

# Capital structure consultation

## FAQs

Updated 1 June 2021

### FAQ Overview

- 10 of the most common questions received to date (Questions 1-10)
- The preferred option (Questions 11-29)
- The other options (Questions 30-35)
- The consultation process and associated temporary measures (Questions 36-47)
- How the review has been conducted and findings to date (Questions 48-58)

### Top 10 Questions

#### 1. Why is the Board proposing potential changes now?

- The review has highlighted that there are elements of our current structure that are challenging for a number of farmers now, or that may create challenges for our Co-operative in a flat or declining milk supply environment. These are explained in more detail on pages [4-5](#) and [22-23](#) of the Consultation Booklet.
- We've evolved our structure before, and it's important we keep evolving it as things change.
- Exactly how our capital structure evolves is what we are consulting with farmers on.
- We appreciate that there is a real sense of optimism in the Co-operative with our improving financial performance. But the issues raised through this review need to be addressed early.
- Acting now gives farmers more choice. For example, at the current share price and Fund size, our farmers have the ability to make a decision about the future of the Fund. If the Fund size grows, then this may no longer be an option for the Co-operative.
- Acting now also means we can better consult with farmers.

#### 2. What will happen to the price of shares and units?

- We cannot forecast share or unit prices. However, when we made the announcement on 6 May, we said that the prices for units in the Fund and shares in the FSM may not be as closely aligned as they have been to date while the temporary cap is in place.
- We have seen this divergence occur since the announcement.
- We also said that pricing of shares under the temporary cap may not reflect pricing of shares in a farmer-only market during normal trading. In other words, what we see during this temporary cap might be different to what we could see if farmers decided to move to a structure with a farmer-only market.
- This is because share standard compliance obligations for the 2021/22 season are temporarily on hold for farmers holding at least 1,000 shares and exiting farmers that are selling shares over three seasons in accordance with the constitution, so there may be lower levels of trading. Plus, because we are consulting on potential changes, there is a degree of uncertainty about our future capital structure.

- If the Board's preferred structure of a Reduced Share Standard with either No Fund or a Capped Fund were to be implemented, then the current uncertainty would no longer exist – some farmer owners would be required to trade shares to at least comply with the Reduced Share Standard and some farmer owners may choose to buy shares over and above their individual minimum requirements.
- We have also stated in the Consultation Booklet that, under the preferred option, the price at which shares in the Co-operative are traded may be impacted, and there may not be as much liquidity.
- Under the preferred option, shares would be priced in a farmer-only market. You may hear the potential price difference in a farmer-only market referred to as a "restricted market discount".
- Restricted market discounts are commonly observed in any market where participation is restricted (in this case, to farmer owners). A restricted market already exists in other New Zealand agricultural companies our farmer owners may be invested in.
- We can't be certain what the price difference might be, but the advice that we have received is that in normal trading the share price is likely to be in the range of 20-25% lower than if the current structure was retained.
- Ultimately, the price of our shares would be determined by the performance of our Co-operative and trading between farmers.
- See [page 12](#) of the Consultation Booklet for further details on the impacts of a farmer-only market.

**3. Is there a way to achieve the objectives of the capital structure review while maintaining share value – for example focussing more on performance, or further utilising MyMilk?**

- To a certain degree, strong performance does help us maintain a sustainable milk supply and we will continue to focus on performance.
- Tools like MyMilk and Share-Up Over Time Contracts provide support for new farmers joining the Co-operative, but they do not provide flexibility for existing farmers. We know that the high compulsory cost of investment is a key factor in farmers' decisions to leave.
- The Board has three main paths if milk supply declines:
  1. An ongoing programme of share buy-backs to maintain the Fund within the thresholds, which impacts our balance sheet and doesn't provide more flexibility for farmers.
  2. Increasing Fund thresholds, which would impact farmer ownership and control and doesn't provide more flexibility for farmers.
  3. Or, looking at other options that both provide flexibility and secure ownership and control.
- All these paths have trade-offs and we need to decide together what trade-offs we are willing to make.
- Reducing the share standard from the current 1:1 to 1:4 would give all farmers equal opportunity to have capital flexibility, making it easier for new farmers to join the Co-op and assisting with succession at the other end of the farming lifecycle – while protecting farmer ownership and control.
- See [Section 3](#) of the Consultation Booklet for more information on the preferred option.

**4. Isn't the preferred option just moving a Fonterra balance sheet risk onto farmers' balance sheets?**

- As a farmer-owned Co-op, every farmer owner has an interest in Fonterra's balance sheet.
- The purpose of this review is to support the long-term financial sustainability of the Co-op and maintain a sustainable milk supply – to protect farmers balance sheets, milk price, and sustainability for the long term.

**5. Can you provide the context of how/why the Board decided on a minimum share standard ratio of 1:4, or 25%?**

- We looked at a range of different minimum share standards from 1:2 to 1:10.
- It is a judgement call. We are trying to balance providing meaningful flexibility for farmers with ensuring that we remain consistent with Co-operative principles around having some capital-backed supply.

- If we reduce the share standard, we would also need to lift the cap on share ownership to ensure that there is more capacity for other farmers to buy shares from those who want to sell. The cap needs to be set at a level that avoids significant concentration of ownership.
- A share standard of say 1:2 might not provide enough flexibility for new and young farmers. A standard of say 1:6 might result in some farmers not having the level of connection to the Co-op that keeps us strong together.
- See also [page 12-13](#) of the Consultation Booklet.
- We want to hear your views on what you think the right level of flexibility is. Your feedback will help us develop the options for further consultation.

**6. What would happen if all farmers decided to sell down their shares to the minimum requirement?**

- Farmers who chose to sell shares would need to sell those shares in a farmer-owner market, at a price determined by farmers in the market. They would not be selling them directly back to the Co-op.
- It is important to remember that the Reduced Share Standard is intended to provide flexibility to farmers over their farming careers and that the 1:4 is a minimum shareholding requirement only. Farmers would not be required to sell shares to the minimum share standard.
- We are keen for views on whether others with an interest in the Co-op should be permitted to participate in the farmer-only market – e.g. sharemilkers and contract milkers.
- We are also looking at what other mechanisms we could put in place to support trading outcomes (such as an expansion of the market maker's role).

**7. Why would farmers want to hold more shares than the minimum required? What would be the benefits of holding extra shares?**

- Shares (including shares held above the minimum) would continue to receive any dividends declared by the Board and any capital appreciation over time.
- Holding more shares than the minimum required would be an investment decision that each farmer will need to make based on their own financial circumstances. We recommend that farmers seek independent advice from an accountant, lawyer, financial advisor or other rural professional.
- Under the preferred option, your voting rights remain linked to your share-backed milk supply (as is the case now under TAF). To retain your full voting rights, you need to stay at a 1:1 shareholding.

**8. Can you explain in more detail the Fund size thresholds and potential risks to farmer ownership and control? What is the concern around reaching the limits when unit holders cannot vote?**

- Although units carry no voting rights and the Fund has no right to appoint directors of Fonterra, there were concerns when TAF was established that the 'weight of capital' of a large Fund might, over time, lead to the Fund (including non-farmer investors and institutions) seeking to influence Fonterra's strategy or direction.
- The original Constitutional provisions passed for TAF in 2010 set both the Aggregate Threshold and the Overall Limit for the Fund size at 25%. In 2012 following debate and discussions with the Co-operative Council (formerly known as the Shareholders' Council), these were reduced to 15% (Aggregate Threshold) and 20% (Overall Limit) "*to give greater protection to ownership and control.*"
- While the Actual Fund Size is currently around 6.5%, the Potential Fund Size is around 16.5%. The Potential Fund Size is an indication of what the size of the Fund could be at any point in time (if all the dry shares were sold into the Fund) and is getting close to the Overall Limit of 20%.

**9. What are your expectations for future performance? e.g. guidance on future earnings to support farmers in their decision-making during consultation?**

- We have been making good progress across the Co-op, including improved business performance, a stronger balance sheet with reduced debt levels and dividend payments being resumed. Our

strategic direction, combined with a diversified portfolio, has positioned us well to navigate through a period of unprecedented global uncertainty as a result of COVID-19. While there is still more work to do, we remain on track to lift our performance in the medium term deliver our targets.

- We provided our third quarter update [on 26 May](#) and confirmed our earnings guidance for this Financial Year of 25-35c.
- We will provide our full year results at the end of September and our EPS guidance for the following Financial Year.

**10. How can the Co-op support those who would be most impacted by the potential changes e.g. farmers currently entering/recently entered/exiting/going through succession?**

- Conversations at the regional meetings have already brought out a number of good ideas from farmers, including how we can better honour the loyalty of our farmers who are considering retirement and succession and we will consider these ideas over the coming months.

## **The preferred option**

**11. Why has the Board decided to put forward a preferred option?**

- The Board wanted to take a leadership position and give the consultation some structure.
- The Board arrived at its preferred option after reviewing a wide range of capital structure options from co-operatives around the world – both within and outside the dairy sector – as well as options to evolve our current structure.
- This indicates our current thinking, but the Board is open minded about adjusting that direction based on farmer feedback on all of the options.

**12. What are the key benefits and trade-offs of this option?**

- Based on the work to date, the Board believes the preferred option would help us address the challenges we face today and those we are likely to face in the future, better enable the delivery of our refreshed strategy and help us build a more financially sustainable Co-operative.
- It would give farmers more flexibility, while ensuring farmer ownership and control is protected.
- A key outcome of this change is that shares would be bought and sold between farmers in a farmer-only market. We want to be clear that we expect this change to impact the price at which shares in the Co-operative are traded, and that there may not be as much liquidity in the market.
- Ultimately, the price of our shares would be determined by the performance of our Co-operative and trading between farmers.
- Under the existing structure our share price moves in line with the price of units in the Fund. In that sense it is influenced by unit holders, who have a different investor profile to that of us farmers – a farmer's cost of capital is typically higher.
- To cater for share flexibility, some farmers would inevitably have more shares than others. We believe this is a more sustainable proposition over the longer term than the alternatives we are confronted with.
- See [Section 3](#) of the Consultation Booklet for more information on the preferred option.

**13. The Co-operative already has tools like MyMilk and Share-Up Over Time Contracts – don't these provide enough flexibility for farmers?**

- These options provide support for new farmers joining the Co-operative, but they do not provide flexibility for existing farmers. We know that the high compulsory cost of investment is a key factor in farmers' decisions to leave.

**14. What would the main differences be between No Fund and a Capped Fund?**

- Removing the Fund would involve an offer by Fonterra to unit holders to buy back their units at a fixed price. The approval of at least 75% of unit holders entitled to vote and voting would be needed for the offer to be accepted. The offer amount would need to be acceptable to unit holders, fair to

farmers and would need to make more sense to the Co-operative than the Capped Fund alternative.

- A Capped Fund would involve the Fund remaining part of Fonterra's capital structure and listed on the NZX/ASX, but with one key change in that farmer owners would no longer be able to sell any further economic rights of shares into the Fund. Shares would be tradeable in the FSM only.
- Members of the public could continue to trade units in the NZX/ASX, with units continuing to receive distributions in line with our performance. Farmer owners would also still be able to exchange any units they hold for shares in the FSM.
- It would mean that the size of the Fund as a proportion of our Co-operative could not increase materially, but it could decrease if farmer owners exchange units they buy or hold into shares. Fonterra could also potentially buy it back in the future – partially or fully.
- See [page 8](#) of the Consultation Booklet for more details.

**15. Does the Board have a preference for No Fund or a Capped Fund? If so, why?**

- We have reached a preliminary view that having No Fund would be preferable to a Capped Fund because it simplifies our Co-operative.
- However, if we cannot reach an acceptable arrangement to buy back the Fund that 75% of voting unit holders support, then a Capped Fund would also work.
- In other words, we would only seek to remove the Fund at a reasonable price that was acceptable to unit holders, fair to farmer owners and made sense to the Co-operative compared to the Capped Fund alternative.

**16. The Fund was set up in part to achieve price discovery i.e. to help in price perception for farmer share trading. Is there value therefore in retaining a capped Fund?**

- There are both pros and cons of retaining a capped Fund. It could be a useful reference point for how external investors value the economic rights of a Fonterra share and capital would not need to be allocated to buy it back.
- On the other hand, the Fund adds complexity to our current structure and some farmers may be of the view that it is better to buy it back and remove it.
- In either scenario we would continue to be subject to financial markets laws and regulations including disclosure requirements.

**17. Is Fonterra likely to get Government support whether it be the No Fund or the Capped Fund variations within the preferred option?**

- We have been consulting with Government and will continue to do so, particularly to understand whether DIRA change is required and what that might look like if farmers are supportive of change.

**18. Why is the preferred option considered better than the Co-operative's current structure and other potential alternatives?**

- The Board prefers the Reduced Share Standard structure over the other options, including staying with our current structure, for several reasons.
- Overall, we think this structure measures well against the design principles for the review while remaining aligned with our Co-operative Principles.
- It provides greater flexibility for farmers, which we think will better support a sustainable milk supply for Fonterra so that we can continue to operate efficiently.
- It also helps protect farmer ownership and control, which in turn protects our interests as suppliers.
- It still requires all suppliers to become farmer owners with capital-backed supply, and all farmer owners would still have exposure to both milk price and some earnings.
- It is preferable to a Dual Share structure at maintaining a strong balance sheet for our Co-operative. This is a high priority for us and was also reflected in farmer feedback. This is because retaining a single share would mean that all share capital is rated as equity (which would not be the case under

a Dual Share structure where one of the shares may be partially classified as debt by ratings agencies).

- We also think it would be more straight forward to implement than other options.
- No structure is perfect. All options involve trade-offs. What we're not willing to trade off is farmer ownership and control that protects overall returns – including milk price and dividends.
- While we know that moving to a farmer-only market may have implications for the price of farmers' shares, we believe maintaining farmer ownership and control of the Co-operative is worth this trade-off.

**19. The Co-operative has been selling a number of assets and has a stronger balance sheet – therefore what is wrong with buy-backs in the future?**

- Buying back shares or units is one potential option to stay within the constitutional thresholds if milk supply declines to the extent suggested by the scenarios included in the Consultation Booklet.
- While it could potentially be accommodated, it would put an uncertain demand on our capital in the future and potentially impact our ability to invest in strategy and growth.
- And, buy-backs don't address the lack of flexibility for farmers that our current structure creates.
- It is also worth noting the other impacts that come along with declining milk. This could include the potential for reduced scale efficiencies across milk collection and manufacturing operations or an ongoing requirement to continually right-size our operations.

**20. How might the preferred option better support the delivery of the Co-operative's strategy?**

- New Zealand milk is at the heart of our strategy – everything starts there. We need a sustainable milk supply in order to execute our strategy.
- We believe that the Reduced Share Standard with No Fund or Capped Fund would create greater flexibility for farmers to better support a sustainable milk supply for the Co-operative.
- It also protects farmer ownership and control, including the maximum sustainable milk price for farmers over the long term.
- If we stay with our current structure and milk supply declines to the extent suggested by the scenarios included on [page 22](#) of the Consultation Booklet, then the actions we would expect to have to make – such as continually funding buy-backs – would mean that resources would not be entirely focussed on delivering our strategy.

**21. Where will the Co-operative get new capital for growth in adding value, which is part of the strategy, if these changes are not raising capital from farmers or non-farmers? Would the preferred option provide for the investment needed in market development?**

- Having adequate and sustainable access to capital to fund our strategy is always front of mind.
- We will fund our strategy through a strong balance sheet, cashflow, and through leveraging our IP and innovation capability to partner in new products and categories where it makes sense.
- This capital structure review is about prioritising New Zealand milk, protecting farmer ownership and supporting a sustainable milk supply over the longer term.
- Our strategy is dynamic, and we will always be reviewing our portfolio – asking ourselves what each asset is worth to us now and into the future. We will continue to turnaround key parts of our portfolio and divest non-core businesses to support new investments as necessary.
- Our focus is on maintaining a strong balance sheet to support growth.

**22. How much would it cost to buy back the Fund?**

- The exact cost is uncertain at this stage but capping the Fund size removes the risk that the Fund size grows and significantly increases the total cost.
- We would need to reach an acceptable arrangement that 75% of voting unitholders support.
- We would only seek to remove the Fund at a reasonable price that was both acceptable to unitholders and fair to farmer owners.

- We have significantly improved our balance sheet over the last couple of years, and this has provided us with the flexibility to buy back the Fund at current levels.
- The Board is committed to achieving long-term gearing ratios of 2.5-3.0x debt to EBITDA and 30-40% gearing.
- If we decide to invest in buying back the Fund, the impact on earnings and EPS would depend on how the buy-back is funded. If it were funded from debt, for example, higher debt levels would increase financing costs, therefore reducing earnings. However, total shares on issue would decrease, meaning that earnings would be spread over fewer shares.

**23. Could the preferred option potentially result in too much concentration in ownership?**

- The Reduced Share Standard structure, with the minimum requirement set at 1:4, is intended to provide meaningful flexibility for farmers to reduce their shareholding while ensuring there is sufficient ability for other farmers to hold a greater number of shares without giving rise to a significant concentration of ownership.
- A different ratio of say 1:10 that allowed farmers to lower their share ownership even further would mean the 4x cap would need to be higher so that there would be enough buyers in the farmer-only market. This could potentially give rise to too much concentration in ownership with a small group of farmers.
- When it comes to voting rights and the potential for concentration of ownership, it's important to note that under the preferred option because voting rights would be "per 1,000 kgMS backed by shares", a farmer who continues to hold shares on a 1:1 basis relative to their supply in the previous season will retain the same voting entitlement as today, and a farmer who holds additional shares over the 1:1 basis (up to the maximum shares at 4x kgMS supplied) would only have voting rights up to the 1:1 level, not their full shareholding.
- During consultation, we welcome farmer views on whether there should be any other mechanisms to support greater alignment between farmers.

**24. What would happen to MyMilk and Share-Up Over Time contracts?**

- Share-Up Over Time and MyMilk contract supply options would be phased out (although all existing commitments would be honoured).

**25. This might mean that those supplying other processors could be attracted back, therefore putting pressure on the share price. Wouldn't this be positive?**

- The preferred option – a Reduced Share Standard with No Fund or a Capped Fund – would allow farmers to make better decisions about which processor to supply on a more like-for-like basis and provide farmers more choice about whether to join, stay in, or leave the Co-op.
- That's due to the Reduced Share Standard, which would make it easier for farmers to join our Co-op and give more flexibility to existing farmer owners who may want to free up capital or who are working through succession. We think this will better support a sustainable milk supply for Fonterra.
- The key things to consider with this option – including what may happen to the share price – are detailed on [pages 12-13](#) of the Consultation Booklet. Ultimately, the price of our shares would be determined by the performance of our Co-op and trading between farmers.

**26. Since TAF has been introduced, there has been a tension between dividend and milk price. How will these proposals ease that tension?**

- Aligning incentives is one of the core design principles that the Board used to assess all potential options.
- Under the existing structure our share price moves in line with the price of units in the Fund. In that sense it is influenced by unit holders, some of who have a different investor profile to that of our farmers – a farmer's cost of capital is typically higher. Under the preferred option, this would no longer be the case.

- All suppliers would still be required to hold capital-backed supply, and all farmer owners would still have exposure to both milk price and some earnings – although some may have more exposure to earnings than others relative to their supply.
- The minimum shareholding requirement of 1:4 and a cap of 4x supply on shareholding is intended to provide meaningful flexibility for farmers to reduce their shareholding, while ensuring there is sufficient ability for other farmers to hold a greater number of shares without giving rise to a significant concentration of ownership.
- Further information about alignment is included in the key things to consider section on [page 13](#) of the Consultation Booklet. We welcome farmer views on whether there should be any other mechanisms to support greater alignment between farmers.

**27. What time period would Fonterra prefer for entry and exit? Can we build depth in the market by allowing retiring farmers to hold onto their shares for longer – say 15 or 20 years?**

- The Board has put forward its current thinking on how the preferred option could work. This includes extending the share-up and share-down periods to five seasons (up from three seasons today), but we are keen to hear farmer views on this over the course of consultation.
- One idea we've heard from farmers is to give them longer to sell down those shares, during which they can continue to toll the value via the dividend. That's something we are open to.
- If departing shareholders were to have 15-20 years to sell their shares, then assuming all shares retain the same rights to a dividend, those departing shareholders would be entitled to dividends for 15-20 years.

**28. How many shareholders hold more than 1:1 now?**

- Currently around 85% of our shareholder hold some dry shares.
- Around 30% of shareholders hold around 53% of the Co-op.

**29. What would happen to Vouchers?**

- Any vouchers would be cancelled (as holders would not need them to count towards the Reduced Share Standard).

## **The other options**

**30. Couldn't the Co-operative stay with the current structure and buy back shares or units in the future if milk supply declines?**

- Buying back shares or units is one potential option to stay within the constitutional thresholds if milk supply declines to the extent suggested by the scenarios in the Consultation Booklet.
- While it could potentially be accommodated, it would put an uncertain demand on our capital in the future and potentially impact our ability to invest in strategy and growth.
- And, buy backs don't address the lack of flexibility for farmers that our current structure creates.
- It is also worth noting the other impacts that come along with declining milk. This could include the potential for reduced scale efficiencies across milk collection and manufacturing operations or an ongoing requirement to continually right-size our operations.

**31. What would the Dual Share option with either No Fund or a Capped Fund look like?**

- This involves moving away from our current single Co-operative share to a structure with two classes of shares – a compulsory supply share and a separate non-compulsory investment share.
- As with the Reduced Share Standard structure, the Dual Share option would give more flexibility to farmers but also has the potential for the existing constitutional thresholds to be exceeded if we took no action in relation to the Fund, as the investment shares could move into the Fund over time.
- That's why we would need to either buy back the Fund or cap the size of the Fund.
- See [Section 5](#) of the Consultation Booklet for more details.



**32. What are the key benefits and trade-offs of the Dual Share option with either No Fund or a Capped Fund option?**

- This option gives farmers the ability to choose whether or not to invest in the Co-operative beyond milk supply and the associated compulsory supply shares.
- Because the supply share would carry a nominal price, this price would not fluctuate over time. This means that those farmer owners that choose to hold only supply shares would not carry any risk of movements in the Co-operative share price over time.
- Farmer owners would not be required to hold any investment shares and could therefore choose to remove most of their exposure to earnings performance.
- Features such as the nominal value for the supply share and the cap on investment shares could be changed over time. In addition, the dividend on supply shares, voting rights and the time frames for sharing up and selling shares on exit could be set differently.
- The impacts of a farmer-only market outlined on [page 12](#) of the Consultation Booklet under the Reduced Share Standard structure would also apply to this Dual Share option.

**33. Why did the Dual Share option with either No Fund or a Capped Fund option not end up being the preferred one?**

- The key reasons why this is not our preferred option are:
  - The supply share is likely to be treated as a half debt and half equity (“hybrid”) instrument by the rating agencies that review Fonterra’s financial strength, and as debt for accounting purposes. This means that it would reduce the Co-operative’s balance sheet capacity by around \$750 million (or potentially \$1.5 billion if it is rated as all debt), which could limit our financial flexibility over time.
  - A Dual Share structure could result in less alignment among the Co-operative’s farmer owners than a Reduced Share Standard structure. Farmer owners that choose to only hold supply shares may be more interested in investment in activities that are milk price focussed with less interest in value-adding strategies and investments. On the other hand, those farmer owners with a large proportion of investment shares may be more aligned with business decisions that drive earnings.
  - As there would be no requirement for farmer owners to hold investment shares, there may be less liquidity in farmer-only market than under a Reduced Share Standard.
  - A Dual Share structure is likely to be more complex to transition to and operate over time.

**34. What other options has the Board considered?**

- Some of the other options that were considered earlier in the review include unshared supply options, traditional 'nominal share' options or options that split the Co-operative.
- These are explained in more detail on pages [28-29](#) of the Consultation Booklet.

**35. Why did those other options not get prioritised?**

- Farmer views helped narrow down the options. The Board prioritised two they thought could best meet the objectives of the review for a closer analysis. That closer analysis resulted in the Board putting forward a preferred option.

## **The consultation process and associated temporary measures**

**36. How can farmers have their say and when do they need to do this by?**

- There are multiple ways farmers can share their views.
- One of the options is via the online form at [Fonterra.com/csfeedback](https://fonterra.com/csfeedback).
- Other channels include face-to-face farmer meetings or webinars (schedule available [here](#)) or by contacting their Director, Area Manager or the service team on 0800 656568 or emailing us at [csfeedback@fonterra.com](mailto:csfeedback@fonterra.com). All the details are provided in [Section 6](#) of the Consultation Booklet.

- We're looking to gain as much feedback as possible by the end of June, as we intend to share initial farmer feedback in July.

**37. What main areas are you looking for feedback on during consultation?**

- The Board is also open to feedback on any of the other options that have been considered.
- The Board has outlined on [page 9](#) of the Consultation Booklet its current thinking on how its preferred structure could work.
- This has been done after looking at different options for some of the features, such as the 1:4 share standard, the 4x cap on shares, associated voting rights and more.
- We are particularly keen to hear farmer views on these points over the course of the consultation process, as well as the key considerations outlined on [pages 12-13](#).

**38. How open is the Board to changing its preferred direction of travel based on feedback received during consultation?**

- The preferred option indicates current thinking, but we are open minded about adjusting that direction based on farmer feedback on all of the options.

**39. What are the next steps and when is the review likely to conclude?**

- Once we hear farmer views, and if the appetite for change remains, we would do further work to refine the preferred option(s) and have a second round of consultation.
- If the Board decides to seek a change to our capital structure, the likely aim is to hold a farmer vote around the time of the Annual Meeting in November. The approval of 75% of votes from voting farmers would be required.
- If the preferred outcome is to buy back the Fund, it would also require the approval of 75% of votes from voting unit holders.
- As some aspects of our current capital structure are reflected in DIRA, any vote is likely to be conditional on any necessary changes to legislation being passed.

**40. Why was it necessary to temporarily cap the size of the Fund before starting consultation?**

- This is not a decision we made lightly. It was clear from the outset that consultation for this review would be more challenging than last time because both shares and units in the Fund are traded securities and we need to comply with continuous disclosure rules.
- As we progressed the review and started looking into options that included buying back the Fund, we identified a risk that, if we started consulting on options for change without temporarily capping the Fund, the Fund size could have grown significantly and taken the option of buying back the Fund off the table before farmers had a chance to consider it.
- Some of the options have the potential to see differences emerge between the price at which a share trades in the FSM compared to what a unit in the Fund trades at, with units trading at a higher price than shares.
- If the temporary cap was not in place, anyone holding dry shares would be able to exchange them into units in the Fund. This could more than double the size of the Fund and make options that include buying back the Fund unaffordable in the context of our current balance sheet targets.
- The temporary cap was a necessary step to keep all of our options for change open while we have a free and frank conversation as owners.

**41. How do the FSM and Fund work during the temporary cap?**

- The temporary cap means that shares can no longer be exchanged into units. Farmers are free to buy and sell shares in the FSM and anyone holding units in the Fund, which may include farmers, are free to continue buying and selling units on the NZX or ASX.

**42. What does putting compliance obligations on hold during consultation mean for farmers?**

- This means that all supplying farmers holding a minimum of 1,000 shares, and exiting farmers that are selling shares over three seasons in accordance with the Constitution, are not required to buy or sell shares to meet the share standard for the 2021/22 season until a later date to be advised.
- Compliance obligations are also temporarily on hold for those farmers who have not yet met their Share Standard compliance obligations for the 2020/21 season. This is so that no farmers are required to trade for compliance purposes during the temporary cap, until a date to be advised.

**43. What happens to delegated compliance trading?**

- With compliance obligations on hold as explained above, delegated compliance trading will not be offered for this season. If a date for compliance is advised in accordance with the above, then delegated compliance trading will likely be offered at that time.

**44. What about farmers on a Share-Up Over Time Contract?**

- These farmers are not required to buy or sell shares to meet their relevant share up requirements for the 2021/22 season until a later date to be advised, as above.
- For farmers whose final year of their Share-Up Over Time contract is 2021/22, they can still submit a cease notice for the following 2022/23 season, even if they will not have fully shared up due to compliance obligations being on hold.

**45. If compliance obligations are on hold why have you set a Compliance Date of 20 April 2022?**

- Our Constitution requires a Compliance Date to be set before the start of each season. The formal Compliance Date for the 2021/22 season has been set as 20 April 2022, which is consistent with previous seasons. However, as explained above, farmers holding a minimum of 1,000 shares will not be required to comply with the Share Standard until a date to be advised.

**46. What does putting the purchase of units under the Contract Fee for Units Trust on hold during the consultation process mean for farmers?**

- Under the Contract Fee for Units trust, the contract fee paid by a farmer under a Share-Up Over Time contract, or supplying MyMilk, is transferred to a trust and used to purchase units which are held on trust for the relevant farmer. Those units are then distributed to the farmer when the farmer needs to share-up under the contract, or for MyMilk suppliers, when they need to acquire shares to supply the Co-operative.
- The Contract Fee for Units Trust is a discretionary scheme we offer. The Trustee will continue to hold the 5c/kgMS contract fee on trust for the relevant farmers but given the consultation on capital structure changes, the Trustee will not apply that 5c/kgMS to purchase units to hold on trust for the relevant farmers.

**47. What happens to the Contract Fee?**

- The Contract Fee is set each season. It was set at 5c/kgMS for the current season and has also been set as 5c/kgMS for next season. It will continue to be deducted from milk payments for next season, and will be held on trust under the Contract Fee for Units Trust. However the purchase of units by the Trustee has been put on hold until a date to be advised by the Board.

## **How the review has been conducted and findings to date**

**48. When did the capital structure review start and what is its objective?**

- The groundwork for our capital structure review was laid in late 2019, after our strategy refresh.
- Alongside the refreshed strategy, the Board has spent a significant amount of time reviewing our Co-operative's capital structure.
- The objective is to have a capital structure that helps ensure our financial sustainability well into the future so we can deliver value for this generation and the next.

- This has led the Board to focus on two main areas: maintaining a sustainable milk supply and protecting farmer ownership and control.

#### **49. What does capital structure cover exactly?**

- Capital structure can be defined as the way a company manages the balance between its debt and equity to finance its activities, assets and growth.
- As a farmer-owned Co-operative, we think about other things as well, like: how should the price of our shares be set; how can we give farmers flexibility with their capital; to what extent should non-farmers be able to invest in the Co-operative; how much capital do we need to support our strategy; and more.

#### **50. Why is capital structure important?**

- Getting our capital structure right is important to helping ensure our financial sustainability.
- It supports our purpose, strategy, performance and ability to maintain farmer ownership and control over the long term.
- It plays an influential role in key areas of our business such as maintaining a strong balance sheet and enabling us to be resilient to shocks.
- It also directly impacts individual farming businesses – from how flexible farmers can be with their capital to how much they're getting as a return on investment, and much more.

#### **51. What has the review involved to date?**

- The Board started by identifying what the key elements of a financially sustainable Co-operative are and developing a set of design principles. These were shared externally after our annual results in September 2020 and are included in [Section 4](#) of the Consultation Booklet.
- The wide range of alternatives were assessed and prioritised based on how well they met the objectives of the review and the design principles.

#### **52. How were farmer views taken onboard?**

- While we would have liked to have been out on the road discussing options with farmers earlier, we have gained useful insights from farmer workshops on capital flexibility that were held in 2019, the roadshows after annual results and interim results, a phone survey we did in December 2020 of a representative sample of 350 farmer owners, as well as the online survey available to all farmers from January to February 2021 where we had around 1,800 responses.

#### **53. What views did farmers express before the consultation process kicked off?**

- The online survey results confirmed that there is an appetite for change, with 62% of respondents either strongly or slightly supporting a change.
- The results also gave us an insight into what farmers consider are the main priorities in any potential structure. These are outlined in [Section 4](#) of the Consultation Booklet.

#### **54. What were the findings to date?**

- The review has highlighted that there are elements of our current structure that are challenging for a number of farmers now, or that may create challenges for our Co-operative in a flat or declining milk supply environment.
- These are explained in more detail on [pages 4-5](#) and [22-23](#) of the Consultation Booklet.

#### **55. In all your research and investigation of Co-op's around the world, did you discover any capital structures that were comparable to Fonterra's current situation?**

- Every Co-op is different, and capital structures evolve depending on the context an organization is operating in.
- We've looked at many examples from Co-ops around the world, and that has helped our thinking, but ultimately what we're proposing is designed for the challenges that we're facing here and now.

**56. Has TAF delivered what it was set up to do?**

- TAF helped to address some of the challenges we faced at the time that it was implemented.
- But it has been important to look at whether it will best support our financial sustainability into the future based on how much has changed since then.
- It's also important to keep in mind Fonterra's capital structure will continue to evolve in the future – we cannot foresee all challenges the Co-op may face in the decades ahead.

**57. How did the Board come to the scenarios in the Booklet around milk supply potentially flattening or declining?**

- The scenarios were developed internally to reflect our views on the impact of the regulatory environment, land use change, productivity changes on our milk supply, plus other changes in milk supply based on the last five seasons.
- We understand that there are many different perspectives on how the milk supply landscape may change over coming years. The scenarios we developed have been used to help understand how change could impact our business.

**58. What are the actual financial impacts of potential milk loss on the Co-op?**

- The potential for declining milk could impact many areas of the Co-op.
- Because we have a large fixed asset base the per kgMS cost of processing milk increases when milk supply declines.
- To some extent these costs can be offset through product mix choices and right sizing our operations, but a smaller business impacts our ability to deliver on strategy and our ability to maximise the value that is created for share and unit holders.
- Fonterra's milk price acts as a benchmark in New Zealand, so having a strong farmer-owned co-operative in our dairy industry is important for all New Zealand dairy farmers and it is also important for our regional communities.