Media release

20 March 2019

Fonterra announces 2019 Interim Result

- Key numbers in Interim Results
  - Sales volumes 10.7 billion liquid milk equivalents (LME), up 2%
  - Revenue $9.7 billion, down 1%
  - Normalised EBIT: $323 million, down 29%
  - NPAT: $80 million, up 123%
  - Total normalised gross margin: $1.5 billion
    - Ingredients Gross Margin: $791 million, down 9%
    - Consumer and Foodservice Gross Margin: $766 million, down 7%
  - Full year forecast earnings: 15-25 cents per share
  - Forecast Farmgate Milk Price: $6.30-$6.60 per kgMS
- Sales process started for Fonterra's 50% share of DFE Pharma
- Completed the sale of Corporacion Inlaca to Mirona
- Update on full strategy review

Fonterra Co-operative Group Limited today announced its 2019 Interim Results which show the Co-op has returned to profitability with a Net Profit After Tax (NPAT) of $80 million, but normalised Earnings Before Interest and Tax (EBIT) are down 29% on the same period last year to $323 million.

Fonterra CEO Miles Hurrell says that while it is good to see the Co-operative back in the black, the Co-operative's earnings performance is not where it should be and this was the reason for revising the full year earnings guidance down to 15-25 cents per share in February.

"The steady performance from New Zealand Ingredients in the first half of FY19 has been offset by challenges in Australia Ingredients and this has seen our total Ingredients EBIT decline by 17% to $461 million.

"Our Australia Ingredients business continues to feel the impact of the drought. We can see it in the decline of Australian milk collections and aggressive price competition for milk, which is resulting in the underutilisation of manufacturing assets and tightening margins.

"Consumer and Foodservice is tracking behind last year with an EBIT of $134 million. This part of the business has been held back by disruptive political and economic conditions as well as high input costs in Latin America. In addition, in our China Foodservice business, demand slowed due to higher prices and in-market inventory levels growing for butter at the end of FY18. In Sri Lanka, our performance was impacted by price constraints."

Outlook for the second half of the year

In talking about priorities for the Co-operative in the second half of the year, Mr Hurrell says the focus is to meet the earnings guidance, deliver the three-point plan and fundamentally reset the business so it can deliver sustainable earnings.

"We have a forecast Farmgate Milk Price of $6.30-$6.60 per kgMS but we also have to meet our earnings guidance range of 15-25 cents per share. This range builds in an expectation of a slightly softer second half for our Ingredients business, but a meaningful increase in Consumer and Foodservice earnings," says Mr Hurrell.

"Our forecast increase in our Consumer and Foodservice performance is based on a few key factors. It needs a strong improvement in our Foodservice business in Greater China, stronger consumer demand for Soprole in Chile and chilled dairy in Brazil, and an improvement in our Sri Lankan business.

"Our three-point plan involves taking stock of our business and conducting a portfolio review, getting the basics right and improving our forecasting. We've made good progress so far and we will continue to take these steps in the second half to firm up our foundations and strengthen our balance sheet.

"The second half will also see us continuing the work on developing a new strategy to support a much-needed change in direction. We are doing the right things but it's clear more is needed to lift our performance. We need to simplify and improve the Co-op so we can grow value."

Portfolio review update

As part of taking stock of the business, Fonterra has let its farmer owners and unit holders know today that the third asset it has identified in its portfolio review is DFE Pharma, a 50/50 joint venture established in 2006 between Fonterra and FrieslandCampina.

DFE Pharma is one of the largest suppliers of pharmaceutical excipients which are used as a carrier agent in medicines such as tablets and powder inhalers.

Mr Hurrell says Fonterra has let FrieslandCampina know that it has started a sales process for our 50% share of DFE Pharma.

"At the same time, we have confirmed that we are committed to maintaining our lactose service and supply agreements from Fonterra's Kapuni operation in Taranaki and supporting the ongoing operations of the DFE Pharma business.

"Together with our partner, we have grown DFE Pharma from relatively small beginnings into a significant and successful business. While continuing to perform well, ownership of DFE is not core to our strategy."

In addition to this sales process, the Co-op has received strong interest in Tip Top and is actively considering its options for its shareholding in Beingmate.

"We are well on track to meet our target to reduce end of year debt by $800 million," says Mr Hurrell.

Mr Hurrell also advised that Fonterra has sold its interest in its Venezuelan consumer joint venture, Corporacion Inlaca, to Mirona, an international food business.

"The decision to sell Inlaca is the result of ongoing instability in Venezuela which has led to challenging operating conditions.

"The economic situation in Venezuela is not expected to improve in the foreseeable future, so we have made the decision to act now to minimise the impact on Fonterra," he says.

Fonterra received $16 million cash for the Inlaca sale. Like any multi-national business, Fonterra is exposed to currency risk on its overseas operations and the impact of changes is held in a foreign currency translation reserve (FCTR). When a business is sold there is a non-cash accounting adjustment that releases the accumulated FCTR to the profit and loss statement. The full impact of this transaction, including the devaluation of the Venezuelan currency which has resulted in a negative FCTR balance of approximately $126 million, will be reflected in the profit and loss statement.

This sale is not directly included in Fonterra's half-year results, and the impact of the FCTR on the profit and loss statement has not been reflected in the forecast earnings per share range. Fonterra expects there to be a number of one-off transactions and adjustments over the course of its financial year (some positive and some negative). The sale of Inlaca would have an eight cents per share negative impact on earnings. As Fonterra has other one-off transactions that are underway but not yet completed, such as the potential sale of Tip Top and DFE Pharma, it is too early to assess the overall impact of its divestment programme on the Co-op's FY19 earnings.

As a result, the announced forecast earnings will continue to reflect only the underlying performance of the business. Fonterra will advise any one-off impacts of a transaction on our FY19 earnings when that transaction is announced, and will provide details of the overall impact of its divestment programme on FY19 earnings as part of its full-year financial statements.

Fundamental change in direction

Fonterra Chairman John Monaghan used today's announcement to give the Co-operative's farmer owners and unit holders a progress update on the full review of its business strategy. He says that the review isn't mere tinkering around the edges.

"There will be fundamental change. We are taking a hard look at our end-to-end business, where we can win in the world and the products where we have a real competitive advantage.

"Our Co-operative values of the last 148 years won't change. Our farmers' quality, pasture-based milk will always be collected, processed and sold for the highest possible returns. They'll always be paid on the 20th of the month – every month.

"Outside of that, there are no sacred cows. The business strategies designed to secure the highest possible returns will change, but some underlying principles will remain."

Mr Monaghan says the Co-operative's strategy will focus on sustainability and provenance throughout the value chain.

"We are a New Zealand dairy farmers' Co-op. Maximising the value of our home milk supply will always be our number one priority. We believe there's a premium to be earned from products backed by our co-operative heritage and provenance.

"Our future will be built on our owners' farming businesses that use advancements in technology and innovation, including adaptations from other industries, to help protect or enhance the premium qualities and reputation of our milk."

Fonterra's portfolio review will simplify its business and concentrate on getting the basics right. It is changing its portfolio of investments to achieve higher return on capital.

"Achievement of our ambition will rely on us maintaining premium quality right across the supply chain - starting on-farm and flowing through to the products we make, and the customers we sell to. It will need the support and commitment of all our people – our farmer owners and our employees.

"It sounds simple. The best strategies often are," says Mr Monaghan.

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About Fonterra

We're a global dairy nutrition company owned by 10,000 farmers and their families. We've built our expertise on the legacy of the thousands of farmers who've made New Zealand a world leader in dairy. With a can-do attitude and a *collaborative spirit, we're a world leading dairy exporter. Our 22,000 people share the goodness of dairy nutrition with the world through our innovative consumer, foodservice and ingredient solutions brands, and our farming and processing operations across four continents.*

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