Media Release

18 September 2020

Fonterra announces its Annual Results and a return to paying dividend

Annual Results Summary

- Final cash payout for 2019/20 season: $7.19 per kgMS
  - Final 2019/20 Farmgate Milk Price: $7.14 per kgMS
  - 2019/20 dividend: 5 cents per share
- Reported Profit After Tax: $659 million, up $1.3 billion
- Normalised Profit After Tax[1]: $382 million, up $118 million
- Total Group Earnings Before Interest and Tax (EBIT): $1.1 billion, up $1.2 billion
- Total Group normalised EBIT: $879 million, up $67 million
- Total Group normalised gross profit: $3.2 billion, up $200 million
- Total Group normalised operating expenses: $2.3 billion, down $14 million
- Free cash flow: $1.8 billion, up $733 million
- Net debt[2]: $4.7 billion, down $1.1 billion
- Debt to EBITDA ratio: 3.4x improved from 4.4x
- Full year normalised earnings per share: 24 cents
- 2020/21 forecast Farmgate Milk Price range: $5.90 - $6.90 per kgMS. Mid-point of $6.40 per kgMS
- 2020/21 forecast earnings: 20 – 35 cents per share

Fonterra Co-operative Group Limited today announced its annual results, final Farmgate Milk Price of $7.14 per kgMS and a dividend of 5 cents per share for the 2019/20 season, bringing the final cash payout for farmers to $7.19 per kgMS.

Fonterra CEO Miles Hurrell says 2019/20 was a good year for the Co-op, with profit up, debt down and a strong milk price.

"We increased our profit after tax by more than $1 billion, reduced our debt by more than $1 billion and this has put us in a position to start paying dividends again," he says.

"I'm proud of how farmers and employees have come together to deliver these strong results in a challenging environment. They have had to juggle the extra demands and stress of COVID-19 and have gone above and beyond. I would like to thank them for their hard work and support.

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[1] *Attributable to Fonterra's equity holders and includes Continuing and Discontinued Operations.*

[2] *Debt means Economic net interest bearing debt. This measure of debt includes the capitalised amount of operating leases following changes to accounting standards, and transitioning to this new accounting standard added $581 million to our measurement of debt. However, this was partially offset by the transfer from borrowings to liabilities of disposal groups held for sale of $266 million of net debt for DPA Brazil and China Farms, as a result of being classified as Discontinued Operations.*

“This time last year we were announcing our new strategy and customer-led operating model. We were clear that to build a sustainable future we needed to focus on three interconnected goals – Healthy People, a Healthy Environment and a Healthy Business.

“We went on to deliver a strong performance for the first half. However, what none of us could have ever predicted was what then played out – a world facing COVID-19. The flow-on effects of the pandemic did impact our performance in the second half, particularly in our Consumer and Foodservice businesses.

“2019/20 proved to be a year of two halves, but we delivered on all four of our priorities:

- We’ve **supported regional** New Zealand, contributing around $11 billion into New Zealand’s rural economies through the milk price, and we’ve rethought our approach to community support, with the aim of helping out more where it’s needed the most – such as, growing the KickStart Breakfast programme alongside Sanitarium and the New Zealand Ministry of Social Development and partnering with the New Zealand Food Network to help get dairy nutrition to those that need it the most.
- We’ve **built a great team** through a focus on our culture, and we’ve seen that in action in how we’ve responded to COVID-19.
- We’ve continued to **reduce our environmental footprint**, including hitting our 2020 target to reduce energy intensity across our New Zealand manufacturing sites by 20%, from a 2003 baseline – cumulatively, that’s enough energy saved to power all the households in New Zealand for 1.5 years.
- We’ve **achieved our key financial targets** with normalised earnings of 24 cents per share, a Total Group normalised gross profit of $3.2 billion, a $181 million reduction in capital expenditure and a $1.1 billion reduction in debt so the ratio of Debt to EBITDA has now improved to be 3.4 times our earnings, down from 4.4 times.

“The work we’ve done to strengthen our balance sheet has allowed us to focus on managing COVID-19. So far, demand for dairy has proved resilient and our diverse customer base and ability to change our product mix and move products between markets has meant we can continue to drive value.

“We’re at our best when we’re clear on what we need to do, why and how, and the whole Co-op is focused on it. When I look back on last year, it’s great to see how this clarity has helped us respond to challenges, adapt and deliver results.”

Business Performance

Total Group normalised EBIT was significantly up on last year from a loss of $17 million to earnings of $1.1 billion. This includes gains from asset sales, and impairments and costs relating to the strategic review.

Once these are taken out, the Total Group normalised EBIT, which the Co-operative uses to show its underlying business performance, was also up from $812 million to $879 million, despite the financial impact of COVID-19 in many of its markets.

Mr Hurrell says the main drivers of the underlying business performance was a strong normalised gross profit in the Ingredients business and, although there was the disruption from COVID-19, the strong sales and gross margins from the Greater China Foodservice business in the first half of the year.

Ingredients’ normalised EBIT improved from $790 million last year to $827 million this year, with normalised gross profit up $165 million to $1.6 billion.

Mr Hurrell says that at the Co-op’s interim results, the normalised gross profit in Ingredients was relatively steady.

“As we moved through the second half, we saw restaurants, cafes and bakeries close and intermittent spikes in supermarket sales, creating uncertainty across the global dairy market. This uncertainty resulted in softening milk prices, which helped improve the gross margin and gross profit in Ingredients.”

Greater China Foodservice’s normalised EBIT increased from $114 million last year to $169 million this year.

Mr Hurrell says the business achieved strong year-on-year sales growth in the first half of the year but was then hit hard by COVID-19 when many food outlets were closed. Normalised gross profit started to quickly rebound in the third quarter – although he also points out it is still not at 100%.

“We have seen significant growth across the Anchor Food Professional product range in China. We have entered 50 new cities across China, taking our total to 350, and our products are now not only being used in Western style restaurants and bakeries but also those serving local cuisine.

“However, as per our guidance in our third quarter business update, our Foodservice businesses across Asia, Oceania and Latin America were impacted by COVID-19 in the fourth quarter. All three markets reported losses in the second half.

“Despite this, normalised EBIT for Foodservice overall was up 14% on last year to $209 million, which is a result of the strong performance by the Greater China business in the first half.

The Consumer business’ normalised EBIT reduced to $149 million from $227 million, mainly as a result of impairments of $57 million relating to the Chesdale™ brand and New Zealand Consumer business’ goodwill.

Normalised EBIT, excluding these impairments, of the Consumer businesses in Oceania and Asia improved, despite COVID-19. However, due to civil unrest and market disruptions in Hong Kong and Chile, the normalised EBIT, after excluding these impairments, of the Consumer business declined 10%.

Mr Hurrell says our Australian Consumer business performed strongly with sales continuing to increase thanks to its popular beverage, spreads and cheese products.

“Our New Zealand Consumer business focused on improving customer service and keeping supermarket shelves well stocked, particularly as New Zealanders were stock piling through COVID-19.

“Despite the better performance this year, due to the economic outlook post-COVID-19, our New Zealand Consumer business’s future cashflow projections are lower than we estimated last year and, as a result, we have decided to write down its goodwill by $21 million. It now has a total value in our accounts of $699 million.”

Mr Hurrell says, in addition to the improved earnings performance, Fonterra has followed through on its commitment to financial discipline and this has increased the financial strength of the Co-op.

“Our cash flow has improved and our debt has reduced by 19% or $1.1 billion compared to last year. Increased earnings, reduced capex, as well as the sale of DFE Pharma and foodspring® for cash proceeds of $623 million in the first half of the year, have all contributed to this improvement.”

Dividend and Farmgate Milk Price for 2019/20

Fonterra announced a dividend for the 2020 Financial Year of 5 cents per share and final Farmgate Milk Price for the 2019/20 season of $7.14 per kgMS.

Fonterra Chairman John Monaghan says for a 100% share backed farm, this gave them a final cash payout of $7.19 per kgMS.

"This year marks a return to paying dividends, a position we expect to maintain in the future, assuming normal operating conditions.

"At 5 cents per share, the dividend is at the lower end of the 5-7 cent range calculated under the Board's dividend policy guidelines.

"In the context of so much uncertainty, as COVID-19 continues to impact our key markets and customer confidence, distributing a 5-cent dividend is a prudent decision and one that balances our aims of further reducing debt and distributing earnings."

Outlook

Fonterra has announced a 2020/21 earnings guidance range of 20-35 cents per share and has also reaffirmed its 2020/21 forecast Farmgate Milk Price range of $5.90-$6.90 per kgMS.

Mr Monaghan says the impact of COVID-19 is still playing out globally.

"From a Milk Price perspective, the supply and demand picture remains finely balanced and for that reason we are maintaining our previous forecast range for this season.

"In terms of our earnings, we are forecasting a full year normalised earnings per share range of 20-35 cents per share.

"There continues to be significant uncertainties – including how the global recession and new waves of COVID-19 will impact demand globally, and what will happen to the price relativities between the products that determine our Milk Price and the rest of our product range.

"As a result of these uncertainties and given that financial year has just begun, we are giving a forecast earnings range wider than we usually would.

"We will be monitoring the situation throughout the season and as the year progresses, we would expect the earnings range to narrow.

"The best way of coping with uncertainty is to stay on strategy and focus on what is within our control – delivering for our farmers, unit holders and customers, and maintaining our financial discipline.

"We need to stay agile and draw on our strengths across the supply chain to manage and adapt to the changing global situation."

Non-GAAP financial information

Fonterra uses several non-GAAP measures when discussing financial performance. These measures include normalised segment earnings, normalised EBIT, EBIT, normalised earnings per share, normalisation adjustments and payout. This reporting period Fonterra has introduced Total group earnings before tax and Total group normalised earnings before interest and tax non-GAAP performance measures that present the combined financial performance of the group's continuing and discontinued operations.

These are non-GAAP financial measures and are not defined by NZ IFRS. Management believes that these measures provide useful information as they provide valuable insight on the underlying performance of the business. They are used internally to evaluate the underlying performance of business units and to analyse trends.

These measures are not uniformly defined or utilised by all companies. Accordingly, these measures may not be comparable with similarly titled measures used by other companies. Non-GAAP financial measures should not be viewed in isolation nor considered as a substitute for measures reported in accordance with NZ IFRS. These non-GAAP measures are not subject to audit unless they are included in Fonterra's annual financial statements.

Definitions of the non-GAAP measures used by Fonterra, and reconciliations of the NZ IFRS measures to the non-GAAP measures can be found on pages 45 and 46 and pages 149 to 151 of Fonterra's Annual Report 2020 that is available on Fonterra's website.

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For further information contact:

Fonterra Communications
24-hour media line
Phone: +64 21 507 072

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.