Fonterra

Dairy for life

Business Update

DECEMBER 2018

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Business update summary

- **Forecast Farmgate milk price range is $6.00 - $6.30 per kgMS and is based on firming global dairy prices over the balance of the season**
- **Maintaining earnings guidance**
  - Q1 margins in-line with last year
  - Solid New Zealand Ingredients performance and growth in Consumer
  - Challenges in Australia Ingredients, Asia Foodservice and China Foodservice
- **Making good progress on plan to lift performance**
- **Committed to financial discipline (opex, capex and debt reduction targets)**
- **Released our second Sustainability Report in November**

Forecast Farmgate Milk Price of $6.00 - $6.30

Forecast based on global dairy prices firming over the balance of the season

- Forecast Farmgate Milk Price has declined this season reflecting lower global dairy prices. Since June
  - GDT index has declined 20%
  - Butter prices have declined 33%
  - AMF is down 24%
  - WMP is down 17%

- Forecast Farmgate Milk Price range of $6.00 - $6.30 per kgMS assumes some firming in global dairy prices over the balance of the season
  - This is consistent with the direction of the dairy future prices according to NZX Futures and other market commentators

- The Farmgate Milk Price profile throughout the year is a key determinant of earnings
  - This global dairy price outlook supports our 25 – 35 cents earnings guidance for FY19

FY19 Q1 performance summary

Volume LME	Revenue	Gross Margin		Opex	Capex
3.6 billion	$3.8 billion	$646m	17.0%	$656 million	$188 million
↓ 6%	↓ 4%	↓ $14m	↑ from 16.6%	↑ 3%	↑ $46 million

Ingredients

Volume LME [1]	3.5b ↓ 4%
Gross Margin[1]	$273m ↑ $28m
	9.1% ↑ from 8.0%

Consumer & Foodservice

Volume LME[1]	1.2b ↓ 4%
Gross Margin[1]	$390m ↓ $17m
	22.9% ↓ from 24.0%

China Farms

Volume LME[1]	56m ↓ 20%
Gross Margin[1]	-$2m ↓ $7m
	-4.2% ↓ from 7.3%

Note: All changes are expressed relative to the first quarter of FY18. Gross margin from Q1 FY18 shown with direction of change denoted by arrow. 1) Includes inter-segment sales.

Outlook for 2019

Forecast Farmgate Milk Price

$6.00 - $6.30 per kgMS

- Forecast Farmgate Milk Price has been lowered to $6.00 - $6.30 from $6.25 - $6.50 per kgMS, based on:
  - Stronger global milk supply
  - Lower global dairy prices to date but forecast to firm over the balance of the season
  - Stable global demand

Forecast Earnings

25-35 cents per share

- Earnings per share range of 25-35 cents maintained
- Key drivers of earnings include:
  - New Zealand Ingredients timing of sales
  - Relative returns between Ingredient products (which are currently positive but can be volatile)
  - Milk price for the balance of the year

Plan to lift performance

Take stock, get back to basics, ensure more accurate forecasting

Commitments	Q1 FY19 Update
Reduce debt by $800 million by year-end	Processes underway for three assets: – Beingmate • Anmum distribution returned to Fonterra • Full ownership of Darnum plant to return to Fonterra, agreed in principle – Tip Top: appointed adviser to review range of options – Third asset: progressing
Bring gearing back within 40-45% range by year-end	On track for the full-year
Reduce capex to $650 million in FY19	On track for the full-year
Reduce opex back to FY17 levels over the next two years	Comprehensive review underway

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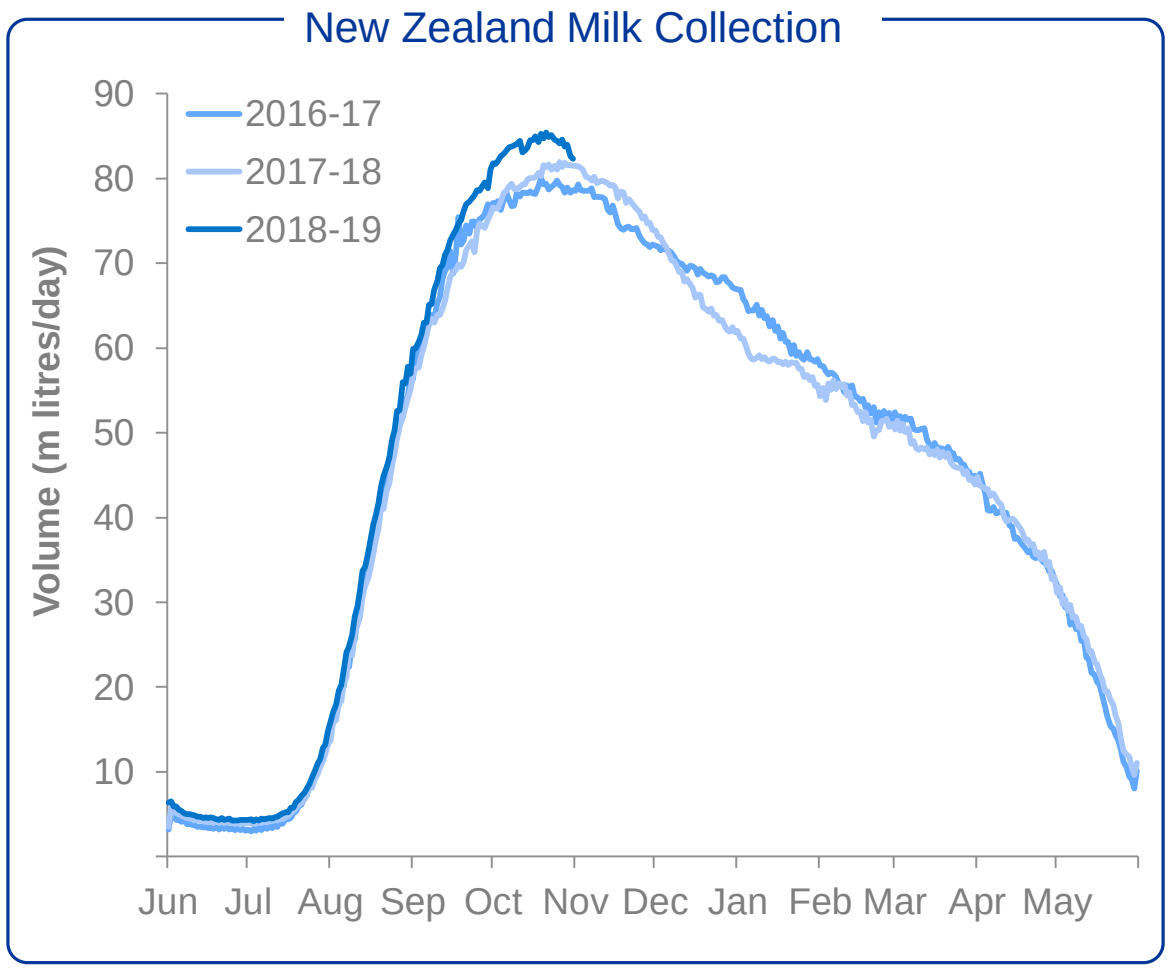
APPENDIX

Milk collections forecast maintained for the season

Strong start to the season but risk of a hot, dry summer



- New Zealand milk collections forecast maintained at 1,550 million kgMS, up 3% compared to last season
- A strong start to the season in New Zealand due to favourable weather conditions
- NIWA forecasting an abnormal El Niño weather pattern over summer

Season	Total Milk Solids (kgMS)	Peak Day Milk
2016/17	**1,526m (down 3%)**	**80m litres**
2017/18	**1,505m (down 1%)**	**82m litres**
2018/19F	**1,550m (up 3%)**	**85m litres**

Global Dairy Market

Higher supply expected to moderate

Global Supply[1]

Global Demand[2]

United States
+1%
12 months

Europe
+2%
12 months

+0.3%
July to September

Russia
EU's largest dairy export market

Trade embargo remains

Rest of Asia
+4%
12 months

China
+17%
12 months

Latin America
-2%
12 months

Middle East/Africa
-1%
12 months

Australia
+2%
12 months

-4%
July to September

New Zealand
+2%
12 months

+6%
August to October

1. *Global Supply is represented by global milk production data*
2. *Global Demand is represented by global dairy import data*

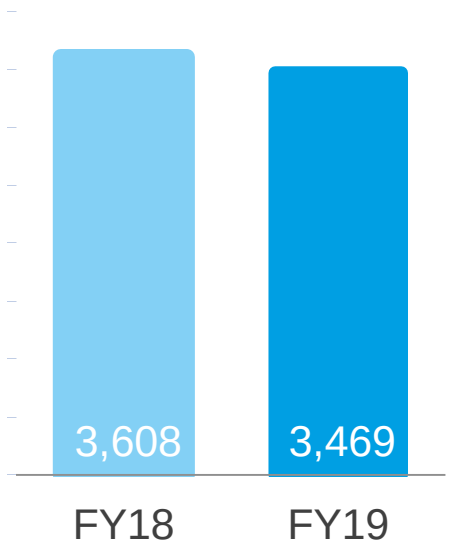
Note: All 12-month figures are rolling 12 months compared to previous comparable period: Australia (Sep), EU (Sep), United States (Oct), China (Mar), Asia (July), Middle East & Africa (July), Latin America (July).

Source: Government milk production statistics; GTIS trade data; Fonterra analysis.

Ingredients

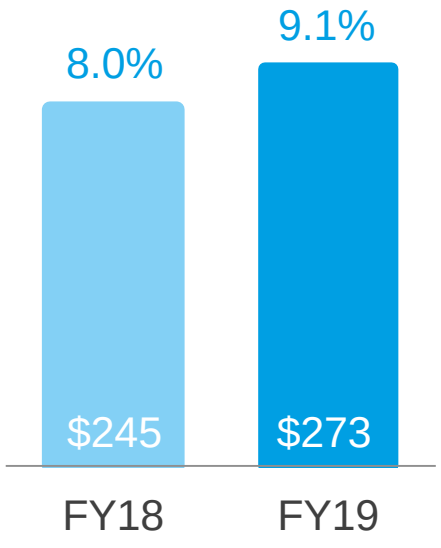
Improved margins even with challenges in Australia

Volume[1]



Growth -4%

Gross Margin



$28

Performance

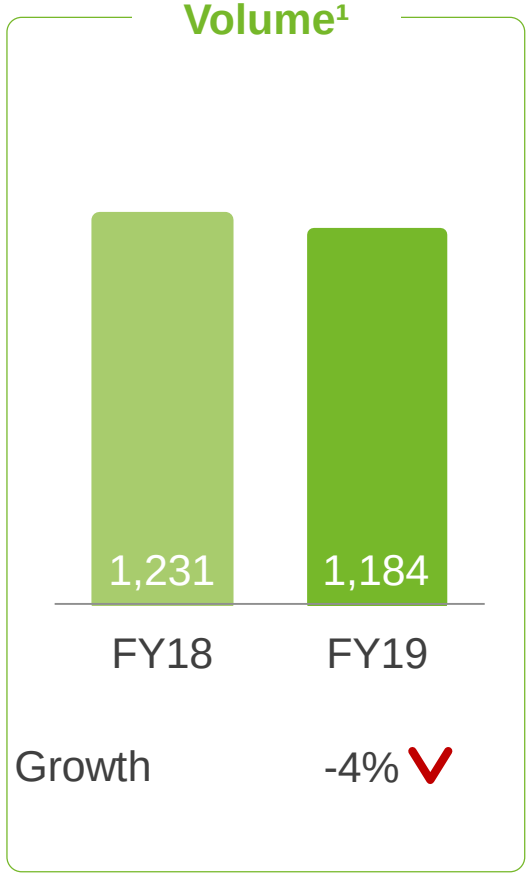
- Q1 volumes are down 4% on last year due to:
  - A slower start but has now picked up
  - Lower government tender volumes
- Q1 margins are up on last year:
  - Lower input costs
  - Improved mix
  - Positive stream returns
- Australia is a challenging market due to lower collections because of drought and increased competition for milk

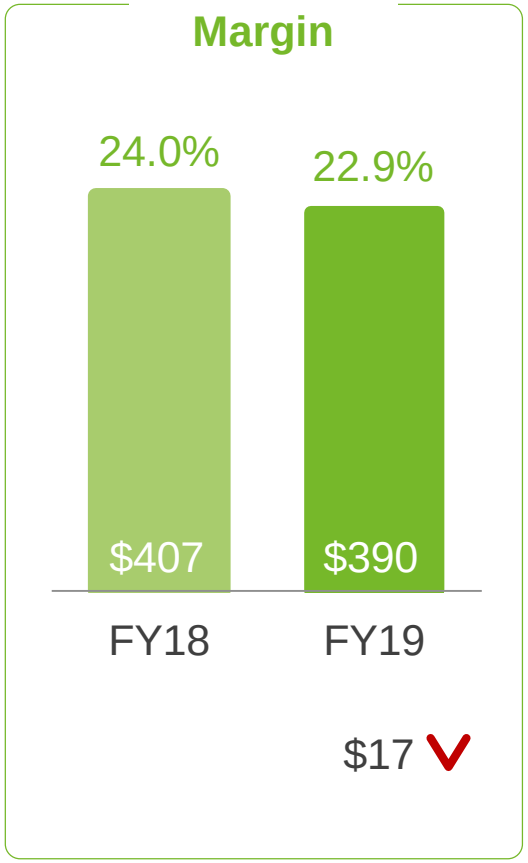
1. Includes sales to other strategic platforms

Note: Volume is in million LME. Gross margin is in NZD millions unless otherwise stated. All changes are expressed relative to the first quarter of FY18.

Consumer and Foodservice

Volumes and margins softening due to Foodservice





Performance

- Q1 volumes are down 4% on last year:
  - Consumer volumes are up 5%
  - Foodservice volumes are down 15%
- Q1 margins are down on last year with Consumer margins flat and Foodservice down
- Foodservice Asia and Greater China below expectations
- Oceania delivered higher margins across both consumer and foodservice portfolios:
  - Improved operational performance in New Zealand
  - Price increases in Australia

1. Includes sales to other strategic platforms.

Note: Volume is in million LME. Gross margin is in NZD millions unless otherwise stated. All changes are expressed relative to the first quarter of FY18.

Consumer and Foodservice by region

Asia and Greater China Foodservice offset stronger Consumer performance

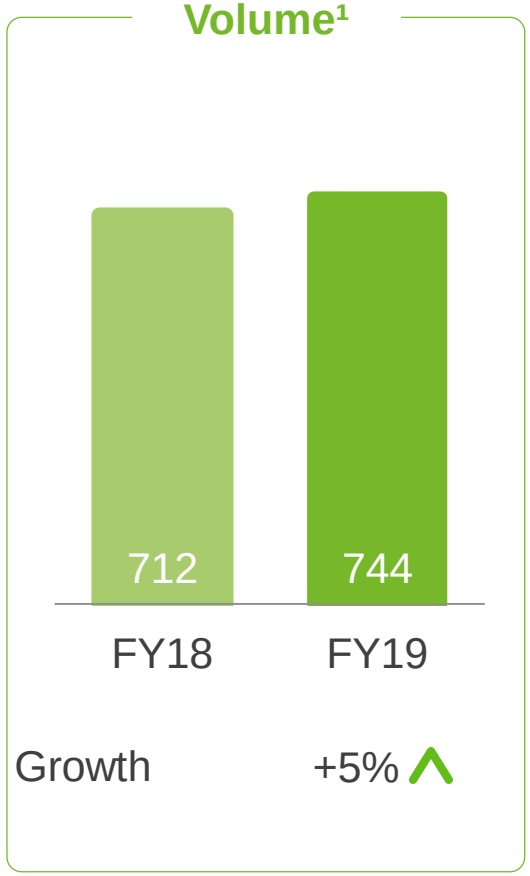
	Asia	Greater China	Oceania	Latin America
Volume[1]	FY18: 364 FY19: 349	FY18: 273 FY19: 222	FY18: 412 FY19: 422	FY18: 181 FY19: 191
Growth	∨ -4%	∨ -19%	∧ +2%	∧ +5%
Gross Margin	$103m ∧ $4m	$75m ∨ $25m	$105m ∧ $12m	$107m ∨ $7m
	22.6% ∨ from 23.2%	23.6% ∨ from 28.6%	19.1% ∧ from 17.7%	28.4% ∨ from 29.3%

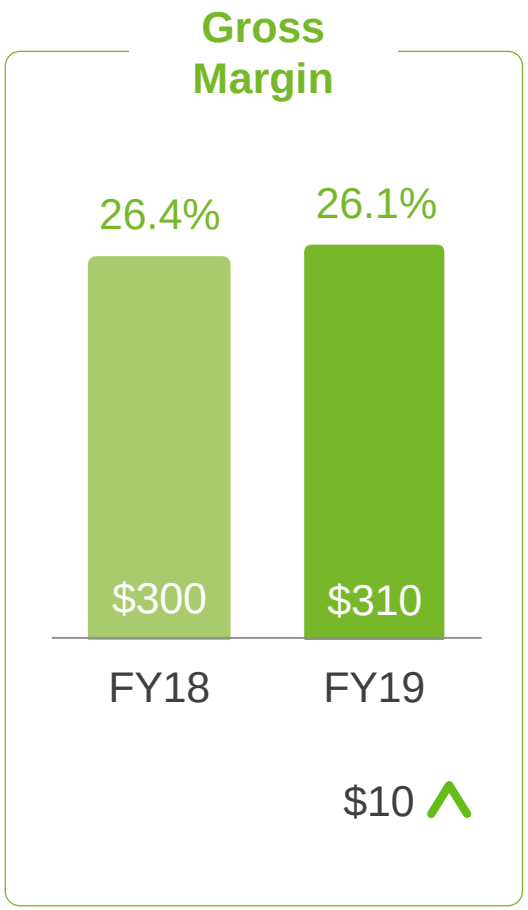
1. *Includes sales to other strategic platforms.*

Note: Volume is in million LME. All changes are expressed relative to the first quarter of FY18.

Consumer

Higher growth and stable margins underpin a strong Q1





Performance

- Q1 volumes are up 5% on last year with growth in all regions
- Q1 Consumer margins are largely flat on last year, with higher margins in Asia and Oceania offset by softer margins in Greater China
- Higher Q1 margins in Asia and Oceania are due to:
  - Benefits from improved product mix as we launched new products in Asia
  - Better operational performance in New Zealand
  - Strong performance in Australia
- Lower Q1 margins in Greater China are due to:
  - Delay in product launch
  - Increase in cross-border restrictions in Hong Kong

1. Includes sales to other strategic platforms.

Note: Volume is in million LME. Gross margin is in NZD millions unless otherwise stated. All changes are expressed relative to the first quarter of FY18

Consumer by region

Growth registered in every region, softer margins in Greater China

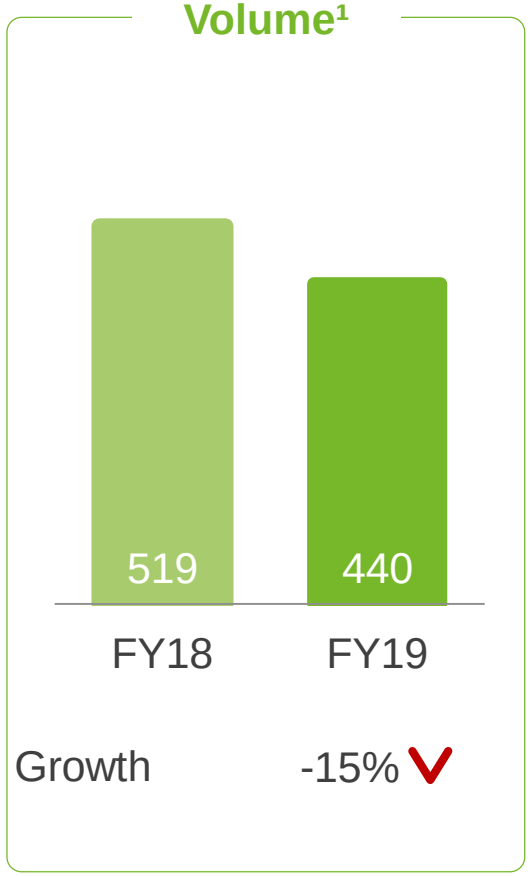
	Asia[2]	Greater China	Oceania	Latin America
Volume[1]	211 FY18, 222 FY19	39 FY18, 41 FY19	306 FY18, 318 FY19	157 FY18, 163 FY19
Growth	^ +5%	^ +6%	^ +4%	^ +4%
Gross Margin	$91m	$38m	$82m	$99m
	^ $14m	v $1m	^ $7m	v $9m
	28.5%	36.3%	19.4%	29.0%
	^ from 27.6%	v from 41.4%	^ from 18.7%	v from 30.0%

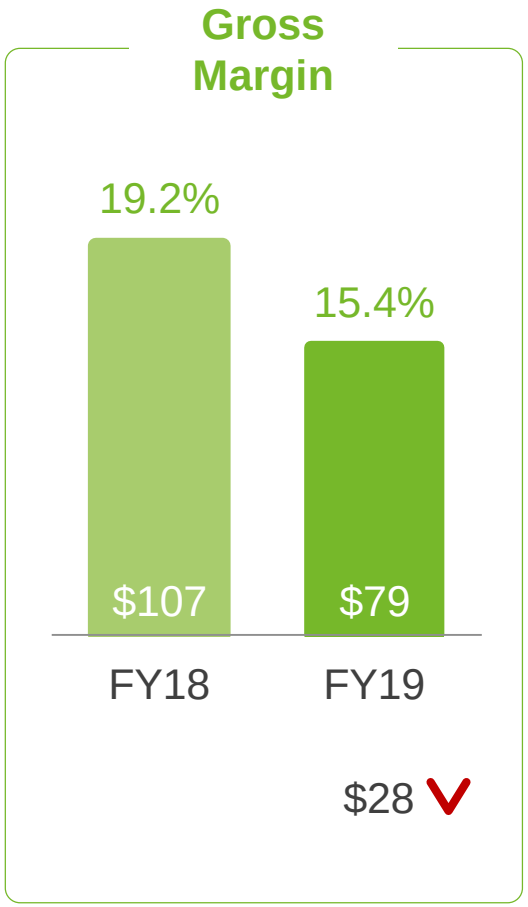
1. *Includes sales to other strategic platforms.*
2. *FY18 LME volume has been adjusted for the inclusion of eliminating entries to improve comparability.*

Note: Volume is in million LME. All changes are expressed relative to the first quarter of FY18.

Foodservice

Asia and Greater China cause lower volumes and profits





Performance

- Q1 volumes are down 15% on last year due to Asia and Greater China performance
  - Follows strong Q4 volumes
- Q1 Foodservice margins are down on last year, with higher margins in Oceania and Latin America offset by lower margins in Asia and Greater China
- Lower Q1 margins in Asia and Greater China are due to:
  - Slower start to sales of butter, cream cheese and UHT cream
  - Narrowing of margins for butter and UHT cream
  - Solid growth of UHT milk sales (lower margin relative to other products)
  - A reduction of volume sold through the QSR channel

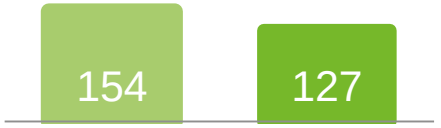
1. Includes sales to other strategic platforms.

Note: Volume is in million LME. Gross margin is in NZD millions unless otherwise stated. All changes are expressed relative to the first quarter of FY18.

Foodservice by region

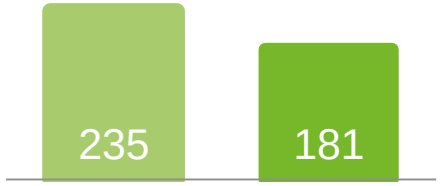
Value over volume drive Asia and Greater China volumes down

Asia



	FY18	FY19
Volume[1]	154	127
Growth		-18%
Gross Margin	$12m	$10m
	8.8%	from 14.9%

Greater China



	FY18	FY19
Volume[1]	235	181
Growth		-23%
Gross Margin	$37m	$24m
	17.4%	from 23.9%

Oceania

	FY18	FY19
Volume[1]	106	104
Growth		-2%
Gross Margin	$23m	$5m
	17.8%	from 14.4%

Latin America

	FY18	FY19
Volume[1]	24	28
Growth		+17%
Gross Margin	$8m	$2m
	22.2%	from 20.7%

1. *Includes sales to other strategic platforms.*

Note: Volume is in million LME. All changes are expressed relative to the first quarter of FY18.

Living within our means

Committed to strong financial discipline

Opex reducing to

FY17 levels
over next two years

- Higher opex in Q1 versus last year was largely due to higher spend in Consumer and Foodservice. The increase was due to:
  - Higher pre-planned A&P
  - Storage expenses
  - Costs related to bringing Anmum back in-house
- In Ingredients, storage and distribution spend was up in Q1 versus last year
- Savings made in Group Functions
- Target to return to FY17 levels within two years

Capex set at

$650
million

- We are on track to reduce capex from $861 million to $650 million this year
- Higher capex in Q1 versus last year due to the timing of completion of projects carried over from last year
- Capex is not evenly spread out through the year

New Zealand Ingredients product mix

	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19[2]	Change Q1 FY18 to Q1 FY19
Production Volume (000 MT)						
Reference	583	683	481	103	633	9%
Non-Reference	237	246	208	70	227	(4)%
Sales Volume (000 MT)						
Reference	287	614	455	439	247	(14)%
Non-Reference[1]	130	180	168	210	159	22%
Revenue ($ per MT)						
Reference	4,928	4,715	4,636	5,214	5,257	7%
Non-Reference[1]	5,777	5,958	5,555	5,764	5,405	(6)%

1) Includes bulk liquid milk. 2) Q1FY19 revenue and sales volume includes Foodservice volumes to China, Latin America and Quick Service Restaurant channels but these are not included in FY18. This volume in Q1FY19 is 34,000 metric tonnes. Prior years have not been restated.

Glossary

Acronyms and Definitions

AMF
Anhydrous Milk Fat

BMP
Butter Milk Powder

Base Price
Prices used by Fonterra's sales team as referenced against GDT prices and other relevant benchmarks

DIRA
Dairy Industry Restructuring Act 2001 (New Zealand)

GDT
Global Dairy Trade, the online provider of the twice monthly global auctions of dairy ingredients

Gearing Ratio
Economic net interest-bearing debt divided by economic net interest-bearing debt plus equity excluding cash-flow hedge reserves

Farmgate Milk Price
The price for milk supplied in New Zealand to Fonterra by farmer shareholders

Fluid and Fresh Dairy
The Fonterra grouping of skim milk, whole milk and cream – pasteurised or UHT processed, concentrated milk products and yoghurt

kgMS
Kilogram of milk solids, the measure of the amount of fat and protein in the milk supplied to Fonterra

LME (Liquid Milk Equivalent)
A standard measure of the amount of milk (in litres) allocated to each product based on the amount of fat and protein in the product relative to the amount of fat and protein in standardised raw milk

Non-Reference Products
All dairy products, except for Reference, produced by the NZ Ingredients business

Price Achievement
Revenue achieved over the base price less incremental supply chain costs above those set out in the Milk Price model

Reference Products
The dairy products used in the calculation of the Farmgate Milk Price, which are currently WMP, SMP, BMP, butter and AMF

Regulated Return
The earnings component of Milk Price generated from a WACC return on an assumed asset base

Season
New Zealand: A period of 12 months to 31 May in each year
Australia: A period of 12 months to 30 June in each year

SMP
Skim Milk Powder

Stream Returns
The gross margin differential between Non-Reference Product streams and the WMP stream (based on base prices)

WACC
Weighted Average Cost of Capital

WMP
Whole Milk Powder

Glossary

Fonterra Strategic Platforms

Ingredients

The Ingredients platform comprises bulk and specialty dairy products such as milk powders, dairy fats, cheese and proteins manufactured in New Zealand, Australia, Europe and Latin America, or sourced through our global network, and sold to food producers and distributors in over 140 countries. It also includes Fonterra Farm Source™ retail stores.

Consumer

The Consumer platform comprises branded consumer products, such as powders, yoghurts, milk, butter, and cheese. Base products are sourced from the ingredients business and manufactured into higher-value consumer dairy products.

Foodservice

The Foodservice platform comprises a range of branded products and solutions for commercial kitchens, including bakery butter, culinary creams, and cheeses.

China Farms

The China Farms platform comprises the farming operations in China, which produce high-quality fresh milk for the Chinese market.