YOUR OPPORTUNITY.

FONTERRA SHAREHOLDERS' FUND PROSPECTUS AND INVESTMENT STATEMENT

26 OCTOBER 2012

Fonterra

Dairy for life

IMPORTANT INFORMATION

(The information in this section is required under the Securities Act 1978.)

INVESTMENT DECISIONS ARE VERY IMPORTANT. THEY OFTEN HAVE LONG-TERM CONSEQUENCES.

READ ALL DOCUMENTS CAREFULLY. ASK QUESTIONS. SEEK ADVICE BEFORE COMMITTING YOURSELF.

CHOOSING AN INVESTMENT

When deciding whether to invest, consider carefully the answers to the following questions that can be found on the pages noted below:

In addition to the information in this document, important information can be found in the current registered prospectus for the investment. You are entitled to a copy of that prospectus on request.[1]

THE FINANCIAL MARKETS AUTHORITY REGULATES CONDUCT IN FINANCIAL MARKETS

The Financial Markets Authority regulates conduct in New Zealand's financial markets. The Financial Markets Authority's main objective is to promote and facilitate the development of fair, efficient, and transparent financial markets.

For more information about investing, go to http://www.fma.govt.nz.

FINANCIAL ADVISERS CAN HELP YOU MAKE INVESTMENT DECISIONS

Using a financial adviser cannot prevent you from losing money, but it should be able to help you make better investment decisions.

Financial advisers are regulated by the Financial Markets Authority to varying levels, depending on the type of adviser and the nature of the services they provide. Some financial advisers are only allowed to provide advice on a limited range of products.

When seeking or receiving financial advice, you should check –

- the type of adviser you are dealing with:
- the services the adviser can provide you with:
- the products the adviser can advise you on.

A financial adviser who provides you with personalised financial adviser services may be required to give you a disclosure statement covering these and other matters. You should ask your adviser about how he or she is paid and any conflicts of interest he or she may have.

Financial advisers must have a complaints process in place and they, or the financial services provider they work for, must belong to a dispute resolution scheme if they provide services to retail clients. So if there is a dispute over an investment, you can ask someone independent to resolve it.

Most financial advisers, or the financial services provider they work for, must also be registered on the financial service providers register. You can search for information about registered financial service providers at http://www.fspr.govt.nz.

You can also complain to the Financial Markets Authority if you have concerns about the behaviour of a financial adviser.

1 This is the wording required by Schedule 13 to the Securities Regulations 2009, which contemplates a separate prospectus and investment statement. This Offer Document comprises both a prospectus and an investment statement and, accordingly, the prospectus available on request is identical to this document.

IMPORTANT NOTICE

This Offer Document is a combined prospectus and investment statement for the purposes of the Securities Act and the Securities Regulations. It is prepared as at, and dated, 26 October 2012.

The information required to be contained in an investment statement is set out in the sections entitled *Important Information* and *Answers to Important Questions*. The purpose of those sections is to provide certain key information that is likely to assist a prudent but non-expert person to decide whether or not to subscribe for Units under the Offer. Investors should be aware that other important information about the Units and the Offer is set out in other sections of this Offer Document.

This Offer Document is an important document and should be read carefully. Investors should consider the risks that are associated with an investment in the Units, particularly with regard to their personal circumstances (including financial and tax issues). A summary of the principal risks associated with an investment in the Units is set out under the heading "What are my risks?" in the section entitled *Answers to Important Questions*. A more detailed description is set out in Section 7 – *Investment Risks*.

Investors who are in any doubt as to any aspect of the Offer should consult a NZX Firm or their solicitor, accountant or other appropriately qualified professional adviser.

No person is authorised to give any information or to make any representation in connection with the Offer which is not contained in this Offer Document. Any information or representation in connection with the Offer not contained in the Offer Document may not be relied upon as having been authorised by the Manager or Trustee of the Fund, Fonterra, the Joint Lead Managers or any of their respective directors, officers, employees, consultants, agents, partners or advisers.

NO GUARANTEE

No person guarantees the Units, or any returns on the Units, offered under this Offer Document.

REGISTRATION

A copy of this Offer Document duly signed by or on behalf of the directors of the Manager of the Fund and every Promoter for the purposes of the Securities Act, and having endorsed thereon or attached thereto copies of the documents and other materials required by section 41 of the Securities Act, has been delivered to the Registrar of Financial Service Providers for registration in accordance with section 42 of the Securities Act.

The documents required by section 41 of the Securities Act to be endorsed on or attached to the copy of this Offer Document delivered to the Registrar of Financial Service Providers are:

- the report of the Auditor in respect of the summary financial information included in this Offer Document, as set out in this Offer Document;
- the signed consent of the Auditor to the audit report appearing in this Offer Document;
- the report of the Investigating Accountant in respect of the Fonterra Prospective Financial Information included in this Offer Document, as set out in this Offer Document;
- the signed consent of PricewaterhouseCoopers to the Investigating Accountant's Report appearing in this Offer Document;
- copies of the material contracts referred to under the heading "Material contracts" on page 156; and
- letters of authority authorising this Offer Document to be signed by an agent of any director of the Manager and any Promoter (if and where required), and a power of attorney authorising this Offer Document to be signed by an attorney appointed by Fonterra (being a Promoter).

CONSIDERATION PERIOD

Pursuant to section 43C of the Securities Act, upon registration of the Offer Document with the Registrar of Financial Service Providers, the Financial Markets Authority will be notified of the registration for the purpose of allowing the Financial Markets Authority an opportunity to consider whether the Offer Document (a) complies with the Securities Act and the Securities Regulations; (b) contains any material misdescription or error, or any material matter that is not clearly legible; or (c) is false or misleading as to a material particular, or omits any material particular. Nothing in that section or in any other provision of the Securities Act limits the Financial Markets Authority's power to consider or reconsider those matters at any time. The nature and extent of the consideration (if any) that the Financial Markets Authority gives to the Offer Document are at the Financial Markets Authority's discretion.

Section 43D of the Securities Act prohibits the Manager of the Fund from accepting Applications or making allotments in respect of the Offer during the period commencing with the date of this Offer Document and ending on the close of the day that is five working days after that date. The Financial Markets Authority may shorten that period, or extend it by no more than five additional working days.

OVERSEAS INVESTORS

The Offer is being made only to members of the public in New Zealand and Australia and to Institutional Investors in New Zealand, Australia and certain other overseas jurisdictions (excluding the United States and any persons who are, or are acting for the account or benefit of, US Persons).

No person may offer, sell (including resell) or deliver or invite any other person to so offer, sell (including resell) or deliver any Units or distribute any documents (including this Offer Document) in relation to the Units to any person outside New Zealand or Australia except in accordance with all of the legal requirements of the relevant jurisdiction. In particular, this Offer Document (including an electronic copy) may not be distributed or released, in whole or in part, to persons in the United States (other than to Pre-identified EUSFMs) or persons who are, or are acting for the account or benefit of, US Persons. Any failure to comply with such restrictions may constitute a violation of applicable securities laws.

The Units have not been, and will not be, registered under the US Securities Act or the securities laws of any state or other jurisdiction of the United States and may not be offered or sold, directly or indirectly, in the United States, other than to a limited number of Pre-indentified EUSFMs, or to, or for the account or benefit of, a US Person.

Accordingly, the Units to be offered and sold in the Offer may only be offered and sold to (i) eligible investors outside the United States who are not US Persons and are not acting for the account or benefit of a US Person, or (ii) to a limited number of Pre-identified EUSFMs, in each case, in "offshore transactions" (as defined in Regulation S under the US Securities Act) in compliance with category 2 of Regulation S under the US Securities Act.

Unless otherwise agreed with the Manager of the Fund, any person or entity subscribing for Units in the Offer shall, by virtue of such subscription, be deemed to represent that he, she or it is not in a jurisdiction which does not permit the making to him, her or it of an offer or invitation of the kind described in this Offer Document, and is not acting for the account or benefit of a person within such jurisdiction. None of the Manager of the Fund, Fonterra, Fonterra's subsidiaries, the Trustee, the Joint Lead Managers or any of their respective directors, officers, employees, consultants, agents, partners or advisers accepts any liability or responsibility to determine whether a person is able to participate in the Offer.

IMPORTANT INFORMATION FOR AUSTRALIAN INVESTORS

Australian investors should have regard to the Additional Australian Information accompanying this Offer Document before deciding whether or not to purchase Units. The Additional Australian Information contains disclosure relevant to Australian investors and important notices required for a recognised offer under Chapter 8 of the Corporations Act and the Australian Corporations Regulations 2001 (Cth).

NZX LISTING

Application has been made to NZX for permission to list the Fund and to quote the Units on the NZX Main Board and all requirements of NZX relating to that application that can be complied with on or before the date of this Offer Document have been duly complied with. However, NZX accepts no responsibility for any statement in this Offer Document.

NZX has authorised NZX Firms to act on the Offer. The NZX Main Board is a registered market operated by NZX, a registered exchange regulated under the Securities Markets Act.

Initial quotation of the Units on the NZX Main Board is expected to occur on 30 November 2012 under the ticker code "FSF".

Announcements during the period of the Offer will be made through the NZX Market Announcement Platform and will be able to be viewed on the NZX website www.nzx.com.

ASX LISTING

The Manager of the Fund will apply to ASX for permission to list the Fund and to quote the Units on ASX. Listing is not guaranteed and is at the discretion of ASX. Similarly, there is no assurance that the ASX listing of the Fund will continue for the life of the Fund.

ASX accepts no responsibility for the contents of this Offer Document or the Additional Australian Information or for the merits of the investment to which this Offer Document or the Additional Australian Information relate. Admission to the official list of ASX and quotation of the Units on ASX are not to be taken as an indication of the merits, or as an endorsement by ASX, of the Fund or the Units.

Initial quotation of the Units on ASX is expected to occur on 30 November 2012 (on a deferred settlement basis) under the ticker code "FSF".

RISK AND SUITABILITY OF AN INVESTMENT IN THE FUND

This Offer Document does not take into account the investment objectives, financial situation or particular needs of any investor. Before applying for Units, investors should read this Offer Document in its entirety. In particular, investors should consider the nature of the investment in Units and the risk factors that could affect the Fund's performance (including those set out under the heading "What are my risks?" in the section entitled *Answers to Important Questions* and in Section 7 – *Investment Risks*), particularly with regard to their personal circumstances. Investors who are in any doubt as to any aspect of the Offer should consult a NZX Firm or their solicitor, accountant or other appropriately qualified professional adviser.

DEFINITIONS

Capitalised terms used in this Offer Document have the specific meaning given to them in Section 12 – *Glossary*. Where helpful, certain other terms are also explained in the Glossary.

Unless otherwise indicated, any reference to dollars, $, NZ$ or cents refers to New Zealand dollars and cents.

All references to dates and time are to dates and time in New Zealand.

Copies of all New Zealand statutes and regulations referred to in this Offer Document can be viewed online, free of charge, at www.legislation.govt.nz.

THIRD PARTY INFORMATION

This Offer Document includes Statistics New Zealand's data which is licensed by Statistics New Zealand for re-use under the Creative Commons Attribution 3.0 New Zealand licence.

Nielsen information reflects estimates of market conditions based on samples, and is prepared primarily as a marketing research tool for consumer packaged goods manufacturers and others in the consumer goods industry. This information should not be viewed as a basis for investments and references to Nielsen should not be considered as Nielsen's opinion as to the value of any security or the advisability of investing in the Fonterra Shareholders' Fund.

ANZ National Bank Limited is a Co-Manager in relation to the Offer, as set out in the section of this Offer Document entitled *Directory*. ANZ National Bank Limited anticipates changing its company name shortly after the date of this Offer Document. Up to date company information is available from the Companies Office of the Ministry of Business, Innovation and Employment on its website at www.business.govt.nz/companies.

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JOIN US.

LETTER FROM FUND CHAIRMAN

DEAR INVESTOR

The Board of the Manager of the Fonterra Shareholders' Fund is pleased to join with Fonterra to offer investors a unique opportunity to invest in the performance of Fonterra and to gain an exposure to the dynamics of the global dairy industry.

Fonterra is a world-leading dairy co-operative based in New Zealand which has global businesses spanning dairy commodity and consumer markets. It has significant businesses in developed countries and stable but growing businesses in emerging markets in China, Asia, the Middle East and Latin America.

The Fonterra Shareholders' Fund is a unit trust that is established as an important part of Fonterra's Trading Among Farmers scheme. The Fund will acquire Economic Rights of Shares in Fonterra and issue Units to investors.

The number of Units on issue will correspond to the number of Fonterra Shares in which Economic Rights are held for the Fonterra Shareholders' Fund. Dividends and other distributions from these Fonterra Shares will be passed through to Unit Holders, and it is anticipated that the price of a Unit will reflect and track movements in the value of a Fonterra Share.

It is important to note that this is an opportunity to invest in Units in the Fonterra Shareholders' Fund, and is not an opportunity to acquire Fonterra Shares. However, the return on a Unit is essentially dependent on the performance of Fonterra. As a result, most of the information in this document has been provided by, and relates to, Fonterra.

On behalf of the Board of the Manager of the Fonterra Shareholders' Fund, I invite you to consider the Offer set out in this Offer Document and take appropriate independent advice to determine whether an investment in Units in the Fonterra Shareholders' Fund may be appropriate for you.

JOHN SHEWAN
CHAIRMAN
FSF MANAGEMENT COMPANY LIMITED

LETTER FROM FONTERRA CHAIRMAN

DEAR INVESTOR

For the first time in Fonterra's history, new investors are being invited to consider participating in our performance. Until now, this opportunity has been limited to our Farmer Shareholders.

With our Farmer Shareholders' support, we now have a unique way of enabling the broader investment community to participate in the Co-operative's performance.

As New Zealand's largest company and the world's largest dairy processor and exporter, we are proud of what we have achieved. Fonterra was formed in 2001 when the farmer owners of New Zealand's two leading dairy co-operatives, The New Zealand Co-operative Dairy Company Limited and Kiwi Co-operative Dairies Limited voted to merge their co-operatives and integrate them with the industry's separate marketing arm, The New Zealand Dairy Board.

This was a bold move, widely debated and very forward looking because it succeeded in laying the foundation for the Fonterra we are today. Our competitive strength owes much to our integrated "grass to glass" business, with a supply chain starting on our Farmer Shareholders' farms and extending to more than 100 markets worldwide. Fonterra is now a single-minded customer-led business.

It is this scale and position which enables us to be a significant participant in the growing global demand for dairy nutrition. As incomes rise in emerging economies, we see firsthand the increasing importance of these economies. Increasingly affluent populations are seeking everyday nutrition, and dairy is an obvious and natural source. Fonterra's strength starts with the quality milk produced in New Zealand by our Farmer Shareholders before it flows through our factories and is delivered to more than 100 countries. We are well positioned to seize these opportunities to grow volumes and value.

Fonterra is unique in a number of ways. Our Farmer Shareholders are resilient, innovative and efficient, competing in the world market without subsidies. Their pasture-based farming underpins our competitive cost base. As our industry has exported since the late 1800s, generations of farmers have worked the land with their sights on selling their milk overseas. As a result, Fonterra exports around 98% of the milk it processes in New Zealand, the only country in the world to export such a large majority of its dairy production. Over time, we have built up an international brand portfolio, known and respected in our key markets in Australasia, South East Asia, the Middle East, Latin America and, increasingly, China.

Co-operatives exist to give their members collective strength and the ability to operate their own businesses to achieve their goals. Our Farmer Shareholders range from small family-run operations through to multi-property operations, but they all rely on their milk, and our ability to process and sell it, to make a living.

Central to this is the price we pay farmers for their milk, known as the Farmgate Milk Price. Fonterra is committed to paying the highest sustainable Farmgate Milk Price that is linked to actual global dairy commodity prices and allows for the recovery of product manufacturing costs by an efficient processor of Fonterra's scale, including a return on capital invested in processing. The Farmgate Milk Price is based on transparent and robust rules which are independently monitored.

Fairly rewarding farmer suppliers is crucial to the success of the Co-operative by retaining and growing valuable milk supply. It is also the foundation for building long-run value for Shareholders and Unit Holders from Fonterra's investment in milk processing assets and downstream businesses.

Fonterra is also focussed on maximising its earnings. The drive to achieve profits above the Farmgate Milk Price is not only important for our Farmer Shareholders, who have a substantial financial stake in the Co-operative, but also those considering participating in our performance through their investment in Units.

Traditionally, our Co-operative has had capital linked to supply. Farmers have bought Shares to ensure their milk is collected, processed and sold. Exiting farmers have the value of these Shares returned in cash by the Co-operative. As a result, we have lacked a stable capital base.

We have known for some time that we had to put the Co-operative's capital structure on a firmer footing.

Earlier this year, our Farmer Shareholders confirmed their decision in 2010 for the Fonterra Board to take steps to address its capital structure by implementing Trading Among Farmers. This will enable Farmer Shareholders to trade Shares among themselves and will result in permanent capital for Fonterra.

The Fonterra Shareholders' Fund has been created to support liquidity in the Fonterra Shareholders' Market in which Farmer Shareholders will trade Fonterra Shares. The wider investment community will have the opportunity to invest in Units, with distributions made in respect of Units linked to dividends paid on Fonterra Shares.

Farmer Shareholders and Unit Holders will invest through separate structures. What they both have in common is the ability to be part of the continuing performance of our Co-operative – a New Zealand success story.

The Fonterra Board is pleased to be able to promote the offer of Units in the Fund. I commend this Offer to you.

SIR HENRY VAN DER HEYDEN
CHAIRMAN
FONTERRA CO-OPERATIVE GROUP LIMITED

INTRODUCING THE OFFER

The Offer is an offer to subscribe for Units in the Fonterra Shareholders' Fund, a unit trust which has been established to invest in the Economic Rights of Shares in Fonterra. It provides investors with an opportunity to earn returns based on the financial performance of Fonterra.

Because the performance of Units will be related to the performance of Fonterra, this Offer Document contains information about Fonterra's business and its financial performance.

No offer is being made in this Offer Document to subscribe for Shares in Fonterra. The Units being offered in this Offer Document will be issued by the Manager of the Fund, not by Fonterra, and do not confer any direct interest in Fonterra.

At the same time as the Offer is being made, Fonterra is establishing the Fonterra Shareholders' Market, which will enable Farmer Shareholders to trade Shares among themselves. Accordingly, this Offer Document also explains how the Fonterra Shareholders' Market will facilitate Trading Among Farmers and its relationship to the Offer of Units.

OVERVIEW OF TRADING AMONG FARMERS

This section contains a summary of Trading Among Farmers. Trading Among Farmers is the name which has been given to a series of inter-related arrangements of which the Fonterra Shareholders' Fund forms a part. A more detailed description of these arrangements is set out in Section 5 – *Trading Among Farmers in Detail*.

FONTERRA IS A CO-OPERATIVE COMPANY

Fonterra is a co-operative company and its Farmer Shareholders are the suppliers of milk to Fonterra in New Zealand.

Farmer Shareholders are required to hold a number of Shares in Fonterra linked to the amount of milk they supply to the Co-operative each year (over the course of a dairy Season). The number of Shares that a Farmer Shareholder is required to hold moves in line with changes in their milk production from one Season to the next.

Fonterra currently issues Shares to Farmer Shareholders when milk production increases, and is obliged to take them back (or redeem them) if the Farmer Shareholder stops supplying milk to Fonterra, or their milk production reduces.

Fonterra's obligation to redeem Shares exposes it to the risk that it may have to pay large sums of money to Farmer Shareholders who stop or reduce their supply of milk to Fonterra, which is described as redemption risk. Trading Among Farmers is designed to remove this obligation for Fonterra, and provide Fonterra with a stable capital base.

WHAT IS TRADING AMONG FARMERS?

Trading Among Farmers is the name which has been given to a series of inter-related arrangements.

The essence of the arrangements is that:

- Farmer Shareholders will trade Shares between themselves, instead of Fonterra being required to issue and redeem Shares; and
- outside investors, who are not allowed to hold Shares in Fonterra, will be able to invest in a security (a Unit in the Fonterra Shareholders' Fund) that gives them access to the Economic Rights that they would have received if they were allowed to own a Share.

WHY IS FONTERRA LAUNCHING TRADING AMONG FARMERS?

A key objective of Trading Among Farmers is to remove Fonterra's obligation to issue Shares to, and to redeem Shares from, Farmer Shareholders. This will provide Fonterra with a stable capital base.

Fonterra considers that there will be long-term alignment between the interests of Farmer Shareholders and Unit Holders under Trading Among Farmers.

ECONOMIC RIGHTS

The Economic Rights of a Share are the rights to receive dividends and other economic benefits derived from a Share, as well as other rights derived from owning a Share.

However, these rights do not include the right to hold legal title to the Share (i.e. to become registered as the holder of the Share), or to exercise voting rights in Fonterra, except in very limited circumstances.

The Fund becomes entitled to Economic Rights of a Share by Farmer Shareholders and the Fonterra Farmer Custodian (on behalf of a specially appointed market maker) transferring, or Fonterra issuing, Shares to the Fonterra Farmer Custodian. The Fonterra Farmer Custodian holds the Economic Rights of those Shares on trust for the Trustee, under a trust called the Fonterra Economic Rights Trust.

This is what is meant in this Offer Document wherever there is a reference to "sell Economic Rights of Shares" to the Fund.

A more detailed description of Economic Rights is set out in Section 5 – *Trading Among Farmers in Detail*.

HOW TRADING AMONG FARMERS WILL WORK

When Trading Among Farmers starts, there will be two key changes:

- Farmer Shareholders will buy and sell Shares among themselves, not with Fonterra. They will do this on a private market called the Fonterra Shareholders' Market. It will be a private market because only Farmer Shareholders, Fonterra, and a specially appointed market maker (which is described below) will be allowed to trade Shares; and
- a fund known as the Fonterra Shareholders' Fund will operate. The Fund is intended to:
  - supplement liquidity in the Fonterra Shareholders' Market through a liquid market for Units which can effectively be "exchanged" for Fonterra Shares (by Farmer Shareholders, Fonterra and the market maker) and *vice versa*;
  - provide additional financial flexibility for Farmer Shareholders, who will have the opportunity to sell Economic Rights of Shares to the Fund; and
  - permit a broader range of investors to buy a security (a Unit in the Fonterra Shareholders' Fund) that essentially passes through the Economic Rights. This is described in Section 5 – *Trading Among Farmers in Detail*.

FONTERRA SHAREHOLDERS' FUND

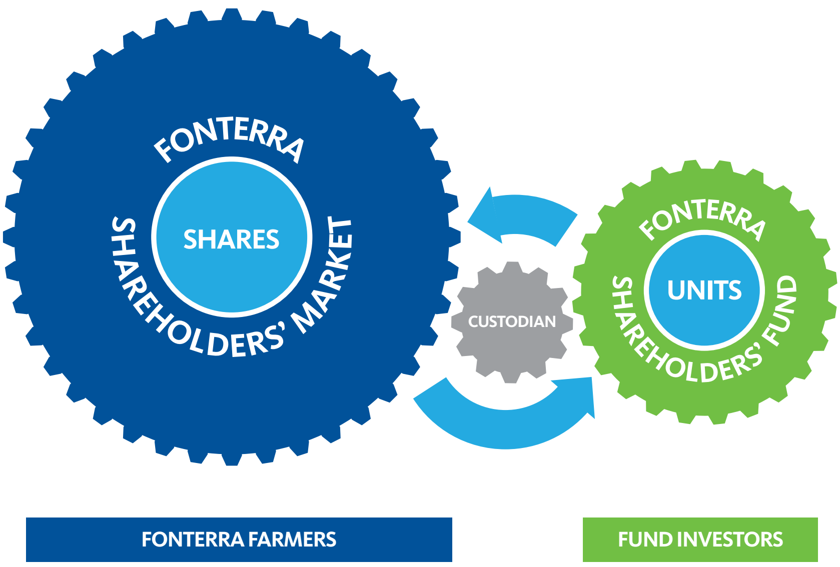
- The Fund is a unit trust formed under the Unit Trusts Act. It is managed by the Manager and the Trustee is appointed to act as trustee of the Fund for the benefit of Unit Holders.
- Units will be listed on the NZX Main Board and on ASX and will be able to be freely bought and sold, in the same way as any other listed security.
- The Manager of the Fund has a board of five directors. Three directors will be elected by Unit Holders. However, the first three directors have been selected by Fonterra so that the Fund can commence operations. The other two directors of the Manager are appointed by Fonterra.
- Units will be able to be exchanged for Shares (and *vice versa*) by Farmer Shareholders, Fonterra and the market maker (discussed below) on a one-for-one basis.
- Other investors will not be able to exchange Units for Shares (or *vice versa*).
- As described on the previous page under the heading "Ecomic Rights", the Economic Rights of Shares are held on trust for the Fund by the Fonterra Farmer Custodian (a special purpose company) under a trust called the Fonterra Economic Rights Trust.
- The Fonterra Farmer Custodian is owned by the trustees of a specially created trust. This trust has three trustees. Farmer Shareholders, Fonterra and the Shareholders' Council each appoint one trustee. A more detailed description of the role of the Fonterra Farmer Custodian, is set out in Section 5 – *Trading Among Farmers in Detail*.
- The Fund will elect to be a "foreign investment variable-rate PIE" for New Zealand income tax purposes. A New Zealand tax summary in relation to the Fund is set out in Section 9 – *Taxation*.

FONTERRA SHAREHOLDERS' MARKET

- The Fonterra Shareholders' Market will be operated by NZX. It will be a registered market on which only FSM Participants accredited by NZX may trade on behalf of Farmer Shareholders. The Fonterra Shareholders' Market will be regulated and monitored by NZX (whose regulatory role will include monitoring compliance with and enforcing the FSM Rules and the NZX Participant Rules) and the Financial Markets Authority, in the same way as other markets operated by NZX.
- There will be a market maker (known as the Registered Volume Provider or RVP) who will be continuously active in offering to buy and sell Shares on the Fonterra Shareholders' Market during the periods of operation of the Fonterra Shareholders' Market (other than in the case of a temporary halt in, or suspension of, trading in Shares). This is intended to assist the liquidity of trading on the Fonterra Shareholders' Market to make it easier for Farmer Shareholders to buy or sell Shares on that market. Craigs Investment Partners Limited has been initially appointed as the Registered Volume Provider.

OVERVIEW OF TRADING AMONG FARMERS

A high level representation of the relationship between the Fonterra Shareholders' Market and the Fonterra Shareholders' Fund is shown in the diagram. The diagram illustrates that the number of Units on issue will be a small proportion of the total number of Fonterra Shares on issue. The diagram is also intended to illustrate the connection between these two markets.



OVERVIEW OF TRADING AMONG FARMERS CONTINUED

RELATIONSHIP BETWEEN THE TWO MARKETS

Although the markets are separate, they have been designed to work together. Farmer Shareholders, Fonterra and the RVP can buy or sell Shares in the Fonterra Shareholders' Market, and buy or sell Units on the NZX Main Board or ASX. They can effectively exchange Shares for Units and *vice versa* and therefore can shift between the two markets. Other investors will not be able to transact in the Fonterra Shareholders' Market and exchange Units for Shares.

LAUNCHING AND MANAGING TRADING AMONG FARMERS

To allow each Unit to essentially pass the Economic Rights of one Share through to the Unit Holder, the number of Units in the Fund must correspond to the number of Economic Rights of Shares held for the Fund by the Fonterra Farmer Custodian. Accordingly, at the same time as this Offer, Fonterra on behalf of the Fund has made an offer to Farmer Shareholders to acquire Economic Rights of Shares from those Farmer Shareholders. The offer to Farmer Shareholders is referred to as the Supply Offer. When Farmer Shareholders accept the Supply Offer, they will transfer Shares to the Fonterra Farmer Custodian, who will hold the Economic Rights of those Shares on trust for the Fund.

If the number of Shares for which the Supply Offer is accepted by Farmer Shareholders is less than the number of Units to be issued under this Offer (see the page headed "Key investment metrics" later in this Offer Document for details of the number of Units to be issued), Fonterra will provide the shortfall. Fonterra will do this by issuing Shares to the Fonterra Farmer Custodian who will hold the Economic Rights of those Shares on trust for the Fund.

Following the launch of the Fund, the Fonterra Board will manage the size of the Fund within parameters which are outlined in the Fund Size Risk Management Policy. That policy anticipates that the number of Units on issue should fall within a target range of between 7% and 12% of the total number of Shares which are on issue at any given time (excluding Shares and Units which have been bought by Fonterra and are being held by it as Treasury Stock).

In tandem with this, Farmer Shareholders will continue to be required to hold Shares related to their milk production. Fonterra's objective will be to maintain a sufficient volume of Shares on issue to promote a liquid market on which Farmer Shareholders can adjust their Shareholding as their milk production increases. To achieve this goal, Fonterra has two key options. It can issue new Shares to raise new equity capital, if required. Alternatively, it can undertake a bonus issue where new equity capital is not required. In either case, the Manager will undertake an equivalent adjustment to the number of Units on issue.

Within the context of Fonterra's Fund Size Risk Management Policy (as described in Section 5 – *Trading Among Farmers in Detail*), Fonterra will also manage the number of Shares on issue if production over time falls resulting in Farmer Shareholders holding Shares in excess of the minimum requirements related to milk production. Unlike today, Fonterra will no longer have an obligation to redeem Shares where this occurs. Instead, it will have more flexibility in the manner and timing of meeting the requirements of the Fund Size Risk Management Policy (through, for example, a Share buy back programme).

PRICE CONVERGENCE BETWEEN SHARES AND UNITS

As previously noted, Farmer Shareholders, the RVP and Fonterra can effectively exchange a Share for a Unit and *vice versa*. This feature allows Farmer Shareholders and the RVP to move between the two markets (for Shares and Units) in order to sell or buy either security. No other person can do this.

The intended result is that Shares and Units should trade at very similar prices. This is referred to as the convergence of prices for Shares and Units. While this has been a key design objective for Trading Among Farmers, there is no assurance that convergence of prices will actually be achieved.

KEY ENTITLEMENTS FOR UNIT HOLDERS

Trading Among Farmers has been designed so that the number of Units in the Fund will correspond to the number of Shares in which Economic Rights are held for the Fund:

- Unit Holders will be entitled to have passed through to them an amount equal to any dividend payable in relation to a Share in Fonterra (less any PIE tax, withholding tax or any other adjustments for tax in relation to that Unit Holder);
- if Fonterra reconstructs or adjusts its Shares, an equivalent reconstruction or adjustment will be made in respect of Units;
- if Fonterra makes bonus issues or rights issues of Shares to its Shareholders, corresponding issues of Units will be made to Unit Holders; and
- if there is an offer to acquire Shares held by the Fonterra Farmer Custodian, the Fund will seek instructions from Unit Holders as to whether the offer should be accepted. If a Unit Holder directs the Fund to accept the offer, the Fund will redeem Units from such Unit Holder, and accept the offer for Shares in proportion to that direction. The amount received from the sale of the Shares will be paid by the Fund to the Unit Holder.

UNIT HOLDER VOTING RIGHTS

Unit Holders are entitled to attend and vote at Unit Holder meetings, and to elect three directors of the Manager of the Fund.

Unit Holders do not have any right to attend or vote, or request the Fonterra Farmer Custodian to attend or vote, at any meeting of Farmer Shareholders. The Fonterra Farmer Custodian will also not have any voting rights at meetings of Farmer Shareholders, except on certain interest group resolutions. Situations where interest group resolutions are required are expected to be rare.

The trustees of the Fonterra Farmer Custodian Trust will hold one Unit known as the Fonterra Unit. Subject to the terms of the NZSX Listing Rules, the Trust Deed cannot be altered without the prior approval of the Fonterra Unit Holder (which can only be given after receipt of a direction to that effect from Farmer Shareholders) if that amendment would change:

- the governance structure of the Board of the Manager, including the number of directors of the Manager elected by the Unit Holders, the manner of their election, or the number of directors of the Manager appointed by Fonterra and the manner of their appointment;
- the scope and role of the Fund;
- the obligation of the Fund to facilitate the exchange of a Share for a Unit or a Unit for a Share;
- the limit of 15% on the number of Units that can be held by any person and their Associates (other than Fonterra) in the Fund; or
- the terms of the Fonterra Unit itself.

In other respects, the Fonterra Unit will have the same rights as all other Units issued by the Manager. A more detailed description of the Fonterra Unit is set out in Section 5 – *Trading Among Farmers in Detail*.

GOVERNANCE ARRANGEMENTS RELATING TO THE FUND

All Shareholders in Fonterra have various rights under the law and in the key documents that give effect to Trading Among Farmers. The governance arrangements described below have been put in place to give effect to those rights.

The Fonterra Farmer Custodian will be the legal holder of the Shares in respect of which Economic Rights are held for the Fund and will have rights under the Constitution, as well as at law.

The Fonterra Board is required to act in the best interests of the Co-operative. The Courts have established that this requires the Fonterra Board to act in the best interests of its Shareholders (which will include the Fonterra Farmer Custodian).

Fonterra is required to consult with the Chairman of the Board of the Manager (representing the three directors who are elected by Unit Holders) regarding the appointment of Appointed Directors to the Fonterra Board, who are the Co-operative's Independent Directors for the purposes of the FSM Rules which govern the operation of the Fonterra Shareholders' Market. If a majority of the three directors who are elected by Unit Holders do not support the proposed appointment, that fact must be publicly disclosed.

The setting of the Farmgate Milk Price (which forms the basis of the price that Fonterra pays its Farmer Shareholders for milk supplied in New Zealand) is governed by a Farmgate Milk Price Manual which is published and has been the subject of various regulatory reviews. The Farmgate Milk Price Manual is governed by a Milk Price Panel which Fonterra has established for that purpose, and which comprises a majority of independent members. The setting of the Farmgate Milk Price is overseen by the competition law regulator in New Zealand, the Commerce Commission.

The FSM Rules are enforceable by Shareholders. They require the following key decisions to be approved by a majority of not less than 75% of the Fonterra Board, with such majority including at least a majority of the Independent Directors:

- a decision to pay an aggregate amount for milk in excess of the amount calculated under the Farmgate Milk Price Manual;
- a decision to amend or replace the Farmgate Milk Price Manual;
- a decision to promote, or support, an amendment to, or replacement of, the Constitution that would have a material adverse effect on the rights attached to Shares which are held by the Fonterra Farmer Custodian (in respect of which Economic Rights are held for the Fund); and
- a decision to appoint an Independent Director where the appointment has not been supported by a majority of the directors of the Manager who are not also Fonterra Directors.

Each of these decisions could normally be taken by a simple majority resolution of the Fonterra Board. The FSM Rules recognise that these decisions of the Fonterra Board are particularly important and, in the case of the first three decisions, could have an impact on the returns derived by all Shareholders, including the Shares held by the Fonterra Farmer Custodian (the Economic Rights of which are held for the Fund). The FSM Rules therefore require a higher than normal majority for these resolutions, and require the agreement of a majority of the Independent Directors on the Fonterra Board.

RELATIONSHIP BETWEEN FONTERRA AND THE FUND

The relationship between Fonterra and the Fund is governed by several key documents, including the Trust Deed, the Authorised Fund Contract, the Shareholding Deed, the Custody Trust Deed and the Fonterra Farmer Custodian Trust Deed.

TERMINATION OF THE AUTHORISED FUND CONTRACT

Trading Among Farmers is intended to be stable and serve the interests of Farmer Shareholders and Unit Holders over the long term. However, Fonterra has the right to give 12 months' notice to terminate the Authorised Fund Contract without cause within the first two years of the Launch Date. Fonterra could, for example, decide to do this if it becomes apparent that Trading Among Farmers is not meeting its intended objectives.

If the Authorised Fund Contract terminates, Fonterra could revert to a regime of issuing Shares to, and redeeming Shares from, its Farmer Shareholders. Should this arise, the Fonterra Farmer Custodian could not seek to have the Shares it holds redeemed, because it is not a supplier of milk to Fonterra. However, Fonterra may be able to establish and implement a replacement fund as an "Authorised Fund", in which case Trading Among Farmers could continue. In that case, Fonterra would not be required to revert to issuing and redeeming Shares.

If the Authorised Fund Contract was terminated by Fonterra without cause within the first two years, Fonterra would be required to purchase the Economic Rights held for the Fund (or the Shares those Economic Rights relate to) or arrange an approved person to purchase them. The price payable would be the greater of:

- a 15% premium to the volume weighted average price of Units and Shares over the period of six months prior to the notice of termination being given; or
- the Final Price, increased at a compounding rate of 15% per year, less cash dividends paid in those years.

The Authorised Fund Contract can also be terminated by Fonterra or the Manager in cases of material breach of the Authorised Fund Contract or under other limited circumstances. A detailed description of the circumstances in which the Authorised Fund Contract can be terminated is set out in Section 5 – *Trading Among Farmers in Detail*.

The Fund will be wound up if all the Economic Rights held for the Fund or all the Shares the subject of the Fonterra Economic Rights Trust are acquired by Fonterra or a person nominated by Fonterra.

ANSWERS TO IMPORTANT QUESTIONS

WHAT SORT OF INVESTMENT IS THIS?

THE UNITS

This Offer Document relates to an initial public offering of units in a unit trust, known as the Fonterra Shareholders' Fund.

Each Unit will constitute an undivided interest in the trust fund comprising the Fund, which has been established to invest in the Economic Rights of Shares in Fonterra. The Fund has been designed so that each Unit issued by it will, essentially, pass through the economic benefits derived from holding a single Share in Fonterra. Full details of the structure and other features of the Fund are contained in Section 5 – *Trading Among Farmers in Detail*.

No offer is being made in this Offer Document to subscribe for Shares in Fonterra. The Units being offered in this Offer Document will be issued by the Manager of the Fund, not by Fonterra, and do not confer any direct interest in Fonterra.

Each Unit gives the holder the right to:

- receive an equal share in any distribution authorised by the Manager of the Fund and paid in respect of that Unit (as described further under the heading "What returns will I get?" in this section);
- be sent certain Fund information, including half and full-year reports for the Fund; and
- attend and vote at meetings of Unit Holders.

In addition, Fonterra will send certain Fonterra information, including half and full-year reports for Fonterra to Unit Holders.

OFFER SIZE AND PRE-CONDITIONS

Overview

The Dairy Industry Restructuring Act 2001 (DIRA) sets out pre-conditions that must be satisfied before Trading Among Farmers, and therefore the Fund, can commence. One of these conditions is that the Manager of the Fund has entered into binding obligations to issue Units, for an aggregate consideration of not less than $500 million. This means that, in order for the Offer to proceed, valid Applications for Units having an aggregate value of at least $500 million must be received.

Number of Units

To satisfy the pre-condition specified above, the number of Units issued at the Launch Date, multiplied by the Final Price, must be not less than $500 million. The number of Units required to be issued to meet this level cannot be determined until the Final Price has been set.

From the Launch Date, the number of Units on issue must correspond with the number of Shares in which the Fonterra Farmer Custodian is holding Economic Rights on trust for the Fund. Following the launch of the Fund, the Fund will continuously acquire Economic Rights and issue Units. The converse also applies where the Fund will, at the initiation of Farmer Shareholders or the RVP, cancel Units they hold and transfer to them Shares (or, in the case of the RVP, hold those Shares for its benefit). This feature of the Fund is described in Section 10 – *Statutory Information* under the heading "Ongoing issue of Units". The number of Units on issue will be limited by the following factors:

- the SHC Deed Poll imposes a limit of 20% (reducing the 25% limit contained in the Constitution) on the number of Shares in respect of which Economic Rights may be held for the Fund; and
- Fonterra is entitled to, and intends to, actively manage the number of Shares in which Economic Rights are held for the Fund to a level significantly below this threshold. Further details of this arrangement are described in Section 5 – *Trading Among Farmers in Detail*.

Issue of Shares by Fonterra

The Fund has been established on the basis that the number of Units issued will correspond to the number of Shares in which Economic Rights are held by the Fonterra Farmer Custodian for the Fund. In order to generate the Economic Rights in respect of which the Fund will issue Units, Shares will need to be acquired by the Fonterra Farmer Custodian (who will then declare that it holds the Economic Rights of those Shares on trust for the Fund).

Therefore, at the same time as the Offer, Farmer Shareholders are being given the opportunity to transfer Shares to the Fonterra Farmer Custodian under the Supply Offer and, if an insufficient number of Shares are offered for transfer in the Supply Offer by Farmer Shareholders, Fonterra has agreed to issue the shortfall of Shares to the Fonterra Farmer Custodian. The exact number of Shares that will be on issue after the Offer is unknown as it will depend upon:

- the number of Shares agreed to be sold by Farmer Shareholders to the Fonterra Farmer Custodian;
- the Final Price; and
- the number of Units issued under the Friends of Fonterra Offer and the Australian Supplier Offer.

Fonterra's intention is that the amount it receives as a result of the issue of Shares in order to meet any shortfall under the Supply Offer will not be retained on a permanent basis by Fonterra. In this situation, Fonterra's intention is to provide one or more further opportunities for Farmer Shareholders to sell Economic Rights of Shares to the Fund, and for Fonterra to acquire the number of Units issued as a result of any such sales (in a manner which does not disturb general trading in Units). Further information about the Supply Offer is contained in Section 8 – *Details of the Offer*.

DIRA pre-conditions

As noted above, DIRA sets out pre-conditions that must be satisfied before Trading Among Farmers can commence. These include that the Manager has entered into binding obligations to issue Units for an aggregate consideration of not less than $500 million and the Minister for Primary Industries has recommended that an Order in Council be made by the Governor-General.

The Offer will not proceed and no Units will be allotted should the Order in Council not be made. Pending allotment of the Units, all Application Monies will be held on trust for the benefit of Applicants and Fonterra. If this DIRA pre-condition is not reached, that fact will be announced through NZX and Application Monies will be refunded in full, without interest.

NZX MAIN BOARD / ASX LISTINGS

Application has been made to NZX for permission to list the Fund and to quote the Units on the NZX Main Board, and all the requirements of NZX relating thereto that can be complied with on or before the date of this Offer Document have been duly complied with. However, the Units have not yet been approved for trading and NZX accepts no responsibility for any statement in this Offer Document.

NZX has authorised NZX Firms to act on the Offer. NZX is a registered exchange and the NZX Main Board is a registered market under the Securities Markets Act.

Application has also been made to ASX for the Fund to be admitted to the official list of ASX and for quotation of the Units on ASX. Listing is not guaranteed and is at the discretion of ASX. Similarly, there is no assurance that the ASX listing of the Fund will continue for the life of the Fund.

ASX accepts no responsibility for the contents of this Offer Document and the Additional Australian Information or for the merits of the investment to which this Offer Document and the Additional Australian Information relate. Admission to the official list of ASX and quotation of the Units on ASX are not to be taken as an indication of the merits, or as an endorsement by ASX, of the Fund or the Units.

Initial quotation of the Units on the NZX Main Board and ASX (on a deferred settlement basis) is expected to occur on 30 November 2012 under the ticker code "FSF".

The Fund will bear a "Non Standard" designation on the NZX Main Board to reflect the Fund's governance arrangements and Unit Holder restrictions.

WHO IS INVOLVED IN PROVIDING IT FOR ME?

UNIT TRUST

The name of the unit trust in which Units are being offered is the Fonterra Shareholders' Fund.

MANAGER

The Manager of the Fund is FSF Management Company Limited. The Manager can be contacted at its registered office at 9 Princes Street, Auckland, New Zealand.

The Manager is the issuer of the Units for the purposes of the Securities Act.

DIRECTORS OF THE MANAGER

The directors of the Manager as at the date of this Offer Document are as follows:

John Bruce Shewan (Chairman)

Philippa Jane Dunphy

Kimmitt Rowland Ellis

Sir Ralph James Norris

Jim William van der Poel

Both Sir Ralph Norris and Jim van der Poel are also directors of Fonterra. The three other directors are Independent Directors for the purposes of the NZSX Listing Rules.

Detailed information about the Board of the Manager is contained in Section 2 – *Governance Framework*.

TRUSTEE

The Trustee is The New Zealand Guardian Trust Company Limited. The Trustee can be contacted at its registered office at Level 7, Vero Centre, 48 Shortland Street, Auckland, New Zealand.

Pursuant to section 16(1) of the Securities Trustees and Statutory Supervisors Act, the Financial Markets Authority granted the Trustee a licence to (among other things) act as a trustee in respect of unit trusts. That licence expires on 16 March 2018.

PROMOTERS

Fonterra Co-operative Group Limited is a Promoter of the Offer. Fonterra can be contacted at its registered office at 9 Princes Street, Auckland, New Zealand.

Each director of Fonterra is also a Promoter of the Offer (other than where a director of Fonterra is also a director of the Manager). As at the date of this Offer Document, the names of the directors of Fonterra who are not also directors of the Manager are as follows:

Malcolm Guy Bailey

Ian James Farrelly

Sir Henry van der Heyden

David Alexander Jackson

David Nigel Macleod

John Anthony Monaghan

Nicola Mary Shadbolt

John Anthony Waller

Ralph Graham Waters

John Speer Wilson

NAMES AND ADDRESSES

The above stated names and addresses (where given) of the Manager, the Trustee and the Promoters are current as at the date of this Offer Document, but are subject to change. The current names and addresses may be obtained free of charge at any time by searching the public register maintained by the Companies Office of the Ministry of Business, Innovation and Employment on its website at www.business.govt.nz/companies.

ACTIVITIES OF THE FUND

The Fund was established as a unit trust under the Unit Trusts Act, under a Trust Deed dated 23 October 2012. The Fund will elect to be a "foreign investment variable-rate PIE" for New Zealand income tax purposes. Other than in connection with preparing for the Offer, the Fund has not undertaken any activities since it was established.

HOW MUCH DO I PAY?

THE FINAL PRICE

The price per Unit payable by investors to subscribe for Units will be the Final Price. As at the date of this Offer Document, the Final Price is yet to be determined.

The Final Price will be determined by Fonterra. A bookbuild process, managed by the Joint Lead Managers, will be used to assess investor demand for the Units and assist Fonterra to determine the Final Price. Under the bookbuild process, selected Institutional Investors and NZX Firms will be invited to submit bids for Units. Fonterra has set an Indicative Price Range of $4.60 to $5.50 per Unit. However, Fonterra reserves the right to set the Final Price within or higher than the Indicative Price Range.

The Final Price is expected to be announced to NZX on 27 November 2012. All Applicants will be required to pay the Final Price, per Unit subscribed for. Full details of the Offer and the bookbuild process through which the Final Price will be set are set out in Section 8 – *Details of the Offer*.

Applications to subscribe for Units must be made on the relevant Application Form and completed in accordance with the accompanying instructions.

BROKER FIRM OFFER

The Broker Firm Offer is open to persons with a registered address in New Zealand who have received an allocation from a NZX Firm. Applicants under the Broker Firm Offer should make payments in accordance with the directions of the NZX Firm from whom they received an allocation. Cheques should be crossed "Non Transferable" and made out to "Fonterra Shareholders' Fund Offer".

Applicants under the Broker Firm Offer must send the completed blue Broker Firm Offer Application Form and Application Monies to the NZX Firm who provided the allocation so as to be received in time to enable them to be forwarded to and received by the Unit Registrar by 5.00pm on 21 November 2012 (being the Broker Firm Offer Closing Date).

STAKEHOLDER OFFER

Friends of Fonterra Offer

The Friends of Fonterra Offer is open to Farmer Shareholders with a valid "Farm / Party number" as at 26 October 2012, Fonterra-supplying sharemilkers with a valid "Farm / Party number" as at 26 October 2012, Fonterra New Zealand and Australian permanent employees and Ex-Farmer Shareholders.

Applications under the Friends of Fonterra Offer must be made for a minimum amount of $2,000, and thereafter in whole multiples of $100, up to a maximum amount of $50,000 (except in respect of Fonterra New Zealand and Australian employees, whose maximum application amount is $25,000).

Application Monies under the Friends of Fonterra Offer should be paid in New Zealand dollars by cheque, bank draft or direct debit (New Zealand only) in each case drawn on a registered New Zealand bank. Cheques should be crossed "Non Transferable" and made out to "Fonterra Shareholders' Fund Offer". Applicants' payment by direct debit must include their bank account details on their Application Form. Fonterra employees in Australia (and all other Applicants under the Friends of Fonterra Offer) will need to make arrangements to make payment of their Application Monies in New Zealand dollars.

Applicants under the Friends of Fonterra Offer must send the completed green Friends of Fonterra Offer Application Form and Application Monies to the Unit Registrar in order to be received by 5.00pm (NZDT) on 21 November 2012 (being the Stakeholder Offer Closing Date). Alternatively, Applications can be lodged with any NZX Firm, the Joint Lead Managers, or any other channel approved by NZX so as to be received in time to enable them to be forwarded to and received by the Unit Registrar by 5.00pm (NZDT) on 21 November 2012 (being the Stakeholder Offer Closing Date).

If the aggregate value of Applications received under the Friends of Fonterra Offer is greater than the value of Units allocated to that offer (as determined by Fonterra), Applications will be scaled in such manner as determined by Fonterra in consultation with the Joint Lead Managers.

Australian Supplier Offer

The Australian Supplier Offer is an offer of up to $25 million of Units to supplier shareholders of Bonlac Supply Company Limited (Bonlac) and to suppliers of milk to Fonterra Milk Australia Pty Ltd (Fonterra Milk Australia).

As described in Section 8 – *Details of the Offer*, as part of the Australian Supplier Offer, Bonlac intends to invite its supplier shareholders to apply to have their Supplier Shares that they hold, bought back at a price of A$1.00 per share, up to the value of the Applicant's holding less one share, on the condition that the proceeds must be applied to subscribe for Units at the Final Price (and subject to certain amendments to the constitution of Bonlac which are to be considered at a general meeting of Bonlac on 31 October 2012 being approved, and the 'Z' class shareholder passing a resolution approving the buyback).

Application under the Australian Supplier Offer must be for a minimum of A$1,800 of Units and thereafter in whole multiples of A$100.

The Final Price for all Applicants (including Applicants under the Australian Supplier Offer) is payable in New Zealand dollars. Once the Final Price and allocation of Units has been determined, the Australian dollar proceeds of the buy back of the Supplier Shares in Bonlac, as well as any cash Application Monies received in Australian dollars in respect of the Australian Supplier Offer, will be converted to New Zealand dollars on behalf of Applicants at the settlement rate struck between the determination of the Final Price and the Allotment Date and applied to the payment of the Final Price on subscription for Units. Where Applications under the Australian Supplier Offer have been scaled, the portion of the Application Monies in respect of each Application that has not been accepted due to scaling will not be converted into New Zealand dollars and will be refunded in Australian dollars.

Further details of how to apply under the Australian Supplier Offer (including payment instructions) will be included in the personalised yellow Australian Supplier Offer Application Form which will be provided to supplier shareholders of Bonlac and to suppliers of milk to Fonterra Milk Australia together with this Offer Document on or around 9 November 2012.

Applicants under the Australian Supplier Offer should send their completed Application Form and Application Monies to:

Computershare Investor Services Pty Limited
GPO Box 7115
Sydney NSW 2001
Australia

Applications under the Australian Supplier Offer must be received by 5.00pm (NZDT) on 21 November 2012 (being the Stakeholder Offer Closing Date). Applicants are encouraged to submit their Application Form and payment as early as possible in advance of the Stakeholder Offer Closing Date and to allow a sufficient period for mail processing.

Applicants under the Australian Supplier Offer may also apply using the online application facility at www.fonterraoffer.com. Applicants applying online are required to pay any Application Monies in Australian dollars using BPAY. All online Applications must be made by 5.00pm (NZDT) on 21 November 2012 (being the Stakeholder Offer Closing Date).

If the aggregate value of Applications received under the Australian Supplier Offer is greater than $25 million, Applications will be scaled in such manner as determined by Fonterra in consultation with the Joint Lead Managers.

Refunds

Residual amounts from any scaling of Applications will be refunded. Refunds will not be paid for any difference arising solely due to rounding or where the aggregate amount of the refund payable to an Applicant is less than $5.00. All refunds will be made without interest. Refunds will be issued within five business days following the Allotment Date.

All refunds will be paid in New Zealand dollars except for refunds in respect of Applications under the Australian Supplier Offer, which will be paid in Australian dollars.

Where Applications under the Australian Supplier Offer have been scaled, the portion of the Application Monies in respect of each Application that has not been accepted due to scaling will not be converted into New Zealand dollars and will be refunded in Australian dollars.

Where any Application Monies have been converted into New Zealand dollars on behalf of any Applicant under the Australian Supplier Offer but are subsequently required to be refunded, those Application Monies will be converted back into Australian dollars at the exchange rate applying at that time. Accordingly, due to fluctuations in the foreign exchange rates for Australian dollars and New Zealand dollars, the Australian dollar amount of any such refunded amount could be more than or less than the relevant amount of those Application Monies provided at the time the Application was made.

INSTITUTIONAL OFFER

Full details of how to participate in the Institutional Offer, including bidding instructions, will be provided to participants prior to the opening of the Institutional Offer.

WHAT ARE THE CHARGES?

Applicants for Units are not required to pay any charges to the Manager of the Fund or Fonterra (or any associated person of either of them) or to the Fund other than the Final Price for each Unit subscribed for which will be determined as set out under the heading "How much do I pay?" above.

Units subsequently purchased or sold on the NZX Main Board or ASX are likely to attract normal brokerage and charges that are payable for transactions conducted on those stock exchanges.

Fonterra will pay all costs associated with the Offer. Details of the expenses of the Offer are set out under the heading "Issue expenses" in Section 10 – *Statutory Information*.

Fonterra has agreed to meet the day-to-day operating costs of the Fund. This arrangement will not change without the agreement of all parties to the Authorised Fund Contract. In addition, the Fund will use corporate facilities, support functions, and services provided by Fonterra. These are generally provided at no cost to the Fund. There are some exceptions to this principle which are described in Section 5 – *Trading Among Farmers in Detail*.

WHAT RETURNS WILL I GET?

RETURNS GENERALLY

Returns on Units may be derived by way of any distributions made by the Fund in respect of the Units, and by way of any capital appreciation realised on the sale or other disposition of Units (although the market price of the Units may also decline).

As each Unit corresponds to the Economic Rights derived from the holding of a single Share in Fonterra, returns on Units will relate to the financial performance of Fonterra and, in particular, decisions made by the Fonterra Board in relation to dividends paid by Fonterra to Shareholders. Fonterra's dividend policy will primarily determine the distributions, if any, made by the Manager in respect of Units.

Distributions will be payable to the Unit Holders entered on the register of Unit Holders at the record date for the relevant distribution.

The key factors that determine the returns that are likely to be derived from an investment in Units are:

- the market price of Units;
- the performance and financial position of Fonterra;
- Fonterra's reserves and retentions;
- decisions of the Fonterra Board in relation to dividends paid by Fonterra to Shareholders;
- general economic conditions;
- movements in the local and global market for listed securities;
- changes to government policy, legislation or regulation;
- competition in the markets in which Fonterra operates;
- general operational and business risks;
- the factors discussed below under the heading "What are my risks?" and in Section 7 – *Investment Risks*; and
- applicable taxes (see Section 9 – *Taxation* for a summary of the material New Zealand tax consequences for Unit Holders).

DISTRIBUTIONS

Cash distributions from the Fund

The Trust Deed provides that where Fonterra pays a cash dividend or other cash benefit (other than supplementary dividends) on a per-Share basis, upon receipt by the Fonterra Farmer Custodian (being the holder of the Shares for which Economic Rights are held for the Fund), the Manager of the Fund will pass on that cash dividend or other cash benefit to Unit Holders on a per-Unit basis, less any adjustments for tax. Supplementary dividends will be passed on in the same way, but only to the Unit Holders that entitled Fonterra to receive a tax credit for the supplementary dividends.

The Manager can give no assurance as to the amount or frequency of such cash dividend or other cash benefit received by the Fonterra Farmer Custodian from Fonterra. Therefore, the Manager cannot give any assurance as to the amount or frequency of cash distributions to be paid in respect of Units.

The Trustee is the entity legally liable to pay any cash distributions declared or made on the Units.

Fonterra's dividend policy

Fonterra's dividend policy targets a payout ratio of 65% to 75% of adjusted net profit after tax (after taking into account non-recurring items and other factors), with 40% to 50% of dividends paid at the half year. The policy also gives the Fonterra Board discretion to have regard to other commercial considerations it considers to be relevant as described in more detail in Section 4 – *Fonterra Financial Information*.

The Fonterra Board reserves the right to amend its dividend policy from time to time.

Other distributions

Unit Holders may also be entitled to receive other distributions, for example, in certain circumstances where Fonterra undertakes to raise new equity. See under the heading "Issues and buy backs of Shares" in Section 5 – *Trading Among Farmers in Detail* for further information.

SALE OF UNITS

Unit Holders may benefit from any increase in the market price of their Units. Unit Holders will realise this benefit upon the sale of their Units. However, the market price of Units may also decline. The price of the Units could rise or fall depending on numerous factors, including (without limitation) those listed above under the heading "Returns generally".

There can be no guarantee that an active market for the Units will develop, or that the market price of the Units will increase.

Information on the selling of Units is set out below under the heading "How do I cash in my investment?" in this section.

NO GUARANTEE

Nothing contained in this Offer Document should be construed as a promise of any particular returns. None of Fonterra, the Manager, Fonterra's subsidiaries, the Trustee, the Joint Lead Managers or any of their respective directors, officers, employees, consultants, agents, partners or advisers gives any guarantee or promise as to the return of capital or the amount of any returns (including distributions) in relation to the Units.

The information set out in this section should be read in conjunction with the information set out under the heading "What are my risks?" below and in Section 7 – *Investment Risks*. The factors described in that section could reduce or eliminate the distributions or other returns intended to be derived from the holding of Units.

ANSWERS TO IMPORTANT QUESTIONS CONTINUED

WHAT ARE MY RISKS?

An investment in Units will expose investors to a range of risks which could materially adversely impact the value of, and returns on, investment.

The principal risks for Unit Holders are:

- the inability to recover some or all of their investment; and / or
- the failure of the Manager to make any distributions because Fonterra does not make any dividend payments in respect of Shares or due to any other extraordinary circumstances.

In no event will persons subscribing for Units under the Offer be required to pay more than the Final Price per Unit subscribed for.

The principal risks set out above could materialise for a number of reasons.

Firstly, there are risks which are common to all investments in securities and which are not specific to an investment in Units. Some of these risks include:

- the returns which investors receive from their Units are less than the price they have paid;
- Unit Holders are unable to sell their Units at all;
- the Fund or Fonterra is placed in receivership or liquidation. If the Fund or Fonterra becomes insolvent for any reason, Unit Holders could receive no returns or lesser returns than those specified under the heading "What are my returns?" above; and
- the general volatility of security prices. This volatility could result from general economic conditions in New Zealand and overseas and other events that may affect Fonterra's business.

Secondly, there are risks which are specific to an investment in the Units. These risks are discussed in detail in Section 7 – *Investment Risks*. Some of these risks include:

- the Fund and its relationship with the Fonterra Shareholders' Market is novel. The structure has been carefully designed but is untested and therefore there is some uncertainty about how it will perform;
- the Fund will not have, and no Unit Holder will have, any voting right at a meeting of Fonterra Shareholders. Generally, the Fonterra Farmer Custodian will not have the right to vote at a meeting of Farmer Shareholders, although there may be limited exceptions to this principle, where the Manager of the Fund can direct the Fonterra Farmer Custodian how to vote. Those circumstances are expected to be rare;
- the Fund structure has been designed with the intention that Shares and Units should trade at very similar prices. This is referred to as the convergence of prices for Shares and Units. There is, however, no assurance that this will be achieved or, if achieved, how long it will take or whether it will be maintained;
- the liquidity of trading in, and the prices of, Units could be affected by constraints on supply, or oversupply, of Shares for the purposes of the Fund;
- certain of the protections available to the Fund and Unit Holders are contained in the FSM Rules. The FSM Rules are enforceable by Shareholders, including the Fonterra Farmer Custodian. Therefore, the Fonterra Farmer Custodian could seek to enforce these protections for the benefit of Unit Holders. However, no individual Unit Holder will be able to enforce the FSM Rules; and
- the FSM Rules could be changed so as to remove these protections by agreement between Fonterra and NZX (as operator of the Fonterra Shareholders' Market), although this would also require the approval of the Financial Markets Authority. NZX may also approve a waiver of rules within the FSM Rules.

Thirdly, there are risks which are specific to Fonterra, its business operations, the markets in which it sells dairy products, and the regulatory environment in which it operates in New Zealand and elsewhere. These risks are discussed in detail in Section 7 – *Investment Risks*. They are relevant to Unit Holders because, as noted above, each Unit corresponds to the Economic Rights derived from the holding of a single Share in Fonterra. Consequently, an investment in the Fund exposes investors to the risks facing Fonterra's business, whether specific to Fonterra's business activities or of a general nature.

Some of the risks associated with Fonterra include:

- changes in the prices of all dairy commodities. In addition, changes in the relative prices of commodity dairy products used in the calculation of the Farmgate Milk Price (whole milk powder, skim milk powder and their by-products, together known as the Reference Commodity Products) and other dairy products manufactured by Fonterra (such as cheese and casein and their by-products);
- the way the Farmgate Milk Price and any Approved Adjustments (e.g. premiums paid for specialty milk such as organic milk) are set has the potential to directly affect the dividends paid by Fonterra and therefore the returns that will be earned by Unit Holders. The Farmgate Milk Price is set by the Fonterra Board based on transparent calculations and rules set out in the Farmgate Milk Price Manual. The governance structures around the setting of the Farmgate Milk Price are described in Section 3 – *Setting the Farmgate Milk Price for New Zealand Milk*. The Fonterra Board has the ability to set the Farmgate Milk Price at a price higher than that determined in accordance with the Farmgate Milk Price Manual. In such circumstances, the Fonterra Board would need to make this fact publicly available and it would need to be approved by not less than 75% of the Fonterra Board with such majority including at least a majority of the Independent Directors;
- the occurrence of biosecurity events (e.g. the outbreak of foot and mouth disease) affecting the security of supply or the reputation of Fonterra's products;
- the occurrence of a food safety incident which could result from products being contaminated or tampered with or otherwise being unfit for consumption;
- fluctuations in the supply of raw milk to Fonterra, which could occur for a number of reasons, including weather and climatic effects, the rate of pasture growth, changes in the economics for dairy farmers generally, or farmers choosing to supply milk to other processors; and
- changes in regulation in New Zealand and elsewhere affecting the production or sale of dairy products. These may include the actions of foreign governments which restrict or influence trade such as the imposition of tariffs, price controls, quotas, subsidies or food-related regulation. Fonterra could also be affected by regulations relating to greenhouse gas emissions, land use or other environmental matters.

Each of the risks associated with Fonterra described above or in Section 7 – *Investment Risks* could have a potential effect on Fonterra's brand or reputation, the supply of raw milk, or its ability to produce or supply products, or otherwise adversely affect Fonterra's earnings, financial performance or financial position with a consequential effect on an investment in the Fund.

The above factors are a brief summary of some of the risks applicable to the Units, to the Fund and to Fonterra.

Prospective investors should not place additional importance on these risks over and above the risks identified elsewhere in this Offer Document.

Prospective investors should carefully consider the risk factors referred to in this section and in Section 7 – *Investment Risks*, in addition to the other information in this Offer Document, before subscribing for Units and should:

- **satisfy themselves that they have a sufficient understanding of these matters; and**
- **have regard to their own investment objectives, financial circumstances, and taxation position before investing in the Fund.**

If you do not understand any part of this Offer Document, or are in any doubt as to whether or not to invest in Units, it is recommended that you seek professional guidance from a NZX Firm, your solicitor, accountant or other qualified professional adviser before deciding whether or not to invest.

CONSEQUENCES OF INSOLVENCY

Unit Holders will not be liable to pay any money to any person in the event of insolvency of the Fund.

Depending on the value of the Fund's assets (which are expected to principally comprise Economic Rights), the Fund may not, in the event of insolvency, after paying all of its creditors, have sufficient funds to pay Unit Holders in full or in part. In these circumstances, Unit Holders may receive less than their original investment in the Fund, or none of it.

Generally, claims of creditors will rank ahead of claims of Unit Holders. After all creditors have been paid, any remaining assets will be available for distribution between all Unit Holders, who will rank equally among themselves.

FORWARD LOOKING STATEMENTS

Certain statements in this Offer Document constitute forward looking statements. Such forward looking statements involve known and unknown risks, uncertainties, assumptions and other important factors, many of which are beyond the control of the Manager and Fonterra, and which may cause actual results, performance or achievements of the Fund and Fonterra to differ materially from those expressed or implied by such statements. Such factors include, but are not limited to, those discussed in Section 7 – *Investment Risks*.

Given these uncertainties, investors are cautioned not to place undue reliance on such forward looking statements. None of the Manager of the Fund, Fonterra, Fonterra's subsidiaries, the Trustee, the Joint Lead Managers or any of their respective directors, officers, employees, consultants, agents, partners or advisers gives any assurance that actual outcomes will not differ materially from the forward looking statements contained in this Offer Document, and the inclusion of forward looking statements should not be regarded as a representation by any person that they will be achieved.

Other than as required by law or by the NZSX Listing Rules or ASX Listing Rules, none of the Manager of the Fund, Fonterra, Fonterra's subsidiaries, the Trustee, the Joint Lead Managers or any of their respective directors, officers, employees, consultants, agents, partners or advisers undertakes any obligation to update any statement in this Offer Document or publicly announce the result of any revisions to the forward looking statements contained in this Offer Document to reflect future developments or events.

CAN THE INVESTMENT BE ALTERED?

AMENDING THE TERMS OF THE OFFER

The full terms of the Offer are set out in Section 8 – *Details of the Offer*. Those terms, including the amounts payable on Application for Units, may be altered by the Manager and Fonterra by an amendment to this Offer Document, details of which must be filed with the Registrar of Financial Service Providers.

AMENDING THE TERMS OF THE UNITS

The terms of the Trust Deed governing the Units (and thus the rights attaching to Units themselves) may be altered by agreement between the Trustee, Fonterra and the Manager, with the authority of an Extraordinary Resolution of Unit Holders. Those terms may also be altered in certain other circumstances set out in the Trust Deed without the authority of Unit Holders. In addition, the consent of the Fonterra Unit Holder is required where any amendment to the Trust Deed would change any of:

- the governance structure of the Board of the Manager;
- the scope and role of the Fund;
- the obligation of the Fund to facilitate the exchange of a Share for a Unit or a Unit for a Share;
- the limit on individual Unit Holders and their Associates (other than Fonterra) holding 15% or more of total Units on issue; or
- the terms of the Fonterra Unit.

The Fonterra Unit will be held by the Fonterra Unit Holder (being the trustees of the Fonterra Farmer Custodian Trust). More information in relation to the Fonterra Unit Holder is set out under the heading "The Fonterra Unit" in Section 5 – *Trading Among Farmers in Detail*.

HOW DO I CASH IN MY INVESTMENT?

REDEMPTION

Fonterra Shareholders, Fonterra and the RVP will be able to exchange Units for Shares, by requiring the Manager to redeem those Units in exchange for the transfer of one Share for each Unit redeemed. Unit Holders will not otherwise have the ability to redeem their Units or exchange them for Shares.

EARLY TERMINATION

The implementation of Trading Among Farmers (part of which includes the establishment of the Fund) is one of the biggest changes to Fonterra since its formation. Due to the risks of the structure and its novelty, Fonterra retains the unilateral right to terminate the Authorised Fund Contract without cause within two years after the Launch Date. In that event, Fonterra will be required to purchase the Economic Rights held for the Fund (or the Shares those Economic Rights relate to) or arrange an approved person to purchase them. The Fund will be wound up if all the Economic Rights held for the Fund (or all the Shares the subject of the Fonterra Economic Rights Trust) are acquired by Fonterra or a person nominated by Fonterra. Fonterra has the right to acquire, or procure the acquisition of, the Economic Rights or the Shares subject to the Economic Rights in certain circumstances, as described in further detail under the headings "Termination of the Authorised Fund Contract" and "Termination of the Fund" in Section 5 – *Trading Among Farmers in Detail*.

SALE OF UNITS

Unit Holders will be able to cash in their investment by selling their Units. The Units are transferable in accordance with the Trust Deed, the NZSX Listing Rules, the ASX Listing Rules, applicable laws and regulations (including the Overseas Investment Act 2005 (New Zealand) and the Securities Act).

As at the date of this Offer Document, there is no established trading market for the Units. However, in the opinion of the Manager of the Fund, a market for the Units is likely to develop.

No charges are payable to the Manager in respect of any sale of Units. However, a sale of Units on the NZX Main Board or ASX is likely to attract normal brokerage and charges that are payable for transactions conducted on those stock exchanges.

Applicants may seek to sell Units quoted on the NZX Main Board by contacting a NZX Firm and supplying their CSN (Common Shareholder Number) and FIN. Applicants should not attempt to sell their Units until they know whether, and how many, Units have been allocated to them. None of Fonterra, the Manager, Fonterra's subsidiaries, the Trustee, the Joint Lead Managers or any of their respective directors, officers, employees, consultants, agents, partners or advisers accepts any liability or responsibility should any person attempt to sell or otherwise deal with Units before statements confirming allotments are received by Applicants.

WHO DO I CONTACT WITH INQUIRIES ABOUT MY INVESTMENT?

Inquiries in relation to the Units may be made to the Unit Registrar at:

Computershare Investor Services Limited
Level 2, 159 Hurstmere Road, Takapuna
Auckland 0622

Private Bag 92119, Auckland 1142, New Zealand

Investor Enquiries: +64 9 488 8777
Email: enquiry@computershare.co.nz
Website: www.investorcentre.com/nz

IS THERE ANYONE TO WHOM I CAN COMPLAIN IF I HAVE PROBLEMS WITH THE INVESTMENT?

Any complaints arising in connection with the Units can be made to the Unit Registrar by contacting Investor Enquiries at the address and phone number set out under the heading "Who do I contact with inquiries about my investment?" above.

The Manager of the Fund is a member of Dispute Resolution Services Limited, a provider of an independent dispute resolution scheme approved by the Ministry of Consumer Affairs. If your complaint is not resolved after contacting the Unit Registrar, you can refer it to Dispute Resolution Services Limited, Level 9, 109 Featherston Street, Wellington 6011, New Zealand or by calling 0508 337 337 (toll free in New Zealand) or +64 4 910 9952. Further information about referring a complaint to Dispute Resolution Services Limited can be found at www.drsl.co.nz.

The Manager of the Fund is also a member of the Financial Ombudsman Service operated by Financial Ombudsman Service Limited (ABN 67 131 124 448) (FOS), which is an independent dispute resolution scheme approved by the Australian Securities and Investments Commission. If you are dissatisfied with the response from the Manager, you can lodge a complaint with the FOS, GPO Box 3, Melbourne, Victoria 3001, Australia. For more information or to access the FOS process, please call +61 1300 780 808. Alternatively, you can write to FOS at GPO Box 3, Melbourne, Victoria 3001, Australia. Access to the FOS is free.

Alternatively, the Trustee is a member of Financial Services Complaints Limited, a provider of an independent dispute resolution scheme approved by the Ministry of Consumer Affairs. If your complaint is not resolved after contacting the Unit Registrar, you can refer it to Financial Services Complaints Limited, Level 4, Sybase House, 101 Lambton Quay, Wellington 6011, New Zealand or by calling 0800 347 257 (toll free in New Zealand) or +64 4 472 3725. Further information about referring a complaint to Financial Services Complaints Limited can be found at www.fscl.org.nz.

WHAT OTHER INFORMATION CAN I OBTAIN ABOUT THIS INVESTMENT?

OFFER DOCUMENT AND FINANCIAL STATEMENTS

Further information about the Units and the Fund is contained elsewhere in this Offer Document. The Fund has been formed to undertake the Offer and, as at the date of this Offer Document, has not produced financial statements.

A copy of this Offer Document and a copy of the most recent financial statements of Fonterra can be obtained free of charge from www.fonterraoffer.com.

Those documents and other documents of, or relating to, the Fund (and Fonterra), including the most recent financial statements of those entities, are also (or will be once available) filed on a public register maintained by the Companies Office of the Ministry of Business, Innovation and Employment and are available for public inspection, including on the Companies Office website at www.business.govt.nz/companies.

ANNUAL INFORMATION

Unit Holders at the relevant record date will be entitled to receive certain information relating to the ongoing performance of the Fund in accordance with the Trust Deed, the Unit Trusts Act, the Financial Reporting Act 1993 (New Zealand), the NZSX Listing Rules and the ASX Listing Rules.

In addition, Unit Holders will also receive the same periodic disclosure as Fonterra provides to its Shareholders (e.g. annual and half-yearly reports).

Unit Holders will either receive this information automatically or will receive notification of their right to request this information.

The Fund is also required to make half-yearly and annual announcements to NZX and ASX, and such other announcements as are required by the NZSX Listing Rules and the ASX Listing Rules from time to time.

ON-REQUEST INFORMATION

Unit Holders are also entitled to request copies of the following documents:

- the most recent financial statements of the Fund, together with a copy of the Auditor's report on those statements, once available;
- the most recent annual report of the Fund, once available;
- the Trust Deed (together with any amendments made to the Trust Deed);
- this Offer Document (together with any documents registered under the Securities Act for the purpose of extending the period during which allotments may be made under this Offer Document);
- a comparison of actual results against the Fonterra Prospective Financial Information set out in Section 4 – *Fonterra Financial Information*, once available; and
- any other information that may be requested under regulation 44 of the Securities Regulations.

This information will be provided, free of charge, upon a written request to the Manager of the Fund at its registered office at 9 Princes Street, Auckland, New Zealand.

OFFER DETAILS AND DATES

IMPORTANT DATES

OFFER DOCUMENT REGISTERED **26 OCT 2012**	BROKER FIRM OFFER AND STAKEHOLDER OFFER EXPECTED TO OPEN **5 NOV 2012**	STAKEHOLDER OFFER CLOSING DATE **21 NOV 2012**
BROKER FIRM OFFER CLOSING DATE **21 NOV 2012**	INSTITUTIONAL OFFER AND BOOKBUILD **26 NOV 2012 TO 27 NOV 2012**	PRICING AND ALLOCATIONS ANNOUNCED **27 NOV 2012**
EXPECTED ALLOTMENT AND COMMENCEMENT OF TRADING ON THE NZX MAIN BOARD AND ASX (ON A DEFERRED SETTLEMENT BASIS FOR ASX) **30 NOV 2012**	EXPECTED COMMENCEMENT OF TRADING ON ASX (ON A NORMAL SETTLEMENT BASIS) **5 DEC 2012**	EXPECTED INITIAL DISTRIBUTION PAID BY THE FUND **APR 2013**

This timetable is indicative only. Applicants are encouraged to submit their Applications as early as possible. Fonterra, with the agreement of the Joint Lead Managers, reserves the right to amend these dates. Any such amendment will be announced through NZX.

OFFER DETAILS AND DATES CONTINUED

STRUCTURE OF THE OFFER

The Offer includes:

- the Broker Firm Offer which is available only to New Zealand resident clients of NZX Firms who have received an allocation from that NZX Firm;
- the Stakeholder Offer comprising:
  - the Friends of Fonterra Offer to current Farmer Shareholders with a valid "Farm / Party number" as at 26 October 2012, Fonterra-supplying sharemilkers with a valid "Farm / Party number" as at 26 October 2012, Fonterra New Zealand and Australian permanent employees and Ex-Farmer Shareholders; and
  - the Australian Supplier Offer of up to $25 million of Units to supplier shareholders of Bonlac Supply Company Limited and to suppliers of milk to Fonterra Milk Australia Pty Ltd; and
- the Institutional Offer, which consists of an invitation to bid for Units made to selected Institutional Investors in New Zealand, Australia and certain other jurisdictions.

There is no general public offer. Therefore, investors are encouraged to contact a NZX Firm to determine whether they may be offered Units under the Broker Firm Offer.

Total funds raised by the Offer are to be a minimum of $500 million, with the ability to accept oversubscriptions of up to an additional $25 million. The Offer will not proceed if valid Applications for Units having an aggregate value of $500 million are not received.

DETERMINATION OF THE FINAL PRICE

The price per Unit payable by investors to subscribe for Units will be the Final Price. As at the date of this Offer Document, the Final Price is yet to be determined. However, Fonterra has set an Indicative Price Range of $4.60 to $5.50 per Unit.

The Final Price will be determined by Fonterra. A bookbuild process, managed by the Joint Lead Managers, under which selected Institutional Investors and NZX Firms will be invited to submit bids for Units, will be used to assist Fonterra to determine the Final Price. Further information about the bookbuild process is contained under the heading "Institutional Offer" in Section 8 – *Details of the Offer*.

OFFER INFORMATION

ISSUER	CORPORATE PROMOTER OF THE OFFER	INDICATIVE PRICE RANGE	TOTAL PROCEEDS FROM THE OFFER	MARKETS ON WHICH APPLICATIONS HAVE BEEN MADE TO QUOTE THE UNITS
FSF MANAGEMENT COMPANY LIMITED (AS MANAGER OF THE FONTERRA SHAREHOLDERS' FUND)	FONTERRA CO-OPERATIVE GROUP LIMITED	$4.60 TO $5.50 PER UNIT	MINIMUM $500 MILLION WITH THE ABILITY TO ACCEPT OVERSUBSCRIPTIONS OF UP TO AN ADDITIONAL $25 MILLION	NZX MAIN BOARD AND ASX

SELECTED FINANCIAL INFORMATION OF FONTERRA[1]

	PROSPECTIVE	HISTORICAL		
($M) (YEAR END 31 JULY)	FY2013	FY2012	FY2011	FY2010
Revenue	18,627	19,769	19,871	16,726
Normalised EBITDA[2]	1,634	1,520	1,494	1,388
Normalised EBIT[3]	1,079	1,028	1,005	904
Profit before tax	726	677	622	765
Profit for the period[4]	690	624	771	685
Earnings per Share (EPS) (cents)[4, 5]	43	42	55	51
Dividends per Share (cents)[6]	32	32	30	27

1 The selected Fonterra historical financial information includes normalisation adjustments. Refer to Section 4 – *Fonterra Financial Information* for further information, including reconciliation to Fonterra's statutory financial statements. The Fonterra Prospective Financial Information in Section 4 – *Fonterra Financial Information* should be read in conjunction with the assumptions and sensitivity analysis contained in that section and the risks described in Section 7 – *Investment Risks*. The selected Fonterra historical financial information has been audited. This Offer Document also includes the Investigating Accountant's Report on the Fonterra Prospective Financial Information.

2 Normalised earnings before interest, tax, depreciation and amortisation includes share of profit from equity accounted investees and excludes non-recurring items as described on pages 74 and 96 in Section 4 – *Fonterra Financial Information*.

3 Normalised earnings before interest and tax includes share of profit from equity accounted investees and excludes non-recurring items as described on page 74 in Section 4 – *Fonterra Financial Information*.

4 Profit for the period and earnings per Share in FY2011 includes a non-cash tax credit of $202 million relating to deferred tax.

5 Represents profit for the period attributable to Shareholders divided by the weighted average number of Shares outstanding in the period.

6 As described in further detail under the heading "What returns will I get?" in the section entitled *Answers to Important Questions* above, the Manager of the Fund will pass on to Unit Holders any cash dividend or other cash benefit (other than supplementary dividends) paid in respect of Fonterra Shares, less any adjustments for tax. Refer to Section 4 – *Fonterra Financial Information* under the heading "Equity and dividends" for further information about dividends paid in respect of Fonterra Shares.

The Final Price is expected to be announced to NZX on 27 November 2012. All successful Applicants will pay the Final Price. Fonterra reserves the right to set the Final Price within or higher than the Indicative Price Range.

EXPECTED INITIAL DISTRIBUTION

As described in further detail under the heading "What returns will I get?" in the section entitled *Answers to Important Questions* above, the Manager of the Fund will pass on to Unit Holders any cash dividend or other cash benefit (other than supplementary dividends) paid in respect of Fonterra Shares, less any adjustments for tax. The Fonterra Board intends to declare an interim dividend for the 2013 Season in March 2013, to be paid in April 2013.

The Manager can give no assurance as to the amount or frequency of any cash dividend or other cash benefit that may be paid in respect of Fonterra Shares. Therefore, the Manager cannot give any assurance as to the amount or frequency of cash distributions to be paid in respect of Units.

DISCRETION REGARDING THE OFFER

Fonterra (as corporate promoter of the Offer) will be responsible for making all decisions in relation to the Offer.

Fonterra reserves the right to withdraw the Offer at any time prior to the allotment of Units to Applicants. If the Offer or any part of it is withdrawn, then all Application Monies, or the relevant Application Monies, will be refunded (without interest).

Fonterra also reserves the right to close the Offer or any part of it early, extend the Offer or any part of it, accept late Applications either generally or in particular cases, reject any Application, or allocate to any Applicant Units with a lesser aggregate value than that applied for.

If Fonterra amends the Offer in any way, any such amendment will be announced through NZX.

WHERE TO FIND OUT MORE ABOUT THE OFFER

Further information about the terms of the Offer and how those terms may be altered is set out in the section entitled *Answers to Important Questions* above and in Section 8 – *Details of the Offer*.

KEY INVESTMENT METRICS[1]

INDICATIVE PRICE RANGE	$4.60	to $5.50
FUND METRICS		
Units on issue following the Offer[2]	109m	91m
Implied Fund market capitalisation[2]	$500m	$500m
FY2013 gross distribution yield[3]	7.0%	5.8%
FY2013 net cash distribution yield[4]	5.0%	4.2%
FONTERRA METRICS		
Shares on issue following the Offer[5]	1,598m	1,586m
Implied Fonterra market capitalisation[6]	$7,352m	$8,722m
Pro forma net debt (as at 31 July 2012)[7]	$3,788m	$3,788m
Implied Fonterra enterprise value[8]	**$11,140m**	**$12,510m**
Offer price / FY2013 EPS	10.6x	12.7x
Implied Fonterra enterprise value / FY2013 normalised EBITDA[9]	6.8x	7.7x
Implied Fonterra enterprise value / FY2013 normalised EBIT[9]	10.3x	11.6x
FY2013 Fonterra dividend yield (unimputed)[10]	**7.0%**	**5.8%**

1 The information in this table has been prepared on the basis of the estimates and assumptions referred to below and in the metrics stated. The yields and ratios provided have been calculated with reference to the Fonterra Prospective Financial Information included in Section 4 – *Fonterra Financial Information*, which should be read in conjunction with the assumptions and sensitivity analysis included in that section and the risks described in Section 7 – *Investment Risks*. The Fonterra Prospective Financial Information is also subject to the Investigating Accountant's Report on Prospective Financial Information.

2 Assumes minimum subscriptions are $500 million and excludes oversubscriptions.

3 Represents the total dividend (unimputed) expected to be paid by Fonterra to the Fund in FY2013 excluding any investor-level tax, divided by the Implied Fund market capitalisation.

4 Assumes distributions paid by the Fund to Unit Holders are net of a prescribed investor tax rate of 28%. Refer to Section 9 – *Taxation* for further information.

5 The number of Shares on issue following the Offer has been estimated based on the aggregate of the total number of Shares on issue as at the date of this Offer Document (1,522 million Shares), the number of Shares required to be issued by Fonterra to meet the minimum Fund size (76.09 to 63.64 million Shares) assuming Fonterra issues Shares to the value of $350 million, and the issue of 110,000 Shares by Fonterra to the Fonterra Farmer Custodian to hold for the Registered Volume Provider. Refer to Section 8 – *Details of the Offer* under the heading "Formation of the Fund" for further information.

6 Represents the number of Shares on issue following the Offer multiplied by the lowest and highest prices respectively in the Indicative Price Range.

7 Represents net debt including the effect of debt hedging in place at balance date, less new equity raised between balance date and the date of this Offer Document being 20 million Shares at $4.52 per Share, less new equity raised from issuing 110,000 Shares to the Registered Volume Provider, less $350 million of assumed new equity issued by Fonterra in order to meet the minimum Fund size.

8 Represents implied Fonterra market capitalisation plus pro forma net debt.

9 Note that normalised EBITDA and normalised EBIT includes share of profit from equity accounted investees and excludes non-recurring items as described on page 96 in Section 4 – *Fonterra Financial Information*.

10 Based on the lowest and highest prices respectively in the Indicative Price Range and prospective dividends per Share for FY2013. Refer to Section 4 – *Fonterra Financial Information* for further information.

FONTERRA AT A GLANCE[1]

10,500	A supply base of around 10,500 Farmer Shareholders throughout New Zealand
17B	A fleet of around 500 milk tankers collected approximately 17 billion litres of New Zealand milk (approximately 89% of national production)
31	31 New Zealand manufacturing sites produced around 2.5 million metric tonnes of dairy products
98%	Around 98% of Fonterra's New Zealand production is exported in 165,000 containers via 103 New Zealand warehouses and 11 ports
2.3B	In addition to New Zealand-sourced milk, Fonterra collected and processed around 2.3 billion litres of milk outside New Zealand, primarily in Australia and Chile[2]
2.6B	A further 2.6 billion litres was collected and processed overseas through joint ventures[2]
21%	Fonterra dairy product exports of around 2.6 million metric tonnes represented an estimated 21% of all Global Dairy Exports, including 46% of Global Dairy Exports of whole milk powder
$19.8B	Fonterra's revenue was approximately $19.8 billion across its integrated and geographically diverse businesses that span everyday dairy nutrition, out-of-home foodservices, branded consumer products and advanced dairy nutrition
$15.1B	Fonterra has total assets of $15.1 billion, and generated normalised earnings before interest and tax (EBIT) of over $1 billion[3]
$5B	Fonterra has an established brand portfolio that includes Mainland™, Tip Top™, Western Star™, Anchor™, Anlene™, Anmum™ and Soprole™, many of which are market leaders. It earned around $5 billion from sales across a diverse range of geographies and product formats
25%	Fonterra accounted for around 25% of New Zealand's merchandise export receipts for the 12 months ending 30 June 2012

Source: Fonterra, Statistics NZ

1 Unless otherwise stated, all references to the collection of milk and the production and export of dairy products are for the 2011 / 2012 dairy Season and all other statistics are for the financial year ended 31 July 2012.

2 These figures exclude the milk collected and processed in the 2011 / 2012 Season that Fonterra does not expect to collect and process in subsequent Seasons.

3 Normalised earnings before interest and tax includes share of profit from equity accounted investees and excludes non-recurring items as described on page 74 in Section 4 – *Fonterra Financial Information*.

FONTERRA AT A GLANCE CONTINUED

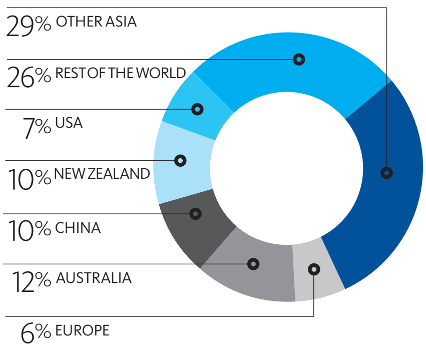
An investment in Units is an investment in the performance of Fonterra, New Zealand's largest company and the world's largest processor of dairy products.

With total revenue of $19.8 billion,[1] around 17,300 employees (including 6,000 outside New Zealand) and a sales network that reaches customers in more than 100 countries, Fonterra is a clear leader in the international dairy market.

Fonterra is a co-operative, owned and supplied by around 10,500 Farmer Shareholders with dairy farms in New Zealand. The billions of litres of milk supplied by Farmer Shareholders every dairy Season contribute directly to Fonterra's scale, which in turn supports its global position. Behind the Fonterra name are generations of expertise in milk production, processing and exporting.

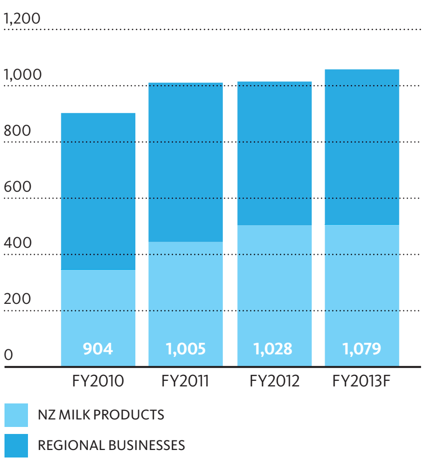
Unit Holders have the opportunity to participate in Fonterra's earnings and value which are derived over and above the aggregate price that Fonterra pays farmers for milk in New Zealand.

FY2012 REVENUE BY REGION



Source: Fonterra

NORMALISED EBIT BY SEGMENT[1]



Source: Fonterra

1 Figures expressed in millions of dollars. Normalised EBIT includes share of profit from equity accounted investees and excludes non-recurring items as described on pages 74 and 96 in Section 4 – *Fonterra Financial Information*. Normalised EBIT includes inter-segment income of positive $17 million in FY2011, negative $14 million in FY2012 and negative $12 million in FY2013 (forecast).

Fonterra is an integrated dairy business with a diverse range of manufacturing, distribution and marketing activities. It is organised around two complementary business segments: NZ Milk Products and regional businesses.

NZ MILK PRODUCTS

The driver of the New Zealand milk supply chain which collects milk from New Zealand farmers, manufactures it into dairy products and then exports it to customers around the world. Products range from everyday dairy nutrition powders (typically whole milk powder and skim milk powder) to innovative advanced dairy nutrition products. Customers include the world's five largest infant formula manufacturers and many of the world's largest food companies.

REGIONAL BUSINESSES

Fonterra builds on its earnings from New Zealand and internationally-sourced milk through the operations of integrated regional businesses.[2] These regional businesses focus on branded consumer dairy products (such as powders, yoghurts, milk, butter and ice cream) and out-of-home foodservices (supplying customers such as bakeries, restaurants, caterers, hotels and quick service restaurants).

AUSTRALIA AND NEW ZEALAND (ANZ)

A leading consumer and out-of-home foodservices business that is also a major processor of Australian milk. Key brands include Anchor™, Mainland™, Tip Top™ and Western Star™.

ASEAN / MENA

A consumer and out-of-home foodservices business spanning multiple countries in Asia and the Middle East that has strong consumer positions under the Anchor™, Fernleaf™, Anmum™ and Anlene™ brands.

GREATER CHINA AND INDIA

An opportunity for Fonterra to expand its everyday dairy nutrition business. A current strategic priority is establishing an integrated business in China, including a secure milk supply from local Fonterra owned farms.

LATIN AMERICA (LATAM)

Encompassing Soprole, the market-leading integrated dairy business in Chile, and Dairy Partners Americas, a joint venture alliance with Nestlé that operates in several markets such as Brazil, Venezuela, Ecuador, Colombia and Argentina.

1 Unless otherwise stated, all references to the collection of milk and the production and export of dairy products are for the 2011 / 2012 dairy Season. All other statistics are for the financial year ended 31 July 2012.

2 On 1 August 2012, Fonterra's organisational structure was re-aligned. One of the key changes included the separation of the Asia / AME business unit into the ASEAN / MENA and Greater China and India business units. For more discussion, please see Section 1 – *About Fonterra*.

INVESTMENT HIGHLIGHTS

1

THE FONTERRA SHAREHOLDERS' FUND IS A UNIQUE INVESTMENT OPPORTUNITY.

The Fund represents the only opportunity for the broader investment community to participate in the performance of Fonterra, a leading multinational processor and marketer of dairy products.

INVESTMENT HIGHLIGHTS CONTINUED

2

FONTERRA IS THE WORLD'S LARGEST PROCESSOR OF DAIRY PRODUCTS.

In the 2011 / 2012 Season, Fonterra collected 17 billion litres of milk in New Zealand, collected and processed another 2.3 billion litres overseas and collected and processed a further 2.6 billion litres through international joint ventures.[1] It manufactures this milk into a range of commodity and value-added dairy products.

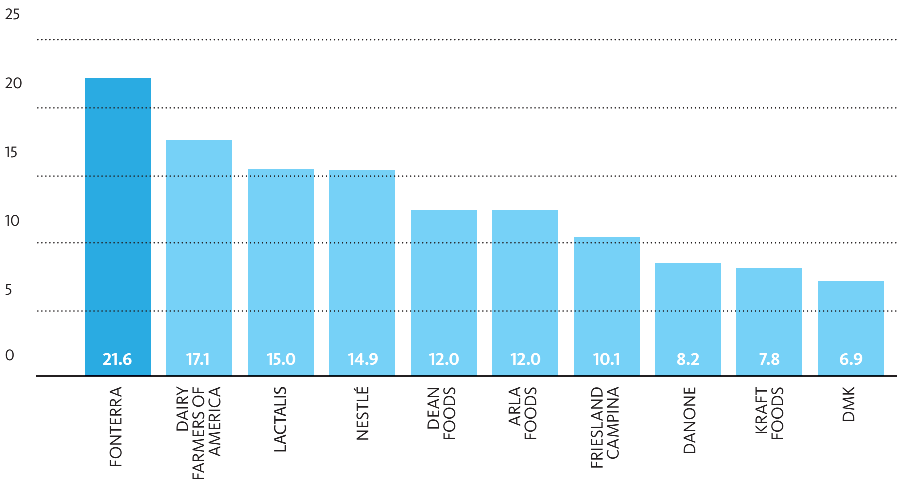
Fonterra represented 21% of Global Dairy Exports for 2011 / 2012 Season (with Global Dairy Exports accounting for approxmately 8% of global dairy production). Its NZ Milk Products business exported around 98% of Fonterra's New Zealand production to more than 100 countries in that Season.

Through its longstanding focus on exports and its significant share of the globally-traded dairy market, Fonterra has built an established sales network and specialised expertise to market its dairy products globally.

1 These figures exclude the milk collected and processed in the 2011 / 2012 Season that Fonterra does not expect to collect and process in subsequent Seasons.

THE WORLD'S LARGEST MILK PROCESSOR

Milk intake (million tons)[2]

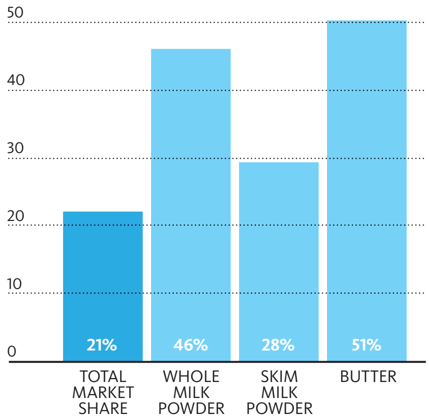


Source: IFCN Dairy Network. Analysis is based on the IFCN Dairy Report 2012. Data represents in most cases the year 2011 (Nestlé data represents the year 2010).

2 Milk intake figures above are measured in millions of tons (not billions of litres) and represent milk volume collected and commodity purchases (in milk equivalents) for the company and its subsidiaries. 50% of Dairy Partners America milk intake has been allocated to each of Fonterra and Nestlé.

FONTERRA'S SHARE OF GLOBAL DAIRY EXPORTS[3]

(% of Global Dairy Exports)



Source: Fonterra, Global Trade Information Services

3 Figures are for the 2011 / 2012 Season. Global Dairy Exports means the market for the cross-border trade of dairy products but excludes trade among countries within the European Union.

3

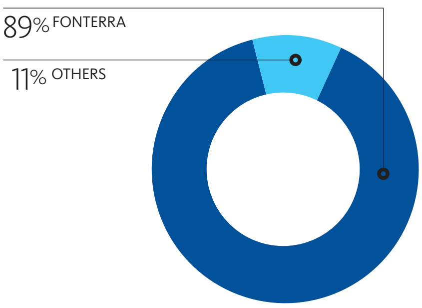
FONTERRA'S CO-OPERATIVE STRUCTURE UNDERPINS ITS ACCESS TO QUALITY MILK SUPPLY.

In the 2011 / 2012 Season, Fonterra collected approximately 89% of New Zealand's milk from around 10,500 Farmer Shareholders who are among the most cost-efficient dairy producers in the world.

Farmers have a substantial financial stake in Fonterra through the link between milk supply and ownership. This promotes a strong connection to the Co-operative and a secure supply of quality milk.

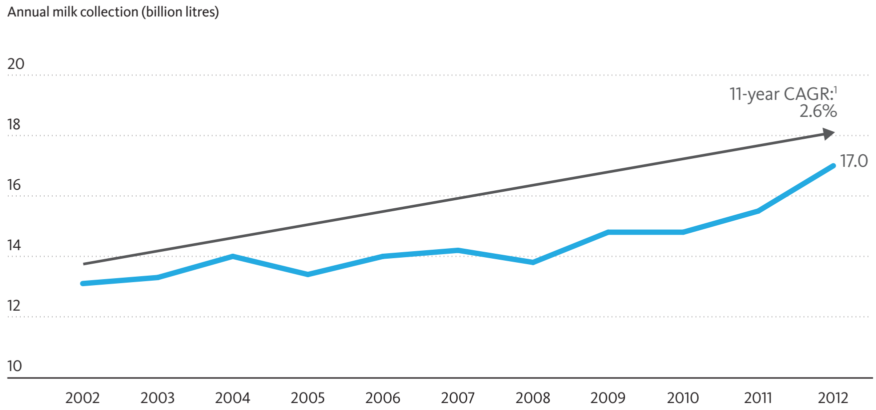
The milk price paid to Farmer Shareholders is linked to the prices of globally-traded dairy products in a transparent manner, and takes into account a return on investment in efficient processing assets.

TOTAL MILK COLLECTED IN NEW ZEALAND



Source: Fonterra and DairyNZ

FONTERRA MILK COLLECTION IN NEW ZEALAND BY SEASON

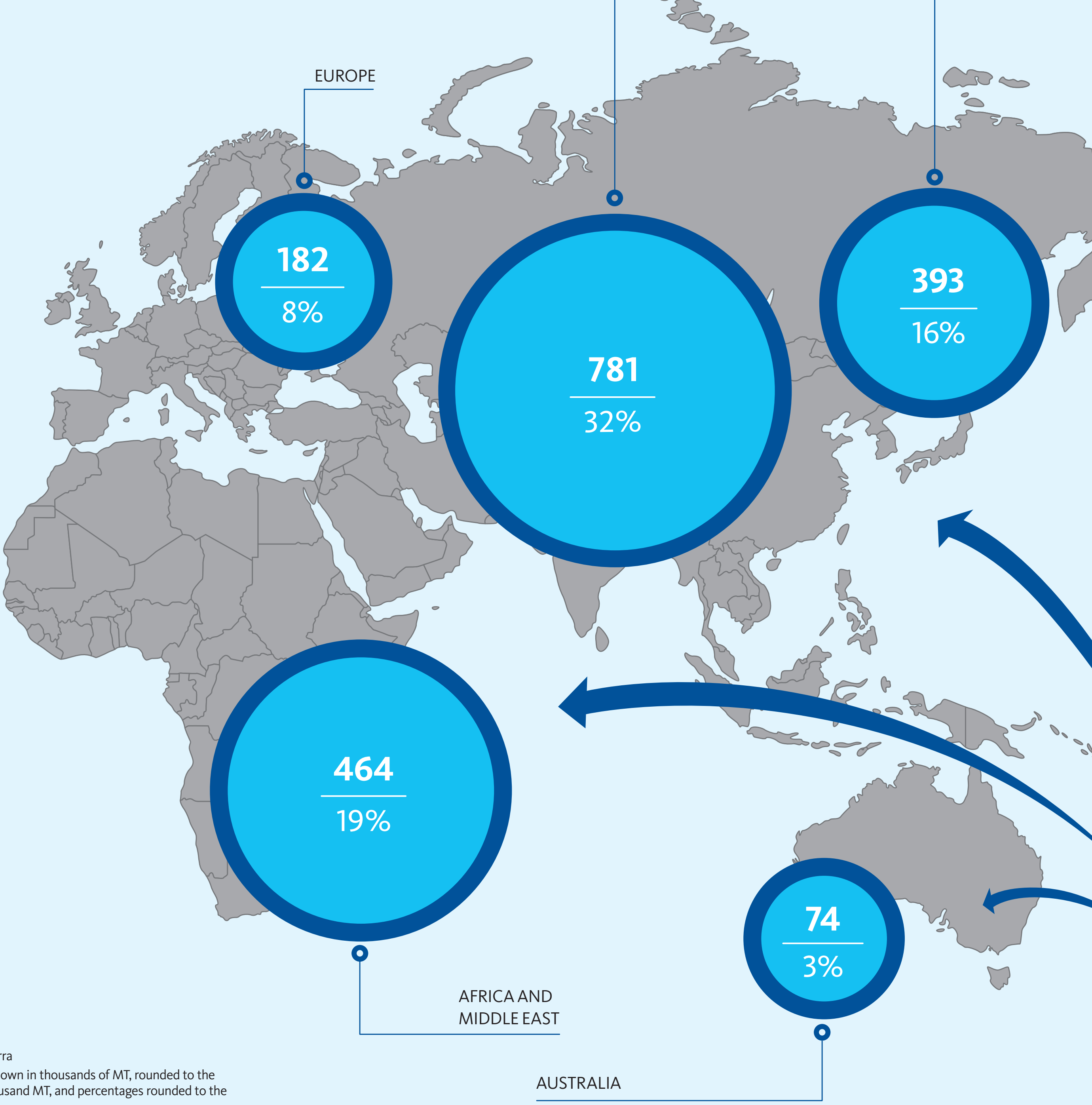


Source: Fonterra

1 CAGR refers to compound annual growth rate.

NZ MILK PRODUCTS' SALES VOLUMES IN FY2012

PRODUCTS MANUFACTURED USING NEW ZEALAND-SOURCED MILK[1]



Source: Fonterra

1 Amounts shown in thousands of MT, rounded to the nearest thousand MT, and percentages rounded to the nearest 1%.

CONSUMER BRANDS IN REGIONAL BUSINESSES

ASEAN/ MENA[3]

Anmum
Anchor
Anlene
Fernleaf

GREATER CHINA AND INDIA[3]

Anmum
Anchor
Anlene

4

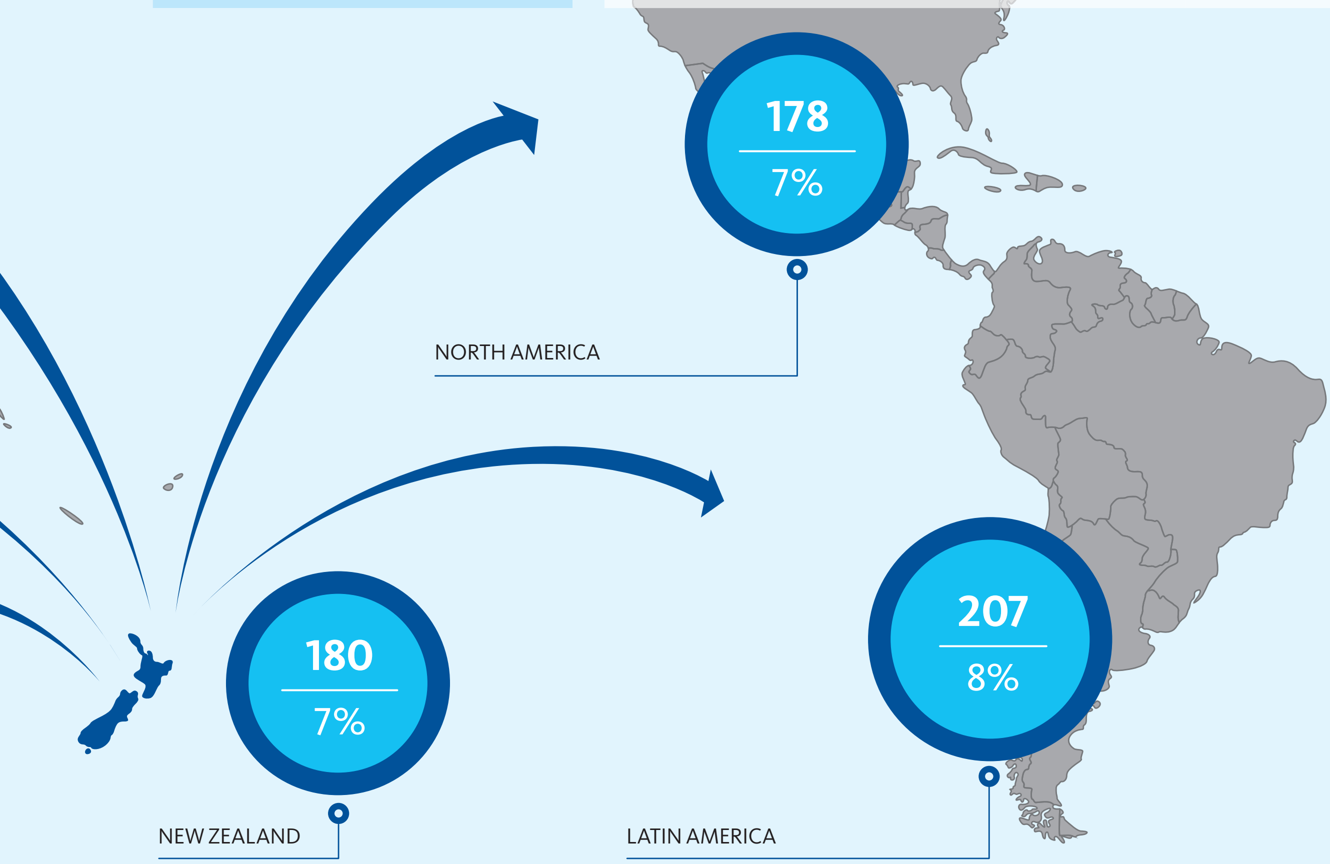
FONTERRA'S INTEGRATED AND DIVERSIFIED BUSINESS OPERATIONS DRIVE SUSTAINABLE EARNINGS GROWTH.

Fonterra derives significant value from leveraging its scale and scope across product groups, sales channels and geographies.

The backbone of Fonterra is its NZ Milk Products business which generates returns from its efficient and diversified processing infrastructure in New Zealand. This is supplemented by milk collection and processing operations in Australia and Latin America, and supported by a global sales network.

From this base, Fonterra has built regional business units from which it intends to increase returns by growing higher-margin consumer and out-of-home foodservices sales.[2]

2 Out-of-home foodservices customers include bakeries, restaurants, institutional caterers, hotels and quick service restaurants.



AUSTRALIA & NEW ZEALAND (ANZ)[3]

LATIN AMERICA (Latam)[3]

Source: Fonterra

3 Some brands are used by the Fonterra Group under licence (such as Bega® and Nestlé Ski®).

INVESTMENT HIGHLIGHTS CONTINUED

5

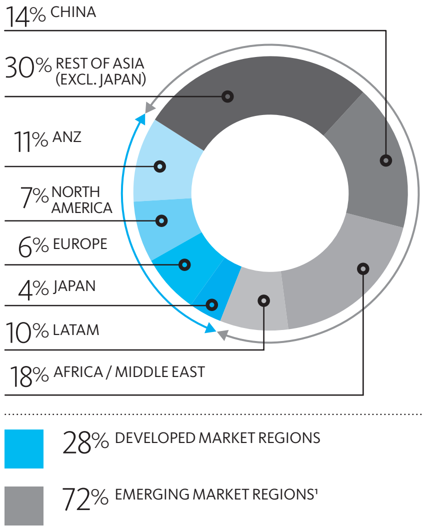
FONTERRA HAS A SIGNIFICANT PRESENCE IN EMERGING MARKETS.

Global demand for dairy is expected to rise, particularly in emerging markets where demand growth is likely to exceed local supply growth.

Fonterra is well placed to meet the growing demand in key regions:

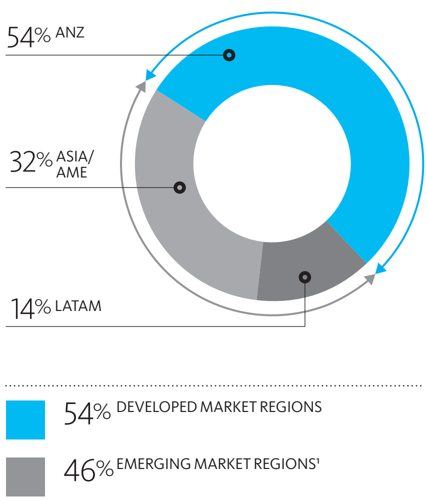
- 72% of NZ Milk Products' sales volumes made to emerging market regions in FY2012; and
- 46% of regional business revenues from emerging market regions in FY2012, a proportion which has been growing.

NZ MILK PRODUCTS' SALES VOLUMES IN FY2012 – NEW ZEALAND AND GLOBALLY-SOURCED MILK



Source: Fonterra

REGIONAL BUSINESS REVENUES IN FY2012



Source: Fonterra

1 References to emerging market regions and emerging markets incorporate all of Fonterra's operations in Asia (excluding Japan), China, Africa, the Middle East and Latin America.

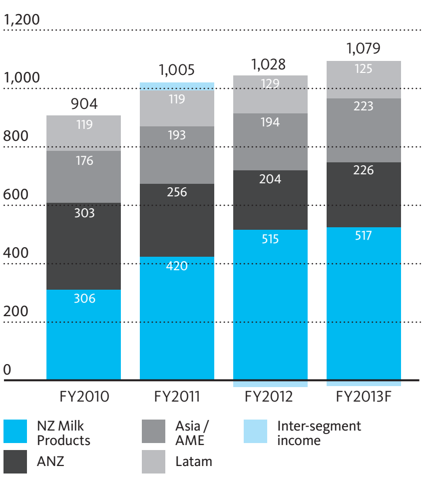
6

FONTERRA'S DIVERSE OPERATIONS UNDERPIN ITS EARNINGS.

Fonterra balances cash generation from its established businesses with investment in key growth areas.

New investment is focused on optimising the manufacturing footprint in New Zealand and higher-growth opportunities in Asia and Latin America.

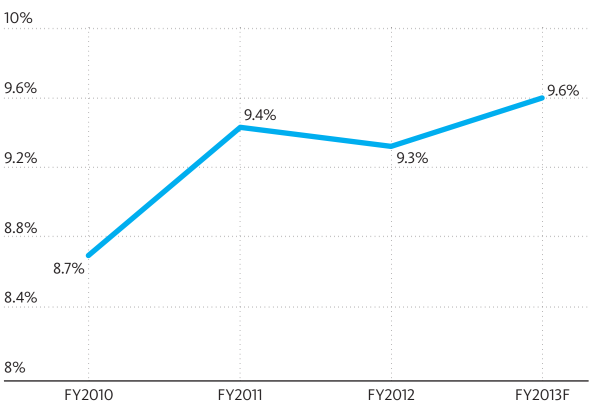
NORMALISED EBIT[1]



Source: Fonterra

1 Figures expressed in millions of dollars. Normalised EBIT includes share of profit from equity accounted investees and excludes non-recurring items as described on pages 74 and 96 in Section 4 – *Fonterra Financial Information*. Normalised EBIT includes inter-segment income of positive $17 million in FY2011, negative $14 million in FY2012, and negative $12 million in FY2013 (forecast).

RETURN ON CAPITAL EMPLOYED[1]



Source: Fonterra

1 Return on capital employed is calculated as normalised EBIT divided by capital employed. Normalised EBIT includes share of profit from equity accounted investees and excludes non-recurring items as described on pages 74 and 96 in Section 4 – *Fonterra Financial Information*.

SECTION 1 ABOUT FONTERRA

FONTERRA OVERVIEW

Fonterra is a leading integrated processor and marketer of dairy nutrition products to customers in over 100 countries.

In the 2011 / 2012 Season, Fonterra:

- collected approximately 17 billion litres of milk in New Zealand (approximately 89% of national production);
- processed approximately 16.4 billion litres of milk in New Zealand;
- collected and processed approximately 2.3 billion litres of milk in overseas jurisdictions (primarily in Australia and Chile);[1] and
- together with its joint venture partners, collected and processed approximately a further 2.6 billion litres of milk in overseas jurisdictions.[1]

Under DIRA, Fonterra is required to supply up to 600 million litres of milk to independent processors in New Zealand each Season. This accounts for approximately 3.5% of the amount Fonterra collects each Season and can be increased up to a maximum of 5% under DIRA. The difference between the amount of milk that Fonterra collects and processes in New Zealand is the amount Fonterra is required to supply to independent processors. 540 million litres of milk was supplied to independent processors in the 2011 / 2012 Season.

Fonterra's position as a key provider of dairy nutrition products has allowed it to cultivate long-term relationships with a diverse range of global customers including some of the world's largest food companies.

Fonterra's investments in New Zealand milk processing assets and global distribution networks support its branded consumer and out-of-home foodservices businesses in regional markets.

Fonterra conducts its operations in two complementary business segments:

- NZ Milk Products – an integrated supplier of dairy nutrition to global customers, which:
  - collects and processes milk from New Zealand farmers;
  - manufactures dairy nutrition products (including everyday nutrition powders such as whole milk power and skim milk powder and advanced dairy nutrition products); and
  - markets these products to global customers under the NZMP™ brand; and
- regional businesses – integrated and regionally focused dairy businesses that provide branded consumer dairy nutrition products and out-of-home foodservices to markets in New Zealand, Australia, Asia, the Middle East, North Africa and Latin America.

Fonterra derives significant value from its globally integrated and diversified business operations, leveraging its economies of scale and scope across multiple product groups, sales channels and geographies.

Fonterra continues to integrate local milk and product sourcing operations in selected overseas countries. Fonterra currently processes approximately 18% of Australia's milk production and around 23% of Chile's milk production, and is also developing secure sources of quality milk in China. Local milk supply also helps Fonterra to grow the market for its New Zealand milk in those regions.

Fonterra is committed to delivering results while maintaining a balance between environmental, economic and social sustainability. Fonterra has environmental compliance systems for farmers and for its own production, as well as carbon emissions reduction programmes and milk quality standards. In addition, Fonterra operates many other social and environmental programmes.

1 These figures exclude the milk collected and processed in the 2011 / 2012 Season that Fonterra does not expect to collect and process in subseqent Seasons.

HOW WE GOT TO WHERE WE ARE...

1846

New Zealand's first shipment of cheese is exported to Australia.

1871

The first co-operative cheese company is formed on the Otago Peninsula, allowing farmers to benefit from pooled resources and market strength.

1882

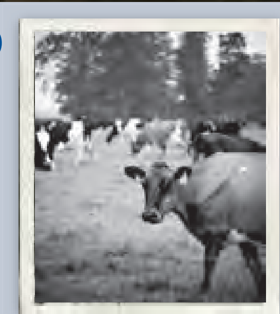
The vessel "Dunedin" carries the first refrigerated shipment of dairy products to London.

1886

The Anchor™ brand is launched.

1910

New Zealand dairy exports account for 14% of total New Zealand export revenue.



1930s-1960s

With the improvement in technology and transport, co-operatives start joining forces to become more efficient. By the 1960s, more than 400 co-operatives are reduced to 168.

1923

The New Zealand Government establishes The New Zealand Dairy Board to control all dairy exports. The New Zealand Dairy Board provides farmers and co-operatives access to new export markets, allowing them to generate higher returns.

1973

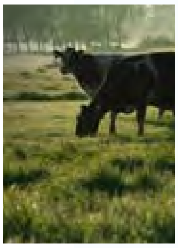
New Zealand loses its cornerstone market for dairy exports as a result of the United Kingdom joining the European Economic Community in 1973. In response, The New Zealand Dairy Board expands exports into new markets beyond the United Kingdom.

TODAY...

Fonterra is a global company with sales of products to more than 100 countries.

2001-2011

Fonterra expands its global presence through investments, acquisitions and partnerships. These include Bonlac Foods, the formation of Dairy Partners Americas (with Nestlé) and DMV Fonterra Excipients. Fonterra also increases its ownership in Soprole.



2001

Fonterra is created with the merger of two leading dairy co-operatives, The New Zealand Co-operative Dairy Company Limited and Kiwi Co-operative Dairies Limited, with The New Zealand Dairy Board.

2008

Fonterra launches the world's first successful online trading platform for internationally traded dairy commodities, GlobalDairyTrade™.

2012

Farmer Shareholders confirm their support for Trading Among Farmers in a final vote.

SECTION 1 ABOUT FONTERRA CONTINUED

FONTERRA'S STRATEGY

Early in 2012, Fonterra announced a "Strategy Refresh". The new strategy focuses on balancing Fonterra's investment in its NZ Milk Products business and its established positions in Australia, New Zealand, the Middle East and North Africa, with higher-growth opportunities in Asia, Latin America, its out-of-home foodservices business and in advanced nutrition products. It has seven distinct paths:

OPTIMISE THE PERFORMANCE OF THE NZ MILK PRODUCTS BUSINESS

Through maintaining milk supply in New Zealand, investing in modern and efficient plants, improving price realisation, optimising product mix, managing risk and delivering even better service to customers.

BUILD AND GROW BEYOND FONTERRA'S CURRENT CONSUMER POSITIONS

By building on leadership positions in consumer brands in Australia, New Zealand, ASEAN / MENA and Chile, and investing in high growth markets within Asia and Latin America.

GROW THE OUT-OF-HOME FOODSERVICES BUSINESSES

By building on established out-of-home foodservices capabilities internationally, particularly in China, ASEAN / MENA and Latin America, to meet the specialised needs of local customers in each market, particularly in bakeries, hotels, quick service restaurants and cafés.

GROW FONTERRA'S POSITION IN AIDING MOBILITY AND BONE HEALTH

Through investment in its market-leading Anlene™ brand in Asia, supported by highly-focused product innovation and development that supports mobility in an aging population.

DEVELOP SELECTED POSITIONS IN THE PAEDIATRICS AND MATERNAL CATEGORIES

By building on Fonterra's current presence in the market for paediatric dairy products through third party manufacturing with multinationals and regional Asian participants, and selectively growing sales of Anmum™ paediatric and maternal dairy products in selected markets.

SELECTIVELY INVEST IN SECURE IN MARKET QUALITY MILK SOURCES

Through targeted international farming and milk sourcing, with China as the prime focus to develop the international farming model.

ALIGNING FONTERRA'S BUSINESS AND ORGANISATION STRUCTURE

By ensuring Fonterra's business structure is aligned to its strategy priorities, and utilising business service centres across the Fonterra Group.

ORGANISATIONAL STRUCTURE

On 1 August 2012, Fonterra's organisational structure was re-aligned to deliver on the strategic priorities described above. A key change included the separation of Asia / AME into two new business units, ASEAN / MENA and Greater China and India, in order to focus on these growing markets. In addition, a new group-wide "Fonterra Nutrition" division was formed to build the dairy nutrition portfolio across the Fonterra Group. As a result of these changes, certain operations were placed under the control of new business units.

These changes include:

- transferring RD1 from NZ Milk Products (formerly known as Standard & Premium Ingredients) to ANZ;
- transferring international farming ventures from NZ Milk Products to the relevant regional business unit (primarily Greater China and India); and
- transferring certain joint ventures and partnerships from NZ Milk Products to Fonterra Nutrition, including DMV Fonterra Excipients (a joint venture with Royal Friesland Campina) and Dairiconcepts (a partnership with Dairy Farmers of America).

As these changes have only recently occurred, financial information contained in this Offer Document (including the Fonterra Financial Information set out in Section 4 – *Fonterra Financial Information*) is presented in respect of Fonterra's business units that existed prior to 1 August 2012 (except as otherwise noted). These are NZ Milk Products, ANZ, Asia / AME and Latam. Information in this section is presented in respect of Fonterra's new business units, which are NZ Milk Products, ANZ, ASEAN / MENA, Greater China and India, and Latam.

REVISED ORGANISATIONAL STRUCTURE

FONTERRA

PREVIOUS BUSINESS UNIT / REPORTABLE SEGMENT	**NZ MILK PRODUCTS**[1]	**ANZ**	**ASIA / AME**		**LATAM**
	Revenue: $15,717 million EBIT: $515 million[2]	Revenue: $3,848 million EBIT: $204 million[2]	Revenue: $1,855 million EBIT: $194 million[2]		Revenue: $805 million EBIT: $129 million[2]
NEW BUSINESS UNIT BY GEOGRAPHY[3]	NZ Milk Products	ANZ	ASEAN / MENA	Greater China and India	Latam
MILK SOURCING ARRANGEMENTS	• Farmer Shareholders	• In-market (Australia) • NZ Milk Products	• Predominantly from NZ Milk Products	• NZ Milk Products • In-market milk sourcing being developed	• In-market • NZ Milk Products
KEY OPERATIONS	• Collection and processing of milk, marketing and distribution of NZ Milk Products	• Branded consumer and foodservices business in NZ • Integrated consumer dairy and milk processing business in Australia • International distribution from Australia and New Zealand • RD1	• Branded consumer and foodservices business	• Branded consumer and foodservices business	• Soprole – integrated consumer dairy and milk processing business • Dairy Partners Americas – integrated consumer dairy and milk processing business
KEY BRANDS[4]	• NZMP™	• Anchor™, Bega®, Mainland™, Fresh 'n Fruity™, Tip Top™, Nestlé Ski®, Kapiti™ and Western Star™	• Anlene™, Anmum™, Anchor™ and Fernleaf™	• Anlene™, Anmum™ and Anchor™	• Soprole™, Huesitos™, California™, Ninho Soleil™, Dos Alamos™, Next™, Activ™, Chamyto™, and Chandelle™

GROUP-WIDE FUNCTIONS	Fonterra Nutrition	People, Culture and Services	Office of the CFO	Group Strategy	Mergers and Acquisitions	Group Optimisation and Supply Chain	Co-operative Affairs

1 Formerly known as Standard & Premium Ingredients.

2 FY2012 revenue and normalised EBIT. Normalised EBIT includes share of profit from equity accounted investees and excludes non-recurring items as described on page 74 in Section 4 – *Fonterra Financial Information*.

3 Business unit names are only a broad guide to regions in which Fonterra operates. For example, there are some countries that fall within the ASEAN / MENA business unit that are located outside the ASEAN / MENA region such as Sri Lanka and Mauritius.

4 Some brands are used by the Fonterra Group under licence (such as Bega® and Nestlé Ski®).

SECTION 1 ABOUT FONTERRA CONTINUED

FONTERRA IN A GLOBAL CONTEXT

Globally-traded dairy products account for approximately 8% or 54 billion litres of global dairy production. The remaining production is consumed in market (i.e. domestically within overseas markets). Commodity products such as milk powders, butter and cheese comprise almost all globally-traded dairy products.

Whole milk powder and skim milk powder together account for more than half of all globally-traded dairy products. Fonterra's market share of Global Dairy Exports for the 2011 / 2012 Season was 46% for whole milk powder, 51% for butter and 28% for skim milk powder.

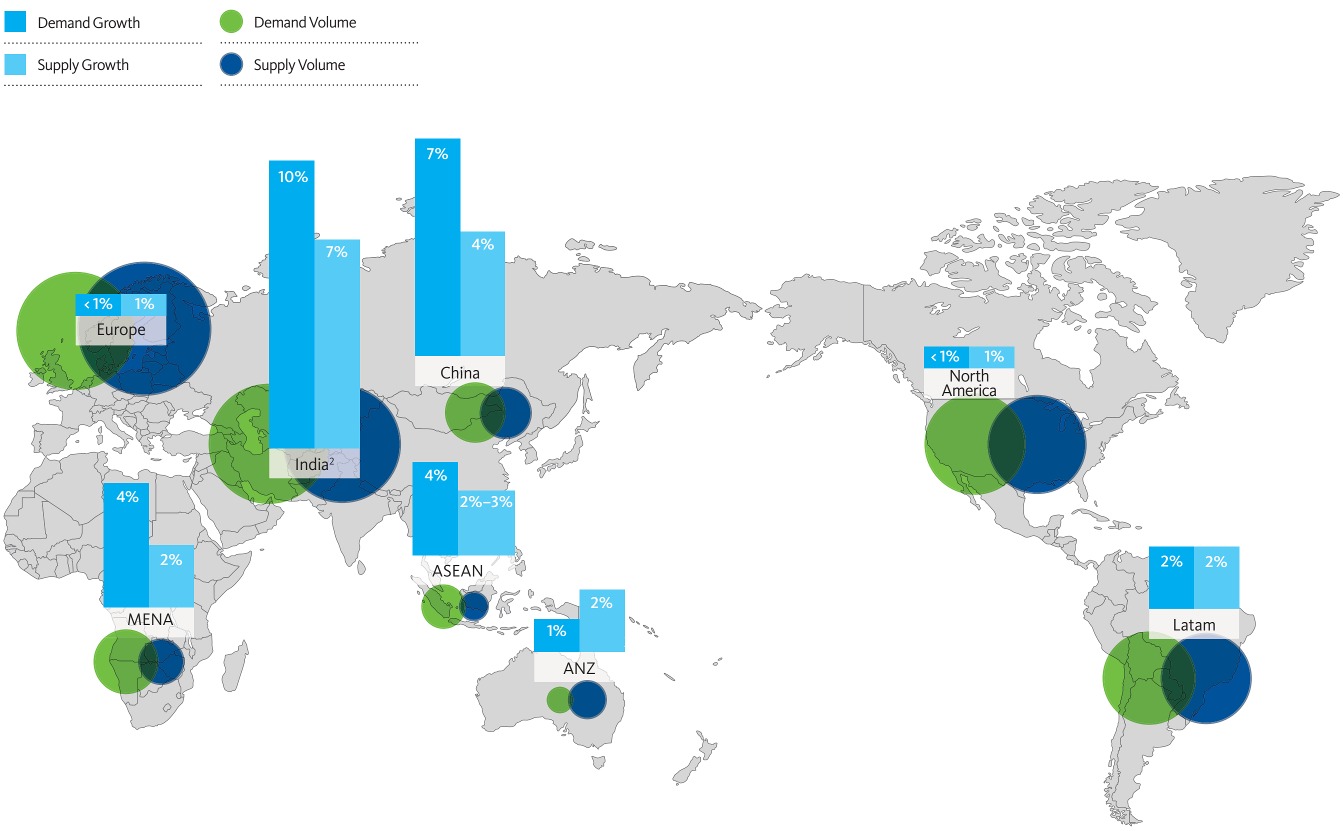
Between now and 2020, Fonterra expects the volume of global trade in dairy products to increase at an annual rate of approximately 4 to 6%. This reflects an expectation that demand growth will exceed local supply growth in major emerging markets, such as China, India, South East Asia, the Middle East and North Africa. It is anticipated that this demand growth will be driven by a growing population, rising incomes, urbanisation and the westernisation of diets.

Fonterra is well placed to respond to this demand growth with dairy nutrition products that have the broad characteristics outlined below. Fonterra is also developing secure sources of quality milk in overseas jurisdictions such as China. The establishment of a local milk supply will assist Fonterra to meet this demand growth and the needs of customers in the relevant overseas market.

WORLD PRICES FOR DAIRY PRODUCTS

World prices for dairy products tend to be volatile, as illustrated on the following page. Prices reached record highs in late 2007, driven by a number of factors including strong Asian demand, reduced European Union subsidies, low global inventories and droughts in the milk producing regions of Europe, Australia and New Zealand. Following the onset of the global financial crisis in 2008, global demand for dairy products fell, while global milk production increased strongly. This resulted in a sharp decline in prices through 2008 and the first half of 2009. Since 2009, prices have generally remained above their pre-2007 levels.

OUTLOOK TO 2020[1]

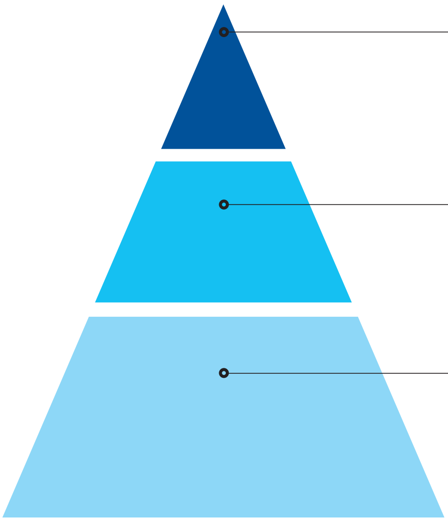


Source: Fonterra estimate

1 Current volumes are represented by the area of the circles displayed. Growth rates represent forecast compound annual growth rates.

2 Although strong growth in demand is expected in India, the ability to supply this market is likely to remain limited. In the 12 months to May 2012, Fonterra exported 22,300 MT of product to India and total imports represented approximately 0.2% of consumption.

FONTERRA'S DAIRY NUTRITION PRODUCTS



ADVANCED NUTRITION

Higher-value, lower-volume products. Products are generally incorporated into Fonterra's own branded products or are supplied to pharmaceutical and premium food companies.

Distribution Channels
– Specialised business customers
– Consumer customers

Key Brands: Anlene™, Anmum™, NZMP™

Nutrition Examples
Infant nutrition, specialty caseinates, hydrolysates and whey proteins, and pharmaceutical lactose

OUT-OF-HOME NUTRITION

Includes specialised products for chefs and bakers. Products command a premium due to their functionality in higher-value applications.

Distribution Channel
– Foodservices customers

Key Brands: Anchor™

Nutrition Examples
Specialised creams, butter, cheese, shredded cheese, cream cheese, desserts, dairy beverages and yoghurt

EVERYDAY NUTRITION

Lower-cost, high-volume products. Generally supplied to global food companies to be used as ingredients for higher-value-added products, or are manufactured into consumer formats for Fonterra's regional consumer businesses.

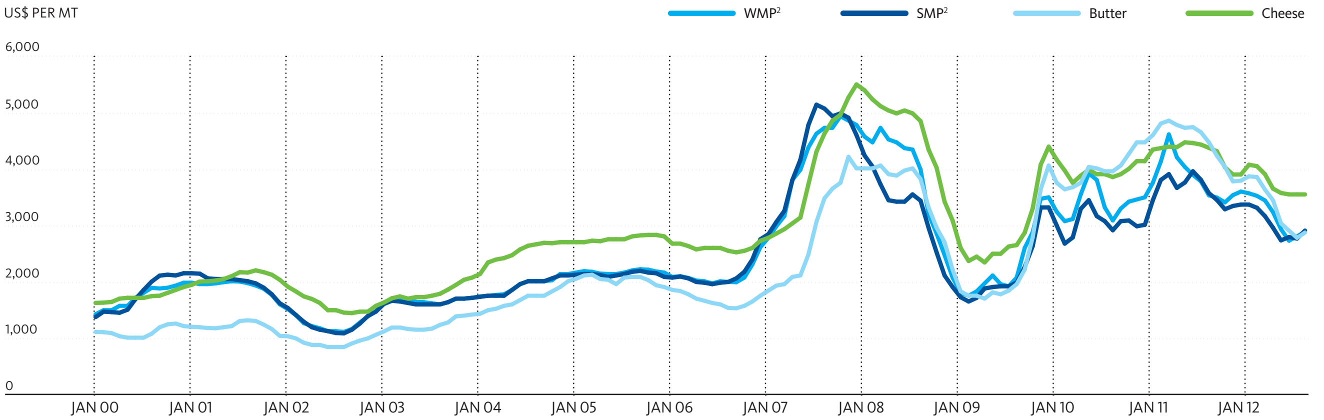
Distribution Channels
– Business customers
– Consumer customers

Key Brands: Anchor™, Soprole™, NZMP™

Nutrition Examples
Milk powders, wholesale butter and cheese

Source: Fonterra

OCEANIA EXPORT MARKET PRICES[1]



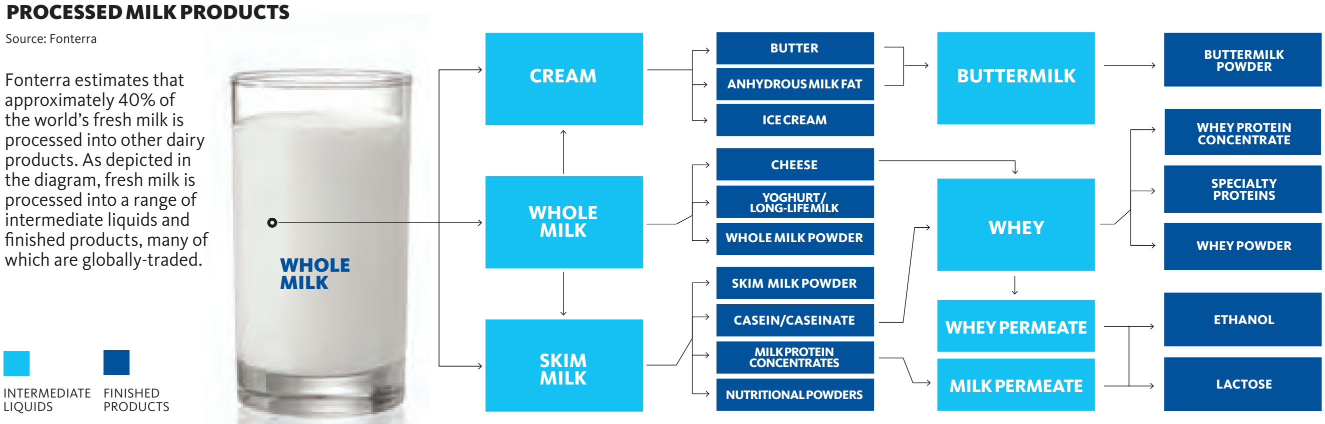
Source: United States Department of Agriculture

1 Prices are a monthly average and not adjusted for inflation.
2 WMP means whole milk powder and SMP means skim milk powder.

PROCESSED MILK PRODUCTS

Source: Fonterra

Fonterra estimates that approximately 40% of the world's fresh milk is processed into other dairy products. As depicted in the diagram, fresh milk is processed into a range of intermediate liquids and finished products, many of which are globally-traded.



Buttermilk powder, butter, and anhydrous milk fat are referred to as by-products of whole milk powder and skim milk powder in the Farmgate Milk Price Manual. Whole milk is separated into skim milk and cream. Skim milk can be used to produce skim milk powder. Cream can be used to produce either butter and buttermilk powder or anhydrous milk fat and buttermilk powder. Whole milk powder is produced from "standardised whole milk". Standardised whole milk contains a mix of skim milk and cream and has a higher skim milk to cream ratio than that contained in whole milk.

SECTION 1 ABOUT FONTERRA CONTINUED

FONTERRA IS A SOURCE OF QUALITY NEW ZEALAND MILK

A temperate climate and low-density population make New Zealand well suited to pasture-based dairy farming.

The relatively low variable cost of production for farmers underpins New Zealand's position as a globally competitive source of dairy nutrition. The result is that Fonterra can source a reliable supply of milk from an efficient and adaptable farming base. Fonterra's pre-eminent position with farmers in New Zealand is supported by a robust and transparent basis for deriving a milk price paid to farmers.

Currently, Fonterra collects approximately 89% of milk produced in New Zealand. This is sourced from its committed co-operative supplier base of around 10,500 farmers in New Zealand. The geographical spread of supply across the North and South Islands reduces Fonterra's exposure to climatic risks and other unforeseen factors.

Fonterra's milk collection volumes have grown by nearly 30% over the past decade. However, over the same period, Fonterra's share of total milk collection in New Zealand has decreased from approximately 96% to 89%. This reflects overall growth across the industry and an increase of new entrants to the industry following a period of de-regulation.

Pasture-based milk production is highly seasonal. Peak milk production in New Zealand is in October and November, as illustrated in the chart below.

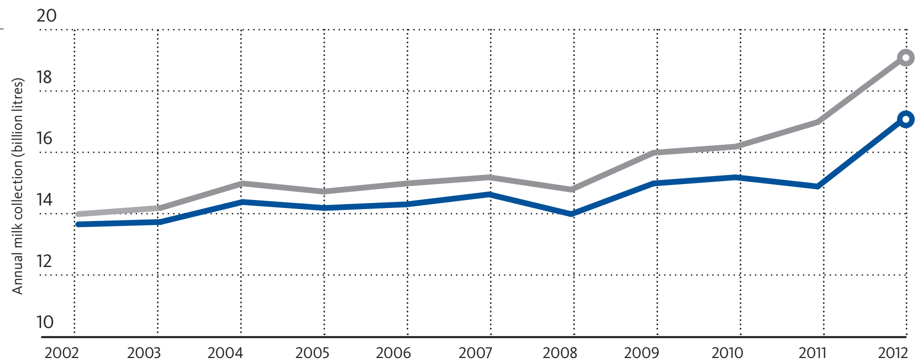
The seasonal nature of milk supply in New Zealand means that, as a general guide, on average Fonterra processing plants process a volume of milk that would keep the plant operating at full capacity for about 200 days per year. However, the extent to which a particular processing plant is utilised in a year will generally differ from the Fonterra average for a range of reasons, including the plant's location and size, and Fonterra's desired product mix.

NEW ZEALAND MILK COLLECTION BY SEASON

Source: Fonterra and DairyNZ

New Zealand
- 12 months to May 2012
- Milk collection: 19.1 billion litres
- 11-year growth: 40.6%
- 11-year CAGR:[1] 3.5%

Fonterra
- 12 months to May 2012
- Milk collection: 17.0 billion litres
- 11-year growth: 29.1%
- 11-year CAGR:[1] 2.6%

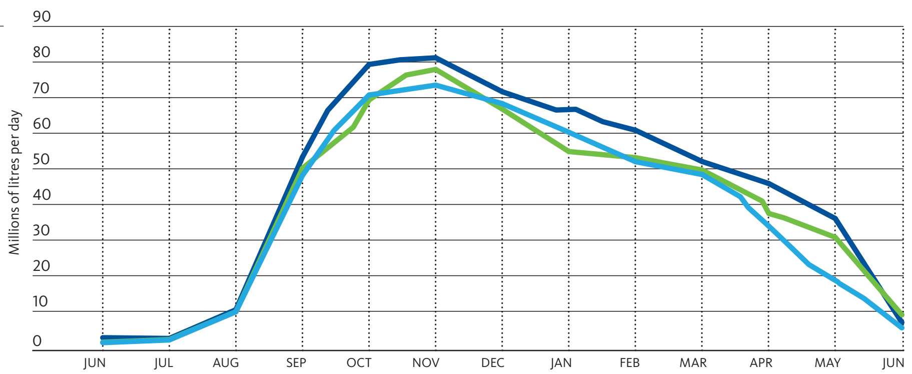


1 CAGR refers to compound annual growth rate.

FONTERRA'S NEW ZEALAND SEASONAL MILK VOLUME[1]

Source: Fonterra

- 2009 / 2010 Season
- 2010 / 2011 Season
- 2011 / 2012 Season



1 Volumes represent a six-day moving average of daily production.


VOLVO
683
GJE45

SECTION 1 ABOUT FONTERRA CONTINUED

NZ MILK PRODUCTS: AN INTEGRATED SUPPLIER OF DAIRY NUTRITION

Fonterra's NZ Milk Products business operates one of the world's largest and most integrated milk processing networks producing a range of dairy nutritional products. As the largest global milk processor, Fonterra has a strong market presence and sales network in the higher-growth emerging markets, as well as in mature markets.

NEW ZEALAND MILK SUPPLY AND MANUFACTURING

In the 2011 / 2012 Season, NZ Milk Products collected approximately 17 billion litres of New Zealand milk and processed approximately 16.4 billion litres through 27 processing sites. 540 million litres was supplied to independent processors as required by DIRA. Fonterra manufactured 97% of the milk it processed into a range of dairy nutrition products including dried powders, various food ingredients, butter and cheese.

The remaining 3% accounted for fresh milk supplied to local grocery and other retail customers. In FY2012, approximately 13% of NZ Milk Products' sales volumes that were manufactured from New Zealand milk was sold to Fonterra's regional businesses.

To help position Fonterra to meet the expected rise in worldwide demand for dairy products and growth in New Zealand milk supply, Fonterra has invested approximately $530 million in processing facilities over the past five years, principally to expand milk powder production capacity in the South Island.

In addition, Fonterra has recently acquired the milk processing assets from the receiver of New Zealand Dairies Limited. Its assets included the Studholme processing plant in South Canterbury. The Studholme plant processes around 180 million litres of milk per Season principally for export, and complements Fonterra's new Darfield plant that began processing in August 2012.

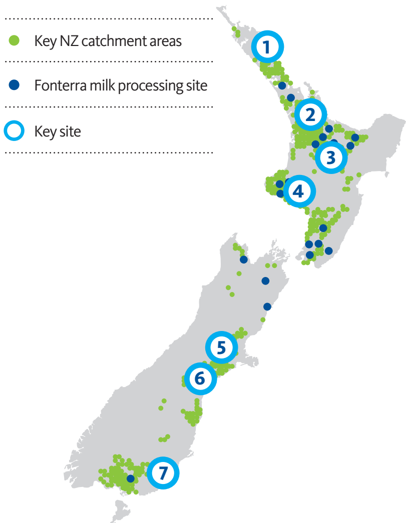
FONTERRA'S DARFIELD PROCESSING PLANT

Fonterra's processing plant in Darfield is situated on a 650-hectare site in one of New Zealand's fastest growing dairy regions, the central South Island. Fonterra has initially invested in a 15 tonne per hour dryer and facilities (D1) which began operating in August 2012. Currently, Darfield has the capacity to convert 2.2 million litres of milk per day into milk powder for export.

Construction of a second dryer is currently underway (D2), together with extra warehouse space and a railway connection. With a 30 tonne per hour capacity, the D2 dryer will be the largest in the world, surpassing Fonterra's ED4 facility at Edendale. Once the D2 dryer is completed, Darfield will be able to process up to 6.6 million litres of milk per day.

The efficiency and capacity of Darfield will help drive further performance improvements for the NZ Milk Products business.

FONTERRA'S KEY NEW ZEALAND MILK PROCESSING ASSETS[1] AND CATCHMENT AREAS[2]



1. KAURI
Capacity: ~3 million litres per day
Ouput: ~123,000 tonnes per Season
Products: WMP[3], SMP[3], butter, AMF[3], nutritional powders

2. TE RAPA
Capacity: ~7 million litres per day
Ouput: ~313,000 tonnes per Season
Products: WMP[3], SMP[3], butter, AMF[3], cream cheese, frozen cream

3. LICHFIELD
Capacity: ~2.8 million litres per day
Ouput: ~63,000 tonnes per Season
Products: cheese, WPC[3], WPI[3]

4. WHAREROA
Capacity: ~13.6 million litres per day
Ouput: ~423,000 tonnes per Season
Products: WMP[3], SMP[3], BMP[3], MPC[3], casein, cheese, butter, AMF[3], WPC[3], WPI[3]

5. DARFIELD
Capacity: ~2.2 million litres per day
Ouput: Production began August 2012
Products: WMP[3]

6. CLANDEBOYE
Capacity: ~13 million litres per day
Ouput: ~415,000 tonnes per Season
Products: WMP[3], SMP[3], MPC[3], cheese, butter, AMF[3], WPC[3], lactose

7. EDENDALE
Capacity: ~13.2 million litres per day
Ouput: ~416,000 tonnes per Season
Products: WMP[3], SMP[3], BMP[3], MPC[3], cheese, casein, AMF[3]

NEW ZEALAND TOTAL FOOTPRINT
Capacity: 82 to 84 million litres per day
Output: ~2.5 million tonnes per Season
Sites: 31 sites (NZ Milk Products – 27, ANZ – 4)
Key manufacturing sites include: Whareroa, Te Rapa, Kauri, Lichfield, Clandeboye, Darfield, Edendale

Source: Fonterra

1 Each dot represents a milk processing site. 27 sites form part of NZ Milk Products and 4 sites form part of ANZ. Only key manufacturing sites are described in detail.
2 Fonterra milk production density for the 2011 / 2012 Season based on 10-kilometre grids.
3 AMF means anhydrous milk fat, BMP means buttermilk powder, MPC means milk protein concentrate, SMP means skim milk powder, WMP means whole milk powder, WPC means whey protein concentrate and WPI means whey protein isolate.

TAKING NEW ZEALAND MILK TO THE WORLD[1]

MILK COLLECTION	TANKERS	MANUFACTURING	WAREHOUSING	SALES	SHIPPING	BUSINESS CUSTOMERS
• 17 billion litres of milk in the 2011 / 2012 Season • Pasture-based milk production	• ~500 milk tankers in 13 depots and 1,400 tanker operators	• 27 NZ Milk Products sites and 4 ANZ sites • 76 plants • Largest milk dryers in the world	• 103 stores, 45 temperature controlled • Supporting road and rail networks to container pack locations, 7 sited on port	• Global sales network • ~30% of NZ Milk Products' sales via GDT™ • ~74,000 delivery orders per year	• 11 NZ ports • 1,800 voyages per year • 165,000 containers per year • 2.3 million metric tonnes of exports per year	• Customers in more than 100 countries • Customers include GDT™, Fonterra consumer division and external business customer sales

INTEGRATED SUPPLY CHAIN AND BUSINESS

Source: Fonterra

1 Unless otherwise stated, references to "per year" are to the financial year ending 31 July 2012 and figures are based on the figures for financial year ending 31 July 2012.

SECTION 1 ABOUT FONTERRA CONTINUED

GLOBALDAIRYTRADE™

In 2008, Fonterra established an auction platform for internationally-traded commodity dairy products called GlobalDairyTrade™ (GDT™). GDT™ has become a leading global price reference indicator for the products traded. GDT™ prices are increasingly used as the basis for calculating the Farmgate Milk Price that Fonterra pays farmers for milk in New Zealand.

GDT™ now includes other global dairy vendors, with DairyAmerica the first to join in October 2011. Murray Goulburn (an established Australian dairy co-operative) and Arla Foods joined in 2012. In FY2012, NZ Milk Products generated approximately 30% of its sales through this platform, which represented over 95% of total GDT™ sales.

Fonterra is able to achieve higher margins through the management of product mix and obtaining prices that are above those generated on GDT™ for the five Reference Commodity Products used in calculating the Farmgate Milk Price (for further information, see the text box entitled "Summary of Setting the Farmgate Milk Price for New Zealand milk"). Accordingly, to the extent possible, Fonterra seeks to achieve an optimal product mix to enhance returns across NZ Milk Products and its regional businesses. For further details, please refer to Section 3 – *Setting the Farmgate Milk Price for New Zealand Milk*.

While New Zealand-sourced milk is the cornerstone of Fonterra's milk production, growth in global demand for dairy presents an opportunity for Fonterra to develop secure sources of quality milk outside New Zealand. Fonterra intends to supplement its New Zealand production with high-quality in market milk production for its offshore customers.

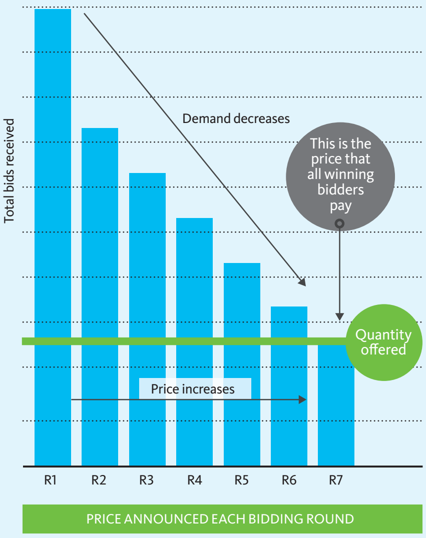
OVERVIEW OF GLOBALDAIRYTRADE™ (GDT™)

GDT™ currently provides a market place for eight different product groups:

- Whole milk powder
- Skim milk powder
- Anhydrous milk fat
- Buttermilk powder
- Casein
- Lactose
- Milk protein concentrate
- Cheddar

GDT™ trading events are conducted as ascending-price clock auctions run over several bidding rounds. In each auction a specified maximum quantity of each product is offered for sale at a pre-announced starting price. Bidders bid the quantity of each product that they wish to purchase at the announced price. If the price of a product increases between rounds, to ensure their desired quantity a bidder must bid their desired quantity at the new, higher price. Generally, as the price of a product increases, the quantity of bids received for that product decreases. The trading event runs over several rounds with the prices increasing round to round until the quantity of bids received for each product on offer matches the quantity on offer for the product (as illustrated in the diagram[1]). Each trading event typically last approximately two hours.

While GDT™ is owned by Fonterra it is operated at arm's length, and is open to other suppliers. GDT™ is operated by Charles River Associates. To date DairyAmerica, Murray Goulburn and Arla Foods have also sold product on GDT™. Updated contractual arrangements to reflect this evolution to a multi-seller platform are in the final stages of negotiation with Charles River Associates.



Source: GDT™

1 The above diagram is an example for illustrative purposes only.

FONTERRA NUTRITION – RESEARCH, SCIENCE AND TECHNOLOGY DEVELOPMENT

Fonterra's nutrition business specialises in developing advanced nutrition dairy products. This provides a platform for a range of focused, science-based solutions to support Fonterra's key brands such as Anchor™, Anmum™ and Anlene™, and specialised business customers. The targeted consumer segments include paediatrics, maternal and medical foods.

Fonterra is a global leader in dairy innovation. It invests in new dairy technology, research and product development. The Fonterra research centre in Palmerston North is one of the world's largest dairy research and innovation centres and it has one of the largest registered dairy pilot plants.

JOINT VENTURES AND PARTNERSHIPS

Through Fonterra Nutrition, Fonterra has a number of joint ventures and partnerships with other global suppliers of food ingredients. These include DMV Fonterra Excipients (a joint venture with Royal Friesland Campina), which is the world's leading supplier of lactose excipients, and Dairiconcepts (a partnership with Dairy Farmers of America), which specialises in the customisation of powders, concentrates, seasonings, flavour enhancers and cheeses.

SUMMARY OF SETTING THE FARMGATE MILK PRICE FOR NEW ZEALAND MILK

The cost of purchasing New Zealand milk from its Farmer Shareholders represents Fonterra's single largest cost (over $9 billion in FY2012). The aggregate Farmgate Milk Price is the base price paid by Fonterra for New Zealand milk. For more details, see Section 3 – *Setting the Farmgate Milk Price for New Zealand Milk*.

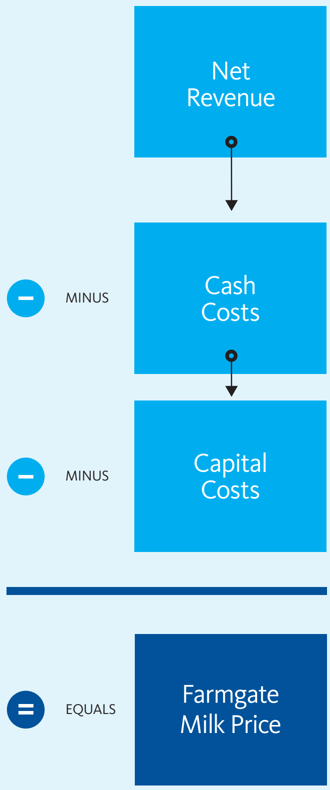
Because Fonterra purchases a very large proportion of New Zealand's total milk supply (approximately 89%), there is no market price for milk that is independent of the price paid by Fonterra. Therefore, Fonterra has needed to ascertain what a milk price would be in a competitive market environment. The Farmgate Milk Price is set by the Fonterra Board based on transparent calculations and rules set out in the Farmgate Milk Price Manual. This methodology has been used since 1 August 2008 and has been an important driver of business performance within Fonterra. A detailed Milk Price Statement is published by Fonterra annually and aims to help Farmer Shareholders and other interested parties understand the determination of the Farmgate Milk Price.

The Farmgate Milk Price is calculated in accordance with the Farmgate Milk Price Manual by:

- determining the revenue that would be earned if all the New Zealand milk Fonterra collects was converted into whole milk powder, skim milk powder and their by-products, buttermilk powder, butter and anhydrous milkfat. These products are collectively known as the Reference Commodity Products. These products are chosen as Reference Commodity Products because together they comprise over 50% of globally-traded commodity dairy products and in addition almost all of the additional milk collected in New Zealand by Fonterra and its competitors over the last decade has been used to produce these products. The prices for the Reference Commodity Products used in determining this revenue primarily reflect the prices achieved for those products on the GlobalDairyTrade™ auction platform;
- deducting cash costs associated with the efficient manufacture of the Reference Commodity Products; and
- deducting capital costs representing an appropriate return on the capital invested in the manufacture of the Reference Commodity Products, depreciation and an allowance for tax.

The result is the aggregate amount that an efficient processor of Fonterra's scale would pay for the New Zealand milk collected by Fonterra. This is an aggregate amount but is usually referred to on the basis of a Farmgate Milk Price per kilogram of milksolids (kgMS).

SETTING THE FARMGATE MILK PRICE



Source: Fonterra

SECTION 1 ABOUT FONTERRA CONTINUED

REGIONAL BUSINESSES

ANZ

Fonterra's ANZ business is one of the largest dairy businesses in Australasia. In New Zealand, it includes Fonterra's consumer operations (Fonterra Brands New Zealand and Tip Top™). In Australia, Fonterra has an integrated business that includes local milk collection, dairy product manufacturing and exporting, and consumer and out-of-home foodservices businesses (Fonterra Ingredients Australia and Fonterra Brands Australia).

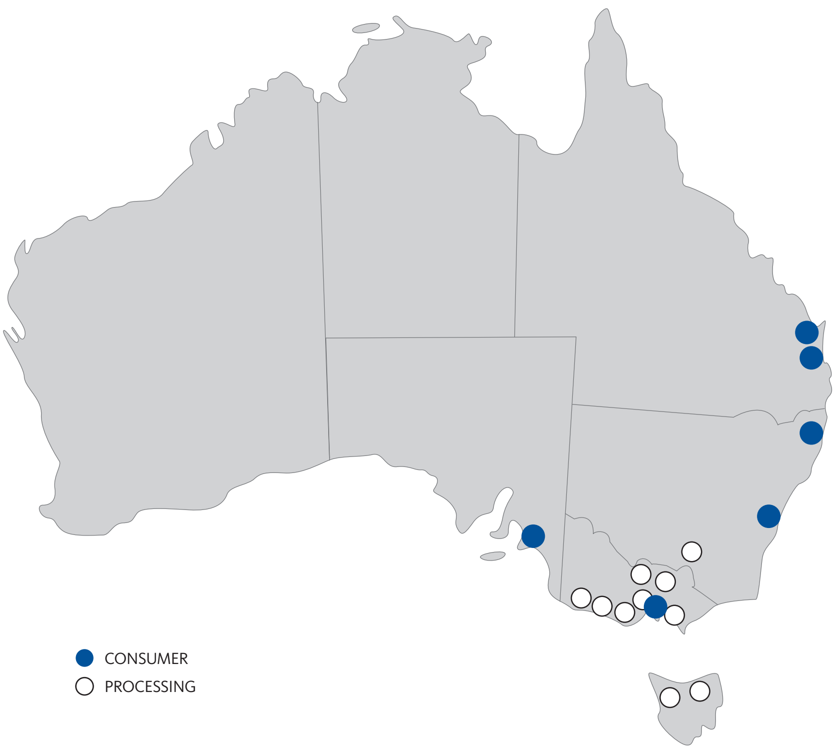
In New Zealand, Fonterra is a market leader in all consumer dairy categories, with iconic brands such as Anchor™, Mainland™, Fresh'n Fruity™, Tip Top™ and Kapiti™. In Australia, Fonterra holds a leadership position in the cheese, yoghurt and dairy spreads consumer markets. Key brands owned or used under licence by Fonterra include Western Star™, Bega®, Mainland™ and Nestlé Ski®.

The Australian operation encompasses the full dairy supply chain and currently collects approximately 1.7 billion litres of milk per year from around 1,300 local suppliers. The manufacturing sites produce a range of whole, skim and other everyday nutritional milk powders, advanced dairy nutrition products and out-of-home dairy nutrition products (e.g. cheese, butter, yoghurts and cream) for out-of-home foodservices customers.

The Australian and New Zealand consumer dairy markets are relatively mature, operating within a concentrated retail trade structure. A key aspect of Fonterra's strategy has been to manage its product mix by continuously reviewing its portfolio. For example, Fonterra divested its white-milk business in Western Australia in 2011. It has a small remaining exposure to this category in eastern Australia. Over the same period, it has acquired leading brands in higher-growth categories. This is consistent with ongoing trends towards consolidation within the Australian consumer dairy market.

Fonterra's ANZ out-of-home foodservices business has a leading position in both countries, with a model based on providing services to meet the specialised demands of customers in bakeries, restaurants, caterers, hotels and quick service restaurants. Fonterra provides out-of-home foodservices operators with a range of innovative dairy products and recipe solutions, including ready-to-serve creams, beverages, butter, yoghurt, cultured dairy, milk, cheese, ice cream and desserts.

FONTERRA IN AUSTRALIA[1]



Source: Fonterra

1 New Zealand's processing and farming operations are described under the heading "New Zealand milk supply and manufacturing" above.

2 Key brands for milk, yoghurt, cheese, butter and ice cream. Some ANZ brands are used by the Fonterra Group under licence (such as Bega® and Nestlé Ski®).

3 Fonterra's market position for each product is determined on a volume basis for the 12 months ending 31 July 2012.

ANZ KEY BRANDS[2] AND PRODUCT POSITIONS[3]

	NZ	AUS
Cheese	#1	#1
Yoghurt	#1	#2
Chilled Spreads	#2	#3
Ice Cream	#1	N/A
Dairy Beverages	#1	N/A

Source: Aztec Information Services Australia market share data (July 2012)

EVERYDAY NUTRITION – ANCHOR™

- The Anchor™ brand was established in New Zealand in 1886 and is now Fonterra's flagship brand. Fernleaf™ is used as an alternative lead brand in some markets.
- Anchor™ and Fernleaf™ branded everyday dairy nutrition products are sold in approximately 70 countries through Fonterra's consumer and out-of-home foodservices channels.
- Anchor™ and Fernleaf™ products include liquid milks, yoghurts, milk powders, cheese and spreads, being items that are included in the everyday diets of consumers.
- Anchor™ and Fernleaf™ have a strong presence in New Zealand, Asia, the Middle East and the Pacific. In the full cream milk powder category Anchor™ and Fernleaf™ hold a market leading position in Sri Lanka and a number two position in the countries that comprise the Cooperation Council for the Arab States of the Gulf (being Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates).

OUT-OF-HOME DAIRY NUTRITION – GLOBAL FOODSERVICES

- Fonterra provides a comprehensive range of products and solutions for the commercial kitchen, including creams, butter, yoghurt, cream cheese, milk, cheese, ice cream and desserts.
- Urbanisation, growing incomes and westernisation of diets in emerging economies are driving the growth of out-of-home consumption in the foodservices channel. In developed economies, time-pressured consumers and the desire for convenience is accelerating demand.
- Fonterra has identified out-of-home nutrition as a key area of growth through the rollout of the successful ASEAN / MENA out-of-home foodservices model into China and other emerging markets.
- In China, Fonterra is currently supplying fast-growing bakeries and other out-of-home foodservices operators with recipe solutions.
- In ANZ, Fonterra continues to build its presence in out-of-home foodservices by working with distribution partners to service an extensive range of customers with a complete portfolio of dairy products.
- Fonterra has dedicated sales channels to meet the specialised demands of out-of-home foodservices customers, covering hotels, restaurants, bakeries and cafés, as well as quick service restaurants.
- Through its Shanghai Innovation Centre, Fonterra advances the development of new products and ingredients and also carries out a number of product training courses for major customers, primarily focused on the Anchor™ dairy product line.

SECTION 1
ABOUT FONTERRA CONTINUED

ASEAN / MENA

In territories such as Malaysia, Singapore, Indonesia, Philippines, the Middle East and Sri Lanka, Fonterra has a longstanding presence in key consumer categories and in the out-of-home foodservices channels that include hotels, bakeries and restaurants. Fonterra's widely recognised brands such as Anchor™ and Fernleaf™ serve as a foundation of the ASEAN / MENA everyday dairy nutrition business and contribute to Fonterra's strong market presence.

Through the Anlene™ brand, Fonterra has built an entirely new category for advanced dairy nutrition products formulated for adults' optimal bone health and mobility. This has been achieved through significant innovation and promotion through the widespread offering of bone scans. Anlene™ holds the largest share of this category and has become one of Fonterra's flagship brands (alongside Anchor™).

Anmum Materna™ is well established as the leading milk for pregnant women across several markets in Asia. In some territories, Anmum™ has also become Fonterra's primary brand within the 'premium infant formula', 'follow-on milks' and 'growing-up milk' categories.

Anchor™ and Fernleaf™ are represented in a number of Asian and Middle Eastern markets, covering full-cream and non-fat milk powders, butter, long-life products and cheese. They are also represented in the 'growing-up milk' category.

Through the supply of quality butter, functional creams, cheeses and milk powders, Fonterra has obtained leading positions in the ASEAN / MENA out-of-home foodservices channels. These market positions, together with strong expected population growth and increasing wealth across the region, provide a well-established platform for expansion.

GREATER CHINA AND INDIA

China provides a significant opportunity for Fonterra to expand its established everyday dairy nutrition business. There is also an opportunity for Fonterra to extend the successful ASEAN business model with the Anlene™ bone health brand and Anmum™ maternal milk brands. These brands already have strong market positions in Hong Kong, Guangzhou and Shanghai.

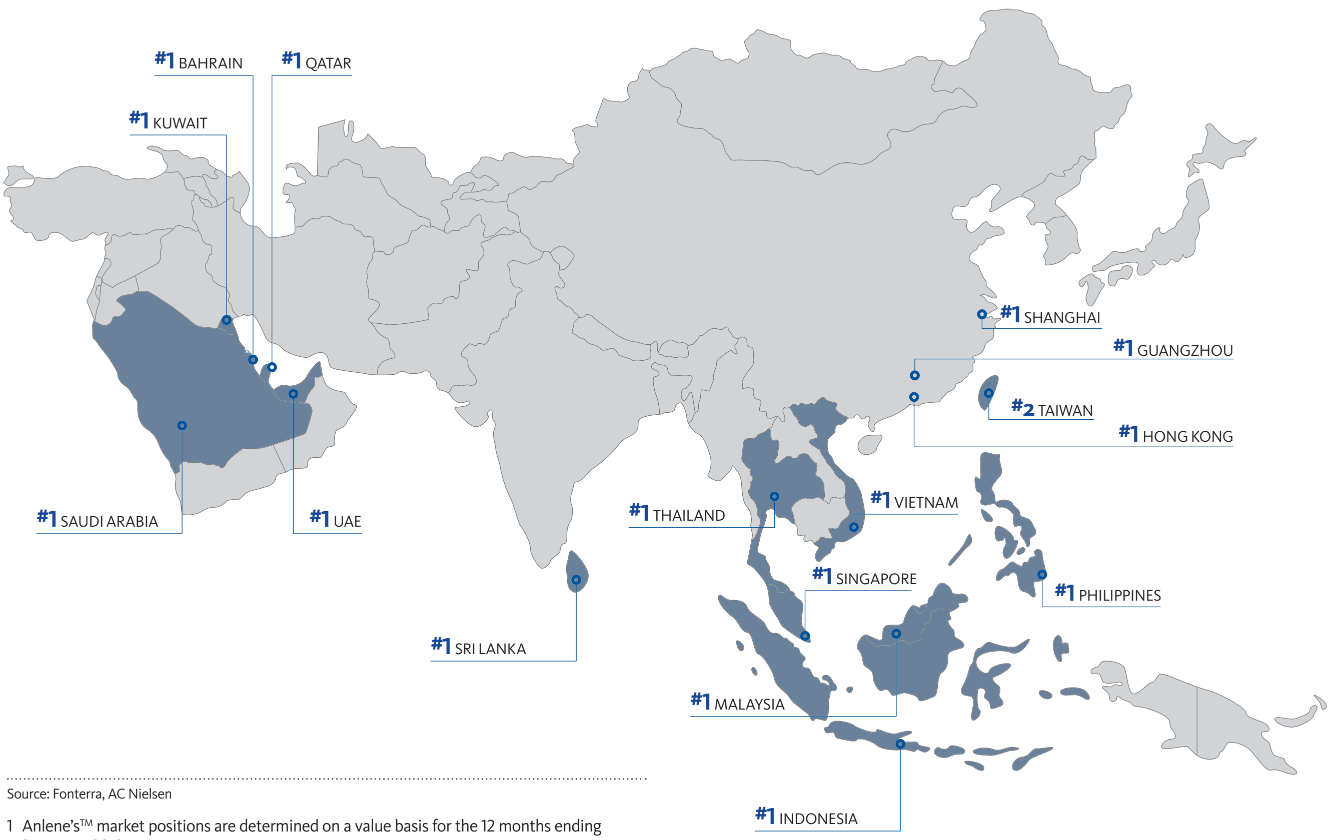
Fonterra is currently developing an integrated milk business in China by establishing farms to provide a local milk supply. The significant issues experienced in 2008 in connection with the widespread adulteration of raw milk in the Chinese dairy industry, including by one of Fonterra's investments, Sanlu, demonstrated the need for Chinese dairy processors to have control over raw milk supply. Once Fonterra's milk supply in China reaches sufficient scale, it will provide a

KEY BRANDS IN ASEAN/MENA

Anmum Anchor Anlene Fernleaf

ANLENE'S™ MARKET POSITION IN ASIA AND THE MIDDLE EAST[1]

(Adult, hi-calcium milk powder category)



Source: Fonterra, AC Nielsen

1 Anlene's™ market positions are determined on a value basis for the 12 months ending 31 August 2012.

foundation to grow a fully integrated dairy nutrition platform.

Fonterra has developed two large dairy farms in China, each with over 3,000 cows. An additional farm is currently in the development stage. Investment in a local presence supports relationships with government and regional participants, complements imported product and provides a local fresh milk supply to expand product offerings. By establishing farms to provide a local milk supply, Fonterra can continue to capitalise on its reputation for product quality and build brand presence.

Significant growth in out-of-home dining in China is being driven by rising incomes and urbanisation. This presents Fonterra with a significant out-of-home foodservices opportunity. Fonterra is currently supplying fast growing bakeries and other out-of-home outlets in 12 cities in China and plans to expand to 19 cities by August 2013. Fonterra is also a leading supplier of cheese to China's growing quick service restaurant market.

Fonterra in mainland China

Source: Fonterra

India provides an exciting new growth prospect for Fonterra. India has a large and increasingly affluent population that is well accustomed to dairy nutrition, but has significant local supply challenges. Although strong growth in dairy consumption is projected in India, barriers to trade are currently high, meaning that opportunities for Fonterra may be some time away.

CHINA GROWTH STRATEGY

- In FY2012, Fonterra shipped to China approximately 16% of NZ Milk Products' sales volumes of products manufactured from New Zealand-sourced milk.
- Fonterra has identified China as a key focus point of its future growth strategy. This is based around three key priorities:
  - *extending consumer brands:* extending the successful ASEAN model through the Anlene™ and Anmum™ brands. A sequential city-by-city approach will enable orderly expansion of the required organisational capabilities to support this growth;
  - *expanding out-of-home foodservices:* expanding Fonterra's out-of-home presence in China from 12 cities to 19 cities by August 2013; and
  - *developing local milk supply:* establishing an integrated milk business in China through developing local milk supply.

Developing local milk supply in China

- Fonterra has the opportunity to establish an integrated milk business in China through the control and development of local milk supply.
- Investments and partnerships in local farms also support relationships with government and regional participants, complement imported product and provide a local fresh milk supply to expand product offerings.
- Fonterra established its first farm (Tangshan Farm) in China in 2008 and opened its second farm (Yutian Farm One) in 2012.
- Tangshan Farm is located on 35 hectares and produces approximately 30 million litres of milk per year. At full capacity, Yutian Farm One will produce approximately 32 million litres per year.
- A third farm is currently under development. Fonterra also plans to develop an additional large scale dairy farm for 6,000 milking cows in the Hebei province. This will complete the first hub of farms in the Hebei province.
- After completion of these farms, Fonterra's total milk production in China will be approximately 150 million litres per year.

ADVANCED NUTRITION – PAEDIATRICS AND MOBILITY

- Fonterra draws on dairy science and technology to develop advanced dairy nutrition products that are intended to deliver health and nutrition benefits.
- Fonterra plans to grow its position in advanced nutrition, focusing on aging populations. This will primarily be led by an expansion of the Anlene™ brand through Asia.
- In Asia, Fonterra markets advanced nutrition for paediatrics and maternal nutrition under its Anmum™ brand.
- Under the Anmum™ brand, Fonterra's advanced dairy nutrition products include infant formula, follow-on formula, maternal milks and growing-up milk powder.

SECTION 1 ABOUT FONTERRA CONTINUED

LATAM

Latam is another growth priority for Fonterra, as both future dairy demand and local milk supply are expected to be strong. Fonterra's Latam business includes Soprole and Dairy Partners Americas.

SOPROLE

Soprole is Chile's largest dairy company. It is a fully integrated dairy business that sources milk domestically (including from its own farms). Soprole produces a comprehensive range of branded dairy and non-dairy products primarily for the Chilean market, including liquid milk, cheese, spreads, yoghurts, desserts, juices and beverages.

Soprole has a market share of approximately 30% of the Chilean consumer dairy market. It has number one or two positions in all key dairy categories. In FY2012, Soprole collected approximately 500 million litres of milk, representing approximately 23% of Chile's milk production.

A key feature of Soprole's business has been the focus on innovation. Over 35% of consumer sales are attributed to innovations introduced in the last three years. Soprole™ is a long established, widely recognised and highly regarded brand in Chile. Soprole's brand profile, together with its integrated sourcing, manufacturing and distribution platform, gives it a strong market position across multiple categories.

DAIRY PARTNERS AMERICAS

In 2003, Fonterra and Nestlé formed a joint venture alliance called Dairy Partners Americas (DPA). DPA operates two distinct businesses across the Latin America region, being a consumer business and a manufacturing business. It operates 15 manufacturing sites in the region and has over 4,000 employees.

DPA's consumer business was set up to produce, commercialise and sell chilled and liquid dairy products including yoghurts, desserts, pasteurised and long-life milks, fermented milks, petit suisse, long-life drinks and juices. Both Fonterra and Nestlé have licensed their brands to the business and provide support in technology, product development, manufacturing and a number of other services. The consumer business is currently operating in Brazil, Venezuela and Ecuador and generates annual revenues in excess of $1 billion.

DPA's manufacturing business was set up to secure a sustainable and competitive supply of fresh milk for its own operations, as well as for the consumer business. The manufacturing business is currently operating in Brazil, Argentina and Colombia. For Nestlé, DPA manufactures basic milk powders in consumer formats. For Fonterra, DPA manufactures basic milk powders in bulk format. It sources around 2.5 billion litres of milk annually and generates annual revenue in excess of $1 billion.

FONTERRA'S INVESTMENT IN LATAM

Source: Fonterra

LATAM KEY BRANDS[1] AND PRODUCTS

1 Key brands for milk, yoghurt, cheese, butter, juices and desserts. Some Latam brands are used by the Fonterra Group under licence.


SOPROLE
Leche con Chocolate
SOPROLE
Larga Vida


SOPROLE
Unoaldía
Next
Leche Cultivada

SENIOR MANAGEMENT

The Fonterra management team roles were announced in May 2012 as part of the reshaping of the organisation to deliver on its "Strategy Refresh".

THEO SPIERINGS, CHIEF EXECUTIVE OFFICER

Theo joined Fonterra in 2011, bringing with him extensive experience from across the dairy industry, particularly in Asia, Latin America, the Middle East and Europe. Theo has 25 years experience in the global dairy industry in a variety of roles including general management, operations and supply chain, and sales and marketing positions. Theo was previously the acting Chief Executive Officer of Royal Friesland Foods, a Dutch dairy co-operative and, in 2008, led the Dutch dairy co-operative through a merger with Campina. Before taking up his leadership role at Fonterra, Theo ran his own company in the Netherlands focusing on corporate strategy, and mergers and acquisitions, in "fast moving consumer goods". Theo has a Bachelor of Arts in Food Technology / Biotechnology and a Master of Business Administration.

JONATHAN MASON, CHIEF FINANCIAL OFFICER

Jonathan has been with Fonterra since 2009, before which he spent three years as Executive Vice-President and Chief Financial Officer at US-based Cabot Corporation. Jonathan worked in a number of financial management positions at International Paper Company and Exxon Mobil Corporation over the period of 1985 to 2000. From 2000 to 2005, Jonathan was Chief Financial Officer of Carter Holt Harvey Limited and was also a director of that company for a time. Jonathan is on the Advisory Board of the University of Auckland Business School and is a trustee of the University of Auckland Foundation. He has a conjoint BA in International Relations and Economics from Beloit College in Wisconsin, as well as an MA in International Relations and an MBA both from Yale University.

JOHN DOUMANI, MANAGING DIRECTOR ANZ

John is based in Australia and joined Fonterra in 2007, after 25 years in international business and consumer brands. In addition to his current role, John is also on the boards of Soprole and Dairy Partners Americas. Before joining Fonterra, John was President International of the Campbell Soup Company. Prior to that, he was Managing Director of Meadow Lea Foods Limited, before which he had 13 years with Johnson & Johnson in Australia, Europe and the United States. In 2008, John was appointed to the board of the Australian Food and Grocery Council, and was appointed Chairman in 2010. He was also appointed to the board of Foodbank Australia Limited in 2010. John has recently joined the board of Double Bay Partnership Incorporated, a not for profit organisation. He was also a member of the board of the Inspire Foundation in Australia, also a not for profit organisation, a position which he held for five years until his resignation in February 2012. John has a Marketing Degree from the University of New South Wales, Australia.

GARY ROMANO, MANAGING DIRECTOR NZ MILK PRODUCTS

Gary joined Fonterra in 2005, but has worked in the dairy industry since 1997, including with New Zealand Dairy Group Limited, a predecessor company to Fonterra. His previous roles include management positions at Alcoa of Australia Limited, The Boston Consulting Group and Dairy Partners Americas. In the dairy industry, he has had significant experience in both the manufacturing and supply chain areas and has led teams charged with the responsibility of achieving world class standards of productivity, quality, safety, cost effectiveness, service and environmental performance. Gary has a Bachelor of Chemical Engineering (Honours) from the University of Queensland, as well as an MBA from the University of Western Australia.

ALEX TURNBULL, MANAGING DIRECTOR LATAM
Alex has more than 20 years experience in the dairy industry, having joined one of the Co-operative's predecessors in 1990. Alex has extensive experience in key senior sales and general management roles within Latin America, and leadership of Fonterra's global paediatrics business since 2008. He is a fluent Portuguese speaker, having spent almost a decade in Brazil. His new role reflects the importance of developing markets as part of Fonterra's strategy. Alex holds a Diploma of Dairy Science and Technology and a Chemical and Materials Engineering Degree.

KELVIN WICKHAM, MANAGING DIRECTOR GREATER CHINA AND INDIA
Kelvin is a long-serving Fonterra executive, having joined one of the Co-operative's predecessors in 1988, and has more than 23 years experience in the dairy industry. Prior to his current role, he was Group Director Supplier and External Relations, Managing Director of Fonterra Global Trade, and Director Group Sales and Operations Planning. Prior to these roles, he was based around the world at a number of Fonterra's operations. Kelvin led the development of Fonterra's innovative GlobalDairyTrade™ platform, and is a product of the New Zealand Dairy Industry Graduate Training Programme. He holds a Diploma of Dairy Science and Technology, a Masters of Management, and a Chemical and Materials Engineering Degree.

MARK WILSON, MANAGING DIRECTOR ASEAN / MENA
Mark joined Fonterra in 2008, bringing with him more than 35 years experience in the consumer goods sector in Asia, the Pacific, South America and Europe. Prior to joining Fonterra, Mark managed Numico's nutrition business across Asia and the Pacific, and from 1995 to 1998 was the Chief Executive Officer of Dumex. From 1998 to 2007, he was President and Chief Executive Officer of the Danish-listed East Asiatic Company. Mark is also director of Chr. Hansen A/S, a Danish-listed biotech company. Mark holds a Bachelor of Science Degree in Food and Management Science from London University and is a Fellow of the Chartered Institute of Marketing.

CHRIS CALDWELL, MANAGING DIRECTOR PEOPLE, CULTURE AND SERVICES
Chris joined Fonterra in 2008 as Commercial Director for the former Global Ingredients and Foodservices business. Chris was General Manager Finance for Fonterra before taking on his current role, in addition to which, he holds a number of board appointments across Fonterra. In his current role, Chris drives initiatives and programmes that enhance the culture of Fonterra, and leads the development of Fonterra's people. He also ensures that the Fonterra Group's internal services are run efficiently and effectively to best serve the needs of its businesses and teams. Before joining Fonterra, Chris spent 10 years with Diageo PLC in different commercial roles across the globe, and earlier in his career held a number of sales and marketing roles. Chris holds a Chemistry Degree and is a member of the Chartered Institute of Management Accountants.

PAUL CAMPBELL, MANAGING DIRECTOR MERGERS AND ACQUISITIONS
Paul has been with Fonterra (and before that The New Zealand Dairy Board) since 1984. He is a chemical engineer, and has held a number of general management, marketing, technical and financial roles with Fonterra in New Zealand, Japan, North Africa and the United Kingdom. Since the formation of Fonterra in 2001, Paul has been closely involved in the design of Fonterra's strategy and has managed Fonterra's Mergers and Acquisitions team. He is also a director of a number of Fonterra's international joint ventures. He holds a Diploma in Dairy Science and Technology and a Chemical and Process Engineering Degree.

SARAH KENNEDY, MANAGING DIRECTOR FONTERRA NUTRITION
Sarah joined Fonterra in 2011, bringing with her more than 20 years experience in agri-food businesses, including 10 years as Managing Director of Healtheries of New Zealand Limited. Prior to her current role, Sarah was Managing Director of RD1 Limited (Fonterra's chain of rural retail stores). Fonterra Nutrition is responsible for the co-ordination and prioritisation of innovation across the Fonterra Group through the exchange of global consumer insights and the centralisation of core research and development resources. Sarah holds a Veterinarian Degree (distinction), and recently completed the Massachusetts Institute of Technology Sloan Fellows Program in Global Leadership and Innovation. Sarah is also a member of the Innovation Board for the Ministry of Science and Innovation, and the Global Women Advisory Board.

MAURY LEYLAND, MANAGING DIRECTOR GROUP STRATEGY
Maury has been with Fonterra since 2005 and has recently been driving the development and deployment of the "Strategy Refresh". She has held a number of senior operational and strategic roles across Fonterra. Prior to joining Fonterra, she spent nine years with The Boston Consulting Group. Originally an engineer, Maury was a member of Team New Zealand during the successful 1995 America's Cup campaign. Maury is also on the board of Telecom Corporation of New Zealand Limited. Maury holds a First Class Honours Degree in Engineering Science, is a Fellow of the Institution of Professional Engineers New Zealand and a member of the Institute of Directors in New Zealand.

TODD MULLER, MANAGING DIRECTOR CO-OPERATIVE AFFAIRS
Todd joined Fonterra's External Relations team in 2011 where he managed Local Government and Regional Relations before being promoted to his current role. The Co-operative Affairs role involves the management of Fonterra's relationship with its Farmer Shareholders, Fonterra's Group Identity and its communications and co-operative social responsibility programmes. It also involves policy development and advocacy with central and local government. Todd also works with the Fonterra Group to develop and deliver Fonterra's sustainability strategy. He was previously Chief Executive Officer of Apata Limited, a kiwifruit and avocado post-harvest company, and has held general management roles with kiwifruit marketer ZESPRI International Limited. He has also served in the Office of the Prime Minister of New Zealand. Todd is on the board of The New Zealand Institute for Plant and Food Research Limited, Central Plains Water Limited and The University of Waikato Council. Todd holds a Masters of Social Science from The University of Waikato.

IAN PALLISER, MANAGING DIRECTOR GROUP OPTIMISATION AND SUPPLY CHAIN
Ian joined Fonterra in 2010 after more than 30 years experience with BP, working in a variety of large and complex business units across Australasia, the United States, Europe and the United Kingdom. Immediately before joining Fonterra, he led the BP Group procurement function. Prior to taking on his current role in Fonterra, Ian headed Fonterra's Optimisation, Trading and Sourcing team. Ian holds an Honours Degree in Commerce and Administration from Victoria University and is a member of the New Zealand Institute of Chartered Accountants.

Fonterra's senior executive team (consisting of the Chief Executive Officer, his direct reports, and a limited number of others) have two variable components of their remuneration:

- an annual component based on:
  - key financial metrics related to earnings and cash flow, and health and safety;
  - a risk-sharing element related to the Farmgate Milk Price, in recognition of the integral link between Fonterra as a co-operative and its Farmer Shareholders. This element has a weighting of 10% of the total annual component; and
- a medium-term component, which is linked solely to net profit after tax and return on capital employed over a rolling three-year period.

SECTION 2
GOVERNANCE FRAMEWORK

OVERVIEW

The description below illustrates the key components for the governance of the Fonterra Shareholders' Fund and of Fonterra:

FONTERRA SHAREHOLDERS' FUND

- Trustee
  - Independent of the Manager
- Manager of the Fund
  - Independent of the Trustee
  - Board of 5 directors appointed as follows:
    - 3 Unit Holder elected; and
    - 2 Fonterra appointed

FONTERRA

- Co-operative company
- Approximately 10,500 Farmer Shareholders
- Board of up to 13 directors:
  - 9 Shareholder elected; and
  - 4 (independent) board appointed
- Shareholders' Council
  - Up to 35 councillors
- Milk Price Panel

FONTERRA FARMER CUSTODIAN

FONTERRA SHAREHOLDERS' FUND

ROLE OF TRUSTEE AND MANAGER OF THE FUND

The Fund is a unit trust established under the Unit Trusts Act. It is required to have a Trustee and a Manager.

The role of the Trustee is to hold any investments and other property that are assets of the Fund. As explained in Section 5 – *Trading Among Farmers in Detail*, it will not hold Economic Rights of Shares directly.

The role of the Manager is to issue or offer Units and to manage the property of the Fund. The Manager does not derive any fee for acting as Manager.

The Trust Deed defines a narrow function of the Fund which is, in summary to:

- issue Units when new Economic Rights are held for the benefit of the Fund;
- redeem Units when required by a Farmer Shareholder, Fonterra or the RVP and direct that the Fonterra Farmer Custodian transfers Shares to the Farmer Shareholder, Fonterra or the Fonterra Farmer Custodian on behalf of the RVP seeking that redemption; and
- not undertake other trading activities. The Fund is to be "passive", i.e. it will not actively solicit Economic Rights or the redemption of Units except for undertaking the initial Supply Offer.

The Manager and the Trustee are not permitted to be associated with each other. Accordingly:

- the Manager is owned by Trustees Executors Limited; and
- the Trustee is The New Zealand Guardian Trust Company Limited.

Further details in relation to The New Zealand Guardian Trust Company Limited and Trustees Executors Limited are set out in Section 10 – *Statutory Information*.

THE MANAGER AND ITS DIRECTORS

The constitution of the Manager provides for five directors of the Manager and sets out how they are appointed. In accordance with the procedure set out in the Trust Deed, Unit Holders are entitled to elect three directors of the Manager (called Elected Directors), and may remove and replace any Elected Director. The first three Elected Directors have, however, been selected by Fonterra so that the Fund can commence operations. Of these first three Elected Directors, one is required to retire at each annual meeting of the Fund over the course of the first three annual meetings of the Fund. Each is eligible for re-election.

The Chairman of the Board of the Manager must be one of these three Elected Directors.

The three Elected Directors must be "Independent Directors" for the purposes of the NZSX Listing Rules.

The remaining two directors of the Manager are appointed, and can be replaced, by Fonterra. There is no requirement as to who these directors must be. While they need not be directors of Fonterra, the first two people that Fonterra has appointed are both directors of Fonterra.

Trustees Executors Limited, as the sole shareholder of the Manager, has entered into a Shareholding Deed with Fonterra. Under this deed, it has agreed not to amend the constitution of the Manager without the prior written approval of Fonterra.

The initial directors of the Manager are listed overleaf.

SECTION 2 GOVERNANCE FRAMEWORK CONTINUED

JOHN SHEWAN CNZM
BCA (Hons), FCA
Independent Director and Chairman deemed to have been appointed by Unit Holders
Former PricewaterhouseCoopers Chairman, John Shewan, is currently an Adjunct Professor of Accounting at Victoria University. He also chairs the Wellington Regional Stadium Trust and the Victoria University Business School Advisory Board, and is a director of Munich Holdings of Australasia Pty Ltd. John was a partner at PricewaterhouseCoopers from 1984, and chaired the firm in New Zealand from 2003 to 2012. He has been a member of several Government advisory committees, and chaired the New Zealand Government's Tax Education Office from 1988 to 1998. He was appointed a Companion of the New Zealand Order of Merit in 2012.

PIP DUNPHY
B.Hort.Sci, CFA
Independent Director deemed to have been appointed by Unit Holders
Pip Dunphy has worked in New Zealand financial markets for more than 20 years, assisting local and offshore companies in capital raising and risk management. She currently chairs the boards of Mint Asset Management Limited and New Zealand Clearing and Depository Corporation Limited and is Deputy Chair of Auckland Transport. Pip's other directorships include Abano Healthcare Group Limited, New Zealand Post Limited, New Zealand Superannuation Fund and Motu, Economic and Public Policy Research. Previous roles have included directorships at the Accident Compensation Corporation and Earthquake Commission. Pip was a Monetary Policy Advisor to the Governor of the Reserve Bank of New Zealand from 2009 to 2011.

KIM ELLIS
BCA (Hons), BE (Hons)
Independent Director deemed to have been appointed by Unit Holders
Kim Ellis was the Chief Executive Officer of listed company Waste Management N.Z. Limited for 13 years, until its sale in 2006. He currently chairs the boards of Enviro Waste Services Limited, New Zealand Social Infrastructure Fund Limited and Macaulay Metals Limited. Kim also holds several directorships including Freightways Limited, Ballance Agri-Nutrients Limited, The Tasman Tanning Company Limited, Jucy Group Limited and Moa Group Limited. He is also a member of the Trust Board of Wanganui Collegiate School. He has previously led companies and organisations in a number of market sectors including health, manufacturing, distribution, transport, property, agriculture and fashion.

SIR RALPH NORRIS KNZM
FNZIM, FNZCS
Appointed to the Board of the Manager by Fonterra
Sir Ralph Norris joined the Fonterra Board in 2012 as an Appointed Director. He sits on the Appointments, Remuneration and Development Committee. Sir Ralph also serves on the board of Origin Energy Limited and on the Council of The University of Auckland. He was Chief Executive of the Commonwealth Bank of Australia for six years until December 2011 and, prior to that, he served as Chief Executive and Managing Director of Air New Zealand Limited from February 2002 to August 2005. Sir Ralph had a 40-year career in banking and served as the Managing Director and Chief Executive Officer of ASB Bank Limited from March 1991 to September 2001, and the Head of International Financial Services for the Commonwealth Bank of Australia from August 1999 to September 2001. Sir Ralph was made a Knight Companion of the New Zealand Order of Merit in 2009 and a Distinguished Companion of the New Zealand Order of Merit for services to business in 2006.

JIM VAN DER POEL
Appointed to the Board of the Manager by Fonterra
Jim van der Poel was elected to the Fonterra Board in 2002. He serves on the Fair Value Share Review Committee, the Co-operative Relations Committee, the Capital Structure Committee and the Trading Among Farmers Due Diligence Committee, and is Chairman of Fonterra's International Farming Ventures Group. Jim is also Chairman of the Spectrum Group of companies and a trustee of the Asia New Zealand Foundation. Jim has won a number of industry awards including the AC Cameron Memorial Award, 2002 New Zealand Nuffield Farming Scholarship, Sharemilker / Equity Farmer of the Year and the Dairy Exporter Primary Performer Award. Jim and his wife Sue live at Ngahinapouri in the Waikato and have farming interests in Waikato, Canterbury and the United States.

REMOVAL OF THE MANAGER

The Trust Deed sets out how the Manager may be removed, which in summary may occur in any of the following circumstances:

- removal by the High Court on the application of the Trustee, any Unit Holder or the Financial Markets Authority;
- the Trustee certifies that it is in the interests of Unit Holders that the Manager should cease to hold office;
- Unit Holders resolve under section 18 of the Unit Trusts Act that the Manager should cease to hold office;
- the Trustee removes the Manager on the grounds specified in the Trust Deed; or
- the Manager ceases to meet the qualification requirements set out in the Trust Deed to be the Manager.

If the Manager ceases to be the Manager, the Trustee may appoint a temporary Manager and is required to call a meeting of Unit Holders to appoint a new Manager. However, the temporary Manager and the new Manager must satisfy the following requirements prior to being appointed:

- they must enter into a deed agreeing to be bound by the Authorised Fund Contract;
- their shareholder(s) must agree to be bound by the Shareholding Deed;
- they must be approved by Fonterra; and
- their constitution must provide for a board of five directors, three elected by Unit Holders and two appointed by Fonterra in the manner set out above.

If Fonterra and the Trustee are unable to agree on a temporary Manager or new Manager, the Trustee has the power under the Unit Trusts Act to apply to the High Court for an order to appoint a person as Manager.

ROLES AND RESPONSIBILITIES OF THE DIRECTORS OF THE MANAGER

The Board of the Manager has statutory responsibilities for the affairs and activities of the Manager and the Fund.

The corporate governance framework of the Board of the Manager takes into consideration contemporary standards in New Zealand and Australia, incorporating principles and guidelines issued by the Financial Markets Authority, the best practice code issued by NZX and the ASX Corporate Governance Principles and Recommendations (ASX Principles). These are generally designed to maximise corporate performance and accountability in the interests of investors and the broader community and encompass matters such as board composition, committees and compliance procedures.

However, the corporate governance framework adopted by the Board of the Manager reflects its role as a manager of a fund with limited operational activity. In several ways, this will be different to the corporate governance structure appropriate for a traditional listed company carrying on an operating business.

The Manager will disclose and explain any recommendations in the best practice code issued by NZX and the ASX Principles that it decides not to implement in its corporate governance statement, which will be included in future annual reports of the Fund.

The roles and responsibilities of the Board of the Manager include:

- monitoring the performance of the Fund and the implementation of its objectives;
- monitoring compliance with regulatory requirements and ethical standards; and
- monitoring compliance with the constituent documents for Trading Among Farmers as they relate to the Fund.

Audit

The Board of the Manager will act as the audit committee for the Fund. The chairperson of the audit committee will be the chairperson of the Board of the Manager. Due to the limited nature of the Fund's operations, the Board of the Manager does not consider it necessary to have an independent chairperson for the audit committee.

The Board of the Manager acting as audit committee will be responsible for:

- providing oversight in relation to financial reporting and regulatory compliance; and
- reviewing financial reporting processes, internal controls, the audit process and the process for monitoring legal and regulatory compliance.

The Board of the Manager acting as audit committee will also act as a forum for communication between the Board of the Manager and external auditors where appropriate.

Nominations

The Board of the Manager will be appointed in accordance with the Trust Deed and the constitution of the Manager as noted above. There will not be a separate nominations committee. The Board of the Manager will be responsible for establishing the criteria for determining the suitability of potential Elected Directors of the Manager and recommending persons suitable for appointment to the Board of the Manager.

Remuneration

Under the Authorised Fund Contract, Fonterra will provide administrative services to the Manager and will meet the operating expenses of the Fund, including the fees of the directors of the Manager. As a result, it is not intended that the Manager will have any employees. Accordingly, the Manager does not consider it necessary or appropriate to establish a remuneration committee.

Continuous disclosure

The Board of the Manager aims to ensure that Unit Holders are informed of all major developments affecting the Fund. Information will be communicated to Unit Holders through NZX Main Board and ASX announcements, the Fund's annual and half-yearly reports and half and full-year results announcements.

Fonterra and the Manager have entered into an arrangement to co-operate with each other and take all steps reasonably required to ensure that information to be disclosed by either of them under the FSM Rules, the NZSX Listing Rules or the ASX Listing Rules (as the case may be) is disclosed simultaneously to the Fonterra Shareholders' Market, the NZX Main Board and ASX in relation to the Fund. It is intended that where NZX, as market operator of the Fonterra Shareholders' Market, receives information provided by Fonterra for release under the Fonterra Shareholders' Market, NZX will simultaneously release the information under the code relating to the Fund. This process is intended to be automatic. Fonterra will also arrange for the information to be disclosed on ASX.

Securities trading policy

The Manager and Fonterra have adopted trading policies that detail the policy on, and rules for, trading in Units. The policies respectively apply to directors of the Manager and directors, officers, employees and contractors of Fonterra and are additional to legal prohibitions on insider trading in New Zealand and Australia.

SECTION 2 GOVERNANCE FRAMEWORK CONTINUED

INTERESTS OF DIRECTORS OF THE MANAGER

Remuneration of directors of the Manager

Fonterra has approved the following amounts of remuneration for the directors of the Manager:

- $80,000 per year to the Chairman of the Board of the Manager; and
- $53,000 per year to each other director of the Manager.

However, currently the two directors of the Manager who have been appointed by Fonterra and who are also directors of Fonterra will not be paid any additional remuneration (in addition to their remuneration as directors of Fonterra), for their service on the Board of the Manager.

The remuneration of the directors of the Manager may be reviewed and adjusted from time to time.

Pursuant to the Authorised Fund Contract, Fonterra will be responsible for the payment of any reasonable fees and expenses payable by the Manager to its directors.

Directors' Unit Holdings

The Independent Directors of Fonterra are prohibited from acquiring any Relevant Interest in Units. The other directors of the Manager and of Fonterra may acquire Units and to the extent any such Units are acquired, these acquisitions will be disclosed to the market as required by law.

FONTERRA

OVERVIEW

Unit Holders have no right to vote on the election or appointment of the directors of Fonterra. However, the interests of Unit Holders are inextricably linked to that of Fonterra and hence to the Fonterra Board and its policies.

DIRECTORS OF FONTERRA

The Constitution provides for there to be up to 13 directors of Fonterra.

Nine of the directors of Fonterra are elected by Shareholders. These persons must either be Shareholders or be a "representative" of a Shareholder (e.g. a shareholder or director of a corporate Shareholder of Fonterra, or a partner of a partnership who is a Shareholder of Fonterra). One third of these directors are required to retire by rotation each year, but are eligible for re-election.

The remaining four directors of Fonterra (called the Appointed Directors) are appointed by the Fonterra Board, with their appointment ratified at the next annual meeting. Their appointment is ratified each three years thereafter, should they remain a director of Fonterra at that time. These four directors must be "Independent Directors" as defined in the FSM Rules that apply to the Fonterra Shareholders' Market (among other things, this prevents the Appointed Directors from owning or having a Relevant Interest in Units).

Fonterra has agreed that it will consult with the Chairman of the Board of the Manager on the persons to be appointed by the Fonterra Board as Appointed Directors. There is, however, no obligation to reach agreement in respect of those appointments. Fonterra will confirm by announcement to the Fonterra Shareholders' Market and to Unit Holders through the NZX Main Board and ASX, if any such appointment was not supported by a majority of the directors of the Manager who were elected by Unit Holders.

The directors of Fonterra are listed on the following three pages.

SIR HENRY VAN DER HEYDEN DCNZM
BE Ag (Hon), Honorary Doctor of Commerce, Honorary Fellowship from Wintech

Sir Henry van der Heyden has been Chairman of the Fonterra Board since 2002. He steps down as Chairman in December 2012 but Sir Henry will remain on the Fonterra Board for the first part of 2013. He is also Chairman of the Appointments, Remuneration and Development Committee. Sir Henry is Chairman of Tainui Group Holdings Limited and a director of Auckland International Airport Limited, Pascaro Investments Limited, Manuka Ltda, Rabobank New Zealand Limited and Rabobank Australia Limited. He is a member of New Zealand Business Forums and a member of the Remuneration Committee of ZESPRI International Limited. Sir Henry was made a Distinguished Companion of the New Zealand Order of Merit for services to agriculture in 2007.

JOHN WILSON
B. Agr. Sc

John Wilson joined the Fonterra Board in 2003 and is up for re-election this year. In August, he was appointed by the Fonterra Board as Chairman elect, subject to being re-elected by Farmer Shareholders. He is Chairman of the Capital Structure Committee and serves on the Appointments, Remuneration and Development Committee, the Fair Value Share Review Committee and the Trading Among Farmers Due Diligence Committee, and is a member of Fonterra's International Farming Ventures Group. John is also the Chairman of MilkTest NZ Limited, a director of Turners & Growers Limited and a member of the Institute of Directors in New Zealand. In 2000, he was awarded the New Zealand Nuffield Farming Scholarship. John lives on his dairy farm near Te Awamutu and jointly owns a dairy farming business based in Geraldine, South Canterbury.

MALCOLM BAILEY
B. Agr. Econ

Malcolm Bailey was elected to the Fonterra Board in 2004. He sits on the Audit, Finance and Risk Committee and the Co-operative Relations Committee. Malcolm also represents Fonterra on the Dairy Companies Association of New Zealand, and is a member of the International Food and Agricultural Trade Policy Council. He is a director of Westpac New Zealand Limited, Embryo Technologies Limited, Hopkins Farming Group Limited, Pastoral Dairy Investments Limited, Gleneig Holdings Limited and Agrico Holdings Limited. Malcolm's dairy farming interests are as a shareholder in Hopkins Farming Group Limited.

IAN FARRELLY
B. Agr.

Ian Farrelly was elected to the Fonterra Board in 2007 following a 20-year career in the banking industry. He is a member of the Audit, Finance and Risk Committee, the Appointments, Remuneration and Development Committee, the Co-operative Relations Committee and Fonterra's International Farming Ventures Group. Ian is also a director of First Mortgage Managers Limited, Spectrum Dairies Limited, Fortuna Group Limited and F.D. Lands Limited. He runs a 400-hectare calf rearing farm in Te Awamutu, owns a 50% share in three Waikato dairy farms and has ownership interests in dairy farms in Canterbury.

DAVID JACKSON
M.Com (Hons), FCA

David Jackson joined the Fonterra Board in September 2007 as an Appointed Director. David is Chairman of the Audit, Finance and Risk Committee and serves on the Fair Value Share Review Committee, the Capital Structure Committee, the Trading Among Farmers Due Diligence Committee, the Milk Price Panel and is a member of Fonterra's International Farming Ventures Group. David also serves on the boards of several other companies including Pumpkin Patch Limited and Nuplex Industries Limited. He is Chairman of The New Zealand Refining Company Limited. David spent more than 30 years with accounting firm Ernst & Young in a variety of roles, and served as Chairman of the board of management for the firm in New Zealand from 1999 to 2002.

DAVID MACLEOD

David MacLeod was elected to the Fonterra Board in 2011. He is a member of the Audit, Finance and Risk Committee, the Capital Structure Committee, the Fair Value Share Review Committee and the Milk Price Panel. David also serves on the boards of Port Taranaki Limited and A.J. Greaves Electrical Limited. He is Chairman of the Taranaki Regional Council. David lives near Hawera in South Taranaki and is a director of P.K.W. Farms Limited, one of Fonterra's largest Shareholders.

JOHN MONAGHAN

John Monaghan was elected to the Fonterra Board in 2008. John is Chairman of the Co-operative Relations Committee and is a member of the Appointments, Remuneration and Development Committee, the Fair Value Share Review Committee and the Capital Structure Committee. He is also a director of CentrePort Limited and CentrePort Properties Limited. He has farming interests in the Wairarapa and Canterbury regions.

SIR RALPH NORRIS KNZM

FNZIM, FNZCS

Sir Ralph Norris joined the Fonterra Board in 2012 as an Appointed Director. See Sir Ralph's full biography under the heading "Directors of the Manager" above.

NICOLA SHADBOLT

BSc (Hons), MAgrSc (Hons), FNZIPIM (Reg)

Nicola Shadbolt was elected to the Fonterra Board in 2009. She serves on the Capital Structure Committee, the Trading Among Farmers Due Diligence Committee, the Co-operative Relations Committee and Fonterra's International Farming Ventures Group. Nicola is a Professor at Massey University, Director of the Centre of Excellence in Farm Business Management, a Director of the International Food and Agribusiness Management Association, trustee of the Agri-Women's Development Trust and represents New Zealand in the International Farm Comparison Network in Dairying. Nicola is a shareholder and a director of five farming and forestry equity partnerships that include two dairy farms in the Manawatu.

JIM VAN DER POEL

Jim van der Poel was elected to the Fonterra Board in 2002. See Jim's full biography under the heading "Directors of the Manager" above.

JOHN WALLER

BCom, FCA

John Waller joined the Fonterra Board in February 2009 as an Appointed Director. John is Chairman of the Fair Value Share Review Committee, the Milk Price Panel and the Trading Among Farmers Due Diligence Committee, and is also a member of the Audit, Finance and Risk Committee and the Capital Structure Committee. John is Chairman of the Bank of New Zealand and the Eden Park Trust. He is a director of National Australia Bank Limited, BNZ Investments Limited, Haydn & Rollett Limited, National Equities Limited, Alliance Group Limited, Sky Network Television Limited, Direct Property Fund Limited, Yealands Wine Group Limited and Donaghys Limited. John was a partner at PricewaterhouseCoopers for over 20 years. He was also a member of their board and led their advisory practice for many years.

RALPH WATERS
C.P.Eng. F.I.E. Aust, M Bus

Ralph Waters joined the Fonterra Board in July 2006 as an Appointed Director. He serves on the Appointments, Remuneration and Development Committee. Ralph is Chairman of Fletcher Building Limited and is also a director of Asciano Limited and of Woolworths Limited, where he will assume the role of Chairman later this year. He is also Deputy Chairman of the Local Organising Committee for the ICC Cricket World Cup 2015, to be hosted in New Zealand and Australia. He was Chief Executive of Fletcher Building Limited from May 2001 until his retirement in August 2006. Before joining Fletcher Building Limited, Ralph was Managing Director of the Australian publicly-listed company Email Limited, and has also held a number of engineering and managerial positions in London and the Middle East.

DIRECTOR ELECTIONS IN DECEMBER 2012
John Wilson (the current Chairman elect of Fonterra) and Nicola Shadbolt are to retire by rotation at the annual meeting of Fonterra scheduled to be held on 17 December 2012. There is one casual vacancy on the Fonterra Board, due to a director having resigned during the year. There are, therefore, three vacancies to be filled through election at the annual meeting. Both John Wilson and Nicola Shadbolt have indicated that they propose to stand for re-election. As there are likely to be other candidates for election, there is no certainty that either of John Wilson or Nicola Shadbolt will be re-elected.

Sir Ralph Norris (having been appointed during the year by the Fonterra Board) and Ralph Waters (having been re-appointed by the Fonterra Board) are required to have their appointments ratified at Fonterra's annual meeting by Farmer Shareholders. In the event that Sir Ralph Norris' appointment is not ratified, Fonterra proposes to replace him on the Board of the Manager with another director of Fonterra appointed by the Fonterra Board, who will be determined at that time.

SHAREHOLDERS' COUNCIL
The Shareholders' Council is a national body of Farmer Shareholders. There are currently 35 councillors, each elected by Farmer Shareholders within the ward of the Farmer Shareholders they represent. The Shareholders' Council is not a separate legal entity, but its role is recognised in the Constitution.

In summary, the Shareholders' Council:

- monitors the performance of the Fonterra Board;
- represents Farmer Shareholders' interests on current issues and decision-making by Fonterra;
- provides learning and development opportunities for understanding Fonterra and its operations;
- appoints the independent valuer to determine the fair value range of Shares which the Fonterra Board then uses to determine the fair value of Shares which is used in the issue or surrender of Shares (it is anticipated that this role will end upon the introduction of Trading Among Farmers);
- appoints an independent "Milk Commissioner" to consider and facilitate resolution of supply-related complaints from Farmer Shareholders;
- determines the election process for Fonterra Board elections, and the election of Farmer Shareholders who constitute the "Directors' Remuneration Committee";
- appoints two members of the Milk Price Panel; and
- has a consultation role in the Fund Size Risk Management Policy.

In addition, the support of a majority of the members of the Shareholders' Council is required for any changes proposed by the Fonterra Board to Part A of the Constitution.

MILK PRICE PANEL
The Fonterra Board has established a panel called the Milk Price Panel. The Milk Price Panel is responsible for providing assurances to the Fonterra Board as to the governance of the Farmgate Milk Price and the proper application of the Farmgate Milk Price Manual. DIRA imposes requirements in relation to the Milk Price Panel's role. Details about the Milk Price Panel, its composition and its responsibilities are explained in Section 3 – *Setting the Farmgate Milk Price for New Zealand Milk*.

FONTERRA FARMER CUSTODIAN

In summary, the Fonterra Farmer Custodian:

- is a special purpose company owned by the trustees of a specially created trust known as the Fonterra Farmer Custodian Trust;
- has a board of three directors (the three trustees of the Fonterra Farmer Custodian Trust, or such other persons as are unanimously nominated by those trustees); and
- has been incorporated for the sole purpose of holding Shares in three capacities:
  - as trustee of the Fonterra Economic Rights Trust under which the Fonterra Farmer Custodian will hold Economic Rights of Shares for the Trustee;
  - on behalf of the RVP in accordance with a custody deed entered into with the RVP and Fonterra; and
  - on behalf of FSM Participants in accordance with the terms of a deed poll granted in favour of those FSM Participants in circumstances where an FSM Participant is required to transfer Shares to the Fonterra Farmer Custodian by the NZX Participant Rules.

SECTION 3 SETTING THE FARMGATE MILK PRICE FOR NEW ZEALAND MILK

INTRODUCTION

The Farmgate Milk Price is the base price that Fonterra pays for milk supplied to it in New Zealand. This section describes:

- the methodology by which Fonterra sets the Farmgate Milk Price;
- the governance framework for the setting of the Farmgate Milk Price (including constraints); and
- the regulatory oversight of the Farmgate Milk Price and the Farmgate Milk Price Manual under the Dairy Industry Restructuring Act 2001 (DIRA) including the role of the Commerce Commission in reviewing the Farmgate Milk Price.

The Farmgate Milk Price has been determined using the methodology contained in the Farmgate Milk Price Manual since 1 August 2008.

HOW THE FARMGATE MILK PRICE IS SET

WHAT IS THE FARMGATE MILK PRICE?

As described in Section 1 – *About Fonterra*, the Farmgate Milk Price is intended to reflect the price that Fonterra would be required to pay for milk in a competitive market environment. The need to calculate the Farmgate Milk Price arises because Fonterra purchases a very large proportion of New Zealand's total milk supply (approximately 89%), and there is no market price for milk independent of the price paid by Fonterra.

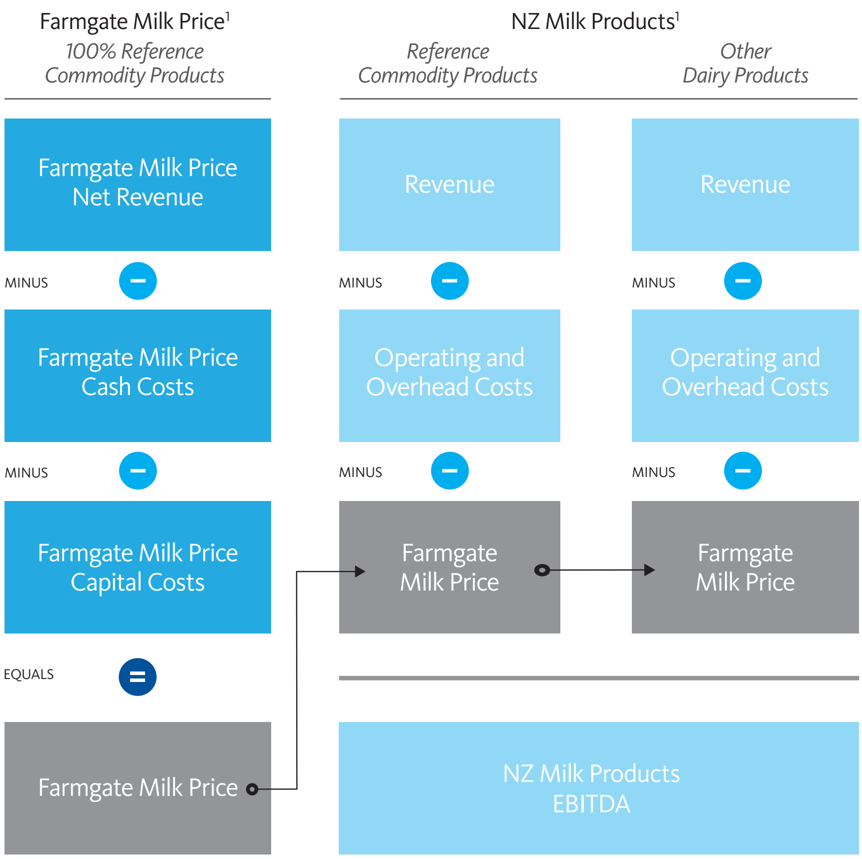
The Farmgate Milk Price is set by the Fonterra Board based on transparent calculations and rules set out in the Farmgate Milk Price Manual. The governance structures around the setting of the Farmgate Milk Price are described below.

As illustrated in the following diagram, the Farmgate Milk Price is a cost to the NZ Milk Products business. Note that the terminology used in the diagram is explained under the following heading "How is the Farmgate Milk Price determined?".

HOW IS THE FARMGATE MILK PRICE DETERMINED?

The model used in the Farmgate Milk Price Manual seeks to calculate the price that an efficient processor of Fonterra's scale, and that only produces certain commodity dairy products (or Reference Commodity Products; refer below), could sustainably pay for the milk collected by Fonterra in New Zealand. The methodology is based on this group of commodity dairy products because it is intended to reflect a price that an efficient new entrant competitor could sustainably pay, and almost all of the additional milk collected in New Zealand by Fonterra and its competitors over the last decade has been used to produce these products. These products also account for over 50% of the global trade in commodity dairy products.

The key items taken into account in calculating the Farmgate Milk Price are notional net revenue, cash costs and capital costs.



Source: Fonterra

1 The left hand side of the diagram depicts the components used to calculate the Farmgate Milk Price (these are explained under the heading "How is the Farmgate Milk Price determined?" below), whereas the right hand side of the diagram represents how the EBITDA of the NZ Milk Products business is impacted by the Farmgate Milk Price.

Farmgate Milk Price Net Revenue

The key net revenue assumptions are as follows:

- the revenue calculation for the Farmgate Milk Price assumes that all the milk collected by Fonterra in New Zealand is manufactured into a group of products that are referred to as the Reference Commodity Products;
- the Reference Commodity Products are based on the two main types of commodity products that Fonterra manufactures and sells on GDT™ (the auction platform referred to in Section 1 – *About Fonterra*). These are whole milk powder and skim milk powder. Related by-products that are also taken into account are butter, buttermilk powder and anhydrous milkfat. Any change to the composition of the Reference Commodity Products "basket" of products would be by way of the process that applies to amendments to the Farmgate Milk Price Manual, as discussed below;
- the prices that are assumed to be received for these products are expressed in United States dollars. Those US$ prices are converted to New Zealand dollars at Fonterra's actual average NZ$:US$ exchange rate in the month in which cash proceeds from sales are received; and
- about 90% of the sales prices for Reference Commodity Products that are taken into account in calculating the Farmgate Milk Price are sourced from GDT™. Butter is not currently sold on GDT™ and accounts for about 9% of Reference Commodity Product volume. The cost of additional lactose to that contained in the milk that Fonterra collects in New Zealand (a product which is required to be purchased to "standardise" the protein content of this product mix) is deducted from the gross revenue in order to derive net revenue.

Farmgate Milk Price Cash Costs

The key cash costs assumptions are as follows:

- costs incurred in manufacturing and selling Reference Commodity Products reflect resources used (such as total labour hours and energy usage) and unit costs (such as energy costs per unit). Unit costs are affected by production yields, which measure how much product is produced per unit of milksolids during the manufacturing process that converts liquid milk into finished dairy products. Production yields may be updated periodically in accordance with the Farmgate Milk Price Manual;
- resources taken into account in operating costs assume that modern and efficiently-operated milk powder plants with "industry-standard" technology are used to manufacture Reference Commodity Products. These plants are assumed to have an average daily processing capacity equal to the average actual and planned daily capacity of Fonterra's milk powder plants;
- the calculation is based on an industry-standard plant because Fonterra currently operates around 30 powder plants with capacity ranging from more than 25 tonnes per hour to less than one tonne per hour. No two of these plants are necessarily the same. Some can make only one or a few products. Others are used to manufacture a range of products, including higher-value products with returns that reflect investment in specialised plants;
- adjustments to the size of the plants assumed in the Farmgate Milk Price model are made at four-yearly intervals. This is to keep the average daily capacity of the assumed asset base broadly in line with Fonterra's actual average daily powder plant capacity. These adjustments are prospective (i.e. they are forward looking);
- costs per unit of labour, energy and other inputs are assumed to be broadly equal to those incurred by Fonterra;
- milk collection and internal logistics costs reflect Fonterra's actual costs; and
- overhead costs reflect those of an efficiently-run business of Fonterra's total scale that is focused on the manufacture of Reference Commodity Products and their sale through a channel like GDT™, with an equivalent offshore supporting network.

Farmgate Milk Price Capital Costs

The key capital costs assumptions are as follows:

- capital costs taken into account in calculating the Farmgate Milk Price are designed to recover the full economic cost of the manufacturing and other fixed assets required to manufacture the Reference Commodity Products over the economic lives of the assets;
- capital costs include an allowance for a benchmark post-tax "weighted average cost of capital" (WACC) return on the total capital employed in the business (capital employed comprising the depreciated value of fixed assets plus net working capital as detailed in the Farmgate Milk Price Manual). Capital costs also include an allowance for depreciation and tax. Parameters which determine the cost of capital such as the asset beta, debt leverage, risk free rates and market risk premiums are updated from time to time in accordance with the Farmgate Milk Price Manual;
- the "net working capital" calculation assumes that product sales occur in the same month as Fonterra's actual sales of Reference Commodity Products manufactured from milk collected during the Season. Sales are invoiced in the month of shipment;
- the net working capital calculation also assumes that Fonterra pays Farmer Shareholders progressively during the Season according to its actual "advance rate schedule". If, due to the impact of commodity price volatility on the Farmgate Milk Price during the year, Fonterra pays relatively more to Farmer Shareholders earlier in the Season (as it did in the 2011 / 2012 Season), then net working capital taken into account in the Farmgate Milk Price is higher than otherwise. This results in higher capital costs and a lower Farmgate Milk Price than otherwise, and *vice versa*;
- capital costs are calculated in a manner that results in the aggregate charge moving each year approximately in line with milk supply and capital goods inflation. Assuming the average WACC remains constant, this means that changes in the average age of the asset base do not result in material year-on-year movements in capital costs; and
- the Farmgate Milk Price assumes capacity is in place to process Fonterra's anticipated milk collections.

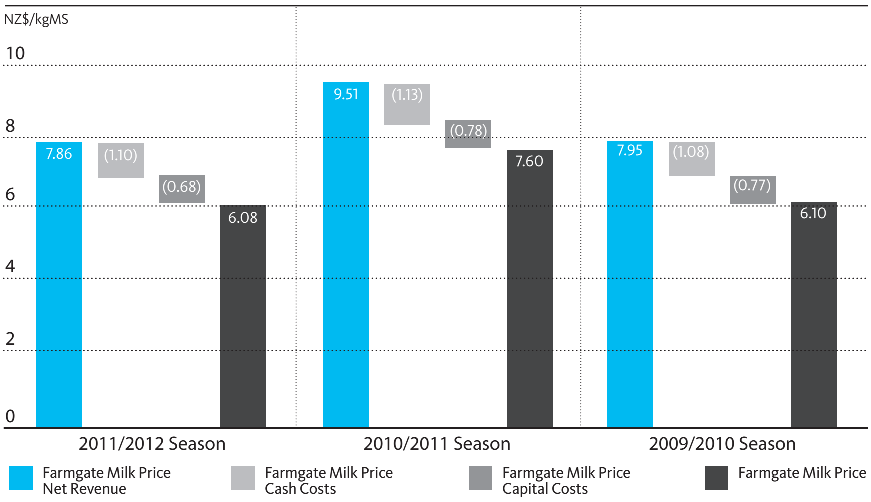
SECTION 3 SETTING THE FARMGATE MILK PRICE FOR NEW ZEALAND MILK CONTINUED

NET IMPACT OF FARMGATE MILK PRICE COMPONENTS FOR THE 2009 / 2010 TO 2011 / 2012 SEASONS

The chart to the right illustrates the relative contributions of net revenue, cash costs and capital costs to the Farmgate Milk Price from the 2009 / 2010 Season to the 2011 / 2012 Season.

By way of further explanation:

- the main driver of changes in the Farmgate Milk Price across the last three Seasons has been changes in net revenue per kilogram of milksolids (kgMS). The factors that affect net revenue are noted above; and
- cash costs and capital costs during this period have exhibited much less variability:
  - cash costs grew from $1.08 to $1.10 per kgMS over the three Seasons. This reflected cost inflation offset by a fall in cash costs between the 2010 / 2011 Season and the 2011 / 2012 Season due to reduced sales costs, and the impact on fixed cost recoveries of a 10% increase in milk supply in the 2011 / 2012 Season; and
  - between the 2009 / 2010 Season and the 2010 / 2011 Season, aggregate capital costs rose by one cent to 78 cents per kgMS, but fell by 10 cents to 68 cents per kgMS in the 2011 / 2012 Season. Six cents of this reduction was due to a lower weighted average cost of capital[1] and a reduced tax charge due to a lower company tax rate. The remaining four cents reflected improved asset utilisation due to higher milk supply in the 2011 / 2012 Season.



Source: Fonterra, Milk Price Statement dated 31 May 2012

FARMGATE MILK PRICE MODEL DIFFERS FROM THAT FOR FONTERRA'S NZ MILK PRODUCTS BUSINESS

As highlighted above, the assumed processor used to calculate the Farmgate Milk Price differs from the actual NZ Milk Products business in relation to a number of factors, including the products it produces and sells, processing plant configuration, cash costs and capital costs.

This means that it is not meaningful to directly compare net revenue, cash costs or capital costs taken into account in calculating the Farmgate Milk Price with the actual revenue, cash costs or core earnings of NZ Milk Products. For that reason, rather than attempting to compare the 'gap' between the EBITDA of NZ Milk Products and the total capital costs allowed for in the Farmgate Milk Price as a measure of performance, Fonterra focuses on margin improvement in its business to sustainably improve return on capital employed in the NZ Milk Products business.

However, in order to assess Fonterra's ability to improve return on capital employed, it is important to understand the key factors that influence the Farmgate Milk Price and their expected effects on NZ Milk Products' EBITDA. These are summarised in the following table and are also discussed further in Section 4 – *Fonterra Financial Information*. Key points to note are:

- across-the-board changes in the level of all dairy commodity prices largely flow through to a higher or lower Farmgate Milk Price, rather than to the EBITDA of NZ Milk Products;
- likewise, changes in the average NZ$:US$ exchange rate largely flow through to a higher or lower Farmgate Milk Price rather than to the earnings of NZ Milk Products; and
- changes in the relative prices obtained for Reference Commodity Products compared to those for other dairy products (like cheese and casein) can have a significant impact on the earnings of NZ Milk Products.

1 Due to both lower market interest rates and a change to calculating interest rates based on rolling five-year averages rather than four-yearly updates.

	Key drivers of the performance of the 100% dairy commodity producer assumed by Farmgate Milk Price model	Key drivers of the performance of the actual NZ Milk Products business	Relative effects of changes in these factors on the Farmgate Milk Price and on NZ Milk Products' EBITDA
Net revenue	Changes in Reference Commodity Product prices, in particular those achieved on GDT™. About 90% of Reference Commodity Product sales taken into account are sold on GDT™ (the exceptions being sales of butter and a proportion of buttermilk powder).	Also includes sales of Reference Commodity Products through non-GDT™ channels.	Relative price differences achieved (net of additional costs) for Reference Commodity Products through non-GDT™ channels, compared to prices achieved on GDT™, will flow through to NZ Milk Products' EBITDA.
	Assumes business only sells Reference Commodity Products.	Also sells other products such as cheese and casein.	Relative differences between prices for Reference Commodity Products and other products will flow through to NZ Milk Products' EBITDA.
	Sales phasings / shipments and forward fixed-price assumptions (prices established five months or less prior to shipment) only relate to Reference Commodity Products.	Also includes (a) phasing of sales / shipments of products other than Reference Commodity Products, such as cheese and casein and (b) the terms of some long-dated fixed-price contracts in relation to Reference Commodity Products and other products.	Relative differences between impacts of (a) sales phasing for Reference Commodity Products compared with that for other products and (b) longer-term fixed-price contracts for Reference Commodity Products and other products will flow through to NZ Milk Products' EBITDA.
	Changes in the exchange rate affect net revenue.	Changes in the exchange rate affect net revenue.	Changes in the exchange rate largely flow directly to a higher or lower Farmgate Milk Price, rather than to NZ Milk Products' EBITDA.
Cash costs	Costs per unit of labour, energy, other inputs and milk collection and logistics costs are assumed to be broadly equal to those incurred by Fonterra.	Costs per unit of labour, energy, other inputs and milk collection and logistics costs are largely the same whether those inputs are applied to the production of Reference Commodity Products or other products.	Changes in input costs per unit and changes in Fonterra's actual milk collection and logistics costs, largely flow to a higher or lower Farmgate Milk Price. While changes in per unit costs flow through to the Farmgate Milk Price, benefits of improved operating efficiencies that reduce the volume of units required (e.g. hours of labour, total energy consumed) primarily flow through to NZ Milk Products' EBITDA.
	Production yields are based on efficiently-run standard powder plants (and ancillary plants to process by-products) using current industry technology.	Production losses tend to be lower for the production of Reference Commodity Products than for other products.[1]	Improved production yields primarily flow through to higher NZ Milk Products' EBITDA.
Capital costs / NZ Milk Products EBITDA	Based on post-tax weighted average cost of capital for 100% dairy commodity producer, an allowance for economic depreciation, and tax at the NZ company tax rate (after adjusting for differences between tax depreciation rates and those allowed for in the Farmgate Milk Price).	Fonterra typically applies a higher internal required return on new investment than that used in the Farmgate Milk Price. While Fonterra pays no tax on earnings because dividends paid on production-backed Shares are deductible, tax is paid by Farmer Shareholders, resulting in a similar economic incidence of tax.	For the reasons noted earlier, it is not meaningful to directly compare the EBITDA of the NZ Milk Products business and the capital costs allowed for in the Farmgate Milk Price. Instead, Fonterra treats the Farmgate Milk Price as exogenously determined, and endeavours to achieve higher returns over time from its invested capital.
	The Farmgate Milk Price assumes total capacity is in place to process Fonterra's anticipated milk collections.		Short-term variability in milk volumes between Seasons means higher or lower fixed operating and capital costs per kgMS largely flow through to the Farmgate Milk Price. However, if milk volumes decline over the longer term, capital costs would decline to reflect lower required total capacity in the Farmgate Milk Price. This would result in the costs of stranded assets and reduced fixed cost recoveries largely flowing through to lower Fonterra NZ Milk Products' EBITDA. Other factors aside, a lower interest rate on sovereign debt should flow through to lower capital costs and a higher Farmgate Milk Price (which was the case between FY2011 and FY2012), and *vice versa*.

The key drivers of NZ Milk Products' core earnings historically are discussed in more detail in Section 4 – *Fonterra Financial Information*.

1 "Losses" refer to components of milk that are not valued in finished products, either because of physical losses in the production process or because usage of that component (such as protein) exceeds minimum product specifications.

SECTION 3 SETTING THE FARMGATE MILK PRICE FOR NEW ZEALAND MILK CONTINUED

GOVERNANCE STRUCTURE FOR CALCULATING THE FARMGATE MILK PRICE

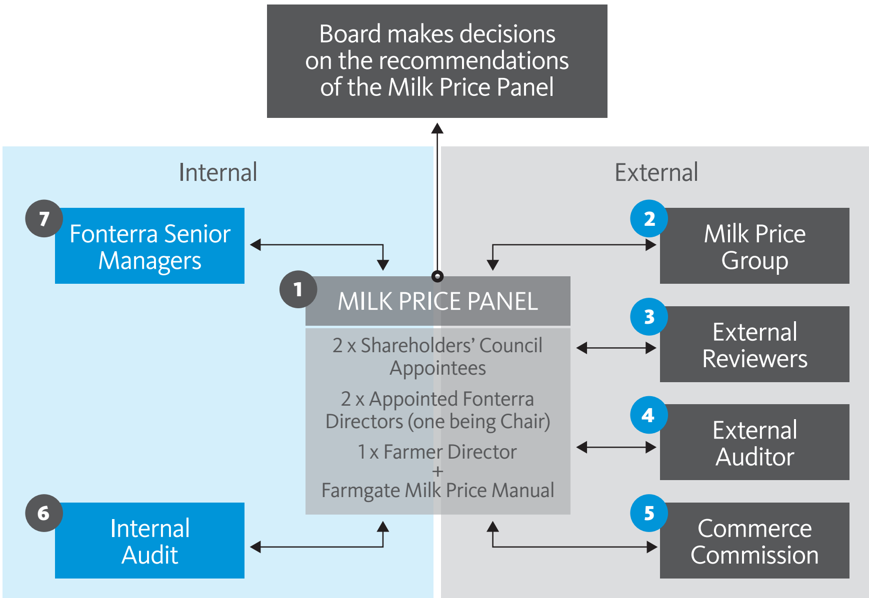
FONTERRA BOARD RESPONSIBLE FOR SETTING AMOUNT PAID FOR MILK

The Fonterra Board is responsible for setting the total amount to be paid by Fonterra for all milk supplied to it in New Zealand in each Season. This amount is made up of the Farmgate Milk Price and any Approved Adjustments (e.g. premium payments for some winter milk and specialty milk such as organic milk).

The Constitution requires Fonterra to maintain a Farmgate Milk Price Manual, which sets out Fonterra's policies and methodology for determining the Farmgate Milk Price. The Farmgate Milk Price Manual must reflect the Milk Price Principles set out in Fonterra's Constitution. The Farmgate Milk Price has been calculated in accordance with the Farmgate Milk Price Manual since 1 August 2008.

GOVERNANCE STRUCTURE

The Fonterra Board has established a robust governance structure to oversee the setting of the Farmgate Milk Price, which comprises the elements illustrated in the diagram to the right:



1. Milk Price Panel – discussed below.
2. Milk Price Group – discussed below.
3. External Reviewers:
   - Provide expert advice on various inputs, as well as assurance over accuracy of financial models.
   - Participate in reviews of key parameters of the Farmgate Milk Price at regular intervals (which can be up to four years).
4. External Auditor:
   - Audits the Farmgate Milk Price each year.
   - Provides assurance that the Farmgate Milk Price has been derived in accordance with the Milk Price Principles, methodologies and detailed rules of the Farmgate Milk Price Manual.

   Fonterra's external auditor is PricewaterhouseCoopers.
5. Commerce Commission – discussed below.
6. Internal Audit: provides assurance over forecasting process controls and data.
7. Fonterra Senior Managers: provide internal oversight of the calculation of the actual and forecast Farmgate Milk Price in accordance with the Farmgate Milk Price Manual and detailed models and procedures.

Source: Fonterra

The key elements of the governance structure are as follows:

MILK PRICE PANEL

The Fonterra Board has established a panel known as the Milk Price Panel. The Milk Price Panel is responsible for providing assurances to the Fonterra Board as to the governance of the Farmgate Milk Price and the proper application of the Farmgate Milk Price Manual. DIRA imposes requirements in relation to the Milk Price Panel's role which are discussed further below.

The Panel consists of five members, as follows:

- two directors of Fonterra. These are required to be from the group of Appointed Directors on the Fonterra Board. Under the FSM Rules, Appointed Directors must be independent (in terms of the test outlined below);
- one of the Farmer Shareholder-elected directors of Fonterra (i.e. the directors who are elected by Farmer Shareholders); and
- two appropriately qualified appointees nominated by the Shareholders' Council, at least one of whom must be independent.

The Milk Price Panel must at all times include a majority of members who are independent from Fonterra (including the Chair). In simple terms, to be "independent" a member must not:

- hold or have a direct or indirect interest in Shares issued by Fonterra, or Units in the Fund;
- be a relative of a person who holds or has a direct or indirect interest in Shares or Units; or
- be an employee of Fonterra or a Farmer Shareholder.

The Chair of the Milk Price Panel is appointed by the Fonterra Board and must be one of the Appointed Directors.

The current members of the Milk Price Panel are:

John Waller (Appointed Director; independent Chair of the Panel)

David Jackson (Appointed Director; independent member of the Panel)

David MacLeod (Farmer Shareholder-elected Director)

Paddy Boyle (Shareholders' Council appointee; independent member of the Panel)

Richard Punter (Shareholders' Council appointee; independent member of the Panel).

John Waller and David Jackson are Appointed Directors of Fonterra and also meet the required standard of independence for members of the Milk Price Panel.

The Milk Price Panel's responsibilities include:

- overseeing the governance of the Farmgate Milk Price and the Farmgate Milk Price Manual, including undertaking reviews of the Farmgate Milk Price and the Farmgate Milk Price Manual, and any changes to the Farmgate Milk Price Manual;
- supervising the calculation of the Farmgate Milk Price and making a recommendation on it to the Fonterra Board;
- making recommendations to the Fonterra Board in respect of the Farmgate Milk Price Manual, including any recommendation that it should be amended and any recommendation that a proposed amendment should not be made; and
- providing to the Fonterra Board an assurance that there were no matters brought to the attention of the Milk Price Panel which indicate:
  - that the Farmgate Milk Price has not been calculated in accordance with the processes provided in the Farmgate Milk Price Manual; or
  - that a change to the Farmgate Milk Price Manual is required.

MILK PRICE GROUP

The Milk Price Group is a working group established by Fonterra.

The Head of the Milk Price Group is independent of Fonterra's management and reports directly to the Chair of the Milk Price Panel. The role of the Milk Price Group includes:

- ensuring that the Farmgate Milk Price is calculated in accordance with the Farmgate Milk Price Manual and making recommendations in respect of both the actual and projected Farmgate Milk Prices;
- considering any proposed amendments to the Manual, including those the Milk Price Group itself considers are appropriate, and ensuring they are in accordance with the Milk Price Principles in Fonterra's Constitution;
- providing assurance over inputs into determining and forecasting the Farmgate Milk Price to the Fonterra Board;
- managing engagement with External Reviewers; and
- engaging with the Commerce Commission, including to ensure full disclosure of all material aspects of the Farmgate Milk Price derivation each year.

The functions of the Milk Price Group are contracted out to Ernst & Young and other technical experts who are not employees of Fonterra.

DETERMINATION OF THE FARMGATE MILK PRICE FOR A SEASON

The Milk Price Panel uses the methodology set out in the Farmgate Milk Price Manual to recommend a Farmgate Milk Price to the Fonterra Board, and makes recommendations in relation to the aggregate amount to be paid by Fonterra for milk supplied to it in New Zealand. The Fonterra Board then determines these amounts. In doing so, the Fonterra Board is not obliged to follow the recommendation of the Milk Price Panel and may pay a price above the price recommended by the Panel and / or different from that derived under the Farmgate Milk Price Manual.

Fonterra's finalised Farmgate Milk Price for a Season is usually announced in late September, after the end of the relevant Season. Fonterra pays its Farmer Shareholders an "advance rate" for milk supplied in a month, representing a percentage of the forecast annual Farmgate Milk Price. This proportion gradually increases during the Season up to 100% when the final Farmgate Milk Price for the prior Season is set by the Fonterra Board. The Farmgate Milk Price Manual requires Fonterra to publish a Milk Price Statement setting out the Farmgate Milk Price for a Season, together with other supporting information.

CONSTRAINTS ON FONTERRA BOARD'S ABILITY TO PAY MORE THAN THE AMOUNT DETERMINED UNDER THE FARMGATE MILK PRICE MANUAL

In addition to the general governance arrangements discussed above, two specific constraints apply in terms of the Fonterra Board's ability to determine the aggregate amount to be paid for milk for each Season.

Firstly, certain disclosures are required under DIRA (section 150N) if Fonterra sets a Farmgate Milk Price other than in accordance with a recommendation by the Milk Price Panel, or without having received a recommendation by the Milk Price Panel for the Farmgate Milk Price. In these circumstances, Fonterra must make publicly available:

SECTION 3 SETTING THE FARMGATE MILK PRICE FOR NEW ZEALAND MILK CONTINUED

- the recommendation of the Milk Price Panel, if any; and
- a statement setting out Fonterra's reasons for setting the Farmgate Milk Price other than in accordance with a recommendation by the Milk Price Panel or without having received a recommendation by the Milk Price Panel for the Farmgate Milk Price.

Secondly, under the FSM Rules, a decision to pay an aggregate amount for milk in excess of the amount calculated under the Farmgate Milk Price Manual must be approved by a majority of not less than 75% of the Fonterra Board, with such majority including at least a majority of the Independent Directors.[1]

CONSTRAINTS ON FONTERRA BOARD'S ABILITY TO AMEND THE FARMGATE MILK PRICE MANUAL

In addition to the disclosure requirements under DIRA discussed below, under the Fonterra Shareholders' Market Rules, a decision to amend or replace the Farmgate Milk Price Manual must be approved by a majority of not less than 75% of the Fonterra Board, including at least a majority of the Independent Directors. The Fonterra Board will apply the same process for any change to the products that make up the Reference Commodity Products.

As noted earlier, some parameters used in calculating the Farmgate Milk Price may be changed year to year, or at regular review intervals (which can be up to four years), in accordance with the Farmgate Milk Price Manual. However, these changes are subject to the processes, criteria and disclosure requirements set out in the Farmgate Milk Price Manual.

REGULATORY OVERSIGHT OF THE FARMGATE MILK PRICE

Recent amendments to DIRA introduced regulatory oversight (by the Commerce Commission) of Fonterra's process for setting the Farmgate Milk Price (referred to as the "base milk price" in the relevant part of DIRA). The oversight role relates to the Farmgate Milk Price rather than the operation of Trading Among Farmers as a whole.

ROLE OF THE FARMGATE MILK PRICE MANUAL AND THE MILK PRICE PANEL NOW ENSHRINED IN DIRA

The key features of Fonterra's governance structure for overseeing the calculation of the Farmgate Milk Price described earlier have now been enshrined in new Subpart 5A of DIRA.

Under DIRA, Fonterra must:

- maintain and make publicly available the Farmgate Milk Price Manual that sets out how the Farmgate Milk Price is calculated (section 150F);
- maintain the Milk Price Panel (section 150D) and ensure that the Chair and a majority of the members are independent (section 150E); and
- set and make publicly available the Milk Price Panel's terms of reference (section 150D), which must include, for each Season:
  - supervising the calculation of the Farmgate Milk Price;
  - advising Fonterra as necessary on the application of the Farmgate Milk Price Manual; and
  - recommending the Farmgate Milk Price to the Fonterra Board.

The Milk Price Panel may also recommend amendments to the Farmgate Milk Price Manual, or recommend that a proposed amendment should not be made (section 150D(4)). While Fonterra is not required to comply with such recommendations, where it acts inconsistently with, contrary to or in the absence of a Milk Price Panel recommendation, it must publish its reasons for doing so, along with the relevant recommendation, if any (section 150G).

Finally, as noted above, if Fonterra sets a Farmgate Milk Price other than in accordance with a recommendation of the Milk Price Panel or without having received a recommendation by the Milk Price Panel, it must make certain public disclosures.

COMMERCE COMMISSION OVERSIGHT OF THE FARMGATE MILK PRICE AND FARMGATE MILK PRICE MANUAL

DIRA also gives the Commerce Commission an oversight role. A purpose of DIRA is to promote the setting of a Farmgate Milk Price that provides an incentive to Fonterra to operate efficiently, while providing for contestability in the market for the purchase of milk from farmers (section 150A). Each year, the Commission is required to review and report on the extent to which the Farmgate Milk Price Manual and the Farmgate Milk Price are consistent with that purpose.

The oversight regime also:

- provides that if notional costs, revenues, or other assumptions taken into account in calculating the Farmgate Milk Price are practically feasible for an efficient processor, then the setting of the Farmgate Milk Price will provide for contestability in the market for the purchase of milk from farmers;
- specifies various assumptions that may be used in calculating the Farmgate Milk Price that do not detract from the statutory purpose; and
- sets out various principles in terms of how cost and revenue inputs are used to calculate the Farmgate Milk Price, which are required for consistency with the statutory purpose.

Fonterra is required to provide the Commerce Commission with the information necessary to complete its review. The Commission must provide its draft reports to Fonterra for comment and must publish its final reports:

- on the Farmgate Milk Price Manual by 15 December during each Season; and
- on the calculation of the Farmgate Milk Price for the just-completed Season by 15 September immediately following the end of that Season.

1 Amounts paid in the past three Seasons in addition to the Farmgate Milk Price have been less than 0.3% of the total of the aggregate amount paid for milk. These payments have related to premiums on certain specialty organic and stolle (hyper-immune) milk, and specific contracts with a subset of Farmer Shareholders that provide for targeted premiums for milk supplied in winter months to serve the domestic market.

The reports on the Farmgate Milk Price Manual and the calculation of the Farmgate Milk Price will not disclose the Commission's view of the final Farmgate Milk Price for the Season. The Commission will instead focus on the consistency with the purpose of the oversight regime of:

- the Farmgate Milk Price Manual; and
- the assumptions adopted and the inputs and process used in calculating the Farmgate Milk Price for the Season.

These reports will contribute to the overall transparency of the setting of the Farmgate Milk Price.

Fonterra is not bound by the Commerce Commission's findings. However, where it considers appropriate, it may amend its calculation of the Farmgate Milk Price or the Farmgate Milk Price Manual in light of a Commerce Commission report. In terms of the reports on the calculation of the Farmgate Milk Price, the timing of their final publication date enables the views of the Commission to be known before Fonterra's annual results relating to that Season are finalised and announced.

COMMERCE COMMISSION'S "DRY RUN" REVIEW

In anticipation of this new oversight regime, the Minister for Primary Industries requested that the Commerce Commission conduct a dry run review of Fonterra's setting of the Farmgate Milk Price and the Farmgate Milk Price Manual in respect of the 2011 / 2012 Season. The purpose of the dry run review was to provide increased investor certainty ahead of the launch of Trading Among Farmers. In particular, the dry run report was to provide an indication of how the Commerce Commission intends to implement the monitoring regime in practice.

The Commerce Commission's report on its dry run review was released on 27 August 2012. In summary, the Commerce Commission concluded, based on its limited review of a number of key issues only, that:

- the Farmgate Milk Price Manual sets a Farmgate Milk Price which is largely independent from Fonterra's actual performance and this provides an incentive for Fonterra to operate more efficiently;
- the Farmgate Milk Price provides for contestability in the market for the purchase of milk from farmers. Most, but not all, of the assumptions used by the Farmgate Milk Price Manual are reasonable and practically feasible;
- the assumptions that the Commerce Commission raised concerns about relate to aspects of the cost of capital and asset base. Having regard to the direction (i.e. whether they increased or decreased the Farmgate Milk Price) and the aggregate size of the impact of these issues, the Commission concluded that its analysis suggests that the Farmgate Milk Price is practically feasible for an efficient processor; and
- based on the evidence available, Fonterra's setting of the Farmgate Milk Price appears to be consistent with the Commerce Commission's interpretation of DIRA's purpose and principles.

As a result of the Commerce Commission's dry run report, Fonterra made the following changes to the Farmgate Milk Price Manual, which will take effect from the start of the 2012 / 2013 Season:

- an amendment to enable explicit adjustments for debt issuance costs and any costs involved in swapping US$-denominated debt premium to NZ$ in calculating the weighted average cost of capital; and
- an amendment to make it unambiguous that the sales phasings assumptions cannot be adjusted retrospectively based on information which was not available at the time the phasings would have actually been established by Fonterra or another actual processor.

The effect of the adjustment to the cost of debt will result in a reduction in the Farmgate Milk Price of one cent per kgMS in the 2012 / 2013 Season.

The results of the Commerce Commission's future reviews under DIRA may differ from the dry run approach as various assumptions may be considered in more detail, and its interpretation of the relevant sections of DIRA may change.

COMMERCE COMMISSION'S DRAFT REPORT ON THE FARMGATE MILK PRICE MANUAL FOR THE 2012 / 2013 SEASON

As part of the first statutory review of the Farmgate Milk Price Manual and the Farmgate Milk Price, on 19 October 2012 the Commerce Commission released its draft report in respect of the Farmgate Milk Price Manual to be used for the 2012 / 2013 Season.

In summary, the Commerce Commission's draft report concluded that:

- the Farmgate Milk Price Manual is materially consistent with the purpose statement in section 150A of DIRA;
- most of the elements of the Farmgate Milk Price Manual provide Fonterra with an incentive to operate efficiently;
- while no areas had been identified where assumptions were not practically feasible for an efficient processor, further information has been requested in relation to some assumptions through a submissions process; and
- the implementation of the Farmgate Milk Price Manual will be reviewed when the Commerce Commission reviews the Farmgate Milk Price for the 2012 / 2013 Season at the end of that Season.

Fonterra and other interested third parties have until 15 November 2012 to make submissions on the draft report. The Commerce Commission's final report in respect of this review must be published by 15 December 2012.

The statutory process for the Commerce Commission's review of the assumptions adopted and the inputs and process used in calculating the actual Farmgate Milk Price for the 2012 / 2013 Season does not begin until July 2013. The Commission's final report on that review is due by 15 September 2013.

SECTION 4
FONTERRA FINANCIAL INFORMATION

OVERVIEW OF FONTERRA FINANCIAL INFORMATION

The Offer is an offer to subscribe for Units in the Fonterra Shareholders' Fund, a unit trust which has been established to invest in Economic Rights of Shares in Fonterra. It provides investors with an opportunity to earn returns based on the financial performance of Fonterra.

The performance of the Units will be related to the performance of Fonterra. Consequently, this section contains financial information and commentary relating to Fonterra.

No offer is being made to subscribe for Shares in Fonterra in this Offer Document. The Units being offered in this Offer Document will be issued by the Manager of the Fund, not by Fonterra, and do not confer any direct interest in Fonterra.

As at the date of this Offer Document, the Fund has not allotted any Units or carried on any other activity on which to report. Accordingly, this Offer Document does not contain any financial information relating to the Fund.

In its own financial statements, the Fund expects to value its investment in Economic Rights of Shares at fair value and record a liability representing the obligation on the Fund to pass dividends received straight through to Unit Holders.

This Offer Document is required by the Securities Regulations to contain five years of historical summary financial statements for Fonterra. These are shown in Section 11 – *Summary Financial Statements*. This Offer Document also contains a more detailed review of Fonterra covering the last three financial years. Because of structural changes to the calculation of the cost of New Zealand-sourced milk and the way in which earnings were presented prior to FY2010, it is not meaningful to provide comparisons to periods prior to FY2010. The business review is contained on pages 74 to 87.

In addition to the historical financial information, this Offer Document contains forecasts of Fonterra's financial performance and position for the financial year ending 31 July 2013. This information is in the format of a set of prospective financial statements, and is contained in pages 88 and 91 to 112.

The Fonterra Financial Information (including the Fonterra Prospective Financial Information) has been prepared by the directors of Fonterra. The Manager and the Board of the Manager have not been involved in the preparation or finalisation of any of the Fonterra Financial Information.

Fonterra's Auditor, PricewaterhouseCoopers, has examined the Fonterra Prospective Financial Information and the summary financial statements in Section 11 – *Summary Financial Statements* and PricewaterhouseCoopers' reports are set out on pages 89 to 90 and 163 to 164 respectively.

The Fonterra Financial Information should be read in conjunction with the risk factors set out in Section 7 – *Investment Risks* and the other information contained in this Offer Document.

The Fonterra Financial Information is shown in millions of New Zealand dollars (unless stated otherwise), and is rounded, which may result in some discrepancies between the sum of components and totals within tables and also in certain percentage calculations.

FONTERRA GROUP PERFORMANCE

Fonterra's integrated and geographically diverse businesses span everyday dairy nutrition, out-of-home foodservices, branded consumer products and advanced dairy nutrition.

Over the period from FY2010 to FY2012, sales volumes have increased by 4%, reflecting increased supply of New Zealand milk and growing global demand for dairy nutrition. Over the same period, Fonterra's revenue has grown 18% from $16.7 billion to $19.8 billion primarily as a consequence of both sales volume growth and the impact of increased commodity prices.

A significant proportion of the volatility in commodity prices and currency is passed through to the Farmgate Milk Price rather than Fonterra's earnings. Normalised EBIT[1] increased by 14% from $904 million to $1,028 million between FY2010 to FY2012, and EBIT as a percentage of sales was in the range of 5.1% to 5.4%.

However, as a result of the way in which the Farmgate Milk Price is calculated, some volatility in commodity prices and currency is not passed through to the Farmgate Milk Price and Fonterra's earnings remain exposed to volatility arising from movements in the price of certain commodity products. These movements may be significant. They are described below in the historical review of NZ Milk Products relating to product mix, and quantified in the sensitivity analysis relating to the Fonterra Prospective Financial Information.

1 Normalised EBIT includes share of profit from equity accounted investees and excludes non-recurring items as described on page 74 in this section.

($M)	FY2012	FY2011[4]	FY2010[4]
Sales volume ('000 MT)	*3,941*	*3,866*	*3,772*
NZ Milk Products	15,717	15,593	12,801
Regional businesses	6,508	6,863	6,034
Eliminations (inter-segment)	(2,456)	(2,585)	(2,109)
Revenue	**19,769**	**19,871**	**16,726**
Growth (pcp)[1]	*(1)%*	*19%*	–
Farmgate Milk Price	9,033	10,235	7,938
Other cost of goods sold	7,688	6,626	6,037
Gross profit	**3,048**	**3,010**	**2,751**
Growth (pcp)[1]	*1%*	*9%*	–
Margin	*15.4%*	*15.1%*	*16.4%*
Normalised EBITDA[2]	**1,520**	**1,494**	**1,388**
Margin	7.7%	7.5%	8.3%
NZ Milk Products	515	420	306
Regional businesses	527	568	598
Eliminations	(14)	17	–
Normalised EBIT[2]	**1,028**	**1,005**	**904**
Growth (pcp)[1]	*2%*	*11%*	–
Margin	*5.2%*	*5.1%*	*5.4%*
Reported EBIT	**987**	**1,028**	**1,078**
Net finance costs	(310)	(406)	(313)
Profit before income tax	**677**	**622**	**765**
Income tax (expense) / credit	(53)	149	(80)
Profit for the period	**624**	**771**	**685**
Capital employed[3]	**11,096**	**10,651**	**10,360**
Return on capital employed[3]	*9.3%*	*9.4%*	*8.7%*

1 pcp means previous corresponding period and is calculated as the percentage change between two comparable periods.

2 A reconciliation of historical profitability to statutory financial information is set out below.

3 Capital employed is calculated as monthly average net assets (excluding derivatives, taxes and investments) other than equity accounted investments plus net debt. Return on capital employed is calculated as normalised EBIT divided by capital employed.

4 FY2010 and FY2011 have been restated to reflect the movement of Quick Service Restaurants (QSR) into NZ Milk Products from ANZ and China foodservices out of NZ Milk Products into Asia / AME. These movements both occurred in FY2012. The comparative in the segment note in the FY2012 financial statements has been restated to reflect this.

Key drivers of EBIT over the period from FY2010 to FY2012 were:

- an increase in price premiums achieved for products sold by NZ Milk Products;
- NZ Milk Products' ability to optimise its product mix, within its capacity and contractual constraints, in response to movements in the prices of products that are not used to calculate the Farmgate Milk Price relative to those that are;
- a fall in profitability of the Australia and New Zealand operations, which continued to be impacted by challenging trading conditions; and
- strong growth in Asia and the Middle East driven by consumer demand for high-quality dairy products and investment in key brands, Anchor™, Fernleaf™, Anlene™ and Anmum™.

SECTION 4
FONTERRA FINANCIAL INFORMATION CONTINUED

The directors of Fonterra believe that the following normalisation adjustments assist potential investors to compare historical and prospective financial information set out in this section. These adjustments have previously been presented in the audited financial statements.

($M)	FY2012	FY2011	FY2010
Normalised EBITDA	**1,520**	**1,494**	**1,388**
Reported depreciation and amortisation	(492)	(489)	(484)
Normalised EBIT	**1,028**	**1,005**	**904**
Impairment losses recorded in equity accounted investees	(8)	–	–
Restructuring costs associated with Fonterra's "Strategy Refresh"	(30)	–	–
Impact of Christchurch earthquakes and Japan earthquake / tsunami	–	(18)	–
Gain on disposal of Western Australia dairy business	–	26	–
Gain on acquisition of RD1	–	23	–
Impact of Chilean earthquake	–	5	(12)
Receipt for amendments to equity accounted investee arrangements	–	–	41
Gain on sale of 25% investment in AFF P/S (joint venture with Arla Foods)	–	–	127
Other	(3)	(13)	18
Total normalisation adjustments	**(41)**	**23**	**174**
Reported EBIT	**987**	**1,028**	**1,078**
Net finance costs	(310)	(406)	(313)
Tax (expense) / credit	(53)	149	(80)
Profit for the period	**624**	**771**	**685**

BUSINESS REVIEW

The financial performance of the four components of Fonterra's business is summarised below. Except as otherwise noted, the Fonterra Financial Information is presented in a format which aligns with Fonterra's historic reportable segments as disclosed in its annual financial statements. These are defined by product type and geographic area to reflect how Fonterra's operations have been managed historically and are as follows:

REPORTABLE SEGMENT	DESCRIPTION
NZ Milk Products[1]	The NZ Milk Products segment encompasses the core New Zealand milk supply chain from collection, manufacturing and logistics through to end sale to business customers and the Fonterra regional businesses. It also includes international milk sourcing, dairy nutrition-related joint ventures, RD1 and the Co-operative's corporate activities.
ANZ	Australia and New Zealand (ANZ) encompasses three separate consumer and out-of-home foodservices businesses, and a dairy processing and manufacturing business that collects approximately 18% of Australia's milk supply.
Asia / AME	Asia / AME comprises Fonterra's consumer and out-of-home foodservices businesses in Asia, Africa and the Middle East. Asia / AME's brands cover a wide range of consumer and customer needs ranging from everyday dairy nutrition under Anchor™, Fernleaf™ and Ratthi™, to advanced nutrition offerings under Anlene™ and Anmum™.
Latam	Latam encompasses Soprole, the market-leading integrated dairy business in Chile, and an investment in Dairy Partners Americas, a 50 / 50 joint venture with Nestlé covering several markets in Latin America including Brazil, Venezuela, Ecuador, Colombia and Argentina.

There have been two changes to the organisation of business units within reported segments during the year ended 31 July 2012, as disclosed in the FY2012 financial statements:

- out-of-home foodservices sales to Quick Service Restaurants (QSR) has been moved from ANZ to NZ Milk Products; and
- China foodservices sales have been moved from NZ Milk Products to Asia / AME.

Comparatives have been restated to reflect these changes.

Additional changes to the organisation of business units from 1 August 2012 (but not reflected in the Fonterra Financial Information) are discussed under the heading "Organisational structure" in Section 1 – *About Fonterra*.

1 NZ Milk Products was formerly described as Standard & Premium Ingredients.

NZ MILK PRODUCTS

Over the period from FY2010 to FY2012, sales volumes increased by 10%, reflecting increased supply of New Zealand milk and growing global demand for Fonterra's dairy nutrition products from business customers and Fonterra's regional businesses. Over the same period, revenue grew 23% from $12.8 billion to $15.7 billion reflecting both sales volume growth and the impact of increased commodity prices.

Normalised EBIT increased by 68% from $306 million to $515 million between FY2010 and FY2012, and EBIT margin from 2.4% to 3.3%.

($M)	FY2012[1]	FY2011	FY2010
Sales volume ('000 MT)	*2,847*	*2,670*	*2,583*
New Zealand-sourced	12,256	11,796	9,678
Other	1,764	1,997	1,591
Inter-segment revenue	1,697	1,800	1,532
Revenue	**15,717**	**15,593**	**12,801**
Growth (pcp)	1%	22%	–
Farmgate Milk Price[2]	(9,033)	(10,235)	(7,938)
New Zealand manufacturing costs	(2,689)	(2,437)	(2,233)
Other cost of goods sold	(2,589)	(1,709)	(1,653)
Gross profit	**1,406**	**1,212**	**977**
Growth (pcp)	*16%*	*24%*	–
Selling and marketing expenses	(106)	(92)	(80)
Distribution expenses	(203)	(161)	(156)
Other operating expenses	(762)	(623)	(540)
Other operating income	102	118	265
Foreign exchange gains / (losses)	9	(75)	(3)
Share of profit of equity accounted investees	45	40	33
Normalisation adjustments	24	1	(190)
Normalised EBIT	**515**	**420**	**306**
Growth (pcp)	*23%*	*37%*	–
EBIT margin	*3.3%*	*2.7%*	*2.4%*
Normalised EBITDA	**895**	**799**	**680**
Capital employed	**6,783**	**6,241**	**5,845**
Return on capital employed	*7.6%*	*6.7%*	*5.2%*

1 FY2010 and FY2011 have been restated to reflect the movement of Quick Service Restaurants into NZ Milk Products from ANZ and China foodservices out of NZ Milk Products into Asia / AME. These movements both occurred in FY2012. The comparative in the segment note in the FY2012 financial statements has been restated to reflect this.

2 As explained in the Milk Price Statement, the Farmgate Milk Price is calculated for a Season to 31 May and Fonterra's financial year runs to 31 July. Hence, there are small timing differences between the Farmgate Milk Price shown in the financial statements and the Milk Price Statement.

Over the period from FY2010 to FY2012, sales volume increased by 10% and weighted average commodity prices rose by 27% in US$ terms, but only 10% in NZ$ terms as a result of the strengthening NZ$:US$ exchange rate. Overall, revenue increased by 23%, and cost of goods sold by 21% over this period. The cost of New Zealand-sourced milk consists of the Farmgate Milk Price together with movements in the value of opening and closing inventories year-on-year, which are shown in other cost of goods sold. Other cost of goods sold also includes the cost of globally-sourced products (which follow global dairy commodity price trends).

As noted in Section 3 – *Setting the Farmgate Milk Price for New Zealand Milk*, changes to US$-denominated prices for dairy products and to the NZ$:US$ exchange rate should largely flow through into the cost of New Zealand-sourced milk through a higher or lower Farmgate Milk Price. This is evident to some extent by changes in the sales of NZ Milk Products being reflected in similar movements in the cost of New Zealand-sourced milk.

A measure of the underlying operational performance of the businesses is contribution margin per MT of sales which is shown in the table below. This measure strips out the impact of both volume changes, and commodity price and exchange rate fluctuations which are in part reflected in the cost of New Zealand milk through the Farmgate Milk Price, and the cost of globally-sourced milk as shown below:

($M)	FY2012	FY2011	FY2010
Sales volume ('000 MT)	*2,847*	*2,670*	*2,583*
Gross profit	**1,406**	**1,212**	**977**
Selling, marketing and distribution expenses	(309)	(253)	(236)
Contribution margin	**1,097**	**959**	**741**
Contribution margin per MT of sales ($)	*385*	*359*	*287*
Growth (pcp)	*7%*	*25%*	–

While changes in commodity prices, exchange rates and milk volumes flow through to the cost of New Zealand-sourced milk to an extent, it is apparent that they do not fully insulate the earnings of the NZ Milk Products business from volatility. This is primarily due to two factors:

- the extent to which the business sells dairy ingredients at prices that differ to the GDT™ (or other benchmark) prices that are relevant in calculating the Farmgate Milk Price. Fonterra may achieve higher prices through offering value-adding customer services and enhanced product specifications. Moreover, between FY2010 and FY2012, Fonterra's forward sale fixed-price commitments were longer-dated than contracts that referenced the Farmgate Milk Price, resulting in earnings exposure in a rising market and earnings contribution in a falling market; and
- the extent to which the business has been able to respond to changes in the relative prices of dairy nutrition products, and the related earnings volatility, by altering its product mix.

Each of these key earnings drivers is explained further below. A number of changes implemented by Fonterra have enabled NZ Milk Products to manage these factors, thereby improving earnings sustainably and reducing exposure to volatility.

The way in which the Farmgate Milk Price is derived also means that there are other avenues for NZ Milk Products to build sustainable earnings. In particular, the capital cost implicit in the Farmgate Milk Price, together with scale and scope efficiencies that arise from new investment, means that additional processing capacity should be expected to at least recover the weighted average cost of capital used in the Farmgate Milk Price calculation. Fonterra has also obtained operational efficiencies unrelated to new investment since FY2010. These benefits generally flow through to improved earnings for a period of time.

PRICE PREMIUMS ABOVE GDT™

A key driver of core NZ Milk Products EBIT growth is the ability to sell products at a premium to the Farmgate Milk Price benchmark, or effectively the prevailing GDT™ price.

GDT™ has been the catalyst for a fundamental change in the NZ Milk Products sales approach, providing a benchmark that has contributed to enhanced disciplines around product pricing, as well as operational efficiency from a more standard range of products offered for sale on GDT™. Superior pricing visibility has enabled customers and Fonterra to assess the value of additional selling services, product customisation and warehousing. GDT™ now represents the minimum pricing benchmark for the sale of Reference Commodity Products that are marketed through that auction platform.

NZ Milk Products typically enters into contracts under which prices for dairy nutrition products are agreed before products are shipped (referred to below as the contract-price horizon). This includes the sales prices of Reference Commodity Products used to calculate the Farmgate Milk Price. The Farmgate Milk Price reflects Fonterra's actual contract-price horizon provided this is five months or less (eight months for the 2011 / 2012 Season and prior). NZ Milk Products holds contracts with a longer contract-price horizon, but has reduced these significantly over the period from FY2010 to FY2012 (reflected in the shortened period now used in the Farmgate Milk Price calculation) and charges a risk-related premium for customers that require a longer contract-price horizon.

The impact of NZ Milk Products having a longer contract-price horizon than that used in the Farmgate Milk Price calculation is that changes in commodity prices pass through to the cost of milk more quickly than they do to NZ Milk Products' revenue. If commodity prices are rising, this is likely to have a negative impact on earnings. If commodity prices are falling, the opposite is likely to occur.[1] This has had an adverse effect on NZ Milk Products' EBIT in FY2011, with commodity prices rising significantly during that period. The opposite occurred in FY2012.

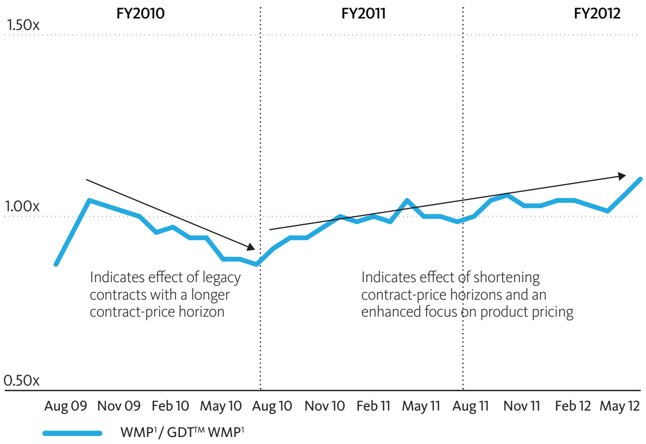
NZ Milk Products has actively reduced its exposure to long contract-price horizon sales arrangements. This is reflected in a reduction in sales volumes of whole milk powder related to contracts where prices were agreed more than five months prior to shipment, from 22% in FY2010 to 11% in FY2011 and 4% in FY2012. This should materially reduce the effect of the contract-price horizon on earnings in future periods.

Improvement in actual price premiums relative to GDT™ between FY2010 and FY2012 is indicated by the relationship between actual whole milk powder prices and GDT™ whole milk powder prices. Chart 1 represents NZ Milk Products' monthly volume weighted average commodity whole milk powder net revenue per tonne divided by net revenue per tonne of whole milk powder sold on GDT™ (whole milk powder price index). While the chart is indicative only of a broad trend, it nonetheless illustrates the effect of a reduced contract-price horizon for products sold through channels other than GDT™ noted above. The adverse effect of legacy non-GDT™ sales with a long contract-price horizon in a period of rising GDT™ prices is indicated in the last half of FY2010 and the first half of FY2011 (refer to the chart below). With a much shorter average contract-price horizon since then, the impact of changes in commodity prices should have a lesser effect on earnings volatility in future periods.

1 Note the same effect also results from the use of formulaic contracts that are based on historical pricing.

CHART 1

WHOLE MILK POWDER PRICE INDEX

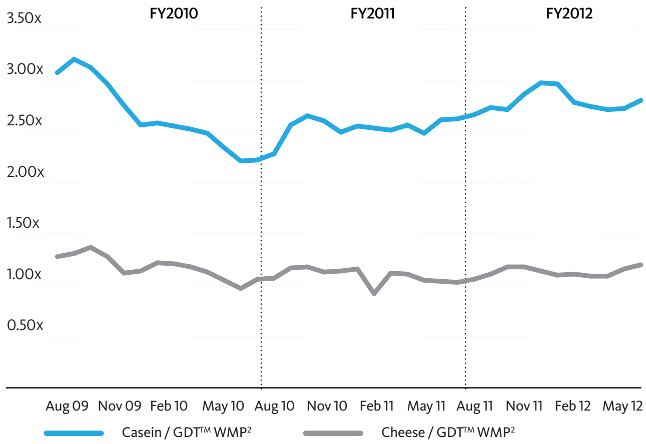


Source: Fonterra

1 WMP means whole milk powder.

CHART 2

CHEESE AND CASEIN RELATIVE PRICE INDICES[1]



Source: Fonterra

1 It is important to note that the effect described above is illustrated by comparing the index of the prices of whole milk powder and the main non-Reference Commodity Products over the time period (cheese being the largest non-Reference Commodity Product by value). The earnings impact of relative price changes of various products over time also depends on returns from by-products that result from using the full volume of milk, such as lactose and whey in the case of cheese. It is relative returns across streams that affect earnings and product mix decisions. Relative stream returns are not shown on this chart. Accordingly, relative headline price differences should be interpreted with caution.

2 WMP means whole milk powder.

RELATIVE PRICE EFFECT

Fonterra's NZ Milk Products business manufactures approximately 20% to 25% of New Zealand-sourced milk into products that do not form part of the Farmgate Milk Price calculation, such as cheese and protein products derived from whey and casein.

Relative prices of Reference Commodity Products that are taken into account in the calculation of the Farmgate Milk Price and prices obtained by Fonterra for other dairy nutrition products often vary over time. If the prices of Reference Commodity Product streams increase relative to those other dairy ingredients (like cheese and its by-products), the impact on NZ Milk Products' EBIT is unfavourable, and *vice versa*.

An example of the relationship between the relative prices of Reference Commodity Products and other dairy nutrition products is illustrated in Chart 2 which shows actual prices compared to GDT™ whole milk powder prices over the period from FY2010 to FY2012. Chart 2 represents Fonterra's monthly weighted average commodity cheese and casein net revenue per tonne divided by net GDT™ whole milk powder revenue per tonne.

A decline in average prices of cheese and related products relative to GDT™ whole milk powder prices in FY2011 compared to FY2010 is indicative of a negative impact on core NZ Milk Products' EBIT in FY2011. Fonterra was able to partly offset this adverse relative price movement, within capacity constraints, through changes to its product mix. The opposite trend was observed between FY2011 and FY2012, indicative of a positive impact on NZ Milk Products' EBIT.

SECTION 4 FONTERRA FINANCIAL INFORMATION CONTINUED

Variability in relative prices between Reference Commodity Products and other dairy nutrition products such as cheese (and its by-products) and casein can have a significant impact on the earnings of NZ Milk Products. For example, if the relative price of other dairy nutrition products compared to that for Reference Commodity Products changes by ±5%, then, other factors aside, the potential impact on FY2013 EBIT is estimated at ±$125 million (refer to the sensitivity analysis later in this section in connection with the Fonterra Prospective Financial Information).

This variability in relative prices (referred to as stream returns) can arise because globally-traded prices of products such as cheese can be less responsive to changes in global supply and demand dynamics than milk powder products. Among other things, this reflects higher trade barriers for cheese, with a broader reach of quotas, licences or high tariffs in key markets like Japan, Korea, the United States and Europe. For example, around two thirds of New Zealand's cheese is exported to markets with duties of 20% or more. This is the case for only about one fifth of whole milk powder exports. The less constrained trade environment for non-cheese products has contributed to new cheese capacity representing less than 5% of total capacity growth in New Zealand over the last decade.

Fonterra can mitigate the short-term impact of relative changes in stream returns through product mix optimisation in its NZ Milk Products operation, subject to constraints on capacity during periods of peak production and existing long-term volume commitments to consumer brands customers (including the regional businesses). Fonterra is also increasingly reflecting the implications of long-term product commitments on its mix flexibility in its general pricing terms, as well as its expected margins from its own downstream consumer and out-of-home foodservices businesses.

IMPLICATIONS OF ADDITIONAL INVESTMENT IN CAPACITY

The Farmgate Milk Price incorporates a capital cost related to the asset base assumed in the Farmgate Milk Price calculation. This allowance for a return on invested capital as a cost in calculating the Farmgate Milk Price means that Fonterra should expect to meet or slightly exceed recovery of depreciation and weighted average cost of capital on incremental capital investment over time. This is particularly the case if, for example, new capacity offers other benefits such as overhead and operating cost efficiencies.

In order to process the growing volume of milk supplied, Fonterra commissioned the ED4 milk powder plant at Edendale in FY2010 and has spent approximately $245 million over the period from FY2010 to FY2012 on additional capacity at Darfield, also in the South Island. Further investment in new processing capacity at Darfield is planned for FY2013. A key impact of this investment profile is an increased focus on the production of whole milk powder (and its by-products). This is illustrated in Chart 3 below.

The new capacity is of world scale. As a capital intensive business, NZ Milk Products benchmarks its performance using return on capital employed, which in FY2012 was 7.6%.

OTHER OPERATING EXPENSES AND INCOME

Other operating expenses increased from $540 million in FY2010 to $762 million in FY2012. The acquisition of RD1 and the operating costs of China farms have added $58 million to the cost base, and FY2012 included $24 million primarily of restructuring costs associated with the Strategy Refresh, as well as other operational expenses of $61 million (such as impairments and increases in debtor provisioning) that relate to issues specific to FY2012.

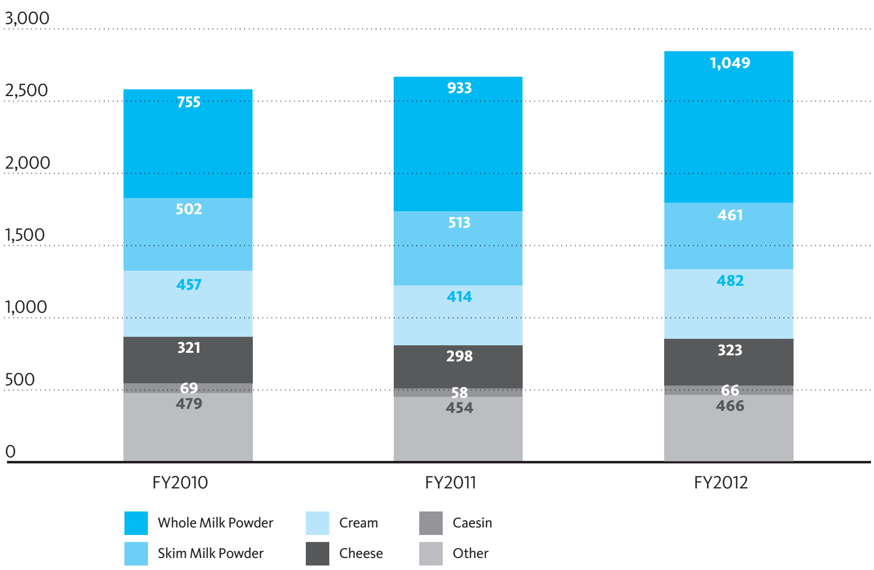
Other operating income in FY2010 included the benefit of the gain on sale of Fonterra's 25% investment in AFF P/S of $127 million, a butter joint venture with Arla Foods in Europe.

Foreign exchange gains and losses include the cost of options used to hedge sales receipts which are mainly in US$. The benefits and premium cost of these hedges is taken into account in calculating the Farmgate Milk Price.

Income from the nutrition joint ventures with Dairiconcepts and DMV Fonterra Excipients increased by 36% over the period from FY2010 to FY2012. This growth trend is expected to continue following the divestment by Dairiconcepts of a loss-making plant in FY2012.

CHART 3

SALES VOLUME IN '000 MT BY PRODUCT



Source: Fonterra

AUSTRALIA AND NEW ZEALAND (ANZ)

Over the period from FY2010 to FY2012, ANZ revenue increased by 12% after adjusting for the Western Australia dairy business that was sold in FY2011. Although the consumer business has faced price and volume pressure, the out-of-home foodservices business has remained stable and revenue from the dairy nutrition business has grown by 26%, reflecting both volume growth and increased commodity prices.

Normalised EBIT has declined by 33% to $204 million primarily due to the challenging trading environment and level of investment made to support market share in key consumer brands and categories.

($M)	FY2012[1]	FY2011	FY2010
Sales volume ('000 MT)	*959*	*1,096*	*1,054*
Revenue – consumer and out-of-home foodservices	2,414	2,582	2,381
Revenue – dairy nutrition	1,812	1,925	1,435
Eliminations (intra-segment)	(378)	(267)	(134)
Revenue[2]	**3,848**	**4,240**	**3,682**
Gross profit	**780**	**898**	**933**
Gross profit	*20.3%*	*21.2%*	*25.3%*
Normalised EBIT[2]	**204**	**256**	**303**
EBIT margin	*5.3%*	*6.0%*	*8.2%*
Normalised EBITDA	**281**	**336**	**385**
Capital employed	**2,873**	**3,022**	**2,991**
Return on capital employed	*7.1%*	*8.5%*	*10.1%*

1 FY2010 and FY2011 have been restated to reflect the movement of Quick Service Restaurants into NZ Milk Products from ANZ. This movement occurred in FY2012. The comparative in the FY2012 segment note in the financial statements has been restated to reflect this.

2 Revenue of $244 million in FY2010 and $159 million in FY2011, and EBIT of $17 million in FY2010 and $5 million in FY2011, relates to business activities in Western Australia that were divested in FY2011.

The trading environment in Australia and New Zealand has been challenging over the last two years. This has been driven by weak consumer spending and the resulting increase in pressure on pricing to maintain volume and market share. Market conditions have been further affected by new entrants in cheese and yoghurt categories. In addition, the retail grocery channel in Australia is dominated by two major supermarket groups. Both groups have responded to the soft consumer environment with increased pressure on pricing. This has resulted in significantly increased pressure on brand owners to reduce price and increase promotional spend in order to protect distribution and defend market share.

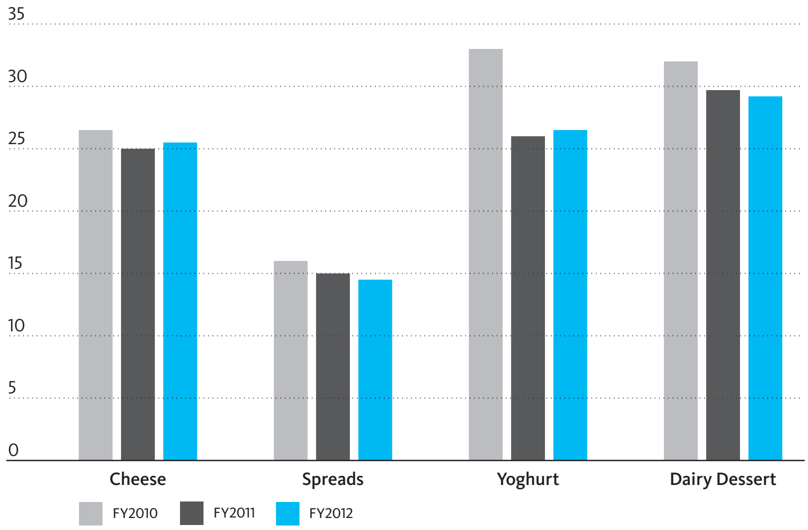
SECTION 4
FONTERRA FINANCIAL INFORMATION CONTINUED

Over the period from FY2010 to FY2012, after adjusting for the divestment of Fonterra's Western Australia consumer business, total consumer and out-of-home foodservices revenue increased 13%, primarily reflecting selective price increases in response to higher commodity prices. However, to maintain market share, Fonterra, like its competitors, significantly increased trade and promotional spend, which is reflected in a material reduction in gross profit percentage for the overall ANZ business. Fonterra experienced market share declines across all major dairy categories in Australia between FY2010 and FY2011. This was most notable in the yoghurt category where Fonterra experienced a significant increase in new competitive entrants and restricted supply due to commissioning of its new capacity at its Echuca factory. These share declines have generally stabilised in FY2012, as shown in Chart 4.

Earnings volatility through the price and retail pressure in the Australian market is expected to continue, and has been a catalyst for Fonterra to reposition its consumer business in Australia and New Zealand. This includes product and brand rationalisation, a reassessment of advertising and promotional priorities, and a restructure of overhead costs. While New Zealand has seen similar trends in price competition to Australia, the impact on earnings has been less significant. In contrast over this period, the out-of-home foodservices businesses remained stable and revenue growth from Fonterra's significant dairy nutrition business in Australia was 26%. This reflected an increase in volumes of 10% and an increase in average selling prices of 15%, which was broadly in line with changes in international commodity prices in FY2012. Earnings for the dairy nutrition business in FY2012 were consistent with those achieved in FY2010.

CHART 4

AUSTRALIAN VOLUME MARKET SHARE BY PRODUCT CATEGORY



Source: Fonterra analysis of published market data

ASIA / AME

Continued investments in support and expansion of the core regional brands Anchor™, Fernleaf™, Anlene™ and Anmum™ strengthened Asia / AME's share position in markets with a growing demand for quality dairy nutrition.

Sales volume grew by 8% over the period from FY2010 to FY2012. Sales revenue grew 15%, ahead of volume due to price increases to recover rising commodity costs and a faster growth of the higher-value products in the brand portfolio.

Collectively, Fonterra's four core regional brands accounted for approximately two thirds of Asia / AME revenues.

Normalised EBIT has increased by 10% from $176 million to $194 million between FY2010 and FY2012, and EBIT margin remained above 10%, despite significant levels of investment in advertising and promotional activities in emerging markets, primarily China.

($M)	FY2012[1]	FY2011	FY2010
Sales volume ('000 MT)	*264*	*256*	*245*
Revenue[2]	**1,855**	**1,793**	**1,614**
Gross profit	**631**	**611**	**602**
Gross profit	*34.0%*	*34.1%*	*37.3%*
Selling and marketing expenses as a % of revenue	*15.4%*	*14.9%*	*17.5%*
Normalised EBIT	**194**	**193**	**176**
EBIT margin	*10.5%*	*10.8%*	*10.9%*
Normalised EBITDA	**204**	**202**	**185**
Capital employed	**773**	**721**	**721**
Return on capital employed	*25.1%*	*26.8%*	*24.4%*

1 FY2010 and FY2011 have been restated to reflect the movement of China foodservices out of NZ Milk Products into Asia / AME. This movement occurred in FY2012. The comparative in the segment note in the FY2012 financial statements has been restated to reflect this.

2 FY2010 revenue is $35 million higher than that for FY2011 and FY2012 on a comparable basis due to reclassification of trade spend from operating expenditure to revenue.

Fonterra's strong growth in Asia / AME was underpinned by rising consumer demand for the high-quality dairy nutrition brands Anchor™ and Fernleaf™, and a focused investment in the development of Fonterra's advanced nutrition brands Anlene™ and Anmum™. Each of these brands has a clearly-defined consumer proposition and, in the case of Anchor™, supports the out-of-home foodservices business as well. This is reflected in increases in the volume and market share of all these brands in their respective market segments.

The most significant growth market for out-of-home foodservices has been China, where Asia / AME has established a business with a significant position in core bakery categories. The Asia / AME business has also invested in launching the Anlene™ and Anmum Materna™ brands commencing in Guangzhou in FY2010, with distribution having reached 12 cities by the end of FY2012.

The brands business in China is in a growth phase supported by significant investments in advertising and promotion, and is forecasting to hit a key milestone of generating positive EBIT in Guangzhou in FY2013 (with positive EBIT in other cities thereafter).

Growth across Asia / AME was achieved despite a number of challenges including a tightening regulatory environment, supply constraints in Indonesia and Thailand, dairy market challenges in the Philippines and the exceptional political turbulence in the Middle East, which had a significant impact.

Gross profit increased to $631 million in FY2012. After adjusting for the changes in the presentation of trade spend from FY2010 onwards, this represented growth of 11%. This rate is lower than that for revenue growth, primarily due to the significant investment in trade spend in key growth markets.

Investment in operating expenses increased by $47 million or 12% between FY2010 and FY2012 on a comparable basis (adjusting for the presentation of trade spend), to deliver a strong product innovation pipeline in everyday dairy, bone health and paediatric nutrition, and to expand proven Anchor™, Fernleaf™, Anlene™ and Anmum™ marketing programmes in both established and developing markets. Also, significant investments were made in selling and marketing capability for both the consumer and the out-of-home foodservices businesses. A significant part of the investment went into incremental selling and marketing activity in China and Vietnam, to support the expansion of Anlene™ and Anmum™.

SECTION 4
FONTERRA FINANCIAL INFORMATION CONTINUED

LATAM

Soprole is Chile's largest dairy company with a market share of approximately 30% by value and 31% by volume of the Chilean consumer dairy market. The Soprole™ brand is among the most recognised and valued by consumers across all industries in Chile.

Dairy Partners Americas is an integrated consumer dairy and milk processing business. Dairy Partners Americas' operating environment is challenging. Fonterra recognises its share of Dairy Partners Americas' earnings, as well as other income (including royalties).

($M)	FY2012	FY2011	FY2010
Sales volume ('000 MT)	*319*	*312*	*312*
Revenue – Soprole[1]	**805**	**830**	**738**
Gross profit – Soprole[1]	**245**	**272**	**239**
Gross profit[1]	*30.4%*	*32.8%*	*32.4%*
Selling and marketing expenses as a % of revenue[1]	*6.1%*	*10.2%*	*10.0%*
Normalised EBIT – Soprole	**83**	**78**	**76**
EBIT margin	*10.3%*	*9.4%*	*10.3%*
Normalised EBIT – Fonterra's share of earnings from Dairy Partners Americas (including royalties)	**46**	**41**	**43**
Normalised EBIT – Latam	**129**	**119**	**119**
Normalised EBITDA – Latam[2]	**154**	**140**	**138**
Capital employed – Latam	**671**	**685**	**804**
Return on capital employed	*19.2%*	*17.4%*	*14.8%*

1 Selling and marketing expenses include promotional costs of $34 million in FY2010 and $38 million in FY2011. In FY2012, $40 million of promotional costs were reclassified as a deduction from external revenue.

2 Normalised EBITDA – Latam is the sum of EBITDA for Soprole and earnings from Dairy Partners Americas.

SOPROLE

Soprole has a strong focus on continuous innovation, reflected by a target of 35% to 40% of consumer sales being from products launched within the last three years. The success of this focus on innovation is reflected in the premium for the Soprole™ brand.

Total volume increased by 2% over the period from FY2010 to FY2012. In contrast, revenue increased by 14% over the same period, after adjusting for the reclassification of promotional costs. This outcome reflects an improved product mix towards higher-value-add products, despite some capacity constraints in yoghurts and dairy desserts. The improved product mix was underpinned by continued success with new product innovation, with an increase in volumes in the higher-margin dairy product categories like yoghurt, dairy desserts and butter, and reduced volumes in the lower-margin white fresh milk category. Soprole began implementation of a project to increase its yoghurt production capacity, which is expected to be completed in January 2013.

Gross profit increased by 19% over the period from FY2010 to FY2012, reflecting the factors noted above and after adjusting for the reclassification of promotional costs.

Higher gross profit was partially offset by increased investment in advertising and promotion to support the Soprole™ brand, and higher freight and third party warehousing costs pending completion of a new central distribution centre in August 2013. Normalised EBIT in FY2012 of $83 million was 6% higher than that for FY2011 (and 14% higher on a constant currency basis).

DAIRY PARTNERS AMERICAS

Earnings from Dairy Partners Americas in FY2012 were $46 million (after normalising for an impairment of $8 million in the value of the investment in Venezuela), $3 million higher than FY2010. Adjusting for a $19 million benefit arising from the review of manufacturing cost recovery arrangements with Dairy Partners Americas in FY2012 (which is not expected to reoccur), earnings were $16 million lower than in those for FY2010 at $27 million (down 37%). In Brazil, price increases introduced in response to higher commodity prices have reduced market share, and in Venezuela, where there is political and economic instability, price controls exist across major categories and inflation rates are high. In Ecuador, flooding in large parts of the country disrupted distribution channels for two months during FY2012.

OTHER CONSOLIDATED FINANCIAL INFORMATION

TAX

Fonterra's offshore companies are taxed in the jurisdiction in which they are resident at the relevant corporate tax rate. No credit for that tax is available in New Zealand, but dividends repatriated are exempt from tax in most cases. The tax paid overseas is consolidated into Fonterra's overall tax expense in its financial statements.

In New Zealand, Fonterra is taxed under the co-operative companies tax regime under the Income Tax Act. Under this regime, all payments to Farmer Shareholders for milk (including any dividend portion) are deductible to Fonterra. This has meant that Fonterra has been in a tax loss position since 2002. Dividends paid by Fonterra that are deductible for tax purposes by Fonterra are taxed in the hands of Farmer Shareholders. Hence, New Zealand tax is paid in respect of Fonterra's activities.

Excluding the impact of tax deductible dividends (that are available because of Fonterra's co-operative ownership structure) and the impact of deferred tax, Fonterra's effective tax rate is below the standard rate of tax in New Zealand and ranged from 22.6% to 27.2% over the period from FY2010 to FY2012.

($M)	FY2012	FY2011	FY2010
Profit before tax	**677**	**622**	**765**
Prima facie tax expense (28% / 30% / 30%)	190	187	230
Effect of tax rates in foreign jurisdictions	(11)	(9)	(16)
Impact of non-assessable income and non-deductible expenses	(17)	(8)	(17)
Impact of prior year under / (over) provision	1	(1)	(24)
Tax expense before the impacts of distributions to Shareholders and deferred tax recognition / de-recognition	**163**	**169**	**173**
Effective tax rate excluding distributions and deferred tax	*24.1%*	*27.2%*	*22.6%*
Tax effect of distributions to Shareholders	(128)	(116)	(109)
Tax expense before the impacts of deferred tax recognition / de-recognition	**35**	**53**	**64**
Impact of recognition / de-recognition of deferred tax	18	(202)	16
Tax expense / (credit)	**53**	**(149)**	**80**

In FY2011, the deferred tax credit includes the impact of the transfer of the Anchor™ and Fernleaf™ brands from New Zealand to Asia / AME, the impact of a restructure of the Soprole business in Chile and the sale of the Western Australia dairy business.

SECTION 4
FONTERRA FINANCIAL INFORMATION CONTINUED

CAPITAL EXPENDITURE

NZ Milk Products accounted for $1.5 billion or 74% of capital expenditure over the period from FY2010 to FY2012. This expenditure primarily related to investments in New Zealand milk processing and supply chain assets, as well as the development of international farming ventures and a major information technology implementation. The remainder was invested in the regional businesses, most notably ANZ.

($M)	FY2012	FY2011	FY2010
NZ Milk Products	645	470	378
ANZ	181	135	74
Asia / AME	19	17	13
Latam	43	22	27
Total capital expenditure	**888**	**644**	**492**

Other than essential replacement capital expenditure, Fonterra made significant investments over the period from FY2010 to FY2012 in new capacity to process growth in New Zealand milk volumes, primarily in the South Island. Darfield is Fonterra's (and its predecessors') first greenfield processing development site in approximately 16 years, at an approximate capital cost of $245 million. The first dryer has now been commissioned and the plant was opened in August 2012. A second, larger dryer is now under construction. As described in Section 3 – *Setting the Farmgate Milk Price for New Zealand Milk*, replacement and new capacity capital expenditure should generally be expected to earn a return at or somewhat above the Farmgate Milk Price cost of capital over the life of the investment.

Fonterra has invested in developing offshore secure sources of quality milk as part of its strategy to access developing dairy markets with both local and New Zealand-sourced milk products. Between FY2010 and FY2012, approximately $100 million was invested in farms in China, and a pilot farm in Brazil.

ANZ includes an asset base to process milk sourced in Australia into consumer and dairy nutrition products. As a result, this business has higher capital expenditure requirements than those for Asia / AME and Latam. Other than essential replacement capital expenditure that broadly matches depreciation, ANZ invested approximately $135 million in business transformation projects. This included an enterprise-wide system in the ANZ business to replace legacy systems across the business. It also included investment to increase capacity in ANZ's Echuca factory to integrate the Nestlé Ski® yoghurt volume previously sourced from a third party.

WORKING CAPITAL

Working capital accounts for a significant proportion of Fonterra's total capital employed, and is driven by a number of specific factors, most notably:

- seasonality of milk production – resulting in a build up to peak inventories and amounts owing to farmer suppliers during a Season. Decisions taken regarding the optimal timing of sales can also impact inventory levels; and
- commodity prices and foreign exchange rates – directly impacting the value of accounts receivable and inventories, and via the Farmgate Milk Price directly impacting the value of amounts owing to farmer suppliers. This is independent of underlying working capital volumes.

The table below summarises net working capital on a half and full-financial year basis (31 January and 31 July) over the period from FY2010 to FY2012:

	FY2012	FY2012	FY2011	FY2011	FY2010	FY2010
($M)	2H	1H	2H	1H	2H	1H
Trade and other receivables	2,302	2,693	2,279	2,358	2,088	2,318
Inventories	2,981	5,204	3,277	5,207	2,870	4,236
Owing to farmer suppliers	(1,083)	(2,641)	(1,679)	(2,966)	(1,138)	(2,014)
Trade and other payables	(1,386)	(1,391)	(1,350)	(1,258)	(1,251)	(1,237)
Other	38	5	83	63	60	48
Working capital	**2,852**	**3,870**	**2,610**	**3,404**	**2,629**	**3,351**
Average working capital days[1]	*68*	*62*	*58*	*59*	*64*	*63*

1 Average working capital days is calculated as the average working capital for the six-month period divided by external revenue for the six-month period multiplied by the number of days in the six-month period.

A step up in inventories value between FY2010 and FY2011 primarily reflects an increase in commodity prices, with inventories volumes maintained at broadly similar levels. Inventories value in FY2012 reflects the opposite effect with lower commodity prices driving a lower value despite unusually high New Zealand milk supply resulting in higher year-end inventories volumes.

Similarly, a step up in amounts owing to farmer suppliers in FY2011 primarily reflects the impact of higher commodity prices on the Farmgate Milk Price. Falling commodity prices and therefore a lower forecast Farmgate Milk Price over the course of the 2011 / 2012 Season resulted in high early "advance rate" payments for milk in FY2012, and a sharp decline in amounts owing to farmer suppliers at the end of FY2012. This was an important factor impacting net working capital days.

CREDIT RATING AND BORROWINGS

Fonterra has a long-term senior unsecured issuer credit rating of A+ stable from Standard & Poor's (Australia) Pty Limited and AA- stable from Fitch Australia Pty Limited. These credit ratings reflect among other things, the effective subordination of payments for New Zealand-sourced milk behind payments to other creditors, the market-based nature of the Farmgate Milk Price, and Fonterra's globally competitive cost position. The Fund has not been assigned a credit rating.[1]

The Constitution provides that the total payment made to suppliers each Season for New Zealand-sourced milk is determined by the Fonterra Board, having regard to the income from all activities of Fonterra less its costs, which includes debt obligations. The directors' duties under the Companies Act mean they may not set a final payment for such milk which jeopardises Fonterra's ability to meet those debt obligations.

The Constitution also authorises the Fonterra Board to determine interim milk payments, and these have traditionally been made each month. If the interim payments are made at a rate which is higher or lower than that which later market conditions justify, they can be adjusted in later months and Fonterra makes a further payment or receives a repayment from the supplier. This places Fonterra in the position of being a contingent creditor of suppliers to the extent of any such overpayment. This means that, for practical purposes, the milk payments are subordinated to other obligations of Fonterra (Effective Subordination).

Once the total milk payment has been determined and announced by the Fonterra Board in respect of any Season, the final amount unpaid is an unsecured obligation of Fonterra ranking pari passu with all other unsecured obligations (as recorded in the financial statements).

As at 31 July 2012, the Fonterra Group had outstanding economic net interest bearing debt of $4,229 million (net interest bearing debt together with debt-related derivatives). This represented an economic debt to debt plus equity ratio of 39.1%. The average maturity of the gross outstanding debt was four years. Fonterra is the borrower under most of these facilities. No facility, where Fonterra is the sole borrower (as distinct from where Fonterra is a joint borrower under a facility with a subsidiary, in which case the borrowers guarantee each other), is guaranteed by any subsidiary (or any other person). Some of the facilities contain a financial covenant that limits the maximum amount of secured (where Fonterra has granted that security) and subsidiary borrowings to no more than 20% of the Fonterra Group's total assets. The Fonterra Group also had committed undrawn bank facilities of $3,565 million as at 31 July 2012.

Gearing

($M)	FY2012	FY2011	FY2010
Current borrowings[1]	1,204	444	902
Term borrowings	3,745	4,206	4,022
Total borrowings	**4,949**	**4,650**	**4,924**
Cash and cash equivalents[1]	(991)	(762)	(534)
Other non-current assets (advances)	(125)	(122)	(122)
Net interest bearing debt	**3,833**	**3,766**	**4,268**
Economic net interest bearing debt	**4,229**	**4,331**	**4,494**
Equity less cash flow hedge reserve[2]	6,592	6,025	5,526
Debt to debt plus equity ratio	36.8%	38.5%	43.6%
Economic debt to debt plus equity ratio	39.1%	41.8%	44.9%

1 Bank overdrafts of $42 million in FY2012, $23 million in FY2011 and $25 million in FY2010 are included within cash and cash equivalents in this table, but are included within current liabilities on the balance sheet.

2 This represents, in FY2012, total equity of $6,655 million less $63 million of cash flow hedge reserve, in FY2011, total equity of $6,541 million less $516 million of cash flow hedge reserve, and in FY2010, total equity of $5,667 million less $141 million of cash flow hedge reserve.

The Fonterra Group borrows a mixture of fixed and variable rate funds in a range of currencies and uses interest rate and currency derivatives to manage the volatility of finance costs. These derivatives are used to manage economic risks. International Financial Reporting Standards (IFRS) require derivative instruments to be held at fair value, and the valuation of cross currency interest rate swaps to take into account movements in basis risk. Basis risk is non-cash, and while its value changes over the life of the derivative, it reverts to zero by maturity. The increase in net finance costs in FY2011 primarily relates to movements in the value of the basis risk on the derivative instruments.

1 A credit rating is not a recommendation to invest in any securities issued by Fonterra or the Fund and may be subject to revision, suspension or withdrawal at any time. Further information about the credit ratings referred to in this Offer Document is available at www.standardandpoors.com and at www.fitchratings.com/creditdesk/public/ratings_definitions/index.cfm. Neither Standard & Poor's (Australia) Pty Limited nor Fitch Australia Pty Limited has been involved in the preparation of this Offer Document. Neither Standard & Poor's (Australia) Pty Limited nor Fitch Australia Pty Limited makes any representation or warranty, express or implied, as to, nor assumes any responsibility or liability for the authenticity, origin, validity, accuracy or completeness of, or any errors or omissions in, any information, statement, opinion or forecast contained in this Offer Document or any previous accompanying or subsequent material or presentation.

SECTION 4
FONTERRA FINANCIAL INFORMATION CONTINUED

HISTORICAL FINANCIAL POSITION AND CASH FLOWS

Fonterra made a significant investment in new capacity to process growing New Zealand milk volumes over the period from FY2010 to FY2012. This was complemented by focused investment in international farms, most notably in China, as part of a strategy to establish offshore secure sources of quality milk and integrated downstream businesses.

Although volatility in commodity prices and currency has a limited impact on Fonterra's EBIT, it was a key factor driving the level of investment in working capital over the period from FY2010 to FY2012, primarily through the impact on valuation of inventories and accounts receivable.

FINANCIAL POSITION

($M)	FY2012	FY2011	FY2010
Cash and cash equivalents	1,033	785	559
Trade and other receivables	2,302	2,279	2,088
Inventories	2,981	3,277	2,870
Other current assets	376	1,219	570
Total current assets	**6,692**	**7,560**	**6,087**
Property, plant and equipment	4,569	4,326	4,356
Equity accounted investments	439	429	458
Intangible assets[1]	2,882	2,748	2,756
Other non-current assets	535	467	512
Total non-current assets	**8,425**	**7,970**	**8,082**
Total assets	**15,117**	**15,530**	**14,169**
Bank overdraft and borrowings	1,246	467	927
Trade and other payables	1,386	1,350	1,251
Owing to farmer suppliers	1,083	1,679	1,138
Other current liabilities	410	150	242
Total current liabilities	**4,125**	**3,646**	**3,558**
Borrowings	3,745	4,206	4,022
Other non-current liabilities	592	1,137	922
Total non-current liabilities	**4,337**	**5,343**	**4,944**
Total liabilities	**8,462**	**8,989**	**8,502**
Net assets	**6,655**	**6,541**	**5,667**
Co-operative shares	5,690	5,261	5,016
Retained earnings	1,078	943	547
Foreign currency translation reserve	(211)	(217)	(73)
Cash flow hedge reserve	63	516	141
Equity attributable to Shareholders of the Parent	**6,620**	**6,503**	**5,631**
Non-controlling interests	35	38	36
Total equity	**6,655**	**6,541**	**5,667**

1 Intangible assets primarily represent a combination of brands and goodwill. Key components are the value recognised during the formation of Fonterra in 2001, goodwill related to acquisitions in the New Zealand consumer business during FY2006, and goodwill relating to the increase in Fonterra's ownership interest in Soprole during FY2008.

CASH FLOW

($M)	FY2012	FY2011	FY2010
Normalised EBITDA	**1,520**	**1,494**	**1,388**
Non-cash items:			
Unrealised foreign exchange losses / (gains)	221	(184)	(77)
Movement in provisions	68	(10)	(37)
Other non-cash items	(7)	(4)	(8)
Total non-cash items	**282**	**(198)**	**(122)**
Change in working capital[1]	(346)	(45)	185
Net tax paid	(66)	(61)	(19)
Normalised net cash flows from operating activities	**1,390**	**1,190**	**1,432**
Capital expenditure[2]	(857)	(623)	(492)
Normalised net cash flows from operating activities after capital expenditure	**533**	**567**	**940**

1 Excludes non-cash movements and items classified as financing / investing.
2 Represents cash outflows actually incurred in the period in respect of the acquisition of property, plant and equipment and intangible assets.

A reconciliation of historical cash flow to operating cash flow in the audited financial statements is set out below. This reflects the operating cash flow impact of the normalisation adjustments described above.

($M)	FY2012	FY2011	FY2010
Normalised net cash flows from operating activities after capital expenditure	**533**	**567**	**940**
Capital expenditure	857	623	492
Operating cash impact of adjustments to EBITDA	–	(6)	47
Historical net cash flow from operating activities as reported	**1,390**	**1,184**	**1,479**

SECTION 4 FONTERRA FINANCIAL INFORMATION CONTINUED

FONTERRA PROSPECTIVE FINANCIAL INFORMATION

The Offer is an offer to subscribe for Units in the Fund. Since the performance of the Units will be related to Fonterra's performance, this section sets out the Fonterra Prospective Financial Information.

The Fonterra Prospective Financial Information has been prepared on the basis of the Fonterra Board's assessment of Fonterra's business activities, and is based on the assumptions and accounting policies detailed on pages 95 and 107 to 112. The Fonterra Prospective Financial Information, including the assumptions underlying it and all other required disclosures, has been prepared by and is solely the responsibility of the Fonterra Board. The Fonterra Board approved the Fonterra Prospective Financial Information on 13 August 2012 (and reconfirmed on 25 October 2012) for use in this Offer Document.

The Manager and the Board of the Manager have not been involved in the preparation of the Fonterra Prospective Financial Information. Neither the directors of Fonterra nor any other person can provide any assurance that the Fonterra prospective financial performance will be achieved.

The Fonterra Prospective Financial Information has been prepared for the purpose of the Offer and may not be suitable for any other purpose.

This section contains prospective financial information for Fonterra that has been prepared in accordance with Financial Reporting Standard No. 42: *Prospective Financial Statements* (FRS-42), including:

- a prospective consolidated income statement for Fonterra for the year ending 31 July 2013;
- a prospective consolidated statement of comprehensive income for Fonterra for the year ending 31 July 2013;
- a prospective consolidated statement of changes in equity for Fonterra for the year ending 31 July 2013;
- a prospective consolidated statement of financial position for Fonterra as at 31 July 2013; and
- a prospective consolidated statement of cash flows for Fonterra for the year ending 31 July 2013,

  (together the Fonterra Prospective Financial Information);
- a description of the Fonterra Board's best estimate assumptions that underpin the Fonterra Prospective Financial Information;
- analysis of the sensitivity of the Fonterra Prospective Financial Information to changes in a number of key assumptions; and
- significant accounting policies applied in the preparation of the Fonterra Prospective Financial Information.

Prospective financial information by its nature is inherently uncertain and includes predictions of future events that cannot be assured and are beyond the control of Fonterra. The directors of Fonterra have used the best information available to them during the preparation of the Fonterra Prospective Financial Information. Although due care and attention has been taken in its preparation, neither the directors of Fonterra nor any other person can provide any assurance that the Fonterra prospective financial performance will be achieved. The Fonterra Prospective Financial Information is based on a series of assumptions that the directors of Fonterra reasonably expect to occur as a result of actions that the directors of Fonterra reasonably expect Fonterra to take. Actual results are likely to vary from the information presented as anticipated results may not occur as expected, and the variations may be material. Investors must consider the assumptions upon which the Fonterra Prospective Financial Information is based, together with the risks described in Section 7 – *Investment Risks*.

Prospective financial information is based on events and conditions existing at the date of this Offer Document and the assumptions and accounting policies stated on pages 95 and 107 to 112. There is no intention to update the Fonterra Prospective Financial Information.

Fonterra will provide to the Manager a report on Fonterra's actual financial results compared to those in the Fonterra Prospective Financial Information for the prospective period in accordance with NZ GAAP and as contemplated by regulation 44 of the Securities Regulations.

The Fonterra Prospective Financial Information is based on the existing business of Fonterra and no significant changes in operations are proposed for the prospective period. The Fonterra Prospective Financial Information is presented in millions of New Zealand dollars (NZ$) unless otherwise stated. The Fonterra Prospective Financial Information is rounded, which may result in some discrepancies between the sum of components and totals within tables and also in certain percentage calculations.

The Directors
Fonterra Co-operative Group Limited
9 Princes Street
Auckland 1010
New Zealand

Fonterra Co-operative Group Limited
9 Princes Street
Auckland 1010
New Zealand

The Directors
FSF Management Company Limited
9 Princes Street
Auckland 1010
New Zealand

FSF Management Company Limited
9 Princes Street
Auckland 1010
New Zealand

26 October 2012

INVESTIGATING ACCOUNTANT'S LIMITED ASSURANCE REPORT ON PROSPECTIVE FINANCIAL INFORMATION

Introduction

We have prepared this investigating accountant's limited assurance report (Report) on certain prospective financial information of Fonterra Co-operative Group Limited and its subsidiaries (together the Fonterra Group) for inclusion in a prospectus and investment statement dated on or about 26 October 2012 (the Offer Document) relating to the offer of units in a unit trust called the Fonterra Shareholders' Fund (the Offer). Expressions defined in the Offer Document have the same meaning in this Report. This Report is an independent assurance report the scope of which is set out below.

Scope

You have requested PricewaterhouseCoopers to prepare this Report which covers the prospective financial information of the Fonterra Group for the year ending 31 July 2013, including notes and assumptions thereto, on pages 91 to 112, referred to as the "Prospective Financial Information".

This report is made solely to Fonterra Co-operative Group Limited, its directors (Fonterra Directors), FSF Management Company Limited, and its directors (together, the Addressees) for inclusion in the Offer Document. To the fullest extent permitted by law and subject to section 61 of the Securities Act 1978 we do not accept or assume responsibility to anyone other than the Addressees of this report for the conclusions that we have formed.

Fonterra Directors' responsibilities for the Prospective Financial Information

The Fonterra Directors are responsible for the preparation and presentation of the Prospective Financial Information, including the assumptions based on best information, on which the Prospective Financial Information is based.

Our responsibility

Our responsibility is to express a conclusion as a result of our limited assurance engagement on the Prospective Financial Information in accordance with International Standard on Assurance Engagements (New Zealand) 3000, issued by the Council of the New Zealand Institute of Chartered Accountants, applicable to assurance engagements other than audits or reviews of historical financial information.

Our procedures consisted primarily of enquiry, discussion and comparison and other such analytical review procedures we considered necessary so as to form an opinion as to whether anything has come to our attention which causes us to believe that:

(a) the Fonterra Directors' assumptions based on best information do not provide a reasonable basis for the Prospective Financial Information;

(b) the Prospective Financial Information was not properly prepared on the basis of the assumptions based on best information;

(c) in all material respects, the Prospective Financial Information is not presented fairly in accordance with the recognition and measurement principles prescribed in New Zealand Accounting Standards and other mandatory professional reporting requirements in New Zealand, and the accounting policies adopted by the Fonterra Group disclosed in the annual financial statements of the Fonterra Group as at and for the 12 months ended 31 July 2012 on pages 107 to 112 of the Offer Document; or

PricewaterhouseCoopers, 188 Quay Street, Private Bag 92162, Auckland 1142, New Zealand
T: +64 (9) 355 8000, F: +64 (9) 355 8001, www.pwc.com/nz

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(d) the Prospective Financial Information is unreasonable.

The Prospective Financial Information has been prepared by the Fonterra Directors to provide investors with a guide to the Fonterra Group's potential future financial performance based upon the achievement of certain economic, operating, development and trading assumptions about future events and actions that have not yet occurred and may not necessarily occur. There is a considerable degree of subjective judgement involved in the preparation of the Prospective Financial Information. Actual results may vary materially from the Prospective Financial Information and the variation may be materially positive or negative. Accordingly, investors should have regard to the risk factors set out in Section 7 – *Investment Risks* of the Offer Document.

Conclusion on the Prospective Financial Information

The work we performed to provide our limited assurance conclusion on the Prospective Financial Information was substantially less in scope than an audit examination conducted in accordance with International Standards on Auditing (New Zealand). Accordingly, we have not performed an audit and we do not express an audit opinion on the Prospective Financial Information included in the Offer Document.

Based on the procedures described in this report, nothing has come to our attention which causes us to believe that, in any material respect:

(a) the Fonterra Directors' assumptions based on best information set out in the Prospective Financial Information section of the Offer Document do not provide a reasonable basis for the Prospective Financial Information;

(b) the Prospective Financial Information was not properly prepared on the basis of the assumptions based on best information;

(c) the Prospective Financial Information is not presented fairly in accordance with the recognition and measurement principles prescribed in accounting standards and other mandatory professional reporting requirements in New Zealand, and the accounting policies adopted by the Fonterra Group disclosed in the annual financial statements of the Fonterra Group as at and for the 12 months ended 31 July 2012 on pages 107 to 112 of the Offer Document; and

(d) the Prospective Financial Information is unreasonable.

The assumptions set out in the Prospective Financial Information section of the Offer Document which form the basis of the Prospective Financial Information are subject to significant uncertainties and contingencies, which are often outside the control of the Fonterra Group. If events do not occur as assumed, actual results and distributions achieved by the Fonterra Group may vary significantly from the Prospective Financial Information. Accordingly, we do not confirm or guarantee the achievement of the Prospective Financial Information, as future events, by their very nature, are not capable of independent substantiation.

Independence or disclosure of interest

PricewaterhouseCoopers does not have any interest in the outcome of the Offer other than the preparation of this Report and participation in due diligence in connection with the Trading Among Farmers structure and the Offer Document for which normal professional fees will be received. We have no relationship with or interests in any member of the Fonterra Group other than in our capacities as auditor, investigating accountant, tax advisors and providers of other assurance services. These services have not impaired our independence as auditor of the Fonterra Group.

Restrictions of Use

This Report has been prepared for inclusion in the Offer Document. We disclaim any assumption of responsibility for any reliance on this Report or on the Prospective Financial Information to which it relates for any purposes other than the purpose for which they were prepared.

Yours faithfully

PricewaterhouseCoopers

PricewaterhouseCoopers
Chartered Accountants, Auckland

PROSPECTIVE CONSOLIDATED INCOME STATEMENT FOR FONTERRA

($M)	FY2013 PROSPECTIVE	FY2012 ACTUAL
Total revenue	**18,627**	**19,769**
Cost of goods sold	(15,319)	(16,721)
Gross profit	**3,308**	**3,048**
Selling and marketing expenses	(693)	(568)
Distribution expenses	(526)	(501)
Administrative expenses	(788)	(784)
Other operating expenses	(395)	(385)
Net other operating income	76	125
Share of profit of equity accounted investees	72	52
EBIT	**1,054**	**987**
Depreciation and amortisation	555	492
EBITDA	**1,609**	**1,479**
Net finance (costs)	(328)	(310)
Profit before tax	**726**	**677**
Tax expense	(36)	(53)
Profit for the year[1]	**690**	**624**
Profit for the year is attributable to:		
Equity holders of the Parent	673	609
Non-controlling interests	17	15
Profit for the year	**690**	**624**

1 Included in the notes to the Fonterra Prospective Financial Information later in this section is a table of prospective profitability by segment that shows the impact of normalisation adjustments in FY2013.

SECTION 4 FONTERRA FINANCIAL INFORMATION CONTINUED

PROSPECTIVE CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR FONTERRA

($M)	FY2013 PROSPECTIVE	FY2012 ACTUAL
Profit for the year	**690**	**624**
Movement in cash flow hedge reserve	(128)	(453)
Movement in net investment hedges	–	(24)
Movement in foreign currency translation reserve	(4)	31
Share of equity accounted investees' movements in reserves	–	1
Other comprehensive expense recognised directly in equity	**(132)**	**(445)**
Total comprehensive income for the year	**558**	**179**
Attributable to:		
Equity holders of the Parent	541	163
Non-controlling interests	17	16
Total comprehensive income for the year	**558**	**179**

PROSPECTIVE CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR FONTERRA

($M)	FY2013 PROSPECTIVE	FY2012 ACTUAL
Opening equity as at 1 August	**6,655**	**6,541**
Total comprehensive income attributable to equity holders of the Parent	541	163
Total comprehensive income attributable to non-controlling interests	17	16
Total comprehensive income for the year	**558**	**179**
Transactions with equity holders in their capacity as equity holders:		
Dividends paid to equity holders of the Parent	(506)	(475)
Dividends paid to non-controlling interests	(15)	(19)
Equity instruments issued net of transaction costs	276	429
Total equity	**6,968**	**6,655**
Represented by:		
Subscribed equity	5,966	5,690
Retained earnings	1,245	1,078
Foreign currency translation reserve	(215)	(211)
Cash flow hedge reserve	(65)	63
Total equity attributable to equity holders of the Parent	**6,931**	**6,620**
Non-controlling interests	37	35
Total equity	**6,968**	**6,655**

PROSPECTIVE CONSOLIDATED STATEMENT OF FINANCIAL POSITION FOR FONTERRA

($M)	FY2013 PROSPECTIVE	FY2012 ACTUAL
Cash and cash equivalents	1,271	1,033
Trade and other receivables	2,143	2,302
Inventories	2,660	2,981
Other current assets	164	376
Total current assets	**6,238**	**6,692**
Property, plant and equipment	5,079	4,569
Equity accounted investments	497	439
Intangible assets	2,868	2,882
Other non-current assets	626	535
Total non-current assets	**9,070**	**8,425**
Total assets	**15,308**	**15,117**
Bank overdraft and borrowings	1,066	1,246
Supplier, trade and other payables	2,244	2,469
Other current liabilities	241	410
Total current liabilities	**3,551**	**4,125**
Borrowings	4,296	3,745
Other non-current liabilities	493	592
Total non-current liabilities	**4,789**	**4,337**
Total liabilities	**8,340**	**8,462**
Net assets	**6,968**	**6,655**
Subscribed equity	5,966	5,690
Retained earnings	1,245	1,078
Foreign currency translation reserve	(215)	(211)
Cash flow hedge reserve	(65)	63
Total equity attributable to equity holders of the Parent	**6,931**	**6,620**
Non-controlling interests	37	35
Total equity	**6,968**	**6,655**

PROSPECTIVE CONSOLIDATED STATEMENT OF CASH FLOWS FOR FONTERRA

($M)	FY2013 PROSPECTIVE	FY2012 ACTUAL
Receipts from customers	18,773	20,045
Payments for milk purchased	(9,154)	(10,721)
Payments to creditors and employees	(7,785)	(7,905)
Dividends received	35	37
Net tax paid	(66)	(66)
Net cash flows from operating activities	**1,803**	**1,390**
Acquisition of property, plant and equipment and intangible assets	(1,144)	(857)
Other investing cash flows	6	31
Net cash flows from investing activities	**(1,138)**	**(826)**
Proceeds from borrowings	137	118
Net interest paid	(351)	(375)
Net proceeds from issue and surrender of equity instruments	332	394
Dividends paid to equity holders of the Parent	(506)	(475)
Other financing cash flows	(28)	(11)
Net cash flows from financing activities	**(416)**	**(349)**
Net increase in cash and cash equivalents	249	215
Cash and cash equivalents at the beginning of the year	991	762
Effect of exchange rate changes on cash balances	1	14
Cash and cash equivalents at the end of the year	**1,241**	**991**
Reconciliation of closing cash balances to the prospective consolidated statement of financial position:		
Cash and cash equivalents	1,271	1,033
Bank overdraft	(30)	(42)
Closing cash balances	**1,241**	**991**

NOTES TO THE FONTERRA PROSPECTIVE FINANCIAL INFORMATION

The principal assumptions upon which the Fonterra Prospective Financial Information is based are summarised below and should be read in conjunction with the sensitivity analysis on page 106, the risk factors set out in Section 7 – *Investment Risks*, and Fonterra's significant accounting policies on pages 107 to 112.

The Fonterra Prospective Financial Information is for the year ending 31 July 2013 and is based on events and conditions existing as at the date of this Offer Document. Actual results for August and September 2012 were consistent with the information included in the Fonterra prospective financial statements for those months.

The Fonterra Prospective Financial Information complies with FRS-42 *Prospective Financial Statements*, and assumes the following:

GENERAL ASSUMPTIONS

Reporting entity

The Fonterra Prospective Financial Information is prepared in respect of the group comprising Fonterra Co-operative Group Limited, its controlled subsidiaries and its equity accounted investments (Fonterra). For accounting purposes, the Fund is treated as an in substance subsidiary of Fonterra under NZ GAAP and consolidated into Fonterra. The Manager itself is not consolidated into the Fund or Fonterra as it is owned by Trustees Executors Limited, and is not under the control of Fonterra.

Fonterra Co-operative Group Limited is a co-operative company incorporated and domiciled in New Zealand. Fonterra is registered under the Companies Act and the Co-operative Companies Act 1996 (New Zealand), and is an issuer for the purposes of the Financial Reporting Act 1993 (New Zealand). Fonterra is also required to comply with DIRA.

Economic environment

There will be no material change in the consensus outlook for the international dairy market.

Legislative and regulatory environment

There will be no change in the legislative and regulatory environment of New Zealand or any of the other countries in which Fonterra operates that will materially impact upon Fonterra.

Competitive environment and industry conditions

There will be no material changes to competitive activity, industry structure, general industry conditions or the employee environments of New Zealand or any of the other countries in which Fonterra operates, and no new entrant that will materially change the competitive environment.

Natural environment

There will be no significant disruption to Fonterra from earthquakes, flooding, biosecurity events, other unforeseen natural disasters or hazards that may disrupt Fonterra's operations. There will be no material unforeseen weather events such as droughts or other weather patterns that impact the global milk supply.

Management of Fonterra

There will be no material change in Fonterra senior management and other key employees remain in their current roles.

Key customers and suppliers

There will be no material change to contractual, business and operational relationships with key customers, supplying farmers and other suppliers.

Accounting policies

The accounting policies applied to the preparation of the Fonterra Prospective Financial Information are consistent with those which are expected to be used in future reporting periods. They are also consistent with those used in the audited financial statements of Fonterra for FY2012, which are summarised under the heading "Fonterra Significant Accounting Policies" in this section, other than disclosure-related changes in connection with the consolidation of the Fonterra Shareholders' Fund.

Taxation

There will be no change to the tax regime in New Zealand, including no change to the company tax rate of 28%. There will be no changes to corporate tax rates in the other jurisdictions in which Fonterra operates that will have a material impact. Included in the FY2013 prospective consolidated statement of financial position is a deferred tax asset relating to New Zealand tax losses, recognised in accordance with NZIAS 12 – *Income Taxes*. The continued recognition of this deferred tax asset for financial reporting purposes is dependent on Fonterra being able to demonstrate that it will be utilised, either by offset against New Zealand deferred tax liabilities or by Fonterra generating future taxable income in New Zealand.

Foreign exchange

The Fonterra Group's largest single foreign exchange exposure is against the US dollar. The forecasts assume there is no other significant-weight currency that will change substantially and impact the Fonterra Prospective Financial Information.

The exchange rate risk is managed in accordance with the Fonterra Board approved Financial Risk Management Standard. The forecast foreign exchange position takes into account the fact that 66% of forecast net US dollar cash receipts for FY2013 were hedged at 31 July 2012, and the assumed rate for the remaining net exposure to US dollar cash receipts as at 31 July 2012 is US$0.8089:NZ$1.00.

Fonterra uses a mixture of forwards and options to manage its foreign exchange risk on forecast sales. The changes in the fair value of those derivatives that are designated and qualify as cash flow hedges and satisfy the effectiveness test are recognised directly in other comprehensive income. Under IFRS, the change in the time value component of options is excluded from the cash flow hedge relationship and is recognised in the income statement. Time value is a non-cash movement and while its value changes over the life of the option due to movements in foreign exchange and other market rates, it reverts to zero by maturity. The forecasts assume that there is no significant income statement impact relating to time value during FY2013. However, this will be sensitive to changes in the option contracts held and to changes in market conditions throughout the year.

SPECIFIC ASSUMPTIONS

Set out overleaf are specific best estimate assumptions that have been adopted in preparing the Fonterra Prospective Financial Information.

SECTION 4 FONTERRA FINANCIAL INFORMATION CONTINUED

OVERVIEW OF FY2013 PROSPECTIVE PROFITABILITY BY SEGMENT

PROSPECTIVE ($M)	NZ MILK PRODUCTS	ANZ	ASIA / AME	LATAM	INTER-SEGMENT	TOTAL
Sales volume ('000 MT)	*2,822*	*967*	*286*	*332*	*(433)*	*3,974*
External revenue	12,727	3,011	2,033	856	–	18,627
Inter-segment revenue	1,276	629	–	–	(1,905)	–
Total revenue	**14,003**	**3,640**	**2,033**	**856**	**(1,905)**	**18,627**
Cost of goods sold	(12,519)	(2,809)	(1,293)	(591)	1,893	(15,319)
Gross profit	**1,484**	**831**	**740**	**265**	**(12)**	**3,308**
Operating expenses	(1,104)	(630)	(517)	(175)	24	(2,402)
Net other operating income[1]	78	–	–	–	(24)	54
Earnings from equity accounted investees[2]	59	–	–	35	–	94
EBIT	**517**	**201**	**223**	**125**	**(12)**	**1,054**
Normalisation adjustment	–	25	–	–	–	25
Normalised EBIT[3]	**517**	**226**	**223**	**125**	**(12)**	**1,079**
Depreciation and amortisation	424	88	15	28	–	555
Normalised EBITDA[3]	**941**	**314**	**238**	**153**	**(12)**	**1,634**
Capital employed[4]	**6,824**	**2,859**	**825**	**698**	**(7)**	**11,199**
Return on capital employed[4]	*7.6%*	*7.9%*	*27.0%*	*17.9%*	–	*9.6%*

1 Net other operating income includes other operating income and net foreign exchange gains / losses but excludes royalty and other income relating to arrangements with equity accounted investees.

2 Earnings from equity accounted investees includes share of profit, as well as royalty and other income.

3 Normalised EBIT and EBITDA in FY2013 exclude the costs associated with the closure of a plant in Australia.

4 Capital employed is calculated as monthly average net assets excluding net debt, derivatives, taxes and investments (other than equity accounted investments). Return on capital employed is calculated as normalised EBIT divided by capital employed.

NZ MILK PRODUCTS

PROSPECTIVE PROFITABILITY

($M)	FY2013 PROSPECTIVE	FY2012 ACTUAL	CHANGE
Sales volume ('000 MT)	*2,822*	*2,847*	*(1%)*
New Zealand-sourced	11,413	12,256	
Other	1,314	1,764	
Inter-segment revenue	1,276	1,697	
Revenue	**14,003**	**15,717**	**(11%)**
Farmgate Milk Price	(7,764)	(9,033)	
New Zealand manufacturing costs	(2,687)	(2,689)	
Other cost of goods sold	(2,068)	(2,589)	
Cost of goods sold	**(12,519)**	**(14,311)**	**(13%)**
Gross profit	**1,484**	**1,406**	**6%**
Gross profit	10.6%	8.9%	
EBIT excluding DFE[1] and Dairiconcepts	**458**	**470**	**(3%)**
EBIT – Fonterra's share of earnings from DFE[1] and Dairiconcepts	**59**	**45**	**31%**
EBIT[2]	**517**	**515**	**-%**
EBIT margin	3.7%	3.3%	

1 DMV Fonterra Excipients.
2 EBIT in FY2012 represents normalised EBIT as stated in the FY2012 financial statements.

VOLUMES AND REVENUE

Fonterra forecasts to process 1,470 million kgMS of New Zealand milk in the 2012 / 2013 Season, a decrease of 2% from the record volumes in the 2011 / 2012 Season. Total sales volumes in FY2013 of 2,822 thousand MT are forecast to be approximately the same as those in FY2012. Sales volumes of New Zealand-sourced milk products are forecast to increase by 1% to 2,493 thousand MT, and volumes of globally-sourced product are expected to reduce by 15% to 329 thousand MT.

External sales of New Zealand-sourced milk products in FY2013 are forecast to be $843 million or 7% lower than those in FY2012. This is expected to primarily be driven by lower dairy commodity prices, with an 11% decrease in the weighted average US$-denominated selling price, as well as a continued shift in product mix towards whole milk powder. External sales of globally-sourced products are forecast to decrease by $450 million or 26%, reflecting both volume and price reductions.

NEW ZEALAND-SOURCED MILK VOLUMES AND PRICES

	SALES VOLUME ('000 MT)			CHANGE IN PRICE	
	FY2013 PROSPECTIVE	FY2012 ACTUAL	CHANGE	NZ$ / MT	US$ / MT
Whole milk powder	1,089	1,012	8%	(12%)	(9%)
Skim milk powder	333	318	5%	(9%)	(6%)
Cream	449	471	(5%)	(17%)	(15%)
Cheese	266	279	(5%)	(14%)	(12%)
Casein	54	61	(11%)	(17%)	(15%)
Other	302	318	(6%)	(11%)	(8%)
Total	**2,493**	**2,459**	**1%**	**(14%)**	**(11%)**

COST OF GOODS SOLD

The Farmgate Milk Price is forecast to be $1,269 million or 14% lower than that in FY2012. The Farmgate Milk Price for the 2012 / 2013 Season, calculated in accordance with the Farmgate Milk Price Manual, is forecast to be $5.25 / kgMS or 14% below the $6.08 / kgMS paid for the 2011 / 2012 Season.

New Zealand manufacturing costs are forecast to remain broadly consistent year-on-year, with a decrease of $2 million in FY2013, in line with only a small decrease in milk collection volumes for the 2012 / 2013 Season.

Other cost of goods sold, which primarily relates to purchases of globally-sourced milk and freight, duties and landings, is forecast to decrease by $521 million or 20%. This is forecast to be primarily due to a reduction in purchases of globally-sourced milk of $431 million or 26%, in line with the reduction in sales.

PROFITABILITY

Gross profit is forecast to be $78 million or 6% higher than that in FY2012, and includes a broadly neutral product mix. Contribution margin per MT is forecast as follows:

($M)	FY2013 PROSPECTIVE	FY2012 ACTUAL	CHANGE
Sales volume ('000 MT)	*2,822*	*2,847*	
Gross profit	**1,484**	**1,406**	
Selling, marketing and distribution expenses	(345)	(309)	
Contribution margin	**1,139**	**1,097**	
Contribution margin per MT of sales ($)	*404*	*385*	*5%*

The business review highlighted the risk to EBIT from movements in relative commodity prices. The sensitivity of FY2013 EBIT to this risk is highlighted in the sensitivity analysis below.

Operating expenses are forecast to remain flat year-on-year, and net other operating income is forecast to decrease by $33 million.

Although EBIT for NZ Milk Products excluding earnings from joint ventures is forecast to decline by 3% from $470 million to $458 million, a major factor is a significant increase in depreciation and amortisation as a consequence of the above-average levels of capital expenditure in FY2012 and FY2013.

Depreciation and amortisation in FY2013 are forecast to increase by $44 million or 12% over FY2012, to $424 million. EBITDA for NZ Milk Products excluding earnings from equity accounted investments is forecast to increase from $850 million in FY2012 to $882 million in FY2013, a $32 million or 4% increase.

Earnings from equity accounted investees is forecast to increase by $14 million or 31% compared to that for FY2012, primarily as a result of Dairiconcepts having disposed of a loss-making plant in FY2012.

EBIT of $517 million in FY2013 is forecast to be $2 million higher than that in FY2012. Return on capital employed is forecast to be 7.6%, consistent with that for FY2012.

Variability in relative prices between Reference Commodity Products and other dairy nutrition products such as cheese (and its by-products) and casein can have a significant and ongoing impact on the earnings of NZ Milk Products. For example, if the relative price of other dairy nutrition products compared to that for Reference Commodity Products changes by ±5%, then, other factors aside, the potential impact on FY2013 EBIT is estimated at ±$125 million (refer to the sensitivity analysis later in this section in connection with the Fonterra Prospective Financial Information).

Fonterra can mitigate the short-term impact of relative changes in stream returns through product mix optimisation in its NZ Milk Products operation, subject to constraints on capacity during periods of peak production and existing long-term volume commitments to consumer brands customers (including the regional businesses).

AUSTRALIA AND NEW ZEALAND (ANZ)

PROSPECTIVE PROFITABILITY

($M)	FY2013 PROSPECTIVE	FY2012 ACTUAL	CHANGE
Sales volume ('000 MT)	*967*	*959*	*1%*
Revenue – consumer and out-of-home foodservices	2,389	2,414	
Revenue – dairy nutrition	1,639	1,812	
Eliminations (intra-segment)	(388)	(378)	
Revenue	**3,640**	**3,848**	**(5%)**
Gross profit	**831**	**780**	**7%**
Gross profit	*22.8%*	*20.3%*	
Normalised EBIT[1]	**226**	**204**	**11%**
Normalised EBIT margin	*6.2%*	*5.3%*	

1 EBIT in FY2012 represents normalised EBIT as stated in the FY2012 financial statements. EBIT in FY2013 represents forecast EBIT excluding the costs associated with the closure of a plant in Australia as described below.

The financial performance of the ANZ business is expected to stabilise in FY2013 in a difficult and challenging trading environment.

While consumer and out-of-home foodservices volume is forecast to grow by 3% in FY2013, revenue is forecast to decline by 1%. The New Zealand consumer and out-of-home foodservices businesses are expected to achieve revenue growth of 9% as a result of capacity expansion to support export growth and new product development. In Australia, revenue is forecast to reduce by 7%, primarily reflecting reduced sales of private label products by the business. Gross profit is expected to improve 1%.

A fall in milk collection volumes due to the commissioning of competing capacity in Tasmania, combined with lower commodity prices, is expected to drive a 10% reduction in dairy nutrition revenue. However, this is forecast to be offset by a lower cost of milk and operating efficiencies.

Gross profit across the ANZ business is expected to improve by $51 million or 7%, reflecting the impact of lower commodity prices on cost of goods sold particularly in the Australian dairy nutrition businesses and the Australian and New Zealand out-of-home foodservices businesses.

In addition to the factors noted above, a key driver of an 11% forecast increase in FY2013 normalised EBIT over that for FY2012 is the restructuring of Australia and New Zealand overhead costs, which is forecast to deliver cost savings of $16 million in FY2013 (or $20 million on an annualised basis). A provision for restructuring costs was incurred in FY2012.

The FY2013 EBIT forecast reflects a recovery on that for FY2012. However, it should be noted (as outlined in the sensitivity analysis on page 106) that there is significant risk associated with this recovery in view of continuing competitive pressure and its impact on margins and ranging of product by major retail customers.

Normalised EBIT excludes a pre-tax expense of $25 million relating to the closure of a plant in Australia, which will see production transferred to other Fonterra sites with existing capacity after the end of FY2013.

Of the $25 million expense, $10 million is a non-cash asset write-down, and $15 million relates to redundancy and other closure costs that are expected to be incurred after the end of FY2013. The plan to absorb production into existing capacity is expected to deliver annualised efficiency benefits of $5 million once the plant closure plan is completed after the end of FY2013.

SECTION 4 FONTERRA FINANCIAL INFORMATION CONTINUED

ASIA / AME

PROSPECTIVE PROFITABILITY

($M)	FY2013 PROSPECTIVE	FY2012 ACTUAL	CHANGE
Sales volume ('000 MT)	*286*	*264*	*8%*
Revenue	**2,033**	**1,855**	**10%**
Gross profit	**740**	**631**	**17%**
Gross profit	36.4%	34.0%	
EBIT[1]	**223**	**194**	**15%**
EBIT margin	11.0%	10.5%	

1 EBIT in FY2012 represents normalised EBIT as stated in the FY2012 financial statements.

Total volume is expected to grow by 8% in Asia / AME, with 10% growth in revenue as profit margins recover to levels consistent with those in FY2010 and FY2011. Revenue growth is expected to vary across the region, with growth significantly higher than the regional average in the investment markets of China and Vietnam, and significantly lower in Sri Lanka due to increased duties and prices.

The increases in revenue are primarily driven by expectations of continued growth in the market for dairy nutrition products and solidifying share in growing categories for Anlene™ and Anmum™. In addition, supply issues experienced in Thailand and Indonesia in FY2012 are not expected to be repeated.

Gross profit margin is expected to increase from 34.0% to 36.4%, resulting in a 17% increase in gross profit to $740 million. This is driven by lower expected commodity input prices, and an increasing proportion of sales of advanced nutrition products compared to base milk powder products.

EBIT margin is expected to improve from 10.5% to 11.0%, resulting in a $29 million (15%) increase in EBIT to $223 million. Operating expenses are expected to increase by 19%. Selling and marketing expenses are expected to grow 22% due to continued investment in China, and other operating expenses are expected to grow by 13%, slightly ahead of revenue growth.

LATAM

PROSPECTIVE PROFITABILITY

($M)	FY2013 PROSPECTIVE	FY2012 ACTUAL	CHANGE
Sales volume ('000 MT)	*332*	*319*	*4%*
Revenue – Soprole	**856**	**805**	**6%**
Gross profit – Soprole	**265**	**245**	**8%**
Gross profit	31.0%	30.4%	
EBIT – Soprole	**90**	**83**	**8%**
EBIT – Fonterra's share of earnings from Dairy Partners Americas (including royalties)	**35**	**46**	**(24%)**
EBIT[1]	**125**	**129**	**(3%)**
EBIT margin	14.6%	16.0%	

1 EBIT in FY2012 represents normalised EBIT as stated in the FY2012 financial statements.

Soprole sales volumes are forecast to increase by 4% and revenue by 6%. This is primarily as a result of continued growth in Chilean dairy consumption coupled with increases in Soprole's market share. This is driven by investments in yoghurt capacity expansion to be commissioned in January 2013, and from innovation and higher investment in advertising and promotional activity. Gross profit margin is expected to increase to 31.0% as a result of product mix benefits arising from innovation and improved product mix resulting from the yoghurt capacity expansion, equivalent to an 8% increase in gross profit in absolute terms. Soprole's operating expenses are forecast to increase by 7%, broadly in line with revenue, resulting in EBIT increasing by $7 million (8%) to $90 million (EBIT margin of 10.5%).

Normalised EBIT from Dairy Partners Americas in FY2012 was $46 million including the benefit of $19 million of other operating income arising from the review of manufacturing cost recovery arrangements in FY2012 that is not expected to reoccur in FY2013. Excluding this, earnings are forecast to increase by $8 million or 30%. Several strategic initiatives are being implemented in Brazil, Venezuela and Ecuador to improve operational performance in FY2013.

SECTION 4
FONTERRA FINANCIAL INFORMATION CONTINUED

OPERATING EXPENSES

Total operating expenses are forecast to increase by 7% in FY2013. Excluding selling and marketing expenses, operating expenses are forecast to increase by $39 million, or $14 million (less than 1%) excluding the costs associated with the closure of a plant in Australia. Selling and marketing expenses are forecast to increase by $125 million or 22%, in particular due to continued investment to support growth in the consumer and out-of-home foodservices businesses in Asia.

($M)	FY2013 PROSPECTIVE	FY2012 ACTUAL	CHANGE
Selling and marketing expenses	(693)	(568)	
Distribution expenses	(526)	(501)	
Administrative expenses	(788)	(784)	
Other operating expenses	(395)	(385)	
Total operating expenses	**(2,402)**	**(2,238)**	**7%**

Fonterra has initiated a programme to reduce operating expenses by $90 million on an annualised basis through a number of initiatives. These initiatives are at an early stage and while the forecast for FY2013 does not include any benefit arising from this programme, Fonterra has set a target to achieve $60 million in FY2013.

DEPRECIATION AND AMORTISATION

Depreciation and amortisation expense is forecast based on existing rates of depreciation and amortisation applied to relevant assets which are adjusted for planned capital expenditure. Depreciation and amortisation rates are based on estimated useful lives which are assumed to remain consistent with levels observed historically and Fonterra's accounting policy.

TAX

The deductibility of dividends payable is forecast to remain a key feature of how Fonterra's tax expense is calculated. Upon implementation of Trading Among Farmers, payment of the Farmgate Milk Price and dividends in relation to Wet Shares will continue to be deductible to Fonterra and taxable income in the hands of the Farmer Shareholder receiving them, assuming Fonterra makes an election (under the Income Tax Act) to that effect. The forecast number of Wet Shares on issue at 31 May 2013 is 1,494 million. Dividends paid to the Fund, or RVP or in respect of most other Dry Shares will no longer be deductible.[1]

($M)	FY2013 PROSPECTIVE	FY2012 ACTUAL
Profit before tax	**726**	**677**
Prima facie tax expense (28%)	203	190
Effect of tax rates in foreign jurisdictions	6	(11)
Impact of non-assessable income and non-deductible expenses	(12)	(17)
Impact of prior year under provision	–	1
Tax expense excluding the impacts of distributions to Shareholders and deferred tax recognition / de-recognition	**197**	**163**
Effective tax rate excluding distributions and deferred tax	*27.1%*	*24.1%*
Tax effect of distributions to Shareholders	(133)	(128)
Tax expense excluding the impacts of deferred tax recognition / de-recognition	**64**	**35**
Impact of recognition / de-recognition of deferred tax	(28)	18
Tax expense	**36**	**53**

1 Following the implementation of Trading Among Farmers, the election under the Income Tax Act to treat dividends as deductible to Fonterra (and as taxable income in the hands of the farmer) will only be able to be made in respect of Wet Shares held by the Farmer Shareholder at the time the dividend is paid or Shares that the farmer would have been required to hold if the farmer had made actual supplies equal to those projected for a Season. Dividends paid on Shares held by the Fonterra Farmer Custodian will not be deductible to Fonterra.

CAPITAL EXPENDITURE

Capital expenditure between FY2010 to FY2012 averaged approximately $675 million per year. Capital expenditure forecast for FY2013 is significantly above that reflecting the following growth initiatives:

- investment in additional New Zealand milk processing capacity at Darfield to accommodate near-term growth in New Zealand milk supply;
- the acquisition of the trade and assets of New Zealand Dairies Limited (in receivership), including its Studholme processing plant; and
- investment in international growth projects, including additional farm capacity in China and a whey processing facility in the Netherlands with strategic partner A-Ware.

Investments in new capacity are relatively “lumpy”. Investments in new plants typically occur at two to three-year intervals based on a long-term milk growth of 2% to 3% per year. However, more rapid recent growth in the South Island required investment in the additional capacity at Darfield to be advanced to FY2013.

($M)	FY2013	FY2012	CHANGE
	PROSPECTIVE	ACTUAL	
NZ Milk Products	906	645	
ANZ	127	181	
Asia / AME	70	19	
Latam	35	43	
Total	**1,138**	**888**	**28%**

No material disposals or asset sales are expected in FY2013.

In addition to the capital expenditure included in these forecasts, Fonterra has plans to expand the farming business in China including building a second hub of five farms, and is considering various options to fund this expansion. The funding options being considered include internal funding and funding from a wide range of potential external partners. Fonterra intends to develop these options in FY2013. However, this has no impact on the forecasts.

No significant brand or other intangible asset acquisitions or disposals are forecast, and no significant acquisitions are forecast by Fonterra that will generate further acquired goodwill. It is also assumed that no impairment expense will be required as a result of the annual impairment testing of goodwill and indefinite life intangible assets as a result of the current high levels of headroom.

WORKING CAPITAL

The key drivers of working capital are assumed to remain consistent with those observed over the period from FY2010 to FY2012.

Lower commodity prices and lower milk supply than in FY2012 are expected to result in lower working capital. The high levels of inventories on hand at 31 July 2012 are expected to be sold through in FY2013, and overall inventories are forecast to be 11% lower at 31 July 2013. In addition, Fonterra is not expecting to repeat the record level of sales in the month of July 2012 in the equivalent month in FY2013, and therefore trade receivables are forecast to reduce by 7%.

Working capital days are forecast to reduce to 60 as a result of the assumptions above. The level forecast is similar to average working capital days achieved in FY2011.

($M)	FY2013	FY2012	CHANGE
	PROSPECTIVE	ACTUAL	
Trade and other receivables	2,143	2,302	
Inventories	2,660	2,981	
Owing to farmer suppliers	(928)	(1,083)	
Trade and other payables	(1,316)	(1,386)	
Other	44	38	
Working capital	**2,603**	**2,852**	**(9%)**
Average working capital days	*60*	*65*	

NET DEBT AND FINANCE COSTS

As at 31 July 2012, the Fonterra Group had outstanding economic net interest bearing debt of $4,229 million. The average maturity of the gross outstanding debt was four years. Some of the facilities relating to this debt contained a specific covenant that limits the amount of secured (where Fonterra has granted that security) and subsidiary borrowings to no more than 20% of the Fonterra Group's total assets. As at 31 July 2012, the Fonterra Group had committed undrawn bank facilities of $3,565 million.

It is assumed that all existing debt facilities will be retained to maturity or renewed on substantially similar terms. Fonterra has a $300 million New Zealand medium term note maturing in November 2012 and £250 million European medium term notes maturing in April 2013 that it intends to replace with new debt and / or an increase in bank facilities. Fonterra is currently undertaking its regular annual process of extending its banking facilities including the $1,350 million of bank facilities due to mature in FY2013.

Gearing

($M)	FY2013 PROSPECTIVE	FY2012 ACTUAL	CHANGE
Current borrowings	1,036	1,204	
Term borrowings	4,296	3,745	
Total borrowings	**5,332**	**4,949**	
Cash and cash equivalents	(1,241)	(991)	
Other non-current assets (advances)	(120)	(125)	
Net interest bearing debt	**3,971**	**3,833**	
Economic net interest bearing debt	**4,116**	**4,229**	**(3%)**
Equity less cash flow hedge reserve	7,033	6,592	
Debt to debt plus equity ratio	36.1%	36.8%	
Economic debt to debt plus equity ratio	36.9%	39.1%	

The Fonterra Group borrows a mixture of fixed and variable rate funds in a range of currencies and uses derivatives to manage the volatility of finance costs. Net finance costs are forecast to remain broadly consistent with those for FY2012, and no significant movements are assumed in the value of basis risk relating to derivatives. A 100-basis point increase or decrease in interest rates (which is considered possible but unlikely) is forecast to result in a $13 million increase or decrease in cash flows in respect of net finance costs.

EQUITY AND DIVIDENDS

It is assumed that Fonterra will have a weighted average of 1,559 million Shares on issue at 31 July 2013, an increase of 123 million or 9% on the average number on issue in FY2012. This reflects additional Shares required to be purchased by suppliers as a result of their 2011 / 2012 Season production increase (net of Shares redeemed), plus new Shares expected to be issued in December 2012. For the purposes of the Fonterra Prospective Financial Information, the Shares are assumed to be issued at the current share price of $4.52 per Share. Note that the actual pricing will be determined by the Offer.

Shares on issue and earnings per Share

	NUMBER OF SHARES ON ISSUE	WEIGHTED AVERAGE
	PROSPECTIVE	PROSPECTIVE
At 1 August 2012	1,502 MILLION	1,502 MILLION
Shares issued to suppliers (net of redemptions)	20 MILLION	18 MILLION
Shares issued to make up the shortfall under the Supply Offer	44 MILLION[1]	39 MILLION
At 31 July 2013	**1,566 million**	**1,559 million**

Earnings per Share	**43.2 cents**
Earnings per Share (no Shares issued to make up the shortfall under the Supply Offer)	**43.6 cents**
Earnings per Share ($500 million of Shares issued to make up the shortfall under the Supply Offer)	**42.5 cents**

1 This excludes approximately 33 million Shares which are assumed to be treated as Treasury Stock.

The extent of Fonterra's requirement to issue Shares to make up the shortfall under the Supply Offer is highly uncertain. The scenario assumed in the forecast is an initial issue of $350 million (77 million shares) reducing to $200 million (44 million shares excluding Treasury Stock) by 31 July 2013.

In the event that no issue is required to make up the shortfall in the Supply Offer, net profit after tax attributable to Shareholders is forecast to reduce by $10 million to $663 million, and earnings per Share (based on a weighted average of 1,520 million Shares on issue) is forecast to be 43.6 cents.

In the event that Fonterra issues all the Shares (with no Farmer Shareholders participating in the Supply Offer), net profit after tax attributable to Shareholders is forecast to increase by $4 million to $677 million, and earnings per Share (based on a weighted average of 1,594 million shares on issue) is forecast to be 42.5 cents.

The Fonterra Board intends to declare an interim dividend for the 2012 / 2013 Season in March 2013, to be paid in April 2013, and a final dividend for the 2012 / 2013 Season in September 2013, to be paid in October 2013. The current dividend policy notes that Fonterra will target a payout ratio of 65% to 75% of adjusted net profit after tax each year, and is forecast to remain unchanged. The actual dividend paid will have regard to all relevant factors, but in particular:

- any items that are not expected to recur which affect profit after tax;
- average dividends paid over the previous three years;
- near-term earnings projections, investment priorities and gearing targets; and
- any other factors the Fonterra Board considers relevant, including the level of milk payments to farmers and other existing or likely market conditions that may impact Fonterra or its Shareholders.

The interim dividend is expected to be 40% to 50% of the expected full-year dividend.

Dividends

	($M)	CENTS / SHARE
	PROSPECTIVE	PROSPECTIVE
Interim 2012 / 2013 Season dividend	220	14
Final 2012 / 2013 Season dividend	286	18
Total dividends for the 2012 / 2013 Season	**506**	**32**

Foreign exchange rates have been held constant over the forecast period and consequently there are no significant movements in the foreign currency translation reserve or cash flow hedge reserve (other than the unwinding of cash flow hedging derivatives held on balance sheet at 31 July 2012). There are no significant movements in other reserves of equity accounted investments.

SECTION 4
FONTERRA FINANCIAL INFORMATION CONTINUED

SENSITIVITY ANALYSIS

The Fonterra Prospective Financial Information is inherently subject to business, economic and competitive uncertainty, and accordingly actual results are likely to vary from those in the Fonterra Prospective Financial Information and this variation could be material.

A summary of the stand-alone indicative effect of variations in certain assumptions on the FY2013 Farmgate Milk Price and EBIT are detailed below. The sensitivities for each assumption are not intended to be predictive of the possible range of outcomes.

- Change in all base commodity prices – reflecting an unexpected change across all commodity prices that impacts NZ Milk Products' revenue and, through the Farmgate Milk Price, NZ Milk Products' cost of goods sold. Assumes no material impact on gross profit for non-Reference Commodity Product streams, and that the regional businesses are able to pass through the change with no impact on profitability.
- Change in non-Reference Commodity Product prices only – reflecting a change in the prices of non-Reference Commodity Products with no corresponding change in the prices of Reference Commodity Products, resulting in a change in NZ Milk Products' revenues with no impact on cost of goods sold. Assumes that the regional businesses are able to pass through the change with no impact on profitability.
- Change in average NZ$:US$ exchange rate – impacting the unhedged portion of NZ Milk Products' sales priced in US dollars, the cost of New Zealand milk, and net offshore margins.
- Change in kgMS of New Zealand-sourced milk – reflecting unplanned increases or decreases in New Zealand-sourced milk volumes for the current Season arising from unexpected climatic or other supply-related factors, taking into account current production capacity. This sensitivity analysis highlights the impact of volume on Fonterra's ability to optimise product mix during the period of peak supply within the current Season, but may not be representative of the impact of longer-term supply volume growth for which Fonterra is constructing additional capacity.
- Change in ANZ EBITDA margin percentage - reflecting the significant risk to earnings recovery in view of continuing competitive pressure and its impact on listings and margins.
- Change in volume of consumer and out-of-home foodservices sales in Asia / AME – reflecting an unexpected change in market growth and / or market share.

Care should be taken in interpreting the information set out below. Each movement in an assumption is treated in isolation from possible movements in other assumptions, which is not likely to be the case. Movements in one assumption may have offsetting or compounding effects on other variables, the effects of which are not reflected (e.g. changes in commodity prices may affect the NZ$:US$ exchange rate). In addition, it is possible that more than one assumption may move at any point in time giving rise to cumulative effects, which are also not reflected. The sensitivity analysis does not take into account any potential mitigating actions that management may take. The +/- range in the parameters below is illustrative of the potential impacts of volatility averaged across a full-year. The assumptions may vary significantly more or less than the parameters within shorter periods.

ASSUMPTION	INCREASE / (DECREASE)	FY2013 MILK PRICE IMPACT ($ / kgMS)	FY2013 EBIT IMPACT ($M)
Change in all base commodity prices	+/- 10%	0.75 / (0.75)	(25) / 25
Change in non-Reference Commodity Products prices only	+/- 5%	-/-	125 / (125)
Change in average NZ$:US$ exchange rate	+/- 5%	(0.16) / 0.20	(29) / 35
Change in kgMS of New Zealand-sourced milk collected	+/- 10%	0.10 / (0.12)	(14) / 9
Change in ANZ EBITDA margin percentage	+/- 1%	-/-	36 / (36)
Change in Asia / AME sales volume	+/- 10%	-/-	30 / (30)

While the table above is illustrative, it nonetheless highlights the external factors that have the most significant impact on Fonterra's EBIT.

As illustrated in the table above, a change in the prices of non-Reference Commodity Products relative to the prices of Reference Commodity Products which are used to calculate the Farmgate Milk Price has the most significant potential stand-alone impact on EBIT.

In contrast, the impact of significant movements in the general level of commodity prices has a much lesser impact on EBIT. Most of the effect of across-the-board changes in commodity prices is passed through into a higher or lower Farmgate Milk Price. The same observation generally applies to changes in the NZ$:US$ exchange rate.

FONTERRA SIGNIFICANT ACCOUNTING POLICIES

These significant accounting policies reflect those used by Fonterra in the preparation of its financial statements for FY2012, as updated to describe the accounting and disclosure policies in respect of the consolidation of the Fund into the Fonterra Group for accounting purposes.

(A) BASIS OF CONSOLIDATION

Subsidiaries

Subsidiaries are entities controlled by the Fonterra Group. Control exists when the Fonterra Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Fonterra Group controls another entity. Subsidiaries are fully consolidated from the date that control is transferred to the Fonterra Group. They are de-consolidated from the date control ceases.

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. Acquisition-related costs are expensed as incurred. On an acquisition-by-acquisition basis, the Fonterra Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree, over the fair value of the Fonterra 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 in the income statement.

Non-controlling interests are allocated their share of profit for the year in the income statement and are presented within equity in the statement of financial position, separately from equity attributable to Shareholders. The effects of all transactions with non-controlling interests that change the Fonterra Group's ownership interest but do not result in a change in control are recorded in equity. Where control is lost, the remaining interest in the investment is re-measured to fair value and any surplus or deficit arising from that re-measurement is recognised in the income statement.

Equity accounted investees (associates and jointly controlled entities)

Associates are those entities in which the Fonterra Group has significant influence, but not control, over the financial and operating policies. Jointly controlled entities are those entities over whose activities the Fonterra Group has joint control, established by contractual agreement and requiring unanimous consent for strategic, financial and operating decisions. Equity accounted investees are initially recognised at cost (including any goodwill identified on acquisition). Subsequent to initial recognition, they are accounted for using the equity method in the consolidated financial statements.

The consolidated financial statements include the Fonterra Group's share of the profit or loss after tax of equity accounted investees, after adjustments to align to the accounting policies of the Fonterra Group, from the date that significant influence or joint control commences until the date that significant influence or joint control ceases. When the Fonterra 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 Fonterra Group has an obligation or has made payments on behalf of the investee. Dividends receivable from equity accounted investees reduce the carrying amount of the investment.

The Fonterra Group determines at each reporting date whether there is any objective evidence that its investments in equity accounted investees are impaired. If this is the case, the Fonterra Group calculates the amount of impairment as the difference between the recoverable amount of the investee and its carrying value, and recognises that amount in the income statement.

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 Fonterra Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

(B) FOREIGN CURRENCY

Foreign currency transactions

Foreign currency transactions are translated into the respective functional currencies of Fonterra 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 balance date, of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in other comprehensive income as qualifying cash flow or qualifying net investment hedges.

Translation of the financial statements into the presentation currency

Where the Fonterra Group'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 balance 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. 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.

(C) FINANCIAL ASSETS AND LIABILITIES

A financial asset or liability is recognised if the Fonterra 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 less any provision for impairment. After initial recognition, financial liabilities are measured at amortised cost method except for financial liabilities at fair value through profit or loss.

In the separate financial statements of the Parent, investments in subsidiaries are stated at cost, less any impairment.

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

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis.

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 financial assets and liabilities at initial recognition. The Fonterra Group has not had any held-to-maturity investments or available-for-sale financial assets in the periods covered by the FY2012 financial statements.

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

Financial assets and liabilities in this category are either designated as fair value through profit or loss, or classified as held for trading. All derivatives are classified as held for trading except when they are in cash flow, fair value, or net investment hedge relationships (refer to accounting policy (h) below). Other financial assets and financial liabilities may be designated at fair value through profit or loss where this eliminates an accounting mismatch, or where they are managed on a fair value basis.

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.

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 debt instruments are classified as financial liabilities measured at amortised cost.

Financial guarantee contracts

Financial guarantee contracts are those contracts that require the issuer to make specific payments to reimburse the holder for a loss it incurs if a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. Financial guarantee contracts are recognised initially as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequently, the liability is measured at the higher of the best estimate of the expenditure required to settle the present obligation at the balance date, and the amount initially recognised less cumulative amortisation.

(D) CASH BALANCES

Cash balances include cash and cash equivalents comprising 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.

(E) TRADE RECEIVABLES

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

(F) 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, except where they relate to borrowings classified as net investment hedges and are recorded directly in other comprehensive income.

Borrowings are classified as current liabilities unless the Fonterra Group has an unconditional right to defer settlement of the liability for at least 12 months after balance date.

(G) TRADE AND OTHER PAYABLES

Trade and other payables are carried at amortised cost.

(H) DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

The Fonterra 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.

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 re-measured to 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 Fonterra Group designates certain derivatives as:

- 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 Fonterra 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 Fonterra 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 12 months. It is classified as a current asset or liability when the maturity of the hedged item is less than 12 months.

Fair value hedges

Changes in the 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 attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used, is amortised and recognised in the income statement over the period to maturity.

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 other comprehensive income. 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.

When the forecast transaction that is hedged results in the recognition of a non-financial asset (e.g. inventories or property, plant and equipment), the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset.

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 hedge is recognised in other comprehensive income. 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 all or part of a foreign operation is disposed of or sold.

(I) INVENTORIES

Inventories are stated at the lower of cost and net realisable value on a first in first out basis.

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 supplied in New Zealand is established by using the monthly Farmgate Milk Price as the cost for raw milk supplied. 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.

(J) PROPERTY, PLANT AND EQUIPMENT

Owned assets

Items of property, plant and 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 Fonterra Group and the cost of the item can be measured reliably. The carrying amount of any replaced part is de-recognised. 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.

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 and equipment is as follows:

Land	Indefinite
Buildings and leasehold improvements	15 to 50 years
Plant, vehicles and equipment	3 to 25 years

Leased assets

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

Assets under finance leases are recognised as property, plant and equipment in the statement of financial position. 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 and equipment.

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

(K) INTANGIBLE ASSETS

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Fonterra 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.

Goodwill is carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Goodwill is tested annually for impairment or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. 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.

Brands and other identifiable intangible assets

Brands and other intangible assets purchased by the Fonterra Group are recognised if 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 for impairment annually or whenever there is an indication that an asset may be impaired 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 (18 to 25 years). Assets that have been impaired are reviewed for possible reversal of impairment 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.

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 Fonterra Group, and that will 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 licences and development costs recognised as assets are amortised over their estimated useful lives, being three to ten 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 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.

(L) IMPAIRMENT OF FINANCIAL ASSETS

Assets carried at amortised cost

The Fonterra Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria that the Fonterra Group uses to determine that there is objective evidence of an impairment loss include:

- significant financial difficulty of the customer;
- a breach of contract, such as a default or delinquency in payments;
- for economic or legal reasons relating to the customer's financial difficulty, granting to the customer a concession that the Fonterra Group would not otherwise consider; and
- it becomes probable that the customer will enter bankruptcy or other financial reorganisation.

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate and is recognised in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the reversal of the previously recognised impairment loss is recognised in the income statement.

Impairment of non-financial assets

Intangible assets that have an indefinite useful life are not subject to amortisation and are tested for impairment annually or whenever there is an indication that an asset may be impaired. 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 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 its 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 have been impaired are reviewed for possible reversal of the impairment at each balance date.

(M) PROVISIONS

Provisions are recognised only in those circumstances where the Fonterra 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 the passage of time is recognised as a finance cost in the income statement.

(N) SUBSCRIBED EQUITY

Equity instruments comprise Co-operative shares and Units and are classified as subscribed equity. Incremental costs directly attributable to equity transactions are recognised as a deduction from subscribed equity.

(O) REVENUE RECOGNITION

Revenue from the sale of goods is recognised at the fair value of the consideration received or receivable, net of returns, discounts and allowances. 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.

Dividend income is recognised when the right to receive payment is established.

(P) NEW ZEALAND-SOURCED COST OF MILK

New Zealand-sourced cost of milk includes milk supplied by Shareholder suppliers, supplier premiums paid, and milk purchased from contract suppliers during the financial year. New Zealand-sourced cost of milk is recognised in cost of goods sold.

New Zealand-sourced cost of milk supplied by Shareholder suppliers comprises the volume of milksolids supplied at the Farmgate Milk Price for the relevant Season. The Farmgate Milk Price for each Season is calculated in accordance with the principles set out in the Farmgate Milk Price Manual and is independently audited. The Farmgate Milk Price broadly represents the maximum sustainable amount a New Zealand-based manufacturer of milk powders could afford to pay for milk and still make an adequate return on capital.

Supplier premiums are paid for specialty milks such as winter milk and colostrum.

(Q) DIVIDENDS

All shares are eligible to receive dividends if declared by the Fonterra Board. Dividends are recognised as a liability in the Fonterra Group's financial statements in the period in which they are declared by the Fonterra Board.

(R) EMPLOYEE BENEFITS

Employee benefits primarily include short-term employee benefits, long-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.

Long-term employee benefits are measured at the present value of expected payments required using an appropriate pre-tax discount rate.

Contributions to defined contribution pension plans are recognised as an expense in the period they are due. The Fonterra 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 the hedged risks on certain debt instruments, and gains and losses relating to translation forward points on forward exchange contracts where revaluation gains and losses on those contracts are included within finance costs. Interest expense and the unwinding of the discount on provisions are recognised in the income statement using the effective interest method. Finance costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of that asset.

(T) TAX

Tax expense comprises current and deferred tax. Tax expense, including the tax consequences of distributions to Shareholders, is recognised in the income statement. The tax consequences of distributions to Shareholders are recognised in the year to which the distribution relates. Other than distributions to Shareholders, tax consequences of items recognised directly in equity are also recognised in equity.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the balance 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 balance date.

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 Fonterra 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) EARNINGS PER SHARE

Earnings per Share is calculated as net profit attributable to equity holders of Fonterra Co-Operative Group Limited, divided by the weighted average number of ordinary shares on issue during the year.

SECTION 5 TRADING AMONG FARMERS IN DETAIL

INTRODUCTION

A summary of Trading Among Farmers is set out in the section entitled *Overview of Trading Among Farmers*. This section:

- explains important features of the Fonterra Shareholders' Fund; and
- explains important features of the Fonterra Shareholders' Market, so that Unit Holders understand how that market will operate, and how it works alongside the Fund.

Trading Among Farmers is the name which has been given to a series of inter-related arrangements.

In essence, they involve the establishment of the:

- **Fonterra Shareholders' Market** – this market:
  - permits Farmer Shareholders to trade Shares among themselves; and
  - requires one or more market makers (called the Registered Volume Provider or RVP) to operate in it.
- **Fonterra Shareholders' Fund** – this has the following features:
  - the Fund will have the Units it issues quoted on the NZX Main Board and ASX, which facilitates the trading of those Units by investors;
  - it will allow Farmer Shareholders to continually exchange a Share for a Unit but they must sell that Unit on the NZX Main Board during the periods of operation of the Fonterra Shareholders' Market;
  - the Registered Volume Provider can exchange a Share for a Unit which it can retain or sell; and
  - each of the Farmer Shareholders, Fonterra and the RVP can exchange a Unit for a Share.

A high level overview of these two markets is shown below. Although the markets are separate, they have been designed to work together. Farmer Shareholders, Fonterra and the RVP can buy or sell Shares in the Fonterra Shareholders' Market, and buy or sell Units on the NZX Main Board or ASX. They can effectively exchange Shares for Units and *vice versa* and therefore can shift between the two markets.

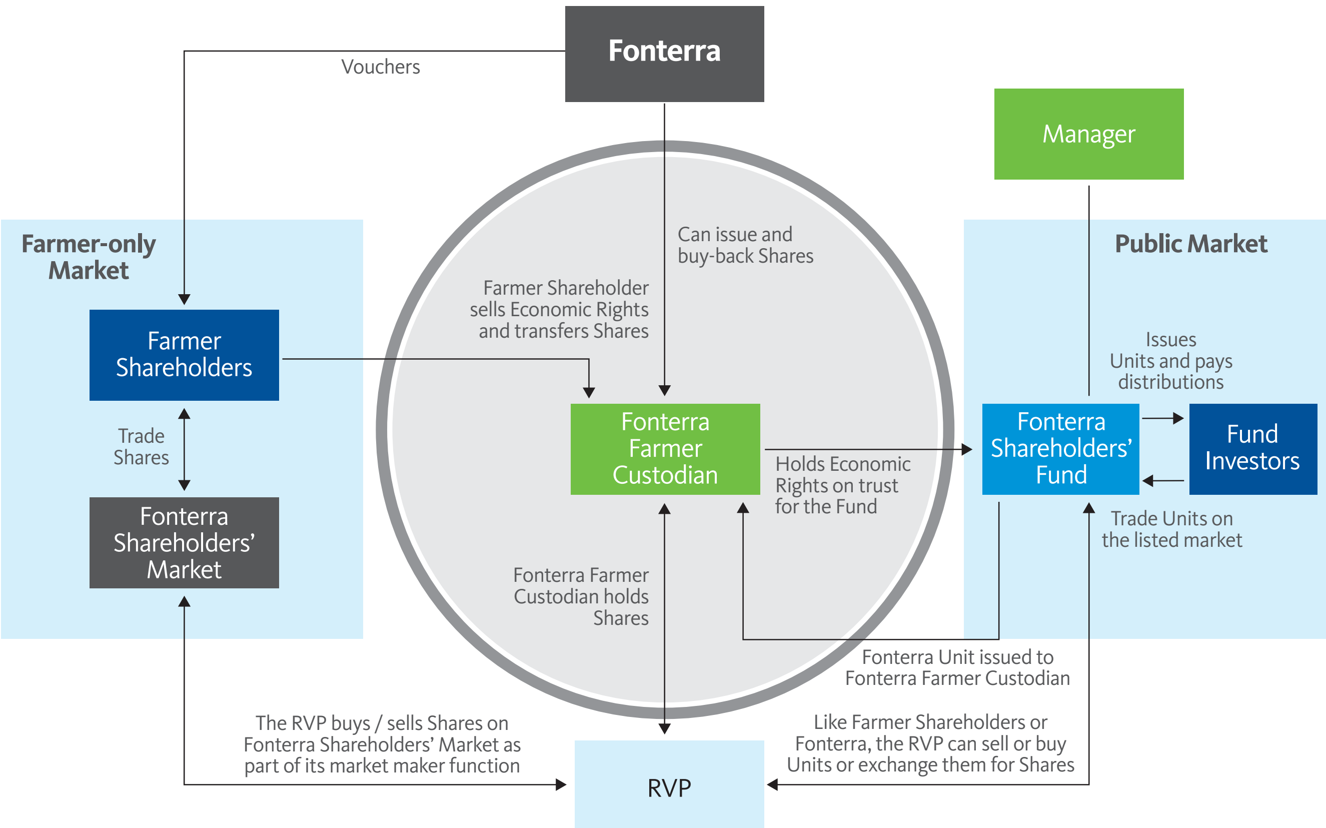
FONTERRA SHAREHOLDERS' MARKET

Fonterra Shareholders are required, by a Share Standard, to hold a certain number of Shares in Fonterra in each dairy Season.

Currently, Fonterra is required by DIRA and its existing Constitution to:

- repurchase Shares that Farmer Shareholders are required to dispose of so as to comply with the Share Standard; and
- issue new Shares if Farmer Shareholders wish to acquire further Shares.

OVERVIEW OF STRUCTURE OF TRADING AMONG FARMERS



Source: Fonterra

SECTION 5 TRADING AMONG FARMERS IN DETAIL CONTINUED

The repurchases and issues are undertaken at the same value. Fonterra is therefore currently exposed to the risk that it may have to pay large sums of money to Farmer Shareholders who cease to supply, or reduce supply of, milk to Fonterra.

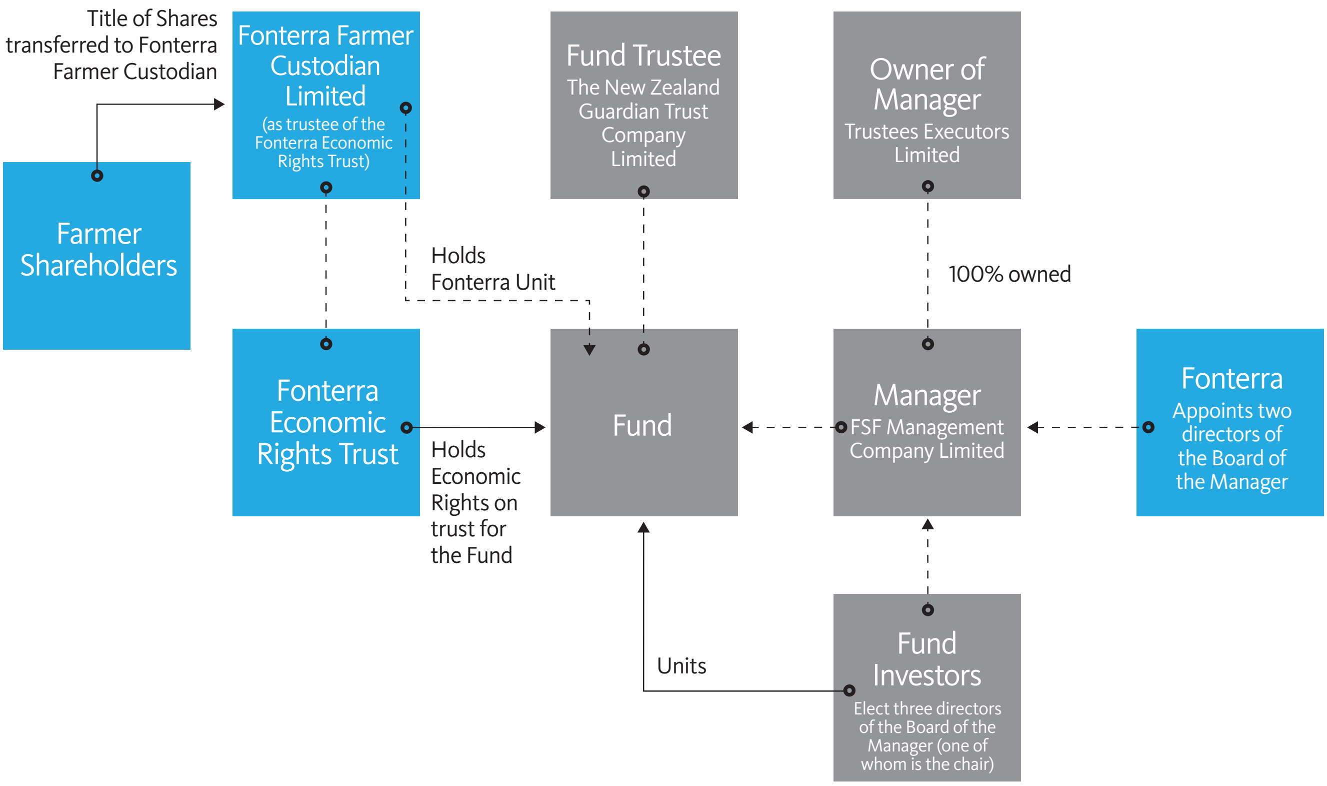
Under Trading Among Farmers, Fonterra's obligation to acquire Shares and to issue new Shares will cease. Instead, Farmer Shareholders will trade Shares among themselves on a new market – the Fonterra Shareholders' Market. Farmer Shareholders will continue to be required to hold Shares in accordance with the Share Standard. Fonterra's objective is that sufficient Fonterra Shares will be on issue to promote a liquid market for Shares, to enable Farmer Shareholders to be able to adjust their shareholding as their milk production increases. To achieve this goal, Fonterra has two key options. It can issue new Shares to raise new equity capital, if required. Alternatively, it can undertake a bonus issue where new equity capital is not required. In either case, the Manager will undertake an equivalent adjustment to the number of Units on issue.

Within the context of Fonterra's Fund Size Risk Management Policy (as described in Section 5 – *Trading Among Farmers in Detail*), Fonterra will also manage the number of Shares on issue if production over time falls resulting in Farmer Shareholders holding Shares in excess of the minimum requirements related to milk production. Unlike today, Fonterra will no longer have an obligation to redeem Shares where this occurs. Instead, it will have more flexibility in the manner and timing of meeting the requirements of the Fund Size Risk Management Policy (through, for example, a Share buy back programme).

Farmer Shareholders will continue to be permitted to hold more or fewer Shares than is prescribed by the Share Standard in a number of situations, including:

- the Share Standard can be met by using a combination of Shares, as well as Vouchers (Vouchers are discussed later in this section);
- Shareholders can hold up to 200% (or a lesser percentage specified by the Fonterra Board) of the number of Shares required to meet the Share Standard;
- if a Farmer Shareholder is a new entrant, they may be given time to achieve full compliance with the Share Standard; and
- retiring Farmer Shareholders who have ceased to supply milk to Fonterra may be given additional time to dispose of their shareholding.

FUND STRUCTURE



Source: Fonterra

To assist in achieving a liquid market, Fonterra has engaged the services of a market maker (called the Registered Volume Provider or RVP). The Registered Volume Provider is required to be continuously active in offering to buy and sell Shares in the Fonterra Shareholders' Market so that Farmer Shareholders will have a party willing to trade at least a minimum volume of Shares. This is also a requirement of DIRA. The initial RVP engaged by Fonterra is Craigs Investment Partners Limited. Under the terms of the RVP Agreement the RVP has agreed that, other than where trading in Shares on the Fonterra Shareholders' Market has been halted or suspended, it will:

- offer a minimum of four buy and four sell quotes for Shares on the Fonterra Shareholders' Market per minute during each Trading Period. This is known as the Minimum Quote Frequency;
- ensure that each quote it offers: is maintaining a maximum bid-ask spread of $0.03 between the best bid / ask quotes (known as the Maximum Bid-Ask Spread); provides 1,000 Shares at each price point for which buy / sell quotes are offered; and complies with a minimum tick size of $0.01; and
- provide a stock lending facility (out of Shares held in accordance with the terms of the custody deed entered between Fonterra, the RVP and the Fonterra Farmer Custodian) to FSM Participants in order to resolve failed trades.

In certain extreme market conditions, the Minimum Quote Frequency and Maximum Bid-Ask Spread may be relaxed. In such circumstances, the Maximum Bid-Ask Spread cannot be increased to greater than $0.10 and the Minimum Quote Frequency cannot be reduced to less than two buy and two sell quotes per minute during the relevant period.

However, the RVP is not permitted by Fonterra to own any Shares. The Shares that the RVP has an interest in will be held in trust for it by the Fonterra Farmer Custodian, Fonterra Farmer Custodian Limited.

Fonterra Farmer Custodian Limited is a special purpose company owned by a specially created trust, known as the Fonterra Farmer Custodian Trust.

MARKET STRUCTURE

The Fonterra Shareholders' Market has been approved by the Financial Markets Authority as a registered market under the Securities Markets Act. The Fonterra Shareholders' Market will be operated by NZX and regulated by the Financial Markets Authority.

Fonterra and NZX have entered into a Market Operator Agreement which sets out the basis on which NZX will operate the market. The agreement requires Fonterra to comply with a set of rules (the FSM Rules). These rules are based on the NZSX Listing Rules (which apply to companies listed on the NZX Main Board) although there are differences. Both the FSM Rules and the NZSX Listing Rules are publicly available at www.nzx.com.

The key elements of the Fonterra Shareholders' Market and the Fund are set out in the diagram entitled "Fund Structure" on the previous page.

FONTERRA SHAREHOLDERS' FUND

The Fonterra Shareholders' Fund is designed to enable an investor who is not a Farmer Shareholder to buy a security that passes through Economic Rights that would be received if the investor owned a Share directly.

The Fund is a unit trust under the Unit Trusts Act. Its Units will be quoted on the NZX Main Board and ASX. The Fund was established under the Trust Deed, which was entered into by the Manager, Fonterra and the Trustee on 23 October 2012. A summary of the principal terms of the Trust Deed is contained in Section 10 – *Statutory Information*.

TRUSTEE

The Trustee is The New Zealand Guardian Trust Company Limited, an independent trustee company which is licensed to act as trustee of the Fund under the Securities Trustees and Statutory Supervisors Act.

MANAGER

The Manager is FSF Management Company Limited. The Manager will manage the trust and other property of the Fund and will issue Units to the public.

The Manager is owned by Trustees Executors Limited, an independent trustee company which is licensed under the Securities Trustees and Statutory Supervisors Act.

The Manager will play a relatively contained role in relation to the Fund. While acting as the Manager, its sole object is to manage the Fund and its property as a passive investment vehicle under the Trust Deed subject to undertaking the initial Supply Offer.

Trustees Executors Limited holds the single share in the Manager in accordance with a Shareholding Deed it entered into with the Manager and Fonterra, which sets out how it must exercise its rights as shareholder of the Manager.

There are strict controls on the holding of the share in the Manager. It must be held by a trustee company which holds a licence under the Securities Trustees and Statutory Supervisors Act. In addition, the transfer of the share or the issue of further shares in the Manager is not permitted without the approval of Fonterra.

Trustees Executors Limited can retire from holding the sole share in the Manager by giving 90 days' notice to the Manager, Fonterra and the Trustee. A new shareholder who is acceptable to Fonterra and the Trustee must be found before the share in the Manager can be transferred.

AUTHORISED FUND

The Fonterra Shareholders' Fund is an "Authorised Fund" for the purposes of the Constitution.

The Constitution states that:

- the Fonterra Board can:
  - authorise an Authorised Fund to acquire, hold or dispose of rights or interests in Shares;
  - permit an Authorised Fund to enter into arrangements with Farmer Shareholders for the acquisition of those rights or interests; and
  - require the underlying Shares, the subject of the rights or interests, to be held by a custodian;
- the role of an Authorised Fund must be set out in an Authorised Fund contract;
- the Fonterra Board can set limits on the extent to which individual Farmer Shareholders can dispose of rights or interests in Shares to an Authorised Fund. These limits can be changed from time to time by the Fonterra Board;
- there is an overall threshold on the aggregate number of Shares in which rights or interests may be held for or in relation to any Authorised Fund. The Constitution sets this threshold at 25% of the total number of Shares on issue (excluding Treasury Stock), but the Fonterra Board has resolved to reduce this threshold to 20%. This is confirmed by the SHC Deed Poll. The Fonterra Board intends to recommend to Farmer Shareholders that they amend the Constitution at the 2012 Fonterra annual meeting to include this lower threshold and other changes relating to Trading Among Farmers; and

- if the overall threshold is breached, the Fonterra Board is required to take steps (within a timeframe it considers appropriate) to cause the number of Shares which are subject to arrangements with the Authorised Fund to be reduced to a number below the threshold. In practice, the Fonterra Board intends to manage the number of Shares subject to the above arrangements, below the 20% threshold. It will do so under its Fund Size Risk Management Policy described later in this section.

AUTHORISED FUND CONTRACT

Fonterra, the Manager, the Trustee and the Fonterra Farmer Custodian have entered into the Authorised Fund Contract, which authorises the Fund to operate as an Authorised Fund and regulates the relationship between Fonterra and the Fund.

The Fund will acquire, hold and dispose of Economic Rights of Shares. The underlying Shares will be held by the Fonterra Farmer Custodian, who agrees to hold the Economic Rights of Shares on trust for the Trustee.

OPERATION OF THE FUND

The Fund will operate by acquiring Economic Rights of Shares and issuing one Unit for each Share in respect of which Economic Rights are held for the Fund. Each Unit will constitute an undivided interest in the trust fund comprising the Fund. The Fund is designed to have the effect that each Unit on issue will confer on its holder the Economic Rights derived from the holding of a single Share.

An outline of the process by which the Fund will continuously acquire Economic Rights and issue Units following the launch of the Fund is set out in Section 10 – *Statutory Information* under the heading "Ongoing issue of Units".

REGISTERED VOLUME PROVIDER (RVP)

The RVP will also be able to exchange Shares for Units (and *vice versa*) (with Shares held on behalf of the RVP by the Fonterra Farmer Custodian). This is intended to promote price convergence between the prices of Shares trading on the Fonterra Shareholders' Market and the prices of Units trading on the NZX Main Board and ASX. There is, however, no assurance that convergence of prices will be achieved or, if achieved, maintained.

The RVP will operate under a contract entered into with Fonterra. As described above, that contract requires the RVP to be continuously active in making offers to buy and sell Shares in the Fonterra Shareholders' Market. It governs the maximum buy-sell spread the RVP can offer, the frequency of refreshment of offers and other standard features of a market-making agreement. The RVP is also expected to trade Units in the Unit market as the RVP is (through the Fonterra Farmer Custodian) able to exchange a Share for a Unit and *vice versa*.

Economic Rights

The Economic Rights of a Share are the rights to receive dividends and other economic benefits derived from a Share, as well as other rights derived from owning a Share.

However, these rights do not include the right to hold legal title to the Share (i.e. to become registered as the holder of the Share), or to exercise voting rights, except in very limited circumstances. These circumstances are described in further detail later in this section.

The Fund becomes entitled to Economic Rights of a Share in the following way:

- Farmer Shareholders and the Fonterra Farmer Custodian on behalf of the RVP can transfer, and Fonterra can issue, Shares to the Fonterra Farmer Custodian. The Fonterra Farmer Custodian holds the Economic Rights of those Shares on trust for the Trustee, under a trust called the Fonterra Economic Rights Trust;
- if the transferor of the Share is a Farmer Shareholder, they will receive one Unit for each Share transferred to the Fonterra Farmer Custodian, but that Unit must immediately be sold on the NZX Main Board. The result is that the Farmer Shareholder receives cash for the Shares transferred to the Fonterra Farmer Custodian;
- if the transferor of the Share is the RVP (through the Fonterra Farmer Custodian), it may retain the Units issued to it for the Shares it transfers to the Fonterra Farmer Custodian; and
- where Fonterra issues Shares to the Fonterra Farmer Custodian, it is not entitled to receive Units as consideration and would receive cash instead.

This is what is meant in this Offer Document wherever there is a reference to "sell Economic Rights of Shares" to the Fund.

It is important to note that:

- when Economic Rights are held for the Trustee, the underlying Shares are sold to the Fonterra Farmer Custodian. Only the Fonterra Farmer Custodian can hold those Shares;
- the Fund does not own the Shares. The only rights of the Fund in relation to the Shares are those provided to it by the Fonterra Economic Rights Trust;
- no Unit Holder has any right to receive, or to hold, any Shares unless they are a Farmer Shareholder, the Fonterra Farmer Custodian on behalf of the RVP or Fonterra; and
- any action taken to enforce the legal rights that arise from the holding of a Share can only be taken in the name of the Fonterra Farmer Custodian, as the registered Shareholder.

FURTHER DETAIL ON ECONOMIC RIGHTS

The Economic Rights of a Share will be passed through to Unit Holders in the following way:

- any cash dividend or other cash benefit paid by Fonterra in respect of a Share will be distributed by the Fund to Unit Holders at the same time as it is paid by Fonterra to its Farmer Shareholders. The amount distributed will be the same as the amount paid by Fonterra per Share, less any PIE tax, withholding tax or any other adjustments for tax in relation to that Unit Holder;
- where the Fonterra Farmer Custodian receives Shares issued by Fonterra as a bonus issue in relation to Shares for which the Fonterra Farmer Custodian holds the Economic Rights for the Trustee, the Manager will make a corresponding bonus issue of Units at the same time as the bonus issue is made by Fonterra;
- if Fonterra gives holders of Shares, including Shares held by the Fonterra Farmer Custodian, the right to acquire further Shares, the Manager will, at the same time, give Unit Holders a corresponding right to acquire further Units in the Fund;
- if Fonterra gives holders of Shares, including Shares held by the Fonterra Farmer Custodian, the right to acquire securities (other than Shares or securities convertible into Shares), the Manager will give Unit Holders the right to acquire those securities;
- if there is an offer to acquire Shares held by the Fonterra Farmer Custodian, the Manager will make a corresponding offer to redeem Units. The Fonterra Farmer Custodian will accept the Share offer for a number of Shares equal to the number of Units which Unit Holders have elected to be redeemed. When Shares are transferred, the relevant Units will be redeemed and the Unit Holders who elected to redeem Units will receive the cash or other consideration for that sale, subject to adjustments for tax purposes; and
- as not all Unit Holders are permitted to own Fonterra Shares, it is not feasible for Unit Holders to hold instruments that convert to Shares. If, in the future, Fonterra offers holders of Shares, including the Fonterra Farmer Custodian, the right to acquire a security convertible into Shares, the Manager will instruct the Fonterra Farmer Custodian to dispose of that right at the best price reasonably obtainable at the time. When the Manager receives the sale proceeds, they will be distributed to Unit Holders, subject to adjustments for tax purposes.

OTHER KEY FEATURES OF THE FONTERRA SHAREHOLDERS' FUND

The Fonterra Unit

The trustees of the Fonterra Farmer Custodian Trust will hold one Fonterra Unit issued by the Manager of the Fund. The Fonterra Unit will not be quoted on any stock exchange. Subject to the terms of the NZSX Listing Rules, the Trust Deed cannot be amended without the prior written approval of the Fonterra Unit Holder, if that amendment would change:

- the governance structure of the Board of the Manager, including the number of Elected Directors, the manner of their election, or the number of directors of the Manager appointed by Fonterra and the manner of their appointment;
- the scope and role of the Fund;
- the obligation of the Fund to facilitate the exchange of a Share for a Unit or a Unit for a Share;
- the limit of 15% on the number of Units that can be held by any person and their Associates (other than Fonterra) in the Fund; or
- the terms of the Fonterra Unit itself.

In other respects, the Fonterra Unit will have the same rights as any other Unit issued by the Manager.

The way in which the trustees of the Fonterra Farmer Custodian Trust will exercise the rights attached to the Fonterra Unit is regulated under the Fonterra Farmer Custodian Trust Deed. The trustees will only give approval after receipt of a direction to that effect from Farmer Shareholders.

If the Fonterra Unit is transferred to any other person without Fonterra's approval, it will cease to have the rights set out above. It will then have the same rights and limitations as any other Unit in the Fund.

The Fonterra Farmer Custodian is a Shareholder

The trustees of the Fonterra Farmer Custodian Trust will also hold the shares in the Fonterra Farmer Custodian. The Fonterra Farmer Custodian is a special purpose company incorporated to hold legal title to Shares in three separate capacities.

The Fonterra Farmer Custodian Trust Deed requires the trustees of the Fonterra Farmer Custodian Trust to ensure that the constitution of the Fonterra Farmer Custodian provides as follows:

- the Fonterra Farmer Custodian has been established for the sole purpose of acting as the trustee of three separate trusts;
- the Fonterra Farmer Custodian must perform its obligations in accordance with the deeds establishing those three separate trusts;
- the Fonterra Farmer Custodian is to undertake no other business, or acquire any other assets, and have no liabilities except as arise from its obligations under the deeds or as otherwise approved by Fonterra;
- the shares in the Fonterra Farmer Custodian may only be held by the trustees of the Fonterra Farmer Custodian Trust, and those trustees may not mortgage or grant any security interest over those shares; and
- the only persons entitled to be appointed as directors of the Fonterra Farmer Custodian are the trustees of the Fonterra Farmer Custodian Trust, or such other persons as are unanimously nominated by those trustees.

The Fonterra Farmer Custodian will hold the legal title to Shares in respect of which Economic Rights are held for the Trustee. This means it is a Shareholder of Fonterra, which gives it rights under the Fonterra Constitution and other legal rights of a shareholder, for example, rights granted to it as a shareholder under the Companies Act which it may seek to exercise, if the Manager directs it to do so, if the Manager is concerned that actions of Fonterra are prejudicial to the interests of the Unit Holders. The rights referred to above are subject to restrictions set out in the Authorised Fund Contract and the Custody Trust Deed, which are also reflected in the Trust Deed. A detailed summary of these restrictions is set out under the heading "Description of unit trust and its development" in Section 10 – *Statutory Information*, in particular, under the subheadings "Investments" and "Rights, benefits and entitlements arising from Shares".

SECTION 5 TRADING AMONG FARMERS IN DETAIL CONTINUED

In addition, if a proposal is put forward which affects the rights attached to Shares held by the Fonterra Farmer Custodian in a way which is different from the effect on the rights attached to other Shares, the Manager of the Fund can direct the Fonterra Farmer Custodian to exercise any interest group voting right which may arise under sections 116 and 117 of the Companies Act.

FSM Rules

The FSM Rules, which are enforceable by Shareholders, require that the following key decisions must be approved by not less than a 75% majority of the Fonterra Board, with such majority including at least a majority of the "Appointed" or "Independent" directors of Fonterra:

- a decision to pay an aggregate amount for milk in excess of the amount calculated under the Farmgate Milk Price Manual;
- a decision to amend or replace the Farmgate Milk Price Manual;
- a decision to promote or support an amendment (or replacement) of the Fonterra Constitution that would have a material adverse effect on the rights attached to Shares which are held by the Fonterra Farmer Custodian in respect of which Economic Rights are held for the Trustee; and
- a decision to appoint an Appointed Director of Fonterra who has not been supported by a majority of the Elected Directors of the Manager.

Each of these decisions could normally be taken by a simple majority resolution of the Fonterra Board. The FSM Rules recognise that these decisions of the Fonterra Board are particularly important and, in the case of the first three decisions, could have an impact on the returns derived by all Shareholders, including the Shares held by the Custodian (the Economic Rights of which are held for the Fund). The FSM Rules therefore require a higher than normal majority for these resolutions, and require the agreement of a majority of the Independent Directors on the Fonterra Board.

The FSM Rules can be changed by agreement between Fonterra and NZX (as the operator of the Fonterra Shareholders' Market). Any such change also requires the approval of the Financial Markets Authority.

Actions against Fonterra

Fonterra has agreed that if a Queen's Counsel or Senior Counsel considers that the Fund has a cause of action against Fonterra and / or the Fonterra Farmer Custodian for breach of its obligations under the Authorised Fund Contract, the Trust Deed and / or the Custody Trust Deed, Fonterra will meet the reasonable costs of investigating and bringing that claim. However, if on two successive occasions the opinion of counsel is that the Fund does not have a cause of action, on the next occasion the Fund must bear counsel's cost itself. In this situation, the Manager may seek a direction from Unit Holders as to whether the opinion is sought and may seek a resolution of Unit Holders to incur that cost.

If Unit Holders or the Manager wish to pursue any other actions or claims against Fonterra, Fonterra will not cover the costs of bringing such a claim and the Unit Holders would need to agree how to fund any such claim and instruct the Manager accordingly. This could involve the Unit Holders agreeing (by way of Extraordinary Resolution) that the Manager may deduct an amount from the distributions received in respect of their Units to fund any investigation and / or bring any such claim.

Role of the Fund in approving Independent Directors of Fonterra

The Elected Directors of the Manager will be consulted in relation to the appointment of the Appointed Directors. The Chairman of the Fonterra Board will consult with the Chairman of the Board of the Manager in relation to the appointment of these Appointed Directors, and will seek the support of the Elected Directors of the Manager for the appointment of each of the Appointed Directors.

Following consultation, the Chairman of the Fonterra Board will advise the Chairman of the Board of the Manager who the Fonterra Board has appointed, and will also advise whether this appointment is ratified by Shareholders at the next annual meeting of Shareholders. Shareholders must ratify the Fonterra Board's appointment of an Appointed Director at the next annual meeting. Prior to doing so, Farmer Shareholders will be advised if the Appointed Director does not have the support of the Elected Directors of the Board of the Manager.

When each Appointed Director is appointed, Fonterra will announce to the Fonterra Shareholders' Market, NZX Main Board and ASX if the appointment was not supported by a majority of the Elected Directors.

Voting rights in respect of Fonterra

Voting entitlements at meetings of Shareholders are based on the supply of milk to Fonterra.

This means that the Fonterra Farmer Custodian cannot exercise any voting rights attached to Shares, notwithstanding that it is a Shareholder, because the Fonterra Farmer Custodian does not supply any milk to Fonterra. None of the Trustee, Manager or any Unit Holder in its capacity as the holder of a Unit can exercise any voting rights attached to Shares as none is a Shareholder, or request or require the Fonterra Farmer Custodian to do so.

Each of the Manager, Trustee and Unit Holders are not permitted to, and will not, require the Fonterra Farmer Custodian to call, attend or speak at any meeting of Shareholders (unless invited to do so by Fonterra), or represent to any third party that it is entitled to do any of the above, except that the Manager may instruct the Fonterra Farmer Custodian how to exercise any voting right that may arise under sections 116 and 117 of the Companies Act and clause 24.2 of the Constitution, which relate to meetings of interest groups.

Voting rights in respect of the Fund

Each Unit confers the right to vote at meetings of Unit Holders, except where an amount is owing on a Unit, and subject to any voting restrictions imposed on a Unit Holder under the NZSX Listing Rules or the ASX Listing Rules.

On a show of hands, every Unit Holder present in person or by proxy or representative has one vote. On a poll, every Unit Holder who is present in person or by proxy has one vote for each Unit they hold.

These voting rights are set out in the Trust Deed and are subject to the rights of the Fonterra Unit described above.

Fonterra is prohibited under DIRA from exercising the voting rights attached to any Units held by it.

Maximum holding in the Fund

No Unit Holder and its Associates (excluding Fonterra) can hold, or have a Relevant Interest in, more than 15% of the Units on issue or 15% of the voting rights in the Fund, whichever is lower.

The Trust Deed contains enforcement provisions to ensure compliance by Unit Holders with this restriction. Where Fonterra determines that a Unit Holder is in breach of this restriction, Fonterra may determine that the Unit Holder is not entitled to vote some or all of the Units it holds in breach of the restriction and can require that the Unit Holder dispose of the Units held in breach of the restriction. If the Units are not disposed of, the Manager or Fonterra can arrange for their disposal.

As Fonterra is unable to exercise the voting rights attached to the Units it holds, if it acquires Units the proportion of votes held by other Unit Holders will consequently increase. Therefore, a Unit Holder could inadvertently breach the 15% maximum holding because Fonterra acquires Units.

Redemption of Units

Farmer Shareholders, the RVP and Fonterra can each request the Manager to redeem some or all of the Units that they hold. They will then have transferred to them (from the Fonterra Farmer Custodian, although, in the case of the RVP, the Fonterra Farmer Custodian will then hold for the RVP) the equivalent number of Shares, and the Manager will arrange for the Units to be redeemed. Farmer Shareholders cannot retain these Units. They are required to be used to settle a sale contract on the NZX Main Board.

A Unit Holder has no other right to redeem Units (except, as noted above, if there is an offer to acquire Shares held by the Fonterra Farmer Custodian).

Costs of the Fund and the provision of services by Fonterra

The Manager and the Trustee have agreed that Fonterra will meet the day-to-day operating costs of the Fund. In addition, the Fund will use corporate facilities, support functions, and services provided by Fonterra. All of these services will be provided at no cost to the Fund.

There are some costs that will not be covered by Fonterra. These principally relate to circumstances where the Manager has breached certain obligations, or seeks to bring claims outside the ambit of those which Fonterra has undertaken to pay. In these circumstances, the Manager would have to seek funding from other sources. This could include seeking a resolution of Unit Holders that they agree to bear the relevant costs through a deduction from distributions that would otherwise be made by the Fund.

Controlling the Fund size

The number of Units on issue can vary, for example as Farmer Shareholders, Fonterra or the RVP sell Economic Rights of Shares to the Fund, or exchange Units for Shares. Fonterra has an interest in ensuring the stability of the Fund and the Fonterra Shareholders' Market.

To that end, the Fonterra Board has adopted a Fund Size Risk Management Policy. The key goals of this policy are that the number of Units on issue remains within a range and that within these limits, the number of Units on issue is managed appropriately. The current policy is intended to achieve a Fund size of between 7% to 12% of the total number of Fonterra Shares on issue (excluding Treasury Stock of both Shares and Units).

To achieve these goals, the Fonterra Board has a range of tools.

Firstly, it can constrain the extent to which Farmer Shareholders can sell Economic Rights of Shares they are required to hold to meet the Share Standard (referred to as Wet Shares). This is achieved through the setting of a Fund Transfer Limit, which is discussed further below.

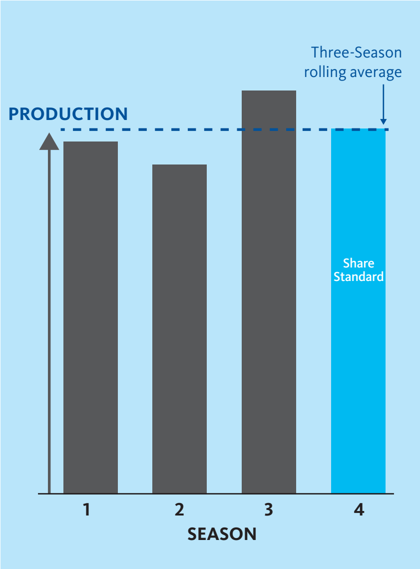
Secondly, the Fonterra Board can manage the aggregate number of Shares on issue, thereby influencing the total number of Shares that are in excess of those required under the Share Standard (referred to as Dry Shares). The proportion of total Shares that are Dry Shares is relevant because Farmer Shareholders can sell them freely on the Fonterra Shareholders' Market, or sell Economic Rights of Shares to the Fund. The Dry Shares represent a readily available pool that can be exchanged for Units, thereby influencing the potential size of the Fund. Under the Fund Size Risk Management Policy, the Fonterra Board intends to manage the proportion of Shares that are Dry Shares to around 5% of the total number of Shares on issue in Fonterra, plus or minus a reasonable tolerance as determined by the Fonterra Board from time to time.

At the end of September 2012, the total number of Shares on issue was 1,522 million. The minimum required Shares under the Share Standard was 1,494 million, with the result that there were then 28 million Dry Shares. Dry Shares represented 1.9% of all Shares on issue.

However, the Share Standard is to move to be based on a rolling average of three Seasons' historical milksolid production with effect from 1 June 2013. A transitional effect of this is that the production of Dry Shares held by Farmer Shareholders is expected to increase above the 5% target level.

Thirdly, Fonterra can decide to pay a different price for milk that is 'backed' by Shares or Vouchers (described under the heading "Vouchers" below), and milk that is not. Even if a Farmer Shareholder is in compliance with the Share Standard (i.e. holds Shares or Shares and Vouchers to the level required by the Share Standard), if their milk production in a particular Season is in excess of the Shares and Vouchers which they hold, that excess will not be 'backed' by Shares or Vouchers. This difference is currently five cents per kgMS, but Fonterra reserves the right to change this difference at any time. If Fonterra increases the amount of this difference, Farmer Shareholders may be incentivised to acquire more Shares, in order to earn a higher Farmgate Milk Price. If Fonterra narrows or eliminates this difference, this may reduce the incentive on Farmer Shareholders to acquire the requisite number of Shares and Vouchers to 'back' their milk production. Fonterra may adjust the amount of this difference whenever it considers that to be appropriate.

THE THREE-SEASON ROLLING AVERAGE SHARE STANDARD RULE



Source: Fonterra

SECTION 5 TRADING AMONG FARMERS IN DETAIL CONTINUED

Fund Transfer Limit

The Fonterra Board can specify limits on the extent to which a Farmer Shareholder can sell Economic Rights of Wet Shares (being those Shares required to be held to comply with the Share Standard) to the Fund. This will be done through the Fund Transfer Limit.

Dry Shares (being Shares held in excess of the number of Shares required to comply with the Share Standard) held by Farmer Shareholders can be sold freely on the Fonterra Shareholders' Market or the Economic Rights of those Shares can, in the normal course, be sold without restriction to the Fund.

Fonterra is entitled to completely halt the flow of Economic Rights to the Fund in both Wet Shares and Dry Shares under the current Fund Size Risk Management Policy.

The Fonterra Board has resolved that the Fund Transfer Limit will not exceed 25% of Wet Shares of an individual Farmer Shareholder.

The Fonterra Board can change the Fund Transfer Limit at any time and on any basis it considers appropriate (up to the 33% constitutional limit). It can either allow Farmer Shareholders to sell Economic Rights to more Wet Shares to the Fund, or reduce or halt completely the sale of further Economic Rights of Wet Shares to the Fund.

Fonterra's current intention is that the Fund Transfer Limit will apply as follows:

- in the initial Supply Offer that will occur at the same time as this Offer, Fonterra will limit the number of Economic Rights of Wet Shares that a Farmer Shareholder can offer to sell to the Fund to 25% of that person's Wet Shares. The actual number of Economic Rights to Wet Shares that a Farmer Shareholder can sell in this period (referred to as the Opening Limit) will depend on the total number of Economic Rights of Shares offered in the course of the Supply Offer. If the Supply Offer is oversubscribed, the Opening Limit may be less than 25% as a result of scaling;
- Farmer Shareholders will receive Vouchers for the Economic Rights of Wet Shares they sell to the Fund. Vouchers enable a Farmer Shareholder to retain voting rights in respect of milksolids previously backed by those Shares, as well as to obtain a full Share-backed milk price on that production. The role of Vouchers is explained in more detail below; and
- Farmer Shareholders might not elect to take full advantage of the financial flexibility that the Fund offers at the time of the initial Supply Offer. To the extent that is the case, the total value of Economic Rights offered by Farmer Shareholders to the Fund may be less than the total proceeds from the Offer. If that happens, Fonterra will issue Shares to the Fonterra Farmer Custodian and thereby cause Units to be issued. Fonterra's intention is that the amount it receives as a result of the issue of Shares will not be retained on a permanent basis. In this situation, Fonterra proposes to provide one or more further opportunities for Farmer Shareholders to sell Economic Rights of Wet Shares in the first 12 months after the initial Supply Offer:
  - it is envisaged that these opportunities will provide for Farmer Shareholders to sell further Economic Rights of Wet Shares to the Fund in exchange for Units and Vouchers. Fonterra would acquire for cash on-market the number of Units issued as a result of any such sales (in a manner that does not disturb general trading in Units);
  - by this means, the proceeds of the earlier issue of Shares at the time the Fund is launched, would be, in effect, paid out to Farmer Shareholders that sell Economic Rights of Shares to the Fund;
  - subject to market conditions, it is intended that the first of these further opportunities would be after Fonterra has announced its half-year results in 2013; and
  - any future opportunity during this first 12-month period would likely be conducted in a similar manner.
- No sooner than 12 months after the Launch Date, the Fonterra Board will also consider whether, and to what extent, it is appropriate to allow further opportunities for Farmer Shareholders to sell Economic Rights of Wet Shares to the Fund, including whether a general Fund Transfer Limit is set so as to allow Farmer Shareholders to sell Economic Rights of Wet Shares to the Fund on a day-to-day basis. For further discussion on such opportunities for Farmer Shareholders, refer to Section 8 – *Details of the Offer* under the heading "Formation of the Fund".
- Prior to this date, Farmer Shareholders will have no ability to sell Economic Rights of Wet Shares to the Fund except as noted above. This would be achieved by setting the Fund Transfer Limit for existing Farmer Shareholders to zero until this time.
- The Fund Transfer Limit will not restrict the sale of Economic Rights of Dry Shares to the Fund. Economic Rights of Dry Shares can be freely sold to the Fund unless the Fonterra Board invokes the Fund Size Risk Management Policy described above to halt such sales.
- Limited exceptions may be allowed by the Fonterra Board in this period to enable new Farmer Shareholders who commence supply to Fonterra to have a "one off" opportunity to sell Economic Rights of Wet Shares up to the limits applicable to existing Farmer Shareholders.

Common registry

Both Fonterra and the Fund will utilise the same registry provider, Computershare Investor Services Limited. Fonterra and the Manager have each agreed to provide access to the other's register. By subscribing to the Offer, a Unit Holder will be deemed to consent to this arrangement.

Vouchers

When a Farmer Shareholder sells Economic Rights of Wet Shares to the Fund, the Fund will issue to that Farmer Shareholder a Unit which that Farmer Shareholder must immediately sell on the NZX Main Board. In addition, the Fund will record the transfer of the Wet Share to the Fonterra Farmer Custodian by giving to the Farmer Shareholder a Voucher. Vouchers can be used by that Farmer Shareholder to comply with the Share Standard. The sale of the Wet Share will therefore not affect their voting rights or their right to receive the full payment for milksolids supplied to Fonterra.

The Fonterra Board has discretion under the Constitution to limit the extent to which it will take Vouchers into account, in respect of one or more Farmer Shareholders. By doing so, Fonterra can require Farmer Shareholders to buy Shares to satisfy the Share Standard, rather than allowing the use of Vouchers for this purpose.

Fonterra has agreed that for a period of four years from the Launch Date, it will not reduce the proportion of Vouchers that are 'counted' for the purposes of satisfying the Share Standard. This is provided that the number of Vouchers is below 25% of the number of Wet Shares the Farmer Shareholder is required by the Share Standard to hold, except where:

- the Fund is wound up; or
- the number of Shares held by the Fonterra Farmer Custodian for the Fund exceeds 15% of the total number of Shares on issue (excluding Treasury Stock).

Issues and buy backs of Shares

Once the Fund is launched, the previous practice of Fonterra issuing Shares to Farmer Shareholders who increase their milk production, will be replaced by Farmer Shareholders purchasing Shares directly on the Fonterra Shareholders' Market (or purchasing Units and exchanging them for Shares). Accordingly, Share-backed milk production will cease to be an automatic means by which Fonterra raises additional equity capital, while the Share Standard will remain an integral ongoing element of Fonterra. Likewise, a fall in Share-backed milk production will no longer cause a reduction of equity capital.

In the future, Fonterra will have the ability to manage its level of equity capital through a range of mechanisms including retained earnings, special dividends, dividend reinvestment plans, and other mechanisms used by companies with tradable shares. It will fund future capital investment using a mix of debt and equity to maintain an appropriate gearing ratio in accordance with its balance sheet strategy.

Separately, Fonterra intends to respond to growing Share-backed milk production by increasing the number of Shares on issue in a transparent and predictable manner to the extent necessary to promote liquidity in the Fonterra Shareholders' Market. To achieve this goal, Fonterra has two key options. It can issue new Shares to raise new equity capital, if required. Alternatively, it can undertake a bonus issue where new equity capital is not required. In either case, the Manager will undertake an equivalent adjustment to the number of Units on issue.

Within the context of Fonterra's Fund Size Risk Management Policy (as described in Section 5 – *Trading Among Farmers in Detail*), Fonterra will also manage the number of Shares on issue if production over time falls resulting in Farmer Shareholders holding Shares in excess of the minimum requirements related to milk production. Unlike today, Fonterra will no longer have an obligation to redeem Shares where this occurs. Instead, it will have more flexibility in the manner and timing of meeting the requirements of the Fund Size Risk Management Policy through, for example, buying back its Shares using mechanisms available to other companies with tradable shares. It can also buy Units (which it will not be allowed to vote) and subsequently sell them, or exchange them for Shares to be held as Treasury Stock or cancelled.

Fonterra will use these tools to manage the total number of Shares on issue, and the size of the Fund, in accordance with its Fund Size Risk Management Policy.

Fund Size Risk Management Policy

The Fund Size Risk Management Policy is designed to address the following requirements:

- the key goals of the Fund are to supplement liquidity in the Fonterra Shareholders' Market, thereby promoting price convergence, and to provide flexibility for Farmer Shareholders;
- the size of the Fund should remain within specified limits; and
- the Fund size should be managed based on graduated responses.

It is important to note that a change in the number of Units on issue does not, of itself, result in a dilution in per Unit measures of financial performance (such as distributions per Unit or earnings per Unit). That is because changes in the number of Units on issue need not (and typically will not) reflect any change in the total number of Shares on issue.

FUND SIZE AND ITS RELATIONSHIP WITH OTHER THRESHOLDS

The following hypothetical example (described at the end of a future hypothetical Season) is intended to illustrate the relationship between Fund size and other thresholds:

- Fonterra has 1,500 million Shares on issue, excluding Treasury Stock;
- the Fonterra Farmer Custodian holds 120 million of those Shares, with 120 million Units on issue. This represents a Fund size that is 8% of Shares on issue;
- the minimum required number of Shares that Farmer Shareholders are required to hold is 1,400 million. When this amount is deducted from the total number of Shares on issue, the number of Dry Shares is derived (being 100 million or 6.7% of Shares on issue);

- forecast milk production for the next Season is 1,430 million kgMS. There are therefore 70 million Shares on issue in excess of expected production, or 4.7% of the total. Since these Shares are not expected to be required to back production, they are the most easily traded by Farmer Shareholders without running the risk of being paid a lower milk price;
- the actual Fund size would be measured at 8% of total Shares on issue under the Fund Size Risk Management Policy outlined below; and
- the Potential Fund Size (as referred to in the Fund Size Risk Management Policy) is the maximum proportion of Shares that could be held by the Fonterra Farmer Custodian, including Dry Shares held by Farmer Shareholders in excess of the aggregate minimum required shareholding. As noted, Dry Shares are 6.7% in this example. When this is added to the actual Fund size of 8%, the Potential Fund Size is 14.7%. However, the implications of a Potential Fund Size of this amount need to be considered having regard to Shares on issue in excess of expected production (4.7% in this example), which is expected to typically be a smaller proportion of Shares, reflecting expected growth in milk production. It is Shares in excess of production that are the most easily exchanged into Units.

Set out below is a summary of relevant provisions of the Fund Size Risk Management Policy.

This description is current as at the date of this Offer Document. Like all Fonterra Board policies, the Fund Size Risk Management Policy may be changed from time to time for a variety of reasons, including due to meeting new circumstances, experiences gained from past events and reviews undertaken by the Fonterra Board. Any changes to this policy will be announced by Fonterra at the relevant time.

The Fund Size Risk Management Policy

Policy: Fund Size	Response
Parameters: The *Actual* Size of the Fund will be managed within a Target Range of 7% to 12% of total Shares on issue (excluding Treasury Stock). The *Potential* Size of the Fund will be managed within a Target Range of 7% to 15% of total Shares on issue (excluding Treasury Stock).	The Fonterra Board will use a range of measures to ensure the Actual Fund Size and Potential Fund Size remain within the relevant Target Ranges, including: a) introducing or cancelling a dividend reinvestment plan; b) operating a Unit and / or Share repurchase programme; c) increasing or reducing the Fund Transfer Limit; and d) issuing new Shares.
Policy: Dry Share Proportion	**Response**
The number of Dry Shares on issue should fall within an acceptable tolerance of 5% (or such lesser percentage as the Fonterra Board determines) of total Shares on issue (excluding Treasury Stock).	The Fonterra Board will take steps to issue or buy back Shares to maintain the number of Dry Shares within the required range.

For the purposes of this Fund Size Risk Management Policy, Treasury Stock means Shares or Units acquired and held by Fonterra.

Consequences of exceeding Fund Size Risk Management Policy thresholds

If the actual or potential Fund size falls outside the ranges noted above, certain actions will be taken, as noted below. The extent and nature of actions required will vary according to the extent to which the target range is exceeded.

Consequences of exceeding a threshold	Response
If the *Actual Fund Size breaches 12%* or the *Potential Fund Size breaches 15%* for a majority of days within any 30 day period.	The Fonterra Board will: a) as soon as it becomes aware of the breach, inform NZX and ASX; b) within 90 days develop a strategy to address the underlying causes of the expansion in the Actual or Potential Fund Size (depending on which has been breached) and consult with the Shareholders' Council on that strategy; and c) for so long as the Actual or Potential Fund Size remains above the breach level, consult with the Shareholders' Council at intervals of not more than three months, and disclose progress towards returning to within the policy range.
If the *Actual Fund Size breaches 15%* or the *Potential Fund Size breaches 18%* for a majority of days in any 30 day period.	The Fonterra Board will: a) immediately advise the Shareholders' Council, NZX and ASX; b) within 90 days obtain advice from an independent expert on a strategy to return to the Target Range and its likelihood of being successful; c) during that 90 day period consult with the Shareholders' Council on plans to return to the Target Range; and d) disclose non-commercially sensitive aspects of those plans. If the Actual or Potential Fund Size remains in breach of these thresholds for six consecutive months, then unless the Shareholders' Council agrees otherwise, the Fonterra Board must take the steps required if the Actual Fund Size breaches 18%, except suspending the sale of further Economic Rights under paragraph (a) of that section.
If the *Actual Fund Size breaches 18%* or the *Potential Fund Size breaches 20%* for a majority of days in any 30 day period.	Within 90 days the Fonterra Board will: a) immediately advise the Shareholders' Council, NZX and ASX; b) suspend the ability for further Economic Rights to be sold to the Fund, unless there is a compelling reason not to do so (with that reason to be disclosed to Fonterra Shareholders, NZX and ASX). This suspension will cease when the Fonterra Board is satisfied that the Actual or Potential Fund Size is sustainably below the thresholds that trigger suspension of the further disposition of Economic Rights, or in any event when the Actual Fund Size falls below 12% (and the Potential Fund Size is below 15%); c) give notice of a special meeting of Fonterra Shareholders to consider options, subject to the minimum required notice periods under the Constitution; d) consult with the Shareholders' Council on the options to be presented to the special meeting; e) obtain expert independent advice on the likely outcome of each of those options, and review that advice with the Shareholders' Council; f) recommend its preferred option at the special meeting, together with an independent advisor's report on the likely outcome of that option; and g) enable the Shareholders' Council to present the Council's preferred option to the special meeting if it is different from the Fonterra Board's preferred option.

SECTION 5 TRADING AMONG FARMERS IN DETAIL CONTINUED

Termination of the Authorised Fund Contract

As described earlier in this section, there are circumstances in which the Authorised Fund Contract can be terminated, and the authorisation to be an Authorised Fund granted to the Fund withdrawn.

These are summarised in the table below:

Where the Manager breaches its obligations under the Authorised Fund Contract
• If the Manager breaches a material term of the contract Fonterra can exercise a "step in right" to manage the Fund as the agent of the Manager. • In addition, if the Manager is instructed or required by the Unit Holders to take any action, or proposes any step, which has breached, or will breach, a Fundamental Term of the contract and this has not been remedied by the Manager within a reasonable period, Fonterra can give a notice to the Trustee seeking replacement of the Manager. • If this occurs, a process would be worked through which would give the Manager an opportunity to retire as the Manager of the Fund, or the Trustee to appoint a replacement Manager. • If the Manager retires and the Trustee appoints a replacement Manager which complies with all of the structural requirements that the Manager is required to comply with, Fonterra would not seek to terminate the contract as a result of the breaches which have occurred or are proposed, the contract will continue and the Fund will continue to operate. • If, however, the Manager fails or refuses to retire or the Trustee fails or refuses to take action to appoint a replacement Manager, Fonterra can terminate the contract by such notice period as it may specify. The Manager may be required to continue to operate the Fund during the notice period. • Where this occurs, Fonterra can require: – the Manager to dispose of the Economic Rights which are held for the Fund to Fonterra or Fonterra's nominated transferee (which may be a substitute Authorised Fund); or – the Manager to procure the Fonterra Farmer Custodian to dispose of the Shares held by the Fonterra Farmer Custodian under the Fonterra Economic Rights Trust to Fonterra or its nominated transferee, at a 'base price' that is a fair reflection of the 'undisturbed' traded value of Shares and Units, based on an average of the daily VWAP of observed prices over a six-month period prior to the date on which Fonterra gave notice to the Manager of the breach (or potential breach), less a discount of 15%. • The valuation would be adjusted for any capital changes which have occurred in this period and the Trustee and Manager must co-operate with Fonterra to give effect to this mechanism.

Where Fonterra breaches its obligations under the Authorised Fund Contract
• If Fonterra breaches a "Fundamental Term" of the contract and this has not been remedied by Fonterra within a reasonable period, the Manager can give a notice to Fonterra requiring that Fonterra either acquires (or procure the acquisition of) the Economic Rights or the Shares the subject of the Fonterra Economic Rights Trust. • Fonterra will then determine who will acquire the Economic Rights or the Shares and how they will be acquired, and must ensure that this occurs within 12 months of receipt of notice from the Manager requiring it. • Where the Manager gives notice of termination under this provision, the contract will be terminated on the date of transfer of the Economic Rights / Shares (or such earlier date as Fonterra may specify). • The acquisition would be at a valuation determined on one of the following bases: – if this termination right is exercised in the first 24 months after the Launch Date, the basis of valuation is to be the same as for "Unilateral termination by Fonterra without cause", as outlined lower in this table; or – if this termination right is exercised after that date, at a 'base price' that is a fair reflection of the 'undisturbed' traded value of Shares and Units, based on an average of the daily VWAP of observed prices over a six-month period prior to the date of notice given by the Manager notifying the breach, plus a premium of 15%. • The valuation would be adjusted for any capital changes which have occurred in this period and the Trustee and Manager must co-operate with Fonterra to give effect to this mechanism.

Where Unit Holders elect to wind up the Fund by Extraordinary Resolution
• The Unit Holders can pass a resolution to wind up the Fund at any time, so long as the procedures in the Trust Deed are followed. Any such resolution is binding on all Unit Holders. • Upon this resolution being passed, Fonterra must act efficiently and use reasonable efforts to facilitate another party nominated by it (which could include a replacement Authorised Fund) to acquire the Economic Rights held for the Fund, or the Shares held by the Fonterra Farmer Custodian under the Fonterra Economic Rights Trust. • Any purchaser of the Economic Rights or the Shares would need to be acceptable to Fonterra and in the case of a purchase of the Economic Rights would need to comply with the terms of the Custody Trust Deed for the Fonterra Economic Rights Trust and the Authorised Fund Contract, subject to such changes to those documents as Fonterra may specify. • If, after a wind-up resolution has been passed, a purchaser acceptable to both Fonterra and the Manager has not been found within a period of 120 business days, Fonterra will have the right (but not the obligation) to require the sale of the Economic Rights to it or to require the Fonterra Farmer Custodian to transfer the associated Shares to it. Upon such acquisition, the Authorised Fund Contract will be terminated. • The valuation mechanism / purchase price in this circumstance is to be a fair reflection of the 'undisturbed' traded value of Shares and Units, based on an average of the daily VWAP of observed prices over a six-month period prior to the date on which any announcement is made to the market advising of the expectation or intent of a vote in respect of the wind-up of the Fund on this basis. • The valuation would be adjusted for any capital changes (as above) which have occurred in this period and the Trustee and Manager must co-operate with Fonterra to give effect to this mechanism.

Unilateral termination by Fonterra without cause
• At any time within 24 months after the Launch Date, Fonterra may (by a board resolution supported by a majority of the Independent Directors) terminate the contract. • This right would not require the agreement of Unit Holders (by resolution or otherwise). • The Fund would be liquidated within 12 months of the notice of termination. During this notice period, the Fund would continue to operate. • At any time during this period, Fonterra can elect whether: – the Manager will dispose of the Economic Rights to Fonterra's nominated transferee (which may be a substitute Authorised Fund); or – the Manager will procure the Fonterra Farmer Custodian to dispose of the Shares held by the Fonterra Farmer Custodian under the Fonterra Economic Rights Trust to Fonterra or its nominated transferee, at a valuation undertaken on the basis specified below. • This valuation mechanism will determine a value which is the greater of: – the Final Price of the Units escalated at a fixed cumulative rate of 15%, less cash dividends paid; and – a 'base price' that is a fair reflection of the 'undisturbed' traded value of Shares and Units, based on an average of the daily VWAP of observed prices over a six-month period prior to announcement of the termination, plus a premium of 15%. • Both the above prices would be adjusted for any capital changes and the Trustee and Manager must co-operate with Fonterra to give effect to this mechanism. • Fonterra must then acquire (or nominate some other person to acquire) the Economic Rights or the Shares at the valuation determined under this mechanism.

The unilateral right of termination by Fonterra outlined in the table above can also be exercised by Fonterra within 24 months after the Launch Date if it considers that the intention or purpose, or operation, of the arrangements described in the Authorised Fund Contract has been rendered impossible or illegal or the commercial intent of those arrangements has been frustrated or materially compromised, as a result of the passage into law of the Financial Markets Conduct Bill which is currently before the New Zealand Parliament.

There are no other rights for Fonterra, the Manager, the Trustee or the Fonterra Farmer Custodian to terminate the Authorised Fund Contract. Any other termination rights that a party to the contract would have at law are excluded.

It is important to note that other than where termination arises due to Fonterra breaching the Authorised Fund Contract or Fonterra exercising its unilateral right of termination without cause, Fonterra has no obligation to purchase or arrange the purchase of the Shares held by the Fonterra Farmer Custodian in which Economic Rights are held for the Trustee, or to acquire those Economic Rights. There are unlikely to be buyers for those assets other than Fonterra or another Authorised Fund approved by Fonterra. This may result in the Fund not being able to dispose of these assets which would prevent it from winding up.

TERMINATION OF THE FUND

The Fund will be wound up if all the Economic Rights held for the Fund or all the Shares the subject of the Fonterra Economic Rights Trust are acquired by Fonterra or a person nominated by Fonterra as discussed under the heading "Termination of the Authorised Fund Contract" above.

If Fonterra proposes a change in its capital structure or any other change (other than the exercise of a termination right as outlined in this section) which involves the winding-up of the Fund, Unit Holders would be asked to approve the change by Extraordinary Resolution. Unit Holders could not, however, be compelled to agree, and if Unit Holders did not agree the change would not proceed. If the Unit Holders approve the change by Extraordinary Resolution, that approval will be binding on all Unit Holders.

PERPETUITY PERIOD

As the Fund is a trust, the current law requires that the Fund cease within 80 years of its establishment. This is also the case in respect of the Fonterra Economic Rights Trust. The law against perpetuities may be amended before the scheduled expiry of the Fund and the Fonterra Economic Rights Trust, and the Trust Deed and Custody Trust Deed have been drafted so that the revised law will then apply to both the Fund and the Fonterra Economic Rights Trust.

The Fonterra Economic Rights Trust has a vesting day one day prior to the expiry of the date of termination of the Fund. Upon the expiry of the Fonterra Economic Rights Trust, all its trust property, which includes the Shares in respect of which Economic Rights have been held in trust for the Fund, will be vested in Fonterra. Accordingly, the Economic Rights will cease to be held for the Fund at that time. No consideration will be payable to the Fund.

SECTION 6
DIRA REGULATORY ENVIRONMENT

BACKGROUND

Fonterra was formed in 2001 by a merger of The New Zealand Dairy Board and the two major New Zealand dairy processors at the time: The New Zealand Co-operative Dairy Company Limited and Kiwi Co-operative Dairies Limited.

The merger was authorised by the Dairy Industry Restructuring Act 2001 (New Zealand) (DIRA). Because the merger would result in Fonterra occupying a significant position in New Zealand dairy markets, DIRA also established a regulatory framework designed to ensure that New Zealand dairy markets remained contestable and efficient. DIRA has been amended from time to time since 2001, most recently by the Dairy Industry Restructuring Amendment Act 2012 (New Zealand).

The provisions of DIRA relating to the Commerce Commission's oversight of the Farmgate Milk Price Manual and setting of the Farmgate Milk Price are discussed in Section 3 – *Setting the Farmgate Milk Price for New Zealand Milk*.

As explained further in Section 7 – *Investment Risks*, Fonterra's operations are also subject to numerous other New Zealand laws and regulations which impact on Fonterra's operations in New Zealand.

OPEN ENTRY AND EXIT

DIRA contains provisions that facilitate "open entry and exit" by farmers to and from Fonterra. These provisions sought to deal with the concern that Fonterra could use its market power to create barriers to farmers switching to competing processors, and thereby undermine contestability in the market for the supply of raw milk.

Subject to specific exceptions, Fonterra:

- must accept all applications to become a Farmer Shareholder made during the specified application period;[1]
- may also be required to accept applications from existing Farmer Shareholders to increase the volume of milk supply;
- must ensure that new entrants (i.e. new suppliers entering the Co-operative) are offered the same terms of supply as apply to an existing Farmer Shareholder in the same circumstances, or differ only to the extent of different circumstances;
- must provide that a Farmer Shareholder who wishes to cease the supply of milk to Fonterra may do so by giving a notice of withdrawal during the application period;
- must permit Farmer Shareholders to supply up to 20% of their weekly production throughout the Season to independent processors; and
- must offer new Farmer Shareholders a supply contract for a minimum of one Season. While Fonterra may offer longer-term contracts, it must ensure that at least one third of all milk produced within a 160-kilometre radius of any point in New Zealand is supplied to:
  - independent processors; or
  - Fonterra, under a contract that expires, or that can be terminated at the Farmer Shareholder's option without penalty, at the end of the Season.

FONTERRA SHARE PRICE

Until Trading Among Farmers is launched, Fonterra is required to issue and redeem Shares under DIRA at a value determined in accordance with DIRA and the current Constitution.

This requirement will cease to apply once Trading Among Farmers is implemented. Under the Constitution applying from the Launch Date, Shareholders will instead be able to trade their shares on the Fonterra Shareholders' Market, and to transfer a proportion of their Shares to the Fonterra Farmer Custodian to hold on behalf of the Fund. These features are described in detail in Section 5 – *Trading Among Farmers in Detail*.

Should Trading Among Farmers end, the requirement in DIRA for Fonterra to issue and redeem Shares will once again apply. In addition, a new methodology to determine the price at which Fonterra must issue and redeem Shares would come into force. In simple terms, this methodology would require Fonterra to calculate the share price at fair value by dividing the sum of Fonterra's assets minus its debts by the total number of Shares on issue. Any Shares held by the Fonterra Farmer Custodian (including those held for the Fund) will not, however, be able to be redeemed.

DIRA sets out certain circumstances in which Trading Among Farmers would end. In particular, if the Fund is being (or has been) wound up, or Shares or Units can no longer be traded as envisaged under DIRA, then a process is triggered to make an Order in Council to repeal the provisions of DIRA that provide for Trading Among Farmers (repeal order). The repeal will take effect the later of (a) nine months after the date the repeal order is made; and (b) the beginning of the next application period to become a Farmer Shareholder.

1 DIRA specifies that, in respect of a Season, the minimum application period must span the dates from 15 December to 28 February before that Season commences.

SECTION 6 DIRA REGULATORY ENVIRONMENT CONTINUED

However, DIRA also provides for a process to allow the repeal order itself to be revoked if certain pre-conditions (including, where necessary, the establishment of a replacement fund) have been met before the repeal date.

OPEN ENTRY AND EXIT REQUIREMENTS UNDER TRADING AMONG FARMERS

The general open exit and entry requirements noted under the heading "Open entry and exit" earlier in this section will continue to apply once Fonterra's Shares become tradable. To ensure that the introduction of Trading Among Farmers does not adversely affect these requirements, DIRA includes an explicit prohibition on Fonterra from engaging in conduct that:

- restricts, prevents, or deters liquidity and fungibility of the Share and Fund markets; and
- has the purpose of restricting, preventing, or deterring open entry and exit.

REGULATED SUPPLY OF RAW MILK

DIRA enables the Government to make regulations to:

- require Fonterra to supply or auction to independent processors certain dairy goods and services (including raw milk, components of milk, products derived from milk, and associated transportation, processing, and packaging services); and
- specify the terms on which such goods and services must be supplied or auctioned.

Currently, the only regulations made under this power are the Dairy Industry Restructuring (Raw Milk) Regulations 2001 (Raw Milk Regulations) which require Fonterra to supply up to 600 million litres of milk each Season to independent processors. This accounts for around 3.5% of Fonterra's total seasonal raw milk supply. DIRA permits this aggregate to be increased to a maximum of 5%. There is a risk, therefore, that the aggregate amount that Fonterra is required to supply to independent processors under the Raw Milk Regulations could increase in the future (or that further regulations could be made requiring Fonterra to supply other dairy goods or services). As explained below, in January 2012 the Government consulted on proposals to, among other things, increase the aggregate under the Raw Milk Regulations to the maximum of 5%.

An "independent processor" in this context includes any person who intends to process the raw milk by means of a contractual arrangement with another processor (known as toll processing).

Unless Fonterra and the independent processor agree otherwise, the price for the supply of raw milk must be calculated in accordance with the formula set out in the Raw Milk Regulations. This formula sets that price (excluding the price for organic or winter milk) based on:

- the "farm gate milk price" as defined in the Raw Milk Regulations;[1]
- reasonable costs of transport to the independent processor; and
- a margin of $0.10 per kgMS.

Fonterra is required to supply Goodman Fielder with up to 250 million litres of raw milk each Season and, for all other independent processors, up to 50 million litres each Season.

In January 2012, the Government consulted on proposed changes to the Raw Milk Regulations. The proposed changes include:

- increasing the total amount of raw milk available to independent processors in a Season to the statutory maximum of 5% of Fonterra's total raw milk supply;
- removing the $0.10 per kgMS margin in the default price;
- introducing specified maximum monthly limits on supply to independent processors (except for Goodman Fielder), which are intended to reflect the seasonal dairy supply curve; and
- restricting eligibility for supply from Fonterra where the independent processor's own supply of raw milk in each of the three consecutive Seasons immediately preceding that Season was at least 30 million litres.

To date, no announcement has been made as to the final proposed changes to the Raw Milk Regulations.

CHANGES TO AND EXPIRY OF THE REGULATORY FRAMEWORK

A "sunset" regime is provided for in DIRA. In particular, the regulatory framework described in this section and the Commerce Commission's oversight role described in Section 5 – *Trading Among Farmers in Detail* may come to an end when the Minister for Primary Industries is satisfied that independent processors are, directly or indirectly, collecting 20% or more of milksolids on or from dairy farms in the North Island and / or South Island. This threshold triggers a review process in relation to what, if any, regulation should remain for the relevant Island. The Minister is also required to initiate that review process if the threshold triggers are not met by 1 June 2015.

It is therefore possible that the regulatory framework affecting Fonterra could change substantially, or even end, if its proportion of raw milk collected in either Island declined substantially. If that occurred, Fonterra would, however, remain subject to general competition law rules under the Commerce Act 1986 (New Zealand) and other applicable legislation.

1 Under Regulation 3 of the Raw Milk Regulations, "farm gate milk price" means the price per kgMS paid for milk supplied to Fonterra by Farmer Shareholders minus the total premiums paid for that milk (including the portion of the winter milk premium that is included in the Farmgate Milk Price set by the Fonterra Board).

SECTION 7 INVESTMENT RISKS

An investment in the Fund should be considered in light of the general and specific risks associated with the Units and Fonterra. Before deciding whether to make an investment in the Fund, prospective investors should read the whole of this Offer Document and should specifically consider the factors contained within this section in order to fully appreciate the risks.

RISKS ASSOCIATED WITH THE FUND STRUCTURE

This section outlines some key features of the Fund structure that prospective Unit investors should be aware of and carefully consider. The unique features of an investment in a Unit in the Fund are described further in Section 5 – *Trading Among Farmers in Detail*.

NOVEL STRUCTURE

The structure has been designed to meet the needs of Fonterra and its Farmer Shareholders, and to enhance the operation of the Fonterra Shareholders' Market, while simultaneously giving other investors an exposure to the financial performance of Fonterra.

The Fund and its relationship with the Fonterra Shareholders' Market are novel. The structure has been carefully designed but is untested and there is therefore some uncertainty about how it will perform.

VOTING AND GOVERNANCE LIMITATIONS

Prospective investors in Units need to be aware that:

- the Fund will not hold any Fonterra Shares. Shares will instead be held by the Fonterra Farmer Custodian, who will declare a trust in respect of the Economic Rights in the Shares. Units will confer the right to vote at meetings of Unit Holders;
- the Fund will not have, and no Unit Holder will have, any voting right at a meeting of Fonterra Shareholders. Generally, the Fonterra Farmer Custodian will not have the right to vote at a meeting of Farmer Shareholders, although there may be limited exceptions to this principle, where the Manager of the Fund can direct the Fonterra Farmer Custodian how to vote. Those circumstances are expected to be rare. No individual Unit Holder will be entitled to exercise any of these rights; and
- neither the Manager nor Unit Holders will have any right to attend or speak at a Shareholders' meeting, to seek proxies, or to otherwise direct or influence the way in which Fonterra Shares are voted.

INDEPENDENT DIRECTORS OF FONTERRA

The Fund will have no right to elect directors of Fonterra, or to otherwise participate in the corporate governance of Fonterra. Fonterra will consult with the Chairman of the Board of the Manager (representing the three directors who are elected by Unit Holders) about the appointment of Independent Directors to the Fonterra Board, but the final choice as to who is appointed remains with Fonterra.

PRICE CONVERGENCE BETWEEN SHARES AND UNITS MAY NOT BE ACHIEVED OR MAINTAINED

The structure incorporates a feature that allows a Share and a Unit to effectively be exchanged, but only by Farmer Shareholders, the RVP and Fonterra. No other Unit Holder is able to do this.

However, this feature will allow Farmer Shareholders to either sell Economic Rights of Shares to the Fund, or to sell Shares on the Fonterra Shareholders' Market. Conversely, Farmer Shareholders can either buy Units and exchange them for Shares, or buy Shares on the Fonterra Shareholders' Market.

The RVP can effectively move between the two markets (for Shares and Units) in order to sell or buy either security, and to effectively exchange one for the other.

The intended result is that Shares and Units should trade at very similar prices. This is referred to as the convergence of prices for Shares and Units. However, there is no assurance that convergence of prices will be achieved or, if achieved, how long it will take or whether it will be maintained.

LIQUIDITY

Size of the Fund

There are limits on the number of Shares in respect of which Economic Rights may be held for the Fund at any one time. The consequences of exceeding those limits are described in Section 5 – *Trading Among Farmers in Detail*.

In addition, Fonterra is entitled to, and intends to, manage the number of Shares in which Economic Rights are held for the Fund to a level significantly below that threshold. In some circumstances, Fonterra can halt the flow of Shares from Farmer Shareholders to the Fonterra Farmer Custodian (to be held for the Fund).

These factors mean that the supply of Shares in which Economic Rights are held for the Fund can (and will) be constrained by Fonterra. This could affect the liquidity of trading in Units, or the prices that buyers of Units are prepared to pay for them.

Sale of Units

There is no guarantee that an active market in the Units will develop. As the number of Units on issue will correspond with the number of Shares held by the Fonterra Farmer Custodian for the Fund, the market for Units will be affected by changes in the volume of Shares that Farmer Shareholders sell to the Fonterra Farmer Custodian (for the Fund).

This could affect both the demand for, and the prices of, Units.

EARLY TERMINATION OF THE AUTHORISED FUND CONTRACT

Fonterra has a unilateral right to give notice to terminate the Authorised Fund Contract without cause within 24 months after the Launch Date.

If Fonterra exercises this right, Fonterra is required to acquire the Economic Rights or the underlying Shares (or find someone else to do so) at a price determined under a formula referred to under the heading "Termination of the Authorised Fund Contract" in Section 5 – *Trading Among Farmers in Detail*.

If Fonterra breaches a Fundamental Term of the Authorised Fund Contract, the Manager of the Fund can require Fonterra (or someone nominated by it) to acquire the Economic Rights or underlying Shares at a price determined in accordance with a formula referred to under the heading "Termination of the Authorised Fund Contract" in Section 5 – *Trading Among Farmers in Detail*. The Authorised Fund Contract will terminate on the date of the transfer of the Economic Rights or underlying Shares, or at such earlier date as Fonterra may specify.

Where the Manager breaches a Fundamental Term of the Authorised Fund Contract, Fonterra can terminate the Authorised Fund Contract by such notice as Fonterra may specify. In addition, Fonterra has the right to acquire the Economic Rights held for the benefit of the Fund or the underlying Shares (or find someone else to do so).

If Unit Holders elect to wind up the Fund by way of an Extraordinary Resolution, a purchaser of the Economic Rights held for the benefit of the Fund or the underlying Shares accceptable to both Fonterra and the Manager is to be sought. If no such purchaser is found, Fonterra will have the right to acquire the Economic Rights held for the benefit of the Fund or the underlying Shares (or find someone else to do so).

The Trust Deed of the Fund provides that upon all the Economic Rights held for the benefit of the Fund or all the underlying Shares being sold, the Fund is to terminate.

The price paid for the Economic Rights or the Shares may be less or more than the price that a Unit Holder has paid for his or her Units. It may take some time to work out a buy-out arrangement that is acceptable to the Fund and to Fonterra. As a result, there is no certainty that any cash distribution would be made to Unit Holders where Fonterra has no obligation to purchase (or procure the purchase) of the Economic Rights or underlying Shares, nor the timeframe for that to occur. Units might still be quoted and traded on the NZX Main Board and ASX in these circumstances even if trading on the Fonterra Shareholders' Market has ceased, but the traded price of Units in these circumstances could be adversely affected by these (or other) uncertainties.

CHANGE IN FSM RULES

Certain of the protections available to the Fund and Unit Holders are contained in the FSM Rules. However, the FSM Rules may be changed so as to remove any of those protections, or NZX may waive provisions of the FSM Rules, by agreement between Fonterra and NZX. The consent of the Trustee, the Manager of the Fund or Unit Holders is not required for an amendment to or waiver of the FSM Rules. However, the agreement of NZX is required for a waiver of a provision of the FSM Rules, and the agreement of NZX and the approval of the Financial Markets Authority is required for an amendment of a provision of the FSM Rules.

LEGAL ACTION BY THE FUND

The Fonterra Farmer Custodian, as the holder of Shares, has rights against Fonterra under the FSM Rules, the Companies Act and the Constitution. Fonterra has agreed to fund the costs of action by the Manager of the Fund resulting from a breach by Fonterra or the Fonterra Farmer Custodian of its obligations under the Authorised Fund Contract, the Trust Deed or the Custody Trust Deed. In other circumstances, the Manager of the Fund may not have access to funding to bring legal action against Fonterra or any other person. That funding would need to be provided by other sources, such as by Unit Holders by way of deduction from distributions payable to Unit Holders, approved by an Extraordinary Resolution.

POTENTIAL FOR PAYMENTS TO FARMER SHAREHOLDERS OTHER THAN BY WAY OF MILK PRICE

The structure of Trading Among Farmers includes provisions which govern the calculation of the Farmgate Milk Price. However, the structure contains no provision specifically preventing Fonterra from making other categories of payments to Farmer Shareholders, or the Fonterra Board from authorising such payments. Accordingly, it is possible that Fonterra could make payments, or provide other benefits, to Farmer Shareholders which do not form part of the Farmgate Milk Price. These could have the effect of reducing profits of Fonterra, and thus reducing dividends payable to holders of Shares, and the returns to the Fund. However, any decision by the Fonterra Board to approve any such payments would be subject to legal and regulatory constraints, including directors' duties applicable under the Companies Act.

CHANGES IN TAXATION

Any change in taxation legislation could impact on Unit Holders' returns.

There is also a risk that returns for Unit Holders may be reduced if the Fund ceases to be a PIE. Although the Manager of the Fund has mechanisms available to manage compliance with the PIE eligibility requirements, there is a risk that the Fund could lose its PIE status if there is a breach of those requirements and the Manager of the Fund does not become aware of the breach in time to correct it.

POTENTIAL CHANGES IN SIZE OF THE FUND

The Fund is exposed to the risk of changes in the numbers of Economic Rights which are from time to time held for the Fund. The number of Units on issue is also intended to be relatively small in proportion to the total Fonterra Shares on issue.

Additional Units on issue could be caused by a variety of factors. For example, Economic Rights of Dry Shares can be sold by Farmer Shareholders to the Fund at any time. This could lead to an increase in the size of the Fund. However, following the launch of the Fund, the Fonterra Board will manage the size of the Fund within the parameters which are outlined in the Fund Size Risk Management Policy. In addition, the Constitution imposes an overall threshold on the aggregate number of Shares in which rights or interests may be held for or in relation to any Authorised Fund at 25% of the total number of Shares on issue (excluding Treasury Stock), but the Fonterra Board has resolved to reduce this to 20%.

If there was a significant decrease in supply of milk to Fonterra (e.g. due to any combination of competition in New Zealand, changes in land use or adverse economic conditions), this could create a larger number of Dry Shares which could in turn be sold to the Fund. With the movement to a Share Standard based on a rolling average of three Seasons' historical milk production to take effect from 1 June 2013, the proportion of Dry Shares is expected to increase to above the 5% target level as using the rolling average will smooth the effect of seasonal fluctuations in total milk production, which correspondingly smoothes the number of Shares that a Farmer Shareholder is required to hold.

These changes could affect the price of Units, as well as the size of the Fund. The resulting expansion in the size of the Fund could also affect Fonterra's capital management strategy. It might result in Fonterra invoking its Fund Size Risk Management Policy.

Growth in Share-backed production may cause Farmer Shareholders to purchase Units and exchange them for Shares. This could lead to a reduction in the size of the Fund and could affect the pricing and liquidity of Units and might also result in Fonterra invoking its Fund Size Risk Management Policy.

RISKS ASSOCIATED WITH FONTERRA

The Offer relates to Units in the Fonterra Shareholders' Fund and not to Shares in Fonterra. No offer is being made to subscribe for Shares in Fonterra.

An investment in the Fund exposes investors to the risks facing Fonterra's business, whether specific to Fonterra's business activities or of a general nature.

These risks might affect the future operating performance of Fonterra and thereby the value of an investment in the Fund. Some of these factors can be mitigated by appropriate commercial action, including use of appropriate safeguards and systems, but many are outside the control of Fonterra and cannot be mitigated. Investors should note that this section does not purport to list every risk that may affect Fonterra or the Fund, now or in the future.

The following paragraphs summarise the key risks that Fonterra faces in its business, and how they may impact on the returns derived from holding a Unit.

Each of the factors described below could have a potential effect on Fonterra's brand or reputation, the supply of raw milk, its ability to produce or supply products, or otherwise adversely affect Fonterra's earnings, financial performance or financial position.

FINANCIAL RISKS

Global dairy commodity prices

Dairy commodity prices can be volatile, with substantial increases and decreases occurring over a relatively short period. A rapid rise in the prices of dairy commodities could reduce earnings, particularly if the increase reduces the margin which Fonterra makes on consumer branded and out-of-home foodservices products.

The Farmgate Milk Price is calculated by assuming that all the New Zealand milk Fonterra collects is converted into whole milk powder, skim milk powder and their by-products (those products are known as the Reference Commodity Products). Fluctuations are commonly observed in the relative price of the Reference Commodity Products and other dairy nutrition products manufactured by Fonterra such as cheese and casein and their by-products. Fluctuations in the relative prices of Reference Commodity Products and other dairy nutrition products can therefore have a significant impact on Fonterra's earnings. Further information about the effect of fluctuations in dairy commodity prices on certain assumptions relating to the FY2013 Farmgate Milk Price and Fonterra's EBIT is set out under the heading "Sensitivity analysis" in Section 4 – *Fonterra Financial Information*.

Credit rating

The obligations of Fonterra to Farmer Shareholders are Effectively Subordinated to all other indebtedness of Fonterra, including its obligations to pay all secured creditors, all creditors preferred by law and all unsubordinated unsecured creditors. This is an important component in Fonterra's strong credit rating. The Effective Subordination of milk payments to farmers, including the factors underpinning it, is discussed under the heading "Credit rating and borrowings" in Section 4 – *Fonterra Financial Information*.

There is a risk that the relative expansion of Fonterra's sourcing of milk offshore may affect Fonterra's credit rating. Payments due to farmers who supply the Fonterra Group in overseas jurisdictions are not subject to the same Effective Subordination as payments to Farmer Shareholders in New Zealand. This could lead to a potential downgrade in Fonterra's current credit rating of A+ stable from Standard & Poor's (Australia) Pty Limited and AA- stable from Fitch Australia Pty Limited.[1] A downgrade in Fonterra's current credit ratings may result in increased interest costs payable by Fonterra or limit Fonterra's ability to access international capital markets.

Fonterra's credit rating is subject to the judgement of the rating agencies, which could change at any time.

Foreign exchange rates

Fonterra is exposed to foreign exchange risk in the revenue it receives on sales of products overseas, its investment and returns in relation to its overseas business and foreign currency-denominated borrowings and other liabilities. Fonterra's main foreign currency exposure is to the US$. Exchange rates can be volatile and fluctuations in exchange rates may have a direct impact on the Farmgate Milk Price and Fonterra's earnings.

Hedging contracts

Through its borrowings, Fonterra is also exposed to fluctuations in interest rates. Fonterra hedges a portion of its foreign currency and interest rate risk through swaps and other derivatives. However, Fonterra still faces material exposure to significant movements in interest rates and foreign currency rates.

In addition, as previously mentioned, Fonterra is exposed to movements in dairy commodity prices. Accordingly, Fonterra enters into hedging contracts under a Commodity Risk Management Policy in order to better manage this volatility. Nonetheless, movements in dairy commodity prices can affect realised hedging gains and losses on

1 A credit rating is not a recommendation to invest in any securities issued by Fonterra or the Fund and may be subject to revision, suspension or withdrawal at any time. Further information about the credit ratings referred to in this Offer Document is available at www.standardandpoors.com and at www.fitchratings.com/creditdesk/public/ratings_definitions/index.cfm. Neither Standard & Poor's (Australia) Pty Limited nor Fitch Australia Pty Limited has been involved in the preparation of this Offer Document. Neither Standard & Poor's (Australia) Pty Limited nor Fitch Australia Pty Limited makes any representation or warranty, express or implied, as to, nor assumes any responsibility or liability for the authenticity, origin, validity, accuracy or completeness of, or any errors or omissions in, any information, statement, opinion or forecast contained in this Offer Document or any previous accompanying or subsequent material or presentation.

these contracts, thereby affecting Fonterra's earnings. There is also a risk that counterparties to these contracts do not fulfil their contractual obligations resulting in losses being incurred by Fonterra.

Farmgate Milk Price and its effect on dividends and returns

As explained in Section 3 – *Setting the Farmgate Milk Price for New Zealand Milk*, the Fonterra Board sets the Farmgate Milk Price according to the Farmgate Milk Price Manual, as well as statutory and constitutional governance procedures.

The way the Farmgate Milk Price and any Approved Adjustments (e.g. premiums paid for specialty milk such as organic milk) are set has the potential to directly affect the dividends paid by Fonterra and therefore the returns that will be earned by Unit Holders. The Fonterra Board has the ability to set the Farmgate Milk Price at a price higher than that determined in accordance with the Farmgate Milk Price Manual. In such circumstances, the Fonterra Board would need to make this fact publicly available and it would need to be approved by not less than 75% of the Fonterra Board with such majority including at least a majority of the Independent Directors.

There is no guarantee that any dividends or other distributions will be paid on Shares, and the level of dividend payments (and consequently distributions on Units) could fluctuate over time.

It is possible that changes to the Farmgate Milk Price Manual (or changes to the Reference Commodity Products used to calculate this price) may have a short or longer-term impact on Fonterra's earnings.

The Farmgate Milk Price may need to change in order to respond to market conditions. Failure of the Farmgate Milk Price to appropriately reflect market conditions could result in the Farmgate Milk Price being perceived as uncompetitive by Farmer Shareholders. This may influence Farmer Shareholders as to whether they choose to produce milk or supply it to Fonterra or other processors and lead to a consequential loss of milk supply potentially impacting Fonterra's earnings.

A minor risk-sharing element of the remuneration of Fonterra senior management relates to the Farmgate Milk Price. This could result in the incentives for senior management not fully aligning with those of Unit Holders.

Asset utilisation in New Zealand

Fonterra has a substantial investment in plant and other manufacturing assets in New Zealand that have few alternative uses other than to process milk. A significant proportion of Fonterra's earnings are derived from milk processing through these plants. Fonterra's earnings would be vulnerable to a significant long-term loss of milk collections due to factors such as competition for milk in New Zealand or changes in land use. This would lead to excess capacity and Fonterra being left with stranded assets, with a consequent adverse impact on earnings, as well as any earnings and balance sheet impact of measures Fonterra may need to take in compliance with the Fund Size Risk Management Policy.

OPERATIONAL RISKS

Biosecurity

The supply of dairy products is principally an agricultural activity, which exposes Fonterra to biosecurity risks, including the risk of animal disease outbreak (e.g. foot and mouth disease among cows). This may occur in New Zealand or any of the offshore markets in which Fonterra sources milk, either directly or through its joint ventures.

Biosecurity risks may arise from inadvertent actions, such as the use of contaminated stock feed, or from deliberate acts such as bioterrorism.

A biosecurity event could significantly disrupt the supply of raw milk to Fonterra and Fonterra's output of manufactured products. Fonterra could also be indirectly affected if the biosecurity event relates to a country or region where Fonterra has significant operations even though the event is not directly related to Fonterra's products. For example, biosecurity events occurring in New Zealand could affect its "clean and green" image. Adverse perceptions resulting from a biosecurity event could affect the reputation of products supplied by Fonterra or curtail demand for Fonterra's products.

Food safety

As with any food business, there are risks relating to the safety of Fonterra's products. There is a risk that Fonterra's products might be contaminated, tampered with or adulterated in the supply or production process or otherwise become unfit for sale or consumption. This could also occur where affected products are procured by Fonterra or its joint venture operations or if product becomes affected when mixed with products supplied by a third party. These risks apply in New Zealand but are more pronounced outside of New Zealand (particularly in emerging markets) and in joint venture arrangements where Fonterra may not necessarily have full control over the milk supply chain.

Food safety issues can result in the dumping of product, claims by customers and significant product recall costs being incurred. Any related adverse publicity (even if from false or malicious or unfounded allegations) may potentially result in Fonterra incurring significant costs and experiencing reputational harm.

Anything adversely impacting the reputation of Fonterra or its brands (including the perception of the quality of New Zealand dairy products) could affect Fonterra's ability to make future sales of products or the price at which products can be sold.

Milk supply

Fonterra is reliant on milk supply in the production of its dairy products and collects and processes milk in a number of countries. Fonterra collects approximately 89% of New Zealand's total milk supply.

The volume and pattern of milk supply may change over time due to the influence of long-term economic trends. Changes in the economy that have implications for the input costs and relative returns for dairy farming may affect farmers' decisions to produce and supply raw milk. More generally, these may affect the competitiveness of milk production in New Zealand or other countries where Fonterra collects milk. Competition for raw milk in countries where Fonterra collects milk, particularly Australia and South America, can lead to an increase in the price paid to suppliers of milk in such countries and, as a result, may impact on Fonterra's earnings.

Under DIRA, Fonterra is required to allow its Farmer Shareholders to supply up to 20% of their weekly milk production throughout a Season to Fonterra's competitors if the Farmer Shareholders meet certain conditions. Accordingly, other processors can gain access to milk supply as they will be able to take milk from Fonterra suppliers without having to ask those suppliers to cease supplying Fonterra entirely. This could result in Farmer Shareholders choosing to supply milk to other processors. At present, the amount of milk supplied to other processors by Farmer Shareholders is not material. Fonterra is also required by DIRA to supply milk to its competitors (up to certain maximum volumes). These factors can reduce the amount of milk supply available to Fonterra in New Zealand.

Fonterra is required to collect up to 100% of the milk produced by Farmer Shareholders. This means that Fonterra is required to process or dispose of milk collected even when market demand is low and / or prices are unfavourable. This could also constrain Fonterra's ability to trade at the level forecast and its ability to optimise production (particularly when milk supply is high). Fonterra is also required to collect additional milk from outlying areas where there is existing supply. It may incur relatively high collection costs in doing so with these costs increasing if milk production in these areas significantly grows.

Due to the seasonality of milk supply in New Zealand, Fonterra is reliant on its forecasts of market demand and product mix requirements in relation to manufacture of products over the peak Season for subsequent sale during the periods in the Season when milk supply volumes are low. Differences between actual market demand and product mix requirements from those forecast by Fonterra can affect Fonterra's earnings.

Milk supply to Fonterra in New Zealand and overseas can also be adversely affected by changes in climate or weather-related events. Prevailing weather and climate conditions affect pasture growth, thereby affecting Fonterra's milk collection volumes. Weather and climatic events such as droughts or other unforeseen weather patterns that impact supply could cause significant fluctuations in the amount of product that Fonterra produces. Such events would adversely impact on Fonterra's reputation in relation to the reliability of the supply of its products.

As noted above, most of the factors that can influence milk supply may affect production in overseas countries, as well as New Zealand. Fonterra has significant investments in milk processing assets in Australia and Chile in particular, as well as through its Dairy Partners Americas joint venture with Nestlé in South America. Factors that adversely affect milk supply in these regions could affect earnings from these investments.

Management of contractual and joint venture relationships

Fonterra conducts a significant portion of its business through joint venture arrangements. Any joint venture arrangement involves risks that differing commercial interests or a dispute between the parties to the joint venture, or the level of financial or commercial support they provide, could affect the business, staff, operations or financial stability of the joint venture.

Water access for Farmer Shareholders constraining supply

The National Policy Statement for Freshwater Management which came into effect in July 2011 established the framework for a regulatory regime for the management of freshwater in New Zealand. Under the regime, local authorities will be able to establish water quality limits for waterways in New Zealand. Once set, farms will need to be managed within those particular limits. This could materially limit growth in the volume of milk Fonterra collects from Farmer Shareholders.

Procurement

Fonterra relies on certain key suppliers of products and services used in the manufacture and supply of dairy products (e.g. suppliers of lactose, third party manufacturers and outsourced service providers). Increases in the costs of inputs or a failure of one or more of those key suppliers to provide those products or services to Fonterra could constrain or disrupt supply or give rise to a risk of Fonterra's products being defective. This may have adverse effects on Fonterra's reputation in relation to the quality of its products and the reliability of its supply.

Catastrophe

A major catastrophe, violent act or local disaster of significant magnitude (e.g. an earthquake, fire, terrorism, war, storm, flood, sabotage or volcanic eruption) could damage or destroy manufacturing facilities or general business infrastructure, which could constrain or disrupt Fonterra's ability to supply products.

Building Code requirements in New Zealand

Councils have a statutory power to require building owners to undertake remedial work to buildings to ensure that such buildings meet at least 34% of the current earthquake standard set out in the Building Code. Following the Christchurch earthquakes of 2010 and 2011, there has been a renewed focus from Councils on the earthquake compliance of buildings and owners may be required to demolish buildings or to undertake remedial work in order to ensure compliance with the required standards. Fonterra is in the process of reviewing its entire property portfolio. To the extent that Fonterra has any buildings which do not meet at least 34% of the current Building Code, it will have to incur capital expenditure to demolish (and if relevant replace) or upgrade the buildings to ensure that the buildings comply with the Building Code.

Environmental concerns

There are risks for Fonterra associated with environmental concerns including water access and usage, agricultural emissions, discharges to land and water, genetic modification, animal welfare and the potential environmental impacts of the use of certain feed supplements and of transporting products over long distances, linked with the global supply of dairy products. These may impact on the supply of raw milk, manufacture, marketing of, and returns for, dairy products in New Zealand or internationally. These environmental concerns could also affect Fonterra's reputation, result in greater regulation, consent and licensing requirements or restrictions on Fonterra's or its suppliers' operations.

Environmental violations or incidents

Fonterra's operations are subject to environmental consents and regulation. In the event of discharges into the environment or other events of non-compliance, Fonterra or its Farmer Shareholders may be subject to clean-up costs and / or financial penalties. Production may also be disrupted in the event of material non-compliance with environmental or other approvals authorising production and associated processes, or from those approvals not being renewed (or being renewed on more onerous terms).

The storage, use, production and transport of Fonterra's products or products used in the production process (including hazardous substances) also involves the risk of accidents, spills or contamination. Each of these occurrences could result in harm to the environment. These may lead to disruption in operations, and / or regulatory sanctions and involve significant cost to remedy. A material environmental violation or other incident could harm the reputation of Fonterra and its brands.

SECTION 7 INVESTMENT RISKS CONTINUED

Reliance on utilities, infrastructure and logistics

The process of converting liquid milk into milk powder is energy intensive and also requires a large available water supply. Fonterra's operations may be adversely affected by increases in the price of electricity, gas and water or the reduction or loss of those utilities. In New Zealand, electricity is predominantly generated by hydro-electric dams. Electricity price increases or shortages may occur in years when water levels for hydro-electric dams are low.

Fonterra depends on infrastructure and third party logistics suppliers (such as rail, roading, warehousing and shipping) to process and transport its products to the market. Material failures to Fonterra's processing facilities or supply chain difficulties (including industrial or other action affecting rail, roading, warehousing or shipping) could lead to delays in production or supply or the loss of product.

Health and safety

Fonterra must comply with various health and safety laws and regulations in various jurisdictions. Penalties and other liabilities for the violation of such standards could be imposed on Fonterra following actual or potential harm to individuals or for non-compliance with the applicable laws and regulations. A major health and safety incident involving serious injury or death could also impact on Fonterra's reputation as an employer, its compliance costs, staff morale and productivity, and may attract media exposure and additional regulatory scrutiny.

Industrial action

There is a risk of industrial action arising from claims for higher wages and / or better conditions in the industries in which Fonterra and its joint ventures operate (such as operators of ports and transport logistics), which could disrupt the production or supply of products by Fonterra. This risk exists in New Zealand and in other countries where Fonterra and its joint ventures operate.

Information technology

Fonterra manages its global supply chain through its information technology system. The failure of information technology systems, business continuity plans and data protection systems, could result in information loss and lead to production delays and other supply chain difficulties.

The infiltration of information technology systems could lead to a failure of systems or loss of confidential sensitive commercial information. Fonterra from time to time undertakes projects relating to the upgrade and / or replacement of its information technology systems. Any delays to, or failure in, the implementation of such projects could have an adverse impact on Fonterra's financial performance.

Departure of key personnel

There is the possibility of key personnel (including the senior management team) leaving Fonterra and the potential for short-term disruption caused by seeking appropriate replacements.

Disruptive or emerging technology

Future changes in the methods and technology used for the collection, manufacture and transport of milk and other dairy products cannot be predicted. Advances may result in Fonterra's existing production facilities becoming obsolete or placing competitors at an advantage and could ultimately affect Fonterra's sale of product into the globally-traded dairy market.

Availability of licences and approvals

There is a risk that licences, approvals or consents that are material to Fonterra in operating its business will not be renewed or will be renewed on more restrictive or onerous terms, or in certain circumstances, revoked.

Litigation and disputes

In the ordinary course of its business, Fonterra has had, and may have, disputes with third parties, including disputes resulting in litigation or threatened litigation. A dispute (whether or not it results in litigation) could have material adverse impacts on Fonterra's financial position.

MARKET RISKS

General economic and market conditions

The international market for dairy products is affected by general economic conditions and other significant events. Changes in general macroeconomic factors in major world economies could significantly affect world commodity prices, the purchasing patterns of some of Fonterra's customers and the general level of consumption of dairy products, having an adverse effect on Fonterra.

Outbreaks of pandemic disease and other disruptive events could affect demand for Fonterra's products or its ability to deliver products into affected countries, or lead to temporary closure of facilities for Fonterra and / or its customers.

Changes in general economic and market conditions could also affect Fonterra's ability to access the capital markets as a source of funding.

The scope and extent of these factors and events cannot be predicted and, as a result, it is not possible to assess with any certainty any additional impact that they may have on the funding, operations and activities of Fonterra.

Political risk in offshore markets

A significant amount of Fonterra's revenue is earned from sales to non-OECD and developing markets that are economically and politically less stable than developed economies. A foreign country may become politically unstable resulting in the loss of an investment, or default in payment by a significant debtor. Sales of dairy products and earnings may also be affected by war, nationalisation of assets, economic instability or downturn, deflation or inflation / hyperinflation, currency volatility, price control, or political interference or uncertainty. Certain political, commercial or economic events in one country may also disrupt delivery of Fonterra's products into other intended markets.

Customer and geographic concentration / bargaining power

Fonterra sells a significant percentage of its dairy ingredients products to a number of key customers. A large proportion of dairy ingredients sales are also concentrated in China. This exposes Fonterra to the credit risk and demand requirements of those key customers and market dynamics in China.

There is also a growing global concentration and sophistication of retail customers in the supermarket sector including in Australia and New Zealand. There is an increased drive by these customers to grow their "private label" product offerings. These factors, together with increased levels of branded competition, could further reduce Fonterra's margins and restrict its access to retail channels.

Consumer preferences and product substitution

Throughout international markets, there are continual changes in consumer preferences and trends, including as a result of emerging health trends and scientific studies. This may result in Fonterra's customers substituting the products they purchase with non-dairy products or dairy products produced by competitors.

REGULATORY RISKS

Dairy regulation in New Zealand

The dairy industry and Fonterra are subject to a number of laws and regulations in New Zealand. A change in or the introduction of new policies, legislation or regulation or the way in which existing policies, legislation or regulation is enforced could adversely affect Fonterra.

DIRA established the regulatory framework for the New Zealand dairy industry. Like any legislation, disputes may arise in relation to the proper interpretation of the regulatory framework. There is also a risk that the regulatory framework may be amended from time to time, including in a way that could adversely affect Fonterra. For example, possible changes to the applicable regulations are summarised in Section 6 – *DIRA Regulatory Environment*. However, the ultimate nature of any such changes and their impact on Fonterra is still to be determined. The regulatory framework is discussed in more detail in Section 3 – *Setting the Farmgate Milk Price for New Zealand Milk* and Section 6 – *DIRA Regulatory Environment*.

Other regulation in New Zealand

Fonterra's operations are also subject to numerous other New Zealand laws and regulations which impact on most aspects of Fonterra's operations in New Zealand. A change to existing district, regional or national environmental standards or planning policies or the imposition of new requirements or standards (e.g. restrictions on the use of water or other natural resources) may have implications for the supply of raw milk or otherwise have a material adverse effect on Fonterra. Failure to comply with resource consent conditions (for example) could result in restrictions being imposed on Fonterra's operations.

Greenhouse gas emissions

Agricultural activity produces significant greenhouse gas emissions. Internationally (under the Kyoto Protocol) and domestically (under the Climate Change Response Act 2002 (New Zealand)) charges, taxes or other imposts are being introduced in relation to greenhouse gas emissions.

Fonterra is a participant under the New Zealand Emissions Trading Scheme (NZETS) and is required to monitor and report on all emissions annually. It is expected that the agriculture sector will enter fully into the NZETS framework by 2015 (however, the New Zealand Government has recently introduced a Bill which would delay entry into the NZETS framework indefinitely). Other political parties have signalled their intention to bring the agriculture sector fully into the NZETS framework as soon as possible. The New Zealand Government has also signalled that it intends to move the responsibility for emissions to the farm level as soon as practicable. Accordingly, the likely impact on Fonterra from the regulation of greenhouse gas emissions is uncertain over the next few years.

Australia introduced its Carbon Pricing Mechanism on 1 July 2012, and this is set to move to a flexible trading system in July 2015, at which time it is likely to merge with the NZETS.

Internationally, a number of emissions trading schemes are planned or have been implemented in various countries in response to obligations under the Kyoto Protocol and may increasingly be extended to apply to the agriculture sector. Due to Fonterra's international business operations, it is possible that Fonterra will face increased costs as a result of these developments.

Trade and market access

Fonterra predominantly derives its revenue from the sale of products in markets outside New Zealand. In addition to the risks associated with commodity prices described under the heading "Financial risks" in this section, the actions of foreign governments may also affect Fonterra.

Foreign governments can take actions which influence or restrict the international trade in dairy products, including through tariffs, quotas, price controls, other non-tariff barriers (such as technical or sanitary requirements), the imposition of anti-dumping measures, subsidies and food-related regulation. A breach of these may potentially result in extended legal action, financial penalties, prosecution, temporary trade embargoes and even permanent loss of market access.

Fonterra operates in certain jurisdictions that have capital controls in place, such as taxation on the repatriation of funds earned in that jurisdiction. This affects Fonterra's ability to remit funds from those jurisdictions.

The extent of these regulations, subsidies and controls may also be influenced by lobbying activities of non-governmental organisations or other commercial or customer groups.

The interaction of these factors is complex and can result in substantial shifts in Fonterra's competitiveness and the levels of returns from overseas markets.

Regulation in offshore markets

Fonterra's operations in overseas jurisdictions are also exposed to the risk of regulatory changes in those jurisdictions. Changes in laws or regulations in overseas jurisdictions could expose Fonterra to increased compliance costs and / or require Fonterra to dramatically change the structure of its operations in that jurisdiction. Any failure to comply with the applicable laws and regulations could also result in fines, injunctions, suspensions, penalties or other sanctions being imposed.

Changing food regulations

In relation to regulation of the sale of products, there is a risk that laws or regulations will be introduced in offshore markets and in New Zealand that seek to reduce the advertising and consumption of certain food categories, require mandatory dietary content disclosure or impose taxation measures that reference food content. There is also increasing regulatory and industry scrutiny of product label health claims which could result in further restrictions on the making of these health claims in the future. Such measures could have a material adverse effect on Fonterra's ability to market products and on its costs and / or earnings.

SECTION 8
DETAILS OF THE OFFER

THE OFFER

No offer is being made to subscribe for Shares in Fonterra in this Offer Document. The Units being offered in this Offer Document will be issued by the Manager of the Fund, not by Fonterra, and do not confer any direct interest in Fonterra.

The Offer comprises the offer of $500 million of Units (with the ability to accept oversubscriptions of up to a further $25 million), which will represent 100% of the Units on issue immediately following the listing of the Fund. The Final Price will be set on or about 27 November 2012 following completion of the bookbuild, in which Institutional Investors and NZX Firms will be invited to participate. The Indicative Price Range is $4.60 to $5.50 per Unit. However, Fonterra reserves the right to set the Final Price within or higher than the Indicative Price Range. All Units issued under the Offer will be issued at the Final Price.

The Offer is made on the terms, and is subject to the conditions, set out in this Offer Document.

STRUCTURE OF THE OFFER

The Offer comprises:

- the Broker Firm Offer, which is available only to New Zealand resident clients of NZX Firms who have received an allocation from that NZX Firm;
- the Stakeholder Offer comprising:
  - the Friends of Fonterra Offer; and
  - the Australian Supplier Offer; and
- the Institutional Offer, which consists of an invitation to bid for Units made to Institutional Investors in New Zealand, Australia and certain other overseas jurisdictions.

No general public offer will be made, however, investors are encouraged to contact a NZX Firm to determine whether they may be offered Units under the Broker Firm Offer. The allocation of Units between the Broker Firm Offer, the Friends of Fonterra Offer, the Australian Supplier Offer and the Institutional Offer will be determined by Fonterra in consultation with the Joint Lead Managers, having regard to the allocation policy outlined under the heading "Allocation policy under the bookbuild" in this section.

On 26 to 27 November 2012, the Joint Lead Managers will undertake a bookbuild by inviting selected Institutional Investors in New Zealand, Australia and certain other jurisdictions, and NZX Firms to indicate the number of Units they wish to apply for at a range of prices. This bookbuild process will be used to determine the Final Price. Following completion of the bookbuild, allocations of Units will be finalised.

PURPOSE OF THE OFFER AND USE OF PROCEEDS

As described in the section entitled *Overview of Trading Among Farmers*, Fonterra is currently implementing Trading Among Farmers under which its Farmer Shareholders will trade Shares among themselves on the Fonterra Shareholders' Market, with liquidity being supported by Units in the Fonterra Shareholders' Fund. The funds raised by the issue of new Units under the Offer will be used to acquire Economic Rights of Shares.

All of the costs of the Offer will be borne by Fonterra.

FORMATION OF THE FUND

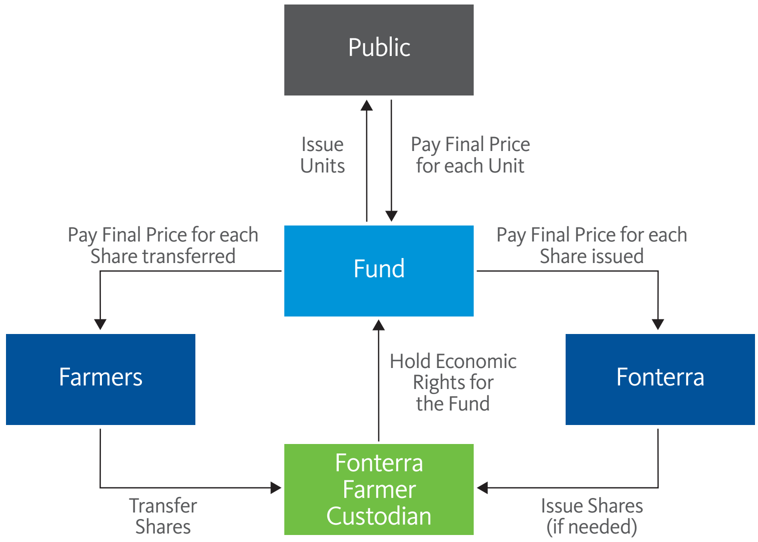
The Fund is a unit trust established under the Unit Trusts Act. It has not yet issued any Units. The Fund is to issue one Unit in respect of the Economic Rights of each Share held for the benefit of the Fund by the Fonterra Farmer Custodian. This is achieved as follows:

(a) Fonterra, on behalf of the Fund will, during the period of the Offer, make an offer to Farmer Shareholders for those Farmer Shareholders to sell Economic Rights of Shares. This is called the Supply Offer. Those Farmer Shareholders who accept the Supply Offer will be agreeing to transfer Shares to the Fonterra Farmer Custodian, who would hold the Economic Rights of those Shares in trust for the Fund. As consideration, the Fund agrees to pay to that Farmer Shareholder the Final Price for each Share transferred to the Fonterra Farmer Custodian; and

(b) Fonterra has agreed that to the extent that the number of Shares which Farmer Shareholders agree to transfer to the Fonterra Farmer Custodian (for the Fonterra Farmer Custodian to hold the Economic Rights for the Fund), when multiplied by the Final Price (the Farmer Sum), is less than the total proceeds from the Offer, it will issue the shortfall to the Fund. This shortfall will be the number of Shares, which when multiplied by the Final Price, is equal to the difference between the total proceeds from the Offer and the Farmer Sum.

Pursuant to this Offer Document, the Fund is issuing one Unit for each Share either sold to the Fonterra Farmer Custodian by Farmer Shareholders (as referred to in paragraph (a) above), or issued to the Fonterra Farmer Custodian by Fonterra (as referred to in paragraph (b) above).

PROCESS FOR LAUNCH OF THE FUND



Source: Fonterra

Units will only be allotted if there is sufficient demand from prospective investors under the Offer such that the number of Units issued at the Launch Date, multiplied by the Final Price, equals or exceeds $500 million. If this minimum threshold is not reached, Application Monies will be refunded in full, without interest.

If the Offer is successful, upon the issue of Units pursuant to the Offer, the Final Price will be paid to the Farmer Shareholders by the Fund for each Share transferred to the Fonterra Farmer Custodian and to Fonterra for each Share issued to the Fonterra Farmer Custodian.

Fonterra's intention is that the amount it receives as a result of the issue of Shares in order to meet any shortfall under the Supply Offer will not be retained on a permanent basis by Fonterra. In this situation, Fonterra's intention is to provide one or more opportunities for Farmer Shareholders to sell Economic Rights of Shares to the Fund, and for Fonterra to acquire on-market the number of Units issued as a result of any such sales (in a manner which does not disturb general trading in Units). The Units acquired may be redeemed by Fonterra, with the Shares then held as Treasury Stock or cancelled. The Units may also be held as if they were Treasury Stock and therefore not taken into consideration when determining the size of the Fund for the purposes of the Fund Size Risk Management Policy, which is discussed in Section 5 – *Trading Among Farmers in Detail*.

Further details relating to the formation of the Fund and details of the Fund structure are set out in Section 5 – *Trading Among Farmers in Detail*.

BROKER FIRM OFFER

WHO MAY APPLY

The Broker Firm Offer is open to persons with a registered address in New Zealand who have received an allocation from a NZX Firm. An Applicant, who has been offered an allocation by a NZX Firm, will be treated as applying under the Broker Firm Offer in respect of their Application. The Broker Firm Offer is not open to investors that are in the United States or that are US Persons or acting for the account or benefit of US Persons.

Investors should contact their NZX Firm to determine whether they may be offered Units under the Broker Firm Offer.

HOW TO APPLY

Complete the blue Broker Firm Offer Application Form accompanying this Offer Document. In making an Application, investors must declare that they were given a copy of this Offer Document, together with an Application Form. Investors wishing to apply under the Broker Firm Offer should contact their NZX Firm if they require further instructions.

Any Broker Firm Application Form must be stamped by the relevant NZX Firm so that the correct allocation of Units is received.

APPLICATION AMOUNTS

Application amounts will be determined by the Applicant's NZX Firm. Note that Applicants are asked to apply for a dollar amount of Units rather than a number of Units.

PAYMENT METHODS

Applications must be accompanied by payment in accordance with the directions of the NZX Firm from whom an allocation is received.

Cheques should be crossed "Non Transferable" and made out to "Fonterra Shareholders' Fund Offer".

BROKER FIRM OFFER CLOSING DATE AND DELIVERY

Applicants under the Broker Firm Offer must send the completed blue Broker Firm Offer Application Form and Application Monies to the NZX Firm who provided the allocation so as to be received in time to enable them to be forwarded to and received by the Unit Registrar by 5.00pm on 21 November 2012 (being the Broker Firm Offer Closing Date). Applications and payment must be in accordance with the directions of the NZX Firm.

SECTION 8 DETAILS OF THE OFFER CONTINUED

Investors applying for Units under the Broker Firm Offer are encouraged to submit their Broker Firm Application Form and Application Monies as early as possible in advance of the Broker Firm Offer Closing Date and to allow a sufficient period for mail processing time.

Subject to the NZSX Listing Rules and the ASX Listing Rules, Fonterra and the Joint Lead Managers reserve the right to extend the Broker Firm Offer Closing Date, in which case the dates referred to may change accordingly.

ALLOCATION UNDER THE BROKER FIRM OFFER

Units which have been allocated to NZX Firms for allocation to their New Zealand resident retail clients under the Broker Firm Offer will be issued to the Applicants nominated by those NZX Firms. It will be a matter for the NZX Firms how they make allocations among their retail clients, and they (and not the Manager, Fonterra or the Joint Lead Managers) will be responsible for ensuring that retail clients who have received an allocation from them receive the relevant Units.

STAKEHOLDER OFFER

Further details of each category of the Friends of Fonterra Offer and the Australian Supplier Offer are set out below. Details on how to apply can be found in the sections entitled *Application Forms*. The Stakeholder Offer is not open to investors that are in the United States or that are US Persons or acting for the account or benefit of US Persons.

FRIENDS OF FONTERRA OFFER

The Friends of Fonterra Offer is an offer to eligible "friends of Fonterra", who are:

- Farmer Shareholders with a valid "Farm / Party number" as at 26 October 2012;
- Fonterra-supplying sharemilkers with a valid "Farm / Party number" as at 26 October 2012;
- Fonterra New Zealand and Australian permanent employees; and
- Ex-Farmer Shareholders (as defined in Section 12 – *Glossary*).

Applications for the Friends of Fonterra Offer may be subject to scaling at the absolute discretion of Fonterra in consultation with the Joint Lead Managers.

Application Forms

To apply under the Friends of Fonterra Offer, eligible investors should complete the green Friends of Fonterra Offer Application Form accompanying this Offer Document.

On the Friends of Fonterra Offer Application Form, Applicants must tick the appropriate box to indicate which group the Application relates to, and include their unique identifier as set out below:

- Farmer Shareholders with a valid "Farm / Party number" as at 26 October 2012: their "Farm / Party number";
- Fonterra-supplying sharemilkers with a valid "Farm / Party number" as at 26 October 2012: their "Farm / Party number";
- Fonterra New Zealand and Australian permanent employees: their "Fonterra Employee Number"; and
- Ex-Farmer Shareholders: their "Old Farm number" and a description of their relationship with Fonterra.

In making an Application, investors must declare that they were given a copy of this Offer Document, together with the Application Form.

To complete the Application Form, follow the detailed instructions on the "Application Instructions" provided with that Application Form.

To request another Application Form, call the Offer Information Line on 0800 888 709 (in New Zealand) or 1800 093 495 (in Australia) or +64 9 488 8709 (outside New Zealand or Australia) from 9.00am until 7.00pm (NZDT) Monday to Friday.

Minimum Application size

The minimum application amount under the Friends of Fonterra Offer will be $2,000 and in whole multiples of $100 thereafter, up to a maximum amount of $50,000 (except in respect of Fonterra New Zealand and Australian employees, whose maximum application amount is $25,000). Note that Applicants are asked to apply for a dollar amount of Units rather than a number of Units.

Payment methods

Payment under the Friends of Fonterra Offer may be made via cheque, bank draft or direct debit (New Zealand only). Fonterra employees in Australia (and all other Applicants under the Friends of Fonterra Offer) will need to make arrangements to make payment of their Application Monies in New Zealand dollars.

Direct debit (New Zealand residents with a New Zealand bank account only)

To make payment via direct debit, tick the box on the Friends of Fonterra Offer Application Form authorising the Unit Registrar to direct debit your nominated bank account for the amount applied for on that Application Form. The bank account must be with a registered New Zealand bank. You cannot specify a direct debit date and you must ensure that:

- the bank account details supplied are correct;
- the Application Monies in the bank account for direct debit are available from the day the Unit Registrar receives the Friends of Fonterra Offer Application Form;
- the person(s) giving the direct debit instruction has / have the authority to operate the account solely / jointly; and
- the nominated bank account is a transactional account eligible for direct debit transactions. If you are uncertain, you should contact your bank.

Should your direct debit fail, your Application may be rejected. If requested, a direct debit authority form may be provided to you by the Unit Registrar.

Bank draft or cheque

Payment by cheque or bank draft must be in New Zealand dollars. All cheques or bank drafts must be made out to "Fonterra Shareholders' Fund Offer" and crossed "Non Transferable". Cheques must be drawn on a registered New Zealand bank and must not be post-dated. Cheques will be banked upon receipt for immediate value.

Friends of Fonterra Offer closing date and delivery

Applicants under the Friends of Fonterra Offer should send their completed Application Form and Application Monies to the Unit Registrar in order to be received by 5.00pm on 21 November 2012 (being the Stakeholder Offer Closing Date). Applicants are encouraged to submit their Application Form and payment as early as possible in advance of the Stakeholder Offer Closing Date and to allow a sufficient period for mail processing.

Alternatively, Applications made in New Zealand can be lodged with any NZX Firm, the Joint Lead Managers, or any other channel approved by NZX so as to be received in time to enable them to be forwarded to and received by the Unit Registrar by 5.00pm on the Stakeholder Offer Closing Date.

Fonterra and the Joint Lead Managers reserve the right to extend the Stakeholder Offer Closing Date.

Scaling

If the aggregate value of Applications received under the Friends of Fonterra Offer is greater than the value of Units allocated to that offer (as determined by Fonterra), Applications will be scaled in such manner as determined by Fonterra in consultation with the Joint Lead Managers.

AUSTRALIAN SUPPLIER OFFER

The Australian Supplier Offer is an offer of up to $25 million of Units to supplier shareholders of Bonlac Supply Company Limited (Bonlac) and to suppliers of milk to Fonterra Milk Australia Pty Ltd (Fonterra Milk Australia). Supplier shareholders in Bonlac currently hold approximately A$35.8 million of Supplier Shares in Bonlac. Bonlac also holds unsecured capital notes in Fonterra Australia Pty Ltd with a corresponding value. Bonlac intends to invite its supplier shareholders to apply to have their Supplier Shares bought back at a price of A$1.00 per share, up to the value of the Applicant's holding less one share, on the condition that the proceeds must be applied to subscribe for Units at the Final Price. The buyback of those shares will trigger the redemption of a corresponding number of the unsecured capital notes that Bonlac holds in Fonterra Australia Pty Ltd. Bonlac intends to direct Fonterra Australia Pty Ltd to pay the proceeds of redemption of those unsecured capital notes in satisfaction of the Bonlac supplier shareholder Applicants' subscription for Units under the Australian Supplier Offer.

The shareholders of Bonlac must approve the buyback of Supplier Shares occurring in connection with the Australian Supplier Offer in accordance with the Corporations Act. Assuming that the necessary amendments to Bonlac's constitution to be considered at a general meeting of Bonlac on 31 October 2012 are approved, it is intended that the 'Z' class shareholder pass a resolution approving the buyback. If the buyback is not approved, the buyback of the Supplier Shares will not proceed and Applications under the Australian Supplier Offer will only be able to be made by way of payment of Application Monies. Bonlac supplier shareholders' entitlement to participate in the Australian Supplier Offer through the buy back of their Supplier Shares will be notified to Bonlac supplier shareholders when they are sent their personalised Australian Supplier Offer Application Forms.

Bonlac supplier shareholders and suppliers to Fonterra Milk Australia may also opt to subscribe for Units at the Final Price by submitting Application Monies in addition to any buy back proceeds applied by Bonlac and Fonterra Australia Pty Ltd in the manner described above.

Minimum Application size

Applications under the Australian Supplier Offer must be for a minimum of A$1,800 of Units and thereafter in whole multiples of A$100. Any Bonlac supplier shareholders who do not hold enough Bonlac shares to provide for this minimum subscription amount may also apply for Units in cash with payment in Australian dollars. Note that Applicants are asked to apply for a dollar amount of Units rather than a number of Units.

Payment methods

Applicants under the Australian Supplier Offer should refer to the application instructions included with their Australian Supplier Offer Application Form to determine the payment methods applicable to them.

Application Forms

To apply under the Australian Supplier Offer, Bonlac supplier shareholders and suppliers to Fonterra Milk Australia should complete their personalised yellow Australian Supplier Offer Application Form which will be provided together with this Offer Document on or around 9 November 2012. The Australian Supplier Offer Application Form will also contain details of the Supplier Shares buy back process. In making an Application, investors must declare that they were given a copy of this Offer Document, together with the Application Form.

Applicants under the Australian Supplier Offer should send their completed Application Form and Application Monies to:

Computershare Investor Services Pty Limited
GPO Box 7115
Sydney NSW 2001
Australia

Applications under the Australian Supplier Offer must be received by 5.00pm (NZDT) on 21 November 2012 (being the Stakeholder Offer Closing Date). Applicants are encouraged to submit their Application Form and payment as early as possible in advance of the Stakeholder Offer Closing Date and to allow a sufficient period for mail processing.

Online Applications

Applicants under the Australian Supplier Offer may also apply using the online application facility at www.fonterraoffer.com. Applicants applying online will be required to pay any Application Monies in Australian dollars using BPAY. All online Applications must be made by 5.00pm (NZDT) on 21 November 2012 (being the Stakeholder Offer Closing Date).

Fonterra and the Joint Lead Managers reserve the right to extend the Stakeholder Offer Closing Date.

Scaling

If the aggregate value of Applications received under the Australian Supplier Offer is greater than $25 million, Applications will be scaled in such manner as determined by Fonterra in consultation with the Joint Lead Managers, without regard to the source of the Application Monies provided with the relevant Application (i.e. whether through the buyback of Supplier Shares or cash).

APPLICATIONS AND REFUNDS

ACCEPTANCE OF APPLICATIONS

An Application is an offer by the Applicant to subscribe for the Units having the value specified in the Application Form at the Final Price on the terms and conditions set out in this Offer Document, including any supplementary or replacement Offer Document and the Application Form (including the conditions regarding quotation on the NZX Main Board and ASX). To the extent permitted by law, an Application by an Applicant under the Offer is irrevocable. By submitting an Application Form, the Applicant agrees to be bound by these terms and conditions and the Trust Deed.

An Application may be accepted in respect of the full dollar amount specified in the Application Form or a lesser amount, without further notice to the Applicant. Acceptance of an Application will give rise to a binding contract.

Fonterra reserves the right to decline any Application and all Applications in whole or in part, without giving any reason. Money received in respect of Applications which are declined in whole or in part will be refunded in whole or in part (as the case may be). Interest will not be paid on any Application Monies refunded.

APPLICATION MONIES AND REFUNDS

Until the issue of Units, Application Monies received will be held in a separate account for the benefit of Applicants according to their respective entitlements and for Fonterra. Any interest on Application Monies will be paid to Fonterra to offset against its issue costs. Applicants should ensure that sufficient funds are held in their account(s) to cover the amount of the cheque(s) or bank draft(s) or direct debit payment(s).

SECTION 8 DETAILS OF THE OFFER CONTINUED

The banking of Application Monies does not constitute confirmation of allotment of any Units or the acceptance of an Application. If a cheque does not clear, the relevant Application may be rejected or any allocation made may be cancelled.

If the amount of an Applicant's cheque(s) or bank draft(s) or direct debit payment(s) for Application Monies (or the amount for which those cheque(s) or bank draft(s) clear in time for allocation) is less than the amount specified on the Application Form, the Applicant may be taken to have applied for such lower dollar amount of Units as for which their cleared Application Monies will pay (and to have specified that amount on their Application Form) or their Application may be rejected in the discretion of Fonterra in consultation with the Joint Lead Managers.

If an Application is rejected, all of the relevant Application Monies will be refunded to the relevant Applicant without interest. If Applications are scaled, the Applicant will receive the number of Units in respect of which the Application is accepted at the Final Price and a refund of the balance of the relevant Application Monies (without interest).

Refunds will not be paid for any difference arising solely due to rounding, foreign exchange rate conversion, or where the aggregate amount of the refund payable to an Applicant is less than $5.00. All refunds will be made without interest.

Cheques will be made payable to the relevant Applicant in their name(s), and will be posted to the address set out in the Application Form. Refunds will be issued within five business days following the Allotment Date.

All refunds will be paid in New Zealand dollars except for refunds in respect of Applications under the Australian Supplier Offer, which will be paid in Australian dollars.

Where Applications under the Australian Supplier Offer have been scaled, the portion of the Application Monies in respect of each Application that has not been accepted due to scaling will not be converted into New Zealand dollars and will be refunded in Australian dollars.

Where any Application Monies have been converted into New Zealand dollars on behalf of any Applicant under the Australian Supplier Offer but are subsequently required to be refunded, those Application Monies will be converted back into Australian dollars at the exchange rate applying at that time. Accordingly, due to fluctuations in the foreign exchange rates for Australian dollars and New Zealand dollars, the Australian dollar amount of any such refunded amount could be more than or less than the relevant amount of those Application Monies provided at the time the Application was made.

INSTITUTIONAL OFFER

INVITATIONS TO BID

Certain Institutional Investors along with NZX Firms will be invited to bid for Units in the Institutional Offer.

The Institutional Offer comprises an invitation to Institutional Investors in New Zealand, Australia and certain other overseas jurisdictions to bid for Units in accordance with arrangements made with the Joint Lead Managers.

The Institutional Offer is not open to investors in the United States (other than to a limited number of Pre-identified EUSFMs) or that are US Persons or acting for the account or benefit of US Persons.

THE BOOKBUILD AND INDICATIVE PRICE RANGE

The Institutional Offer will be conducted under a bookbuild managed by the Joint Lead Managers to be undertaken on 26 to 27 November 2012. Full details of how to participate, including bidding instructions, will be provided by the Joint Lead Managers to invited participants in due course.

Participants can only bid into the book for Units through the Joint Lead Managers. They may bid for Units at a specific price(s). Participants may bid above or within the Indicative Price Range of $4.60 to $5.50 per Unit.

All successful bidders will pay the Final Price for each Unit allocated to them.

ALLOCATION POLICY UNDER THE BOOKBUILD

Fonterra, in consultation with the Joint Lead Managers, will determine the allocation of Units among Institutional Investors and NZX Firms that have bid for Units in the bookbuild. There is no assurance that any participant in the bookbuild will be allocated any Units or the number of Units for which it has bid. The allocation policy will be influenced, but not constrained, by factors such as:

- the number of Units bid for by particular bidders;
- the timeliness of the bid by particular bidders;
- Fonterra's desire for an informed and active trading market following listing on the NZX Main Board and ASX;
- Fonterra's desire to establish a wide spread of institutional Unit Holders;
- the overall level of demand under the Broker Firm Offer, the Friends of Fonterra Offer, the Australian Supplier Offer and the Institutional Offer;
- the size and type of funds under management of particular bidders;
- the likelihood that particular bidders will be long-term Unit Holders; and
- any other factors that Fonterra and the Joint Lead Managers consider appropriate.

DETERMINATION OF THE FINAL PRICE

The Final Price will be determined by Fonterra on or before the date on which Units are allocated under the Offer. The bookbuild will be used to assist Fonterra to determine the Final Price.

It is expected that the Final Price will be announced on 27 November 2012.

In determining the Final Price, consideration may be given to the following factors (among others):

- the level of demand for Units in the Broker Firm Offer, the Stakeholder Offer and the Institutional Offer;
- the level of demand for Units in the bookbuild at various prices;
- the minimum Fund size required under DIRA;
- the desire for an orderly secondary market in the Units; and
- any other factors Fonterra considers relevant in meeting its objectives.

All successful Applicants will pay the Final Price for each Unit allocated to them under the Broker Firm Offer, the Friends of Fonterra Offer, the Australian Supplier Offer and the Institutional Offer. The Final Price will not necessarily be the highest price at which Units could be sold under the Offer and may be set within or higher than the Indicative Price Range. Accordingly, successful Applicants may pay a Final Price which is within or higher than the Indicative Price Range.

BROKERAGE, COMMISSION AND STAMP DUTY

No brokerage, commission or stamp duty is payable by Applicants on subscribing for Units under the Offer. See the information under the heading "Issue expenses" in Section 10 – *Statutory Information* for details of the brokerage payable to NZX Firms in connection with the Offer.

ALLOCATIONS AND ALLOTMENTS

New Zealand residents with a Common Shareholder Number (CSN) and Faster Identification Number (FIN) will have their Units allotted under their CSN, if the CSN was provided on the Application Form.

Units allocated under the Offer are expected to be issued on 30 November 2012.

It is expected that allotment notices will be sent to successful Applicants within five business days of the Allotment Date. Unit Holders on the New Zealand register of Unit Holders will be sent a statement confirming their allotment and, if a new investor, advised of their CSN and FIN.

Unit Holders on the Australian register of Unit Holders will be sent an initial statement of holding that provides details of a Unit Holder's Holder Identification Number (HIN) for CHESS holders or Securityholder Reference Number for issuer sponsored holders.

Unit Holders on the Australian register of Unit Holders will subsequently receive statements showing any changes to their unitholding in the Fund. Additional statements may be requested at any other time either directly through the Unit Holder's sponsoring broker, in the case of a holding on the CHESS subregister, or through the Unit Registrar in the case of a holding on the issuer sponsored subregister. The Fund or Unit Registrar may charge a fee for these additional issuer sponsored statements.

Applicants may call the Unit Registrar, their NZX Firm or their broker after 9.00am on the Allotment Date to ascertain their allocation before trading in the Units.

It is expected that trading of the Units on the NZX Main Board and ASX (on a deferred settlement basis for ASX) will commence on or about 30 November 2012. Units are expected to commence trading on ASX on a normal settlement basis on or about 5 December 2012.

In the event that admission to list on either the NZX Main Board or ASX is denied, or for any other reason the issue of Units under the Offer does not proceed, all Application Monies will be refunded in full without interest.

All refunds will be paid in New Zealand dollars except for refunds in respect of Applications under the Australian Supplier Offer, which will be paid in Australian dollars.

Where Applications under the Australian Supplier Offer have been scaled, the portion of the Application Monies in respect of each Application that has not been accepted due to scaling will not be converted into New Zealand dollars and will be refunded in Australian dollars.

Where any Application Monies have been converted into New Zealand dollars on behalf of any Applicant under the Australian Supplier Offer but are subsequently required to be refunded, those Application Monies will be converted back into Australian dollars at the exchange rate applying at that time. Accordingly, due to fluctuations in the foreign exchange rates for Australian dollars and New Zealand dollars, the Australian dollar amount of any such refunded amount could be more than or less than the relevant amount of those Applications Monies provided at the time the Application was made.

None of the Manager, Fonterra, Fonterra's subsidiaries, the Trustee, the Joint Lead Managers or any of their respective directors, officers, employees, consultants, agents, partners or advisers accepts any liability or responsibility should any person attempt to sell or otherwise deal with Units before the statements confirming allotments are received by the Applicants.

CHESS

The Fund will apply to participate in ASX's Clearing House Electronic Subregister System (CHESS), in accordance with the ASX Settlement Operating Rules. CHESS is an automated transfer and settlement system for transactions in securities quoted on ASX under which transfers are effected in a paperless form.

When the Units become CHESS Approved Securities, holdings will be registered in one of two subregisters, an electronic CHESS subregister or an issuer sponsored subregister. The Units of a Unit Holder who is a participant in CHESS or a person sponsored by a participant in CHESS will be registered on the CHESS subregister. All other Units will be registered on the issuer sponsored subregister.

Following the issue of Units, any Unit Holder who has elected to have their Units registered in CHESS will be sent an initial statement of holding that sets out the number of Units that have been allocated.

This statement will also provide details of a Unit Holder's Holder Identification Number (HIN) or, where applicable, the Securityholder Reference Number for issuer sponsored holders. Unit Holders will subsequently receive statements showing any changes to their holding of Units in the Fund.

OFFER MANAGEMENT AGREEMENT

The Offer is not underwritten. Fonterra, the Manager of the Fund and the Joint Lead Managers have entered into the Offer Management Agreement which sets out the obligations of the Joint Lead Managers in relation to the conduct of the bookbuild.

Under the Offer Management Agreement, the Joint Lead Managers commit to conduct the bookbuild in the manner described in this Offer Document. Once the Final Price has been determined, the Joint Lead Managers will be obliged to provide settlement support in respect of Applications under the Institutional Offer and in respect of uncleared payments of Application Monies under the Stakeholder Offer and the Broker Firm Offer. The Offer Management Agreement sets out certain circumstances in which the Joint Lead Managers may terminate the Offer Management Agreement and their settlement support obligations. The Offer Management Agreement also sets out a number of warranties and undertakings given by Fonterra and the Manager to the Joint Lead Managers. The Offer Management Agreement is described in more detail under the heading "Material contracts" in Section 10 – *Statutory Information*.

SELLING RESTRICTIONS

The Offer is only being made to members of the public resident in New Zealand and Australia and to Institutional Investors in New Zealand, Australia and certain other jurisdictions.

No person may offer, sell (including resell) or deliver or invite any other person to so offer, sell (including resell) or deliver any Units or distribute any documents (including this Offer Document) in relation to the Units to any person outside New Zealand or Australia, except in accordance with all of the legal requirements of the relevant jurisdiction.

Unless otherwise agreed with Fonterra, any person or entity subscribing for Units in the Offer shall, by virtue of such subscription, be deemed to represent that he, she or it is not in a jurisdiction which does not permit the making to him, her or it of an offer or invitation of the kind described in this Offer Document, and is not acting for the account or benefit of a person within such jurisdiction. None of Fonterra, the Manager, Fonterra's subsidiaries, the Trustee, the Joint Lead Managers or any of their respective directors, officers, employees, consultants, agents, partners or advisers accepts any liability or responsibility to determine whether a person is able to participate in the Offer.

No person may offer, sell (including resell) or deliver or invite any other person to so offer, sell (including resell) or deliver any Units or distribute any documents (including this Offer Document) in relation to the Units to any person outside New Zealand or Australia, except in accordance with all of the legal requirements of the relevant jurisdiction. In particular, this Offer Document (including an electronic copy) may not be distributed or released, in whole or in part, to persons in the United States (other than Pre-identified EUSFMs) or persons who are, or are acting for the account or benefit of, US Persons. Any failure to comply with such restrictions may constitute a violation of applicable securities laws.

The Units have not been, and will not be, registered under the US Securities Act or the securities laws of any state or other jurisdiction of the United States and accordingly may not be offered or sold, directly or indirectly, in the United States (other than to a limited number of Pre-identified EUSFMs) or to, or for the account or benefit of, a US Person. Accordingly, the Units to be offered and sold in the Offer may only be offered and sold to (i) eligible investors outside the United States who are not US Persons, and are not acting for the account or benefit of a US Person, or (ii) to a limited number of Pre-identified EUSFMs, in each case, in "offshore transactions" (as defined in Regulation S under the US Securities Act) in compliance with category 2 of Regulation S under the US Securities Act.

Each Applicant in the Broker Firm Offer, the Friends of Fonterra Offer, and the Australian Supplier Offer will be taken to have represented, warranted and agreed as follows:

- it understands that the Units have not been, and will not be, registered under the US Securities Act or the securities laws of any state or other jurisdiction of the United States and may not be offered or sold, directly or indirectly, in the United States (other than to a limited number of Pre-identified EUSFMs) or to, or for the account or benefit of, a US Person;
- it is not in the United States and is not a US Person, and is not acting for the account or benefit of a US Person (or it is a Pre-identified EUSFM);
- it has not and will not send the Offer Document or any other material relating to the Offer to any person in the United States (other than Pre-identified EUSFMs) or to any person that is, or is acting for the account or benefit of, a US Person;
- if in the future it decides to sell or otherwise transfer the Units, it will only do so in regular way transactions on the NZX Main Board or ASX, where neither it nor any person acting on its behalf knows, or has reason to know, that the sale has been pre-arranged with, or that the purchaser is, a person in the United States or a US Person or a person acting on behalf of a US Person; and
- if it is acting as a nominee or custodian, each beneficial holder on whose behalf it is participating is resident in New Zealand or Australia and is not in the United States or a US Person, and it has not sent the Offer Document or any other material relating to the Offer to any such person.

Each Applicant under the Institutional Offer will be required to make certain representations, warranties and covenants set out in the confirmation of allocation letter provided to it.

DISCRETION REGARDING THE OFFER

Following completion of the bookbuild, the determination of the Final Price and once Fonterra determines that the Manager has received Valid Applications for a total number of Units which multiplied by the Final Price equals or exceeds a minimum amount of $500 million, the Manager will be bound to issue Units to successful Applicants in accordance with the finalised allocation of Units. Fonterra expects to be in a position to make such a determination in respect of the number of Valid Applications received by the Manager on 28 November 2012. This binding obligation to issue Units will be subject to compliance by Fonterra and the Manager with all applicable laws.

Subject to the foregoing, Fonterra reserves the right to withdraw the Offer at any time prior to the allotment of Units to Applicants. If the Offer or any part of it is withdrawn, then all Application Monies, or the relevant Application Monies, will be refunded (without interest).

Fonterra also reserves the right to close the Offer or any part of it early, extend the Offer or any part of it, accept late Applications either generally or in particular cases, reject any Application, or allocate to any Applicant Units with a lesser aggregate value than that applied for.

If Fonterra amends the date of the Institutional Offer and bookbuild, the Broker Firm Offer Closing Date or the Stakeholder Offer Closing Date, any such amendment will be announced through NZX.

ENQUIRIES

All enquiries in relation to this Offer Document should be directed to the Offer Information Line on 0800 888 709 (in New Zealand) or 1800 093 495 (in Australia) or +64 9 488 8709 (outside New Zealand or Australia) from 9.00am until 7.00pm (NZDT) Monday to Friday.

Investors who are unclear in relation to any matter, or are uncertain as to whether an investment in the Fund is a suitable investment, should consult a NZX Firm, their solicitor, accountant or other appropriately qualified professional adviser before deciding whether to invest.

SECTION 9
TAXATION

NEW ZEALAND TAX SUMMARY

OVERVIEW

The following contains a summary of the material New Zealand tax consequences for Unit Holders investing in the Fund based on New Zealand tax law applying as at the date of this Offer Document.

The tax consequences for each Unit Holder may vary depending on each Unit Holder's individual circumstances. Unit Holders should obtain independent tax advice in relation to the tax consequences of acquiring, holding, disposing of and redeeming Units in the Fund.

INLAND REVENUE BINDING RULINGS

The Fund has obtained binding private and product rulings from Inland Revenue concerning the operation of the Fund, which are consistent with the tax implications set out below.

Please refer to the Inland Revenue's website www.ird.govt.nz/technical-tax/product-rulings/2012/ to view a copy of the binding product ruling.

FUND TO BE "FOREIGN INVESTMENT VARIABLE-RATE PIE"

The Fund will elect to be a "foreign investment variable-rate PIE" for New Zealand income tax purposes. If the Fund loses or surrenders this status, the tax treatment set out in this summary will not apply to the Fund or its Unit Holders.

FUND WILL MAKE TAX PAYMENTS ON RECEIPT OF FONTERRA DIVIDENDS

The Fund will attribute PIE income (being Fonterra dividends) to Unit Holders and pay tax on that income at each relevant Unit Holder's prescribed investor rate (PIR), being their applicable tax rate, subject to the option to apply the non-resident withholding tax rules in respect of Notified Foreign Investors. When the Fund receives Fonterra dividends the Fund will retain an amount from dividends distributed to a Unit Holder to satisfy the PIE (or withholding) tax liability in relation to that Unit Holder.

CALCULATION OF THE FUND'S TAXABLE INCOME AND LOSS

The Manager of the Fund will calculate the taxable income of the Fund to be attributed to Unit Holders. The taxable income attributed to Unit Holders will generally comprise Fonterra dividends.

The Fund may derive amounts of taxable income other than income derived from Fonterra Shares, such as interest income. These amounts will be used to meet the Fund's costs and will not be attributed to Unit Holders in accordance with the Trust Deed and the Income Tax Act, unless the Manager of the Fund directs otherwise.

The Fund will incur deductible expenses in relation to its operations which will be met by Fonterra. Those expenses may be attributed to the Unit Holders. The corresponding amounts received from Fonterra to meet those expenses will be taxable to the Fund. To the extent that the Fund has any net income resulting from this which is taxable, it will receive funding from Fonterra to meet that tax liability.

It is not anticipated that the Fund will have a PIE tax loss or excess tax credits which will be attributed to Unit Holders.

PRESCRIBED INVESTOR RATES (PIRs)

At the time of acquiring Units, Unit Holders must notify the Manager of the Fund of their IRD number, and their applicable tax rate (being their PIR). Unit Holders must notify the Manager if any of these details change. Unit Holders who do not provide the Manager with a notification will have a default PIR of 28% applied.

TAX-PAYING UNIT HOLDERS

Unit Holders with a PIR of greater than 0% are referred to as tax-paying Unit Holders. The PIRs applicable to investors that are individuals are 10.5%, 17.5% or 28%, based on the level of their taxable and PIE income in one of the two previous tax years. The PIRs applicable to investors that are trustees are 0%, 10.5%, 17.5% or 28%. (For New Zealand resident joint Unit Holders, the highest PIR of the joint Unit Holders must be elected.) Non-resident investors that are not Notified Foreign Investors have a PIR of 28%.

Tax-paying Unit Holders that notify their correct PIR (other than trustees that have notified a PIR of 10.5% or 17.5%) will not be liable for any further tax or be required to file a tax return in respect of an investment in the Fund. This is because the PIE tax paid by the Fund on such Unit Holders' attributed PIE income will be a final tax. This will therefore be of benefit to Unit Holders who have a marginal tax rate that is higher than 28%.

Trustees that notify a PIR of 10.5% or 17.5% will need to return their attributed PIE income in the trust's tax return and will be liable for tax at the trustee rate, or at beneficiaries' marginal tax rates where the PIE income is distributed to beneficiaries.

Unit Holders that notify, or are subject to, a higher PIR than they are eligible for (including the default rate) will not be able to receive a credit or refund for any excess PIE tax paid by the Manager.

Unit Holders that notify or are otherwise subject to PIE tax at a lower PIR than that applicable, may be liable to Inland Revenue for any consequential tax shortfall (together with any interest and penalties) and may have to file a tax return.

ZERO-RATED UNIT HOLDERS

New Zealand resident Unit Holders with a PIR of 0% are referred to as zero-rated Unit Holders. Zero-rated Unit Holders include companies, unit trusts, charities, other PIE investors, and trustees (including superannuation funds) that have not elected a PIR of 10.5%, 17.5% or 28%.

Zero-rated Unit Holders must account for tax on attributed PIE income / loss in their own tax return, as the Fund does not pay PIE tax in respect of zero-rated Unit Holders.

NOTIFIED FOREIGN INVESTORS

Unimputed Fonterra dividends attributed to Notified Foreign Investors who can benefit from one of New Zealand's double tax treaties are subject to PIE tax at the 15% rate. Otherwise, the applicable rate in relation to such dividends is 30%.

Instead of paying PIE tax, the Manager of the Fund may elect to pay non-resident withholding tax in respect of an amount of dividend income paid to the Notified Foreign Investor. The non-resident withholding tax rate on unimputed Fonterra dividends paid to a Notified Foreign Investor is 30% for non-treaty residents or otherwise at the applicable treaty rate. The benefit in opting to apply non-resident withholding tax rather than PIE tax is that Notified Foreign Investors may be in a better position to obtain a credit in their home jurisdiction for New Zealand tax paid. It is anticipated that the Manager will make such an election in relation to Notified Foreign Investors.

TRANSFERS

A Unit Holder should not be subject to tax on any gain made from the transfer (e.g. sale) of Units provided that:

- the Unit Holder does not carry on a business of dealing in Units or in respect of which the sale of Units is an ordinary incident;
- the Units were not acquired for the purpose of resale; and
- the gains on the sale of the Units have not been derived from an undertaking or scheme entered into or devised for the purpose of making a profit.

REDEMPTIONS

Redemptions of Units will generally only be made to Unit Holders who are Farmer Shareholders, RVPs or Fonterra. On redemption of a Unit, a Farmer Shareholder will receive a Fonterra Share for each Unit which is redeemed, and will be treated as acquiring the Fonterra Share for its market value. If the distribution of a Fonterra Share received on redemption of a Unit constituted income, the income is treated as excluded income, and is not subject to tax.

SECTION 10 STATUTORY INFORMATION

The following information is set out as required by Schedule 4 of the Securities Regulations.

DESCRIPTION OF UNIT TRUST

UNIT TRUST

The name of the unit trust on behalf of which the Manager of the Fund is offering Units in this Offer Document is the Fonterra Shareholders' Fund.

The Fund was established in Auckland, New Zealand by the Trust Deed dated 23 October 2012.

The Fund will continue until the earlier of:

- 80 years from the date of execution of the Trust Deed (being the period specified by section 6 of the Perpetuities Act 1964, or such later date as may be permitted by any amendment to the Perpetuities Act 1964, provided that if section 6 of the Perpetuities Act 1964 is repealed and not substituted with another perpetuity period, this provision will cease to apply); or
- the date on which all Economic Rights (or the underlying Shares) held by the Fonterra Farmer Custodian for the benefit of the Trustee in its capacity as Trustee are disposed of in accordance with the Trust Deed.

UNITS

The Units offered in this Offer Document are units in the Fonterra Shareholders' Fund. The Fund is governed by the Trust Deed dated 23 October 2012 between Fonterra, the Trustee and the Manager of the Fund.

The Fund will acquire Economic Rights derived from holding of Shares by the Fonterra Farmer Custodian in Fonterra. The Fund will not hold any Shares in Fonterra. Shares will instead be held by the Fonterra Farmer Custodian in its capacity as the trustee of the Fonterra Economic Rights Trust. Pursuant to that trust, the Trustee is declared the beneficiary in respect of the Economic Rights in the Shares which have been transferred to the Fonterra Farmer Custodian for that purpose.

Each Unit will constitute an undivided interest in the trust fund comprising the Fund. The trust fund will consist of the Economic Rights being held for the Trustee by the Fonterra Farmer Custodian. The Fund is designed to have the effect that each Unit on issue in the Fund will represent the Economic Rights derived from a single Share.

There is no maximum number of Units which may be issued, provided that the number of Units on issue must correspond with the number of Shares in which the Fonterra Farmer Custodian is holding Economic Rights on trust for the Trustee.

However:

- the Constitution imposes a limit of 25% on the number of Shares in respect of which Economic Rights may be held for the Trustee. As required by the SHC Deed Poll, the Fonterra Board has resolved to further reduce this threshold to 20%. The Fonterra Board intends to recommend to Farmer Shareholders that they amend the Constitution at the 2012 Fonterra annual meeting to include this lower threshold and other changes relating to Trading Among Farmers;
- if the overall threshold is breached, the Fonterra Board is required by the SHC Deed Poll to take steps (within a timeframe it considers appropriate) to cause the number of Shares which are subject to arrangements with the Authorised Fund to be reduced to a number below the threshold; and
- in practice, the Fonterra Board intends to manage the number of Shares subject to the above arrangements below the 20% threshold. It will do so under its Fund Size Risk Management Policy.

As of the date of this Offer Document, the Final Price is yet to be determined. The price is to be determined through a bookbuild, whereby selected Institutional Investors and NZX Firms are invited to submit bids for Units at various prices within a set range. This process allows the investor demand for the Units to be gauged and assists Fonterra to set an appropriate price. Further details are set out in Section 8 – *Details of the Offer.*

No charges are payable to the Manager of the Fund in respect of any sale of Units. Any sale of Units on the NZX Main Board or ASX is likely to attract brokerage.

No Units have yet been allotted and, as such, as at the date of this Offer Document, the Fund does not have any substantial security holders.

The opening date of the Offer is 5 November 2012. Both the Stakeholder Offer and the Broker Firm Offer close on 21 November 2012.

The bookbuild under the Institutional Offer which will be used to determine the Final Price will be conducted on 26 and 27 November 2012. Fonterra, with the agreement of the Joint Lead Managers, reserves the right to amend these dates. Any such amendment will be announced through NZX.

SECTION 10 STATUTORY INFORMATION CONTINUED

ONGOING ISSUE OF UNITS

Following the Launch Date, the Fund will continuously acquire Economic Rights and issue Units to Farmer Shareholders as follows:

- Farmer Shareholders will place an order on the NZX Main Board to sell Units;
- when that order is matched on the market by an order from an investor to acquire Units, the Farmer Shareholder will transfer Shares to the Fonterra Farmer Custodian;
- the Fonterra Farmer Custodian will accept the transfer of the Shares and will be registered as the holder of those Shares in the share register of Fonterra;
- the Fonterra Farmer Custodian will hold the Economic Rights in those Shares on trust for the Trustee in accordance with the terms of the Custody Trust Deed;
- contemporaneously, the Manager of the Fund will issue an equal number of Units to the Farmer Shareholder's broker as the number of Shares that the Farmer Shareholder transferred to the Fonterra Farmer Custodian; and
- the Farmer Shareholder will then use those Units to settle the sell order placed on the NZX Main Board and will receive cash from the investor in respect of the sale of the Units. The Farmer Shareholder is not able to retain the Units issued to their broker. If the Farmer Shareholder wishes to retain Units, they must purchase Units on the NZX Main Board or ASX in the same manner as any other investor.

The Fund will similarly issue Units to the RVP although the RVP is not required to dispose of those Units on the NZX Main Board. The Fund may also issue Units for cash if Fonterra issues Shares for the Fonterra Farmer Custodian to hold for the Trustee in terms of the Fonterra Economic Rights Trust.

The Fund may also issue Units from time to time as set out in the Trust Deed (e.g. by way of bonus issue or rights issue where Fonterra is undertaking a corresponding bonus issue or a rights issue).

MANAGERS AND PROMOTERS

MANAGER

The Manager of the Fund is FSF Management Company Limited. Its registered office is at 9 Princes Street, Auckland 1010, New Zealand.

At the date of this Offer Document, the directors of the Manager of the Fund and their principal residences are:

Philippa Jane Dunphy	Auckland
Kimmitt Rowland Ellis	Auckland
Sir Ralph James Norris	Auckland
John Bruce Shewan	Wellington
Jim William van der Poel	Ohaupo

The directors of the Manager may be contacted at the Manager's registered office, as set out above.

The Manager of the Fund is owned by Trustees Executors Limited. The ultimate holding company of Trustees Executors Limited (and therefore the Manager) is Sterling Grace (NZ) Limited.

There are no other unit trusts managed by the Manager. The Manager was incorporated on 15 August 2012. Other than in connection with preparing for the Offer, the Manager has not carried on any activities. While the Manager acts as manager of the Fund, its sole activity will be the performance of that role.

PROMOTERS

Fonterra Co-operative Group Limited is a promoter of the Fund. The registered office of Fonterra is at 9 Princes Street, Auckland 1010, New Zealand.

Each director of Fonterra is also a promoter of the Fund (other than where a director of Fonterra is also a director of the Manager of the Fund). The names of the relevant directors are as follows:

Malcolm Guy Bailey
Ian James Farrelly
Sir Henry van der Heyden
David Alexander Jackson
David Nigel Macleod
John Anthony Monaghan
Nicola Mary Shadbolt
John Anthony Waller
Ralph Graham Waters
John Speer Wilson

No administration manager or investment manager has been appointed for the Fund.

None of the Manager of the Fund, the directors of the Manager or the Promoters has been adjudged bankrupt or insolvent, convicted of a crime involving dishonesty, prohibited from acting as a director of a company, or placed in statutory management, voluntary administration, liquidation, or receivership during the five years preceding the date of this Offer Document.

REGISTRAR, CUSTODIAN, AUDITORS, ADVISERS AND EXPERTS

AUDITOR

The Auditor of the Fund is PricewaterhouseCoopers. The contact address of the Auditor is set out in the *Directory*. PricewaterhouseCoopers and the partners of PricewaterhouseCoopers have obtained a transitional licence under the Auditor Regulation Act 2011 (New Zealand). The transitional licences are effective from 1 May 2012 until the earlier of 1 May 2014 or when a full licence is issued.

UNIT REGISTRAR

The Unit Registrar is Computershare Investor Services Limited. The contact address of the Unit Registrar is set out in the *Directory*.

ADVISERS

The names and addresses of Fonterra's and the Fund's financial advisers, solicitors and other professional advisers who have been involved in the preparation of this Offer Document (being Russell McVeagh, King & Wood Mallesons, Chapman Tripp, Harmos Horton Lusk Limited, PricewaterhouseCoopers, Craigs Investment Partners Limited, Deutsche Bank AG, New Zealand branch, Goldman Sachs New Zealand Limited, UBS New Zealand Limited and KPMG) are set out in the *Directory*.

EXPERTS

PricewaterhouseCoopers has given their consent and has not withdrawn their consent before delivery of this Offer Document for registration under section 41 of the Securities Act to the distribution of this Offer Document with the inclusion of the Investigating Accountant's Report and Auditor's report in this Offer Document in the form and context in which they are included.

The address of PricewaterhouseCoopers is set out in the *Directory*.

Neither PricewaterhouseCoopers nor any director, officer or employee of PricewaterhouseCoopers is or is intended to be a director, officer or employee of the Manager of the Fund or Fonterra. PricewaterhouseCoopers has provided and, may in the future provide, professional advisory services to the Manager and / or Fonterra and its related entities.

PricewaterhouseCoopers is the auditor of Fonterra and has been appointed the auditor of the Fund and of the Manager. PricewaterhouseCoopers carries out other assurance services and other assignments for the Fonterra Group and the Manager. These matters have not impaired the independence of PricewaterhouseCoopers as the auditor of Fonterra, the Fund and the Manager.

INDEPENDENCE OF UNIT TRUSTEE AND ANY CUSTODIANS

The Trustee is independent of the Manager of the Fund and the Promoters.

UNIT TRUSTEE

The name of the Trustee is The New Zealand Guardian Trust Company Limited. Its registered office is at Level 7, Vero Centre, 48 Shortland Street, Auckland 1010, New Zealand.

As at the date of this Offer Document, the directors of The New Zealand Guardian Trust Company Limited and their places of residence are:

John Atkin of Sydney, NSW, Australia
John Richard Avery of Auckland
Christopher Robert Darlow of Auckland
Michael Privett Reed of Auckland
Timothy James Shaw of Auckland
David Roko Grbin of Glebe, NSW, Australia (as an alternate director for John Atkin)

The directors of the Trustee may be contacted at The New Zealand Guardian Trust Company Limited's registered office address, as set out above.

The Trustee was incorporated in New Zealand under the Companies Act 1955 (New Zealand) on 7 September 1982 and was reregistered in New Zealand under the Companies Act 1993 (New Zealand) on 23 April 1997.

Pursuant to section 16(1) of the Securities Trustees and Statutory Supervisors Act, the Financial Markets Authority granted the Trustee a licence to (among other things) act as a trustee in respect of unit trusts. The current licence expires on 16 March 2018.

As at the date of this Offer Document, the ultimate holding company of the Trustee is The Trust Company Limited, a company incorporated in Australia.

Pursuant to a deed of indemnity entered into between Fonterra and the Trustee, the Trustee is indemnified by Fonterra (and not out of the Fund) for all expenses, liabilities, losses and costs that the Trustee may suffer or incur in its capacity as trustee of the Fund, except for liabilities arising from its wilful default or wilful breach of trust, or a breach of trust where the requisite degree of care and diligence has not been shown. The Trustee is not indemnified out of the Fund.

The Trustee does not guarantee or promise any return of capital or any other returns (including distributions) in relation to the Units.

DESCRIPTION OF UNIT TRUST AND ITS DEVELOPMENT

TRUST DEED

The Trust Deed for the Fund is dated 23 October 2012.

SUMMARY OF THE TRUST DEED

Trust Deed

The Units are constituted by and issued under the Trust Deed dated 23 October 2012 between FSF Management Company Limited (as Manager), The New Zealand Guardian Trust Company Limited (as Trustee) and Fonterra.

The following is a summary only of the principal terms of the Trust Deed governing the Fund which have not been detailed elsewhere in this Offer Document. Unless the context otherwise requires, capitalised terms used in this summary that are not otherwise defined in this Offer Document have the meaning given to them in the Trust Deed. As this is a summary only, reference should always be made to the Trust Deed, especially in the case of doubt.

Restrictions

In giving effect to the powers and obligations under the Trust Deed, the Manager, Trustee and Fonterra are bound to comply with their respective obligations under, and are subject to certain limitations and restrictions imposed by, the Authorised Fund Contract and the Custody Trust Deed and accordingly, the powers and obligations of the Manager, Fonterra and the Trustee under the Trust Deed and with respect to the Fund generally must be given effect to and construed subject to and are limited by such obligations, limitations and restrictions.

Compliance with, and incorporation of, the NZSX Listing Rules and ASX Listing Rules

While Units are Listed, the Manager and the Trustee must comply with the NZSX Listing Rules and the ASX Listing Rules. A provision of the Trust Deed shall be of no effect to the extent it is inconsistent with any applicable NZSX Listing Rule, and in those circumstances the applicable NZSX Listing Rule shall prevail.

Subject to clause 4.5 of the Trust Deed, if NZX has given a Ruling in relation to the Fund authorising any act or omission which, in the absence of that Ruling, would be in contravention of the NZSX Listing Rules or the Trust Deed, that act or omission is deemed to be authorised by the NZSX Listing Rules and by the Trust Deed.

Without limiting clause 2.6 of the Trust Deed, but subject to clause 4.5 of the Trust Deed, if ASX has given a ruling in relation to the Fund authorising any act or omission which, in the absence of that ruling, would be in contravention of the ASX Listing Rules or the Trust Deed, that act or omission is deemed to be authorised by the ASX Listing Rules and by the Trust Deed.

While the Fund is admitted to the Official List of the ASX, clause 2.5 of the Trust Deed provides:

- notwithstanding anything contained in the Trust Deed (other than clause 2.6), if the ASX Listing Rules prohibit an act being done, the act must not be done;
- nothing in the Trust Deed prevents an act being done that the ASX Listing Rules require to be done;
- if the ASX Listing Rules require an act to be done or not to be done, authority is given for that act to be done or not to be done (as the case may be);
- if the ASX Listing Rules require the Trust Deed to contain a provision and it does not contain such a provision, the Trust Deed is deemed to contain that provision;
- if the ASX Listing Rules require the Trust Deed not to contain a provision and it contains such a provision, the Trust Deed is deemed not to contain that provision; and
- if any provision of the Trust Deed is or becomes inconsistent with the ASX Listing Rules, the Trust Deed is deemed not to contain that provision to the extent of the inconsistency.

However, the above is subject to clause 2.6 of the Trust Deed which provides that for so long as any Units are listed on the NZX Main Board and while the Fund is admitted to the Official List of ASX:

- the Trust Deed is not required to be consistent with the ASX Listing Rules to the extent that the ASX Listing Rules are inconsistent with the NZSX Listing Rules; and
- to the extent that the NZSX Listing Rules are inconsistent with the ASX Listing Rules in a way that affects or is relevant to the operation of a provision of the Trust Deed, the NZSX Listing Rules prevail to the extent of the inconsistency,

and in each case, to the extent required to give effect to anything in clause 2.6 of the Trust Deed, the requirements of clause 2.5 of the Trust Deed (which are set out above) do not apply.

Units

The beneficial interest in the Trust Fund shall be divided into Units.

Subject to the rights of Unit Holders created by the Trust Deed or by law, no Unit Holder may interfere with or question the exercise or non-exercise by the Manager, Fonterra or the Trustee of any of the trusts, powers, authorities or discretions conferred upon them by the Trust Deed or in respect of the Trust Fund or, by virtue of holding Units, attend meetings or vote or take part in or consent to any action concerning any property or corporation in which the Fund holds an interest.

The Fonterra Unit

The following rights and limitations shall attach to the Fonterra Unit:

- the Fonterra Unit may be held only by the Fonterra Unit Holder. Upon any transfer of the Fonterra Unit (other than from a retiring trustee of the Fonterra Farmer Custodian Trust to a new trustee, or with the prior written consent of Fonterra), the Fonterra Unit shall convert to a Unit;
- no provision of the Trust Deed may be amended, removed, or altered in effect, without the prior written consent of the Fonterra Unit Holder, if such amendment, removal, or alteration would change:
  - the governance structure of the Board of the Manager;
  - the scope and role of the Trust Fund;
  - the obligation of the Trust Fund to facilitate the exchange of a Share for a Unit or a Unit for a Share;
  - the limit of 15% on the number of Units that can be held by any person and their Associates (other than Fonterra); or
  - the terms of the Fonterra Unit.

No Unit or any other security may be issued by the Fund or subsequently altered so that it has the same rights as those attached to the Fonterra Unit, or that ranks equally with the Fonterra Unit for the purposes of any provision of the Trust Deed which requires that the consent of the Fonterra Unit Holder be obtained.

Acquisition of Economic Rights

Upon the Fonterra Custodian advising the Manager that it holds new Economic Rights, the Manager shall either issue Units in respect of such new Economic Rights, or pay such Cash sum in respect of such new Economic Rights received by the Manager for the issue of Units for Cash, to the relevant Transferor. Cash may only be paid to the Transferor if the Transferor has agreed to accept Cash prior to the transfer of the relevant Shares to the Fonterra Custodian.

Upon a Shareholder transferring a Share to the Fonterra Custodian in respect of which the Fonterra Custodian advises the Manager that it holds the Economic Rights and, subject to the issue of the Voucher being in accordance with the policy set by Fonterra and advised to the Manager from time to time, the Manager or Fonterra will send a Voucher to that Shareholder. Vouchers may not be transferred, except in accordance with any policy set by Fonterra. The Trustee has no obligations in relation to Vouchers.

To facilitate the establishment of the Trust Fund, the Manager is authorised to undertake the Supply Offer at the time of the first issue of Units after the establishment of the Fund.

Maximum holding

No person (together with their Associates), other than Fonterra, may hold or have an Interest in more than 15% of the lesser of the total number of Units on issue for the time being, or, the total Voting Rights for the time being.

Fonterra may determine that Affected Units cannot vote, or must be disposed of. In deciding which Units are to be treated as Affected Units for the purposes of clauses 6.5 and 6.6 of the Trust Deed, Fonterra shall have regard to such criteria as it may, in its discretion, consider appropriate and equitable.

Issue of Units

The Manager may make offers, invite subscriptions or applications for Units, may issue rights or options to subscribe for Units, and may issue Units of any Class, upon and subject to the terms and conditions contained in the Trust Deed and otherwise in such manner and upon such terms and conditions as the Manager shall from time to time determine.

The Trustee or the Manager may, at any time, cancel or redeem Units for no consideration, or such consideration that the Trustee or the Manager determines in its absolute discretion, to comply with section HM 48 of the Income Tax Act or otherwise satisfy any Tax Liability of the Fund relating to the relevant Unit Holder. Should the Trustee or the Manager cancel or redeem any Units, the Manager shall direct the Fonterra Custodian to contemporaneously sell a corresponding number of Economic Rights.

Subject to clauses 5.1 and 13.3 of the Trust Deed, the Manager may in its absolute discretion accept or refuse an application for Units in whole or in part without reason, and may limit the size of the Fund in its discretion.

There is no maximum number of Units which may be issued provided that, at no time shall the number of Units on issue exceed or be less than the number of Economic Rights which comprise Investments.

Issue price

The price at which Units may be issued shall be determined by the Manager in accordance with the Authorised Fund Contract provided that in respect of:

- the first issue after the establishment of the Fund, the issue price shall be determined in the manner set out in the Authorised Fund Contract and this Offer Document; and
- issues made to Permitted Persons, the issue price may be satisfied by the transfer or issue to the Fonterra Custodian of one fully paid Share where the Fonterra Custodian holds the Economic Rights arising from the Share transferred or issued to it for the Trustee pursuant to the Custody Trust Deed.

Where a Unit is issued to or on behalf of a Shareholder, including through a settlement system, with the issue price satisfied by the transfer by or on behalf of that Shareholder to the Fonterra Custodian of Shares, then such Units must not be retained by or on behalf of that Shareholder but must be used to settle a sale contract previously entered into on the NZX Main Board or the ASX in relation to the sale of Units. The Trustee has no obligations in relation to monitoring or enforcing this.

Redemption of Units

Subject to clause 9.2 of the Trust Deed, if any Unit Holder wishes some or all of their Units to be redeemed, that Unit Holder must give notice (Withdrawal Notice) to the Manager or such other nominated person. A Withdrawal Notice may not be revoked except by Fonterra or the RVP.

The following restrictions apply to the redemption of Units:

- no Withdrawal Notice may be given unless the Unit Holder is a Fonterra Shareholder, a Registered Volume Provider, or Fonterra;
- the Manager may refuse to redeem Units where to do so would cause, or threaten to cause, the Fund to become ineligible to be a PIE; and
- the Manager may refuse to redeem Units where to do so would result in any limit or threshold from time to time applicable under Fonterra's Constitution, the Trust Deed (except for clause 6.1 of the Trust Deed) or any relevant legislation being exceeded or otherwise not complied with.

Subject to clauses 9.1 and 9.2 of the Trust Deed, the Manager shall procure that within one Working Day of receipt of a Withdrawal Notice, or within such other period as the Manager determines, the relevant number of Units are redeemed by the Trustee and shall direct that the Fonterra Custodian transfers to the holder of those Units one Share for each Unit so redeemed.

Investments

The Trust Fund shall be invested only in Authorised Investments. Authorised Investments are Economic Rights, Distributions, Benefits, Cash, and any investment, asset, right, interest, estate or property of any nature whatsoever arising directly or indirectly from any Economic Rights, Distributions, Benefits and Cash but does not include Shares.

The Manager and the Trustee must not take or omit to take any action which would prevent the ability of the Fund to continually acquire Economic Rights and the Manager must enter into arrangements with the Fonterra Custodian for the Fonterra Custodian to continuously offer to purchase Shares during the periods the Fonterra Shareholders' Market is open for trading with the Fonterra Custodian holding Economic Rights in respect of each such Share acquired on trust for the Trustee in accordance with the terms of the Custody Trust Deed.

The Fund is to be a passive investment vehicle which must not actively trade in Shares or Economic Rights, nor undertake any other trading activity but may undertake the Supply Offer.

Neither the Manager nor the Trustee will at any time call for, demand or seek, the transfer of any part of the trust property held pursuant to the Custody Trust Deed to itself, do anything or take any step which has the purpose or effect of transferring, or otherwise vesting, legal title, or any rights or interests, in any Shares forming part of the trust property held pursuant to the Custody Trust Deed, to the Trustee or any other person who is not a Permitted Person, or do anything which affects the holding of the trust property held pursuant to the Custody Trust Deed (except as required under clauses 9.3 and 15.1 of the Trust Deed).

Neither the Manager nor the Trustee will:

- except in the case that any of the exceptions in the Custody Trust Deed apply, obtain a judgment for the payment of money or damages by the Fonterra Farmer Custodian in its personal capacity;
- issue any demand under section 289 of the Companies Act (or any analogous provision under any law) against the Fonterra Farmer Custodian;
- apply for the liquidation or dissolution of the Fonterra Farmer Custodian;
- levy or enforce any distress or other execution to, or on, or against any asset of, or held by, the Fonterra Farmer Custodian;
- apply for the appointment by a Court of a receiver or manager to any of the assets of, or held by, the Fonterra Farmer Custodian from time to time;
- exercise or seek to exercise any set off or counterclaim against the Fonterra Farmer Custodian in the performance of its duties under the Custody Trust Deed;
- appoint, or agree to the appointment of, any administrator to, or in respect of, the Fonterra Farmer Custodian;
- take any step which would lead to a recommendation being made supporting the appointment of a statutory manager in respect of the Fonterra Farmer Custodian; or
- propose or approve any proposal for a compromise under Part XV of the Companies Act (or any analogous provision under any other legislation having substantially similar effect) in respect of the Fonterra Farmer Custodian, or take any proceedings for any of the above.

The Trustee shall not act on the direction of the Manager to acquire or dispose of any Investment in the Fund if, in its opinion, the proposed acquisition or disposition is manifestly not in the interests of Unit Holders.

Rights, benefits and entitlements arising from Shares

In respect of Economic Rights and Distributions and other Benefits which arise from Economic Rights held as Assets:

- upon receipt of a Cash dividend or other Cash Benefits (other than a Supplementary Dividend) paid by Fonterra, this will be distributed to Unit Holders who were recorded in the Register at the same time and on the same record date as applied by Fonterra to determine the entitlement to the cash dividend or other cash Benefits. The amount to be paid or transferred to each such Unit Holder in respect of each Unit held by that Unit Holder as at that time, will be equal to the amount Fonterra paid or transferred per Share adjusted to take into account any Tax Liability of the Fund relating to the Unit Holder or any adjustments in accordance with section HM 48 of the Income Tax Act, and less any non-resident withholding tax deducted in respect of the Unit Holder and less any sum authorised in accordance with an Extraordinary Resolution pursuant to paragraph 11.1(b)(viii) of Schedule 1 of the Trust Deed;

- upon receipt of any Supplementary Dividend paid by Fonterra, this will be distributed to the Unit Holders that entitled Fonterra to apply section LP 2 of the Income Tax Act and receive a tax credit for the Supplementary Dividend;
- upon receipt of any imputation credits attached to a dividend paid by Fonterra, the amount of imputation credits attributable to each Unit Holder will be determined in accordance with section HM 50 of the Income Tax Act;
- upon the Fonterra Custodian receiving any Shares issued by Fonterra as a bonus issue in respect of Shares the subject of Economic Rights (which will then in turn be the subject of Economic Rights), the Manager will issue bonus Units to Unit Holders who were recorded in the Register at the same time and on the same record date as was applied by Fonterra to determine the entitlement to the bonus issue of the Shares. The number of Units to be issued to each such Unit Holder in respect of each Unit held by that Unit Holder as at that time, will be the same number as Fonterra issued per Share as its bonus issue;
- if Fonterra gives holders of Shares, including Shares held by the Fonterra Custodian the subject of Economic Rights, the Right to acquire further Shares, then the Manager will give to Unit Holders who were recorded in the Register at the same time and on the same record date as applied by Fonterra to determine the entitlement to the Right, the Right to acquire further Units so that all directions (and appropriate subscription proceeds) are received in sufficient time for the Manager to instruct the Fonterra Custodian how to deal with the Rights received from Fonterra in respect of the Shares the subject of Economic Rights and to meet any payment obligations in respect of the Fonterra Rights. Upon the issue of Shares to the Fonterra Custodian pursuant to the exercise of the Economic Rights by the Fonterra Custodian and such Shares being the subject of Economic Rights, the corresponding number of Units will be issued to persons who exercised the Rights issued by the Fund;
- if Fonterra gives holders of Shares, including Shares held by the Fonterra Custodian the subject of Economic Rights, the Right to acquire securities other than Shares (and other than a security Convertible to a Share) then the Manager will give to Unit Holders who were recorded on the Register at the same time and on the same record date as applied by Fonterra to determine the entitlement to that Right, the Right to acquire those securities to be issued by Fonterra;
- if Fonterra gives holders of Shares, including Shares held by the Fonterra Custodian the subject of Economic Rights, the Right to acquire a security Convertible to a Share, then the Manager will direct the Fonterra Custodian to dispose of such Right at the best price reasonably obtainable at the relevant time, based on advice obtained by the Manager for that purpose, and, upon receipt of the sale proceeds from the Fonterra Custodian, this will be distributed to Unit Holders who were recorded on the Register at the same time and on the same day as was applied by Fonterra to determine the entitlement to the Right; and
- if Fonterra or a third party makes an offer to acquire Shares held by the Fonterra Custodian which are the subject of Economic Rights, the Manager will seek a direction from each Unit Holder whether or not to accept such offer (being for the Manager to direct the Fonterra Custodian to accept the offer and for the Manager to redeem one Unit for each Share the subject of Economic Rights transferred pursuant to that offer). Should any such offer be accepted by Unit Holders, the amount to be paid to the relevant Unit Holders who duly elected to accept the offer (in proportion to the number of Units each such Unit Holder elected be redeemed) will be the consideration received adjusted to take into account any Tax Liability of the Fund relating to the Unit Holder, any non-resident withholding tax deducted in accordance with section HM 44B of the Income Tax Act or any adjustments in accordance with section HM 48 of the Income Tax Act and, contemporaneously with the transfer of the Shares pursuant to the offer, Units held by those Unit Holders who duly accepted the offer will be redeemed for that consideration. None of the Manager, the Trustee or Fonterra has any liability to a Unit Holder if the Manager is unable to seek a direction from each Unit Holder whether or not to accept the offer. If no direction is received from a Unit Holder, then the Manager will not accept the offer for the number of Shares equal to the number of Units held by the Unit Holder who does not give the direction.

The Manager, Trustee and each Unit Holder is not entitled to, and will not, request or require the Fonterra Custodian to:

- subject to clause 15.3 of the Trust Deed (which relates to the Manager being entitled to instruct the Fonterra Custodian how to vote at a meeting of an interest group where the Fonterra Custodian is entitled to vote), cast any votes attached to or arising from the Shares the subject of the Economic Rights and held by the Fonterra Custodian appointing or procuring the Fonterra Custodian to appoint any proxy or representative to cast any vote attached to such Shares; or
- requisition or join in requisitioning any meeting of shareholders of Fonterra; or
- propose or join with any other party in proposing any matter for discussion or resolution at any meeting of shareholders of Fonterra; or
- attend or speak at any meeting of shareholders of Fonterra,

and Unit Holders are deemed to acknowledge that neither the Manager nor the Trustee is entitled to exercise such powers.

Registers

The Manager must keep an up to date Register of Unit Holders. The Manager may appoint a Registrar acceptable to the Trustee to keep and maintain the Register on the Manager's behalf.

Transfer and transmission of Units

Subject to any restrictions in the Trust Deed, any Unit Holder may transfer all or any of the Units held by that Unit Holder.

The Manager may decline to register any transfer if (without limiting clause 20.3 of the Trust Deed):

- the Manager or the Trustee has a lien on any or all of the Units the subject of the transfer; or

- the instrument of transfer is not accompanied by such evidence as the Manager or the Trustee may reasonably require to show the right of the transferor to make the transfer; or
- registration of the transfer would result in the Fund becoming ineligible as a PIE, or would operate to threaten any such eligibility; or
- the registration of the transfer would result in a breach of clause 6.1(a) of the Trust Deed.

The Manager or Fonterra may require that any Unit Holder holding less than the Minimum Number of Units dispose of those Units, or acquire further Units to bring the relevant holding to the Minimum Number.

Restrictions on acquisitions, enforcement of acquisition restrictions and compulsory acquisitions

No Restricted Transfer (as that term is defined in the NZSX Listing Rules) of Units may take place if any Transferee under the Transfer in question is an Insider (as that term is defined in the NZSX Listing Rules) unless:

- a notice has been given to the Manager and to NZX in a manner complying with NZSX Listing Rule 10.2.3 for release to the market, not later than the time specified in the Trust Deed, containing the particulars specified in NZSX Listing Rule 4.5.2;
- a notice of any change in, or addition to, the particulars notified in accordance with the previous paragraph is given not later than the time specified in the Trust Deed; and
- any Restricted Transfer status report, if required under the Trust Deed, has been given in accordance with the Trust Deed.

In the event of a breach of the restrictions on acquisitions contained in the Trust Deed, the Manager has the power to order the sale of the defaulting Unit Holder's Units.

If a person acquired a Relevant Interest in breach of clause 20 of the Trust Deed (not being a breach committed only by the Manager or by Fonterra exercising any power of disposal under clause 6 of the Trust Deed) no Vote may be cast in respect of the Defaulter's Units on a poll while the Default is un-remedied.

A person or a group of Associated Persons that acquires beneficial ownership of 90% or more of a Class of Quoted Units (the Majority Holder) must give notice of that fact to all other holders (the Remaining Holders) of Units of that Class, the Manager and NZX. Upon becoming the Majority Holder, the Majority Holder may acquire all Affected Securities held by the Remaining Holders, or, any Remaining Holder may require that the Majority Holder acquire the Affected Securities held by that Remaining Holder.

Remuneration of Trustee

The Trustee shall be paid by Fonterra, by way of remuneration for its services as Trustee, fees agreed from time to time between Fonterra and the Trustee.

Removal and retirement of Trustee

Subject to Part 2 of the Securities Trustees and Statutory Supervisors Act, the Trustee may be removed from office as trustee by the Manager, with the approval of the High Court.

The Trustee may retire at any time without assigning any reason provided that it has given not less than 90 days' notice in writing to the Manager of its intention to do so and either all functions and duties of the position have been performed, the Manager has appointed a new Trustee, or the High Court consents.

The power of appointing a new Trustee is vested in the Manager. No person can be appointed as a new Trustee unless they are qualified to act as such pursuant to the Securities Trustees and Statutory Supervisors Act, have been approved by Fonterra and all of the Assets of the Trust Fund have been transferred from the Trustee to the new Trustee. If the Manager fails or refuses to appoint a new Trustee, Fonterra will have this right.

Remuneration, removal and retirement of Manager

The Manager shall not be entitled, in respect of its services, to any fees.

No person may be appointed as the Manager unless that person has entered into and, remains a party to, a deed agreeing to be bound by the terms of the Authorised Fund Contract, its shareholder (or shareholders) has entered into, and remains a party to, a deed agreeing to be bound by the terms of the Shareholding Deed, that person's appointment has been approved by Fonterra, and the constitution of that person provides for the appointment of five directors, three of whom to be appointed by Unit Holders and two of whom to be appointed by Fonterra.

The Manager will cease to hold office as Manager of the Fund if:

- the Manager is removed from that office by the High Court; or
- the Trustee certifies that it is in the interests of Unit Holders that the Manager should cease to hold office; or
- the Unit Holders direct that the Manager should cease to hold office; or
- the Manager is removed from office by the Trustee on the grounds of breach of the Trust Deed or the Authorised Fund Contract, failure to carry out duties to the satisfaction of the Trustee, a breach by the shareholder of the Manager of the Shareholding Deed, or insolvency or the like, specified in clause 27.3 of the Trust Deed; or
- the Manager ceases to be qualified to be appointed as the Manager.

The Manager may retire as manager of the Fund at any time without assigning any reason, upon giving six Months' notice in writing to the Trustee of its intention to do so (or such lesser period as the Trustee may agree to). No such retirement shall take effect until a new Manager has been appointed and has complied with the requirements of the Trust Deed.

The Trustee must, upon a vacancy in the office of the Manager occurring, summon a meeting of Unit Holders and must take such steps as that meeting or any subsequent meeting of Unit Holders may require to secure the appointment of a new Manager.

Any new Manager must execute a deed in such form as the Trustee may require whereby the new Manager undertakes to the Trustee, Fonterra and Unit Holders to be bound by all covenants on the part of the Manager from the date of such appointment, execute a deed agreeing to be bound by the Authorised Fund Contract in place of the previous Manager, and procure that its shareholder enters into an agreement (in a manner acceptable to the Trustee) for the purposes of clause 27.1(b) of the Trust Deed.

Borrowing and security

The Trustee has no power to borrow in respect of the Fund and the Manager may not direct the Trustee to borrow in respect of the Fund. Neither the Trustee nor the Manager shall have any power to grant any security to any person over any part or parts of the Trust Fund.

Auditor

The auditor of the Fund shall be the same auditor as is the auditor of Fonterra unless that auditor declines to be the auditor of the Fund or Fonterra agrees or requires that the Fund have an auditor different from the auditor of Fonterra.

Should the auditor of Fonterra decline to be the auditor of the Fund or Fonterra agrees or requires that the Fund have an auditor different from the auditor of Fonterra, then the Manager and Fonterra shall, after consultation with the Trustee, appoint the auditor of the Fund.

The Trustee can remove the auditor.

Meetings of Unit Holders

The Manager may convene a meeting of Unit Holders at any time, but in any event must:

- convene an annual meeting of Unit Holders to be held not less than six Months after the end of each Financial Year and not later than 15 Months after the previous annual meeting; and
- summon a meeting of the Unit Holders upon the request in writing of the Trustee, or of one-tenth in number of the Unit Holders, or of a Unit Holder or Unit Holders holding not less than one-tenth in value of the Units at the date of such request.

Unit Holders of all Classes are entitled to attend meetings of Unit Holders and to receive copies of all notices, reports and financial statements issued generally to Unit Holders entitled to vote at meetings of Unit Holders, but are not entitled to vote at any such meeting unless the terms of the relevant Units so provide.

The Unit Holders will have the ability to appoint three directors to the board of the Manager in accordance with the following:

- at the time of the annual meeting of the Fund in each year one of the Elected Directors shall retire from office;
- a retiring Elected Director is eligible for reappointment;
- Unit Holders and the Manager shall each have the right to nominate persons for appointment as Elected Directors at the annual meetings of the Fund;
- the Manager will give notice of the period for nominations in accordance with the NZSX Listing Rules;
- the nominee must be an "Independent Director" for the purposes of the NZSX Listing Rules;
- Unit Holders shall vote on the nominees and any retiring Elected Director seeking reappointment and the candidate receiving the most votes of Unit Holders at the annual meeting of the Fund will be elected as one of the Elected Directors of the Manager or, if there is more than one vacancy, the candidates with the most votes will be so elected. If there is only one candidate for election, including if that candidate is a retiring Elected Director seeking re-appointment, the candidate will be elected or re-elected (as the case may be) if they receive more votes in favour of their appointment than opposed to their appointment;
- Unit Holders may remove any Elected Directors appointed by Unit Holders by an Ordinary Resolution.

The Unit Holders, by means of a Section 18 Resolution passed at a meeting of Unit Holders, have the power to give such directions to the Trustee as they think proper concerning the Fund, being directions that are consistent with the provisions of the Trust Deed and the Unit Trusts Act and any direction given by the Financial Markets Authority.

No business may be transacted at any meeting unless the requisite quorum is present at the commencement of business. The quorum for meetings is not less than five Unit Holders present in person, by proxy, by attorney or by authorised representative.

Subject to paragraphs 6.6 to 6.8 (both inclusive) of Schedule 1 of the Trust Deed and any rights or restrictions for the time being attached to any Unit, where voting is by show of hands or by voice (or any other method permitted by the Chairman where participation is by means of audio, audio and visual, or electronic communication), every Unit Holder present (whether present, in person or by proxy, attorney or authorised representative) has one vote. On a poll every Unit Holder present in person or by proxy, attorney or authorised representative has, in respect of each Unit held by that Unit Holder, one vote. A resolution put to the vote of a meeting will be decided on a show of hands unless a poll is demanded by the Chairman, the Trustee, or a Unit Holder or Unit Holders representing not less than 10% of the total Voting Rights of all Unit Holders having the right to vote at the meeting.

Subject to clause 4.5 of the Trust Deed and paragraph 12.1 of Schedule 1 of the Trust Deed, a meeting of Unit Holders has the following powers exercisable by Extraordinary Resolution:

- to sanction the exchange of Units for, or the conversion of Units into, shares, stock, debentures, debenture stock or other obligations or securities of any company, trust, fund or scheme, or other person, formed or to be formed;
- to sanction any alteration, release, modification, waiver, variation or compromise or any arrangement in respect of the rights of the Unit Holders howsoever such rights shall arise;
- to assent to any alteration, modification of, variation, or addition to the provisions contained in the Trust Deed or other agreement or deed, or the conditions attaching to the Units and to authorise the Manager and Trustee to concur in and execute any supplemental trust deed or other document embodying any such alteration, modification, variation, or addition;
- to give any sanction, assent, release or waiver of any breach or default by the Manager, Fonterra or the Trustee under any of the provisions of the Trust Deed;
- subject to the Unit Trusts Act, to discharge, release or exonerate the Manager, Fonterra or the Trustee from all liability in respect of any act or omission for which the Manager, Fonterra or the Trustee has or may become responsible under the Trust Deed;
- to give directions to the Trustee as to the appointment of a new Manager;
- to terminate the Fund; and
- to sanction any proposal by the Manager to investigate whether the Manager or the Trustee or the Fonterra Custodian has the right to exercise or enforce rights or any claim, and / or to exercise or enforce any such rights or claim, and fund the investigation and enforcement of any of those rights or claims, including by deducting the costs from any distributions payable to Unit Holders.

An Extraordinary Resolution passed at a meeting duly convened and held in accordance with the Trust Deed is binding upon all Unit Holders, provided that a resolution which affects the rights or powers granted to Fonterra pursuant to the Trust Deed will not be of effect unless Fonterra so agrees, and no variation may be made to clause 4.5, 4.6, 4.7 or 4.8 of the Trust Deed unless the Fonterra Unit Holder so agrees.

Amendments to Trust Deed

Subject to obtaining any consent required from the Fonterra Unit Holder, the Trustee, Fonterra and the Manager may at any time make any alteration, modification, variation or addition to the Trust Deed (by means of a deed executed by the Trustee, Fonterra and the Manager) if:

- in the opinion of the Trustee, it is made to correct a manifest error or is of a minor, formal, administrative or technical nature;
- in the opinion of the Trustee, it is necessary or desirable for the more convenient, economical or advantageous working, management or administration of the Fund, or for safeguarding or enhancing the interests of the Fund or Unit Holders or any Class thereof;
- in the opinion of the Trustee it is not, or is not likely to become, prejudicial to the interests of the Unit Holders generally;
- it is authorised by an Extraordinary Resolution of Unit Holders;
- in the opinion of the Trustee, it is necessary or desirable to obtain or maintain listing of the Units on any stock exchange;
- in the opinion of the Trustee, it is necessary for the Fund to comply with any obligation or requirement in the Income Tax Act, the TAA or any other statute or regulation (or any administrative requirement of the Inland Revenue or any other revenue authority) relating to a PIE;
- in the opinion of the Trustee, it is necessary to enable the Fund to take all or any actions and make all or any determinations, decisions or elections relevant to the taxation treatment or taxation status of the Fund; or
- in the opinion of the Trustee, it is necessary or desirable to comply with any statute or regulation or the requirement of any statutory authority, or it is to give effect to any modifications, alterations or variations arising from the operation of clause 1.4 of the Authorised Fund Contract.

Trustee's and Manager's liabilities and indemnities

The Trustee and the Manager, in incurring liability in connection with the affairs of the Fund or the Trust Fund, are deemed to be acting on behalf of the Fund and not in their own respective capacities. Neither the Trustee nor the Manager are under any personal liability for the satisfaction of any obligation or claim arising out of any obligation of the Fund.

The Trustee, Fonterra and the Manager will each be liable to the Trust Fund for any loss arising out of wilful default or wilful breach of trust but subject thereto none of the Trustee, Fonterra nor the Manager will be liable to the Fund or to any Unit Holder for any act or omission as a result of acting as Trustee or Manager or, in the case of Fonterra, undertaking, or not undertaking, any matter under the Trust Deed.

No provision of clauses 34.1 to 34.3 of the Trust Deed shall have the effect of exempting the Trustee or Manager or any of their directors or officers from, or indemnifying any such person against, any liability for breach of trust where the requisite degree of care and diligence has not been shown, having regard to the provisions of the Trust Deed.

Trustee's powers and covenants

Subject to the matters set out under the heading "Restrictions" above, the Trustee has the power to settle and complete all transactions in respect of the Fund. Subject to the provisions in the Trust Deed and the Unit Trusts Act, the Trustee shall have all powers which it could exercise if it were the absolute and beneficial owner of the Trust Fund.

The Introduction to the Trust Deed sets out the transactions intended to be entered into on behalf of the Fund. The wider powers of investment under section 13A of the Trustee Act 1956 (New Zealand) and any provisions of law which impose obligations on the Trustee in respect of the diversification of investments do not apply to the Trust Deed or the Fund. The Trustee is not required to exercise any care, diligence and skill that a prudent person might otherwise exercise in monitoring the performance of the Authorised Investments.

Taxation

The Trustee or Manager may deduct or require to be deducted from any amount otherwise payable to, or to be applied in respect of, a Unit Holder an amount equal to the PIE tax payable by the Fund in respect of amounts attributed to the Unit Holder or any withholding tax withheld or deducted in respect of that Unit Holder. Such amounts are to be applied in:

- payment of the relevant taxation amount to the person or authority entitled thereto; or
- reimbursement of the Trustee or the Manager for any corresponding amount paid from their own funds; and
- any balance shall be refunded to the Unit Holder.

Each Unit Holder shall indemnify the Trustee and the Manager in respect of any taxation amount paid or payable by the Manager or the Trustee in respect of the Unit Holder.

The Manager and Fonterra have (among other powers) the power and discretion to take all steps as the Manager considers necessary or desirable to ensure the Fund is eligible or continues to be eligible as a PIE, or otherwise to comply with the requirements of the Income Tax Act relating to PIEs.

Termination

See Section 5 – *Trading Among Farmers in Detail* for a description of these matters under the heading entitled "Termination of the Fund".

RESTRICTIONS ON INVESTMENT

The Manager may only invest the Fund in:

- Economic Rights derived from the holding of Shares in Fonterra;
- Distributions;
- any benefits, entitlements and rights which arise from the Economic Rights and from Distributions;
- cash; and
- any investment, asset, right, interest, estate or property of any nature whatsoever arising directly or indirectly from any of the items set out above.

SECTION 10 STATUTORY INFORMATION CONTINUED

ACTIVITIES

The Fund was established by Trust Deed dated 23 October 2012, and has made no investment or undertaken other material activities during the five years preceding the date of this Offer Document on which to report.

INVESTMENT POLICY

The Fund will acquire Economic Rights derived from the holding of Shares in Fonterra. The Fund will not hold any Shares in Fonterra. Shares will instead be held by the Fonterra Farmer Custodian, who will declare a trust in respect of the Economic Rights of Shares in favour of the Trustee.

Each Unit will constitute an undivided interest in the trust fund comprising the Fund, and the Fund is designed to have the effect that each Unit on issue in the Fund will represent the Economic Rights derived from the holding of a single Share.

The Trust Deed defines a narrow function of the Fund which is, in summary, to:

- issue Units when new Economic Rights are held for the benefit of the Fund;
- redeem Units when required by a Farmer Shareholder, Fonterra or the RVP and procure that the Fonterra Farmer Custodian transfers a Share to the Farmer Shareholder, Fonterra or the Fonterra Farmer Custodian on behalf of the RVP seeking that redemption; and
- not undertake other trading activities. The Fund is to be "passive" i.e. it will not actively solicit Economic Rights or the redemption of Units except for undertaking the initial Supply Offer.

The scope and role of the Fund may only be altered by the Manager and the Trustee with the prior written consent of the Fonterra Unit Holder.

HISTORICAL PERFORMANCE

The Fund was established by Trust Deed dated 23 October 2012, and other than in connection with preparing for the Offer has not undertaken any activities since it was established. As such, the Fund has no historical investment performance during the five years preceding the date of this Offer Document on which to report.

DISTRIBUTIONS

The Trust Deed provides that where the Fonterra Board pays a dividend or makes any other distribution on a per-Share basis, the Fund will pass on that dividend or distribution to Unit Holders on a per-Unit basis (less any PIE tax, withholding tax or any other adjustments for tax in relation to that Unit Holder). Similarly, where Fonterra issues Shares (e.g. a bonus issue), the Shares to which the Fonterra Farmer Custodian is entitled (by virtue of the Shares already held by it for the purpose of the Fund) will be issued to the Fonterra Farmer Custodian and the Manager will make a corresponding issue of Units to Unit Holders. For further information, refer to the heading "Further detail on Economic Rights" in Section 5 – *Trading Among Farmers in Detail*.

Fonterra's distribution policy will ultimately determine the distributions, if any, made by the Manager on Units. Details of Fonterra's distribution policy are set out under the heading "What returns will I get?" in the section entitled *Answers to Important Questions.*

NO UNDERTAKING OR GUARANTEE

None of the Manager, Fonterra, Fonterra's subsidiaries, the Trustee, the Joint Lead Managers or any of their respective directors, officers, employees, agents, consultants, partners or advisers gives any guarantee, undertaking or promise as to the return of capital or the amount of any returns (including distributions) in relation to the Units.

UNIT HOLDER LIABILITY

There are no liabilities (including contingent liabilities) which may be incurred by Unit Holders in relation to the Fund other than in respect of payment of the Final Price.

The Trust Deed provides that no Unit Holder will be, or will become, personally liable in respect of any debt or liability of the Fund and no Unit Holder will be liable to indemnify the Trustee or the Manager in respect of any debt or liability, except on account of that Unit Holder's own tax liability incurred in respect of the Fund or that Unit Holder's Units.

SUMMARY FINANCIAL STATEMENTS

The Fund was established by Trust Deed dated 23 October 2012. Accordingly, no financial statements of the Fund have been prepared.

MINIMUM SUBSCRIPTION

In order for Fonterra to cease to be required to issue and redeem Shares, DIRA requires that the minimum size of the Fund at the Launch Date be $500 million. As a result, Units will only be allotted if there is sufficient demand from prospective Unit Holders such that the number of Units issued at the Launch Date, multiplied by the Final Price, equals or exceeds $500 million. Pending allotment of the Units, all Application Monies will be held on trust for the benefit of Applicants and Fonterra. If this minimum threshold is not reached, Application Monies will be refunded in full, without interest. Any interest on Application Monies will be paid to Fonterra to offset against its issue costs.

Given one Unit will be issued for each Share held by the Fonterra Farmer Custodian in respect of which the Economic Rights are held for the Trustee, it is necessary that one Share be transferred to the Fonterra Farmer Custodian in respect of each Unit to be issued. Contemporaneously with the Offer, Fonterra on behalf of the Fund is making the Supply Offer for Farmer Shareholders to sell Economic Rights of Shares to the Fund. The purchase price for Economic Rights of Shares under the Supply Offer will be equal to the subscription price for Units under the Offer (i.e. the Final Price). In the event that more Economic Rights of Shares are tendered by Farmer Shareholders under the Supply Offer than the number of Units to be issued under the Offer, the Supply Offer will be scaled. If the number of Economic Rights of Shares tendered in the Supply Offer is insufficient, Fonterra has agreed to issue Shares to the Fonterra Farmer Custodian to meet the shortfall.

ACQUISITION OF BUSINESS OR EQUITY SECURITIES

ACQUISITION OF ECONOMIC RIGHTS

The Fund has been established to acquire Economic Rights derived from the holding of Shares in Fonterra. The Fund will not hold any Shares in Fonterra. Shares will instead be held by the Fonterra Farmer Custodian, who will declare a trust in respect of the Economic Rights of Shares and hold those Economic Rights in trust for the Trustee.

The amount payable for the acquisition of Economic Rights on the initial creation of the Fund in connection with the Offer will equal the Final Price at which Units are allotted pursuant to the Offer. After this initial public offering of Units, the Fund will acquire additional Economic Rights and issue further Units as described above.

SUMMARY OF FONTERRA'S ACTIVITIES

Fonterra Co-operative Group Limited was created in October 2001, as a result of several decades of consolidation in the New Zealand dairy industry. Details in relation to the business carried on by Fonterra are included in Section 1 – *About Fonterra*.

SUMMARY FINANCIAL STATEMENTS

As required by clause 11(3)(c) of Schedule 4 to the Securities Regulations, summary financial statements for Fonterra in respect of the five accounting periods preceding the date of this Offer Document that comply with clause 8(2) to (4) of Schedule 4 (with any necessary modifications) are included in Section 11 – *Summary Financial Statements*.

The most recent financial statements for Fonterra dated 25 September 2012 that comply with, and have been registered under, the Financial Reporting Act 1993 (New Zealand) for the accounting period ended 31 July 2012 were registered with the Registrar of Companies on 19 October 2012 and may be viewed on the Companies Office website at www.business.govt.nz/companies.

OPTIONS AND UNITS PAID UP OTHERWISE THAN IN CASH

No options to subscribe for Units in the Fund have been, or are at the date of this Offer Document proposed to be, issued.

No Units in the Fund have been issued for a consideration other than cash. After the initial issue pursuant to this Offer Document, Units will be issued to Farmer Shareholders and the RVP in exchange for the transfer of Shares to the Fonterra Farmer Custodian, which in turn will hold the Economic Rights to those Shares in trust for the Trustee. All Units which are issued in consideration for the acquisition of Economic Rights in the manner described above will be issued as fully paid up. There is no maximum number of Units that may be issued by the Fund.

INTERESTED PERSONS

PROMOTERS

Fonterra will meet its own costs as a promoter of the Offer. Fonterra will also pay the fees and expenses of its directors.

TRUSTEE

Under the Trust Deed, Fonterra will pay the Trustee's fees (as agreed from time to time with the Trustee) as remuneration for its role as Trustee of the Fund. Under the Authorised Fund Contract, Fonterra has agreed to pay the costs and expenses of the Trustee.

MANAGER

Under the Unit Trust Deed, the Manager is not entitled, in respect of its services, to any fees.

Under the Authorised Fund Contract, Fonterra will pay or reimburse the operating costs of the Manager. For any unbudgeted costs or expenses, Fonterra will co-operate with the Manager to agree an additional allowance for such costs or expenses. There are some limitations on the costs that Fonterra will pay, as described in Section 5 – *Trading Among Farmers in Detail.*

Fonterra also agrees under the Authorised Fund Contract to pay the costs and expenses payable by the shareholder of the Manager. The role of the shareholder is described further in Section 5 – *Trading Among Farmers in Detail* under the heading "The Manager".

JOINT LEAD MANAGERS

Fonterra has appointed the Joint Lead Managers to manage the Offer. That appointment was on terms that are customary in relation to the appointment of persons providing investment banking services, including the payment of fees. Certain fees and expenses of the Joint Lead Managers will be paid by Fonterra.

MATERIAL CONTRACTS

1. Trust Deed

Date:	23 October 2012
Parties:	Fonterra The New Zealand Guardian Trust Company Limited, as Trustee of the Fund FSF Management Company Limited, as Manager of the Fund
General nature:	A deed establishing the Fonterra Shareholders' Fund, a unit trust established under the Unit Trusts Act. For a detailed summary of the terms of the Trust Deed, see under the heading "Description of unit trust and its development" earlier in this section

2. Fonterra Farmer Custodian Trust Deed

Date:	25 October 2012
Parties:	Fonterra, as settlor Malcolm Guy Bailey, Brian Paul Todd and Kevin John Turnball, as trustees Fonterra Farmer Custodian Limited, as the Fonterra Farmer Custodian
General nature:	A deed establishing the Fonterra Farmer Custodian Trust whereby the trustees hold all the shares in Fonterra Farmer Custodian Limited and the Fonterra Unit

3. Custody Trust Deed for the Fonterra Economic Rights Trust

Date:	25 October 2012
Parties:	Fonterra, as settlor The New Zealand Guardian Trust Company Limited, as Trustee of the Fund FSF Management Company Limited, as Manager of the Fund Fonterra Farmer Custodian Limited, as the Fonterra Farmer Custodian
General nature:	A deed pursuant to which the Fonterra Farmer Custodian holds legal title to Shares which are transferred to it and declares a trust in respect of Economic Rights in those Shares for the Trustee of the Fund, with the final beneficiary of this trust being Fonterra

4. Authorised Fund Contract

Date:	25 October 2012
Parties:	Fonterra The New Zealand Guardian Trust Company Limited, as Trustee of the Fund FSF Management Company Limited, as Manager of the Fund Fonterra Farmer Custodian Limited, as the Fonterra Farmer Custodian
General nature:	An agreement to provide for the establishment of the Fund, to authorise the Fund to be, and operate as, an "Authorised Fund" for the purposes of Fonterra's Constitution, and to regulate the relationship between Fonterra and the Fund once the Fund has been established

5. Shareholding Deed

Date:	23 October 2012
Parties:	Trustees Executors Limited, as shareholder of the Manager of the Fund FSF Management Company Limited, as Manager of the Fund Fonterra
General nature:	A deed to record the terms on which Trustees Executors Limited will be the sole shareholder of FSF Management Company Limited

6. Offer Management Agreement

Date:	25 October 2012
Parties:	Fonterra FSF Management Company Limited, as Manager of the Fund Craigs Investment Partners Limited, together with Deutsche Bank AG, New Zealand branch, Goldman Sachs New Zealand Limited and UBS New Zealand Limited, as Joint Lead Managers

General nature:	An agreement to provide for the obligations of the Joint Lead Managers in relation to the operation of the bookbuild and also provide arrangements whereby the Joint Lead Managers are obliged to provide settlement support in respect of Applications under the Institutional Offer and in respect of uncleared payments of Application Monies under the Stakeholder Offer and the Broker Firm Offer. The Joint Lead Managers may terminate the Offer Management Agreement in certain circumstances, including, where on or before 5.00pm on 28 November 2012: • any material adverse change or event occurs which is likely to materially adversely affect Fonterra or the Fund; • an insolvency event occurs in relation to Fonterra or the Manager; • the Offer Document, any invitations to apply for Units under the Offer Document or any part of the Offer is withdrawn by Fonterra or the Manager; • the Manager is unable to issue the Units under applicable law; or • any of the following occurs, and, in the reasonable opinion of the Joint Lead Managers is likely to have a material adverse effect on the Offer, or, is likely to give rise to a contravention of applicable law: – particular disruptions in certain major financial markets following the successful completion of the bookbuild in relation to the Offer; – any information or statement contained in the Offer Document is untrue, inaccurate, misleading or deceptive (including by omission); – a representation or warranty contained in the Offer Management Agreement on the part of Fonterra or the Manager is not true or correct; or – a breach of the Offer Management Agreement on the part of Fonterra or the Manager; or – a contract material to the Offer is terminated, amended , entitled to be terminated, or breached by Fonterra or the Manager. The Joint Lead Managers have a more limited termination right from 5.00pm on 28 November 2012 to 11.00pm on 29 November 2012. Pursuant to the terms of the Offer Management Agreement, the sole recourse of each Joint Lead Manager in the event of any breach of any obligation of the Manager of the Fund under that agreement (other than in the event of fraud or wilful default) will be against Fonterra.

PENDING PROCEEDS

There are no legal proceedings or arbitrations that are pending at the date of this Offer Document that may have a material adverse effect on the Fund.

ISSUE EXPENSES

Issue expenses (including brokerage and commission, expenses in relation to the Unit registry, legal fees, accounting fees, advertising costs, printing costs, postage and courier costs) relating to the Offer are estimated to amount to an aggregate of $17.2 million of which $12.6 million is brokerage and commission as detailed below.

Fonterra will pay all costs and expenses associated with the Offer (other than certain fees and expenses inccured by the Joint Lead Managers).

Fonterra will pay the Joint Lead Managers:

- a commission of 1.95% of the gross proceeds of the Offer, payable to the Joint Lead Managers in equal proportions (Base Fee); and
- at Fonterra's absolute discretion, a discretionary fee of up to 0.45% of the gross proceeds of the Offer.

The Joint Lead Managers will pay Co-Lead Managers, Co-Managers and NZX Firms certain fees as agreed between them including a commission of 1.50% of the gross proceeds in respect of Units allotted pursuant to valid Applications bearing their stamp submitted under the Broker Firm Offer.

Other than as set out above, none of the Manager of the Fund, Fonterra, Fonterra's subsidiaries, the Trustee, the Joint Lead Managers or any of their respective directors, officers, employees, consultants, agents, partners or advisers will be liable for any fees payable to the Co-Lead Managers, Co-Managers, NZX Firms, or any participants in the bookbuild process.

OTHER TERMS OF OFFER AND UNITS

All terms of the Offer are set out in this Offer Document except for those implied by law and those contained in the Trust Deed or otherwise set out in a document that has been registered with a public official, is available for public inspection and is referred to in this Offer Document.

FINANCIAL STATEMENTS AND AUDITOR'S REPORT

The Fund was established by Trust Deed dated 23 October 2012. Accordingly, no financial statements for the Fund or Auditor's report have been prepared.

PLACES OF INSPECTION OF DOCUMENTS

Copies of the Trust Deed (and any amendments to the Trust Deed), material contracts disclosed in this Offer Document, the latest financial statements of the Fund (if any) and the latest annual report for the Fund may be inspected during normal business hours without payment of any fee at the office of the Manager of the Fund, at 9 Princes Street, Auckland 1010, New Zealand, or at the office of the Trustee, Level 7, Vero Centre, 48 Shortland Street, Auckland 1010, New Zealand.

Copies of the Trust Deed (and any amendments to the Trust Deed), the latest financial statements of the Fund (if any) and any material contracts disclosed in this Offer Document can also be inspected online on the Companies Office website under the Manager's file reference at www.business.govt.nz/companies. Copies of these documents may also be obtained (on payment of a fee, if applicable) by telephoning the Ministry of Business, Innovation and Employment Business Service Centre on 0508 266 726 or by emailing info@companies.govt.nz.

OTHER MATERIAL MATTERS

As at the date of this Offer Document, there are no other material matters relating to the Fund, other than those set out elsewhere in this Offer Document, or in contracts entered into in the ordinary course of business of the Fund.

MANAGER'S STATEMENT

The directors of the Manager, after due enquiry by them, are of the opinion that between the date of the Trust Deed constituting the Fund and the date of this Offer Document, there has not been any material adverse change:

- in the value of the Fund's assets relative to its liabilities (including contingent liabilities); or
- the ability of the Fund to pay its debts as they come due in the normal course of business during the period between.

WAIVERS / RULINGS OBTAINED FROM NZX IN RESPECT OF THE FUND

NZX has granted the following rulings or waivers to the Fund:

(a) a waiver from NZSX Listing Rule 3.1.1(a) to the extent that NZSX Listing Rule 3.1.1(a) would require the Trust Deed to incorporate provisions consistent with, or having the same effect as, NZSX Listing Rules 3.3.10 and 3.4.3 (for which separate waivers have been granted as described below);

(b) a ruling from NZX that clause 4.5(c) of the Trust Deed represents a "contrary intention" appearing in the constitution, for the purposes of NZSX Listing Rule 3.1.1(d), such that no act or omission which seeks to circumvent the rights of the holder of the Fonterra Unit could be authorised by a ruling granted by NZX;

(c) waivers from the following NZSX Listing Rules, due to the procedure for the appointment of the directors of the Manager being inconsistent with:

  (i) NZSX Listing Rule 3.3.5 to the extent necessary to allow Fonterra to appoint two directors to the Board of the Manager, even though Fonterra is not a Unit Holder and to allow a precondition to be imposed in respect of persons who may be nominated by Unit Holders to fill three director positions, that those candidates be Independent for the purposes of the NZSX Listing Rules;

  (ii) NZSX Listing Rule 3.3.10 so that only Fonterra may remove its Appointed Directors from the Board of the Manager in accordance with the constitution of the Manager; and

  (iii) NZSX Listing Rule 3.3.11 to the extent that the Fonterra Appointed Directors are not subject to the requirement to retire by rotation but are subject to removal by a direction from Fonterra, with the effect that the reference to "Directors" in NZSX Listing Rule 3.3.11 refers solely to the directors of the Manager appointed by the Unit Holders;

  The waivers described in this paragraph (c) are conditional upon the Fund bearing a "Non-Standard" designation to alert the market of the Fund's unique governance arrangements, and upon Fonterra only appointing and removing appointed directors in accordance with the provisions of the constitution of the Manager and the Trust Deed. (Details of the governance arrangements for the Manager are set out under the heading "The Manager and its Directors" in Section 2 – *Governance Framework*);

(d) a ruling that no director of the Manager is "interested" in any matter, within the meaning assigned to that term in section 139 of the Companies Act, solely because that person is a director of the Manager;

(e) a waiver from NZSX Listing Rules 3.5.1 and 3.5.2 to permit the directors of the Manager to be paid by the Manager without the approval by an ordinary resolution of Unit Holders. The waiver from NZSX Listing Rules 3.5.1 and 3.5.2 is conditional upon the Fund bearing a "Non-Standard" designation to alert the market to the Fund's unique governance arrangements. (Details of the remuneration and how it may be varied is set out under the heading "Remuneration of directors of the Manager" in Section 2 – *Governance Framework*);

(f) a ruling that a transfer of Units to Fonterra will not be a "restricted transfer" for the purposes of that definition in NZSX Listing Rule 4.1.1, because DIRA prohibits Fonterra from exercising voting rights in respect of any Units that it holds;

(g) a waiver from NZSX Listing Rule 5.1.10 to permit the Trust Deed to omit the information required under paragraphs (a) (that the Trustee is entitled to appoint an independent valuer to value the assets of the Fund) and (c) (that if the office of the Trustee is vacated and a new Trustee not appointed within two months, the Fund be wound up) of Appendix 10 to the NZSX Listing Rules. (Details of the termination provisions relating to the Fund are set out under the heading "Termination of the Fund" in Section 5 – *Trading Among Farmers in Detail*);

(h) a waiver from NZSX Listing Rule 7.3 to allow the Manager to issue Units as set out in the Trust Deed, without requiring the approval of the Unit Holders;

(i) a waiver from NZSX Listing Rule 7.4 to permit the Fund to pass on any Benefit or Distribution (as those terms are defined in the Trust Deed) to Unit Holders that Fonterra passes on to Shareholders, without requiring Unit Holders' approval. (The manner in which such Benefits and Distributions may be distributed is set out under the heading "Further details on Economic Rights" in Section 5 – *Trading Among Farmers in Detail*);

(j) a ruling that a holding of an interest in units that is less than 15 per cent of the total number of Units on issue, or the total voting rights, shall not amount to "effective control" for the purposes of NZSX Listing Rule 7.5;

(k) a waiver from NZSX Listing Rules 7.6.1 and 7.6.2 to the extent necessary to allow Unit Holders to redeem Units as required by the Trust Deed, without requiring prior Shareholder approval or any other restrictions. (The persons who may require a Unit to be redeemed and the circumstances when Units may be redeemed is set out under the heading "Redemption of Units" in Section 5 – *Trading Among Farmers in Detail*);

(l) a waiver from NZSX Listing Rules 8.1.3 and 8.1.4 in respect of the pricing of Units issued in accordance with the Trust Deed to reflect Shares transferred or issued to the Fonterra Farmer Custodian. (An outline of the process by which the Fund will continuously issue Units following the launch of the Fund is set out under the heading "Ongoing issues of Units" in Section 10 – *Statutory Information*);

(m) a ruling from NZX that the acquisition or disposal of Economic Rights of Shares in accordance with the Trust Deed and the issue or redemption of Units in accordance with the Trust Deed are not a "series of linked or related transactions" for the purposes of NZSX Listing Rule 9.1.1 and not a "related series of transactions" for the purposes of NZSX Listing Rule 9.2.2;

(n) a ruling that the entry into, and the performance of obligations under, the Authorised Fund Contract, is not a major transaction or series of linked or related transactions for the purposes of NZSX Listing Rule 9.1.1, nor a material transaction with a related party for the purposes of NZSX Listing Rule 9.2;

(o) a waiver from the requirements in NZSX Listing Rule 9.1.1 and in NZSX Listing Rule 9.2 to seek Unit Holder approval to allow the Fund to dispose of its assets as permitted by the termination provisions of the Trust Deed. (Details of the termination provisions relating to the Fund are set out under the heading "Termination of the Fund" in Section 5 – *Trading Among Farmers in Detail.*)

NZX has also granted approval, in accordance with NZSX Listing Rule 11.1.5, to the restriction contained in the Trust Deed allowing the Manager to refuse to register a holding that would cause a Unit Holder and its Associates (other than Fonterra) to have a Relevant Interest in more than 15% of Units on issue or voting rights, and may require a sell down if this level is exceeded, or would cause the Fund to become ineligible as a PIE or threaten any such eligibility.

WAIVERS / CONFIRMATIONS OBTAINED FROM ASX IN RESPECT OF THE FUND

ASX has made an in-principle decision to grant waivers from, and confirmations in relation to, the ASX Listing Rules. Due to the novel structure of the Fund and the NZX Main Board being the primary exchange, the ASX waivers and confirmations will, among other things:

- enable the operation of the Trust Deed generally;
- permit the ongoing issue / redemption of Units feature of the Fund without Unit Holder approval; and
- give primacy to the NZSX Listing Rules and New Zealand laws, to the extent of any inconsistency with the ASX Listing Rules.

The key waivers and confirmations to be granted include:

- confirmation that ASX has no objection to the Trust Deed on the condition that it includes the modified provisions of Appendix 15A of the ASX Listing Rules as set out in, and confirmation that ASX Listing Rule 15.11.1 will be satisfied through the inclusion of, clauses 2.5 and 2.6 of the Trust Deed – with the effect that the Trust Deed is not required to comply with the ASX Listing Rules to the extent of any inconsistency with the NZSX Listing Rules (subject to any waivers and rulings obtained from time to time);
- ASX Listing Rule 1.1 Condition 5: a waiver to permit the Manager to allow the redemption of Units by Permitted Persons in accordance with the Trust Deed;
- ASX Listing Rules 8.10, 8.11, 6.8, 6.9, 6.10.5, 6.12.3 and 15.14: waivers and confirmations to permit the Trust Deed to contain provisions allowing the Manager to enforce a 15% ownership restriction on the holding of Units or voting rights in connection with Units;
- ASX Listing Rule 6.8 and 6.9: waivers to reflect the terms, and the underlying statutory context, of the Fonterra Unit; and
- ASX Listing Rule 7.1, 10.1 and 10.11: waivers to allow the issue by the Fund of one Unit for each Share sold to the Custodian without Unit Holder approval as part of the ongoing sale of Shares and issue of Units feature of Trading Among Farmers.

SECURITIES ACT EXEMPTIONS

The Financial Markets Authority has granted exemptions from the Securities Act in relation to the implementation and operation of Trading Among Farmers. For the purpose of these exemptions, described below, a reference to “shareholders” means either of the following:

- a person whose name is entered in the Share register maintained by Fonterra as the holder of a Share; or
- a person whose application to become a holder of a Share has been accepted in writing by Fonterra.

The following exemptions from the Securities Act have been granted by the Financial Markets Authority:

(a) an exemption for Fonterra, the Manager, and every person acting on behalf of either or both of them from sections 33(1), 37 and 37A of the Securities Act and the Securities Regulations (except regulation 23) in respect of Shares that have been previously allotted by Fonterra to the Fonterra Farmer Custodian on the Allotment Date and are subsequently offered to shareholders by the Manager;

(b) an exemption for Fonterra, any Registered Volume Provider, and every person acting on behalf of either or both of them from sections 33(1), 37 and 37A of the Securities Act and the Securities Regulations (except regulation 23) in respect of Shares that have been previously allotted by Fonterra to the Fonterra Farmer Custodian on the Allotment Date and are subsequently offered to shareholders by the Registered Volume Provider;

(c) an exemption for the Manager and every person acting on its behalf from sections 33(1), 37 and 37A of the Securities Act and the Securities Regulations (except regulation 23) in relation to Units offered and allotted to a Shareholder as consideration for the transfer of Shares by that shareholder if those Units are used to settle a sale contract previously entered into on the NZX Main Board or ASX in relation to the sale of Units.

The exemptions referred to in paragraphs (a) and (b) above are subject to the following conditions:

(d) at the time of the allotment of Shares to the Fonterra Farmer Custodian, there is a registered prospectus for the Units;

(e) it is an implied term of every offer of the Shares to shareholders to which paragraphs (a) and (b) above relate that, except to the extent disclosed for the purposes of the offer of the Shares, the offeror has no information in relation to Fonterra that is not publicly available and that would, or would be likely to, affect materially the price of the Shares if it were so disclosed; and

(f) for the purposes of paragraph (e) above, an offeror is not to be taken to have information in relation to Fonterra if:

   (i) arrangements existed to ensure that no individual who took part in the decision to offer the Shares to the public received, or had access to, that information or was influenced, in relation to that decision, by an individual who had that information; and

   (ii) no individual who took part in the decision to offer the Shares to the public received, or had access to, that information or was influenced, in relation to that decision, by an individual who had that information.

ASIC RELIEF

ASIC has granted the following relief from various provisions of the Corporations Act in respect of the ongoing activities of the Fund:

- A declaration that the Fund be registered as a managed investment scheme under the Corporations Act, but only for the purposes of the continuous disclosure provisions of the Corporations Act and the provisions of the Corporations Act relating to on-market and off-market transfers of Units.
- A declaration that the disclosure requirements of the Corporations Act do not apply in respect of the on-sale of Units on ASX, as a result of the Manager issuing one Unit per Share transferred to the Fonterra Farmer Custodian from time to time.

SECTION 11
SUMMARY FINANCIAL STATEMENTS

Summary financial statements for the Fonterra Group, as required by clause 11(3) of Schedule 4 of the Securities Regulations, are set out in this section.

The summary financial statements are presented for the years ended 31 July 2012, 2011, 2010 and 2009, and the 14-month period ended 31 July 2008. The summary financial statements are presented in New Zealand dollars and are rounded to the nearest million dollars.

The summary financial statements comply with FRS-43 *Summary Financial Statements*. FRS-43 requires the amounts in the summary financial statements to be drawn from and be consistent with information presented in the full financial statements for the relevant periods (unless that information has subsequently been restated or reclassified in which case it is required to be drawn from and be consistent with the restated or reclassified information). The historical financial information has been extracted from the relevant full financial statements subject to the following restatements:

- the financial statements for the year ended 31 July 2010 reflect a change in accounting policy arising from changes in Fonterra's capital structure during that year. The change in accounting policy was applied retrospectively and as a result, the tax credit relating to distributions to Shareholders of $177 million recognised in equity in the financial statements for the year ended 31 July 2009 was presented in the income statement. There was no impact on the comparative balance sheet in the 31 July 2010 financial statements as a result of this change; and
- because the financial statements for the year ended 31 July 2010 only include the 2009 financial year as a comparative, no retrospective restatement has been made to reflect this change in accounting policy on the full financial statements for the periods ended 31 July 2008 and prior. However, this restatement is reflected in the historical financial information; the tax credit relating to distributions to Shareholders of $28 million recognised in equity in the full financial statements for the period ended 31 July 2008 has been presented in the summary income statement for that period in the following tables.

The summary financial statements of Fonterra have been authorised for issue by a resolution of directors dated 25 October 2012. The Fonterra Board authorised the issue of the relevant full financial statements from which the summaries have been drawn and are consistent with, on the following dates:

- year ended 31 July 2012 – 25 September 2012;
- year ended 31 July 2011 – 21 September 2011;
- year ended 31 July 2010 – 22 September 2010;
- year ended 31 July 2009 – 22 September 2009; and
- 14-month period ended 31 July 2008 – 23 September 2008.

The full financial statements for each period have been audited. The audit opinions received for each period presented in the summary were unqualified and none of the audit reports contained an explanatory paragraph.

The full financial statements for each period have been prepared in accordance with NZ GAAP as applicable to profit oriented entities, and each includes an unreserved statement of compliance with International Financial Reporting Standards.

Summary financial statements do not include all the disclosures provided in the full financial statements and cannot be expected to provide as complete an understanding as provided by the full financial statements. The full financial statements may be obtained from Fonterra at 9 Princes Street, Auckland 1010, New Zealand.

SUMMARY INCOME STATEMENTS FOR THE PERIODS ENDED 31 JULY

($M)	FY2012	FY2011	FY2010	FY2009	FY2008
Revenue from sale of goods	19,769	19,871	16,726	16,035	19,512
Cost of goods sold[1]	(16,721)	(16,861)	(13,975)	(13,217)	(16,820)
Gross profit	**3,048**	**3,010**	**2,751**	**2,818**	**2,692**
Other operating income	132	165	277	119	108
Other operating expenses	(2,238)	(2,119)	(1,999)	(2,036)	(2,211)
Net foreign exchange (losses) / gains	(7)	(91)	(7)	21	9
Operating profit	**935**	**965**	**1,022**	**922**	**598**
Net finance costs	(310)	(406)	(313)	(448)	(367)
Share of profit of equity accounted investees	52	63	56	68	16
Profit before tax	**677**	**622**	**765**	**542**	**247**
Tax (expense) / credit	(53)	149	(80)	68	75
Profit for the period[2]	**624**	**771**	**685**	**610**	**322**
Attributable to:					
Shareholders of the Parent	609	754	669	599	272
Non-controlling interests	15	17	16	11	50
Profit for the period	**624**	**771**	**685**	**610**	**322**

1 For the years from FY2009 to FY2012, cost of goods sold includes the cost of milk based on the volume of milksolids supplied by Shareholders at the Farmgate Milk Price for the Season. The Farmgate Milk Price for the Season is calculated in accordance with the principles set out in the Farmgate Milk Price Manual and is independently audited. In FY2008, the cost of milk was based on an estimated milk price modelled using a combination of actual and forecast sales. At the time of moving to the independent Farmgate Milk Price, the financial impact was not able to be quantified and the FY2008 cost of milk was not required to be, and therefore was not, restated.

2 The following non-recurring items had a significant impact on the profit for the period:
(a) impairment of Fonterra's 43% investment in Shijiazhuang San Lu Group Company Limited of $201 million ($139 million in FY2008 and $62 million in FY2009);
(b) a pre-tax gain of $127 million in FY2010 on the disposal of Fonterra's 25% interest in AFF P/S, a joint venture with Arla Foods; and
(c) non-cash tax credits of $202 million in FY2011 relating to deferred tax.

SUMMARY STATEMENTS OF COMPREHENSIVE INCOME FOR THE PERIODS ENDED 31 JULY

($M)	FY2012	FY2011	FY2010	FY2009	FY2008
Profit for the period	**624**	**771**	**685**	**610**	**322**
Movement in cash flow hedge reserves	(453)	375	(29)	258	(237)
Movement in net investment hedges	(24)	35	46	1	(124)
Foreign currency translation reserve attributable to Shareholders	37	(164)	(150)	12	162
Foreign currency translation reserve transferred to income statement	(7)	(15)	19	–	(1)
Foreign currency translation attributable to non-controlling interests	1	(4)	(2)	5	12
Share of equity accounted investees' movements in reserves	1	7	–	–	(1)
Other comprehensive (expense) / income recognised directly in equity	**(445)**	**234**	**(116)**	**276**	**(189)**
Total comprehensive income for the period	**179**	**1,005**	**569**	**886**	**133**
Attributable to:					
Shareholders of the Parent	163	992	555	870	71
Non-controlling interests	16	13	14	16	62
Total comprehensive income for the period	**179**	**1,005**	**569**	**886**	**133**

SECTION 11 SUMMARY FINANCIAL STATEMENTS CONTINUED

SUMMARY STATEMENTS OF CHANGES IN EQUITY FOR THE PERIODS ENDED 31 JULY

($M)	FY2012	FY2011	FY2010	FY2009	FY2008
At the start of the period	**6,541**	**5,667**	**4,805**	**4,269**	**4,978**
Total comprehensive income for the period attributable to:					
Shareholders of the Parent	163	992	555	870	71
Non-controlling interests	16	13	14	16	62
	179	**1,005**	**569**	**886**	**133**
Transactions with Shareholders in their capacity as Shareholders:					
Dividends paid to Shareholders	(475)	(365)	(107)	(591)	(87)
Co-operative shares issued	584	404	617	766	754
Co-operative shares surrendered	(155)	(159)	(158)	(506)	(1,354)
Purchase of non-controlling interests	–	–	(47)	–	(147)
Dividends paid to non-controlling interests	(19)	(11)	(12)	(19)	(11)
Contribution from non-controlling interests	–	–	–	–	3
As at 31 July	**6,655**	**6,541**	**5,667**	**4,805**	**4,269**
Components of equity:					
Co-operative shares	5,690	5,261	5,016	4,557	4,297
Retained earnings	1,078	943	547	26	18
Foreign currency translation reserve	(211)	(217)	(73)	12	(1)
Cash flow hedge reserve	63	516	141	170	(88)
Equity attributable to Shareholders of the Parent	**6,620**	**6,503**	**5,631**	**4,765**	**4,226**
Non-controlling interests	35	38	36	40	43
Total equity	**6,655**	**6,541**	**5,667**	**4,805**	**4,269**

SUMMARY STATEMENTS OF FINANCIAL POSITION AS AT 31 JULY

($M)	FY2012	FY2011	FY2010	FY2009	FY2008
Current assets	6,692	7,560	6,087	5,988	6,457
Non-current assets	8,425	7,970	8,082	8,129	7,982
Total assets	**15,117**	**15,530**	**14,169**	**14,117**	**14,439**
Current liabilities	4,125	3,646	3,558	4,414	5,071
Non-current liabilities	4,337	5,343	4,944	4,898	5,099
Total liabilities	**8,462**	**8,989**	**8,502**	**9,312**	**10,170**
Equity attributable to Shareholders of the Parent	6,620	6,503	5,631	4,765	4,226
Non-controlling interests	35	38	36	40	43
Total equity	**6,655**	**6,541**	**5,667**	**4,805**	**4,269**

SUMMARY CASH FLOW STATEMENTS FOR THE PERIODS ENDED 31 JULY

($M)	FY2012	FY2011	FY2010	FY2009	FY2008
Net cash flows from operating activities	1,390	1,184	1,479	1,594	1,310
Net cash flows from investing activities	(826)	(488)	(354)	(756)	(795)
Net cash flows from financing activities	(349)	(433)	(1,154)	(929)	(25)
Net cash flow for the period	**215**	**263**	**(29)**	**(91)**	**490**

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The Directors
Fonterra Co-operative Group Limited
9 Princes Street
Auckland 1010
New Zealand

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9 Princes Street
Auckland 1010
New Zealand

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FSF Management Company Limited
9 Princes Street
Auckland 1010
New Zealand

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9 Princes Street
Auckland 1010
New Zealand

26 October 2012

AUDITOR'S REPORT

As auditor of Fonterra Co-operative Group Limited and its subsidiaries (together the Fonterra Group), we have prepared this report pursuant to the Securities Regulations 2009 relating to the summary financial statements and the prospective financial statements of the Fonterra Group for inclusion in a prospectus and investment statement (Offer Document) to be dated 26 October 2012.

The Offer Document includes:

(a) a summary of financial statements of the Fonterra Group which comprise summary statements of financial position as at 31 July 2008, 2009, 2010, 2011 and 2012, summary income statements, summary statement of comprehensive income, and the summary statement of cash flows for the fourteen month period ended 31 July 2008 and the years ended 31 July 2009, 2010, 2011 and 2012; and

(b) the prospective financial statements, comprising a prospective statement of financial position, a prospective income statement, a prospective statement of comprehensive income, a prospective statement of changes in equity and a prospective statement of cash flows, of the Fonterra Group for the period ending 31 July 2013, including the assumptions on which they are based.

The summary financial statements do not contain all the disclosures required for full financial statements under generally accepted accounting practice in New Zealand. Reading the summary financial statements therefore is not a substitute for reading the full financial statements of the Fonterra Group.

This report is made solely to Fonterra Co-operative Group Limited, its directors (Fonterra Directors), FSF Management Company Limited, and its directors (together, the Addressees) in accordance with the Securities Regulations 2009. Our work has been undertaken so that we might state to the Addressees those matters we are required to state to them in a report from the auditor and for no other purpose. To the fullest extent permitted by law and subject to section 61 of the Securities Act 1978, we do not accept or assume any responsibility to anyone other than the Addressees for this report, or for the opinions we have formed. In addition, we take no responsibility for, nor do we report on, any part of the Offer Document not specifically mentioned in this report.

DIRECTORS' RESPONSIBILITIES

The Fonterra Directors are responsible for the preparation and presentation of:

(a) the summary of financial statements of the Fonterra Group for the fourteen month period ended 31 July 2008 and the years ended 31 July 2009, 2010, 2011 and 2012; and

(b) the prospective financial statements of the Fonterra Group for the year ending 31 July 2013, including the assumptions on which they are based.

PricewaterhouseCoopers, 188 Quay Street, Private Bag 92162, Auckland 1142, New Zealand
T: +64 (9) 355 8000, F: +64 (9) 355 8001, www.pwc.com/nz

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AUDITOR'S RESPONSIBILITIES

We are responsible for reporting, in accordance with the Securities Regulations 2009, on the following matters which have been prepared and presented by the Fonterra Directors:

(a) the amounts included in the summary of financial statements of the Fonterra Group for the fourteen month period ended 31 July 2008 and the years ended 31 July 2009, 2010, 2011 and 2012; and

(b) the prospective financial statements of the Fonterra Group for the year ending 31 July 2013.

In respect of the summary financial statements, we have undertaken procedures to provide reasonable assurance that the amounts set out in the summary of financial statements of the Fonterra Group on pages 161 to 162 of the Offer Document have been correctly taken from the audited financial statements of the Fonterra Group for the fourteen month period ended 31 July 2008 and the years ended 31 July 2009, 2010, 2011 and 2012.

In respect of the prospective financial statements, we have examined the prospective financial statements for the year ending 31 July 2013 to confirm that, so far as the accounting policies and calculations are concerned, the prospective financial statements have been properly compiled on the footing of the assumptions made or adopted by the Fonterra Directors as set out on pages 95 to 106 of this Offer Document and are presented on a basis consistent with the accounting policies normally adopted by the Fonterra Group.

We have no relationship with or interests in any member of the Fonterra Group other than in our capacities as auditor, investigating accountants, tax advisors and providers of other assurance services (including in connection with the Trading Among Farmers structure). These services have not impaired our independence as auditor of the Fonterra Group.

OPINION ON THE SUMMARY OF FINANCIAL STATEMENTS

In our opinion, the amounts set out in the summary of financial statements, on pages 161 to 162 of the Offer Document and taken from the audited financial statements of the Fonterra Group for the fourteen month period ended 31 July 2008 and the years ended 31 July 2009, 2010, 2011 and 2012:

(a) are consistent, in all material respects, with those audited financial statements; and

(b) have been correctly taken from the audited financial statements of the Fonterra Group for those years from which they were extracted.

OPINION ON THE PROSPECTIVE FINANCIAL STATEMENTS

In our opinion, the prospective financial statements for the year ending 31 July 2013 so far as the accounting policies and calculations are concerned, have been properly compiled on the footing of the assumptions made or adopted by the Fonterra Directors as set out on pages 95 to 106 of the Offer Document and are presented on a basis consistent with the accounting policies normally adopted by the Fonterra Group.

Actual results are likely to be different from those in the prospective financial statements since anticipated events frequently do not occur as expected and the variation could be material. Accordingly, we express no opinion as to whether the results in the prospective financial statements will be achieved.

RESTRICTION ON USE

This report has been prepared for inclusion in the Offer Document for the purpose of meeting the requirements of the Securities Regulations 2009. We disclaim any responsibility for reliance on this report or the amounts included in the summary financial statements or the prospective financial statements, for any other purpose other than that for which they were prepared.

Yours faithfully

PricewaterhouseCoopers

PricewaterhouseCoopers
Chartered Accountants
Auckland

SECTION 12
GLOSSARY

"Additional Australian Information" means additional information containing disclosure relevant to Australian investors and to comply with requirements for a recognised offer under Chapter 8 of the Corporations Act and the Australian Corporations Regulations 2001 (Cth), which accompanies or is attached to this Offer Document for the purposes of the Offer made in Australia.

"Allotment Date" means the date on which allotment of Units occurs, currently scheduled to be 30 November 2012.

"ANZ" means Fonterra's reportable segment and business unit that operates in Australia and New Zealand.

"Applicant" means any person named as an applicant on an Application Form and, as the case may be, an Institutional Investor.

"Application" means an application for Units made on the Application Form and accompanied by the Application Monies (or otherwise in the case of Institutional Investors in accordance with the instructions of the Joint Lead Managers).

"Application Form" means the Australian Supplier Offer Application Form, the Broker Firm Application Form or the Friends of Fonterra Offer Application Form attached to or accompanying this Offer Document (as applicable).

"Application Monies" means the monies required to pay for the Units applied for and that accompany an investor's Application Form.

"Appointed Directors" means the four directors of Fonterra who are appointed by the Fonterra Board and who are required to be "Independent Directors" as defined in the FSM Rules.

"Approved Adjustments" means an amount approved by the Fonterra Board to be paid for milk in addition to, or to be subtracted from, the amount calculated under the Farmgate Milk Price Manual.

"ASEAN / MENA" means Fonterra's business unit that operates in South East Asia, the Middle East and North Africa. There are some countries that fall within the ASEAN / MENA business unit that are located outside these geographical regions such as Sri Lanka and Mauritius.

"Asia / AME" means Fonterra's current reportable segment and former business unit that operates in Asia, Africa and the Middle East.

"Associate" in relation to a Unit Holder, means a person who is acting jointly or in concert with, or who is, directly or indirectly, under the same control as, that Unit Holder.

"ASX" means ASX Limited (ABN 98 008 624 691), or the financial market operated by ASX Limited, as the context requires.

"ASX Corporate Governance Principles and Recommendations" or **"ASX Principles"** means the Corporate Governance Principles and Recommendations with 2010 Amendments (2nd Edition) published by the ASX Corporate Governance Council and available on the ASX website at www.asx.com.au.

"ASX Listing Rules" means the listing rules of ASX as in force from time to time.

"ASX Settlement Operating Rules" means the rules of ASX Settlement Pty Ltd.

"Auditor" means PricewaterhouseCoopers, the auditor of Fonterra and the Fund.

"Australian Supplier Offer" means the offer of Units under this Offer Document to shareholders of Bonlac and to suppliers of Fonterra Milk Australia in Australia as more fully described under the heading "The Australian Supplier Offer" in Section 8 – *Details of the Offer*.

"Australian Supplier Offer Application Form" means the yellow application form which is to be used to apply for Units under the Australian Supplier Offer.

"Authorised Fund" means any person or persons authorised by the Fonterra Board under the Constitution to perform the role and functions of an "Authorised Fund" outlined in the Constitution.

"Authorised Fund Contract" means the agreement entered into between Fonterra, the Manager, the Trustee, and the Fonterra Farmer Custodian dated 25 October 2012 as more fully described under the heading "Material contracts" in Section 10 – *Statutory Information*.

"Board of the Manager" means the board of directors of the Manager.

"Bonlac" means Bonlac Supply Company Limited.

"Broker Firm Offer" means the offer to New Zealand resident investors (other than Institutional Investors) to apply for an allocation of Units from a NZX Firm that has obtained a Firm Allocation.

"Broker Firm Offer Application Form" means the blue application form which is to be used to apply for Units under the Broker Firm Offer.

"Broker Firm Offer Closing Date" means 5.00pm on 21 November 2012.

"CAGR" means compound annual growth rate.

"CHESS" means ASX's Clearing House Electronic Subregister System.

"Co-Lead Managers" means First NZ Capital Securities Limited, Forsyth Barr Limited and Macquarie Capital (New Zealand) Limited.

"Co-Managers" means ASB Bank Limited and ANZ National Bank Limited.

"Co-operative" means Fonterra.

"Companies Act" means the Companies Act 1993 (New Zealand).

"Constitution" means the constitution of Fonterra in effect from time to time, and with effect from the Launch Date, the form of constitution set out as Annexure 2 to the constitution of Fonterra (as amended or replaced from time to time).

"Corporations Act" means the Corporations Act 2001 (Cth) of Australia.

"Custody Trust Deed" means the custody trust deed between the Fonterra Farmer Custodian, the Trustee, the Manager, and Fonterra dated 25 October 2012 as more fully described under the heading "Material contracts" in Section 10 – *Statutory Information*.

"DIRA" means the Dairy Industry Restructuring Act 2001 (New Zealand).

"Dry Shares" means any Shares held by a Farmer Shareholder in excess of the number of Shares required to be held by that Farmer Shareholder in accordance with the Share Standard for a Season.

"EBIT" means earnings before interest and tax (including earnings from equity accounted investments).

"EBITDA" means earnings before interest, tax, depreciation and amortisation (including earnings from equity accounted investments).

"Economic Rights" means the interest in Shares held by the Fonterra Farmer Custodian for the benefit of the Trustee in its capacity as the trustee of the Fund as set out in the Custody Trust Deed.

"Effective Subordination" has the meaning given on page 85 under the heading "Credit rating and borrowings" and **"Effectively Subordinated"** has a corresponding meaning.

"Elected Director" means a director of the Manager elected by Unit Holders.

"Eligible U.S. Fund Manager" means a dealer or professional fiduciary organised, incorporated or (if an individual) resident in the United States acting for an account (other than an estate or trust) held for the benefit or account of persons that are not US Persons for which it has and is exercising investment discretion, within the meaning Rule 902(k)(2)(i) of Regulation S under the US Securities Act.

"Ex-Farmer Shareholder" means a person who although not currently a Farmer Shareholder:

- has been a Farmer Shareholder;
- has retired from the dairy industry during the period of five years preceding the date of this Offer Document (i.e. after 26 October 2007); and
- has not supplied a competitor of Fonterra with milk since last supplying Fonterra.

"Extraordinary Resolution" means a resolution passed at a meeting of Unit Holders by a majority of not less than three quarters of the persons voting at such meeting upon a show of hands, or if a poll is demanded, by a majority consisting of not less than three quarters of votes given on such a poll.

"Farmer Shareholder" means a Shareholder who is supplying milk to Fonterra.

"Farmgate Milk Price" means the base price that Fonterra pays for milk supplied to it in New Zealand for a Season.

"Farmgate Milk Price Manual" means the manual which sets out the policies and methodology for the determination of the Farmgate Milk Price as provided for under the Constitution and DIRA.

"Final Price" means the price per Unit at which Units will be issued under the Offer, to be determined on or about 27 November 2012.

"Firm Allocation" means Units reserved for subscription by clients of the Joint Lead Managers, NZX Firms, Institutional Investors and other participants in the bookbuild.

"Fonterra" means Fonterra Co-operative Group Limited and, where relevant, includes the other members of the Fonterra Group.

"Fonterra Board" means the board of directors of Fonterra.

"Fonterra Economic Rights Trust" means the trust created by deed between the Fonterra Farmer Custodian, the Trustee, the Manager, and Fonterra, and constituted by the Custody Trust Deed.

"Fonterra Farmer Custodian" means Fonterra Farmer Custodian Limited.

"Fonterra Farmer Custodian Trust" means the trust created by deed between Fonterra, Malcolm Guy Bailey, Brian Paul Todd and Kevin John Turnball as trustees, and the Fonterra Farmer Custodian, and constituted by the Fonterra Farmer Custodian Trust Deed.

"Fonterra Farmer Custodian Trust Deed" means the trust deed between Fonterra, Malcolm Guy Bailey, Brian Paul Todd and Kevin John Turnball as trustees, and the Fonterra Farmer Custodian dated 25 October 2012 as described under the heading "Material contracts" in Section 10 – *Statutory Information*.

"Fonterra Financial Information" means the financial information relating to Fonterra as set out in Section 4 – *Fonterra Financial Information*.

"Fonterra Group" means Fonterra and its subsidiaries.

"Fonterra Milk Australia" means Fonterra Milk Australia Pty Ltd.

"Fonterra Prospective Financial Information" means the prospective financial information relating to Fonterra for the year ending 31 July 2013 as set out under the heading "Fonterra Prospective Financial Information" in Section 5 – *Fonterra Financial Information*.

"Fonterra Shareholders' Market" means the exchange or trading facility selected by Fonterra which provides a facility for the trading of Shares among Permitted Persons.

"Fonterra Unit" means the Unit to be issued by the Manager to the trustees of the Fonterra Farmer Custodian Trust in accordance with the Trust Deed.

"Fonterra Unit Holder" means the person recorded in the Unit register as the holder of the Fonterra Unit, being initially the trustees of the Fonterra Farmer Custodian Trust.

"foodservices" means the business of preparing meals for consumption outside of homes.

"Friends of Fonterra Offer" means the offer of Units under this Offer Document to Farmer Shareholders with a valid "Farm / Party number" as at 26 October 2012, Fonterra-supplying sharemilkers with a valid "Farm / Party number" as at 26 October 2012, Fonterra New Zealand and Australian permanent employees and Ex-Farmer Shareholders as more fully described under the heading "Friends of Fonterra Offer" in Section 8 – *Details of the Offer*.

"Friends of Fonterra Offer Application Form" means the green application form which is to be used to apply for Units under the Friends of Fonterra Offer.

"FSM Participant" means an NZX Trading and Advising Firm who has been accredited for participation in the Fonterra Shareholders' Market under section 22 of the NZX Participant Rules.

"FSM Rules" means the listing rules of the Fonterra Shareholders' Market.

"Fund" or **"Fonterra Shareholders' Fund"** means the unit trust constituted under the Trust Deed, which is authorised under the Constitution to acquire, hold or dispose of rights or interests in Shares.

"Fund Size Risk Management Policy" means the policy adopted by the Fonterra Board from time to time which prescribes the actions that the Fonterra Board will take to manage the size of the Fund.

"Fund Transfer Limit" means the limit set by the Fonterra Board from time to time in relation to the maximum number of Wet Shares in respect of which Shareholders may sell Economic Rights to the Fund.

References to a breach of a **"Fundamental Term"** mean, in essence:

- in relation to the Manager, a breach of the obligations not to exercise or seek control over any voting rights in Fonterra, not to attend or speak at Shareholder meetings (unless invited to do so), not to requisition a meeting of Shareholders, and not to call for or seek the transfer of any part of the trust property of the Fonterra Economic Rights Trust; and
- in relation to Fonterra, a breach of the obligations to provide services at no cost to the Fund and to pay the operating costs and expenses of the Fund (except for certain excluded costs) as described in Section 6 – *DIRA Regulatory Environment*.

"FY" means financial year.

"GDT™" means GlobalDairyTrade™, the auction platform for internationally-traded commodity dairy products.

"Global Dairy Exports" means the market for the international trade of dairy products but excludes trade among countries within the European Union.

"Greater China and India" means Fonterra's business unit that operates in China (including Hong Kong), Taiwan and India.

"IFRS" means International Financial Reporting Standards.

"Income Tax Act" means the Income Tax Act 2007 (New Zealand).

"Independent Director" means in relation to a director of Fonterra, an "Independent Director" as defined in the FSM Rules, and in relation to a director of the Manager, an "Independent Director" as defined in the NZSX Listing Rules.

"Indicative Price Range" means $4.60 to $5.50 per Unit.

"Institutional Investor" means an investor outside the United States (other than Pre-identified EUSFMs) and that is not, and is not acting for the account or benefit of, a US Person, to whom offers or invitations in respect of securities can be made without the need for a registered prospectus (or other formality), including in New Zealand persons to whom offers or invitations can be made without the need for a registered prospectus under the Securities Act.

"Institutional Offer" means the offer of Units under this Offer Document to Institutional Investors as described more fully under the heading "Institutional Offer" in Section 8 – *Details of the Offer*.

"interest group" has the meaning set out in section 116 of the Companies Act.

"Investigating Accountant" means PricewaterhouseCoopers.

"Investigating Accountant's Report" means the investigating accountant's report prepared by the Investigating Accountant in respect of the Fonterra Prospective Financial Information.

"IRD" or **"Inland Revenue"** means the Inland Revenue Department in New Zealand.

"Joint Lead Managers" means Craigs Investment Partners Limited, together with Deutsche Bank AG, New Zealand branch, Goldman Sachs New Zealand Limited and UBS New Zealand Limited.

"Joint Organising Participants" means Craigs Investment Partners Limited, Goldman Sachs New Zealand Limited and UBS New Zealand Limited.

"kgMS" means a kilogram of milksolids.

"KT" means a kilo tonne (being 1,000 MT).

"Latam" means Fonterra's reportable segment and business unit that operates in Latin America.

"Launch Date" means the date on which the Order in Council to be made by the Governor-General under DIRA becomes effective (see the heading "DIRA pre-conditions" in the section entitled *Answers to Important Questions*), expected to be 30 November 2012.

"Manager" means the person appointed as the manager of the Fund in accordance with the Trust Deed from time to time, being initially FSF Management Company Limited.

"Market Operator Agreement" means the agreement entered into between Fonterra and NZX for the provision of operational and administrative services in relation to the Fonterra Shareholders' Market dated 30 August 2012, and which is deemed to be a listing agreement for the purposes of the Securities Markets Act.

"milk" means whole milk, cream and any other component of the mammary secretion of a cow, as may be specified by the Fonterra Board.

"Milk Price Group" means the group responsible for ensuring that the Farmgate Milk Price is calculated in accordance with the Farmgate Milk Price Manual and the day-to-day administration of the Farmgate Milk Price Manual, as described in the Farmgate Milk Price Manual.

"Milk Price Panel" means the Milk Price Panel established and maintained by Fonterra in accordance with section 150D of DIRA.

"Milk Price Principles" means the milk price principles set out in an annexure to the Constitution.

"Milk Price Statement" means the milk price statement with respect to the Farmgate Milk Price for a Season, which Fonterra discloses pursuant to the Farmgate Milk Price Manual on or around the date that Fonterra releases its financial results for a financial year.

"milksolids" means the valued components of milk which are determined by the Fonterra Board from time to time.

"MT" means a metric tonne.

"Notified Foreign Investor" means a Unit Holder who meets the requirements of sections HM 55D(3) and (4) of the Income Tax Act and notifies the Fund under section HM 55D(2) of the Income Tax Act that such a Unit Holder wishes to be treated as a notified foreign investor.

"NZ GAAP" means generally accepted accounting practice in New Zealand.

"NZ Milk Products" means Fonterra's reportable segment and business unit which collects and processes milk from New Zealand farmers, manufactures and markets dairy nutrition products (including specialty dairy ingredients and base nutrition powders such as whole milk powder and skim milk powder) under the NZMP™ brand.

"NZSX Listing Rules" means the listing rules of NZX and **"NZSX Listing Rule"** means a rule contained in the NZSX Listing Rules.

"NZX" means NZX Limited.

"NZX Firm" means an entity designated as a NZX Firm under the NZX Participant Rules.

"NZX Main Board" means the main equities board of NZX.

"NZX Participant Rules" means participant rules made by NZX, and applying to the NZX Main Board and Fonterra Shareholders' Market.

"Offer" means the offer of Units pursuant to this Offer Document.

"Offer Document" means this combined prospectus and investment statement.

"Offer Management Agreement" means the agreement dated 25 October 2012 between Fonterra, the Manager of the Fund and the Joint Lead Managers, as summarised under the heading "Material contracts" in Section 10 – *Statutory Information*.

"Parent" means Fonterra Co-operative Group Limited.

"Permitted Person" means:

- a Shareholder;
- a person whose application to become a Shareholder has been accepted in writing by Fonterra in accordance with the Constitution;
- the Registered Volume Provider (who acts through the Fonterra Farmer Custodian); or
- Fonterra.

"PIE" means a portfolio investment entity and / or foreign investment PIE (as the context requires) as defined in section YA 1 of the Income Tax Act.

SECTION 12
GLOSSARY CONTINUED

"PIR" means the prescribed investor rate for a Unit Holder set out in schedule 6, table 1 or table 1B of the Income Tax Act.

"Pre-identified EUSFMs" means those Eligible U.S. Fund Managers agreed between Fonterra and the Joint Lead Managers.

"Promoter" means Fonterra and every director of Fonterra (other than those directors who are also directors of the Manager).

"RD1" or **"RD1 Limited"** mean Fonterra's rural supplies retail business that operates in New Zealand.

"Reference Commodity Products" means the commodity dairy products used in the calculation of the Farmgate Milk Price, which are currently whole milk powder, skim milk powder, and their by-products, buttermilk powder, butter and anhydrous milkfat.

"Registered Volume Provider" or **"RVP"** means a person appointed, engaged or authorised under clause 6.1 of the Constitution that will apply with effect from the Launch Date, to provide services intended to enhance the operation and liquidity of the Fonterra Shareholders' Market.

"Relevant Interest" has the meaning given to that term in the Constitution that will apply with effect from the Launch Date, when referring to a Share; or has the meaning given to the term "Interest" in the Trust Deed when referring to a Unit.

"RVP Agreement" means the agreement between Fonterra and Craigs Investment Partners Limited setting out the terms and conditions of Craigs Investment Partners Limited's appointment as an RVP.

"Season" means a period of 12 months to 31 May (or such other date as the Fonterra Board may specify from time to time) in each year.

"Securities Act" means the Securities Act 1978 (New Zealand).

"Securities Markets Act" means the Securities Markets Act 1988 (New Zealand).

"Securities Regulations" means the Securities Regulations 2009 (New Zealand).

"Securities Trustees and Statutory Supervisors Act" means the Securities Trustees and Statutory Supervisors Act 2011 (New Zealand).

"sell Economic Rights of Shares" has the meaning given to that term in the text box entitled "Economic Rights" on page 116, and references to **"sell Economic Rights of Wet Shares"** and **"sell Economic Rights of Dry Shares"** have a corresponding meaning in relation to the relevant Shares.

"Share" or **"Fonterra Share"** means a fully paid co-operative share in Fonterra.

"Share Standard" means the number of Shares a Farmer Shareholder is required from time to time to hold as determined in accordance with the Constitution, being at the date of this Offer Document, one Share for each kilogram of milksolids obtainable from milk supplied to Fonterra by a Farmer Shareholder in the relevant Season (excluding milk supplied on contract supply). The Fonterra Board may permit the Share Standard to be satisfied through the holding of both Shares and Vouchers.

"Shareholder" means a holder of Shares.

"Shareholders' Council" means the councillors whose number is not less than the required quorum set out in the Constitution, acting together as the Shareholders' Council.

"Shareholding Deed" means the deed entered into between Trustees Executors Limited, the Manager of the Fund and Fonterra dated 23 October 2012 as more fully described under the heading "Material contracts" in Section 10 – *Statutory Information*.

"SHC Deed Poll" means the deed poll letter dated 6 August 2012 given by Fonterra for the benefit of the Shareholders' Council which provides comfort to the Shareholders' Council as to the application of limits to the Constitution.

"Stakeholder Offer" means the offer of Units under this Offer Document comprising the Friends of Fonterra Offer and the Australian Supplier Offer.

"Stakeholder Offer Closing Date" means 5.00pm (NZDT) on 21 November 2012.

"Supplier Shares" means the class of redeemable preference shares in Bonlac referred to as "Supplier Shares".

"Supply Offer" means the offer made to Farmer Shareholders to sell Economic Rights of Shares as described under the heading "Formation of the Fund" in Section 8 – *Details of the Offer*.

"Trading Among Farmers" means the Share trading system known as Trading Among Farmers.

"Treasury Stock" means Shares or Units acquired and held by Fonterra.

"Trust Deed" means the trust deed dated 23 October 2012 constituting the Fonterra Shareholders' Fund between Fonterra, the Trustee and the Manager as summarised under the heading "Summary of the Trust Deed" in Section 10 – *Statutory Information*.

"Trustee" means the trustee for the time being of the Fund, being initially The New Zealand Guardian Trust Company Limited.

"Unit" means a unit issued by the Manager of the Fund.

"Unit Holder" means a person for the time being entered into the register of Unit Holders as the holder of a Unit.

"Unit Registrar" means the person appointed by the Manager to maintain the register of Unit Holders, being initially Computershare Investor Services Limited.

"Unit Trusts Act" means the Unit Trusts Act 1960 (New Zealand).

"United States" means the United States of America.

"US Person" means "U.S. person" as defined in Rule 902(k) under the US Securities Act.

"US Securities Act" means the U.S. Securities Act of 1933, as amended.

"US$" means United States dollars.

"Valid Application" means an application for Units made on the relevant Application Form and accompanied by the Application Monies (or otherwise, as the case may be, for Institutional Investors, made in accordance with the instructions of the Joint Lead Managers), which is received by the relevant closing date and is capable of acceptance.

"Voucher" means a certificate referred to in clause 3.4 of the Constitution that will apply with effect from the Launch Date and provided to a Farmer Shareholder upon the transfer of the Economic Rights of a Wet Share to the Fund in accordance with the Trust Deed.

"VWAP" means volume weighted average price.

"Wet Shares" means any Shares held by a Farmer Shareholder which are required to be held in accordance with the Share Standard for a Season.

SIGNATURES

SIGNED BY EACH DIRECTOR OF FSF MANAGEMENT COMPANY LIMITED:
(or by their agent authorised in writing)

JOHN BRUCE SHEWAN
Director

SIR RALPH JAMES NORRIS
Director

KIMMITT ROWLAND ELLIS
Director

JIM WILLIAM VAN DER POEL
Director

PHILIPPA JANE DUNPHY
Director

SIGNED BY FONTERRA CO-OPERATIVE GROUP LIMITED BY ITS ATTORNEYS (AS PROMOTER):

Attorney

Attorney

SIGNED BY THE DIRECTORS OF FONTERRA CO-OPERATIVE GROUP LIMITED WHO ARE NOT ALSO DIRECTORS OF THE MANAGER (AS PROMOTERS):
(or by their agent authorised in writing)

SIR HENRY VAN DER HEYDEN
Director

DAVID NIGEL MACLEOD
Director

JOHN SPEER WILSON
Director

JOHN ANTHONY MONAGHAN
Director

MALCOLM GUY BAILEY
Director

NICOLA MARY SHADBOLT
Director

IAN JAMES FARRELLY
Director

JOHN ANTHONY WALLER
Director

DAVID ALEXANDER JACKSON
Director

RALPH GRAHAM WATERS
Director

DIRECTORY

REGISTERED OFFICE OF THE MANAGER OF THE FUND
9 Princes Street
Auckland 1010, New Zealand

DIRECTORS OF THE MANAGER OF THE FUND
Philippa Jane Dunphy
Kimmitt Rowland Ellis
Sir Ralph James Norris
John Bruce Shewan
Jim William van der Poel

TRUSTEE
The New Zealand Guardian Trust Company Limited
Level 7, Vero Centre
48 Shortland Street
Auckland 1010, New Zealand

PROMOTERS
Fonterra Co-operative Group Limited
9 Princes Street
Auckland 1010, New Zealand

Malcolm Guy Bailey
Ian James Farrelly
Sir Henry van der Heyden
David Alexander Jackson
David Nigel Macleod
John Anthony Monaghan
Nicola Mary Shadbolt
John Anthony Waller
Ralph Graham Waters
John Speer Wilson

JOINT LEAD MANAGERS
Deutsche Bank AG, New Zealand branch, together with Craigs Investment Partners Limited
Level 36, Vero Centre
48 Shortland Street
Auckland 1010, New Zealand

Goldman Sachs New Zealand Limited
Level 38, Vero Centre
48 Shortland Street
Auckland 1010, New Zealand

UBS New Zealand Limited
Level 17, PricewaterhouseCoopers Tower, 188 Quay Street
Auckland 1010, New Zealand

RETAIL AFFILIATES OF THE JOINT LEAD MANAGERS
Craigs Investment Partners Limited
Level 32, Vero Centre
48 Shortland Street
Auckland 1010, New Zealand

JBWere (NZ) Pty Ltd
Level 38, Vero Centre
48 Shortland Street
Auckland 1010, New Zealand

JOINT ORGANISING PARTICIPANTS
Craigs Investment Partners Limited
Level 32, Vero Centre
48 Shortland Street
Auckland 1010, New Zealand

Goldman Sachs New Zealand Limited
Level 38, Vero Centre
48 Shortland Street
Auckland 1010, New Zealand

UBS New Zealand Limited
Level 17, PricewaterhouseCoopers Tower, 188 Quay Street
Auckland 1010, New Zealand

CO-LEAD MANAGERS
First NZ Capital Securities Limited
Level 39, ANZ Centre
23–29 Albert Street
Auckland 1141, New Zealand

Forsyth Barr Limited
Level 9, Forsyth Barr House
The Octagon
Dunedin 9054, New Zealand

Macquarie Capital (New Zealand) Limited
Level 17, Lumley Centre
88 Shortland Street
Auckland 1010, New Zealand

CO-MANAGERS
ASB Bank Limited
135 Albert Street
Auckland 1140, New Zealand

ANZ National Bank Limited
Level 7, 1 Victoria Street
Wellington 6140, New Zealand

AUDITOR OF THE FUND, THE MANAGER AND FONTERRA
PricewaterhouseCoopers
Level 22, PricewaterhouseCoopers Tower
188 Quay Street
Auckland 1010, New Zealand

INVESTIGATING ACCOUNTANT
PricewaterhouseCoopers
Level 22, PricewaterhouseCoopers Tower
188 Quay Street
Auckland 1010, New Zealand

LEGAL ADVISERS TO FONTERRA
Russell McVeagh
Level 30, Vero Centre
48 Shortland Street
Auckland 1010, New Zealand

King & Wood Mallesons
Level 61, Governor Phillip Tower
1 Farrer Place, Sydney
NSW 2000, Australia

LEGAL ADVISER TO THE DIRECTORS OF FONTERRA
Harmos Horton Lusk Limited
Level 37, Vero Centre
48 Shortland Street
Auckland 1010, New Zealand

LEGAL ADVISER TO THE MANAGER OF THE FUND AND ITS DIRECTORS
Chapman Tripp
Level 35, ANZ Centre
23–29 Albert Street
Auckland 1010, New Zealand

LEGAL ADVISER TO THE TRUSTEE OF THE FUND
Bell Gully
Level 21, Vero Centre
48 Shortland Street
Auckland 1010, New Zealand

TAX ADVISERS
Russell McVeagh
Level 30, Vero Centre
48 Shortland Street
Auckland 1010, New Zealand

KPMG
KPMG Centre, 18 Viaduct Harbour
Auckland 1140, New Zealand

FINANCIAL ADVISER TO FONTERRA
Rothschild Australia Limited
Level 41, 50 Bridge Street
Sydney NSW, Australia

Cameron Partners Limited
Level 23, Vero Centre
48 Shortland Street
Auckland 1010, New Zealand

UNIT REGISTRAR
Computershare Investor Services Limited
Level 2, 159 Hurstmere Road
Takapuna, Auckland 0622

Private Bag 92119
Auckland 1142, New Zealand

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Fonterra

Dairy for life