



Dairy for life

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CHAIRMAN / CEO REVIEW

Record commodity prices combined with improved returns from the sale of specialty ingredients and branded dairy products saw Fonterra Co-operative Group increase our half year revenues by \$853 million to achieve total revenues of \$7.3 billion in the six months to November 30, 2007.

This result saw Fonterra completing the first half of the season with \$4.5 billion available for payout, compared to \$2 billion in the comparable prior period.

Our results reflect the higher prevailing prices during the first half of the year when supply was tight, as well as good performances across the whole Fonterra business. Prices achieved in the first half more than offset the average exchange rate of 75 cents.

The period under review also saw steady increases in returns from our overseas equity investments. These returns, excluding royalties, were up \$46 million to \$72 million for the six months. Strong improvement was shown by DMV Fonterra Excipients, Arla Fonterra Foods, and DPA. Other investments also contributed in line with expectations.

Fonterra's total cost of goods sold, including payout to suppliers, was \$1 billion ahead of the comparable period at \$6.4 billion, reflecting the higher prevailing milk price. Despite cold wet conditions in some North Island regions ahead of the peak, Fonterra's suppliers achieved an overall 2.5 per cent increase in production over the same period last season.

Total operating expenses, which include sales and marketing, distribution, administration and other operating costs for the six months ended November 30 2007, at \$841 million were \$19 million below the comparable period last year, reflecting good cost control.

Fonterra recorded an operating cash inflow of \$77 million. This compares to an inflow of \$627 million for the comparable half year which was aided by a strong inventory sell down early in the season.

A \$1 billion surplus from financing activities has been held as cash to provide an additional liquidity buffer given the present state of global credit markets. Having taken a conservative approach to managing our funding requirements Fonterra's total net interest bearing debt of \$5 billion is the same as May 31, 2007.

CHAIRMAN / CEO REVIEW (continued)

Fair Value Share

In December, the Board set the interim Fair Value Share price for the 2008/09 season at \$7.01, an increase of 22 cents on the current Fair Value Share price of \$6.79.

The independent valuer, Duff & Phelps, provided the Board with a valuation range for the Fair Value Share of \$6.49 to \$7.54 and the interim price of \$7.01 is the midpoint of that range.

The net increase in the Fair Value Share reflects some compression of Fonterra Ingredients' long term margins, driven by the higher commodity prices. However the valuer has recognised that this is more than being made up for by improvements in Fonterra's consolidated Australian operations and our Soprole business in Chile. The valuer also recognised additional business efficiencies and cost savings initiatives.

Balance Date

In January 2008, the Board resolved to change Fonterra's balance date from May 31 to July 31, effective immediately. The change applies to financial reporting only, with no change to the June 1 to May 31 season and no change in the dates for the issuing or redeeming of shares.

The Board believes the later July 31 balance date will better reflect the financial performance achieved from the total sales of milk supplied in the season. As shareholders will recognise, July 31 is a clearer cut off point as new season supply is minimal at that time and we have generally sold the bulk of carryover inventories held to supply customers through our low production period. As a result, shareholders can be given a more precise valuation of inventory and a more accurate picture of the season's results, as well as allowing for a better seasonal comparison in the future.

This change is in line with other improvements to Fonterra's financial reporting which included separating the milk price and value component of payout in September 2006. It is also in line with the Board's commitment to provide shareholders with increased information around our financial performance, particularly in light of the discussions regarding capital structure.

In considering the balance date change, the Board was very conscious of the need to ensure minimal impact on our shareholders. We are confident that there are no significant tax or other implications for shareholders, and with the seasonal calendar remaining the same at June 1 to May 31 the following year, there will be no change to share transaction dates.

The final payment for this season will move from August 20 to October 20 as a consequence of the new balance date, however the advance payment rate schedule has been adjusted to ensure there is no cashflow impact. The total payout for the 2008 season, subject to retentions, will be based on the results for the 14 month period from June 1, 2007 to July 31, 2008.

Capital Structure

Having rolled out our preferred option in November 2007, we are now moving to outline how shares in the co-operative would be treated, together with providing detail around the milk price mechanism.

These two topics will be discussed in a full round of meetings with farmers in March.

Farmers will always want to be certain about the value of their milk at the farm gate and, quite independently of capital structure, the Board has had a Milk Price Working Committee focused on the best system for ensuring farmers have that clarity. Separating the milk price component from value returns in the payout was a first step, but the goal is to provide a more robust and transparent milk price against which farmers can determine what margins they are making on their milk after deducting their on farm costs versus what returns they are achieving on their shares in the co-operative.

The milk price work is complex but it is crucial that we get it right. We are now in a position to give shareholders the level of detail they have been seeking on the new milk price mechanism and how the proposed changes to it will provide them with more certainty about the value of raw milk at the farm gate and hence more accurate information on which to base production decisions.

Outlook

We have forecast a \$6.90 kgMS payout for the 2007/08 season, with a milk price component of \$6.70 and a value component of 20 cents. This is a record payout for the business, reflecting the unprecedented commodity prices prevailing in the market.

High prices inevitably lead to a supply response as producers worldwide seek to capitalise on them. This is particularly so in the United States where production is accelerating but local demand is softening in response to higher consumer prices. As a result we are seeing growth in United States skim milk powder production. This will factor into the market over the short to medium term and will bring a softening to the historically high prices.

However, structurally the market is much stronger than it has traditionally been. There is very strong global demand for grains, in particular, the large amounts of grains going into biofuels. This is putting upward pressure on global farming costs, which in turn is pushing up global food prices, including dairy. Combine this with the weak US dollar, and we believe the long term outlook for dairy prices will remain above traditional averages.



Henry van der Heyden
CHAIRMAN



Andrew Ferrier
CEO

Consolidated Interim Income Statement

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

	NOTES	6 MONTHS TO 30 NOV 2007 UNAUDITED \$ MILLION	6 MONTHS TO 30 NOV 2006 UNAUDITED \$ MILLION	12 MONTHS TO 31 MAY 2007 AUDITED \$ MILLION
Revenue		7,334	6,481	13,687
Cost of goods sold ¹	3	(6,427)	(5,417)	(11,671)
Gross profit		907	1,064	2,016
Other income		31	32	96
Selling and marketing expenses		(220)	(238)	(436)
Distribution expenses		(192)	(204)	(441)
Administrative expenses		(321)	(309)	(550)
Net foreign exchange gains/(losses)		(10)	35	30
Other operating expenses		(108)	(109)	(250)
Operating profit before finance costs and tax		87	271	465
Finance income		25	13	24
Finance costs		(186)	(197)	(358)
Net finance costs		(161)	(184)	(334)
Share of equity accounted investees profit after tax		72	26	73
Profit/(loss) before tax		(2)	113	204
Tax credit/(expense)		28	(44)	(39)
Profit from continuing operations		26	69	165
Profit from discontinued operations (net of tax)		–	–	–
Profit for the period		26	69	165
Profit for the period attributable to:				
Equity holders of the company		–	58	134
Minority interests		26	11	31
Profit for the period		26	69	165

¹ Included in Cost of goods sold is \$4,540 million accumulated payout to suppliers (30 November 2006: \$2,045 million; 31 May 2007: \$5,592 million).

Fonterra Co-operative Group Limited

The Directors hereby approve the financial statements for the six month period ended 30 November 2007. For and on behalf of the Board of Directors, who authorised the issue of these financial statements on 21 February 2008.



Henry van der Heyden
CHAIRMAN



David Jackson
DIRECTOR

Consolidated Interim Statement of Total Recognised Income and Expense

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

	NOTES	6 MONTHS TO 30 NOV 2007 UNAUDITED \$ MILLION	6 MONTHS TO 30 NOV 2006 UNAUDITED \$ MILLION	12 MONTHS TO 31 MAY 2007 AUDITED \$ MILLION
Cash flow hedges:				
– net fair value gains		402	102	421
– transferred and reported in revenue		(199)	(10)	(197)
– tax on cash flow hedge transactions		(61)	(30)	(74)
– effect of tax rate change on cash flow hedge reserve		–	–	6
Net fair value gains on net investment hedges		2	30	57
Foreign currency translation attributable to co-operative shareholders		(18)	(30)	(89)
Foreign currency translation attributable to minority interests		(4)	(6)	(18)
Income and expense recognised directly in equity		122	56	106
Profit for the period		26	69	165
Total recognised income and expense for the period	7	148	125	271
Attributable to:				
Equity holders of the company		126	120	258
Minority interests		22	5	13
Total recognised income and expense for the period		148	125	271

Consolidated Interim Balance Sheet

AS AT 30 NOVEMBER 2007

	NOTES	AS AT 30 NOV 2007 UNAUDITED \$ MILLION	AS AT 30 NOV 2006 UNAUDITED \$ MILLION	AS AT 31 MAY 2007 AUDITED \$ MILLION
ASSETS				
Current assets				
Cash and cash equivalents		974	143	184
Trade and other receivables		2,452	2,238	2,139
Inventories		4,037	2,797	2,783
Taxation receivable		–	50	–
Derivative financial instruments		520	416	698
Other current assets		92	99	35
Total current assets		8,075	5,743	5,839
Non-current assets				
Property, plant & equipment	5	4,291	4,296	4,232
Equity accounted investments		666	663	630
Intangible assets		2,491	2,435	2,507
Deferred tax asset		39	12	10
Derivative financial instruments		329	78	127
Other non-current assets		164	81	149
Total non-current assets		7,980	7,565	7,655
Total assets		16,055	13,308	13,494

Consolidated Interim Balance Sheet (continued)

AS AT 30 NOVEMBER 2007

	NOTES	AS AT 30 NOV 2007 UNAUDITED \$ MILLION	AS AT 30 NOV 2006 UNAUDITED \$ MILLION	AS AT 31 MAY 2007 AUDITED \$ MILLION
LIABILITIES				
Current liabilities				
Bank overdraft		17	28	69
Borrowings	8	2,391	2,442	1,066
Trade and other payables		1,168	1,001	939
Owing to suppliers		2,726	851	974
Taxation payable		11	46	15
Derivative financial instruments		115	204	308
Provisions		102	109	115
Other current liabilities		8	30	4
Total current liabilities		6,538	4,711	3,490
Non-current liabilities				
Borrowings	8	3,580	3,201	4,059
Capital notes	8	35	36	35
Derivative financial instruments		258	154	296
Provisions		45	55	45
Deferred tax liability		547	538	534
Other non-current liabilities		56	60	57
Total non-current liabilities		4,521	4,044	5,026
Total liabilities		11,059	8,755	8,516
EQUITY				
Co-operative shares	7	4,769	4,613	4,897
Retained earnings	7	(166)	(248)	(166)
Foreign currency translation reserve	7	(54)	–	(38)
Cash flow hedge reserve	7	291	55	149
Total equity attributable to equity holders of the company		4,840	4,420	4,842
Minority interests	7	156	133	136
Total equity		4,996	4,553	4,978
Total liabilities and equity		16,055	13,308	13,494

Consolidated Interim Cash Flow Statement

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

	6 MONTHS TO 30 NOV 2007 UNAUDITED \$ MILLION	6 MONTHS TO 30 NOV 2006 UNAUDITED \$ MILLION	12 MONTHS TO 31 MAY 2007 AUDITED \$ MILLION
Cash flows from operating activities			
Cash inflows	7,027	6,697	13,996
Cash outflows	(6,950)	(6,070)	(12,674)
Net cash flow from operating activities	77	627	1,322
Cash flows from investing activities			
Cash inflows	19	161	270
Cash outflows	(286)	(603)	(882)
Net cash flow from investing activities	(267)	(442)	(612)
Cash flows from financing activities			
Cash inflows	3,445	3,360	5,128
Cash outflows	(2,413)	(3,452)	(5,726)
Net cash flow from financing activities	1,032	(92)	(598)
Net increase in cash held	842	93	112
Opening cash balances	115	22	22
Effect of exchange rate changes on cash held	-	-	(19)
Closing cash balances	957	115	115
Reconciliation of closing cash balances			
Cash and cash equivalents	974	143	184
Bank overdraft	(17)	(28)	(69)
Closing cash balances	957	115	115
Reconciliation of profit for the period to net cash flows from operating activities			
Profit for the period	26	69	165
Adjustment for non-cash items:			
Depreciation/amortisation	231	238	461
Other non-cash items	(97)	(27)	(135)
Movements in working capital	141	533	687
Items classified as investing and financing activities	(224)	(186)	144
Net cash flows from operating activities	77	627	1,322

Notes to the Interim Financial Statements

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

1. General information

Fonterra Co-operative Group Limited ("Fonterra" or the "Company") is a co-operative company incorporated and domiciled in New Zealand. Fonterra is registered under the Companies Act 1993, the Co-operative Companies Act 1996, and the Dairy Industry Restructuring Act 2001, and is an issuer for the purpose of the Financial Reporting Act 1993.

These consolidated interim financial statements of Fonterra, as at and for the six months ended 30 November 2007, comprise Fonterra and its subsidiaries (together referred to as the "Group") and the Group's equity accounted investees.

The Group is primarily involved in the collection, manufacture and sale of milk and milk derived products and is a profit oriented entity.

For the purpose of these financial statements it is assumed that 100% of profit attributable to Co-operative shareholders for the six months to 30 November 2007 will be paid out as Payout to suppliers. The Payout to suppliers in the comparative period to 30 November 2006 has not been amended for the profit related adjustments resulting from the transition to New Zealand Equivalents to International Financial Reporting Standards ("NZ IFRS"), as set out in note 10. At year end the Payout to suppliers is based on the amount declared by the Directors.

2. Summary of significant accounting policies

(a) Basis of preparation

On 1 June 2007 Fonterra adopted NZ IFRS. These consolidated interim financial statements have been prepared in accordance with New Zealand Equivalent to International Accounting Standard ("NZ IAS") 34: Interim Financial Reporting. By complying with NZ IAS 34 the Group is also in compliance with International Accounting Standard ("IAS") 34: Interim Financial Reporting.

NZ IFRS 1: First-time Adoption of NZ IFRS, requires an entity to use the same accounting policies in its opening NZ IFRS balance sheet and throughout all the periods presented in its first NZ IFRS financial statements. The Group has adjusted amounts reported previously in financial statements prepared in accordance with its old basis of accounting ("Previous NZ GAAP"), except where exemptions from full retrospective application of NZ IFRS, allowable under NZ IFRS 1, have been applied. Note 10 explains the transition from Previous NZ GAAP to NZ IFRS.

These financial statements are prepared on a historical cost basis except for derivative instruments and the hedged risks on certain debt instruments, which are recognised at their fair values.

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

These financial statements are presented in New Zealand dollars (“\$”), which is the Company’s functional and presentation currency, and rounded to the nearest million.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions of accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

(b) Basis of consolidation

Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Subsidiaries are included in the consolidated financial statements using the purchase method of consolidation from the date control commences until the date control ceases.

10 The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the Group’s share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets acquired, the difference is recognised directly in the income statement.

Equity accounted investees (Associates and jointly controlled entities)

Associates are those entities in which the Group has significant influence but not control over the financial and operating policies. Jointly controlled entities are those entities over whose activities the Group has joint control, established by contractual agreement and requiring unanimous consent for strategic financial and operating decisions. Associates and jointly controlled entities are initially recognised at cost (including any goodwill identified on acquisition). Subsequent to initial recognition associates and jointly controlled entities are accounted for using the equity method. The consolidated financial statements include the Group’s share of the profit or loss after tax of equity accounted investees, after adjustments to align to the accounting policies of the Group, from the date that significant influence or joint control commences until the date that significant influence or joint control ceases. When the Group’s share of losses exceeds its interest in an equity accounted investee, the carrying amount of that interest is reduced to nil and no further losses are recognised except to the extent the Group has an obligation or has made payments on behalf of the investee.

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

Transactions eliminated on consolidation

Intra-group transactions, balances, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent there is no evidence of impairment.

(c) Foreign currency

Foreign currency transactions

Foreign currency transactions are translated into the respective functional currencies of Group entities using the exchange rate at the dates of transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation, using the exchange rates at the reporting date, of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow or qualifying net investment hedges.

Translation of the financial statements into the presentation currency

Where the Company's presentation currency differs from the functional currency of an entity, the assets and liabilities of the operation are translated from the functional currency into the presentation currency at the exchange rates at the reporting date. The income and expenses of these entities are translated at rates approximating the exchange rates at the dates of the transactions. Exchange differences arising on the translation of the financial statements of these entities and of borrowings and other currency instruments designated as hedges of such investments are recognised directly in the foreign currency translation reserve ("FCTR"). When an entity is partially disposed of or sold, the exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.

(d) Financial assets and liabilities

A financial asset or liability is recognised if the Group becomes a party to the contractual provisions of the asset or liability. A financial asset or liability is recognised initially at its fair value plus, in the case of a financial asset or liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the instrument. Financial assets and liabilities carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in the income statement.

After initial recognition, financial assets are measured at their fair values except for loans and receivables and held-to-maturity investments, which are measured at amortised cost using the effective interest method. After initial recognition, financial liabilities are measured at

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

amortised cost using the effective interest method except for financial liabilities at fair value through profit or loss.

Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Financial liabilities are derecognised if the Group's obligations specified in the contract expire or are discharged or cancelled.

Financial assets are classified on initial recognition into the following categories: at fair value through profit or loss, held-to-maturity investments, loans and receivables, and available-for-sale. Financial liabilities are classified as either fair value through profit or loss, or financial liabilities measured at amortised cost. The classification depends on the purpose for which the financial assets and liabilities were acquired. Management determines the classification of its financial assets and liabilities at initial recognition. The Group has not had any held-to-maturity investments or available-for-sale financial assets in the periods covered by these financial statements.

(i) Financial assets and financial liabilities at fair value through profit or loss

Financial assets and liabilities in this category are either classified as held for trading or designated as fair value through profit or loss. Derivatives are classified as held for trading unless designated as hedges. The hedged risks on certain foreign currency denominated debt instruments are designated as fair value through profit or loss as this eliminates an accounting mismatch on the recognition of gains or losses between those hedged risks and the related derivative instruments.

(ii) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity for which there is a positive intention and ability to hold to maturity, other than those that are designated on initial recognition as either fair value through profit or loss or available-for-sale, or meet the definition of loans and receivables.

(iii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Trade and other receivables are classified as loans and receivables.

(iv) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. Fair value changes are recognised directly in equity until the investment is either derecognised or determined to be impaired,

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

at which time the cumulative gain or loss that was reported in equity is recognised in the income statement.

(v) *Financial liabilities measured at amortised cost*

Financial liabilities measured at amortised cost are non-derivative financial liabilities with fixed or determinable payments that are not quoted in an active market. Trade and other payables, and certain debt instruments are classified as financial liabilities measured at amortised cost.

(e) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, deposits held at call with banks, other short term highly liquid investments with original maturities of three months or less, and bank overdrafts.

(f) Trade receivables

Trade receivables are carried at their net realisable value.

(g) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortised cost using the effective interest method, with the hedged risks on certain debt instruments measured at fair value. Changes in fair value of those hedged risks are recognised in the income statement. Where borrowings are classified as net investment hedges, any fair value changes relating to foreign exchange are recognised directly in the FCTR.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least twelve months after balance date.

(h) Trade and other payables

Trade and other payables are carried at amortised cost.

(i) Derivative financial instruments and hedging activities

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.

The Group does not engage in speculative transactions or hold derivative financial instruments for trading purposes.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into (the trade date) and transaction costs are expensed immediately. They are subsequently

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either:

- hedges of the fair value of recognised assets or liabilities, or a firm commitment (fair value hedges);
- hedges of a particular risk associated with a recognised liability or a highly probable forecast transaction (cash flow hedges); or
- hedges of a net investment in a foreign operation (net investment hedges).

The Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The full fair value of a hedging derivative is classified as a non-current asset or liability when maturity of the hedged item exceeds twelve months. It is classified as a current asset or liability when the maturity of the hedged item is less than twelve months.

(i) Fair value hedges

Changes in fair value of derivatives that are designated and qualify as fair value hedges are recognised in the income statement, together with any changes in the fair value of the hedged asset or liability.

(ii) Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised directly in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are transferred to the income statement when the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is recognised immediately in the income statement.

(iii) Net investment hedges

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

hedge is recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Gains and losses accumulated in equity are included in the income statement when the foreign operation is partially disposed of or sold.

(j) Inventories

Inventories are stated at the lower of cost and net realisable value.

Net realisable value is the estimated selling price in the ordinary course of business, less the costs of completion and selling expenses.

The cost of dairy product manufactured from milk suppliers in New Zealand is established by estimating an arm's length cost for raw milk, being the price that could be paid by a hypothetical efficient competitor based on forecasted hedged selling prices while still making an adequate return on capital. In the case of manufactured inventories and work in progress, cost includes all direct costs plus that portion of the fixed and variable production overhead incurred in bringing inventories into their present location and condition.

(k) Property, plant & equipment

Owned assets

Items of property, plant & equipment are measured at cost less accumulated depreciation and impairment losses. Cost includes the purchase consideration 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. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each financial year end.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount, and are recognised in the income statement.

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

Depreciation

Depreciation is calculated on a straight line basis to allocate the cost of the asset, less any residual value, over its estimated useful life. The range of estimated useful lives for each class of property, plant & equipment is as follows:

Land	Indefinite
Buildings	15 – 50 years
Plant, vehicles & equipment	3 – 50 years

Leased assets

Leases of property, plant & equipment where the Group assumes substantially all the risks and rewards of ownership are classified as finance leases.

Assets under finance leases are recognised as property, plant & equipment in the balance sheet. They are recognised initially at their fair value, or if lower, at the present value of the minimum lease payments. A corresponding liability is established and each lease payment allocated between the liability and interest expense using the effective interest method. The assets recognised are depreciated on the same basis as equivalent property, plant & equipment.

Leases that are not finance leases are classified as operating leases and the assets are not recognised on the Group's balance sheet. Operating lease payments are recognised as an expense on a straight line basis over the term of the lease.

(I) Intangible assets

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary or equity accounted investee at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in Intangible assets. Goodwill on acquisitions of equity accounted investees is included in Equity accounted investments and is tested for impairment as part of the overall balance. Any negative goodwill arising on an acquisition is recognised immediately in the income statement.

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

Brands and other identifiable intangible assets

Brands and other intangible assets purchased by the Group are recognised where the asset is controlled through custody or legal rights and could be sold separately from the rest of the business. Brands and other intangible assets have a combination of both indefinite and finite useful lives. Items with indefinite useful lives are tested annually for impairment and carried at cost less accumulated impairment losses. Items with finite useful lives are carried at cost less accumulated amortisation and accumulated impairment losses, and are amortised on a straight line basis to allocate the cost over their licence period. Assets that have been impaired are reviewed for possible reversal of impairments at each balance date.

Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives, being three to eight years.

Costs associated with developing or maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with the development of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Costs include the employee costs incurred as a result of developing software and an appropriate portion of relevant overheads.

Computer software development costs recognised as assets are amortised over their estimated useful lives, not exceeding three years.

Research and development expenditure

All research expenditure is recognised in the income statement as incurred. Significant development expenditure is recognised as an asset when it can be demonstrated that the commercial production of the material or product, or use of the process, will commence.

Development expenditure recognised as an asset is stated at cost and amortised in the income statement over the period of expected benefits on a straight line basis, not exceeding five years. Amortisation begins at the time that commercial production or use of the process commences. All other development expenditure is recognised in the income statement as incurred.

(m) Impairment of non-financial assets

Intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the estimated recoverable amount of an asset is less than its carrying amount, the asset is

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

written down to its estimated recoverable amount and an impairment loss is recognised in the income statement. The recoverable amount of an asset is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash inflows (cash-generating units).

Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

(n) Provisions

Provisions are recognised only in those circumstances where the Group has a present legal or constructive obligation as a result of a past event, when it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as a finance cost in the income statement.

(o) Co-operative shares

Co-operative shares are classified as equity as the shares are puttable instruments at fair value and represent a residual interest in the Company. Incremental costs directly attributable to the issue of co-operative shares are recognised as a deduction from equity.

(p) Revenue recognition

Revenue is recognised at the fair value of the consideration received or receivable, net of returns, discounts and allowances from the sale of inventory items. Sales revenue is recognised when the amount of revenue can be reliably measured, significant risks and rewards of ownership of the inventory items have passed to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, and there is no continuing management involvement with the goods.

(q) Payout to suppliers

Payout to suppliers is the total available (after retentions determined by the Board) for payment to supplier shareholders for the milk they supply to the Group. Payment for contract milk supplied is included within Cost of goods sold.

The Milk Price for the season is based upon a model determined by an independent valuer as part of the fair value share process, and broadly represents the maximum amount a hypothetical efficient competitor could afford to pay for milk and still make an adequate

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

return on capital. The actual monthly commodity prices and hedged conversion rates achieved by Fonterra are applied to the Milk Price.

(r) Employee benefits

Employee benefits primarily include short term employee benefits and defined contribution pension plans.

Short term employee benefits include salaries, wages, annual leave and sick leave, and are expensed on an undiscounted basis as the relevant service is provided.

Contributions to defined contribution pension plans are recognised as an expense in the period they are due. The Group has no further payment obligations once the contributions have been paid.

(s) Finance income and costs

Finance income comprises interest income on funds on deposit. Interest income is recognised as it accrues using the effective interest method.

Finance costs comprise interest expense on borrowings, unwinding of the discount on provisions, gains and losses on the revaluation of debt hedges, and gains and losses relating to forward points on forward exchange contracts. Interest expense and the unwinding of the discount on provisions are recognised in the income statement using the effective interest method. Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of that asset.

(t) Taxation

Income tax expense comprises current and deferred income tax. Income tax expense is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable or receivable on the taxable income or loss for the period, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable or receivable in respect of previous years.

Deferred tax is recognised, using the balance sheet method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is measured at the tax rate that is expected to apply to the temporary differences when they reverse, based on laws that have been enacted or substantively enacted by the reporting date.

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

Deferred tax is not recognised on the following temporary differences:

- The initial recognition of goodwill;
- The initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit; and
- Differences relating to investments in subsidiaries and equity accounted investees to the extent that the timing of the reversal is controlled by the Group and it is probable that they will not reverse in the foreseeable future.

Deferred tax assets are recognised to the extent it is probable that future taxable profits will be available against which the temporary differences can be utilised.

(u) New International Financial Reporting Standards

The Group has chosen to early adopt NZ IFRS 8: Operating Segments. NZ IFRS 8 requires qualitative and quantitative disclosures regarding the Group's operating segments and replaces NZ IAS 14: Segment Reporting. Mandatory adoption of NZ IFRS 8 is required for periods commencing on or after 1 January 2009.

The Group has chosen to early adopt amendments made recently to NZ IAS 32: Financial Instruments: Presentation. The amendments allow the Group to continue to classify Fonterra's co-operative shares as equity instruments. Mandatory adoption of the amendments to NZ IAS 32 is required for periods commencing on or after 1 January 2009.

3. Cost of goods sold

	6 MONTHS TO 30 NOV 2007 UNAUDITED \$ MILLION	6 MONTHS TO 30 NOV 2006 UNAUDITED \$ MILLION	12 MONTHS TO 31 MAY 2007 AUDITED \$ MILLION
Opening inventory	2,783	3,300	3,300
Payout to suppliers	4,540	2,045	5,592
Other purchases (including manufacturing costs and production overheads)	3,141	2,869	5,562
Closing inventory	(4,037)	(2,797)	(2,783)
Total cost of goods sold	6,427	5,417	11,671

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

4. Segment reporting

The Group has four reportable segments that are defined by geographical area and the manufacturing and supply business within New Zealand ("Fonterra Commodities & Operations" or "FC&O"). The geographically assigned reportable segments exclude any part of the Group's operation in their geographical area that is included within FC&O. Each reportable segment has its own Managing Director who reports to the Group's Chief Executive Officer.

Reportable segment	Description
FC&O	Includes New Zealand milk supply, New Zealand manufacturing, Sales and operations planning, Global trade, Global supply chain, Latin American investments and Corporate.
ANZ	Represents operations in New Zealand (other than those included in FC&O) and Australia (including milk supply and manufacturing).
Asia / AME	Represents operations in Asia (excluding North Asia), Africa and the Middle East.
Fonterra Ingredients	Represents operations in North Asia, North America and Europe.

To complete segmental profit analysis for the Group, it is necessary to calculate Milk Price. Due to the seasonal nature of Fonterra's business, the final Milk Price can only be calculated at the end of the financial year. Accordingly, segmental profit analysis is not prepared for the half year reporting periods.

Comparative segmental profit analysis for the twelve months to 31 May 2007 has not been presented as the necessary information is not available and the cost to develop it would be excessive.

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

	FC&O \$ MILLION	ANZ \$ MILLION	ASIA/AME \$ MILLION	FONTERRA INGREDIENTS \$ MILLION	ELIMINATIONS \$ MILLION	TOTAL GROUP \$ MILLION
For the six months ended and as at 30 November 2007 (unaudited)						
External revenue	3,474	1,345	788	1,727	–	7,334
Inter-segment revenue	1,813	236	24	20	(2,093)	–
Total revenue	5,287	1,581	812	1,747	(2,093)	7,334
Total assets	11,591	3,587	753	1,426	(1,302)	16,055
For the six months ended and as at 30 November 2006 (unaudited)						
External revenue	2,805	1,184	755	1,737	–	6,481
Inter-segment revenue	1,827	297	5	6	(2,135)	–
Total revenue	4,632	1,481	760	1,743	(2,135)	6,481
Total assets	9,327	3,231	622	1,339	(1,211)	13,308
For the twelve months ended and as at 31 May 2007 (audited)						
External revenue	6,340	2,366	1,534	3,447	–	13,687
Inter-segment revenue	3,626	588	11	15	(4,240)	–
Total revenue	9,966	2,954	1,545	3,462	(4,240)	13,687
Total assets	9,544	3,322	619	1,271	(1,262)	13,494

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

5. Property, plant & equipment

	6 MONTHS TO 30 NOV 2007 UNAUDITED \$ MILLION	6 MONTHS TO 30 NOV 2006 UNAUDITED \$ MILLION	12 MONTHS TO 31 MAY 2007 AUDITED \$ MILLION
Acquisitions	272	277	433
Disposals	(11)	(10)	(16)
Capital commitments	78	117	102

6. Business combinations

There have been no material business combinations during the six months to 30 November 2007. The only material business combination during the comparative periods was the acquisition on 12 January 2007 of the sales, marketing and distribution business of Norco Co-operative Limited for \$85 million, including transaction costs and stamp duty. The Norco acquisition resulted in the following impact on the Group's balance sheet:

	12 JAN 2007 AUDITED \$ MILLION
Total assets	14
Total liabilities	(4)
Net assets acquired	10
Total consideration paid	(85)
Goodwill arising on acquisition	75

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

7. Capital and reserves

\$ MILLION	ATTRIBUTABLE TO		
	CO-OPERATIVE SHARES	PEAK NOTES	SUPPLY REDEMPTION RIGHTS
Balance at 1 June 2007	4,897	–	–
Total recognised income for the period	–	–	–
Co-operative shares issued	120	–	–
Co-operative shares surrendered	(248)	–	–
Dividend paid to minority interests	–	–	–
Buyout of minority interests	–	–	–
Acquisition of subsidiary	–	–	–
Balance at 30 November 2007	4,769	–	–
Balance at 1 June 2006	3,569	1,149	285
Total recognised income for the period	–	–	–
Co-operative shares issued	1,337	–	–
Co-operative shares surrendered	(238)	–	–
Supply redemption rights price differential	(55)	–	–
Surrender of supply redemption rights and peak notes	–	(1,149)	(285)
Dividend paid to minority interests	–	–	–
Buyout of minority interests	–	–	–
Disposal of subsidiary	–	–	–
Balance at 30 November 2006	4,613	–	–
Balance at 1 June 2006	3,569	1,149	285
Total recognised income for the period	–	–	–
Co-operative shares issued	1,337	–	–
Co-operative shares surrendered	(245)	–	–
Supply redemption rights price differential	(55)	–	–
End of season issues current year	362	–	–
End of season surrenders current year	(71)	–	–
Surrender of supply redemption rights and peak notes	–	(1,149)	(285)
Dividend paid to minority interests	–	–	–
Buyout of minority interests	–	–	–
Disposal of subsidiary	–	–	–
Transfer between FCTR and retained earnings	–	–	–
Balance at 31 May 2007	4,897	–	–

EQUITY HOLDERS OF THE COMPANY

FCTR	CASH FLOW HEDGE RESERVE	RETAINED EARNINGS	TOTAL	MINORITY INTERESTS	TOTAL EQUITY
(38)	149	(166)	4,842	136	4,978
(16)	142	-	126	22	148
-	-	-	120	-	120
-	-	-	(248)	-	(248)
-	-	-	-	(5)	(5)
-	-	-	-	(1)	(1)
-	-	-	-	4	4
(54)	291	(166)	4,840	156	4,996
-	(7)	(306)	4,690	128	4,818
-	62	58	120	5	125
-	-	-	1,337	-	1,337
-	-	-	(238)	-	(238)
-	-	-	(55)	-	(55)
-	-	-	(1,434)	-	(1,434)
-	-	-	-	(9)	(9)
-	-	-	-	10	10
-	-	-	-	(1)	(1)
-	55	(248)	4,420	133	4,553
-	(7)	(306)	4,690	128	4,818
(32)	156	134	258	13	271
-	-	-	1,337	-	1,337
-	-	-	(245)	-	(245)
-	-	-	(55)	-	(55)
-	-	-	362	-	362
-	-	-	(71)	-	(71)
-	-	-	(1,434)	-	(1,434)
-	-	-	-	(14)	(14)
-	-	-	-	10	10
-	-	-	-	(1)	(1)
(6)	-	6	-	-	-
(38)	149	(166)	4,842	136	4,978

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

8. Loans and borrowings

	6 MONTHS TO 30 NOV 2007 UNAUDITED \$ MILLION	6 MONTHS TO 30 NOV 2006 UNAUDITED \$ MILLION	12 MONTHS TO 31 MAY 2007 AUDITED \$ MILLION
Balance at beginning of period	5,160	5,645	5,645
New issues			
Loans drawn	58	184	1,001
New finance leases	–	–	51
Capital notes issued	–	13	13
Commercial paper issued	2,061	2,118	2,903
Medium term notes issued	–	–	457
Repayments			
Bank lending	(525)	(13)	(82)
Finance leasing	(17)	(13)	(27)
Capital notes repurchased	–	(577)	(577)
Commercial paper matured	(804)	(1,555)	(3,005)
Medium term notes matured	(3)	(85)	(1,016)
Other movements			
Amortisation of commercial paper	15	31	64
Changes in the fair value of medium term notes	41	(1)	(22)
Changes due to movements in foreign exchange rates	20	(68)	(245)
Balance at end of period	6,006	5,679	5,160
Represented by:			
Current borrowings	2,391	2,442	1,066
Non-current borrowings	3,580	3,201	4,059
Capital notes	35	36	35
	6,006	5,679	5,160

9. Subsequent events

On 24 January 2008, the Board approved a change in the Group's balance date from 31 May to 31 July, with immediate effect. The 2008 annual report will include financial statements for the 14 month period to 31 July 2008.

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

10. Explanation of transition to NZ IFRS

Reconciliation of NZ IFRS equity with Previous NZ GAAP at 31 May 2006

\$ MILLION	EQUITY	TOTAL LIABILITIES	TOTAL ASSETS
Reported under Previous NZ GAAP	5,145	7,935	13,080
Deferred taxation ¹	(572)	572	–
Business combinations ²	128	(5)	123
Fair value of land ³	126	–	126
Financial instruments ⁴	(49)	317	268
Recognition of tax losses ⁵	44	(44)	–
Other adjustments	(4)	(2)	(6)
Total NZ IFRS adjustments	(327)	838	511
Restated under NZ IFRS	4,818	8,773	13,591

Reconciliation of NZ IFRS equity and profit with Previous NZ GAAP at and for the six months ended 30 November 2006

\$ MILLION	EQUITY	TOTAL LIABILITIES	TOTAL ASSETS	PROFIT FOR THE PERIOD
Reported under Previous NZ GAAP	4,760	7,932	12,692	11
Deferred taxation ¹	(571)	571	–	(2)
Business combinations ²	150	(5)	145	22
Fair value of land ³	125	–	125	–
Financial instruments ⁴	43	302	345	32
Recognition of tax losses ⁵	44	(44)	–	–
Other adjustments	2	(1)	1	6
Total NZ IFRS adjustments	(207)	823	616	58
Restated under NZ IFRS	4,553	8,755	13,308	69

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

Reconciliation of NZ IFRS equity and profit with Previous NZ GAAP at and for the year ended 31 May 2007

\$ MILLION	EQUITY	TOTAL LIABILITIES	TOTAL ASSETS	PROFIT FOR THE PERIOD
Reported under Previous NZ GAAP	5,016	7,615	12,631	31
Deferred taxation ¹	(533)	533	–	35
Business combinations ²	174	(4)	170	47
Fair value of land ³	125	–	125	–
Financial instruments ⁴	143	424	567	39
Recognition of tax losses ⁵	53	(53)	–	9
Other adjustments	–	1	1	4
Total NZ IFRS adjustments	(38)	901	863	134
Restated under NZ IFRS	4,978	8,516	13,494	165

1. Deferred taxation

Under NZ IFRS deferred tax is recognised on all temporary differences between the accounting carrying value and tax base for each asset and liability, which is known as the balance sheet approach. Under Previous NZ GAAP deferred tax was only recognised for the effect of timing differences between accounting and tax profits. This change in methodology results in the recognition of deferred tax under NZ IFRS that would have been considered permanent differences under Previous NZ GAAP and not recognised.

Under NZ IFRS deferred tax liabilities will be recognised in respect of brands and property, plant & equipment revalued on the formation of Fonterra. The additional deferred tax liability recognised at 31 May 2007 is \$471 million (30 November 2006: \$521 million; 31 May 2006: \$525 million). The impact on net surplus for the year ended 31 May 2007 is an increase of \$50 million (period ended 30 November 2006: \$1 million), of which \$47 million relates to the change in deferred tax recognition rates (period ended 30 November 2006: nil), and \$3 million relates to the unwinding of deferred tax liability relating to property, plant & equipment revalued on the formation of Fonterra (period ended 30 November 2006: \$1 million).

The application of the balance sheet approach to calculating deferred tax results in the recognition of the withholding tax payable on offshore subsidiaries' retained earnings to the extent the temporary difference will probably reverse in the foreseeable future. Under Previous NZ GAAP this liability only arose when the repatriation of retained earnings was recognised in the parent company's profit or loss. This has resulted in the recognition of a deferred tax liability at 31 May 2007 of \$62 million (30 November 2006: \$50 million; 31 May 2006: \$47 million), and a reduction in net surplus for the year to 31 May 2007 of \$15 million (period to 30 November 2006: \$3 million).

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

2. Business combinations

The Group has taken advantage of the exemption available under NZ IFRS 1 and applied NZ IFRS to all business combinations since 31 August 2005 and re-performed the fair value exercise on all business combinations subsequent to that date.

The key impacts for Fonterra in respect of the differences between Previous NZ GAAP and NZ IFRS relate to the amortisation of goodwill and the treatment of discounts on acquisition. Under NZ IFRS goodwill is no longer amortised but is subject to impairment testing. Discounts on acquisition are recognised in the income statement under NZ IFRS rather than being offset against the fair values of non-monetary items, as required under Previous NZ GAAP.

In respect of the business combinations re-opened, the recognition of additional deferred tax liabilities has resulted in an increase to the amount of goodwill recognised. The overall impact is to increase net assets at 31 May 2007 by \$90 million (30 November 2006: \$90 million; 31 May 2006: \$90 million), of which goodwill represents \$86 million (30 November 2006: \$85 million; 31 May 2006: \$85 million).

The effect of reversing goodwill amortisation from 31 August 2005 is to increase goodwill at 31 May 2007 by \$63 million (30 November 2006: \$43 million; 31 May 2006: \$24 million), and increase investments in associates at 31 May 2007 by \$16 million (30 November 2006: \$9 million; 31 May 2006: \$5 million). This results in an increase to net surplus for the year to 31 May 2007 of \$50 million (period to 30 November 2006: \$22 million).

The impact of the change in treatment of the discount on acquisition is to increase property, plant & equipment at 31 May 2007 by \$5 million (30 November 2006: \$8 million; 31 May 2006: \$8 million). This results in a decrease to net surplus for the year to 31 May 2007 of \$3 million (period to 30 November 2006: nil).

3. Fair value of land

NZ IFRS 1 provides entities an exemption allowing the fair value of items of property, plant & equipment to be used as deemed cost on transition to NZ IFRS, without the requirement to revalue those items going forward. Fonterra has elected to apply this exemption to land on its balance sheet at the date of transition. The effect of this is to increase property, plant & equipment at 31 May 2007 by \$125 million (30 November 2006: \$125 million; 31 May 2006: \$126 million). The aggregate fair value of land at 31 May 2007 for which fair value is used as deemed cost on transition to NZ IFRS is \$237 million (30 November 2006: \$238 million; 31 May 2006: \$239 million).

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

4. Financial instruments

NZ IAS 39 requires all derivative instruments to be recorded at fair value in the balance sheet with the related changes in fair value recognised in the income statement unless the instruments qualify for hedge accounting and the strict NZ IAS 39 hedging criteria are met. Fonterra currently uses foreign exchange contracts (options and forwards) to hedge forecast cash flows, and foreign exchange swaps as well as cross currency and interest rate swaps to hedge borrowings. Fonterra has applied hedge accounting wherever practicable. Where such instruments qualify as cash flow hedges the effective portion of changes in fair value of those instruments will be recorded directly in equity until the hedged transaction occurs. Where such instruments qualify as fair value hedges, changes in the fair value of the instruments along with changes in the fair value of the related debt will be recorded in the income statement. The resulting financial instrument adjustments had the following impact on the transition and comparative balance sheets and comparative profit for the periods to 30 November 2006 and 31 May 2007:

\$ MILLION	31 MAY 2007 DR/(CR)	30 NOV 2006 DR/(CR)	31 MAY 2006 DR/(CR)
Current derivative assets	493	300	226
Other current assets	(53)	(33)	(56)
Non-current derivative assets	127	78	98
Current derivative liabilities	(302)	(225)	(255)
Non-current derivative liabilities	(108)	(60)	(95)
Impact of recognising derivative instruments at fair value	157	60	(82)
Debt	47	4	9
Deferred tax liability	(61)	(21)	24
Impact on net assets	143	43	(49)
Transition retained earnings adjustment	42	42	42
Impact on profit for the twelve months ended 31 May 2007 and six months ended 30 November 2006	(39)	(32)	–
Cash flow hedge reserve	(149)	(55)	7
Foreign currency translation reserve	3	2	–
Impact on total equity	(143)	(43)	49

Notes to the Interim Financial Statements (continued)

FOR THE SIX MONTHS ENDED 30 NOVEMBER 2007

5. Recognition of tax losses

Fonterra has recognised additional New Zealand tax losses because of the recognition of deferred tax liabilities on other NZ IFRS adjustments. Fonterra still has unrecognised offshore tax losses. The effect of recognising tax losses at 31 May 2007 was to decrease the deferred tax liability by \$53 million (30 November 2006: \$44 million; 31 May 2006: \$44 million), and increase net surplus for the year to 31 May 2007 by \$9 million (period to 30 November 2006: nil).

6. Foreign currency translation reserve

Fonterra has elected to apply the exemption in NZ IFRS 1 to reset the foreign currency translation reserve to nil on transition, by transferring the balance of \$156 million to retained earnings, which has no overall impact on equity.

7. Software

Software, to the extent it is not an integral part of the related hardware, has been reclassified from Property, plant & equipment to Intangible assets. The total amount of the reclassification at 31 May 2007 is \$225 million (30 November 2006: \$224 million; 31 May 2006: \$243 million). The amortisation expense has also been reclassified from depreciation to amortisation. The total amount reclassified within the income statement for the twelve months ended 31 May 2007 is \$53 million (period to 30 November 2006: \$35 million). This adjustment has no overall impact on equity.

Independent Accountants' Report



To the shareholders of Fonterra Co-operative Group Limited

We have reviewed the interim financial statements on pages 4 to 31. The interim financial statements provide information about the past financial performance and cash flows of the Group for the six month period ended 30 November 2007 and its financial position as at that date. This information is stated in accordance with the accounting policies set out on pages 9 to 20.

Directors' responsibilities

The Company's Directors are responsible for the preparation and presentation of the interim financial statements that present fairly the financial position of the Group as at 30 November 2007 and its financial performance and cash flows for the six month period ended on that date.

Independent Accountants' responsibilities

We are responsible for reviewing the interim financial statements presented by the Directors in order to report to you whether, in our opinion and on the basis of the procedures performed by us, anything has come to our attention that would indicate that the interim financial statements do not present fairly the matters to which they relate.

This report is made solely to the Company's shareholders, as a body, in accordance with our engagement terms. Our review has been undertaken so that we might state to the Company's shareholders those matters we are required to state to them in an independent accountants' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's shareholders as a body, for our review, for this report, or for the opinions we have formed.

Basis of opinion

A review is limited primarily to enquiries of Group personnel and analytical review procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit on the interim financial statements and, accordingly, we do not express an audit opinion.

We have reviewed the interim financial statements of the Group for the six month period ended 30 November 2007 in accordance with the Review Engagement Standards issued by the New Zealand Institute of Chartered Accountants.

Independent Accountants' Report (continued)

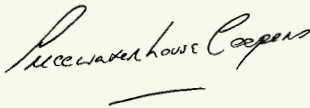
We carry out other assignments on behalf of the Group in the areas of taxation compliance, financial assurance and international accounting standard advisory services. Partners and employees of our firm may deal with the Group on normal terms within the ordinary course of trading activities of the Group. The firm has no other relationship with, or interest in the Group.

Review opinion

We have reviewed the financial performance and cash flows of the Group for the six month period ended 30 November 2007 and its financial position as at that date.

Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements do not present fairly the financial position of the Group as at 30 November 2007 and its financial performance and cash flows for the six month period ended on that date.

Our review was completed on 21 February 2008 and our review opinion is expressed as at that date.

A handwritten signature in blue ink, reading "PricewaterhouseCoopers", with a horizontal line underneath.

Chartered Accountants
Auckland



Fonterra

Private Bag 92032

Auckland

NEW ZEALAND

64 9 374 9000 (phone)

64 9 379 8284 (fax)