Northington Partners

FONTERRA CO-OPERATIVE COUNCIL

Review of FY23 Performance

Fonterra Co-operative Group

October 2023

Important Notice

Declarations

This report is dated 19 October 2023 and has been prepared by Northington Partners at the request of the Fonterra Co-operative Council ("**FCC**") on behalf of Fonterra Co-operative Group Limited ("**Fonterra**") for the purposes of s109LA of the Dairy Industry Restructuring Act 2001. The report is intended to provide Fonterra shareholders and unitholders with an independent review of Fonterra's performance for FY23.

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The individuals responsible for preparing this report are Greg Anderson B.Com, M.Com (Hons), Ph.D, Jonathan Burke B.Com (Hons), Marcus Henderson CA, BAppSc (Hons), BCom and Fletcher Edmond BSc. Each individual has a wealth of experience in providing independent corporate finance advice to a wide range of clients.

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FY23 Highlights

1	**Record Earnings and Return on Capital**	Fonterra reported a record full year normalised EBIT of $1,881 million, a material 90% increase on last year's result of $991 million. Favourable price relativities between Reference and Non-Reference Products continued in the second half of the financial year, helping to drive a 12.4% return on capital (6.8% in FY22) and a significant improvement in normalised earnings per share (80 cents compared to 35 cents last year).
2	**Ingredients Channel Delivers a Significant Increase in Earnings**	Ingredients was again the largest contributor to EBIT at $1,577 million (+$764 million, +94%), with significantly improved earnings from Foodservice as well (EBIT of $334 million (+$217 million, +185%)). The Consumer channel reported an EBIT of -$156 million (compared to EBIT of $16 million in FY22). The Ingredients result reflects a 12% increase in revenue on an 8% increase in volume and an improved gross margin of 15.2% (10.8% in FY22). The loss in the Consumer channel is a result of impairments to the New Zealand Consumer business and Asia brands of $121 million and $101 million, respectively, as well as increases in operating expenses due to inflation.
3	**Milk Price Negatively Impacted by Demand**	Fonterra declared a final 2022/2023 Farmgate Milk Price (FGMP) of $8.22 per kgMS. A total dividend for the year of 50 cents per share and the 50 cents per share capital return from the Soprole divestment gave an effective total cash return of $9.22 per share backed kgMS. The reductions in FGMP throughout the 2022/2023 season were the result of weak international demand for whole milk powder (particularly in China), with prices dropping ~16% on average compared to the 2021/2022 season. This weaker international demand has continued into the 2023/2024 season.
4	**Resource Allocation Framework and Targets Introduced**	Fonterra has introduced a Resource Allocation Framework to provide a clear structure for operational priorities, the allocation of milk into product divisions and the allocation of operating cashflows to debt, new investment opportunities and distributions. Fonterra's overall objective is to maximise the risk-adjusted returns for shareholders. To further improve transparency and accountability, targets have also been set for the following key metrics - cash operating expenses per kgMS and gross profit from core operations per kgMS. The combined benefits from achieving the stated targets are expected to remove $1.0 billion from Fonterra's cost base by 2030.
5	**Well Positioned for Capital Investment**	Fonterra's net debt has significantly reduced from $5.3 billion to $3.2 billion. Key drivers included higher earnings, the unwinding of excess inventory from FY22 year end and the application of proceeds from the Soprole divestment. The much lower leverage position at the end of FY23 (Debt/EBITDA of 1.3x vs 3.2x in FY22) means that Fonterra is currently well positioned to meet its capital expenditure requirements and make long-term sustainability investments.
6	**FY24 Earnings Outlook**	The Fonterra Board has forecast earnings of 45 – 60 cents per share for FY24. The lower outlook largely reflects expectations of a reduction in the favourable price relativities that were maintained throughout FY23, partially offset by forecast improvements in Consumer and Foodservice margins.
7	**Strong Performance Against Current Long Term Aspirations**	Fonterra's performance in FY23 in relation to earnings, return on capital and debt reduction was well ahead of the Long Term Aspiration targets announced in 2021. The normalised EPS of 80 cents per share delivered in FY23 was a particular standout, well above the 60 cents midpoint target set for FY30. However, as noted above, the strong performance in FY23 was driven by very favourable price relativities which are expected to moderate over the FY24 year.

Table of Contents

Northington Partners

FONTERRA
CO-OPERATIVE
COUNCIL

Fonterra
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Section 1:

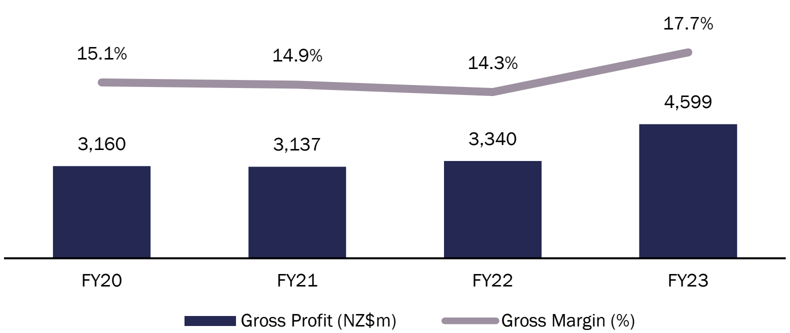
FY23 Results Review

Total Group Financial Performance

Fonterra reported a record full year normalised EBIT of $1,881 million, a 90% increase on last year's result.

NZ$ Million (Normalised Basis)	FY22	FY23	*% Change*
Sales Volume ('000 MT)	3,924	3,973	*1%*
Total Revenue	**23,425**	**26,046**	***11%***
Cost of Goods Sold	(20,085)	(21,447)	*7%*
Gross Profit	**3,340**	**4,599**	***38%***
Gross Margin	*14.3%*	*17.7%*	*n/a*
Operating Expenses	(2,397)	(2,787)	*16%*
Other Items	48	69	*44%*
Normalised EBIT	**991**	**1,881**	***90%***
Normalised EBIT Margin	*4.2%*	*7.2%*	*n/a*
Normalisations	(15)	337	*n/a*
Reported EBIT	**976**	**2,218**	***127%***
Reported Net Profit After Tax	**583**	**1,577**	***170%***
Reported Earnings Per Share	$0.36	$0.95	*164%*
Normalised Earnings Per Share	$0.35	$0.80	*129%*
Dividend per Share	$0.20	$0.50	*150%*

Reported Gross Profit and Gross Margin



Fonterra delivered a record earnings result for FY23, with Normalised EBIT increasing by 90% to $1.88 billion. Including the gain on sale for the Soprole business, Reported EBIT increased 127% to $2.22 billion.

Despite limited growth in sales volume (+1%), the continued shift to higher value Non-Reference Products (particularly cheese and proteins) resulted in an 11% increase in Revenue and a 38% increase in Gross Profit. Total Group Gross Profit increased $1.3 billion relative to the prior year, largely due to favourable pricing and margins in the Group's Ingredients and Foodservice channels. Gross margins improved materially year-on-year from 14.3% to 17.7%.

Total Group normalised operating expenses were $2.8 billion in FY23, also representing a significant increase on last financial year. Key elements of this increase included $204 million of impairments (mainly through the Consumer channel), $103 million for additional employee benefits and higher professional fees from the implementation of the new Flexible Shareholding capital structure and divestments.

Despite the increase in operating expenses, Normalised Earnings before Interest and Tax (EBIT) increased ~90% to $1,881 million. This is equivalent to a Normalised EBIT margin of 7.2% (4.2% in FY22) and is the highest Normalised EBIT margin since the FY16 result (7.9%, $1,358 million). Reported EBIT was a record $2,218 million, a 127% increase on the FY22 result.

The combination of key factors outlined above resulted in a record year for the Group with normalised EPS of 80 cents per share compared to opening guidance of 30 - 45 cents per share. This result is also at the top end of the 65 cents per share to 80 cents per share guidance provided in early August.

This outcome allowed the Group to declare a final dividend of 40 cents per share, bringing the total FY23 dividend to 50 cents per share, equivalent to a 63% payout (slightly above the top of target payout range of 40% to 60%).

Financial Performance by Channel

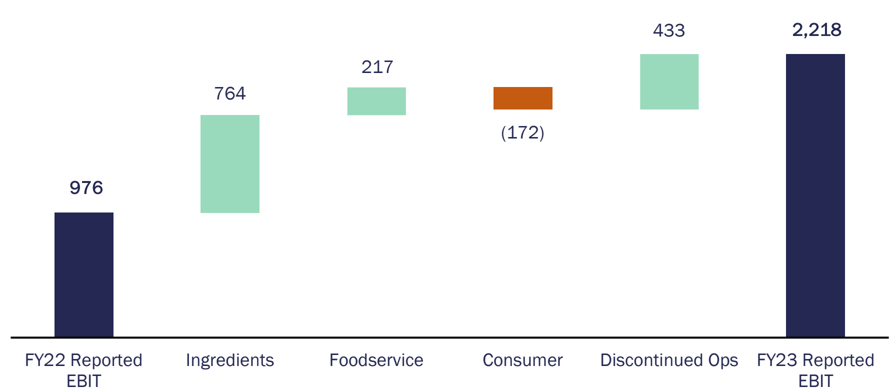
Ingredients was again the largest contributor to EBIT at $1,577 million (+$764 million, +94%), with significantly improved earnings from Foodservice as well (EBIT of $334 million (+$217 million, +185%).

The Ingredients channel had a very strong year in FY23, with an increase in EBIT of $764 million representing a 94% improvement over the previous year. The main driver of this performance was the sustained price differential between Non-Reference Products (particularly cheese and protein portfolios) and Reference Products (particularly WMP and butter) throughout the year.

As summarised in the adjacent chart, FY23 price relativities began at the FY22 peak and performed above historic levels throughout the year. Management estimates that the earnings benefit from the pricing differential was mostly delivered via protein and cheese products and represented close to 40 cents of the 80 cents normalised EPS.

The FY23 result for the Ingredients channel benefited from higher sales volumes due to the sell down of additional inventory held at FY22 year-end. This sell down was supported by the securing of new contracts and tenders in both the Asia Pacific and Africa regions. Additionally, the business was able to increase sales volumes of cream products to European customers on the back of more competitive pricing. Greater China sales volumes and demand were negatively impacted by local milk processors converting excess liquid milk into WMP. This is expected to be a short-term issue, as consumption of dairy continues to increase in China following the lift of COVID-19 related restrictions.

Reported EBIT Bridge FY22 – FY23 (NZ$ million)

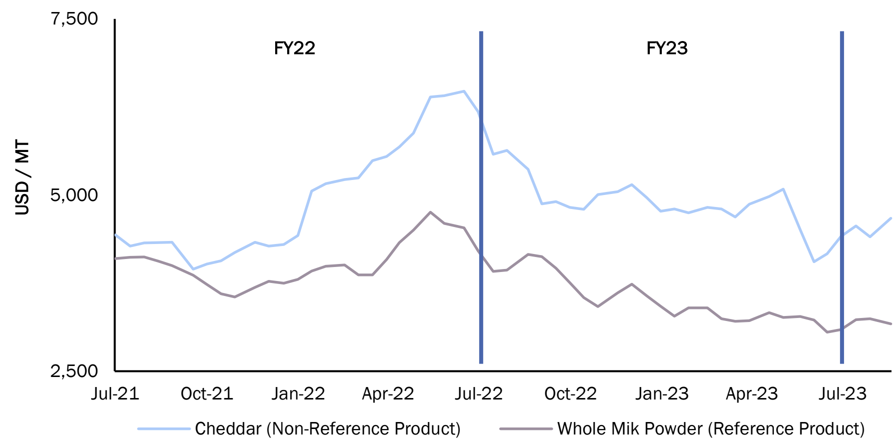


Foodservice EBIT grew to $334 million in FY23 (vs. $117 million in FY22), with particularly strong performance following in-market price increases in the first quarter, supported by increased out-of-home dining in Australia and the removal of COVID-19 restrictions in China and Southeast Asia.

The Consumer channel reported a loss of $156 million at the EBIT level in FY23, compared to a profit of $16 million in FY22. This result includes $222 million of impairments in the New Zealand consumer business and Asia brands. The impairments for the New Zealand consumer business reflect higher input costs which began to flow through during the second half of the prior year, and which were not fully offset by increases in sales prices. The impairments for the Asia brands are largely due to a reduction in forecast sales growth as well as changes to discount rates and exchange rates.

The EBIT contribution from Discontinued Operations in FY23 was $463 million, representing earnings from Soprole, Hangu China Farm and DPA Brazil. Note that while the EBIT contribution from Soprole increased from $78 million to $431 million, approximately $349 million of that increase related to the gain on sale. Both Hangu China Farm and DPA Brazil delivered relatively immaterial contribution at the EBIT level, with DPA Brazil the only asset still owned and held for sale at the end of FY23.

Price Relativities



Source: Global Dairy Trade, adjusted forward 3 months to reflect shipment delay.
WMP and Cheddar used as proxies for Reference & Non-Reference Products.

Financial Performance by Segment

Fonterra introduced major changes to its segment reporting structure in FY23, with the changes designed to better align reporting with the current focus on New Zealand milk.

Fonterra announced changes to its segment reporting structure in October 2022. The FY23 annual results were reported for the first time using the following updated structure:

FY22 Reporting Segments	**FY23 Reporting Segments**	
Asia Pacific	Global Markets	Core Operations
AMENA	Global Markets	Core Operations
Greater China	Greater China	Core Operations

Consistent with Fonterra's focus on New Zealand milk collection, supply chain operations and manufacturing efficiency, Core Operations is a new reportable segment that represents the collecting, processing and delivery of product to customer facing markets, as well as Farm Source™ retail stores and several Group functions. Previously, Core Operations were allocated between geographic segments based on activity and share of product sold.

Global Markets and Greater China represent all Ingredients, Foodservice and Consumer channels within their respective geographic locations, but now show the in-market value after purchasing from Core Operations at internal transfer prices.

The Global Markets business covers all sales regions outside of the Greater China region, which includes Africa, Middle East, Europe, North Asia, Americas, New Zealand, Australia, Pacific Islands, Southeast Asia, and South Asia.

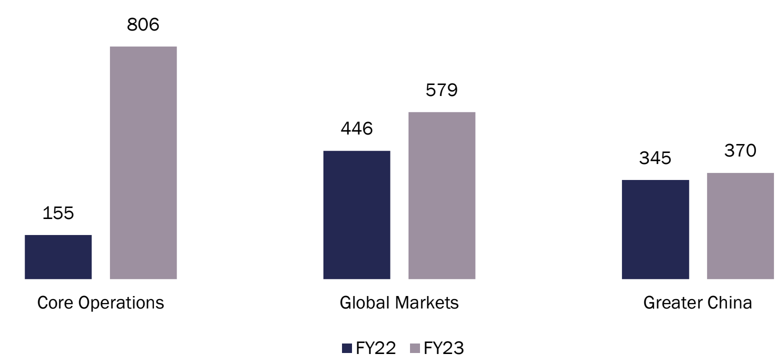
The performance of Core Operations reflects the efficiency of NZ milk collection, manufacturing, supply chain operations and ability to optimise product mix. The performance of the regional business units reflects the in-market value added after purchasing the products from Core Operations.

Reported EBIT from Core Operations increased from $155 million in FY22 to $806 million in FY23, with a significant increase of the EBIT margin from 0.9% to 4.2%. The key driver of this dramatic increase again reflects the benefit of price relativities.

The improvement in earnings for Global Markets was attributed to increases to in-market pricing (to reflect higher cost of goods), which increased gross margin by 19%. Volume also increased by 10%. Some of these gains were offset by an increase in operating expenses, mainly due to $176 million of impairments recognised in the period.

Reported EBIT in Greater China increased by 7%, or $25 million to $370 million. The reasonable growth achieved in the Ingredients and Foodservice businesses following the lifting of COVID restrictions in the second half of the financial year was partially offset by $46 million of impairments of the Group's Asia consumer brands.

Reported EBIT by Segment (NZ$ million)



Return on Capital

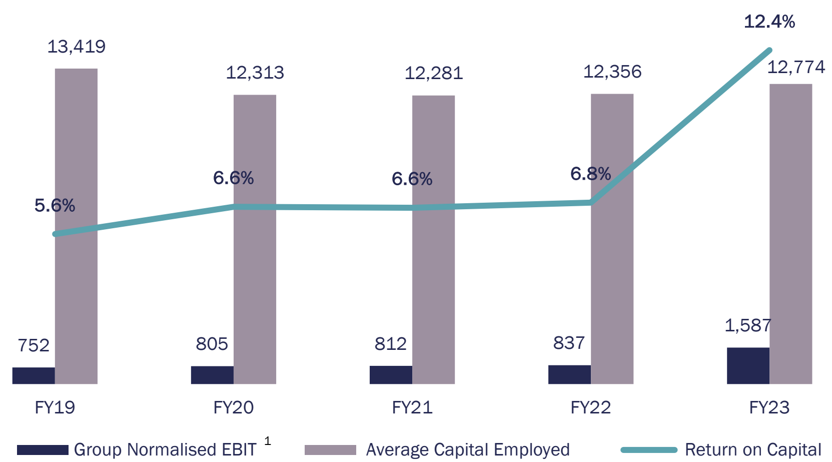
Increased earnings in FY23 has driven a significant improvement in return on capital employed, increasing from an average of 6.4% over the previous four years to 12.4% in FY23.

Our review of Fonterra's financial performance since inception (published in November 2018) noted that the average return on capital employed ("**ROCE**") was approximately 6.0%, below the assessed benchmark range of 6.9% - 7.7%. The chart below summarises ROCE since FY19 and shows the dramatic improvement recorded in FY23.

These results are based on Fonterra's approach to calculating ROCE; it reflects normalised EBIT and is based on the book value of equity. Normalised EBIT excludes the $349 million related to the gain on sale from Soprole, as well as a $12 million loss related to the disposal of Hangu China Farm. FY23 impairments totaling $252 million, mainly recognised in the Group's Consumer channel, are however included in the calculation of normalised EBIT. Based on reported earnings, we estimate the actual ROCE for FY23 at 14.7%.

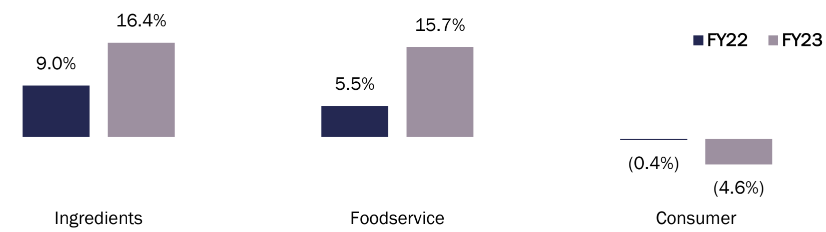
The level of capital employed has not changed significantly over the last five years, and the improved outcome in FY23 therefore reflects the increase in normalised EBIT. As discussed previously, the improved earnings in FY23 is in turn attributed to the favourable price relativity between Reference and Non-Reference Product prices. To the extent that that relativity is expected to return to historical averages, the near-term ROCE is also likely to reduce.

Historical Return on Capital (Based on Fonterra Estimates)



[1] Plus finance income on long term advances less notional tax charge

Historical Return on Capital by Channel (Based on Fonterra Estimates)



Fonterra provided a breakdown of return on capital by channel for the first time in FY23, along with the comparable data for FY22. In line with the earnings improvements previously discussed, the ROCE for both the Ingredients and Foodservice channels were materially higher in FY23. The relative year-on-year improvement was higher for Ingredients due to the larger impact of the price relativities in this channel.

ROCE calculations reflect the impact of the impairments taken in FY23 – that is, the channel earnings used in the calculation have not been normalised for the impairments. While the reported ROCE for the Consumer channel is clearly well below an acceptable target, the outcome in FY23 was particularly affected by the significant impairment charge of $222 million.

We welcome the on-going provision of the return on capital information by channel. This level of detail was not available in 2018 when we completed the performance review but will be an important input when assessing capital allocation decisions in the future.

Explanation

Return on Capital (ROC) or Return on Capital Employed (ROCE) is a measure of how well capital has been invested. As shown below, this is assessed by looking at the post-tax return from the assets as a proportion of their book value.

$$\text{ROCE} = \frac{(\text{Group Normalised EBIT} + \text{finance income on long term advances}) \times (1 - \text{notional tax rate})}{\text{Average Capital Employed (Seasonally-adjusted)}}$$

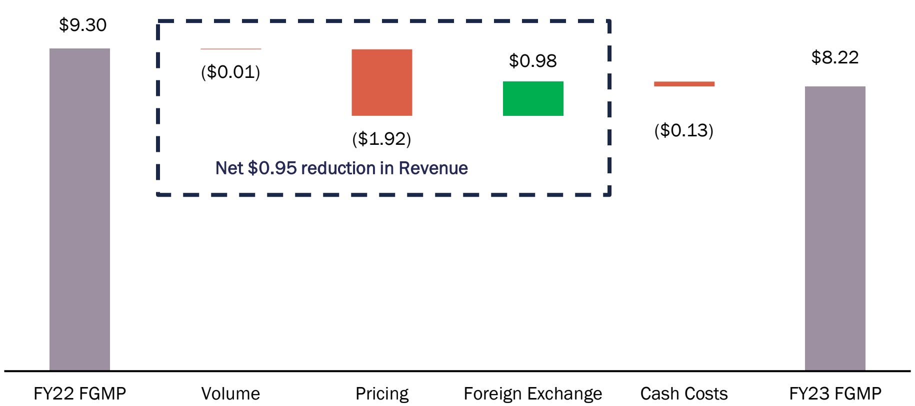
Final Milk Price Negatively Impacted by WMP Demand

Fonterra declared a final 2022/2023 Farmgate Milk Price of $8.22 per kgMS.

Fonterra declared a final Farmgate Milk Price of $8.22 per kgMS for the 2022/2023 season, a meaningful decrease from the $9.30 in the prior year. The reductions have been largely attributed to the negative impact of weak international demand for whole milk powder (particularly in China). The impact of reduced demand was mainly reflected in pricing rather than volume, with WMP pricing an average of ~16% lower than last year. As summarised in the chart below, reduced pricing had a negative impact of $1.92 per kgMS, partly offset by favourable foreign exchange movement resulting from on-going weakness in the New Zealand dollar.

At the time of the results announcement, Fonterra indicated continuing weakness in international demand from key importing regions but that conditions were expected to improve from early 2024. The most recent GDT auctions have confirmed an improvement in the market demand and have led to a 50 cent upgrade to the forecast FY24 FGMP, now at $6.50 - $8.00 per kgMS with a mid-point of $7.25 per kgMS[1]. Notwithstanding the improvement, the mid-point of $7.25 per kgMS remains below Dairy NZ's estimated national breakeven milk price of $7.78 per kgMS, placing significant pressure on many farmers.

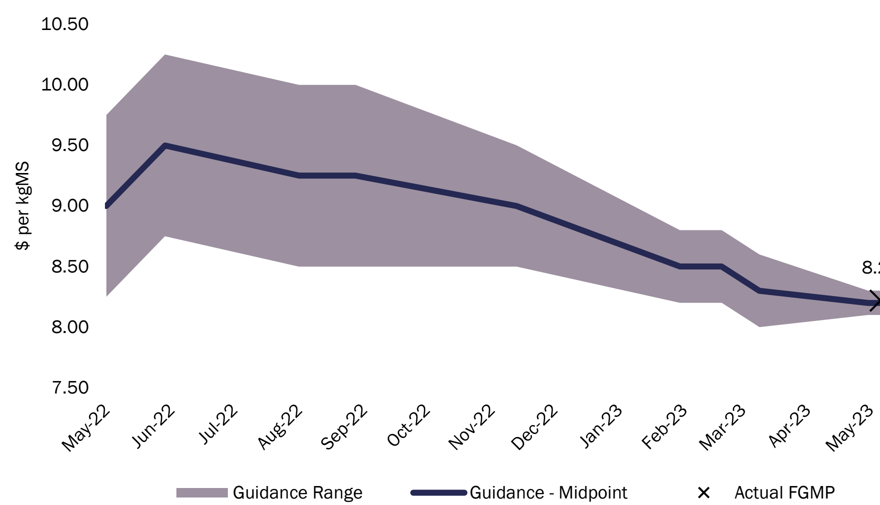
Normalised Earnings Per Share and Payout Ratio ($ per kgMS)



The graph below shows that the milk price guidance for FY23 issued to farmers in May 2022 was much higher than the final declared price of $8.22. Frequent downgrades during the season highlighted the difficulty and complexity of the Group's milk price forecasts.

We therefore understand the need to maintain a reasonably wide range between the high and low guidance prices for the FY24 FGMP (currently $1.50 kgMS). We note that in recent years prior to FY23, much of the uncertainty and subsequent changes to milk price midpoints were favourable uplifts, peaking at the final price of $9.30 for the 2021/2022 season. Given that this pattern effectively happened in reverse during FY23, farmers should exercise caution and apply contingencies to any milk price guidance and consider the flow on impact to on-farm financing decisions for the upcoming season.

2022/2023 Farmgate Milk Price Guidance Range



[1]As at 10 October 2023

Total Payout and Payout Ratio

Shareholders have benefitted from strong dividends and a capital return during FY23. The total payout was $8.72 for the year. This is likely to reduce in the upcoming financial year with expectations of a reduced milk price and reduced earnings / dividends.

Fonterra announced a final dividend of 40 cents per share for FY23, bringing the total dividend for the year to 50 cents per share. This is a meaningful increase on the total dividend paid in FY22 of 20 cents per share.

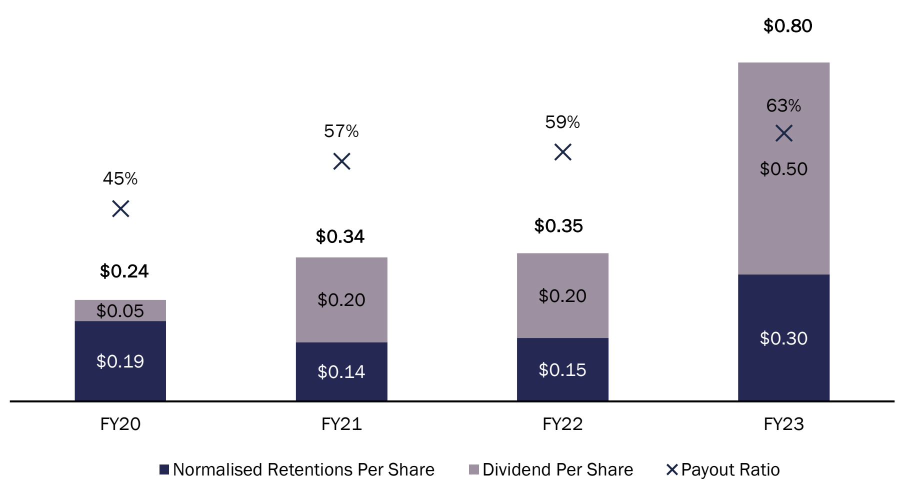
Fonterra's dividend policy is to pay 40% to 60% of reported net profit after tax that is attributable to Co-operative equity holders (excluding abnormal gains such as the $349 million gain realised from the sale of Soprole). The adjusted NPAT for the basis of the dividend calculation was $0.79 per share, meaning the 50 cents per share dividend corresponds to a 63% payout ratio. The decision to distribute slightly above the upper end of the guidance range was justified by a strengthened balance sheet and strong leverage metrics relative to targeted levels.

Importantly, proceeds from the completed sale of Soprole allowed the Group to also declare a one-off tax-free capital return of $804 million, or 50 cents per share. The potential capital return had been signaled by the Co-op at the start of the divestment process and helped to bolster the lower FGMP in FY23.

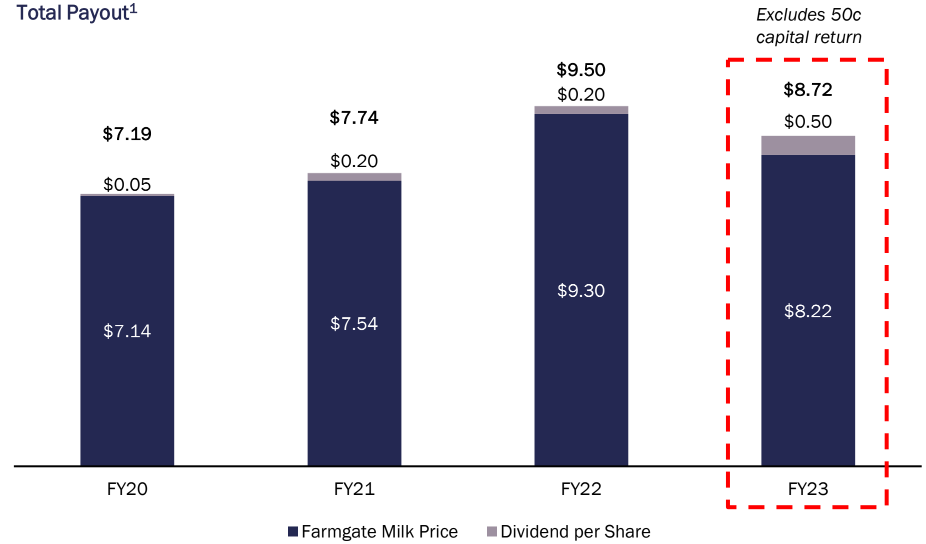
The chart below summarises the total payout per share since FY20 (see page 35 for further details). With a final 2022/2023 Farmgate milk price of $8.22 and the 50 cent total dividend, total payout reached $8.72 per share backed kgMS in FY23. Even including the capital return, the total cash return of $9.22 in FY23 was below the FGMP ($9.30) and total payout ($9.50) in the prior year[1]. While relatively high in historical terms, the lower FY23 payout was also exacerbated by a dramatic increase in on-farm costs during the year.

Given the sale of Soprole and the lower earnings guidance issued for FY24, shareholders are likely to receive dividends which are more in line with prior years (an implied 18 – 36 cents per share under the current EPS guidance range). Combined with the expectation of a lower milk price for the current season, total payout is likely to continue trending downwards from its peak in FY22.

Normalised Earnings Per Share and Payout Ratio



Total Payout[1]



1. Per share backed kgMS

Resource Allocation Framework and Efficiency Targets Introduced

Fonterra has announced new initiatives that guide allocation of capital and resources to help maximise risk-adjusted returns for shareholders.

Fonterra has introduced the Resource Allocation Framework summarised below to provide (a) a clear structure for operational priorities; (b) the allocation of milk into product divisions; and (c) the allocation of operating cashflows to debt, new investment opportunities and distributions. Fonterra's overall objective is to maximise the risk-adjusted returns for shareholders through implementation of this framework in key budgeting and investment decisions.

Target metrics for cash operating expenses per kgMS and gross profit from core operations per kgMS have also been set and were announced at year-end. Both metrics are designed to monitor the cost base having regard to changing milk volumes and adjustments for inflation, with the aim of ensuring that underlying efficiency gains/losses are more transparent. The combined benefits from achieving the stated targets in these areas are expected to remove $1.0 billion from Fonterra's cost base by 2030 via a collection of measures including better procurement and targeted investment in new systems and automation. Further discussion of these metrics is set out on page 20.

We think that publicly announcing these frameworks should improve transparency and accountability to shareholders and is a progressive step in terms of investment and operational discipline. These initiatives now need to be implemented and managed effectively and we plan to report on the new metrics in detail in future.

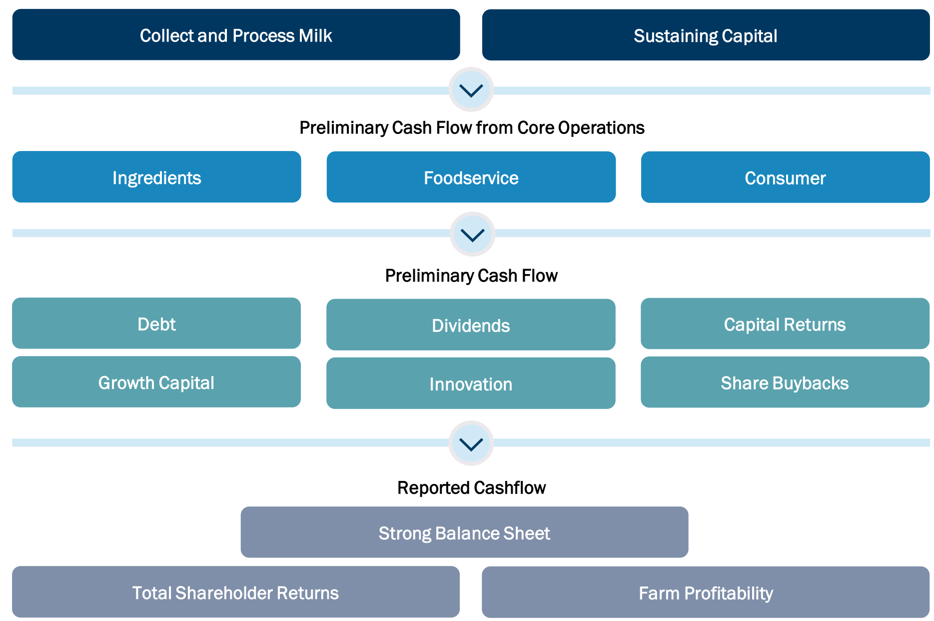
Fonterra Resource Allocation Framework

Sustain safe, productive operations
A primary allocation of capital is used to deliver a safe, sustainable capacity of processing assets, while maintaining a surplus margin for plant capacity

Competition for milk
We allocate milk to the products and channels where we believe it will earn the highest risk-adjusted returns.

Competition for cash
We allocate cash to our balance sheet, shareholders and businesses where we believe it will earn the highest risk-adjusted returns.

Outcome for the Shareholder
Management is aligned to the delivery of value to our stakeholders through targets and incentives.



Financial Position at FY23 Year-End

Net debt has decreased by $2.1 billion due to record FY23 earnings, the unwinding of excess inventory from FY22 year end and the application of proceeds from the Soprole divestment.

Net Assets increased to $7,968 million at the end of FY23, representing an increase of $1,062 million (+15%) from the previous year.

The Group's cash and cash equivalents increased to $1,822 million following the sale of Soprole and strong operating cash flow during FY23. However, we note that the capital return of $804 million was yet to be paid as at the balance date.

The abnormally high inventory balance of $5,148 million at the end of FY22 has reduced to $4,346 million as at 31 July 2023. This reflects two factors: the excess inventories on hand at the end of FY22 have been sold; and in addition to lower volumes of inventory held at FY23 year end, reductions to the milk price decrease the value of inventory held on a per metric tonne basis.

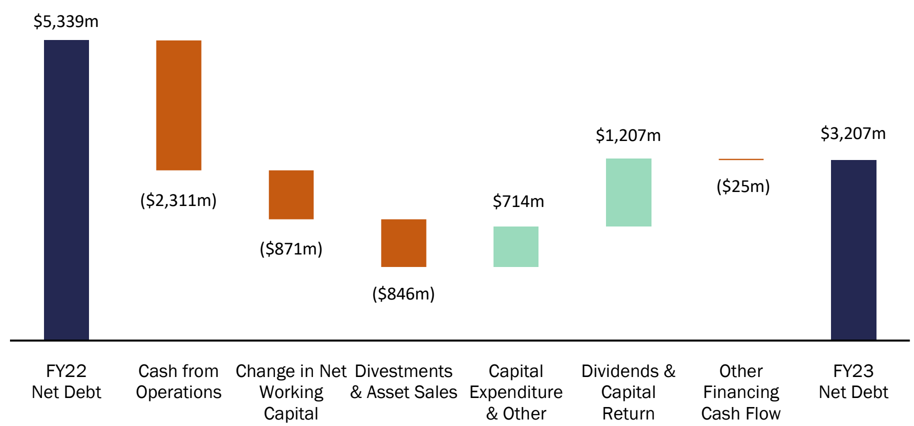
NZ$ Million	FY22	FY23	*% Change*
Assets			
Cash and Cash Equivalents	288	1,822	*533%*
Receivables	2,482	2,473	*(0%)*
Inventories	5,148	4,346	*(16%)*
Other Current Assets	874	854	*(2%)*
PP&E	6,465	6,343	*(2%)*
Intangible Assets	2,153	1,824	*(15%)*
Other Non-Current Assets	1,371	939	*(32%)*
Total Assets	**18,781**	**18,601**	***(1%)***
Liabilities			
Payables	2,403	2,373	*(1%)*
Owing to Suppliers	2,119	1,997	*(6%)*
Current Borrowings	356	785	*121%*
Capital Return Payable	-	804	*n/a*
Other Current Liabilities	1,640	1,302	*(21%)*
Non-Current Borrowings	4,900	3,156	*(36%)*
Other Non-Current Liabilities	457	216	*(53%)*
Total Liabilities	**11,875**	**10,633**	***(10%)***
Net Assets	**6,906**	**7,968**	***15%***
Equity Attributable to Co-op	**6,933**	**7,906**	***14%***

Key contributors to the changes in net debt over the FY23 period are summarised below. Healthy operating cash flows from record earnings and positive working capital movements (including the unwinding of excess inventory from FY22 year-end) have helped to significantly reduce net debt by $2,132 million during the year. This reduction was also supported by the net sale proceeds from the Soprole divestment (noting that the capital return which was made after balance date has been incorporated into the net figures shown in the chart).

The net impact of dividends during the FY23 year includes the FY22 final dividend and the FY23 interim dividend (totaling $403 million), as well as the $804 million capital return.

Further analysis of the ending net debt position and the corresponding key metrics is set out on page 22.

Net Debt Bridge (NZ$ million)



Capital Expenditure & Divestments

Total capital invested during FY23 was $747 million, representing an increase of $130 million compared to the prior year.

Capital investment for the last four years has been broken down into three broad categories:

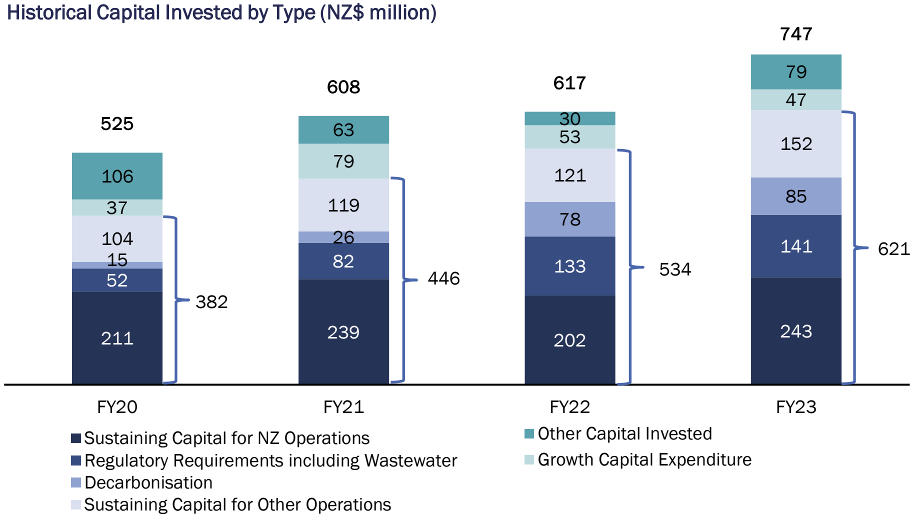
1. Sustaining capital expenditure;
2. Growth capital expenditure; and
3. Other capital investment.

Most of the expenditure in FY23 was allocated to sustaining capital expenditure ($621 million) which generally reflects the maintenance and improvement of existing assets. Fonterra has further broken down this category into four sub-components categories, as shown in the chart below.

Key FY23 projects within this category included the installation of a biomass boiler to remove the use of coal at the Group's Waitoa processing site, introduction of improved refrigerant technology at the Whareroa site and a utilities upgrade at the Te Rapa site. Fonterra also continued with its annual replacement programmes for trucks, trailers and milk vats which will help to achieve future operating efficiency targets.

Also included within the sustaining capital expenditure for FY23 is $85 million of decarbonisation spending, to support Fonterra's aim of improving the sustainable collection and processing of milk across the Group's network of assets. Investment in decarbonisation has increased significantly in the past two financial years and will continue in the medium to long term.

Historical Capital Invested by Type (NZ$ million)



The Group invested $47 million during FY23 in capital projects to drive future growth. This included an upgrade to the probiotic's capacity in Palmerston North and the expansion of a cheese processing capacity in Malaysia which supports global foodservice customers. The $79 million of other investments were mainly for right-of-use assets and equity investments.

As already mentioned, the Group made a number of divestments during the year in line with its strategy to increase focus on Core Operations (i.e. New Zealand milk collection and processing). Fonterra completed the divestment of Soprole in March 2023, fully exited the last China Farms asset in April 2023 and continued to progress the sale process of DPA Brazil.

The net gain / (loss) on sale for FY23 was $337 million on a pre-tax basis ($248 million post-tax), with the $349 million Soprole gain marginally offset by a $12 million loss on sale of the Hangu China Farm asset.

As at balance date, the agreed sale of DPA Brazil to French dairy company Lactalis continues to progress through various conditions and regulatory approval processes. Expectations are that the sale process will be completed by the end of FY24, with proceeds from Fonterra's 51% share of the business used to repay debt held directly by DPA Brazil.

Summary of Recent Divestments (NZ$ million)

	FY23		FY22	
	Sale Price	Gain/(Loss)	Sale Price	Gain/(Loss)
Soprole	1,066	349		
China Farms (Hangu)	18	(12)		
Global Dairy Trade			26	42
Total	**1,084**	**337**	**26**	**42**

Note: Gain / (Loss) on Sale is on a pre-tax basis

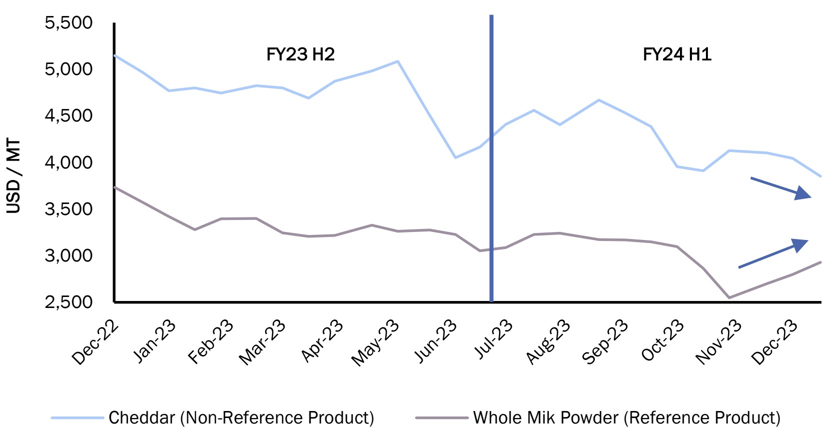
FY24 Outlook

Fonterra's EPS guidance indicates that FY24 earnings are likely be more in line with historical averages and well below the record achieved in FY23.

Reflecting changing market conditions, the Group has issued guidance of normalised EPS from continuing operations of 45 cents to 60 cents for FY24. While obviously a reduction on the record result achieved in FY23, the FY24 guidance is still slightly higher than the top end of the target range set out in the Long-Term Aspirations announced in 2021 (FY24 target earnings per share range of 45 cents to 55 cents).

Management has also advised that the EPS guidance for FY24 incorporates an allowance for a 15c contribution from favourable price relativities. The outlook for price relativities for the first half of FY24 is shown in the graph below. While the favourable conditions enjoyed in FY23 were maintained in the first three months of the current year, recent GDT auctions indicate the differential will reduce in the near term. This is generally consistent with the expectation of reverting to a longer-term average throughout FY24, with long term relativities expected to deliver ~5 cents of earnings per share. As discussed further in Section 2, the external factors driving the price relativities will continue to be a key determinant of Fonterra's performance (particularly for the Ingredients channel).

FY24 Year-to-Date Price Relativities



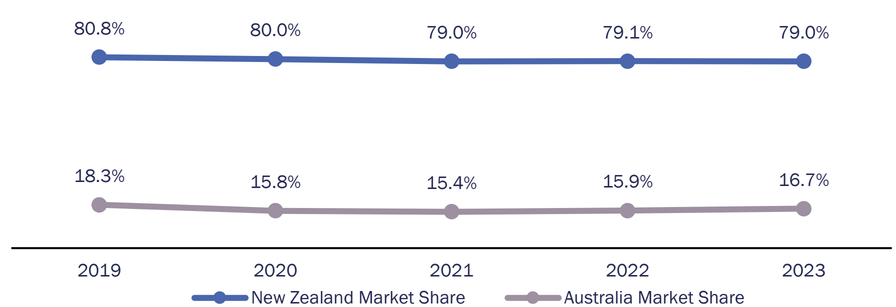
Note: GDT prices are adjusted forward 3 months to reflect delay between GDT contracts struck and the shipment date (at which the invoice and revenue is recognised)

Fonterra continues to benefit from a dominant share of NZ milk supply and has increased its share of Australian milk supply over the past few years. However, there are some signs of medium and longer terms risks to the Group's supply base emerging including farm conversions to other land uses and increased competitor activity. In recent years, the shift to value-added products and productivity gains have helped to offset reductions in New Zealand milk collections, but we believe Fonterra remains at risk that the trend of reduced collections will continue. The impact of the change to the minimum required shareholding which was designed to help with farmer retentions is not yet verified.

The medium to longer term outlook for Australian business remains uncertain with some question marks remaining in relation to the Group's decision to hold the Australian business (announced September 2022). We expect Fonterra will continue to focus on operational efficiency and strict resource allocation within the Australian business throughout FY24. We also think a significant turnaround in the Australian business in the short term is unlikely and that asset performance should be scrutinised closely over the next couple of years.

Although the asset base in Greater China is now much smaller in comparison to six or seven years ago, operational exposure remains high with 28% of external volume sold through Greater China in FY23 (based on continuing operations). Improvements to demand and pricing are expected in the short term with the removal of WMP and SMP duties from 1 January 2024 onwards. Fonterra continues to monitor the competitive dynamic relating to China domestic production and will be constantly reviewing the optimal product production to meet demand. However, we note that Fonterra ultimately has limited control over key drivers of supply and demand in China.

Milk Collections Market Share (% of kgMS)



New Zealand market share and collections are for the period 1 June – 31 May.
Australia market share and collections are for the period 1 August – 31 July.

Northington Partners

FONTERRA CO-OPERATIVE COUNCIL

Section Two:

Revisiting Fonterra's Long Term Aspirations

Introduction

In this section we review Fonterra's progress relative to the LTAs established in 2021 and the key factors that will contribute to its future performance, including recent strategic initiatives as part of Fonterra's focus on NZ milk and moving towards higher value products.

As part of a significant reset of the business announced in 2019, Fonterra provided some key business targets for the following 3-5 years. Those targets were subsequently updated and amended in September 2021 with the publication of Long Term Aspirations ("**LTAs**") which extended out to 2030. The table below summarises Fonterra's results to date relative to the LTA targets:

- While the FY22 results were ahead of target on most profitability measures, outcomes for capital investment and debt levels were below target largely as a result of increased working capital.
- The FY23 performance was significantly ahead of all near-term (FY24) and longer-term (FY30) earnings related LTA targets. As previously discussed, this outcome is largely attributable to favourable price relativities between Reference and Non-Reference Products and a reduced cost of milk driving Group gross margins up to 17.0% from 13.3% in FY22 (continuing operations).
- The FY23 debt-related LTAs were supported by a significant reduction in working capital and asset sales, driving net debt down to $3.2 billion in FY23 relative to $5.3 billion in FY22 (see page 22 for further information).

While Fonterra has clearly surpassed the targets in FY23, much of the out-performance centred on "abnormal" price relativities which are unlikely to be maintained at similar levels over the long term. We analyse the impact of price relativities on FY23 performance and the potential impact on future performance on page 19.

Current expectations are that current year earnings will be much lower than FY23. We note that Fonterra has provided initial EPS guidance for FY24 of 45 – 60 cents per share. This level of earnings is in line with the original LTA target of 45 – 55 cents and implies EBIT around the $1.2 billion level (vs $1.9 billion in FY23).

Fonterra has also announced its intention to provide an update on long-term strategy and targets in early CY24. We expect this to be in the form of both revisions to the existing metrics as well as the introduction of new measures.

LTA Measure	Forecast FY22	Actual FY22	Actual FY23	Forecast FY24	Forecast FY27	Forecast FY30	Principal Drivers of Performance Relative to LTA
EBIT ($ million)	875–975	991	1,881	1,025–1,125	1,150–1,250	1,325–1,425	• Commodity prices / FGMP • Price relativities
Earnings per Share (cents)	25–40	35	80	45–55	50–60	55–65	
Return on Capital	6.5%–7.0%	6.8%	12.4%	7%–8%	7.5%–8.5%	9%–10%	• Success of value-add strategy • Cost efficiencies / margins
Capital Investment ($ million)	650	617	747	980	980	980	• Plant maintenance requirements • Sustainability investment • Growth capital investment
Debt to EBITDA	2.4x	3.2x	1.3x	<2.5x	<2.5x	<2.5x	• Cash profitability • Working capital management • Net investment (capex less divestment)
Gearing Ratio	35%	42%	29%	<35%	<35%	<35%	
Dividends (cents)	15–20	20	50	22–27	30–35	40–45	• Profitability • Dividend policy

Factors largely out of Fonterra's control

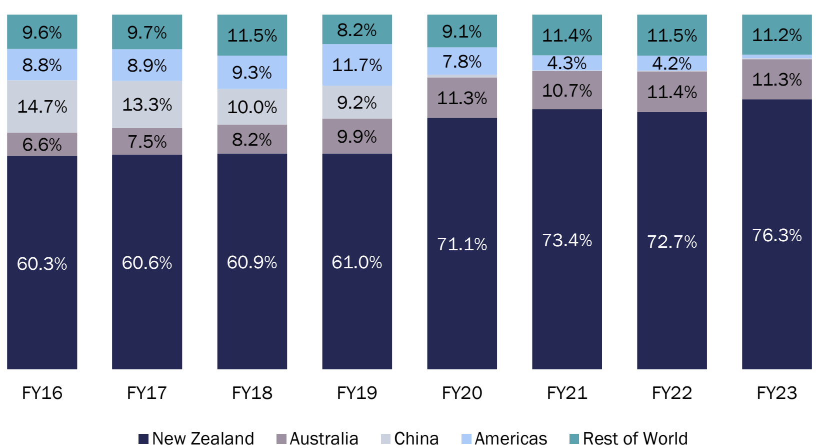
Focus on NZ Milk and Value-add

Fonterra is making good progress on its strategy to prioritise NZ Milk and shift greater volume into higher value Non-Reference Products across the specialised Ingredients, Foodservice and Consumer channels.

Fonterra's strategic repositioning into NZ milk has seen some significant changes in its asset portfolio and capital investment over the last few years. The review and subsequent sale of its interests in China and the Americas has allowed greater focus on its NZ manufacturing sites and sustainability initiatives. The chart below shows that approximately 61% of the asset base in FY19 (excluding working capital) was located in NZ, increasing to 76% in FY23 largely as a result of the divestment program.

In order to better measure the earnings contribution and return on capital from the NZ milk strategy, Fonterra has initiated reporting for a new Core Operations segment which represents the key activities of collecting and processing milk into products for its customer facing operations. The performance of Core Operations reflects the efficiency of Fonterra in milk collection, manufacturing and supply chain as well as its ability to maximise the product mix, including between Reference and Non-Reference Products. We assume the revised LTAs expected to be announced in early CY24 will be consistent with the new reporting structure.

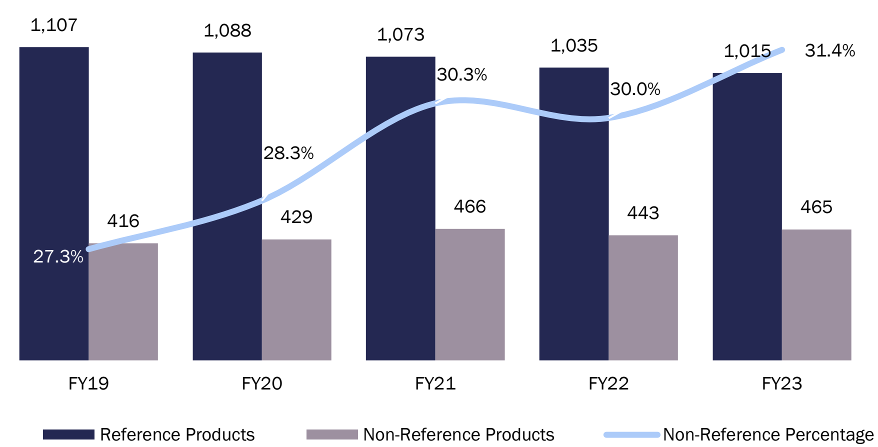
Non-Current Asset Carrying Value by Geography (Portion of Total)



Fonterra's focus on shifting milk into value-add products is another of its key long-term strategic priorities. The chart below illustrates that the business has made some progress in this respect over the last five years, with the allocation of milk volumes into Non-Reference Products increasing from 27.3% in FY19 to 31.4% in FY23. Non-Reference Products focus on speciality ingredients targeting health and wellness as well as products sold into the Foodservice and Consumer channels, including branded products.

Given the scale and nature of the Fonterra business, we expect that on-going annual increases in the proportion of Non-Reference Products will be relatively modest. Some guidance from the Company in relation to realistic long-term targets would be useful as part of the LTA reset in CY24.

Reference and Non-Reference Product Volume - NZ Milk Solids Manufactured (million kgMS)



Impact of Price Relativities

While prices for Non-Reference Products remain favourable relative to Reference Products, it is unlikely that the price differential will be sustained. Consistent with Management, our analysis suggests that favourable price relativities in FY23 contributed over half of Fonterra's underlying EPS (>40 cents).

Fonterra's strong FY23 earnings performance is predominantly attributable to the high price relativity between Non-Reference and Reference Products. The bottom left chart summarises the price relativities by financial year using monthly GDT data for the prices of cheddar and WMP as a proxy. This illustrates that the average price relativity in FY23 was materially higher than any other recent period with an annual average of ~1.4x (FY16 and FY20 being the next highest at ~1.3x). The start of FY24 has also indicated a continuation of this trend.

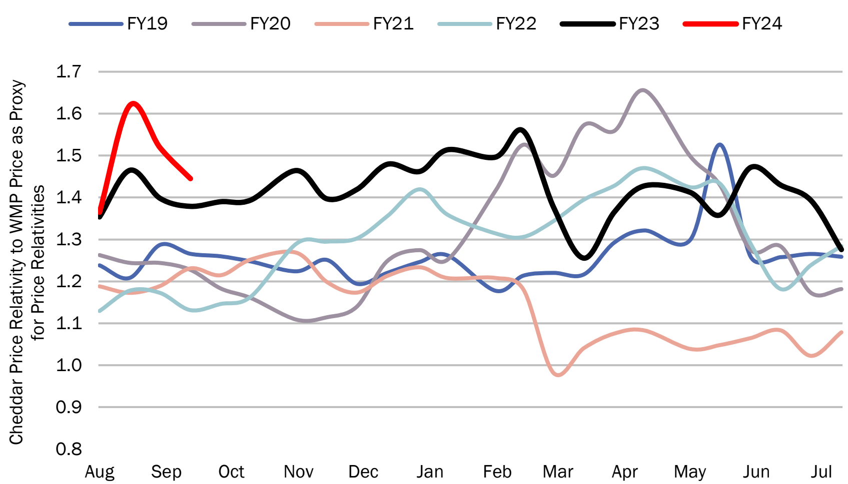
While it is difficult to reliably identify specific factors which drive the changes through time, the price relativity must ultimately be underpinned by changing supply and demand dynamics between the product categories. This implies a current demand imbalance for Non-Reference Products. Without any evidence for a structural change in the market, we would expect that over the long-run, the price relativity will revert to average levels as the current price signalling should see more supply of Non-Reference Products.

As is the case with general commodity prices, Fonterra is effectively a 'price-taker' in relation to price relativities. Year-to-year volatility in earnings will therefore continue to be exposed to the underlying variability in this key driver of performance.

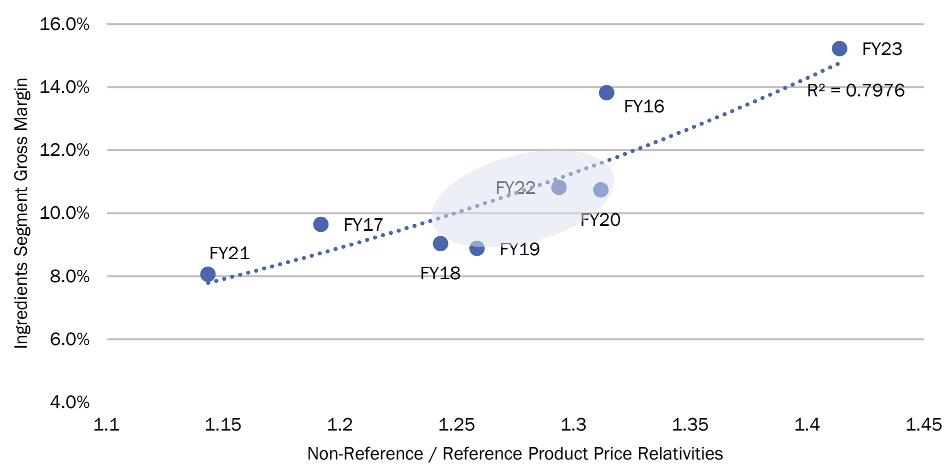
Based on the monthly GDT prices for Non-Reference and Reference Products averaged over financial years, the chart below right shows a strong relationship between the relative prices and the gross margins generated by the Ingredients segment. Eight years of monthly pricing data suggests that the price relativities have averaged 1.27x, consistent with the Ingredients segment delivering gross margins of ~10.4%. Our analysis further suggests that FY23 excess or "abnormal" price relativities were >$830 million (the gross margin difference of an average year at 10.4% and FY23 actual Ingredients gross margins of 15.2%), equivalent to approximately 40 cents per share. This is consistent with an estimate provided by Management and explains the majority of Fonterra's financial outperformance in FY23 relative to recent financial years.

If the price relativities revert to the historic mean, we expect that the gross margin achieved by the Ingredients channel will reduce towards 10% in the long-run (absent periodic volatility and Fonterra's other cost reduction initiatives but before any further improvement in the relative volume split between Reference and Non-Reference Products). However, on the evidence of FY24 pricing year to date for Non-Reference Products, we would suggest that Fonterra could outperform relative to its current EPS guidance of 45 – 60 cents per share.

Historic Price Relativities (Non-Reference / Reference Product Prices)



Relationship Between Price Relativities and the Ingredients Segment Gross Margin



Operational Efficiency Metrics

Fonterra has introduced two new efficiency targets focusing on operating costs and gross profit per kgMS. The new targets are part of a strategy to reduce its cost base by ~$1 billion by 2030 to drive enhanced margins and profitability.

Fonterra has announced a target of sustainably removing ~$1 billion of costs from its operational and overhead cost base by 2030 and has introduced two new efficiency targets to support that goal.

1. **Cash operating expenses per kgMS**

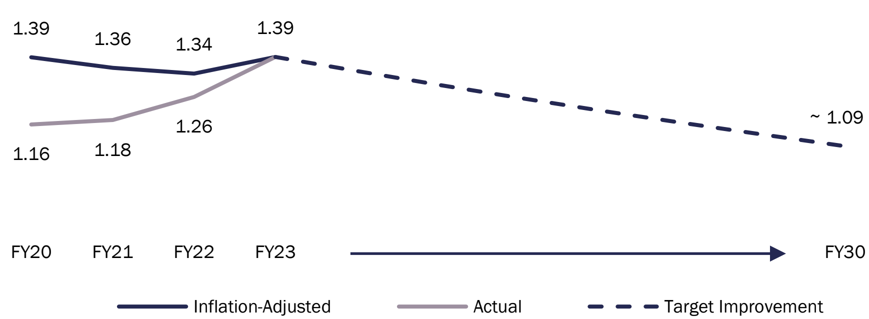
   Cash operating expenses represent the global overheads of the Group and include head office, selling, marketing, storage and distribution costs. In order to objectively assess cost efficiencies relative to varying milk volumes, the cash operating costs are assessed per kgMS of NZ milk solids collected.

   The total costs in FY23 were $2.1 billion (based on continuing operations) and are targeted to reduce by ~$0.5 billion in nominal terms by 2030, largely offsetting expected cost inflation over the period to FY30. Fonterra also stated a target to reduce "real" (excluding the impact of inflation) cash operating costs by 4% per annum. Our analysis implies a reduction from $1.39/kgMS in FY23 to ~$1.09/kgMS in FY30, assuming flat milk volumes over the full period. This is illustrated in the chart below.

   The information provided by Fonterra implies a >20% reduction in real operating expenses on a per kgMS basis by FY30. Given Fonterra's recent performance shows no efficiency gains were generated in real terms between FY20 and FY23 (on the back of a 2% decrease in milk volumes), it could be argued that this appears to be an ambitious target.

   While Fonterra has not provided specific details of how it expects to deliver the reduction in cash operating expenses, we assume that it will be mostly driven by reductions in head office headcount, reduced consulting fees and efficiencies in advertising and distribution costs.

Cash Operating Expenses per kgMS (Inflation Adjusted)



2. **Gross profit from Core Operations per kgMS**

   This metric is aimed at improving efficiencies in Fonterra's core NZ processing and manufacturing cost base to improve gross profit margins on each kgMS. These costs largely represent manufacturing costs, employee expenses and the other costs directly incurred in getting milk products to the point of sale. The measure has intentionally excluded the cost of milk (i.e. the FGMP) which is out of Fonterra's control and is assessed on total kgMS sales volumes across Core Operations (rather than milk collected).

   The target is to maintain current gross profits from Core Operations at ~$9.20 per kgMS between FY23 and FY30 (in real terms). We note that a metric based on gross profit per kgMS not only incorporates cost savings, but also the impact of revenue per kgMS. This in turn will depend on the future sales mix (Reference vs Non-Reference) and on-going revenue variability.

   We understand why Fonterra may have adopted this metric instead of the potentially more meaningful measure of manufacturing costs per kgMS. All else being equal, processing costs per unit will be higher for higher value products and just focusing on costs will not fairly measure any change in operating efficiency. However, in our view, an evaluation of the long-term target is difficult because it includes factors over which Fonterra has limited influence.

   Nonetheless, Fonterra has established its aim to drive annual operational costs savings of 2% per year on a per kgMS basis to achieve total cost savings of ~$0.5 billion by FY30, relative to a current manufacturing cost base of $4.0 billion (FY23). Similar to the cash operating expense per kgMS target, this reduction in Fonterra's core processing and manufacturing cost base will offset expected cost inflation over the period to FY30. We estimate this represents an effective reduction in the cost of milk collection, processing and manufacturing of ~$0.30 per kgMS by FY30 relative to what they would be without the cost efficiencies.

Collectively, the $1 billion in cost efficiency target savings by FY30 would represent a 4.1% EBIT margin improvement on FY23 sales and compares to long-run average historic Group EBIT margins of 4% - 5%. Therefore, the efficiency improvements will be a meaningful contributor to future earnings performance if they are successfully delivered.

Long Term Capital Expenditure Outlook

Fonterra is forecasting approximately ~$800m of capex per annum to support its operations and sustainability targets, with ~$250 million per annum for other, yet to be identified growth investments.

Following a period of relatively low investment over the last four years, Fonterra expects capex over the period to FY30 will be materially higher. As summarised in the chart below, the average annual spend between FY24 – FY30 exceeds $1 billion.

This reflects an estimated average investment of ~$800m per year across:

– A catch-up on maintenance for existing plant (referred to as "sustaining capital expenditure") in both Fonterra's NZ operations as well as for "other" operations (primarily Australia); and

– Increased capital expenditure to meet Fonterra's sustainability goals, made up of investment in "decarbonisation" and "regulatory requirements". This includes investment in key projects such as coal to electric / biomass boilers, improved refrigerants and wastewater collection and treatment – expected to be ~$1 billion over the next decade.

We also estimate an average of ~$300 million additional investment per year earmarked for growth. While the nature of this growth capital expenditure has not been detailed, it includes investment in plant upgrades, extensions and investment in new product lines such as the FY23 investment in string cheese processing capacity in Malaysia.

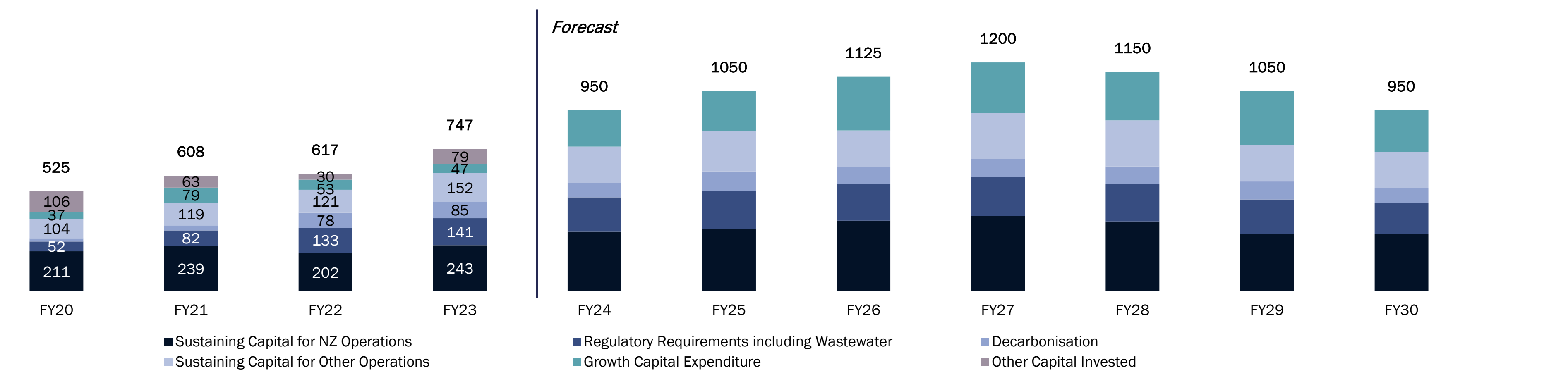
The projected level of capital expenditure represents a material increase in investment - ~$500 million more than average capital expenditure over the FY20 – FY22 period and at least twice the current depreciation charge (~$480 million). However, we suggest that:

– The sustaining capital expenditure is necessary to meet Fonterra's new asset health targets and follows a period of relative under-investment. This capital expenditure is unlikely to contribute to earnings growth but is fundamental to maintaining plant and meeting Fonterra's customer expectations;

– Similarly, the material increase in decarbonisation and regulatory capital expenditure (>$1 billion over the next 4 years) is essential to meet Fonterra's own sustainability targets as well as the increased ESG demands of its customers. While it is hard to determine the earnings or premium contribution from this investment, without it, Fonterra could lose the increasing number of customers who are seeking sustainably-sourced milk; and

– Any investment in growth projects is likely to face significant scrutiny and will have to satisfy Fonterra's internal return requirements (9% - 10% on capital employed) which will contribute to future earnings growth. Maintaining this investment discipline will clearly be important.

Forecast Capital Expenditure FY24 – FY30 (NZ$ million)



Capital Structure

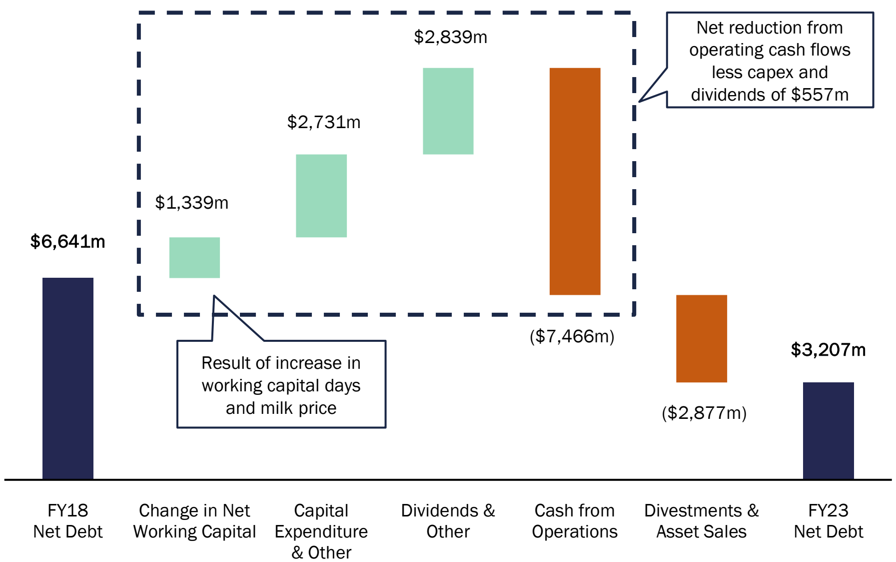
Asset divestments of ~$2.9 billion over the last five years have been the primary contributor to Fonterra more than halving its debt level over the period, with cash from operations largely funding Fonterra's working capital, capital expenditure and shareholder returns.

Fonterra has significantly reduced its net debt over the last five years, from >$6.6 billion in FY18 to $3.2 billion in FY23. The chart below demonstrates that this reduction has been driven by $2.9 billion of asset sales, with the cash flow generated from operations largely used to maintain Fonterra's investment in working capital and capital expenditure, as well as funding distributions to shareholders.

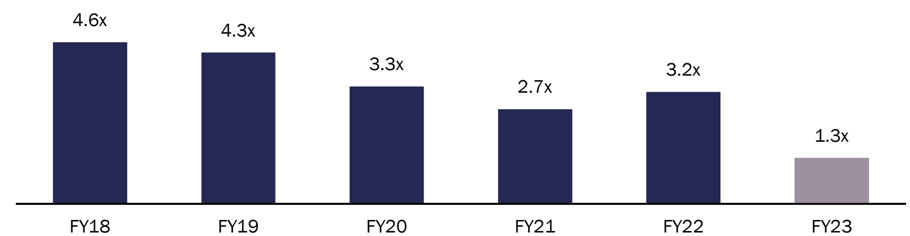
The significant debt reduction along with continued growth in earnings has resulted in a material improvement in Fonterra's key credit ratios (bottom right charts) and the maintenance of Fonterra's high investment grade credit rating (A-).

After allowing for the final FY23 dividend of 40 cents paid in FY24 (~$640 million), we expect that near term earnings performance should support Fonterra maintaining net debt below $4 billion despite the expected increase in capital expenditure. We note that the mid-point of the 45 – 60 cent EPS guidance for FY24 is equivalent to over $1.8 billion of EBITDA (a proxy for pre interest and tax cash flows), an earnings level which underpins this view. Absent any significant growth investment or acquisitions / divestments, this should see Fonterra preserve its LTA debt targets comfortably below 2.5x debt / EBITDA and 35% gearing levels. We also expect that retaining the current high investment grade rating will be a key priority to ensuring these target ratios are maintained.

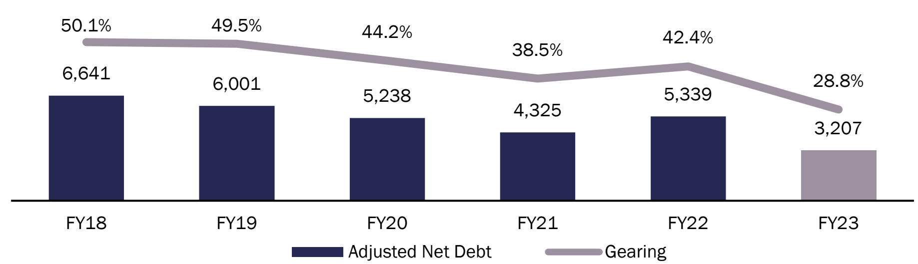
FY18 – FY23 Free Cash Flows & Net Debt Bridge[1] (NZ$ million)



Debt / EBITDA[2]



Net Debt (NZ$ million) and Gearing[3] (%)



[1] Publicly available Fonterra information and Northington estimates

[2]Calculated as Adjusted Net Debt / Normalised EBITDA
[3]Calculated as Adjusted Net Debt / (Adjusted Net Debt + Equity (excluding cash flow hedge reserve))

Competition for NZ Milk and Shareholder Flexibility

Fonterra's recent capital structure changes should support greater flexibility for farmers while maintaining Fonterra's competitiveness for milk supply and ensuring the financial sustainability of the Co-op.

Given that Fonterra's revised strategy is designed to optimise the value of NZ milk volumes, maintaining stability in its future milk volumes will be critical to future performance. Fonterra's NZ milk collections have been relatively stable over the last five years, an outcome that is consistent with the overall market levelling off in terms of total milk production. This has resulted in Fonterra maintaining ~79% market share since FY21. Long-term NZ milk volumes are also expected to remain broadly consistent with the current level, but with the potential for further small declines.

The potential for increased competition, including from new market entrants, could however impact on Fonterra's milk volumes. Any further declines would generate excess processing capacity and could have a negative impact on margins.

Recent changes to the minimum required shareholding (as outlined in the Appendix on page 39) should support a more sustainable supply of milk, particularly in an environment of increased competition from competitors who may not require farmers to invest capital to support supply (i.e. buy shares). However, restricting share trading to meet Fonterra's new minimum required shareholding in the farmer-only market means that farmers now set the price for shares and this has resulted in a larger disconnect between the Fonterra share price and the FSF unit price (currently a ~25% difference)[1]. See page 37 for a recent history of relative prices between the shares and units.

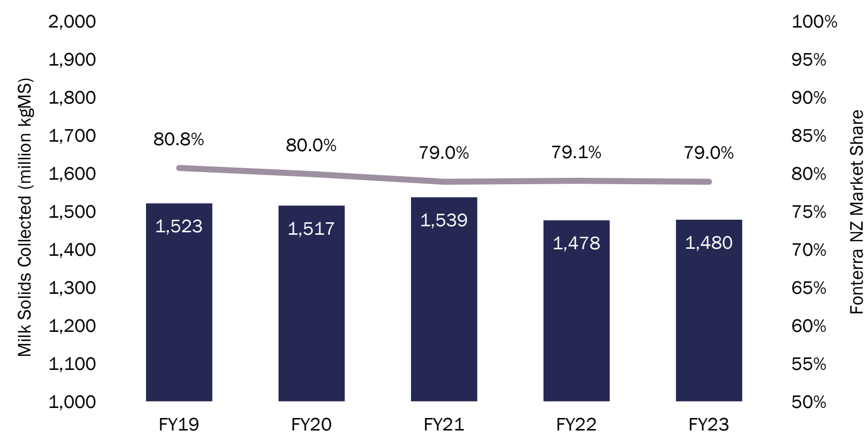
While the changes to the minimum required shareholding reduce the investment needed by farmers to continue to supply Fonterra, the investment in FCG shares remains material even at the minimum level. Fonterra must therefore ensure that the shares deliver long-term returns in line with the level of required investment and the risk profile of the business. The shares must be seen as a compelling, standalone investment opportunity rather than just a cost of remaining with the Co-op.

Any future loss of milk supply volumes could limit future earnings growth, but we also expect that it may provide some potential benefits, including:

- Reducing the requirement for Fonterra to collect milk from farmer suppliers that may be of marginal profitability (i.e. sub-optimal from a cost or volume basis, for instance, due to location and size); and
- Reduce the need to invest in processing capacity or provide the opportunity to shutdown marginal processing capacity and avoid capacity duplication with other milk processors.

Taking all factors into consideration, we consider that Fonterra's future collection volumes may decline further (through either or both of declines in total market collections and increased competition), but the net earnings impact may be limited and more than offset by Fonterra's other strategic objectives.

Fonterra NZ Milk Collections and Market Share



[1] *As at 10 October 2023*

Future Earnings and Dividends

We expect that future earnings and dividends could be more stable if Fonterra's NZ milk and value-add strategy is successfully implemented, but with long-run variability ultimately driven by the price relativities between Reference and Non-Reference Products.

Fonterra's recent earnings profile has been relatively volatile, with much of this variability attributable to not only price relativities, but also the underperformance in the businesses which Fonterra has subsequently divested (e.g. China Farms and Beingmate).

With an increased focus on Core Operations utilising NZ milk, we would expect some reduction in earnings variability. However, year-to-year earnings will continue to be significantly influenced by the price relativities for Reference and Non-Reference Products. Other key factors contributing to Fonterra's future earnings performance will include:

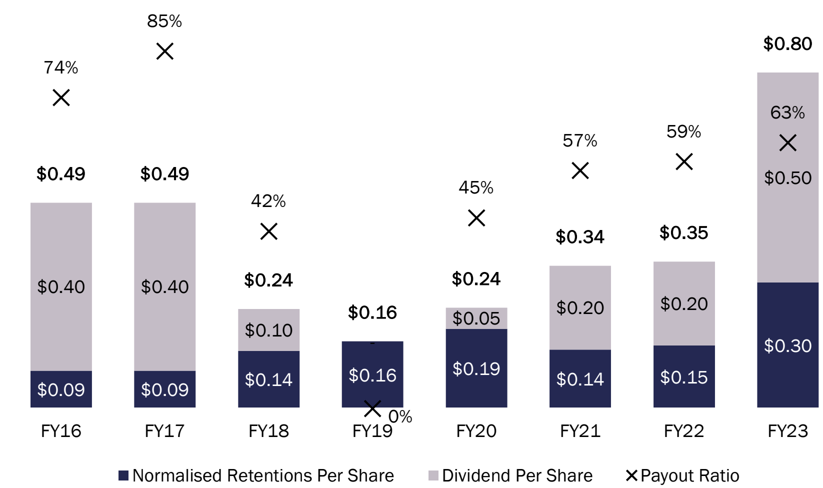
- Fonterra's success in achieving its target of delivering $1 billion in overhead and manufacturing cost savings (equivalent to ~62 cents per share on a pre-tax basis[1]);
- The ability to source new growth investments expected to average ~$250 million per year and those growth investments achieving their target returns. Based on the combined impact of Fonterra's target return on capital of 9% - 10% and the level of expected growth capital investment, post-tax returns could increase by >$150 million by FY30 (>10cents per share);
- Execution of the value-add strategy from both increasing volumes of Non-Reference Products and increasing brand equity (supporting higher margins in the Active Living, Foodservice and Consumer channels); and
- Market factors including global demand for milk proteins and the performance of Fonterra's international operations, particularly Australia and Asia.

We believe the business should be capable of generating "stabilised" EPS >45 cents over the short-term relative to FY24 guidance of 45 – 60 cents and a 5-year historic average of ~38 cents. Variability around this level will depend on annual price relativities. Long-term performance will largely hinge on Fonterra's ability to deliver on its strategic targets (as noted earlier), which provide the potential for Fonterra to more than double normalised EPS by FY30.

In line with the significant EPS variability, Fonterra's recent dividends have been highly volatile. As summarised in the chart below, dividends have varied between nil in FY19 and 50 cents in FY23 (excluding capital returns / special dividends). The current dividend policy was introduced in FY19, and is based on a target of distributing between 40% – 60% of reported profit after tax but excluding abnormal gains.

Increased EPS stability along with a relatively broad dividend payout range and increased financial capacity to debt fund capital expenditure (from reduced debt levels) should support Fonterra's ability to provide greater dividend consistency to shareholders. Based on FY24 earnings guidance and our assessment of normalised EPS, short-term dividends >25 cents per share should be maintainable, albeit with annual variability through any abnormal price relativities. We note that based on current pricing for FCG shares and FSF units, a dividend of 25 cents translates to a current cash yield of over 11% and 8% respectively[2].

Normalised Earnings Per Share and Payout Ratio



[1]*Based on the ~1.61 billion shares currently on issue*

[2] *As of 10 October 2023*

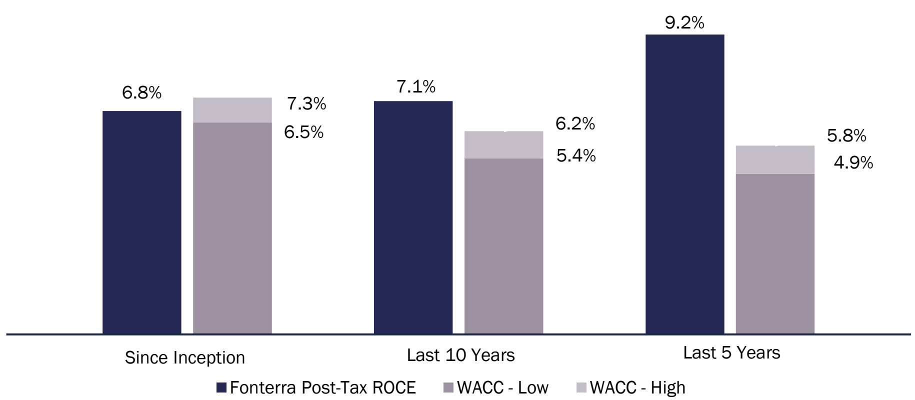
Return on Capital

Fonterra is seeking to improve returns on its invested capital by increasing earnings from a smaller, more focused capital base. We expect that improved investment disciplines and greater contributions from Fonterra's value-add strategy should increase returns to be more commensurate with its risk profile.

As noted on page 9, Fonterra's return on capital has improved from 6.8% in FY22 to 12.4% in FY23. There has been particularly strong improvement across the Ingredients and Foodservice channels and continued weak performance in the Consumer channel. Over the longer term, average returns have continued to trend upwards, with recent returns now typically exceeding the return requirements expected for Fonterra's relative risk profile (i.e. its risk-adjusted cost of capital). These results are summarised in the chart below, showing an estimate of Fonterra's average ROCE for the last 5 years, the last 10 years and since inception in 2001. Actual returns are compared to our assessment of Fonterra's weighted average cost of capital ("**WACC**"), which varies over the period primarily due to interest rates.

While the increased reporting on returns by channel are a welcome new metric, it would be useful to also understand Fonterra's returns by segment, particularly at a NZ and Australia regional level, to better assess performance and capital allocation decisions. Fonterra's Australian operations were recently reviewed as part of the broader strategy to focus on NZ milk and, while the decision was made to retain the Australian business, improved transparency on its performance and the decision to retain the business would be useful.

Northington View of ROCE[1] and WACC (%)

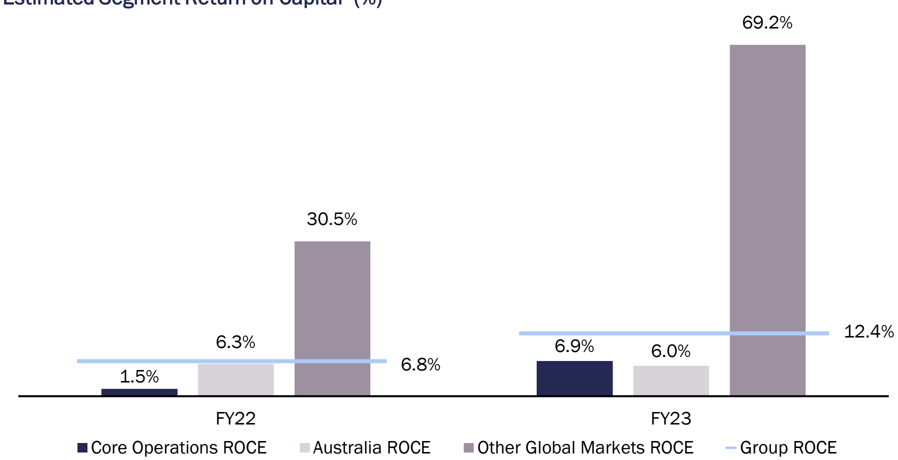


[1] Our calculation of Group ROCE differs to Fonterra. We use reported EBIT (as opposed to Normalised EBIT) and the market value of equity (as opposed to book value) in our assessment of capital employed.

Based on Fonterra's new disclosures, we have sought to independently assess ROCE performance on a segment basis across Core Operations (NZ), Australia and other global markets. Our approach uses the percentage of total fixed assets employed in each geographic region as a proxy for the relative weighting of total capital employed to each segment.

The chart below summarises the results, demonstrating that the return on Core Operations has increased significantly from 1.5% to 6.9% between FY22 and FY23, Australia has maintained returns just over 6% while the remaining global operations have delivered a strong performance in both years. While the global operations performance is not unexpected and largely reflects the small amounts of capital investment in these regions (now primarily working capital following the sale of China Farms and assets in the Americas), the Australian return on capital remains low relative to Group performance and our estimate of the expected return requirements. Consequently, we would expect to see improved performance in Australia to support Fonterra's decision to retain the business and invest further capital into this market.

Estimated Segment Return on Capital[2] (%)



[2] Northington analysis based on post-tax segment EBIT and geographic grouping of non-current assets as a proxy for the proportion of total capital employed.

Sustainability Targets

Fonterra is investing significantly into sustainability initiatives across the supply chain to showcase the NZ sustainable milk story. Along with its financial strategy, this should support top and bottom-line growth in a market where customers also have high sustainability goals.

Fonterra has established a strategy to be a leader in sustainability. It has also established a range of targets in support of its goals, as summarised below. Fonterra has committed ~$1 billion of investment to support its sustainability initiatives over the next decade. The sustainability strategy aligns with Fonterra's customers who have established emission reduction targets and are seeking sustainably sourced milk. The number of customers seeking supply chain reduction commitments has increased dramatically in recent years.

A significant portion of Fonterra's customer emissions come from their supply chain, many of whom now have ambitious sustainability goals for net zero emissions by 2050 (if not earlier). While Fonterra can do its part through climate initiatives at the factory and indirectly via organisations that it uses in production (Scope 1 and 2 emissions), more reductions are expected on-farm (Scope 3). Although Fonterra has not yet established Scope 3 emission reduction targets, it is expected to do so before the end of CY23. It is expected that Fonterra will work with its farmers to understand their emission profile and ways to reduce or mitigate those emissions. In the short-term, this is likely to be through improved animal health and wellbeing, nutrient optimisation and on-farm efficiencies. However, new innovations and technological solutions will be required longer term – Fonterra has also committed to investment that supports these goals, including through R&D.

We expect that Fonterra's performance against its sustainability targets, including for Scope 3 emissions on-farm, will have a significant influence on Fonterra's long-term financial performance. While it is hard to determine what "sustainability premium" Fonterra and farmers may receive for the investment required to support the sustainability goals, without the investment Fonterra may simply lose customer and consumer confidence which could significantly undermine the business. The carbon footprint of NZ's on-farm milk supply is amongst the lowest in the world – maintaining this edge will be essential to preserving Fonterra's competitive advantage.

	Metric	Actual FY22	Actual FY23	Scorecard FY24	Targets
Climate Change	Scope 1 & 2 GHG emissions relative to FY18 baseline levels	(11.2)%	(14.1)%	(15.6)%	• 50% reduction in manufacturing emissions by 2030 • 100% by 2050 (net zero)
	Scope 3, on farm, GHG emissions reduction target	Not Available			• Targets expected by end of calendar year 2023
	Coal usage	Not Available			• Stop using coal by 2037
Land & Water	Fonterra farm environment plan adoption rate (NZ)	71%	85%	92%	• 100% by 2025
	Fonterra water usage	Not Available			• Reduce water usage at manufacturing sites by 30% by 2030
	Water improvement plans in place	Not Available	44%	100%	
Packaging & Waste	Packaging	56%	63%	Not Available	• 100% reusable, recyclable or compostable packaging by 2025
	Waste	33% reduction since FY19	46% reduction since FY19	Not Available	• Zero solid waste to landfill

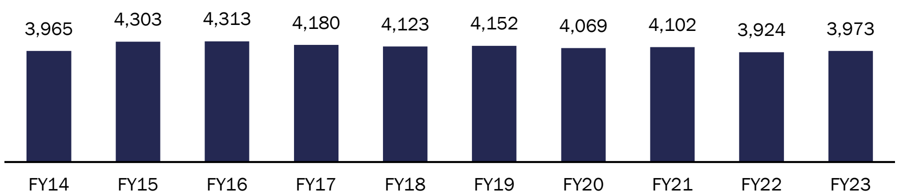
Appendix – Supporting Information

FY23 & FY24 Integrated Scorecard

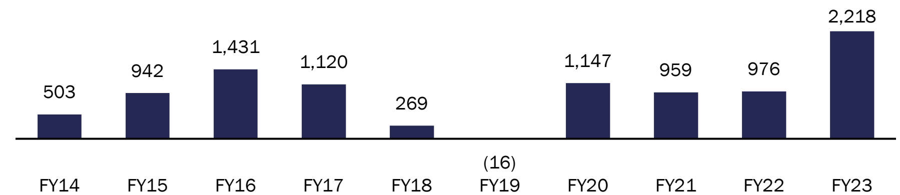
	Key Performance Indicator (KPI)	FY21 Actual	FY22 Actual	FY23 Target	FY23 Actual	FY24 Scorecard
People	Serious harm	9	8	5	**5**	*4*
	Gender diversity (Band 12+)	36.3%	37.6%	38.8%	**39.5%**	*40.0%*
	Culture Measure	n/a	-	n/a	**79**	-
Nature	GHG emissions (Scope 1,2)	(6.6%)	(11.2%)	(10.6%)	**(14.1%)**	*(15.6%)*
	FEP adoption (New Zealand)	53%	71%	84%	**85%**	*92%*
	Water Improvement Plans in place	-	-	37.5%	**44.0%**	*100.0%*
Relationships	Share of New Zealand milk collected for the season to 31 May	79.0%	79.1%	79.0%	**79.0%**	*79.0%*
	Delivered in full, on time (DIFOT, ex-New Zealand)	n/a	51.6%	n/a	**53.2%**	*80.0%*
Financial / Assets & Infrastructure	Cash operating expenses per kgMS (real)	n/a	1.34	n/a	**1.39**	*1.37*
	Gross profit from Core operations per kgMS (real)	n/a	8.83	n/a	**9.21**	*8.52*
	Return on capital	6.6%	6.8%	7.0% - 7.5%	**12.4%**	*8.0% - 9.0%*
	Farmgate Milk Price ($)	7.54	9.30	9.50	**8.22**	*6.00 – 7.50*
Alignment Rights	Total shareholder return (share price plus dividend)	n/a	$2.73 ($0.20)	n/a	**$3.20 ($1.00)**	*No Target*
	On-farm profitability ($ per hectare)	n/a	4,150	n/a	**2,063**	*No Target*

Historical Financial Information

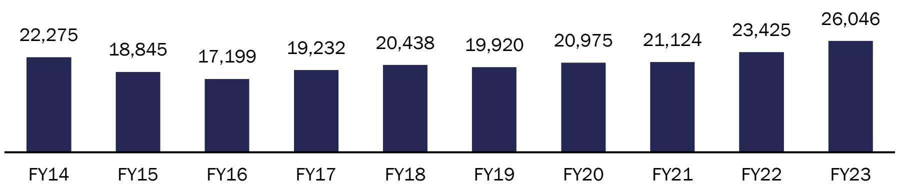
Sales Volume ('000 MT)



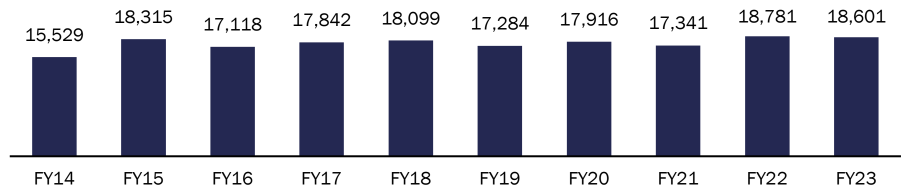
Reported EBIT (NZ$ million)



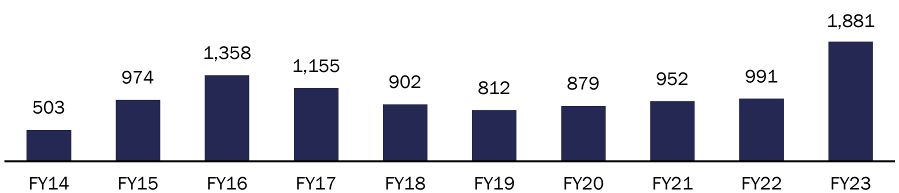
Revenue (NZ$ million)



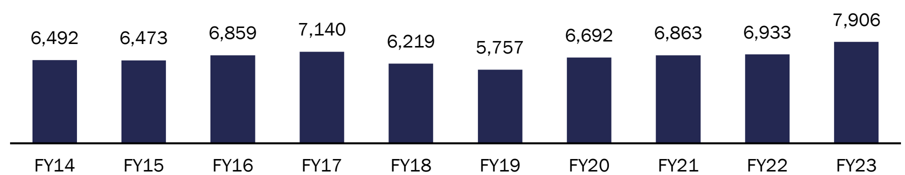
Total Assets (NZ$ million)



Normalised EBIT (NZ$ million)



Total Equity (NZ$ million)[1]

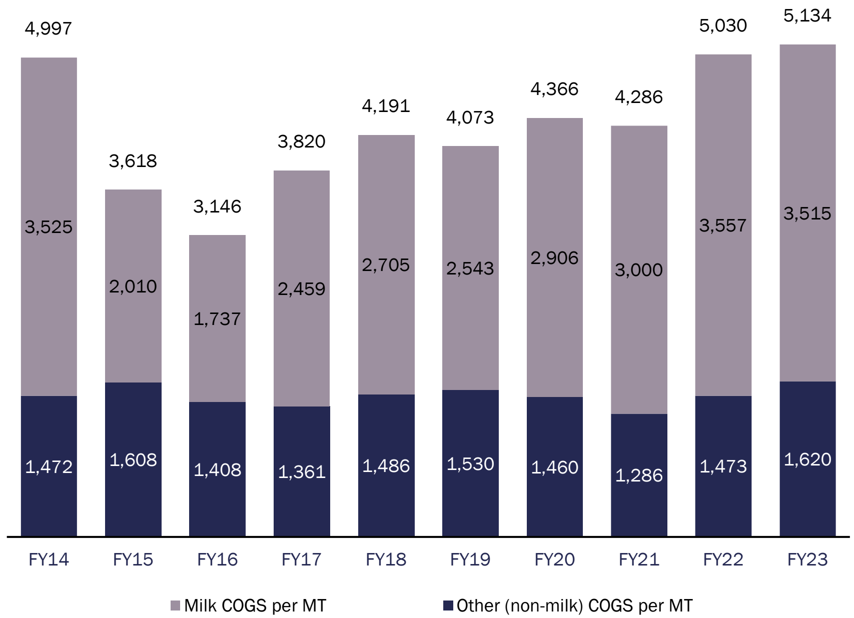


[1]*Excluding minority interests*

Note: Includes continued & discontinued operations where known.

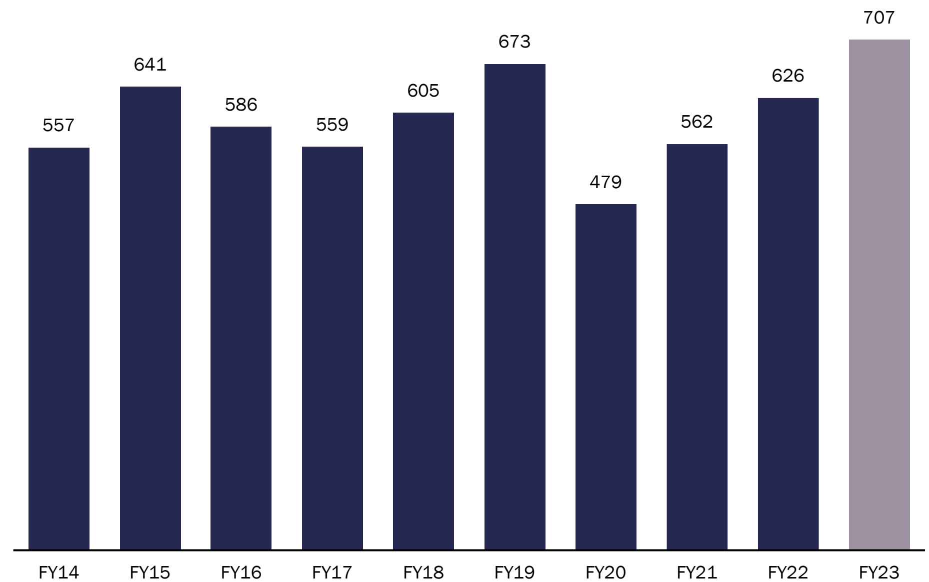
Production & Operational Efficiency

Cost of Goods Sold per MT[1]



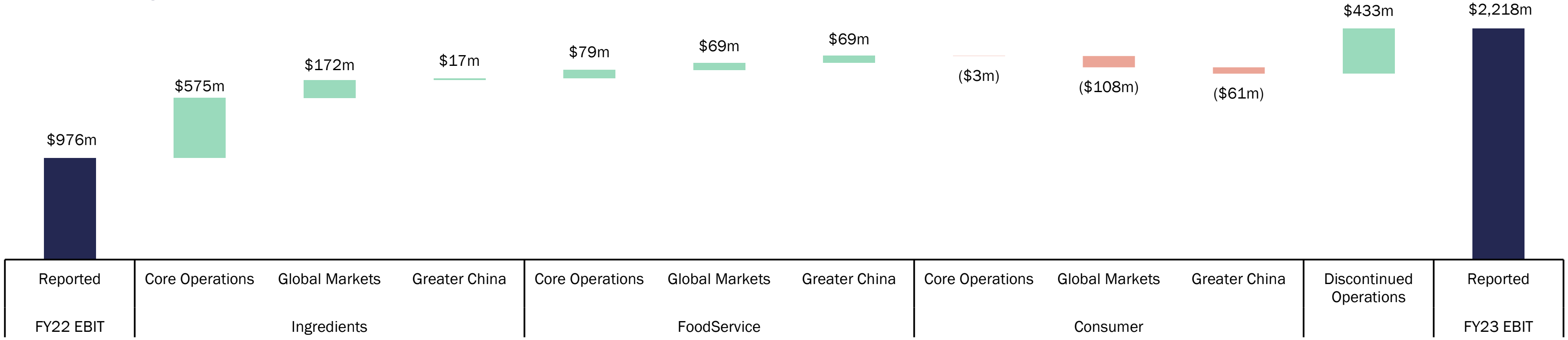
[1]*Impact of inventory movements on cost of goods sold have been spread pro-rata across Milk COGS and Other COGS.*

Operating Expenses per MT

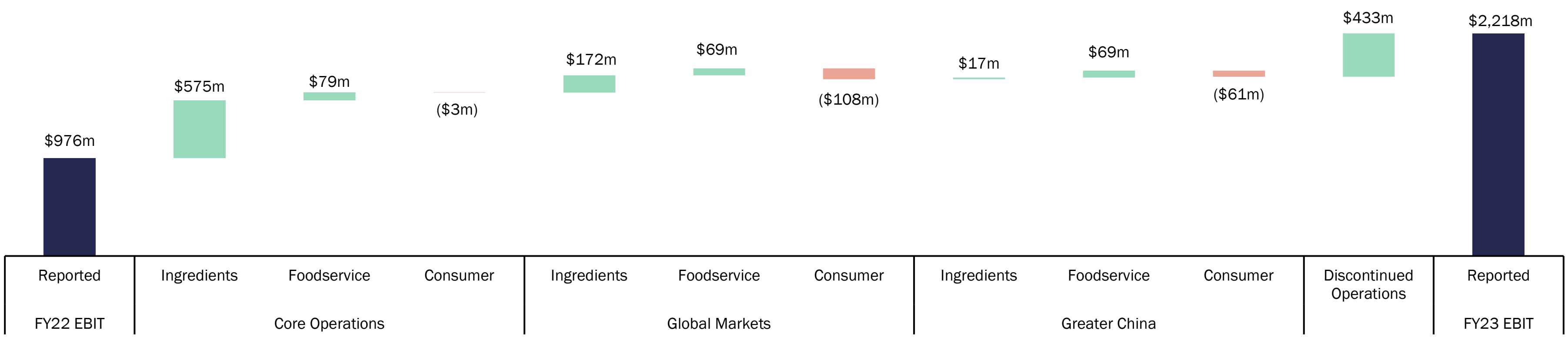


EBIT Bridge by Channel and Segment

Reported EBIT Bridge by Channel



Reported EBIT Bridge by Segment



Summary of Normalisations

Impact of FY23 Normalisations

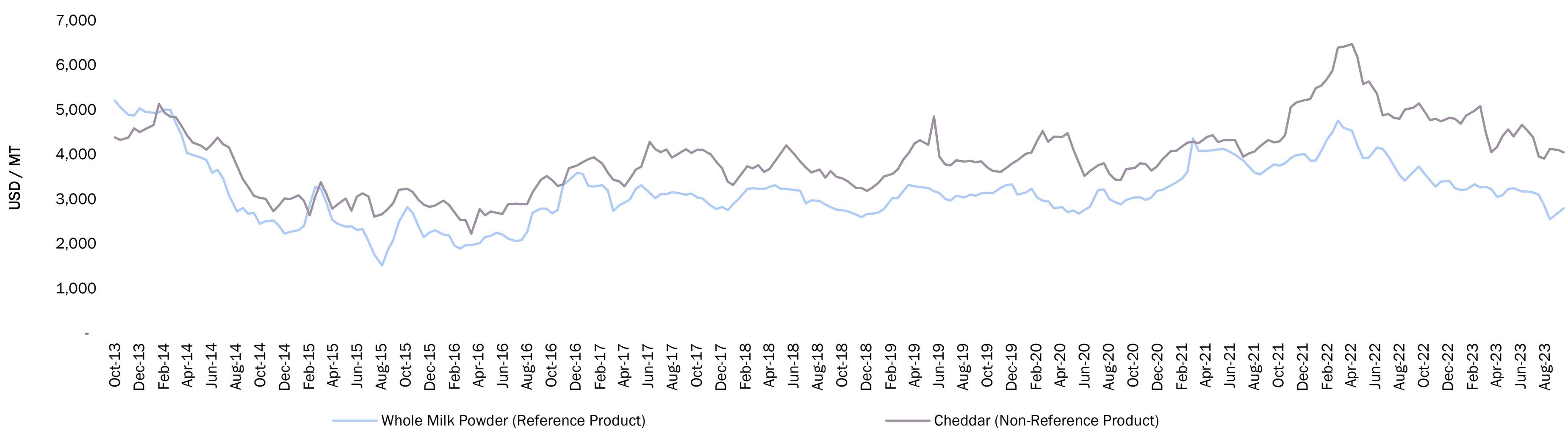
Item	Impact on EBIT		Impact on Gearing	
Gain on Sale of Soprole	▲	$349m gain on sale	▼	Sale proceeds reduce Net Debt, although this was offset by the one-off $804m capital return. The gain on sale increases Equity.
Gain on Sale of Hangu China farm	▼	$12m loss on sale for the 100% owned subsidiary.	▼	Sale proceeds reduce Net Debt, while the loss on sale decreases Equity. Given current gearing levels the net impact should be a reduction in Gearing.

Normalisation Adjustments to EBIT

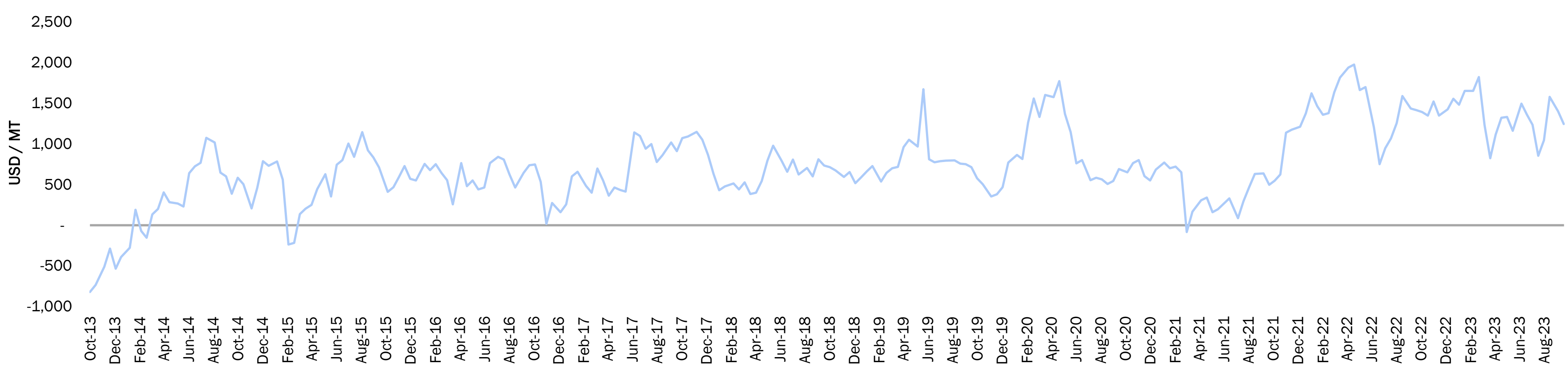
NZ$ million	FY20	FY21	FY22	FY23
Disposals	$543m	$23m	$42m	$337m
Impairment	($232m)	($16m)	($57m)	
Other / Strategy	($43m)			
Total	**$268m**	**$7m**	**($15m)**	**$337m**
Reported EBIT	**$1,147m**	**$959m**	**$976m**	**$2,218m**
Normalisations	($268m)	($7m)	$15m	($337m)
Normalised EBIT	**$879m**	**$952m**	**$991m**	**$1,881m**

Long Term Reference vs Non-Reference Price Relativities

Reference vs Non-Reference Price Relativity Proxies



Price Margin between Reference and Non-Reference Proxies

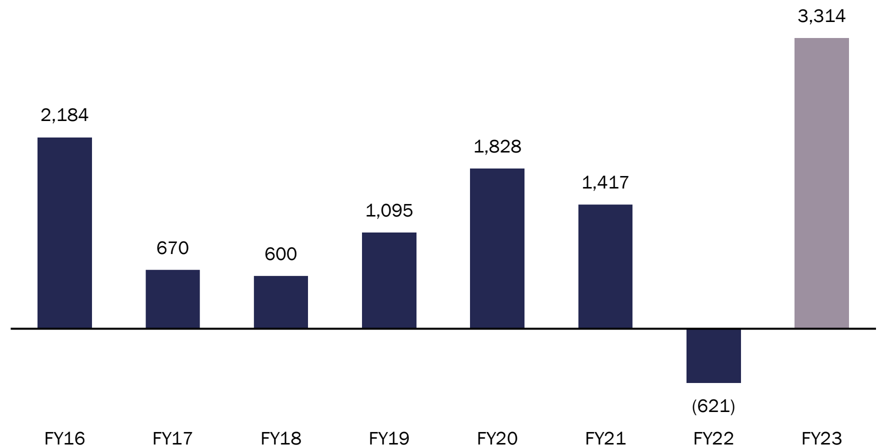


Source: GDT

Free Cash Flow

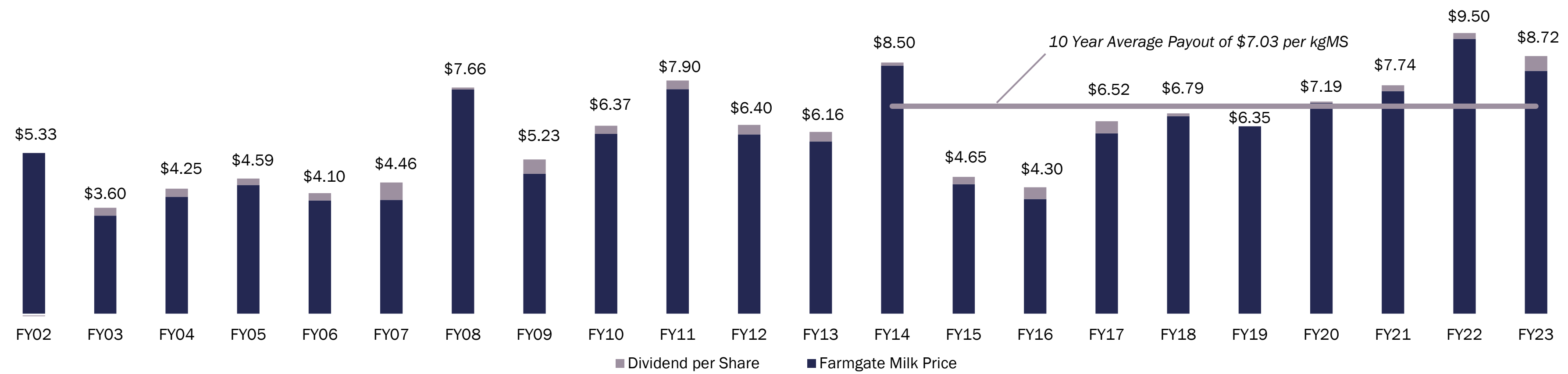
NZ$ Million	FY22	FY23	*% Change*
Profit before Finance and Tax	976	2,218	*127%*
Adjustments	952	502	*(47%)*
Change in NWC	(1,598)	871	*(155%)*
Interest & Taxes Paid	(434)	(409)	*(6%)*
Cash Flow from Operations	**(104)**	**3,182**	***n/a***
Divestments & Asset Sales	26	846	*3154%*
Capital Expenditure & Other	(543)	(714)	*31%*
Cash Flow from Investments	**(517)**	**132**	***(126%)***
Dividends Paid	(323)	(403)	*25%*
Capital Return Payable		-804	*n/a*
Other Financing Cash Flows	(70)	25	*(136%)*
Cash Flow from Financing	**(393)**	**(1,182)**	*201%*
Net Cash Flow	(1,014)	2,132	*(310%)*
Free Cash Flow (Operating & Investing)	**(621)**	**3,314**	***(634%)***

Free Cash Flow (NZ$ million)

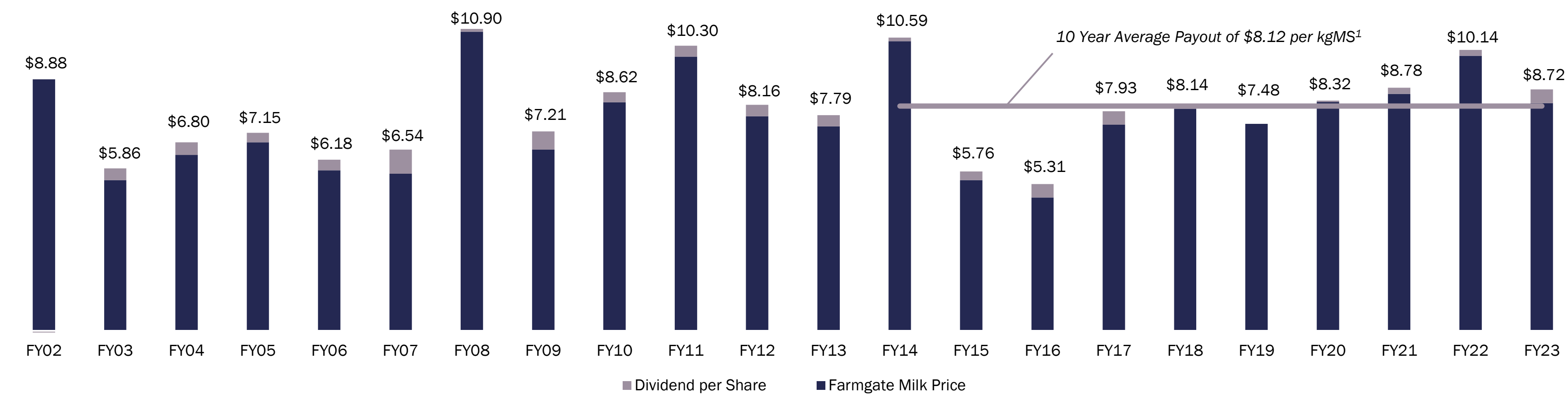


Historical Total Payout

Total Payout (Nominal NZ$ per kgMS)



Total Payout[1] (Real NZ$ per kgMS)



Figures reflect the average payout for a 100% share-backed supplier.
[1]Adjustment made based on CPI average during relevant period, reflects price in today's dollars

Total Shareholder Returns Since Inception

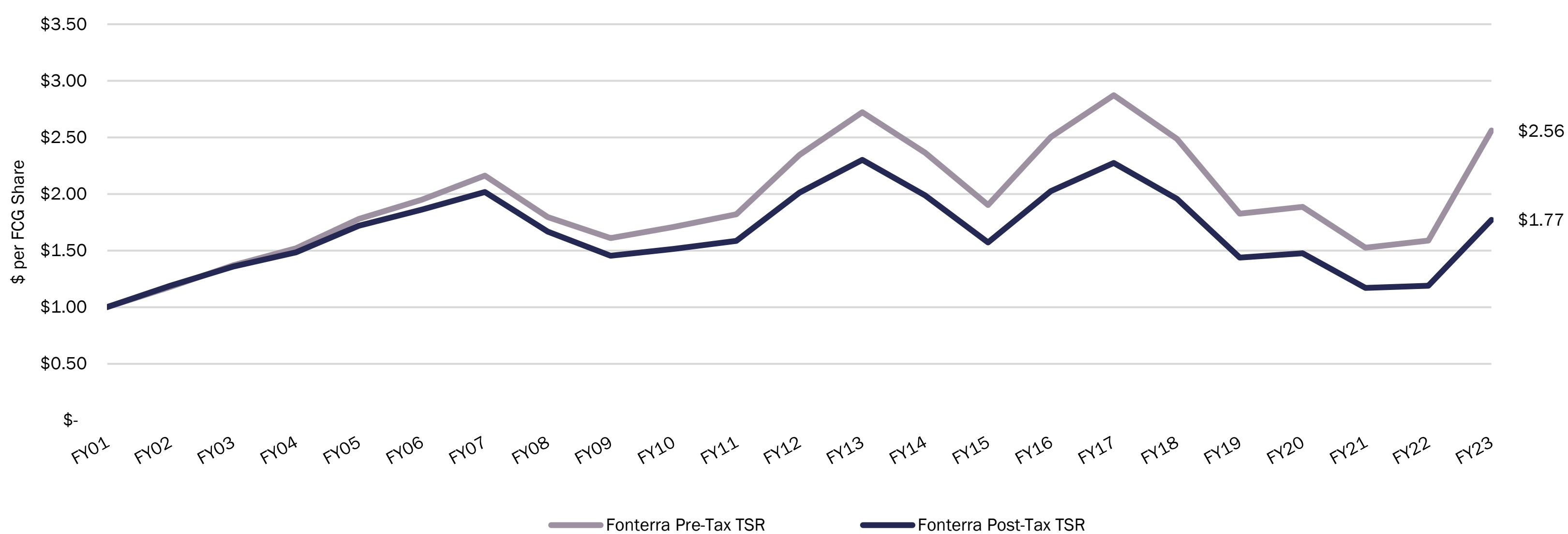
The below chart identifies the current value of $1.00 invested in Fonterra Co-operative Group at its inception in 2001.

Including the 50c one-off tax-exempt capital return, values at the end of FY23 were $2.56 on a pre-tax basis ($1.85 post-tax), equivalent to a 4.3% pre-tax CAGR[1] (2.8% post-tax). Without the inclusion of the capital return these values were $2.21 on a pre-tax basis ($1.58 post-tax), equivalent to a 3.6% pre-tax CAGR[1] (2.1% post-tax).

The pre-tax total shareholder return for the full FY23 year was +61%, a material increase from 4% in FY22. This outcome for FY23 reflects a 17.2% increase in share price over the year (from $2.28 to $2.67), an effective 22% return from the capital return and a 22% dividend yield on the opening share price.

The annualised TSR in the last five years is 0.6% and -1.2% on a post and pre tax basis, respectively[2].

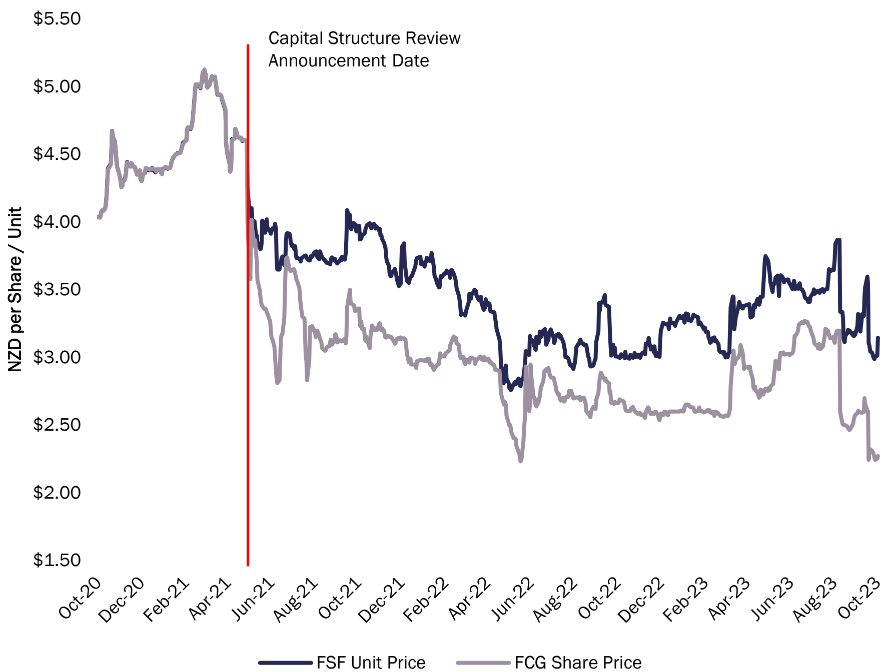
Investment Value of $1 Invested in Fonterra at Inception



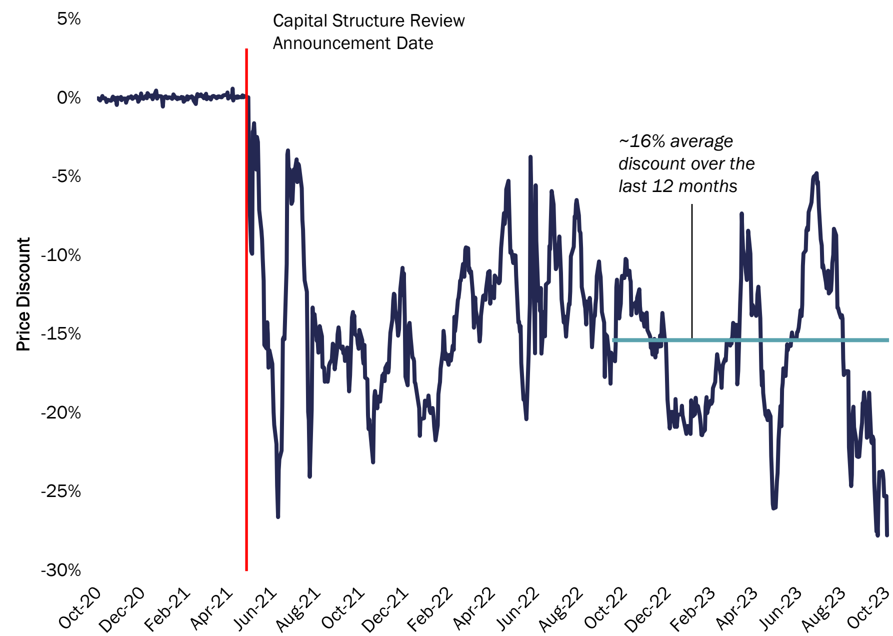
[1]*CAGR = Compound annual growth rate.*
[2]*Share price taken from FYE2017 (31/07/17)*

FSF and FCG Share Price Comparison

Daily Share Price Comparison[1]



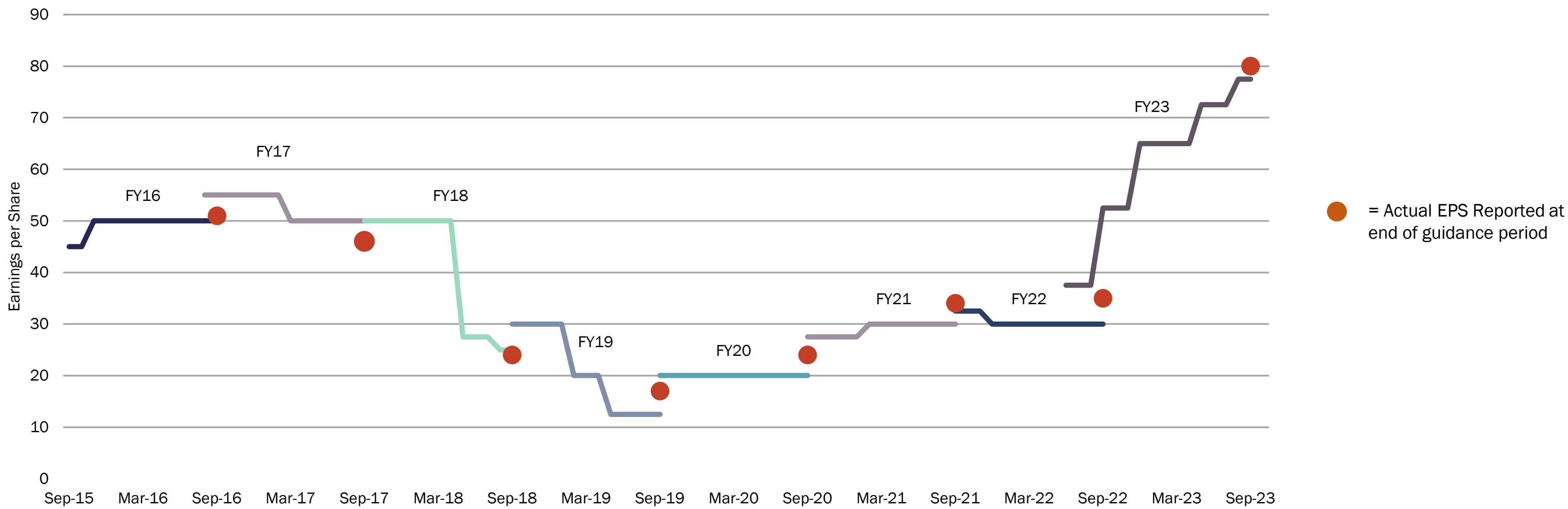
Discount of FCG Share Price to FSF Share Price[1]



[1]Uses daily volume-weighted average price (VWAP). Source: Fonterra

Historical Earnings per Share Performance vs Guidance

Historical Earnings Per Share Guidance Midpoint vs Actual Reported



Flexible Shareholding Summary

A new Flexible Shareholding structure came into effect during FY23. The key changes between the old structure and the new structure are summarised in the table below.

Key Items	Old Structure	New Structure
Increased flexibility	Share minimum: 1:1 / 100%	Share minimum: 1:3 / 33%
Move to a farmer-only market with the Fund capped	Shares and units traded and exchanged between FSF and FCG.	Capped FSF, can only transfer shares into units
More types of farmers can hold shares	Supplying Farmer owners and sharemilkers if transferred	Addition of associated sharemilkers, contract milkers and farm lessors.
Entry provision eased	Up to 3 seasons to exit Share-up & My Milk offered	Up to 6 seasons to exit No Share-up & My Milk
Exit provisions extended	Up to 3 seasons to exit, minimum 1/3 per year.	Large extension for current and new supplying farmers.
Same voting rights	1 vote per 1000 kgMS supplied (share-backed)	1 vote per 1000 kgMS supplied (share-backed)

Since Flexible Shareholding came into effect on 28th March 2023, there hasn't been any material change to the Group's shareholding structure. As at 31st July 2023, the Group was well within the specified thresholds for all three Flexible Shareholding metrics:

Metric	As at July 2023	Threshold
Total Shares on Issue above the aggregate Share Standard	12.22%	+/- 15.00%
Shares Held by Ceased Shareholders and Permitted Transfers	9.23%	≤ 25.00%
Shares held for the Fonterra Shareholders' Fund ("Overall Limit")	6.67%	≤ 15.00%

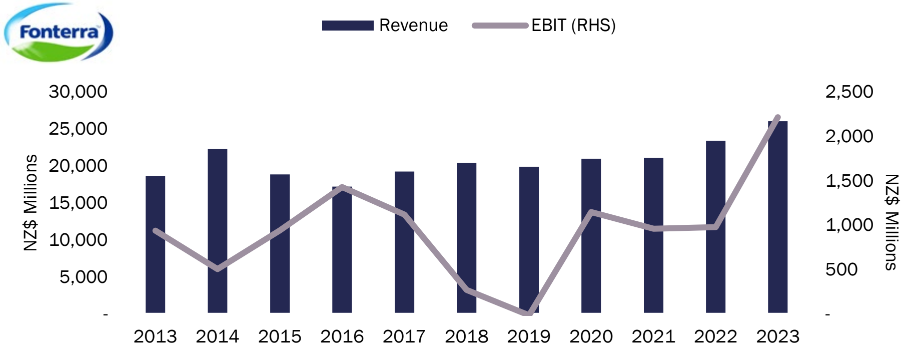
Comparable Company Performance

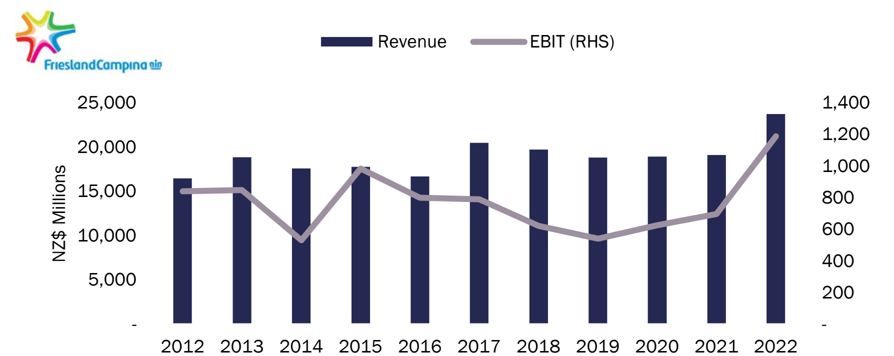
Fonterra is very different to other entities operating in the NZ dairy sector and to overseas dairy co-ops and companies. This is due to a range of factors including the DIRA regulatory regime, scale and product mix. Arguably the most comparable entities to Fonterra can be found overseas. This includes Arla and Friesland Campina, which are both farmer co-operatives (based in Denmark and the Netherlands respectively) with substantial commodity and consumer operations. However, neither company is subject to the same regulatory regime as Fonterra.

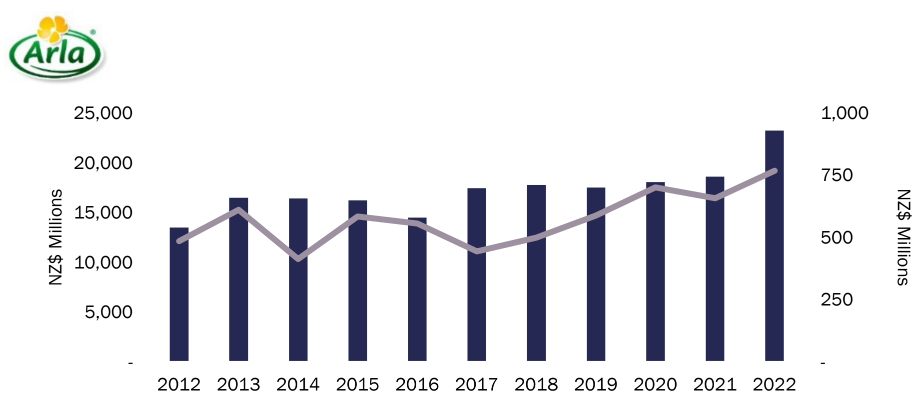
The comparisons on the following pages provide a high-level overview of revenue and earnings over time for companies in both dairy ingredients and value-add sectors, along with a single 'point in time' view of summary financial ratios. It is important to note that these comparisons do not take into account the differing mix of core dairy ingredients and value-add divisions for each company, which is a key driver of the differing margins and gearing.

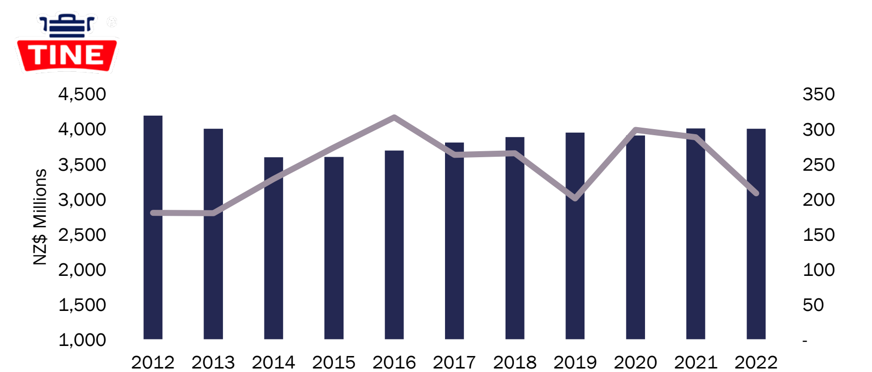
They also do not take into account different regulatory regimes for the other dairy co-operatives and the impact such regimes may have on margins, capital investment required and ultimate returns. Finally, the performance trends over time all reflect the currency exchange rates at the relevant time, and relative changes in those rates may affect the values presented.

Dairy Co-ops





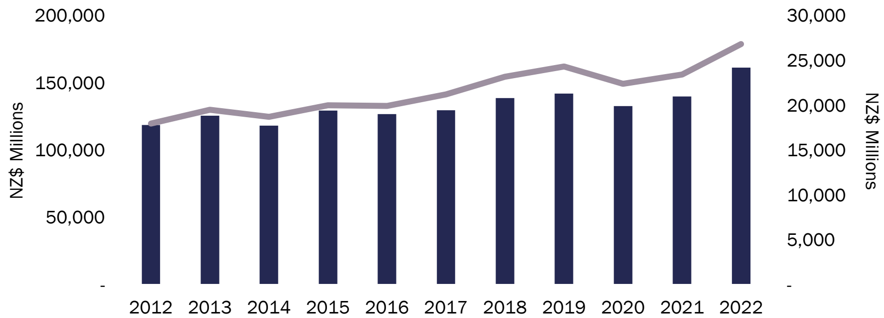


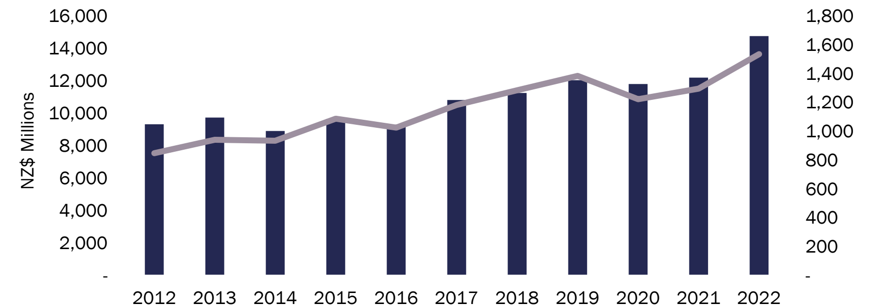


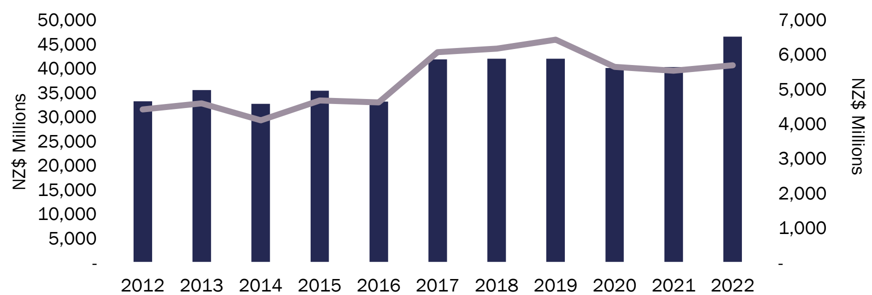
All figures are quoted in New Zealand dollars unless otherwise stated. Figures sourced from Capital IQ and Annual Reports.
Note: Companies presented here have a December financial year end compared to Fonterra's July year end.

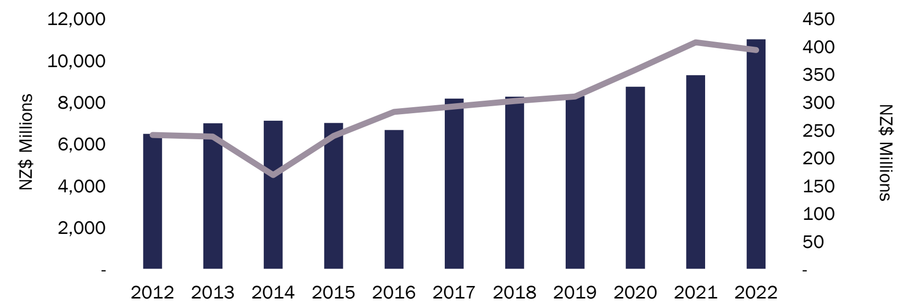
Comparable Company Performance (Continued)

Dairy Companies









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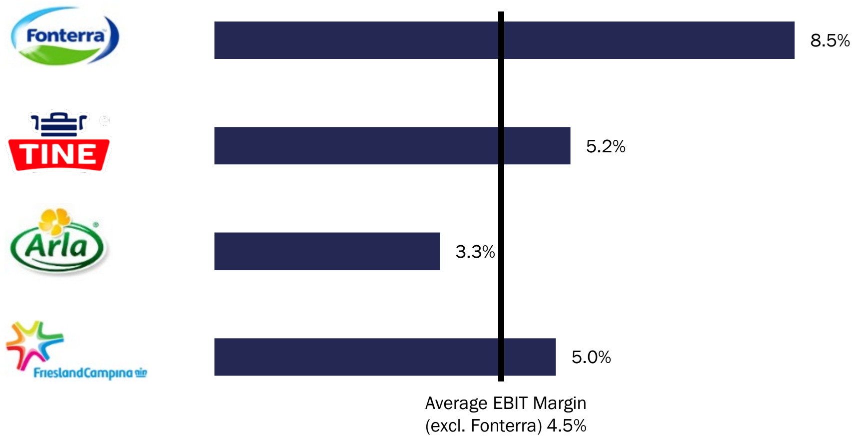
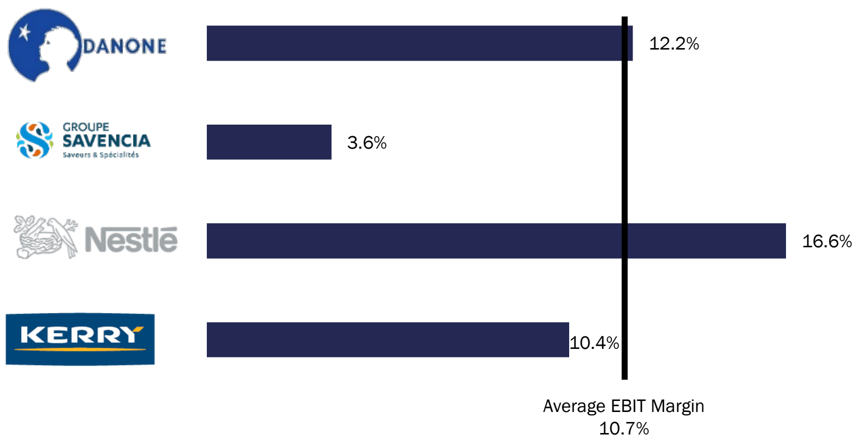
Note: Companies presented here have a December financial year end compared to Fonterra's July year end.

EBIT Margin

Dairy Co-ops

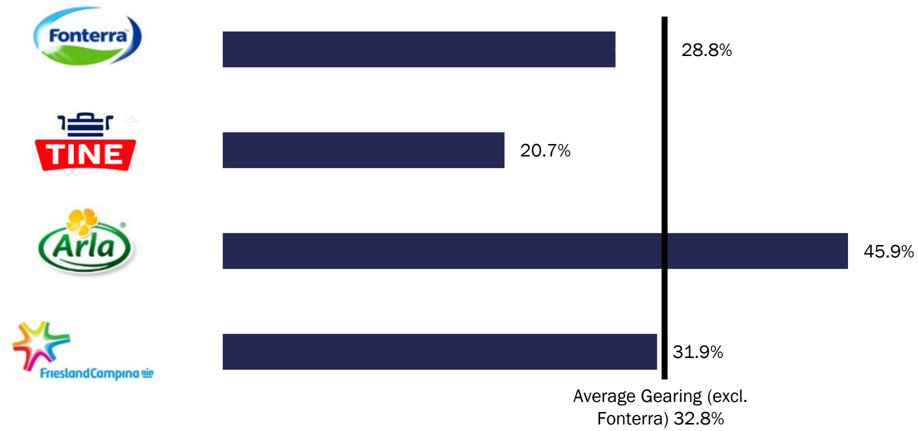


Dairy Companies

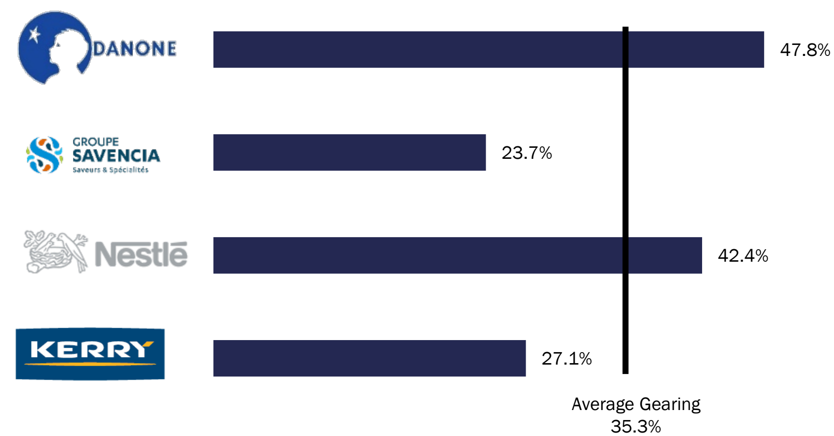


Gearing Ratio

Dairy Co-ops



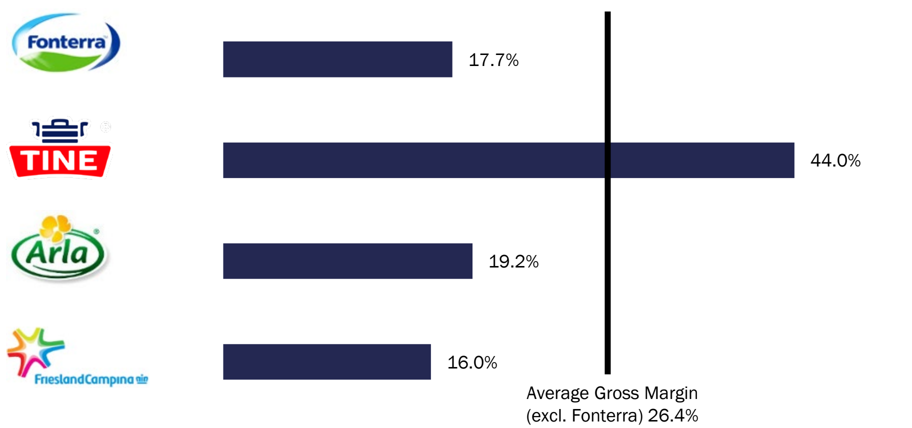
Dairy Companies



All figures are quoted in New Zealand dollars unless otherwise stated. Figures sourced from Capital IQ and Annual Reports.
Note: Companies presented here have a December financial year end compared to Fonterra's July year end.

Gross Margin

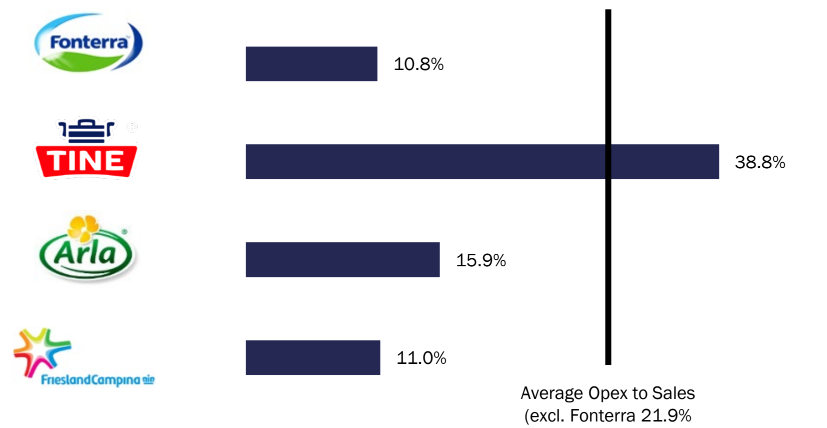
Dairy Co-ops



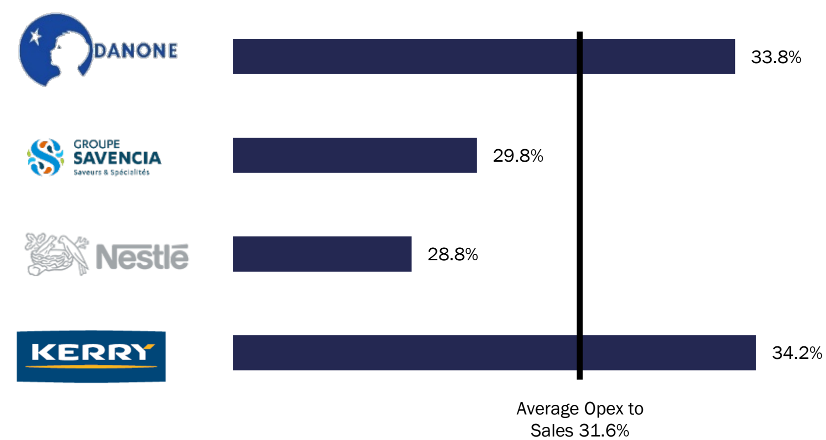
Dairy Companies

Operating Expenses to Sales

Dairy Co-ops



Dairy Companies

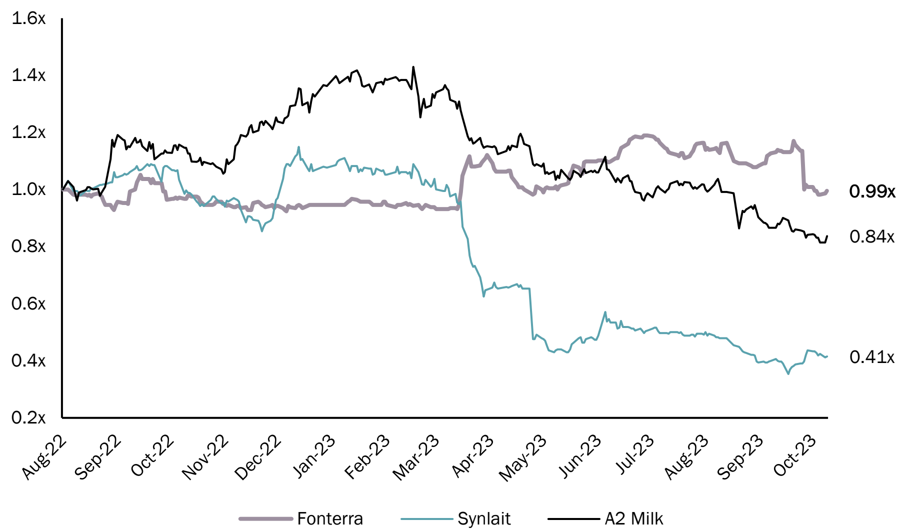


All figures are quoted in New Zealand dollars unless otherwise stated. Figures sourced from Capital IQ and Annual Reports.
Note: Companies presented here have a December financial year end compared to Fonterra's July year end.

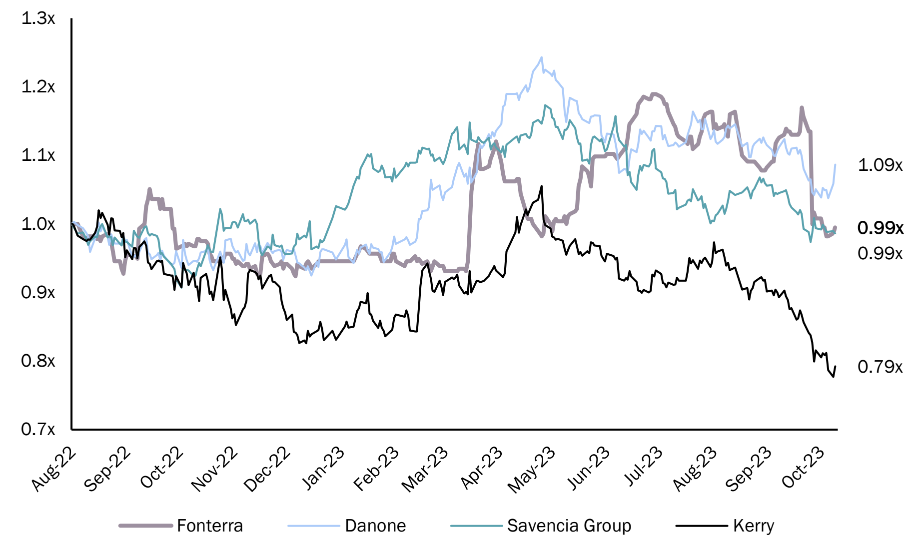
Share Price Performance – Dairy Competitors

- The share price data below provides comparisons to New Zealand and international dairy competitors to illustrate the performance of Fonterra's share price against some of the company's peers.
- Fonterra is the only entity within our Co-op set that is both a co-operative and a publicly listed company, therefore comparison of market pricing has only been completed against other publicly listed companies. Similar to prior analysis, it is important to note that this does not take into account any regulatory differences or local market conditions that may ultimately impact share price data. It also excludes dividends paid to shareholders or unitholders.
- The below chart demonstrates the current share price of Fonterra and its competitors in comparison to their share price at the start of FY23 (1 August 2022). Fonterra's final position of 0.99x indicates that the share price is currently at 99% of its opening price ($2.29 opening vs $2.28 closing).

New Zealand Dairy Manufacturers



Global Dairy Competitors



Daily price information has been rebased in NZD to 1/08/22 for comparability between share price and local currency.
Source: CapitalIQ as at 10 October 2023, Fonterra share price is represented by FCG.NZ

Abbreviations & Definitions

Term	Definition
AMENA	Represents the Ingredients, Foodservice and Consumer channels in Africa, Middle East, Europe, North Asia and Americas
CAGR	Compound average growth rate
Capex	Capital expenditure
Co-op, Group or the Company	Fonterra Co-operative Group Limited
CY	Calendar year ending 31 December
DIRA	Dairy Industry Restructuring Act
DPA Brazil	Dairy Partners Americas Brazil
EBIT	Earnings before interest and tax
EBITDA	Earnings before interest, tax, depreciation and amortisation
EPS	Earnings per share
ESG	Environmental, social and governance
FCG	Shares in Fonterra Co-operative Group Ltd (FCG.NZ)
FGMP	Farmgate Milk Price
FSF	Shares in Fonterra Shareholders' Fund (FSF.NZ)
FY	Financial year ending 31 July
FX	Foreign exchange
GDT	Global Dairy Trade
kgMS	Kilograms of milk solids
LTAs	Long Term Aspirations
MT	Metric tonnes
NPAT	Net profit after tax
Non-Reference Products	Products that are not included in the calculation of the Farmgate Milk Price.
NWC	Net working capital
NZD	New Zealand dollars
PP&E	Plant, property and equipment
Reference Products	Includes commodity products and groups that are included in the calculation of the Farmgate Milk Price.
RHS	Right hand side (axis)
ROCE	Return on capital employed
SMP	Skim milk powder
TSR	Total shareholder return
USD	United States dollars
WACC	Weighted average cost of capital
WMP	Whole milk powder

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