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COMPANY RESEARCH
12 AUGUST 2022

Zespri
FY22 results and company overview

Private Wealth Research

Current Results
On 8 July, Zespri (ZGL) released its full year operating statistics **for the fiscal period ending 31 March 2022**. ZGL delivered a record FY22 net profit after tax of $361.5 million, along with a strong (second best) orchard gate return per tray for NZ growers.

While sales of NZ fruit came in lighter than expected, this was largely offset by stronger gains from hedging of $108.4M which is used to mitigate foreign exchange risk for growers and shareholders.

As a result of changes to international accounting standards, cloud computing research and development costs of $39.75M were recognised as an expense in FY22. Computer software restatement adjustments were also recognised for FY20 and FY21. Horizon is a 4-year programme which will result in expenditure incurred upfront through to FY24. It is a phased approach to modernise ZGL's systems and processes to support future growth. The financing & offshore supply chain components of the upgraded SAP Analytics Cloud platform are expected to go live in November.

FY22 growing season (FY23 results)
The NZ Supply season was expected to have a record-breaking crop of at least 191 million trays of kiwifruit. However, forecast revisions indicate this year's volume will be below 2021, likely due to labour supply, crop loading, weather, and higher than planned fruit loss. The total New Zealand crop is estimated to be 168.4M trays supplied for the 2022 growing season (162.5M trays sold after accounting for onshore/offshore fruit loss), a reduction of 6.3% from 2021.

Supply chains and inflation are key issues of 2022, affecting virtually every commodity at every level. The ongoing disruption has been shaped by multiple interrelated factors: higher input costs such as energy, packaging, and fertilisers; labour shortages; surging freight costs and shipping delays. Strong consumer demand has somewhat countered these issues.

ZGL has been able to use their scale to move from containers to charter vessels. Despite significant disruptions and congestion to sea freight services worldwide due to continued high volumes resulting in capacity constraints on vessels, ZGL has to date been able to ship 120M trays this year compared to 118M at the same time last year. To get fruit into market, ZGL has been able to move to new ports such as the Damaiyu Port in Taizhou, which is 400km south of Shanghai. During the lockdown period in Shanghai, where most of the city's 25 million residents were confined to their homes for almost two months from April 1 to June 1, ZGL was able to increase volume shipped to China. In comparison, other fresh produce shipments were down over the same period.

Of concern is a trend over recent seasons of increasing fruit loss, both onshore and offshore. This will require a collaborative industry response to address future season quality issues and prevent value erosion.

Key data

Code	ZGL
Current price	NZ$7.82
FY22 PE ratio	4.0x
Gross div yield	22.8%
Market cap (m)	NZ$1,433m

Zespri RubyRed

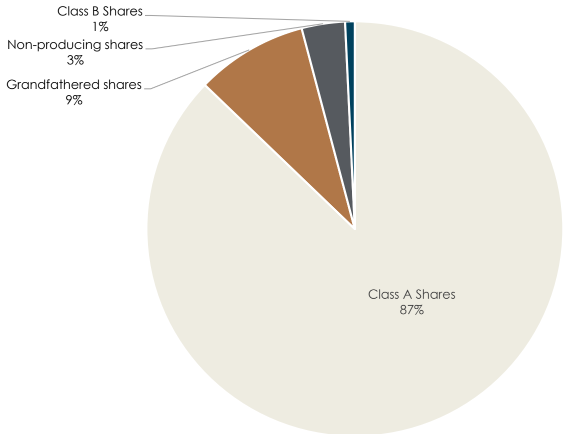
Initial reports indicate that the first year of sales of commercial volumes of Zespri RubyRed are going well, but it will take a few years to get up to significant volumes. There is some quality concern (consistency in colour and fruit softness), but the demand has been strong so far, particularly with younger customers.

Dividends

The Zespri Board declared a FY22 final net dividend of $0.29 per share (the gross dividend is also $0.29 due to no imputation credits attached). The total FY22 net dividend is $1.78 per share (the gross dividend is $2.36), up from a net dividend of $1.33 in FY21 (the gross dividend was $1.85). The Board also declared an 80% imputed first interim FY23 dividend of $0.89 per share (the gross dividend is $1.17). Both dividends ($1.18 per share) are to be paid on 12 August 2022, for shares on the register on 5 August 2022.

Only class A shares are eligible for ZGL dividends. When a shareholder becomes a non-producer, after 3 years their shares will convert to Class B shares. There are currently 7.5M shares held by non-producing shareholders, of which 1.37M have already converted to Class B shares. Further, there are 15.9M grandfathered shares that will convert to Class B shares on 14 March 2025. Class B shares have no entitlement to dividends.

Figure 1: ZGL Share Registry



Source: Company data, Craigs Investment Partners

Business Segments

ZGL has 3 operating business segments.

1) NZ kiwifruit

ZGL is a regulated monopsony. To access export markets outside of Australia, growers of kiwifruit in NZ must sell their kiwifruit to ZGL.

While ZGL is a commercial business, they must act in the best interests of NZ growers as well as their shareholders. Because of this, ZGL has agreed with NZ growers to target an EBIT margin of 1% on NZ Kiwifruit sales, which ensures that most of the returns for NZ kiwifruit are returned to growers through fruit and service payments. Any EBIT over 1% is shared equally between the growers and the shareholders by way of a loyalty payment to growers. On $3.5B of revenue attributable to NZ pools in FY22, after overheads, pool costs (freight, insurance, duty & customs etc.) and fruit and service payments to NZ growers, ZGL's EBIT was $25M (c0.7% margin). Of note for FY22, EBIT was lower due to higher expenses incurred on Horizon.

In comparison, a non-regulated commercial fruit marketing business would target a 3-7% EBIT margin on revenue.

2) Non-NZ Supply

ZGL's goal is to keep Zespri Kiwifruit on shelves all year through Zespri Global Supply (ZGS). A 12- month supply means ZGL can maintain trade relationships and shelf space throughout the year and keep kiwifruit in stock for customers, ultimately helping to support strong returns for both New Zealand and offshore growers.

This requires procuring fruit or contracting growers to grow fruit overseas to fill the shelves during the NZ off-season when NZ fruit is not available. For Hayward (Green), around 10M trays of fruit that is up to ZGL's specifications were procured in the spot market. ZGL brands the fruit and markets it for a profit. The procured Hayward allowed ZGL to achieve 12-month supply of Green in five markets in Europe and Singapore in FY22.

Zespri SunGold kiwifruit is produced under licence in Italy, France, Korea & Japan, with pre-commercial trial sites in Greece and the USA. Offshore growers are ZGL suppliers, meaning all their fruit goes to ZGL. They are treated like NZ growers in that there is a pool arrangement, and how the returns are calculated is similar.

Offshore growers cannot be shareholders; therefore, they cannot have any say in the business. Offshore growers of SunGold get higher per tray returns because they do not have costs like duty, freight, and storage over long periods of time. However, the yields are significantly lower. In comparison to NZ where yields averaged 15.3K trays/ha this year, offshore growers are achieving yields of c6.5K trays/ha.

This is the result of a combination of factors, including the weather being a lot harsher, with more temperature extreme events (i.e., heat waves and cold waves), different soil types, and several diseases, including PSA, which are not controlled as well as in NZ. As a result of lower returns, as well as competition from other crops, offshore growers do not pay for licences.

ZGL has not been able to achieve 12-month supply of SunGold. The offseason for NZ fruit is from Jan-May. Fruit grown in Italy does not have the same storage qualities as fruit from NZ, so when it is harvested in October it is not able to be held through until May when the first shipment of the next season arrives in Europe from NZ. ZGL is working on increasing the storage life in Italy to achieve 12-month supply of SunGold.

ZGL targets EBIT for non-NZ Kiwifruit of 3-5%. ZGL's FY22 EBIT on Non-NZ Supply was $26.9M from $538.5M revenue (c5% margin).

3) New Cultivars

This segment earns revenues from selling Plant Variety Right (PVR) licences and ongoing royalties.

In October 2021, the Kiwifruit Breeding Centre was established. The Centre is 50/50 jointly funded by Zespri and Plant & Food Research (PFR) – a Government-owned Crown Research Institute, and builds on a 30-year relationship between the organisations that has delivered varieties such as Hort16A, Zespri SunGold and Zespri RubyRed Kiwifruit.

With a focus on commercial success, the Centre's mission is to deliver new, proprietary varieties of kiwifruit and drive greater innovation within kiwifruit breeding. When a new variety of kiwifruit is commercialised, there is a royalty paid to ZGL. For the varieties that exist today, the royalty (which is charged to grower pool costs) is 3 percent on net sales. Net sales is defined as Gross Sales of kiwifruit less promotional rebates, claims and discounts. This royalty is made up of two components: 1.35 percent of this royalty is paid to PFR and 1.65 percent royalty income from new cultivars goes to ZGL.

The royalty income to ZGL in FY22 was $45.3M, up 15.3% on the prior year. The royalty income has been growing strongly as NZ & offshore volumes of SunGold have increased. ZGL has the PVR Rights in NZ to SunGold until Nov 2038 (USA until 2030). As such, we expect the royalty income stream to continue growing until FY39 at which point we expect a significant drop in royalty income. Note, this assumes there is not a pool of other PVRs coming through at critical mass.

ZGL also has the right to sell PVR licences, the most notable being SunGold and the more recently commercialised RubyRed. ZGL likes to build market demand ahead of supply, and will reduce/increase the number of hectares released, as they have done in FY23, to maintain the balance between supply and demand.

To allocate the licences, ZGL implement a closed tender bid process where the price ZGL receives per hectare is market driven. An independent review of the licence release mechanism is underway which is looking to determine whether there are different commercial models that could be used in future releases that address some of the pain-points growers have expressed about the current mechanism.

Cost model

Cost of sales totalled $3,562m in FY22 which included cost of procuring New Zealand and non-New Zealand fruit, freight, promotion and other costs, corporate overheads, research and development costs and depreciation and amortisation expenses. The largest items were:

- Cost of Fruit procurement and loyalty premium accounted for 74% of FY22 operating costs.
- Freight, promotion duties and other direct onshore and offshore costs comprised 17% of operating costs. Freight costs per tray saw a material increase in FY22. High freight costs have continued for the 2022 growing season, but we expect these to moderate in 2023 as shipping capacity returns to pre-COVID levels.
- Corporate and other overhead expenses were 9% of FY22 operating costs.
- R&D, depreciation and amortization were approximately 2% of total costs. R&D[1] was $71m in FY22, an increase of 37% on the year prior. This is largely due to expenses incurred for Project Horizon ($39.75M).
- Hedging reduced operating expenses by 2.8% in FY22. FY22 saw a large foreign exchange derivative gain of $108.4M due to the average New Zealand Dollar spot being higher than the average of all realised foreign exchange hedges for the season. During CY2020 the lower New Zealand Dollar spot allowed ZGL to hedge a portion of future seasons' returns at favourable rates leading to the gain.

[1] Including Cloud Computing research and development costs

Table 1: Historical financial information ($nzd)

	FY18a	FY19a	FY20a	FY21a	FY22a	FY23f	FY18-23 CAGR
NZ Kiwifruit	2,055	2,599	2,755	3,185	3,356	3,298	9.9%
Non-NZ Kiwifruit	264	312	369	474	539	576	16.9%
Sale of PVR licences	100	193	215	307	437	303	24.9%
PVR Royalty income	21	28	33	39	45	44	16.1%
Other Revenue	9	10	15	14	17	15	11.8%
Revenue	**2,448**	**3,142**	**3,386**	**4,019**	**4,394**	**4,237**	**11.6%**
Growth %	*5.7%*	*28.4%*	*7.8%*	*18.7%*	9.3%	-3.6%	n/a
Cost of Goods sold	-2,095	-2,603	-2,769	-3,180	-3,562	-3,448	10.5%
Gross Profit	**352**	**539**	**618**	**840**	**832**	**789**	**17.5%**
Growth %	*1.0%*	*53.1%*	*14.5%*	*35.9%*	*-0.9%*	*-5.2%*	n/a
Selling General & Admin Exp.	-229	-273	-308	-324	-351	-377	10.5%
Other Expenses	10	-20	-50	-85	20	-94	-257.6%
EBIT	**133**	**246**	**259**	**430**	**501**	**317**	**19.0%**
Net Interest Income	6	5	5	1	3	3	-16.3%
Other Non-Operating Exp.	6	4	14	-45	2	-2	n/m
Net Profit before Tax	**146**	**256**	**277**	**387**	**505**	**318**	**16.9%**
Income Tax	44	76	76	110	144	90	15.4%
Net Profit	**102**	**180**	**201**	**277**	**362**	**228**	**17.5%**
Growth %	*38.2%*	*76.6%*	*11.7%*	*38.0%*	*30.4%*	*-36.9%*	n/a
Earnings per share	0.56	0.99	1.10	1.51	1.97	1.23	17.0%
Free cash flow	48	145	332	359	410	189	31.5%
Dividend per share	0.51	0.92	0.94	1.33	1.78	1.11	16.8%
Net debt (cash)	-154	-193	-293	-385	-414	-414	21.9%

Key metrics	FY18a	FY19a	FY20a	FY21a	FY22a	FY23f	FY18-23 Change
Gross Margin	14.4%	17.2%	18.2%	20.9%	18.9%	18.6%	+420 bps
EBIT Margin	5.4%	7.8%	7.6%	10.7%	11.4%	7.5%	+200 bps
Free cash flow margin	2.0%	4.6%	9.8%	8.9%	9.3%	4.5%	+250 bps
EPS growth	37.6%	76.0%	11.2%	38.0%	30.4%	-37.3%	n/a
Dividend payout ratio	91%	93%	86%	88%	90%	90%	n/a
Return on Equity	59.9%	94.1%	90.1%	114.4%	125.8%	72.3%	+1200 bps
Net Debt/EBITDA	-1.1x	-0.8x	-1.1x	-0.9x	-0.8x	-1.3x	-

Source: Company data, Craigs Investment Partners

Forecasts

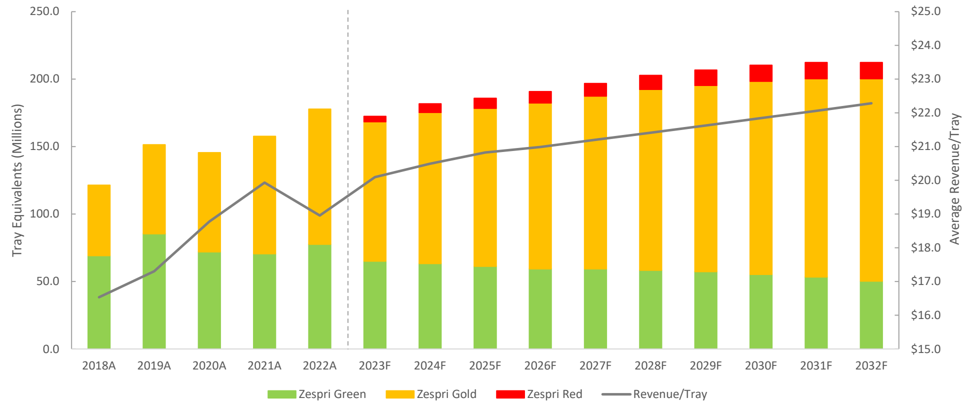
NZ kiwifruit

ZGL is projecting global demand for NZ kiwifruit to grow to 266m trays by FY32 (195M trays of SunGold, 56M trays of Green, and 15M trays of RubyRed) from 180m trays today (112M trays of SunGold, 66M trays of Green, and 2M trays of RubyRed).

Keeping demand ahead of supply is important. We are forecasting supply to reach 218M trays by FY32 (156M trays of Sungold, 50M trays of Hayward, and 13M trays of RubyRed). Increased supply will be driven by additional SunGold and RubyRed licence hectares, along with increases in yields on existing orchards. We are forecasting a steady decline in Hayward variety as orchards continue to cutover to other varieties.

With 175M trays sold in FY22, the average price per tray (across all varieties) dropped to $18.95, a 5% decrease on the year prior. With the lower crop predicted and higher inflation for FY23, we are forecasting a 6% rise in the price per tray to $20.10. We are forecasting further price rises of c1.2%/annum through until the 2031 growing season for an average price/tray of $22.30 in FY32. ZGL could achieve a higher price per tray if all fruit went to China, but ZGL chose to restrict Greater China fruit volume to 30% of total volume.

Figure 2: NZ Kiwifruit Supply



Source: Company data, Craigs Investment Partners

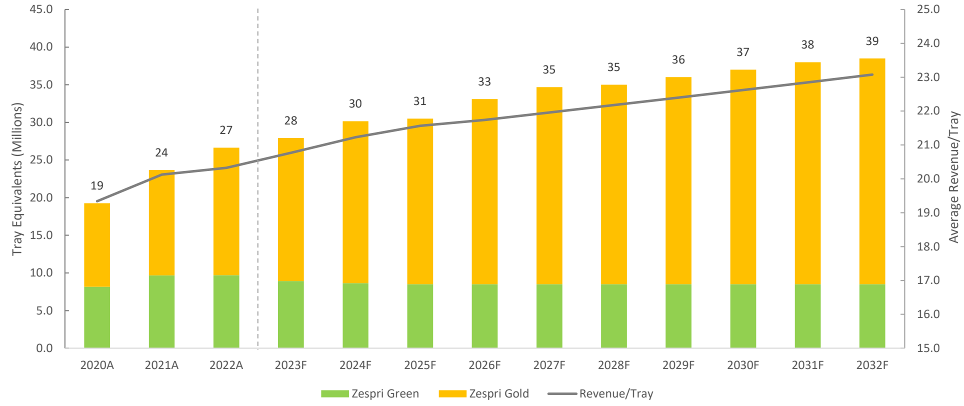
Non-NZ Kiwifruit

From a Producer Vote in 2019, ZGS has approval to plant 5,000 hectares of Gold3, procure 20 million trays of Green and grow 1,000 hectares of any new variety (excluding China and Chile). Zespri is expected to complete the 5,000ha of SunGold Kiwifruit planting in CY2023. When those hectares are all in full production, based on current yields ZGL expects this to generate around 35m trays of SunGold Kiwifruit. Our forecasts are slightly more conservative than ZGL's, with SunGold supply growing to 30M trays in FY32.

Current procurement of Green is about 10m trays. We are forecasting Green supply to remain fairly constant at c8.5M trays per year through to FY32.

There is no commercial production of any new varieties, although some trials of RubyRed in Italy are in progress.

Figure 3: Non-NZ Kiwifruit Supply



Source: Company data, Craigs Investment Partners

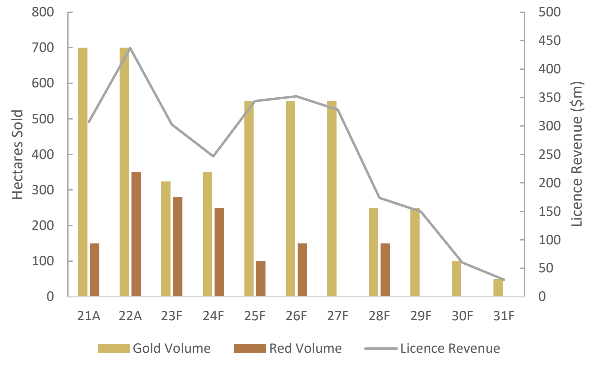
New cultivars

Licence release: We have forecast revenue from the 2022 licence tender process, which will contribute to FY23 results, at $300.7M, down 30% from the 2021 tender.

We forecast another 350 hectares of SunGold licences sold FY24, 500 in FY25-27, 250 in FY28, 100 in FY30 and 50 in FY31-32. We forecast a further 650 hectares of RubyRed licences sold through to FY28 at an average price of $156K/hectare.

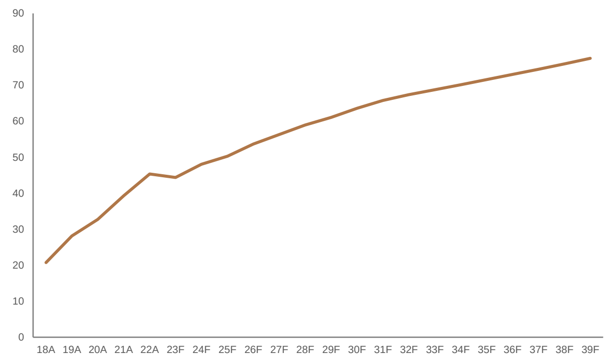
Plant Variety Right royalty income: ZGL has the PVR Rights in NZ to SunGold until Nov 2038 (USA until 2030). Because the royalty income has a finite life, we value the royalty income as a separate cash flow stream through until FY39 with no terminal value.

Figure 4: Licence Release forecast



Source: Company data, Craigs Investment Partners

Figure 5: PVR Royalty Income (nz$m)



Source: Company data, Craigs Investment Partners

Zespri Group forecasts

ZGL has provided a forecast range of corporate net profit after tax for FY23 between $227m to $247m, including licence release income, down from FY22 record profit of $361.5m. This is largely due to a reduction in licence revenue with less licence released in FY23, lower than expected volumes this season, and higher than average onshore fruit loss impacting the New Zealand Supply business segment. **We are expecting net profit after tax for ZGL to be between $227m to $237m for FY23.**

Growth Opportunities

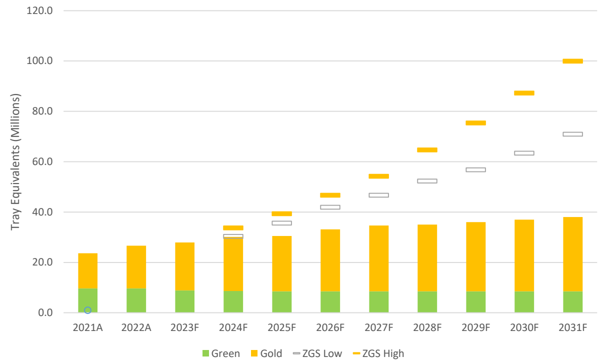
Zespri Global Supply Producer Vote

ZGL has forecast non-NZ SunGold to reach 35M trays when the current approved 5K hectares are in full production. We have forecast SunGold trays more conservatively growing to 30M trays by 2031 harvest.

If the producer vote is successful, ZGL is forecasting non-NZ supply to ZGL could increase to 70-106M trays by 2030 harvest. This will impact ZGL's revenue in two ways, first by increasing sales of Non-NZ grown kiwifruit through higher volumes, and secondly new cultivars will see a boost to revenue through increased royalty income.

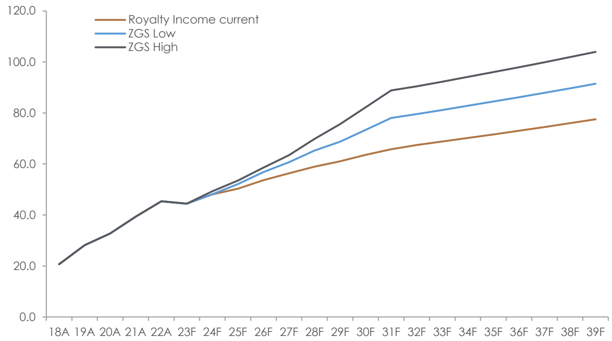
We believe this is a good way to maximise the revenue stream from SunGold while the PVR is still in place and will setup ZGL to benefit from higher marketing revenue in the longer term. We have modelled growth of SunGold expanding to 60-90M trays by 2031 harvest and believe this could alone add $0.90-1.74 to ZGL's share price based on current margins if the vote is successful.

Figure 6: ZGS expanded SunGold volume



Source: Company data, Craigs Investment Partners

Figure 7: ZGS expanded Royalty Income ($m)



Source: Company data, Craigs Investment Partners

Hi-Cane

Preparation continues at Zespri for the upcoming EPA public hearings on the reassessment of hydrogen cyanamide (often known by the brand name Hi-Cane), which have been delayed to 7 March 2023.

We view this as both a risk to the industry, and as a potential opportunity for ZGL. On the one hand, ZGL has estimated that should Hi-Cane be banned, this will have profitability implications in some growing regions. On the other hand, this provides an opportunity for ZGL, if they are able to find a new Green variety which will provide growers a viable alternative should the EPA's recommendation stand. Grower trials for an alternative variety are already underway.

United States

The US is one of the top countries for Food Product imports. While their fruit consumption is lower per person than Europe or China, the US is a large economy with strong purchasing power.

ZGL is now an importer of record to the US, which means they can import kiwifruit directly. In the past, almost all fruit (c95%) has gone to Oppenheimer who then market & distribute the fruit within the USA. In 2019, ZGL renegotiated their agreement with Oppenheimer. While Oppenheimer will still land the product, store it, and perform services for ZGL as a service provider, ZGL can now go direct to large supermarket chains for up to 30% of volume. To gear up for direct imports, ZGL has changed their management in NA. While they have not gone direct yet, they have the facilities in place to land & pack.

Because ZGL restricts fruit volume to Greater China (China, Hong Kong, and Taiwan) to 30% of total volume, volume growth in the US will help to support increased exports to China. While ZGL has seen an increase in pricing & service from Oppenheimer, the ability to go direct to large supermarket chains (Costco, Walmart) is key to maximising US potential.

What are the key risks?

Production risks - weather events, disease and pests

In New Zealand the major climatic risks are hail, frost, storm damage and drought. All horticultural undertakings are susceptible to disease and pest incursions. The kiwifruit vine disease Pseudomonas syringae pv. actinidiae (Psa) is widespread throughout New Zealand and is being actively managed. The Queensland fruit fly and brown marmorated stink bug are potential threats to the horticulture industry. Both are not presently in New Zealand.

Labour availability and Covid-19

Border closures due to Covid-19 have reduced the workforce that the NZ kiwifruit industry relies on through the Recognised Seasonal Employer (RSE) scheme and from backpackers. Some of the quality issues the industry is facing is likely due to shortage of labour which has resulted in lower picking standards (e.g., picking in the wet). Labour may remain a challenge for the next growing season.

China

ZGL's revenues and earnings could be impacted should it be shut out of any market or markets. For example, in the mid 1990's ZGL was banned from selling fruit in the US for 10 years (a significant market at that time) because it was found to engage in dumping of fruit. Any issues with China (comprising nearly a quarter of kiwifruit exports) would significantly impact volumes.

ZGL is also facing a complex challenge in China with 12-15K hectares of unauthorised Gold3 plantings. As yields and quality are improved, this fruit could start competing with ZGL fruit being imported from NZ, further increasing the risk of market access. To help alleviate this risk, ZGL could partner with some of the local Chinese growers and procure fruit for ZGS. This, however, will require a successful producer vote or support from 75% of growers that vote.

In the longer-term China production could suppress kiwifruit prices, if the continued rapid expansion in kiwifruit production resulted in China becoming a net exporter of kiwifruit.

Licensing revenues

The value of licensing revenue could fall due to a deterioration in demand or oversupply of SunGold. ZGL has recently commercialised the Red19 variety. Should the company decide to withdraw the variety for any reason, and the licence holder has not accepted a new licence under the terms of the Licence Agreement, the Company is required to reimburse the licence holder. As at 31 March 2022, the maximum exposure under the decommercialisation scenario is $38.6m (2021: $11.3m).

Competition

There are other gold varieties in the world, but none have the yield and storage qualities of SunGold. PSA was brought into NZ on kiwifruit pollen from overseas. Immediately following the discovery of PSA all movement of vines and pollen into NZ was stopped. As such, breeders in NZ could only create new varieties from cultivars that were already in the country, the vast majority of which were owned by ZGL and PFR. After 10 years from PSA these import restrictions were eased, meaning other

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Craigs Investment Partners Limited provides a market maker service to Zespri Group Limited.

varieties can come into the country after a quarantine period and be planted in competition to SunGold.

Industry Alignment

ZGL is a regulated business. To undertake activities not covered under core business, ZGL must either provide prior notice to Kiwifruit New Zealand before carrying out an activity that supports core business or seek approval from growers in a Producer Vote for activities that fall outside the "support core business" definition in the Regulations[2]. To gain approval, the Producer Vote needs at least **75 percent support** from those growers who vote, calculated by both (a) number of voters, and (b) volume (weight) of production.

As **less than 50% of growers are currently shareholders**, ZGL may face limitations on expanding operations if they are not able to successfully pass Producer Votes. ZGL is seeking approval via a Producer Vote in August 2022 to expand ZGS plantings overseas (excluding Chile and China) by up to 10K additional hectares, and new varieties by up to 1K additional hectares.

Industry Deregulation

The kiwifruit industry is regulated and governed by a single point of entry (SPE) market structure. ZGL holds an SPE for the NZ industry ensuring that all of NZ's kiwifruit exports (excluding Australia and collaborative marketing) are directed through the company. There will always be a risk that the SPE structure is unwound which would likely cause a significant fall in kiwifruit exports through ZGL.

Sustainability

ZGL has made climate change and sustainability a key strategic priority.

The company views a climate-resilient industry as core to fulfilling their purpose of helping people, communities, and the environment around the world thrive through the goodness of kiwifruit.

It is also part of ZGL's mission to create sustainable long-term value for kiwifruit growers, and its belief in kaitiakitanga as a core value underpinning the industry.

ESG Targets

Packaging	**2025:** 100% recyclable, reusable or compostable **2025:** plastic packaging will be made from at least 30% recycled plastic **2030:** reduce packing footprint, per KG of fruit, by 25%
Water	**2025:** alignment of nutrient inputs and losses to good practice limits **2025:** actively manage & demonstrate efficient use of water resources
Climate	**2025:** Zespri corporate carbon neutral **2030:** Industry carbon positive to retailers **2035:** Industry Carbon positive

ZGL has commissioned research to understand climate risks in growing regions around the world, aligning with the best-practice standard, the Taskforce for Climate-Related Financial Disclosure (TCFD).

[2] Regulation 11 of the Kiwifruit Export Regulations 1999