Media release

24 September 2014

FONTERRA ANNOUNCES 2014 FINANCIAL RESULTS

Highlights

- Cash Payout $8.50, up 38%
  - Farmgate Milk Price $8.40 per kgMS
  - Dividend of 10 cents per share
- Revenue $22.3 billion, up 19%
- Normalised EBIT $503 million, down 50%
- Net profit after tax $179 million, down 76%
- Earnings per share 10c, down 77%
- Total sales volumes stable at 4 million metric tonnes

Annual results

Fonterra Co-operative Group announced today a final Cash Payout of $8.50 for the 2014 year for a 100 per cent share-backed farmer, comprising a Farmgate Milk Price of $8.40 per kgMS and a dividend of 10 cents per share[i].

Chairman John Wilson said that the Cash Payout to the Co-operative's 10,500 farmer shareholders was the highest ever made since Fonterra's formation in 2001.

"The Farmgate Milk Price on its own represents an injection of more than $13.3 billion to the New Zealand economy for the season.

"It is a strong result, reflecting the determination of our farmer shareholders to lift on-farm performance, matched within the business by a focus on driving revenue.

"Our farmers took advantage of good conditions to produce 1,584 million kgMS, eight per cent more than last season, to make the most of the good prevailing prices early in the season.

"North Island volumes were up nine per cent at 969 million kgMS, while the South Island delivered a seven per cent rise in volumes to 615 million kgMS.

"A very good spring saw our farmer shareholders achieve record milk production through an extended peak, stretching our production capacity for powders. This led to early impacts on stream returns from the less valuable products we were forced to make."

Fonterra CEO Theo Spierings said the Co-operative had come through a very demanding year.

"We have continued to stay on track with our strategy, focusing on securing the best returns to our farmer shareholders.

"We achieved record revenue of $22.3 billion for the year, a direct result of the focus on achieving the highest possible revenue line that is good for the Farmgate Milk Price.

"Constrained margins in our foodservice and consumer businesses and on non-milk powder products were the knock-on effect, contributing to a 27 per cent rise to $19.8 billion in the cost of goods sold. However, we maintained our focus on efficiency and achieved a two per cent reduction of $46 million in our operating costs.

"Our higher cost of goods sold, along with higher interest and taxation, saw our net profit after tax decline by 76 per cent to $179 million."

Strategy in action

Mr Spierings said 2014 was a tough but defining year and Fonterra had held to its strategy. High commodity prices, while good for farmers, had put margins under pressure in Fonterra's consumer and foodservice businesses.

"We focused on building volumes and value in our key markets, especially Asia and Latin America," Mr Spierings said. "In Asia, we saw volume growth of 12 per cent, primarily driven by excellent performance in China. In Latin America, our Soprole business' focus on new product development and innovation contributed to the region's three per cent volume growth.

"However, our New Zealand and Australian businesses had a challenging year due to much higher input costs and competitive pressure that constrained our ability to pass these on. These businesses are now on a firmer footing to lift their performance in the current financial year.

"Very strong milk flows and an extended peak season stretched our powders capacity and forced us to make lower-returning products. We fast-tracked investments to expand our New Zealand capacity and undertook immediate projects to maximise output from existing plant."

In addition to the $235 million expansion at Pahiatua, the Fonterra Board in August approved $555 million of investment in a new high-efficiency drier at Lichfield and three additional plants at Edendale.

At the same time, Fonterra is supporting the growth of its foodservice and consumer businesses by investing $126 million in a UHT plant at Waitoa, $72 million in expanding its mozzarella capacity at Clandeboye, and a $32 million expansion at Eltham.

Mr Spierings said Fonterra had made positive steps forward this year in complementing New Zealand milk supply with milk pools offshore, protecting the Co-operative's scale in order to remain truly globally relevant.

"Our global partnership with leading infant food manufacturer Beingmate in China puts our high-quality dairy ingredients in a strong position to capitalise on the opportunity in China's rapidly growing infant formula market with a respected local partner."

Good progress was being made in securing the necessary regulatory approvals and proceeding with the partial tender offer as part of the Beingmate transaction, Mr Spierings said.

Global outlook

The revised forecast Cash Payout for 2014/15 is $5.55-$5.65:

- Forecast Farmgate Milk Price of $5.30 per kgMS
- Targeted dividend range of 25 to 35 cents per share.

While the fundamentals for dairy remained strong, the revised forecast reflected current high levels of volatility, said Mr Wilson.

"The forecast reflects an uncertain outlook for the global economic environment and an expectation of continued volatility for dairy prices driven by geopolitical events and the supply/demand imbalance.

"The Board will continue to keep farmers informed as we move through the year."

Consumer and foodservice margins are expected to recover from the second quarter of this financial year. Stream returns are currently making a positive earnings contribution but it is still very early in the financial year.

Forecast capital expenditure of $1.6 billion for 2015 financial year, signalled in earlier announcements, remains unchanged.

A further update will be provided at Fonterra's Annual Meeting in November.

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

NB: All dollars quoted are New Zealand dollars.

- ENDS -

For further information contact:
Mike Burgess
Fonterra Communications
Phone: 027 502 8830

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

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.

Business units

Global Ingredients and Global Operations (formerly NZ Milk Products)

Global Ingredients and Global Operations had a solid year, with a mild winter and spring ensuring that the season started well. The North Island faced dry conditions through summer but returned to more favourable conditions in autumn, leading to robust growth in New Zealand dairy production. Milk collection across New Zealand reached 1,584 million kgMS, 8% higher than last season. However, record milk volumes did not fully translate into increased sales volume, as the year began with low inventory levels as a result of the previous season's drought. Total sales volume was up 1% and revenue increased 30% from $13.9 billion to $18 billion.

The relative increase in the price of Reference Commodity Products (RCPs) compared to the increase in the price of Non-Reference Commodity Products (Non-RCPs), was significant for most of the year and this had a substantial impact on stream returns. The extent of these differences was unprecedented and our asset footprint limited our ability to fully respond by switching production to higher-returning milk powders. This was exacerbated by the fact that the relative stream returns strongly favoured RCPs during our peak milk collection period in October and November, when we have limited product mix flexibility. As a result, our ability to switch production from Non-RCPs to RCPs was substantially constrained.

This resulted in significant margin pressure for Non-RCP products, with milk input costs rising disproportionately against the sales price and selling prices being below the input cost in some product streams. In the second half of the year, the divergence in prices between RCPs and Non-RCPs decreased and then reversed. However, the timing of the decrease in commodity prices and the weighting of milk purchasing to the first half of the year, were insufficient to offset the impact on earnings.

In December last year, the Board decided to maintain the Forecast Farmgate Milk Price at $8.30 per kgMS, $0.70 per kgMS lower than that calculated under the Farmgate Milk Price Manual, due to asset inefficiency issues that created considerable margin pressure. In May 2014, the Board reduced that 70 cent gap by 17 cents to 53 cents, resulting in a Forecast Farmgate Milk Price of $8.40 per kgMS. The Milk Price adjustment partially offset the impact of the significantly lower stream returns, and contributed to a Normalised EBIT of $269 million, 46% lower than last year.

Oceania

The integrated Australia and New Zealand business experienced another challenging year, with higher input costs that were difficult to recover in very competitive environments. Total sales volumes of 832,000 MT for Australia and New Zealand were 6% lower than last year, in part due to the sale of the Norco liquid distribution business in 2013, decreased nutritional volumes from the Australian ingredients business and reduced yoghurt volumes in Australia. The New Zealand business held volumes despite challenging market conditions. Oceania’s Normalised EBIT declined 78% to $31 million and revenue declined 4% to $3.6 billion.

Significant progress has been made in the transformation of the Australian business through lowering operating costs and streamlining the brands portfolio. Normalised EBIT fell $37 million in Australia and $75 million in New Zealand as a result of a margin squeeze in the consumer brands business, with significantly higher input costs and competitive pressure that constrained the ability to pass these on.

Asia

The focus in 2014 was to increase volume across our key leadership and strategic markets in Asia, given the earnings challenges presented by global dairy pricing dynamics. Volume growth of 12% was primarily driven by excellent performance in China. In Indonesia, volumes were up 20%, driven by growth in foodservice and the Anlene and Anmum premium brands.

However, volumes were down 20% in Sri Lanka, partly due to the temporary suspension of our operations, which resulted in a large short-term decline in volumes and a temporary loss of the market leadership position. Market share has now returned to previous levels, and excluding Sri Lanka, volumes across Asia have increased by 18%.

Normalised EBIT dropped 56% to $91 million, due to significantly higher input costs as a result of high dairy commodity prices and the challenging market conditions in Sri Lanka. Price increases were taken in line with individual market conditions, while ensuring that the Co-operative was positioned for future earnings growth. This allowed Fonterra to largely maintain or improve its strong market share position in all key markets.

The China business experienced continued growth in a number of strategically important areas. Normalised EBIT in China grew 38%, driven by our farming business and foodservice. Supply shortages in China benefited Fonterra’s local farming operations, with increased volumes and higher price per litre.

Latin America

Latin America grew volumes by 3% to 387,000MT, driven by the Soprole business in Chile. Consumer volumes were up 2% in Soprole driven by growth in liquid milk, mature cheese and powdered milk. Soprole continues to grow volume through new product development, particularly in cheese, and innovation in serving size and packaging, to expand beyond traditional products and help grow the category.

Normalised EBIT for Latin America decreased by 19% to $111 million, driven by Soprole, where earnings fell 40% or 31% in constant currency terms. The priority this year was to grow market share and volumes to position the business for long-term success, which resulted in a lower margin, as increased input costs were not fully passed on to customers. Soprole has positioned the business for the more challenging economic environment ahead with the review and realignment of its structure.

Normalised EBIT in Dairy Partners Americas (DPA) increased for the DPA Venezuela liquid and chilled joint venture. This was partly due to some one-off actions, including a hyperinflationary accounting gain and a land sale. Although this remains a challenging market, underlying business performance was stronger than the previous year, driven by changes in product mix into more profitable categories.

[i] This comprises an interim dividend of $0.05 and a final dividend of $0.05. Record date of final dividend is 9 October 2014, with a final dividend payment date of 20 October 2014.

Non-GAAP measures

Fonterra uses several non-GAAP measures when discussing financial performance. For further details and definitions of non-GAAP measures used by Fonterra, refer to the Glossary in Fonterra's 2014 Annual Review. These are non-GAAP measures and are not prepared in accordance with NZ IFRS.

Management believes that these measures provide useful information as they provide valuable insight on the underlying performance of the business. They may be used internally to evaluate the underlying performance of business units and to analyse trends. These measures are not uniformly defined or utilised by all companies. Accordingly, these measures may not be comparable with similarly titled measures used by other companies. Non-GAAP financial measures should not be viewed in isolation nor considered as a substitute for measures reported in accordance with NZ IFRS.

- Fonterra calculates normalised earnings by adding back depreciation, amortisation, net finance costs, taxation expense and normalisation adjustments to net profit for the period.
- Normalisation adjustments are transactions that are unusual by nature or size so that they materially reduce the ability of users of the financial results to understand the ongoing performance of the Group or operating segment to which they relate.
- Unusual transactions by nature are the result of a specific event or set of circumstances that are outside the control of the business, or relate to the major acquisitions or disposals of an asset/group of assets or business.
- Unusual transactions by size are those that are unusually large in a particular accounting period that is not expected to repeat regularly to the same extent in future periods.
- Normalisation adjustments are determined on a consistent basis each year.

Reconciliation of normalised earnings to reported profit

($M)	**31-Jul-14**	31-Jul-13
Profit after tax for the year	**179**	736
Add: Net finance costs	**366**	269
Less: Taxation credit	**(42)**	(68)
Total EBIT	**503**	937
Add/(less): Normalisation adjustments		
- Costs associated with closure of Cororooke plant in Australia	**-**	30
- Restructuring costs associated with Group Strategy	**-**	38
- Other items	**-**	(3)
Total normalised EBIT	**503**	**1,002**