MEDIA RELEASE

Fonterra
Dairy for life

25 September 2013

FONTERRA ANNOUNCES 2013 FINANCIAL RESULTS

Highlights

- Cash Payout $6.16, down 4 %
    - Farmgate Milk Price $5.84 per kgMS
    - Dividend of 32 cents per share
- Total sales volumes flat at 4 million metric tonnes
- Revenue $18.6 billion, down 6%
- Normalised EBIT $1 billion, down 3%
- Net profit after tax $736 million, up 18%
- Earnings per share 44c, up 7%

Annual Results

Fonterra Co-operative Group announced today a Cash Payout of $6.16 for the 2013 year for a 100 percent share-backed farmer, comprising a Farmgate Milk Price of $5.84 per kgMS and a dividend of 32 cents per share.

Chairman John Wilson said that while the Payout was higher than forecast at the beginning of the season, it was 4 per cent down on the previous year.

"2013 was a year that tested our resilience. After a superb first six months for both production and performance, our farmer shareholders endured a drought which in some regions was the worst in nearly 70 years.

"The extremely dry conditions meant a drop in New Zealand milk production of 9 per cent in the last six months of the season. Overall, New Zealand milk production declined 2 per cent to 1,463 million kgMS for the season to 31 May 2013, which hit our farmers and the business financially.

"Our strong balance sheet, with a debt to debt plus equity ratio of 39.6 per cent, and operating cash flows meant we were able to support farmers through the drought's immediate impact by raising the Advance Rate paid to farmers for their milk. This change, however, contributed to a 28 per cent drop in operating cash flows compared with the previous year.

"We now have a much stronger capital structure which came into its own this year, following the launch of the Fonterra Shareholders' Market and the Fonterra Shareholders' Fund.

"The Fonterra Shareholders' Market brought in greater flexibility, with farmers able to buy and sell shares throughout the year at the prevailing price.

“Meanwhile, the response to the Fund from both institutions and smaller investors was a genuine expression of confidence in the Co-operative and our performance,” said Mr Wilson.

Business Overview

Fonterra Chief Executive Theo Spierings said Fonterra had made good progress with its strategy during the year, particularly in foodservice, everyday nutrition and advanced nutrition. Climatic and market conditions, however, frustrated efforts to achieve higher earnings.

“The combined impact of the drought and the reshaping of Fonterra’s Australian business, saw the Co-operative’s normalised EBIT of $1 billion for the 2013 year fall 3 per cent short of last year.

“The business achieved strong EBIT growth in Asia, Africa, the Middle East and in our Soprole business in Chile. However, this was offset by a weaker second half from NZ Milk Products and a 37 per cent decline in normalised EBIT in Australia and New Zealand (ANZ) as we make changes to our Australian business.

“The extreme drought caused unprecedented volatility – reflected in a 64 per cent spike in Whole Milk Powder prices from January 2 to April 16. This, in turn, had a significant impact on the cost of milk purchased by NZ Milk Products, and meant the high returns achieved in the first half as a result of price premiums, product mix, cost savings and productivity gains were eroded in the second half.

“Although the New Zealand consumer business grew its earnings in a tough trading environment, Australia faced heightened competition for lower milk volumes, and continuing margin squeeze for consumer brands. We expect the significant reshaping of our Australian operations, which is going to plan, will turn performance around. The business has already achieved a 7 per cent reduction in operating expenses of $49 million (after excluding the impact of the closure of the Cororooke site and Brand impairments),” said Mr Spierings.

Net finance costs were $41 million lower than last year, mainly due to the benefit of an increase in gains from fixed interest rate hedging and the lower cost of funding. Earnings also benefitted from a tax credit of $68 million which was primarily due to the revaluation of deferred tax balances and recognition of New Zealand tax losses.

Earnings per share were up 7 per cent to 44 cents after taking into account the bonus issue, and on a normalised basis were up 9 per cent to 47 cents per share.

Precautionary Recall, Reviews and Rebuilding Reputation

Just as farms and farmer confidence started to recover from the drought, Fonterra initiated a precautionary recall of some whey protein concentrate, as a result of test results received on the last day of the Co-operative’s financial year.

“The subsequent all clear following further tests was a relief, but did not alter our view that the recall was the correct course of action at the time. Fonterra cannot, and will not, take risks with food safety and the health of consumers,” said Mr Wilson.

“The thorough internal Operational Review instigated by CEO Theo Spierings has been completed. The Board is also undertaking its own independent inquiry and we are fully co-operating with the New Zealand Government’s Joint Ministerial Inquiry which is taking place over a longer timeframe,” said Mr Wilson.

The precautionary recall challenged the Co-operative, but has also provided the opportunity to make a profound change for the better, said Mr Spierings.

"Within days of locating and quarantining product, we began an operational review to find out what happened, why, and what we must do to prevent this from happening again – and we are now implementing the recommendations of the review.

"Additional resources have also been deployed to ensure we manage change and rebuild our reputation, while at the same time we continue to run the business efficiently. The creation of a new role of Group Director of Food Safety & Quality, reporting directly to me, sends a clear message about the sharper focus we are giving to continuously improving food safety and quality.

"In the past year, we have invested $925 million in building production, manufacturing and supply chain capability to process our New Zealand milk, developing our China farms, as well as beginning construction of a $144 million new cheese and dairy ingredients plant in partnership with A-ware Food Group in the Netherlands.

"We have also made a number of key senior appointments to our management team. In addition to the appointment of Judith Swales as Managing Director Australia, we have hired Lukas Paravicini as our new Chief Financial Officer, and Jacqueline Chow as Managing Director of Global Brands and Nutrition.

"They join an already strong, dedicated management team which will drive the business forward in the coming year," said Mr Spierings.

Global Situation

Fonterra provided guidance to the market yesterday (24 September) about an increase to its Forecast Farmgate Milk Price for the 2014 season, and the likely impact on earnings for the current financial year.

The Co-operative announced that it has increased its Forecast Farmgate Milk Price for the 2014 season by 50 cents to $8.30 per kgMS. The increase – along with an estimated dividend of 32 cents per share - amounts to a Forecast Cash Payout for 2014 of $8.62.

The record Forecast Farmgate Milk Price reflected continuing strong international prices for dairy, particularly Whole Milk Powder driven by robust demand from Asia, especially China. Fonterra is still facing high volatility around the world.

The business also faced headwinds, especially in the first half of the current financial year when earnings were expected to be significantly lower than the strong performance in the first half of 2013.

The higher cost of goods will make it more difficult to drive earnings growth in Fonterra's consumer and foodservice businesses in the first half of this financial year. The Co-operative also expects to see a negative impact on product mix returns during the first half of the current year as milk powder prices significantly outpace the relative prices of cheese and casein.

Prospects for the second half look more positive for Fonterra's consumer businesses, but remain uncertain for NZ Milk Products.

The estimated dividend of 32 cents per share for 2014 currently remains unchanged. Fonterra can draw upon its balance sheet and cash flow performance to support the estimated dividend.

It is difficult to predict when extreme price volatility on product mix will reverse, but expectations are that the impact is likely to be short-term.

The Co-operative has continuing confidence in its Volume and Value strategy in our key markets. Looking ahead, prospects for the dairy industry and for Fonterra look positive and its growth ambitions remain unchanged.

Business units

NZ Milk Products

NZ Milk Products had a mixed year, resulting in a 1 per cent decline in normalised earnings to $494 million. Although total sales volumes were 1 per cent higher, revenue declined 7 per cent to $13.9 billion for the year. At the half year, milk collection was up 6 per cent compared to the same period last season. Excellent spring and early summer growing conditions across most of the country led to robust growth in New Zealand dairy production.

In the second half of the season, milk collection was down 9 per cent as the drought led to poor pasture conditions across New Zealand. In the second half, unprecedented volatility caused by the extreme drought had a negative influence on earnings. The drought contributed to a spike in Whole Milk Powder (WMP), up 64 per cent from 2 January to 16 April peak price. This had a significant impact on the cost of milk purchased by NZ Milk Products, which was offset to some extent by a positive contribution from price achievement, global sourcing and tighter cost control.

Australia New Zealand (ANZ)

The integrated ANZ business experienced another difficult year with a 37 per cent decline in normalised earnings to $142 million. Total sales volumes for Australia and New Zealand were 9 per cent lower than last year. Normalisation adjustments relate to $30 million in costs associated with the planned closure of the Cororooke site in Australia, and $19 million in costs associated with restructuring. Revenue declined 13 per cent to $3.7 billion. Fonterra Brands NZ volumes (excluding the impact of RD1) were 5 per cent ahead of last year, but volume in our consumer brands business in Australia was lower, driven primarily by the loss of a large private label contract which offset the volume growth in butter and spreads.

The reshaping of the Australian business is progressing. Our strategy includes streamlining our brands, expanding our high value nutritionals output to capitalise on the growing demand for these dairy products in emerging markets and ensuring our manufacturing facilities are aligned to our best market demand prospects. The significant reshaping of the Australian operations has already resulted in a 7 per cent reduction in operating expenses of $49 million after excluding the impact of Cororooke and brand impairments.

Asia/ Africa Middle East (AME) - including China

Asia/AME is now Fonterra' largest consumer business by normalised EBIT. The business achieved a 15 per cent increase in normalised earnings to $209 million. On a constant currency basis, normalised EBIT was up 22 per cent compared to last year due to the Asia/AME basket of currencies weakening against the NZD.

Sales volumes increased by 11 per cent, driven primarily by new operations in China Farms, strong growth in foodservice across all markets, and growth in Everyday Nutrition in Indonesia and Malaysia. This was supported by distribution expansion of advanced nutrition in Vietnam and geographic development in China foodservice. Revenue grew 3 per cent to $2 billion.

Everyday nutrition, advanced nutrition and foodservice are key platforms for growth in terms of Fonterra's Group strategy. Across South East Asia, the Middle East and North Africa, all three platforms delivered growth in EBIT with everyday nutrition up 21 per cent, advanced nutrition up 6 per cent and foodservice up 45 per cent.

Normalised EBIT for Greater China was up 20 per cent on last year with a strong result from China foodservice, Hong Kong and our businesses in Taiwan. This was partially offset by a lower contribution from China Brands, as a result of increased investment to grow market share and roll out Anlene into new cities. On a constant currency basis normalised EBIT for Greater China was up 21 per cent compared to last year.

Latin America (LATAM)

LATAM's normalised earnings increased 4 per cent to $137 million. Sales volumes increased 6 per cent, and revenue was up 12 per cent to $1.1 billion. Soprole, our largest operation in Latin America, performed well with strong growth in its consumer business. Normalised EBIT of $109 million was up 31 per cent compared to last year driven by volume increases, product innovation and improved pricing in the yoghurt and dairy dessert categories. On a constant currency basis normalised EBIT was also up 31 per cent as the currency was relatively stable.

Normalised EBIT in Dairy Partners Americas (DPA) was 46 per cent lower at $25 million driven mainly by lower earnings in DPA manufacturing as a result of last year's $19 million benefit arising from the review of manufacturing cost recovery arrangements. In addition, EBIT in DPA was negatively impacted by currency movements.

Click here to view Annual Results presentation; the Annual Review; and the Financial Statements & Statutory Information

NB: All dollars quoted are NZ dollars.

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About Fonterra

Fonterra is a global leader in dairy nutrition – the preferred supplier of dairy ingredients to many of the world's leading food companies. Fonterra is also a market leader with our own consumer dairy brands in Australia/New Zealand, Asia/Africa, Middle East and Latin America.

The farmer-owned New Zealand co-operative is the largest processor of milk in the world, producing more than two million tonnes of dairy ingredients, value added dairy ingredients, specialty ingredients and consumer products every year. Drawing on generations of dairy expertise, Fonterra is one of the largest investors in dairy based research and innovation in the world. Our more than 16,000 staff work across the dairy spectrum from advising farmers on sustainable farming and milk production, to ensuring we live up to exacting quality standards and delivering every day on our customer promise in more than 100 markets around the world.