid: declared that he sold one cow to the Company for \$1,687.50.

G Fraser: affirmed that he has been and remains a Director of:

- Skellmax Industries Ltd - Director since May 2002

and will therefore be interested in all transactions between this company and Livestock Improvement Corporation and/or its subsidiaries.

P Lough: affirmed that he has been and remains a Director of:

- Tatua Co-operative Dairy Co Ltd - Director since November 2002
- Meridian Energy Ltd - Director since August 1999

and will therefore be interested in all transactions between these companies and Livestock Improvement Corporation and/or its subsidiaries.

B O'Donnell: affirmed that he has been and remains a Director of:

- Dexcel Holdings Ltd - Director since March 2003
- Dexcel Ltd - Director since March 2003

and will therefore be interested in all transactions between these companies and Livestock Improvement Corporation and/or its subsidiaries.

All Elected Directors - are customers and shareholders of Livestock Improvement Corporation Limited and purchase products and services for their farming activities on an ongoing basis.

B Share Dealings of Directors

The Directors other than the independent directors (either in their own names and/or in the name(s) of their dairy farming entities) as qualifying users of Livestock Improvement Corporation's products and services are holders of the following shares:

	<i>Shares</i>
D J Milne	299
S B Bay	1,374
J E Bicknell	460
E G Coats	508
B R Guy	869
R D Jackways	1,468
M E Jagger	441
P J Lynskey	1,206
A J Reid	2,600

C Loans to Directors

There have been no loans to Directors during the year.

D Directors' Indemnity and Insurance

The Company has issued a Deed of Indemnity and insured all its Directors against liabilities to other parties (except the Company or a related party) that may arise from their positions as Directors. The indemnity and insurance does not cover liabilities arising from criminal actions.

E Independent Directors

The appointment of Graham Fraser and Phillip Lough as independent Directors was approved by shareholders at the Annual Meeting in October 2002. Barry O'Donnell was appointed as independent Director in February 2003. Approval for his appointment will be sought from shareholders at the 2003 Annual Meeting.

Executive Employees' Remuneration

During the year the following numbers of employees received total remuneration, including benefits, of at least \$100,000:

100,000 – 109,999	9
110,000 – 119,999	9
120,000 – 129,999	2
130,000 – 139,999	1
140,000 – 149,999	1
150,000 – 159,999	1
160,000 – 169,999	3
170,000 – 179,999	1
250,000 – 259,999	1

Co-operative Company Resolution

Pursuant to section 10 of the Co-operative Companies Act 1996, the following resolution was passed unanimously at a meeting of all the Directors of the Company held on 14 August 2002.

That it be recorded:

- Livestock Improvement Corporation Limited ("Company") was registered as a co-operative company under the provisions of the Co-operative Companies Act 1996 ("Act") on 1 March 2002
- In the opinion of the Board of Directors, the Company has been a co-operative company from that date to the end of the accounting year ended 31 May 2003
- The grounds for this opinion are:
 1. The principal activity of the Company involves supplying artificial breeding, herd testing, herd recording and other services to transacting shareholders (as that term is defined in section 4 of the Act). Accordingly, the principal activity of the Company is, and is stated in the Constitution of the Company as being, a co-operative activity (as that term is defined in section 3 of the Act); and
 2. Not less than 60% of the voting rights attached to shares in the Company are held by transacting shareholders.

