FONTERRA ANNUAL REPORT 2011
FONTERRA CO-OPERATIVE GROUP LIMITED

HERE AT HOME...

& AROUND THE WORLD...

CONTENTS

DAIRY IS IN A SWEET SPOT.

DAIRY IN PHARMACEUTICALS
Lactose carries the active ingredients in medicinal inhalers and tablets. We lead the world in its supply.

AGEING POPULATIONS
The over-65 population will triple by 2050. We support healthy ageing with calcium-rich Anlene™ improving bone health and specialised dairy proteins providing quality, easily-digested nutrition.

POPULATION GROWTH
Global food demand will double by 2050. Dairy offers considerable nutritional quality and we're in key growth markets with trusted brands to meet rising demand.

THE 'ASIAN CENTURY'
Asia's growing economic wealth fuels demand for dairy. We are a trusted source of dairy nutrition in Asia, and China is now our leading market for dairy ingredients.

RISING CONSUMER INCOMES
A fast-growing Asian middle class wants to provide the best nutrition for everyone in the family. We are there with healthy, proven products suited to all of life's stages and ages.

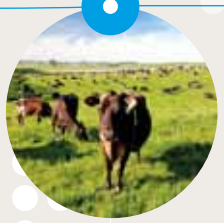
BUSY LIFESTYLES
Convenience doesn't mean compromise. We work with many of the world's top foodservice businesses to bring healthy and handy options for time-short consumers.

HEALTHIER NUTRITION

Dairy has always been good. We make it even better through science, with dairy probiotics to support healthy digestive and immune systems, and dairy proteins to support weight loss and good nutrition.

CHANGING DIETS

Around the world, we turn consumer trends into market opportunities with new products tailored to busier lifestyles, broadening dietary choices and emerging health concerns.



FOOD QUALITY

New Zealand's pasture-based farms are the start of a quality chain which extends to our customers' doors and into consumers' homes. We set ourselves the highest standards of food quality.

2011
AT A GLANCE

REVENUE

$19.9b ▲19%

PROFIT

$771m ▲13%

DIVIDEND
PER SHARE

30c ▲11%

PAYOUT
BEFORE RETENTIONS

$8.25 ▲23%

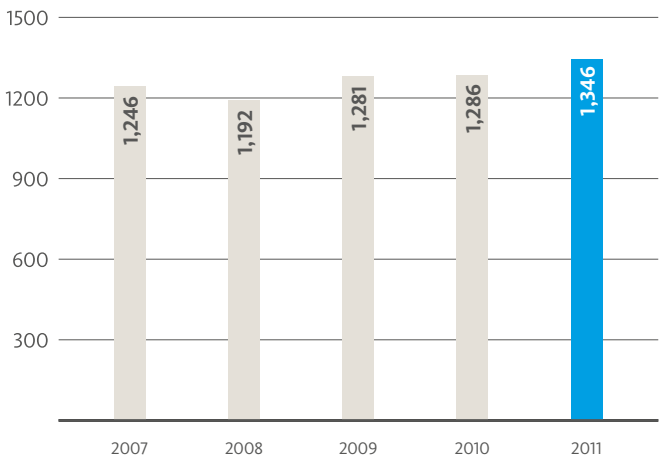
FARMGATE MILK PRICE
PER kgMS

$7.60 ▲25%

DISTRIBUTABLE PROFIT
PER SHARE

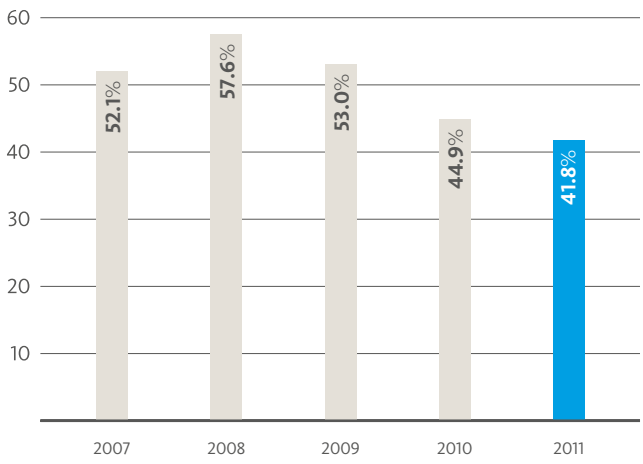
65c ▲8%

TOTAL NZ MILKSOLIDS COLLECTED[1, 2]
MILLION kgMS



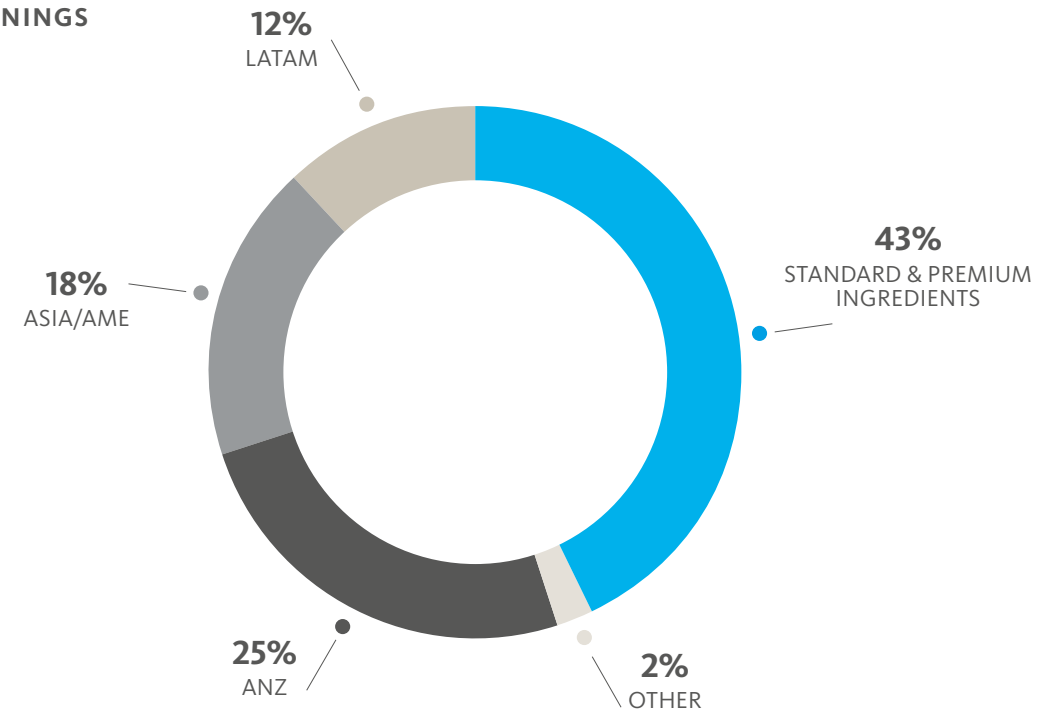
1. NZ milk collected for 12 month milk season of 1 June to 31 May.
2. 2008 affected by drought.

GEARING[1]
PERCENTAGE

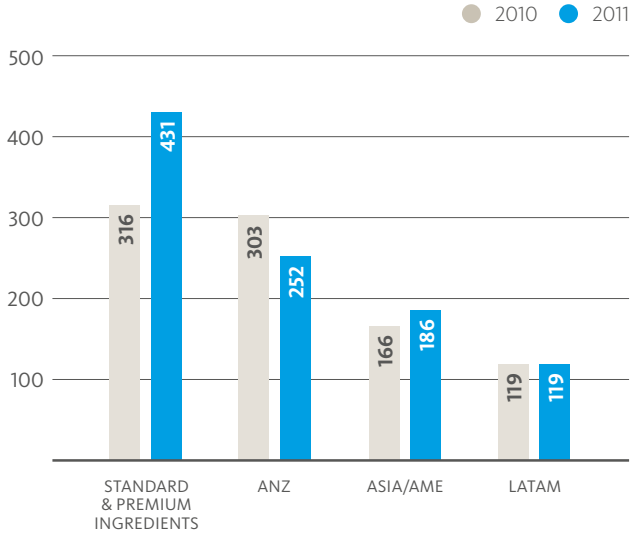


1. Gearing is measured as economic net interest bearing debt over economic net interest bearing debt plus equity (reflecting the effect of debt hedging in place at balance date). Equity excludes the cash flow hedge reserve.

SHARE OF EARNINGS
2011

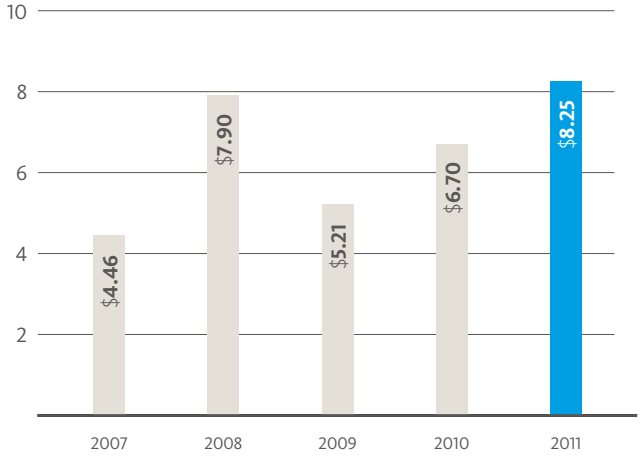


SEGMENT EARNINGS[1]
$ MILLION



1. Normalised segment earnings adjusted for non-recurring items, before impairment of equity accounted investees.

PAYOUT (BEFORE RETENTIONS)[1]
DOLLARS



1. Payout before retentions comprises the Farmgate Milk Price per kgMS for the season ended 31 May plus Distributable Profit. Distributable Profit is recognised on a dollar per share basis from the 2010 financial year. Prior to this Distributable Profit was recognised on a dollar per kgMS basis.

WE SET NEW BENCHMARKS FOR THE CO-OPERATIVE.

2011 was a year in which Fonterra set new benchmarks for the Co-operative and our Shareholders as we delivered on the mandate to be a national champion for New Zealand.

International dairy prices rose strongly for the second year running, underpinning record returns to our farmer Shareholders. Milk production in New Zealand also reached a new record, as some of the best autumn conditions in recent years offset poor weather in many regions earlier in the season.

This season, Fonterra will distribute record milk payments and dividends totalling $10.6 billion – $1.5 billion higher than our previous best. That money flows right back into the local economy as farmers reinvest in their businesses and buy more farm supplies and equipment.

2011 also marks Fonterra's 10th anniversary. Ten years ago, the New Zealand dairy industry came together to form a national champion. Our collective vision was to create a business with the scale to become a world leader in dairy ingredients and maximise dairying's contribution to the New Zealand economy.

That's exactly what Fonterra is doing. Today, we are the world's largest processor of dairy products. We invest actively in our business to achieve real efficiencies. We have effective and growing partnerships with many of the world's largest food and nutrition companies. We are helping to reshape the way dairy ingredients are traded globally. We own consumer brands businesses across key growth markets in Asia, Middle East and Latin America, as well as in Australia and New Zealand. We are at the forefront of breakthrough uses for dairy products in areas such as medical nutrition and pharmaceuticals. And while New Zealand dairying will always be our top priority, more than a quarter of our milk supply is now sourced and processed overseas.

Returns flow to our farmers by paying them a price for the milk they supply based on our Milk Price Principles, plus a dividend on the earnings Fonterra achieves. Those earnings come from processing milk as efficiently as possible and looking for the best ways to add value to it, as well as from our consumer businesses and other dairy investments.

FARMER RETURNS & PROFIT PERFORMANCE

In 2011, Fonterra achieved a Payout (before retentions) of $8.25 for share-backed production, substantially ahead of the prior period's $6.70. This Payout comprised a Farmgate Milk Price of $7.60 per kilogram of milksolids (kgMS) and a Distributable Profit of 65 cents per share, from which a dividend of 30 cents per share is being paid.

The $7.60 per kgMS Farmgate Milk Price is our highest ever and is well up on last season's $6.10 per kgMS. Its strength reflects recent

SIR HENRY VAN DER HEYDEN CHAIRMAN

"International dairy prices rose strongly for the second year running, underpinning record returns to our farmer Shareholders."

world dairy markets, with prices in some categories reaching or nearing historical highs during the past year. In addition, our hedging policy shielded farmers from the full brunt of a stronger New Zealand dollar, especially over the latter stages of the year.

The Distributable Profit of 65 cents per share is also the highest ever achieved, ahead of the 60 cents per share achieved in 2010.

The dividend of 30 cents per share is 11 per cent higher than the prior year. As the annual dividend includes an interim dividend of 8 cents per share paid in April 2011, a final dividend of 22 cents per share will be paid on 20 October 2011. Based on the current Fair Value Share price of $4.52, the dividend yield is 6.6 per cent (6.0 per cent last year).

CAPITAL STRUCTURE

We have made significant progress towards implementation of important changes to Fonterra's capital structure that will strengthen the Co-operative and improve our ability to make long-term business and investment decisions. Under Trading Among Farmers, our Shareholders will buy and sell shares from one another through a farmer-only market, rather than via the Co-operative.

At the core of Trading Among Farmers is the need for Fonterra to remain a Co-operative with 100 per cent farmer control and ownership. That is non-negotiable. While members of the public will be able to own units in a Fund that will mirror the economic benefits of Fonterra shares, neither the Fund nor individual unitholders can ever own Fonterra shares and voting rights in the Co-operative will continue to be based on share-backed production.

In accordance with the mandate from our Shareholders, we are working towards implementing Trading Among Farmers by late calendar year 2012. Much of the technical work required to develop the farmer-only share trading platform has now been completed, but we await legislative changes being approved by Parliament. We are working constructively with the Government and anticipate that the necessary changes to legislation will be introduced by early next year.

INDUSTRY ISSUES

The Government has undertaken a review of Fonterra's Farmgate Milk Price. We acknowledge and respect the right of regulatory authorities to themselves confirm that the Farmgate Milk Price methodology is robust and appropriate. But we also note that calls to change this methodology have mostly come from some of our competitors who, given the opportunity, would want to pay New Zealand farmers a lower price for raw milk.

The reality is that competition is thriving in the New Zealand dairy market, with competitors making significant investments recently in new processing plants. Fonterra has continued with its own investments and efficiency improvements. We are performing well in this competitive environment – meaning some other processors are struggling to match the returns we are achieving for our Shareholders.

GOVERNANCE

Two of our Directors, Greg Gent and John Ballard, have advised the Board that they will be retiring at this year's Annual Meeting.

Greg is one of our founding Directors and has decided not to stand for re-election. Greg has been an influential leader of the New Zealand dairy industry for 18 years and as Chairman of Kiwi Dairies played a pivotal role in the formation of Fonterra. He has always been a passionate believer of the farmer co-operative and in the ability of Fonterra to be a world leader in dairy. On behalf of my fellow Directors, I would like to thank Greg for his outstanding contribution towards shaping the success of Fonterra today and into the future.

John was appointed as a Director in May 2006 and has made a valued contribution at Board and Committee level, especially with his global perspective and insights into consumer businesses. A new appointed Director will be announced in due course.

During the year, we took steps to enhance the governance of Fonterra. The Milk Price Panel had its first year of governance oversight around Fonterra's Farmgate Milk Price. The Panel comprises five members: two Fonterra appointed Directors (one of whom must be Chairman), one farmer-elected Director and two appropriately qualified persons nominated by the Fonterra Shareholders' Council. The current Council nominees are both independent and experienced company directors.

The Board approved a formal Disclosure Policy to improve the transparency and consistency of information disclosure by Fonterra. We have also made public our full Farmgate Milk Price Manual and other disclosures on how we calculate the Farmgate Milk Price.

CEO TRANSITION

In July, we announced the appointment of Theo Spierings to succeed Andrew Ferrier, effective 26 September 2011. Andrew indicated to the Board some time ago that he wanted to move on by the end of 2011, which gave us plenty of time to embark on a global search for a new CEO and achieve an orderly transition.

We are delighted to have attracted someone of Theo's calibre to lead Fonterra into its second decade. Theo led the Dutch farmer dairy co-operative, Royal Friesland Foods, into its merger with Campina in 2008. He brings 25 years of knowledge of the global dairy industry and a wealth of experience managing dairy businesses across Asia, Latin America, Middle East and Europe. Most importantly, he has an in-built respect for the farmer co-operative structure.

Over the past eight years, Andrew has led the way in transforming Fonterra from a brave vision to a thriving international success story. He has brought together the people of Fonterra into a world class team, working to a clear strategy and with a real shared sense of purpose. Andrew's contribution was recognised recently in two prestigious industry awards: Federated Farmers' Agribusiness Person of the Year for 2011, and a Distinguished Service Award from the New Zealand Institute of Food Science and Technology. Fonterra has never been in better shape and that is a lasting credit to Andrew's leadership. I know he leaves Fonterra with the heartfelt appreciation of Directors, his colleagues and all our farmer Shareholders.

CONCLUSION/OUTLOOK

In May 2011, we announced an opening forecast Farmgate Milk Price for the 2012 season of $6.75 per kgMS and a forecast Distributable Profit range of 40-50 cents per share.

The year ahead will not be without its challenges. Volatility remains a byword not only for dairy prices and the New Zealand dollar, but also for world financial markets and the entire global economy. As we have seen with recent turmoil in financial markets, the outlook for the global economic environment remains far from certain.

Although there are many factors beyond the control of Fonterra that may affect this year's Farmgate Milk Price and profit, the efforts of the last decade have put Fonterra in a great place. The opportunities for dairy across both emerging and developed markets are immense. We have a strong business footprint across these markets and a sound strategy to build on the best opportunities for future growth.

SIR HENRY VAN DER HEYDEN
CHAIRMAN

WE GET MORE VALUE OUT OF EVERY DROP OF MILK.

Fonterra's commitment to get more value from every drop of milk underpinned a positive year for our Shareholders:

- We posted record revenue of $19.9 billion
- We paid our highest ever Farmgate Milk Price of $7.60 per kilogram of milksolids (kgMS), despite the headwind of a stronger New Zealand dollar
- We achieved a net profit after tax of $771 million – a 13 per cent increase on the previous year, even after paying our farmers 29 per cent more for the milk they supplied last year. Similarly with last year's result, earnings benefited from some one-off gains
- Our balance sheet has further strengthened, with increased equity from farmers buying more shares and from retained earnings. Fonterra's economic gearing ratio was 41.8 per cent at 31 July 2011, compared with 44.9 per cent a year earlier.

The 2011 financial year was marked by the business impact of higher dairy ingredients prices and a fragile global economy. However, our normalised profitability showed solid growth over last year due to improved efficiencies within our ingredients businesses and the strength of our consumer brands. We continue to receive the distinction of being the world's largest milk processor.

Normalised earnings before net finance costs and tax from our Standard & Premium Ingredients (SPI) segment was 36 per cent higher than the previous year. This was despite the fact that, for the second year running, market prices for the standard dairy ingredients that feed into Fonterra's Farmgate Milk Price rose significantly.

Our consumer businesses faced a challenging year as margins came under pressure from the rise in commodity prices. Despite these challenges, in Asia, Africa and Middle East we had another good year of growth and normalised earnings before net finance costs and tax rose 12 per cent. We continue to focus on high-quality nutritional and foodservice solutions that leverage our trio of power brands – Anchor™, Anlene™ and Anmum™.

In our Latam segment, normalised earnings before net finance costs and tax was unchanged from the previous year, with both our Chilean business Soprole and the Dairy Partners America (DPA) joint venture performing solidly.

In ANZ, normalised earnings before net finance costs and tax fell 17 per cent. Margins were compressed as a fiercely competitive market environment in both Australia and New Zealand made it harder to fully reflect higher commodity costs in consumer pricing. Our market leadership positions across most categories mean we are in a sound position to work through the current market challenges.

HITTING THE SWEET SPOT FOR DAIRY

Any single year's financial performance should not be viewed in isolation. The bigger perspective is what we are doing to achieve quality growth in earnings and shareholder returns on a sustainable basis over the longer term.

We are shaping the business to capture the best opportunities for dairy in a fast-growing, fast-changing world. For example, around the world, more and more people are looking for nutritious food choices for themselves and their families – and more and more have the money to pay for them. They want the assurance of quality brands and increasingly are prepared to pay a premium for them.

We are shaping the business to capture the best opportunities for dairy in a fast-growing, fast-changing world.

Things are also changing in the established markets. Busier lifestyles mean people want more convenient food options and products to help them manage their weight. Others are looking for healthier foods containing probiotics and other nutritional ingredients. An ageing population is increasing demand for specialised medical-nutrition products. All these needs and more can be fulfilled through emerging uses for specialised dairy ingredients.

Fonterra is in a great place to make the most of these trends. Our vision is to be the natural source of dairy nutrition for everybody, everywhere, every day.

INVESTING TO ACHIEVE REAL EFFICIENCIES

This all starts on every farm, even before the Fonterra milk tanker shows up. New Zealand is blessed with a climate perfect for turning the finest green grass into high-quality milk. That's a powerful competitive advantage for Fonterra, both financially and reputationally. But it's one we must work hard to preserve. That's why our efforts to ensure our farmers adopt best practice in sustainable dairying are so important.

Once that tanker enters our factory, our goal is to make a range of dairy products as efficiently as possible, that get the most value out of that milk. Although our manufacturing flexibility will always reflect the realities of factory capabilities and capacities, as well as commitments we have in place with long-term customers, even incremental improvements are aimed at better earnings over time. We are also continuing to manage our sales book, including the volume of product subject to fixed-price contracts, to better manage the impact of market volatility.

We have streamlined our supply chain through initiatives such as new warehousing hubs, greater use of rail and consolidated port operations to give us access to more frequent, flexible and reliable shipping operations.

RESHAPING THE WAY DAIRY INGREDIENTS ARE TRADED GLOBALLY

Back in Fonterra's earlier years, global dairy trading was not nearly as sophisticated as it is now. But since we launched online trading via the GlobalDairyTrade™ (GDT) platform in July 2008, international dairy pricing has become much more transparent and competitive. GDT has grown to offer seven product categories and in 2011 accounted for around a quarter of our dairy ingredients sales volumes. The platform has now been opened up to other dairy vendors, with DairyAmerica the first to join from October 2011.

As we have sold more standard ingredients via GDT, our sales teams have been freed up to focus more on premium ingredients – working to achieve better product margins and optimise our overall product mix.

EFFECTIVE AND GROWING CUSTOMER PARTNERSHIPS

Fonterra is well placed to be the dairy supply partner of choice for leading companies in the food and nutrition industries. We can offer them security of supply, technological leadership and an efficient global supply chain. The deeper we build these partnerships, the more opportunity we have to provide these customers with higher-value dairy solutions customised to their needs.

The increasing value of our customer partnerships was demonstrated by two key customer segments, Formulated Foods, and Foodservices, building on their $1 billion revenues in 2011.

Fonterra is well placed to be the dairy supply partner of choice for leading companies in the food and nutrition industries.

AT THE FOREFRONT OF BREAKTHROUGH USES OF DAIRY

Our commitment to innovation, as one of the world's largest investors in dairy-based research, is also a driver of earnings growth. We are leading the way in areas such as new generation cheese technologies and the use of dairy proteins in sports bars and beverages, medical-nutrition, and weight management products. As well as leveraging innovations in high-value ingredient sales to customers, we seek to commercialise new technologies in products ourselves – such as cheese manufactured using our proprietary CHEDDAR*plus*™ ingredient at a leased plant in the United States, which in its first full year generated sales of around $50 million during 2011.

CONTINUING TO BUILD STRONG-PERFORMING CONSUMER BRANDS

This year, our consumer business represented 55 per cent of normalised earnings and over the past four years their profit growth has averaged 11.1 per cent annually. Increasingly, our focus is on growth markets within Asia, Middle East and Latin America, while maintaining our strong market positions in Australia and New Zealand.

We have highly talented people running these businesses who really know how to make the most out of brands. In key Asian markets, we are positioning our brands in response to specific concerns such as osteoporosis, pregnancy and childhood development. We have also invested significantly over recent years in advertising and promotion to make our brands resonate better with Asian consumers.

DEVELOPING THE CHINA OPPORTUNITY

No assessment of Asia can ignore China. In 2011, China ranked as our number one market for ingredients. And while our brands are relatively new to the China market, they have been growing quickly. We recognised early on that China is a market in massive transition, with a rapidly emerging middle class and expanding appetite for fresh dairy. However, local milk supply is not growing as fast as the market, is fragmented, and has had serious quality issues to confront over recent years. That creates opportunities for Fonterra and is why we are establishing our own farms and milk supply chain in China. During 2011, we confirmed plans for our second and third Chinese farms and outlined a vision to develop more farms to play a bigger role in the development of the Chinese dairy industry. The farms will give us the ability to source high quality local milk both for our customers and potentially over time for our own branded products.

MANAGING RISK, GENERATING VALUE

Good financial management is vitally important at Fonterra. Managing the costs and risks associated with the vast flows of money through the business can generate real value to Shareholders. Through increased equity from our farmer Shareholders, together with improved working capital and balance sheet management, we closed out the 2011 financial year with the strongest balance sheet in our history.

Our finance team's expertise was acknowledged when our Chief Financial Officer, Jonathan Mason, was named New Zealand CFO of the Year for 2011.

MOVING FORWARD

I made it clear to the Board some time ago that I thought that the end of 2011 was a good time to 'pass the baton' on to a new CEO. I have had 17 years as a CEO, including eight years at Fonterra, and I am looking forward to more flexibility in my life and choosing from a number of less strenuous business interests that are available to me.

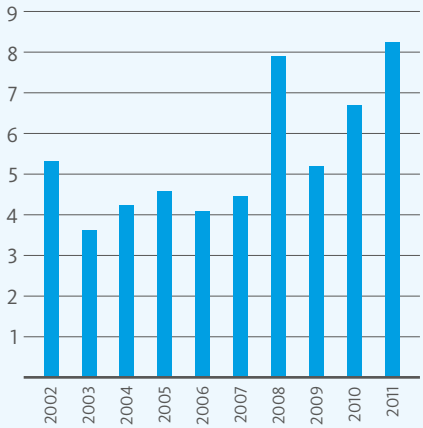
I would not have missed a minute of the past eight years. I have truly developed 'milk in my veins' in my time at Fonterra. But I know with the Co-operative and the industry in good shape, this is the best time for the transition to a new CEO. My successor, Theo Spierings, will inherit a world-class team of dedicated men and women and a business poised for even greater success.

I sincerely thank all our farmer Shareholders for the support they have consistently given to my colleagues and me. It has been a privilege to work on your behalf.

ANDREW FERRIER
CHIEF EXECUTIVE

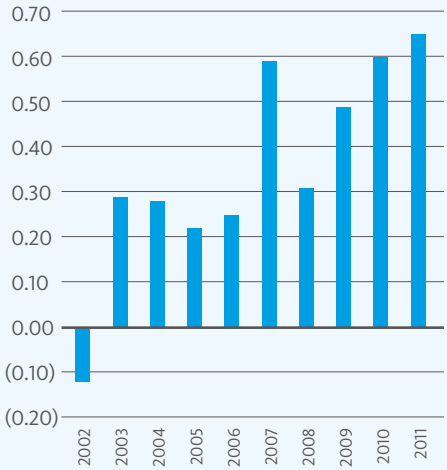
10 YEARS OF FONTERRA

FARMER RETURNS OVER 10 YEARS[1]
PAYOUT (BEFORE RETENTIONS) $



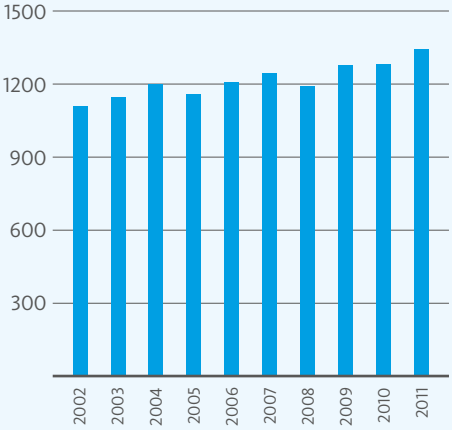
1. Payout before retentions comprises the Farmgate Milk Price per kgMS for the season ended 31 May plus Distributable Profit. Distributable Profit is recognised on a dollar per share basis from the 2010 financial year. Prior to this Distributable Profit was recognised on a dollar per kgMS basis.

VALUE RETURN / DISTRIBUTABLE PROFIT[1]
$ PER kgMS / SHARES



1. Distributable Profit is recognised on a dollar per share basis from the 2010 financial year. Prior to this Distributable Profit was recognised on a dollar per kgMS basis.

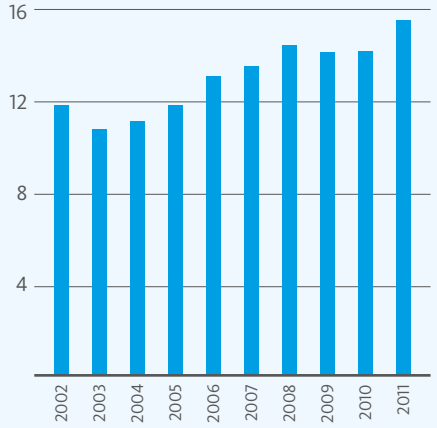
TOTAL NZ MILKSOLIDS COLLECTED[1]
MILLION kgMS



1. NZ milk collected for 12 month milk season of 1 June to 31 May.

GROWTH OF BALANCE SHEET[1, 2]

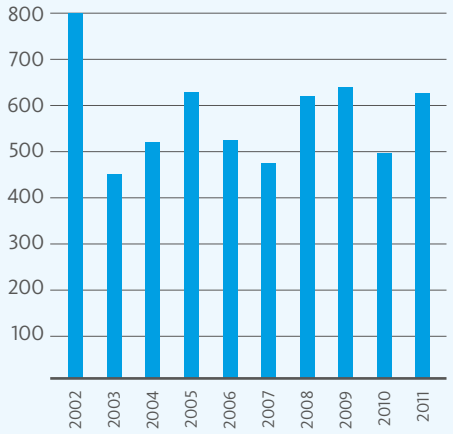
TOTAL ASSETS ($ BILLIONS)



1. Total assets for 2011, 2010, 2009 and 2008 are as at 31 July. Total assets for 2007, 2006, 2005, 2004, 2003 and 2002 are as at 31 May.
2. 2007-2011 figures are prepared under NZ IFRS, with 2002-2006 figures prepared under previous NZ GAAP.

CAPITAL INVESTED[1, 2]

PP&E AND INTANGIBLE ASSET ADDITIONS ($ MILLIONS)



1. Property, plant and equipment (PP&E) and intangible asset additions represent cash additions for the period. On 24 January 2008 the Board resolved to change the Company's balance date to 31 July from 31 May, and therefore additions for 2008 are for the 14 month period to 31 July 2008.
2. 2007-2011 figures are prepared under NZ IFRS, with 2002-2006 figures prepared under previous NZ GAAP.

10 YEAR TIMELINE

2001

- New Zealand Dairy Board, New Zealand Dairy Group and Kiwi Co-operative Dairies combine to form Fonterra Co-operative Group in October.

2002

- Fonterra and Bonlac Foods form New Zealand Milk (Australasia), combining consumer operations in Australia. With a brand portfolio including Mainland, Tip Top, Bega, Perfect Italiano and Western Star, this set the stage for growth in the Australian dairy consumer market.

2003

- Fonterra Customer Service Centre in Auckland takes first calls in October. Its around-the-clock, and around-the-world service simplifies our customers dealings with us with a one stop shop for ordering.

2004

- Fonterra delivers full merger benefits ahead of schedule, with annualised savings of more than $310 million confirmed by Deloitte.

2006

- Fonterra acquires Kapiti Fine Foods business.
- DMV Fonterra Excipients joint venture formed.

2008

- Fonterra increases Soprole shareholding to 99.8 per cent.
- Fonterra launches world's first online trading platform for dairy commodities – GlobalDairyTrade™.
- Fonterra acquires Nestlé's dairy dessert business in Australia and the licence for Ski™ yoghurt brand.
- Fonterra begins developing a 35 hectare farm in China where dairy consumption is growing in excess of 10 per cent per annum.

2009

- World's biggest milk drier commissioned at Edendale – capable of producing one tonne of milk powder every two minutes.
- Fonterra's Anmum Materna™ becomes the leading maternal milk in five markets across Asia.
- Fonterra becomes supplier to all five of the world's largest infant formula companies.

2010

- Highest ever daily volume collected in one day – 76.8 million litres.
- Consumer businesses hit 65 per cent of Group's normalised earnings.
- Shareholders vote in favour of Trading Among Farmers capital structure changes.

2011

- Biggest ever milk payments and dividends totalling $10.6 billion.
- Record 1346 million kilograms of milksolids collected.

MAKING THE MOST OF EVERY DROP.

Our vision is to be the natural source of dairy nutrition for everybody, everywhere, every day. Our business is organised to do that. It all starts with collecting fresh milk – about 22 billion litres a year. Our sites work to extract every drop of value from it.

The quality of our dairy ingredients opens doors to many of the world's leading food companies. The quality of our brands opens doors to consumers' fridges and pantries in New Zealand, Australia, Asia, Africa, Middle East and Latin America. Our research and development opens more opportunities to make milk even better.

None of this would be possible without our people and our belief in doing what's right in the communities where we operate.

WE COLLECT IT

OUR BUSINESS STARTS WITH HIGH QUALITY MILK. MOST IS SOURCED IN NEW ZEALAND. WE WORK HARD TO BE FARMERS' PROCESSOR OF CHOICE.

Fonterra's business is founded on a secure, high quality source of milk. Most of that milk comes from New Zealand and we aim to be the processor of choice for New Zealand farmers.

With large international customers wanting the confidence of year-round global supply, we are increasingly looking to complement New Zealand-sourced milk with overseas supply.

In the 2011 season, Fonterra and its business partners sourced around 22 billion litres of milk globally. In New Zealand, we collected 15.4 billion litres, representing around 89 per cent of the country's milk production.

In Australia, we have been sourcing milk directly from farmers since 2005 and this season collected 1.8 billion litres, representing around 20 per cent of Australia's milk production.

In Chile, Fonterra-owned Soprole collected around 440 million litres of milk, representing about 24 per cent of Chile's milk production. Elsewhere in Latin America, our joint venture with Nestlé, Dairy Partners Americas, sourced about 2.6 billion litres of milk in the 12 months to 30 June 2011.

We also aim to develop our own milk production capabilities in key growth markets as we seek to play an active role in local dairy industry development. In China, we have one farm operational and two more in the pipeline, while in Brazil we have announced plans to develop a pilot farm. We continue to explore opportunities in other markets such as India.

WE PROCESS IT

SCALE, EFFICIENCY, FLEXIBILITY – THAT'S WHAT OUR MANUFACTURING OPERATIONS ARE ALL ABOUT. THAT WAY, WE'RE FAST TO RESPOND WHEN CUSTOMER NEEDS OR MARKET DYNAMICS CHANGE.

Fonterra's manufacturing operations combine world-class scale and efficiency with the flexibility needed to respond to customer needs and changing market dynamics.

In New Zealand, a fleet of 480 tankers delivers raw milk for processing at 76 plants across 26 sites. A large global team evaluates the market to decide exactly what mix of ingredients is made from month to month.

We continue to expand our New Zealand manufacturing capabilities to improve overall efficiency and ensure we have the capacity for growing milk supply. At an expected total capital investment of around $450 million over two stages, our first greenfields processing site in about 14 years is under development at Darfield, Canterbury.

A sophisticated international sales and marketing network is complemented by the GlobalDairyTrade™ online platform, which now accounts for around one-quarter of total ingredients sales. Our streamlined supply chain efficiently gets products to customers: every hour of the year, we close the doors on an average of 12 containers with over 90 per cent of them making their way across the equator to destinations far and wide.

In 2011, Fonterra traded approximately 2.5 million tonnes of dairy ingredients in world markets, of which around 2.1 million tonnes came from New Zealand.

In June 2011, the Germany-based International Farm Comparison Network ranked Fonterra as the world's largest milk processor.

WE SUPPLY IT TO WORLD-LEADING FOOD COMPANIES...

OUR DAIRY INGREDIENTS ARE THE FIRST CHOICE FOR MAJOR GLOBAL CUSTOMERS.

Fonterra is a supply partner to many of the world's leading food companies.

Our partnerships include global and regional agreements to supply basic dairy ingredients such as milk powder, cheese for burgers and pizzas, milk for lattes, and functional ingredients such as specialised proteins for sports and other nutritional beverages.

We partner with the five largest infant formula manufacturers in the world, providing semi- or fully-finished products, as well as including our specialised ingredients in their applications.

We supply the cream, butter and assorted dairy products used in around 45 countries by a myriad of bakery and confectionary chains, as well as by chefs in hotels and restaurants.

Our customer relationships are built around understanding how consumer lifestyles and attitudes are changing – and how this is likely to influence their appetite for dairy. These insights drive our product development and help ensure our own growth plans are aligned with those of our key customers.

...AND TO DISCERNING CONSUMERS

WE'RE BUILDING TRUSTED BRANDS IN OUR CHOSEN MARKETS, CREATING VALUE FOR OUR SHAREHOLDERS WITH EVERY SALE.

Fonterra's consumer businesses play a pivotal role in creating value for our Shareholders by building trusted brands in chosen markets.

Our fast-growing presence in Asia, Africa and Middle East, coupled with our strong businesses in Australia and New Zealand, are important to overall financial performance as well as representing a high-value channel for about 13 per cent of the New Zealand milk Fonterra collects and processes.

Across Asia, Africa and Middle East, consumers are increasingly focusing on health and wellness, and they consider milk to be a 'gold standard' for nutrition. Fonterra sells to consumers in 40 countries, with a growing portfolio of products based around the Anchor™, Anlene™ and Anmum™ brands. The Anchor™ brand proposition is trusted nutrition from New Zealand across a broad range of products. Calcium-rich Anlene™ stands for adult bone and joint health and Anmum™ represents nutrition for mothers and children.

In Australia and New Zealand, our brands hold number one or two positions in most dairy categories, including those such as yoghurts and dairy desserts which offer superior value and growth prospects.

In Chile, Soprole™ has around a quarter of the market for dairy products. During 2010, Soprole™ was named one of Chile's most respected brands by both the Marketing Hall of Fame and in an independent consumer poll. Fonterra also has a significant interest in consumer dairy across Brazil, Venezuela and Ecuador via our Dairy Partners Americas joint venture with Nestlé.

WE BRING FRESH THINKING TO MILK

DECADES OF RESEARCH AND DEVELOPMENT GIVE US THE EDGE IN INNOVATION.

Much of the respect that Fonterra enjoys around the world as a natural source of dairy nutrition can be traced back to decades of intensive research and development (R&D).

Our R&D headquarters is the Fonterra Research Centre, which has operated continuously in Palmerston North for over 85 years. The centre is supplemented by regional technical development centres in Melbourne, Amsterdam and Chicago.

Recent innovations now in commercial production with world-leading food companies include milk protein concentrates under brands such as Deluxe Protein™, Sure Protein™ and ClearProtein™, probiotic DR10™ in cultured goods and beverages, as well as low sodium cheese, CHEDDAR*plus*™ and the C21 accelerated cheese making technique.

Fonterra currently has over 600 patents and patent applications to protect our intellectual property.

In August 2010, Fonterra entered a broad research collaboration with the New Zealand Government and dairy industry partners. Fonterra is investing $47 million towards the seven year, $170 million programme and is leading post farmgate research in the areas of nutrition, food structure, and manufacturing and supply chain processes.

WE HARNESS THE TALENT OF OUR PEOPLE

WHEREVER THEY ARE IN THE WORLD AND WHATEVER JOB THEY DO, OUR PEOPLE SHARE A REAL PASSION FOR DAIRY.

Fonterra has one of the most diverse workforces of any New Zealand-based company in terms of skillsets, cultures and geographies. Almost 36 per cent of our 16,800 employees work overseas in more than 50 countries around the world.

For the past two years, Fonterra has measured employee engagement using an internationally recognised Gallup system. The second poll in 2011 showed an improvement in results, with an overall increase in the number of engaged employees. The push is now on to drive engagement right across the business.

We are also moving to the second phase of a health and safety programme which includes a clear focus on injury prevention. In 2011, the Total Recordable Injury Frequency Rate (TRIFR) was 14.8 per million work-hours, an improvement from 18.2 in the previous year. Since 2006, TRIFR has fallen by 82 per cent including a 38 per cent drop over the last three years.

We have established clear safety processes and enabling systems, and an independent review of our performance in 2010 acknowledged genuine progress. The next stage of our health and safety journey is based on achieving world-class standards across all aspects of our health and safety performance including increasing our global focus and strengthening initiatives targeted at preventing fatal and serious injury.

Fonterra won the Best Large Organisation Health and Safety Initiative category in the 2011 New Zealand Workplace Safety Awards, for a new tanker driver training programme which has led to a reduction in tanker mishaps. At the same awards, the Most Influential Employee category went to Fonterra's Greg Chaffey, from Mataura, Southland. A tanker driver and health and safety representative, Greg is actively involved in safety audits and first aid capabilities.

EVERY DAY, WE AIM TO GET THE BALANCE RIGHT...

SUSTAINABILITY IS IMPORTANT. WE AIM TO ACHIEVE THE RIGHT BALANCE BETWEEN ENVIRONMENTAL, ECONOMIC AND SOCIAL SUSTAINABILITY.

In New Zealand, Fonterra has implemented an energy efficiency programme since 2003.

This programme is based on conducting an 'energy blitz' on a selection of sites each year where projects and investments are identified and then implemented in order to reduce energy use.

In Australia, both energy efficiency and water efficiency are areas of focus. Fonterra Dennington has implemented a closed loop cooling water system for its refrigeration compressors. The upgrade saves as much as 240 megalitres of bore water a year, which is equivalent to 96 Olympic size swimming pools.

While over the past eight years great progress has been made within Fonterra's direct operations, Fonterra is now focusing on improving supplier environmental performance.

Since August 2010 Fonterra has appraised every New Zealand Shareholder's farm effluent management system identifying farms at risk of non-compliance with regional council rules. This resulted in development of 1380 Effluent Improvement Plans (EIP) by Fonterra Sustainability Advisors tailored for individual farmers. Of these, 763 have already been implemented.

Through the Primary Growth Partnership, Fonterra is partnering with DairyNZ and Government to develop and pilot an audited nutrient management system for testing with farmers in three pilot catchments around New Zealand.

Fonterra is extending the development of on-farm sustainability programmes to milk supply beyond New Zealand. The Fonterra Standard of Excellence (FSOE2) is applied as a minimum quality standard for milk across Fonterra's international supply base and suppliers are audited against this.

Sustainability for these operations, from farm to factory, is our current focus and an extended FSOE2 will be rolled out during the 2012 financial year to enable us to benchmark sustainability performance and identify areas for improvement.

We are continuing to work on reducing the carbon footprint of Fonterra's global operations. Fonterra has conducted a full lifecycle assessment of the carbon footprint of a series of our New Zealand products. This year Fonterra participated in a national study to calculate the carbon footprint of Australian dairy products. This will enhance our understanding of emissions in the Australian dairy system enabling targeted reduction programmes to be implemented.

We believe that with continued investment in research initiatives such as the Pastoral Greenhouse Gas Research Consortium, adoption of research outcomes by farmers, and initiatives such as ongoing achievements in our energy reduction programme, we can reduce the carbon footprint of each litre of milk sourced and processed in New Zealand by over 30 per cent by 2030.

...AND TO LOOK AFTER THE COMMUNITIES WHO SUPPORT US

CO-OPERATIVE SPIRIT IS ONE OF OUR VALUES. ONE OF THE WAYS WE LIVE IT IS BY HONOURING OUR LOCAL COMMUNITIES.

Fonterra aims to do what's right in the communities where we operate, recognising that a sustainable business must provide both financial and practical support to social initiatives.

As measured by the London Benchmarking Group, Fonterra's community contribution as a percentage of pre-tax profit is above the average of a benchmarked sample of around 200 companies internationally.

We partner with Sanitarium to run the KickStart Breakfast programme which provides more than 18,000 students at almost 500 schools nationwide with breakfast twice a week. The programme marked a milestone on 1 June 2011, serving its two millionth breakfast.

After the Canterbury earthquakes, we provided fresh water to Christchurch by rail and road tankers. Our emergency response team worked alongside international urban search and rescue personnel and we provided thousands of litres of milk to relief distribution centres. Fonterra, along with our Shareholders and staff, combined to contribute $5.9 million in financial support to Canterbury relief efforts.

Community support during 2011 also included donation of product to charities such as Auckland City Mission, Salvation Army and Australia's Foodbank, and financial donations to victims of the Japanese earthquake/tsunami and the floods in Queensland and Victoria, Australia.

Fonterra also invested more than $500,000 in New Zealand schools and communities through a competition that enabled Anchor™ milk drinkers to win cash for themselves and the school of their choice, with a top school prize of $50,000.

Beyond New Zealand, we are a strong supporter of programmes that reflect the importance of nutrition in health and development. Initiatives include partnering with the Soong Ching Ling Foundation, which works with mothers, their infants and health workers in rural China. Across Indonesia, the Philippines and Sri Lanka, we are partnering from 2011 with ChildFund to improve access to early childhood care and development services for children up to age five. In Chile, a Soprole programme to get students at more than 1750 schools involved in sports marked its 10th successful year. The programme is in line with Chilean Government efforts to reduce child obesity.

MANAGEMENT DISCUSSION & ANALYSIS

The Management Discussion & Analysis provides commentary on the factors affecting Fonterra's performance and to facilitate understanding of the 2011 financial results. This discussion and analysis supplements the financial information included in the Financial Statements, and other financial and non-financial information elsewhere in the Annual Report.

FINANCIAL HIGHLIGHTS

The 2011 financial year was notable for a recovery in the earnings of our Standard & Premium Ingredients business (formerly called Commodities & Ingredients). Growth in our consumer businesses in mature markets slowed as higher dairy commodity prices compressed margins. In contrast, our emerging market consumer businesses continued to post strong growth.

A significant rise in international dairy prices underpinned record returns to our farmers. The Farmgate Milk Price for the 2011 season was $7.60 per kilogram of milksolids (kgMS) up $1.50 or 24.6 per cent over the same period last year. Other notable highlights include:

- Revenue for the year ended 31 July 2011 was $19.9 billion, 18.8 per cent higher than the $16.7 billion achieved in the prior year
- Earnings before interest, tax, depreciation and amortisation (EBITDA) decreased 2.9 per cent to $1.5 billion ($1.6 billion in the previous year). After adjusting for non-recurring items, normalised EBITDA was 7.6 per cent higher than last year
- Net profit after tax was $771 million, a 12.6 per cent improvement on the prior year's $685 million, driven by largely non-recurring tax items
- Earnings per share increased to 55 cents per share, a 7.8 per cent or four cents per share improvement on last year
- Dividend per share of 30 cents was three cents per share or 11.1 per cent higher than the previous year's 27 cents
- Return on Net Assets (RONA), before interest and taxes and excluding non-recurring items, was 9.3 per cent compared with 8.7 per cent last year
- Our gearing ratio (based on net interest-bearing debt to net interest-bearing debt plus equity) was 38.5 per cent as at 31 July 2011, compared with 43.6 per cent as at 31 July 2010. The economic gearing ratio (which includes the impact of debt hedging) was 41.8 per cent, compared with 44.9 per cent 12 months earlier
- Distributable Profit was 65 cents per share compared with 60 cents last year, an improvement of 8.3 per cent. Distributable Profit is used to calculate Payout, which is used to compare Fonterra's performance with that of other New Zealand co-operatives. Fonterra calculates Distributable Profit by adding to net profit after tax the additional tax credit that would be available if all current year profits were declared as a dividend.

GROUP RESULT

	2011 $M	2010 $M	CHANGE $M	CHANGE %
Revenue	19,871	16,726	3,145	18.8
Gross profit	3,010	2,751	259	9.4
Gross profit margin	15.1%	16.4%		
Earnings before interest, tax, depreciation and amortisation (EBITDA)	1,517	1,562	(45)	(2.9)
EBITDA margin	7.6%	9.3%		
Operating profit	965	1,022	(57)	(5.6)
Earnings before interest and tax	1,028	1,078	(50)	(4.6)
Net finance costs	406	313	93	29.7
Profit before tax	622	765	(143)	(18.7)
Tax credit/(expense)	149	(80)	229	286.2
Profit after tax	771	685	86	12.6
Earnings per share	55 cps[1]	51 cps[1]	4 cps[1]	7.8
Dividend per share	30 cps[1]	27 cps[1]	3 cps[1]	11.1

1. Cents per share

Our solid performance in 2011 was achieved under challenging operating conditions. This result reflects a strong improvement in the profitability of our Standard & Premium Ingredients business segment and continued growth in the Asia/AME consumer business segment. Total Group revenue grew 18.8 per cent driven by strong international dairy prices and good volume growth.

Gross profit increased 9.4 per cent to $3 billion but gross profit margin declined 1.3 percentage points primarily due to margin reduction within our consumer businesses as a result of rapidly rising dairy ingredient prices.

Operating costs increased by 6.0 per cent over the prior year. This was mainly driven by a number of significant projects across the business, increased salary costs, and higher storage expenses due to increased inventory volumes.

Normalised Group EBITDA for 2011 was $1.5 billion, which was an improvement of 7.6 per cent on last year (refer to table). Solid growth in our Standard & Premium Ingredients and continued consumer brands success in emerging markets were key factors in the increase of EBITDA.

	2011 $M	2010 $M	CHANGE $M	CHANGE %
Operating profit	965	1,022	(57)	(5.6)
Add back depreciation	414	416	(2)	(0.5)
Add back amortisation	75	68	7	10.3
Add share of profit of equity accounted investees	63	56	7	12.5
EBITDA	1,517	1,562	(45)	(2.9)
Less non-recurring items	(23)	(174)	151	86.8
Normalised EBITDA	1,494	1,388	106	7.6

Net finance costs of $406 million were $93 million or 29.7 per cent up on 2010. The increase was primarily due to the negative impact from the net change in fair value of interest rate derivatives and debt, along with higher average market interest rates. This was partly offset by lower interest costs arising from reduced levels of borrowings in 2011.

A largely non-recurring tax credit of $149 million in 2011 compared with an $80 million tax expense was mainly due to the tax effect of changes to intangibles and the recognition of New Zealand tax losses.

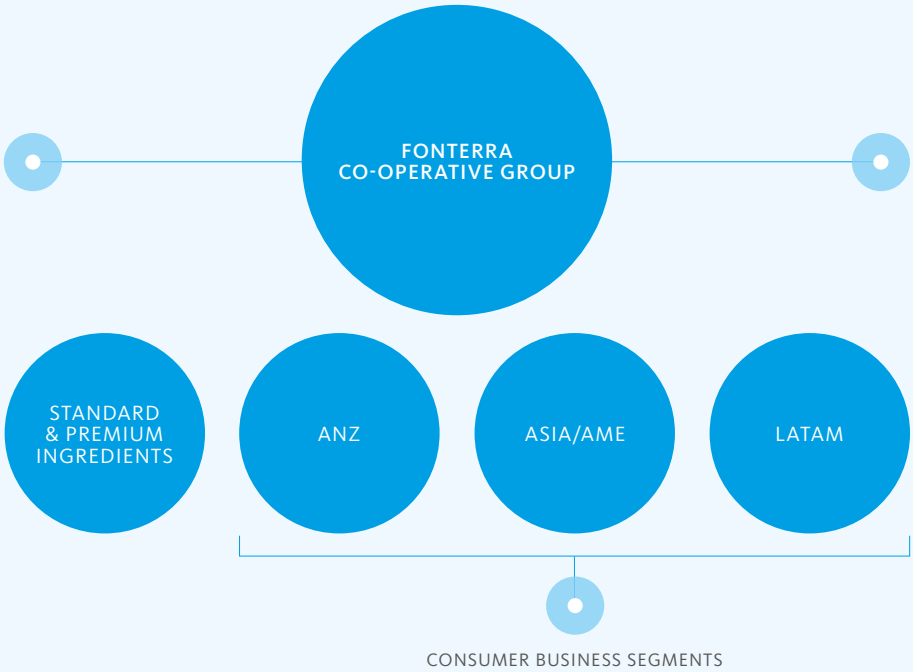
RESULTS OF OPERATIONS

Fonterra has four reportable segments that are defined by product type and geographic area to reflect how the Group's operations are managed. One segment is focused on dairy ingredients and the other three segments are primarily focused on consumer dairy products.

The performance of the Group's segments are summarised below followed by detailed commentaries.

When analysing the performance of our operations it is important to understand that these segments are interdependent and, therefore, are managed with the objective of maximising performance for the Group.

The following segment results analysis focuses on earnings before significant non-recurring items (i.e. normalised earnings).



STANDARD & PREMIUM INGREDIENTS

INTRODUCTION

The Standard & Premium Ingredients business (formerly Commodities & Ingredients) segment produces and distributes a range of ingredients made from milk that are tailored to the needs of international customers, especially food manufacturers. We work with our customers to unlock the natural goodness of dairy and provide ingredients for a range of applications. Our manufacturing operations combine world-class scale with the flexibility to respond to changing market dynamics and customer requirements.

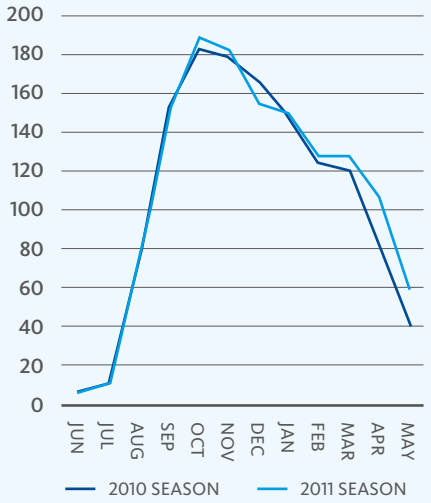
NEW ZEALAND MILK SUPPLY

The New Zealand milk production season extends from June to May with production ramping up to peak from October to December before gradually falling away through the shoulder months in late summer and autumn. This seasonal production curve requires processing and logistics capacity to handle peak milk flows while also providing flexibility to adjust product mix during the season in response to changes in relative prices and market demand. It is optimal management of these factors that enables Fonterra to extract additional value from milk processed.

Milk collection from New Zealand farmers for the 2011 season (1 June 2010 to 31 May 2011) totalled 15.4 billion litres, representing 1346 million kgMS. This included contract milk supply of 26 million kgMS. This was Fonterra's largest annual volume of milk collected and an increase of 4.7 per cent from the 2010 season. The increase was a result of favourable autumn weather conditions offset, in part, by dry conditions in many areas earlier in the season. Monthly milk collections compared with the previous year are illustrated in the graph below.

MONTHLY NEW ZEALAND MILK SUPPLY

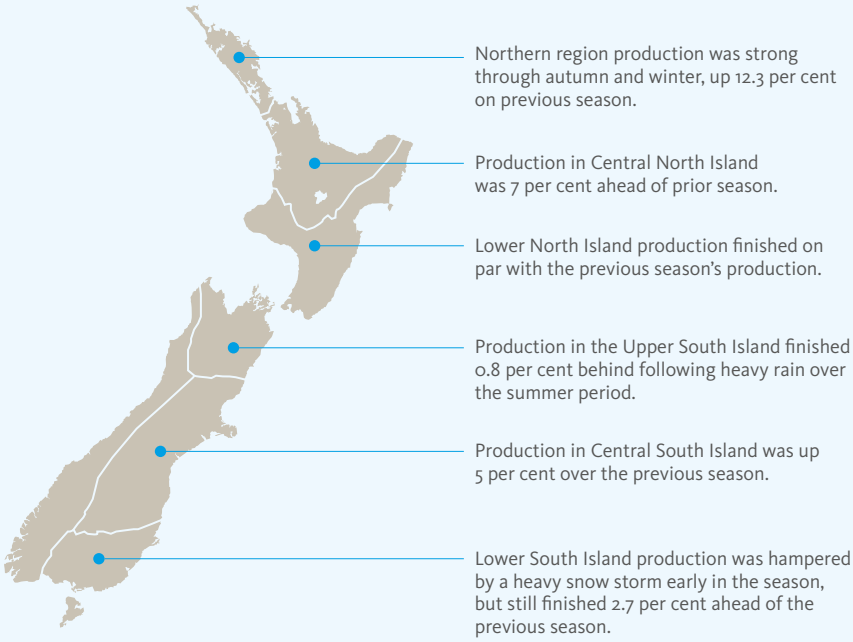
kgMS (MILLION)



Production from the North Island was 5.2 per cent higher than the previous season. This was achieved despite a tough spring and an early summer dry period.

South Island production grew 3.7 per cent as a result of mostly favourable conditions through the season and a continuation of dry-farm conversions, and recent conversions reaching full potential, in Canterbury and Southland.

New Zealand by milk supply regions



FINANCIAL PERFORMANCE

	2011 $M	2010 $M	CHANGE $M	CHANGE %
NZ sourced	11,782	9,634	2,148	22.3
Other	1,997	1,591	406	25.5
Inter-segment revenue	1,800	1,532	268	17.5
Revenue	**15,579**	**12,757**	**2,822**	**22.1**
Cost of New Zealand milk	(10,235)	(7,938)	(2,297)	(28.9)
Inventory movement	383	190	193	101.6
NZ manufacturing costs	(2,437)	(2,233)	(204)	(9.1)
Other costs of goods sold	(2,077)	(1,800)	(277)	(15.4)
Cost of goods sold	**(14,366)**	**(11,781)**	**(2,585)**	**(21.9)**
Gross profit	**1,213**	**976**	**237**	**24.3**
Normalised EBIT[1, 2]	**431**	**316**	**115**	**36.4**
Normalised EBITDA[1, 2]	**809**	**690**	**119**	**17.2**

1. Represents normalised segment earnings adjusted for non-recurring items.

2. 2010 has been restated to exclude indirect allocations previously recharged to ANZ, Asia/AME and Latam.

REVENUE GROWTH

Standard & Premium Ingredients achieved sales of $15.6 billion in 2011, up 22.1 per cent from 2010.

Sales for New Zealand sourced milk increased 22.3 per cent to $11.8 billion. This was due mainly to significant increases in the average US dollar denominated selling price for dairy ingredients, and volume growth from higher milk supply as noted earlier.

Most of Standard & Premium Ingredients' sales are generated from milk sourced from New Zealand. But the business is increasingly complementing New Zealand sourced milk with overseas supply to meet customer demands. This year Fonterra sourced product and processed dairy ingredients from 27 external suppliers from around the world. These sales are recorded under 'other' revenues and increased during the year due to greater volumes, and higher prices for dairy ingredients.

Inter-segment revenue is predominantly internal sales to Fonterra's consumer operations in Australia, New Zealand and Asia.

Management of Product Mix

The Standard & Premium Ingredients business processes New Zealand milk collected into a wide range of world-class dairy products.

Five reference products; Whole Milk Powder (WMP), Skim Milk Powder (SMP), Butter Milk Powder (BMP), Butter and Anhydrous Milk Fat (AMF), are used to derive the Farmgate Milk Price paid to farmers. Commentary under 'cost of goods sold' below provides a more detailed description of how these reference products inform the Farmgate Milk Price. In addition, this business manufactures a wide range of protein, cheese and cream based products.

Higher margins arise from the management of product mix and achieving prices that are above those of the five reference products informing the Farmgate Milk Price. In 2011, improved optimisation capabilities enabled us to better manage product mix by adjusting volumes during the season, having regard to manufacturing constraints and contractual obligations.

The accompanying table shows the movement between product categories.

PRODUCTION IN METRIC TONNES (MT)	2011 (MT 000)	2010 (MT 000)	CHANGE (MT 000)	CHANGE %
WMP	839	671	168	25.0
SMP	512	489	23	4.7
Cheese	202	219	(17)	(7.8)
Cream	44	62	(18)	(29.0)
Butter	195	206	(11)	(5.3)
AMF	126	136	(10)	(7.4)
BMP	35	40	(5)	(12.5)
Other	447	473	(26)	(5.5)
Total	**2,400**	**2,296**	**104**	**4.5**

Market Driven Price

Fonterra's online sales platform, GlobalDairyTrade™ (GDT) accounted for some 565,000 metric tonnes in 2011 or around 24 per cent of our total ingredients sales. The platform reached its third anniversary in July 2011 with sales to date totalling more than USD3.9 billion. During 2011, GDT increased the frequency of trading events to twice-monthly and expanded the range of products from four to seven.

The Farmgate Milk Price is informed primarily by GDT prices. To the extent that Fonterra's sales book lags GDT due to contractual arrangements with customers, earnings are exposed to pricing and margin risk. During 2011, a sharp rise in GDT prices resulted in a negative impact from longer-period fixed price contracts. Action by management to address some of these commitments helped reduce the impact of these losses.

Currency Impact

Dairy ingredient prices are denominated primarily in US dollars, which weakened against the NZ dollar in 2011. Fonterra's policy to hedge its foreign exchange exposure proved successful in reducing volatility, and yielded an effective average conversion rate of US72 cents, 5 cents lower than the average spot rate.

The impact of foreign exchange movements between the NZ dollar and the US dollar were largely mitigated by our hedging policy, and the offset between the foreign exchange impacts on revenue and cost of milk (via the impact of foreign exchange rates on prices which inform the Farmgate Milk Price). The net result was only a marginal impact on the earnings of Standard & Premium Ingredients.

COST OF GOODS SOLD

Standard & Premium Ingredients' cost of goods sold increased 21.9 per cent to $14.4 billion. The increase was primarily due to a rise in global dairy commodity prices leading to a higher Farmgate Milk Price in New Zealand, and increased volumes of milk collected in New Zealand and product sourced from overseas.

Cost of New Zealand Milk

The cost of New Zealand milk represents Fonterra's single largest cost category and in 2011 was $10.2 billion, an increase of $2.3 billion (28.9 per cent) over 2010. This includes the cost of milk supplied in the year ended 31 July 2011 (including contract-backed and share-backed milk), premiums for specialty milk, and premiums paid for winter milk. A record 1346 million kgMS of New Zealand sourced milk was supplied to Fonterra this year.

For ease of expression, the Farmgate Milk Price is described as the aggregate amount calculated in accordance with the Farmgate Milk Price Manual of $10.2 billion divided by total New Zealand milk supply, which equals $7.60 per kgMS. The average amount available to pay for share-backed supply is $7.59 per kgMS, after adjusting for winter milk premiums and contract milk discounts.

Of the $2.3 billion increase in the cost of New Zealand milk, $1.8 billion reflected higher prices, and $0.5 billion was due to growth in the volume of milksolids collected.

The Farmgate Milk Price has been derived in accordance with the Principles, methodologies and detailed rules in Fonterra's Farmgate Milk Price Manual. Because Fonterra purchases such a large proportion of New Zealand's total milk, it is not possible to distinguish a market price for milk that is independent of the price paid by Fonterra. It is therefore necessary to use a methodology such as that contained in the Farmgate Milk Price Manual.

The Farmgate Milk Price determines the amount paid for milk delivered to the farmgate by farmer Shareholders. It is calculated in accordance with the Manual by:

- Determining the revenue that the Co-operative would earn if the equivalent of all the milk Fonterra collects was converted into commodity specifications of WMP, SMP, and their by-products, which are BMP, Butter, and AMF. These products are referred to in the Manual as 'Reference Commodity Products'. Prices primarily reflect US dollar prices achieved on the twice-monthly GDT trading events, converted to New Zealand dollars using Fonterra's actual average monthly foreign exchange conversion rate
- Deducting costs, including the cost of transporting raw milk to factories, and the cost of efficiently manufacturing Reference Commodity Products and then transporting them to the point of export from New Zealand, along with selling and administration expenses. They also include amounts for depreciation of fixed assets and an appropriate return on investment, including investment in working capital. To the extent feasible and where doing so is consistent with the Milk Price Principles, costs are derived from Fonterra's actual costs associated with these activities.

The balance comprises the aggregate amount payable to farmer Shareholders. This is an aggregate amount but is usually referred to on the basis of a Farmgate Milk Price per kgMS.

For further information see the Fonterra Farmgate Milk Price Statement and Fonterra Farmgate Milk Price Manual available at *www.fonterra.com*.

Inventory Movement

The higher volumes of milk collected in the last quarter meant that 23,600 metric tonnes of additional inventory was on hand as at 31 July 2011 compared to 31 July 2010. The higher Farmgate Milk Price also meant that the value of the inventory was higher than the previous period. These factors had a positive impact of $193 million on the cost of goods sold when compared with last year.

New Zealand Manufacturing Costs

New Zealand manufacturing costs were $204 million or 9.1 per cent higher than last year. The increase in total manufacturing costs primarily reflected the combined effect of higher volumes of milk collected and processed this year, and increased per unit costs.

The key drivers behind the increase in manufacturing costs when compared with last year were:

- A $53 million increase in cheese production costs due to increased raw materials costs partially offset by lower cheese production levels compared to last year
- Higher milk collection costs of $60 million arising from the record levels of milk collected in 2011
- Other variable costs were $91 million higher due to a 4.5 per cent increase in production which contributed to additional raw materials, packaging, ingredients and lactose costs, and
- Higher unit costs for fuel and electricity.

The increase in manufacturing cost on a per metric tonne basis was 4.8 per cent.

Other Costs of Goods Sold

Other costs of goods sold mainly relate to the costs of overseas product purchases, which increased by 15.4 per cent this year primarily due to higher commodity prices.

GROWTH INVESTMENTS

Several ingredient innovations developed at Fonterra over the past few years moved beyond customer testing during 2011 and into commercial production with world-leading food companies. Examples of these innovations include the following:

- The development of new generation cheese technologies tailored to customers' requirements. In North America, cheese manufactured using our proprietary CHEDDAR*plus*™ ingredient completed its first year of production. CHEDDAR*plus*™ is manufactured at Los Banos, California
- Partnerships with the world's leading beverage manufacturers across multiple regions continued to be developed and extended. Fonterra has a wide range of functional protein ingredients that allow these manufacturers to deliver dairy nutrition to their consumers in convenient, great tasting formats. As the beverage market moves beyond traditional dairy and protein beverage applications into mainstream functional waters and sports drinks, ClearProtein™ provides a compelling solution to beverage manufacturers
- Fonterra successfully increased sales in cultured products with three new product ranges for the Japanese and South Korean markets using our DelightProtein™ ingredient.

The increasing value of our customer partnerships was evidenced by two key customer segments building on their $1 billion in revenues in 2011. In the first of these, Formulated Foods, Fonterra partners with the five largest infant formula manufacturers in the world, providing semi or fully-finished products, including our specialised ingredients in their applications. The second, the Foodservice business, is aimed at the burgeoning 'out of home eating' market. This global business now operates in around 50 countries with a portfolio of cheese, cream, butter, yoghurt, pastries and beverages, and our customers include the largest restaurant chains in the world, as well as hotels, cafés, airlines, work places, entertainment venues and institutions.

Our manufacturing capacity continues to expand to ensure capacity is in place to process growing milk supply and increase overall efficiency. The first greenfields processing site in approximately 14 years is under development at Darfield, Canterbury. The investment in stage one of around $200 million is due to be completed in 2012. It will have the capacity to convert 2.2 million litres of milk a day into milk powder for export. A further $250 million, in a stage two development, is planned that would lift daily processing capacity to 6.6 million litres. Darfield ranks among Fonterra's largest New Zealand manufacturing investments in the past five years, and reflects significant milk growth in Canterbury.

While New Zealand milk will always be our top priority, global demand for dairying is growing at a pace that New Zealand production cannot match. Prospects in key growth markets will be underpinned by Fonterra's ability to grow high-quality local milk production for customers and to play a strong role in the development of local dairy industries. During the year we announced agreements to develop second and third farms in China and a pilot farm in Brazil. Fonterra is continuing to explore opportunities in other markets such as India.

Investment continued in milk collection technology. An upgrade to add new environmentally-efficient tankers commenced and all tankers were fitted with high visibility colours to enhance road safety. Growth in milk production resulted in 50 more milk tankers operating this year compared with last year.

In 2011, we reacquired the remaining 50 per cent share of rural supplies chain, RD1, from Australian company Landmark. In August 2011, RD1 took over seven stores previously operated by Allied Farmers. The move strengthens Fonterra's presence in the rural services sector.

CONSUMER OPERATIONS

INTRODUCTION

Fonterra has three business segments that focus on fast moving consumer goods products:

- Australia and New Zealand (ANZ) represents the consumer operations in New Zealand and the consumer and manufacturing operations in Australia
- Asia/AME comprises the consumer operations in Asia, Africa and the Middle East
- Latin America (Latam) comprises the Soprole business in Chile and our joint venture in the Dairy Partners Americas (DPA) business across Latin America. It is important to note that DPA is not consolidated into Fonterra's result and Fonterra's share of DPA's earnings is treated as profits from equity accounted investees.

CONSOLIDATED CONSUMER PERFORMANCE

	2011					2010				
$M	REVENUE[1]	SEGMENT NORMALISED EBIT[2]	OPERATING MARGIN[3]	NORMALISED EBITDA[4]	EBITDA MARGIN	REVENUE[1]	SEGMENT NORMALISED EBIT[2,5]	OPERATING MARGIN[3]	NORMALISED EBITDA[4,5]	EBITDA MARGIN
ANZ	4,360	252	5.8%	333	7.6%	3,803	303	8.0%	385	10.1%
Asia/AME	1,687	186	11.0%	195	11.6%	1,537	166	10.8%	175	11.4%
Latam	830	119	14.3%	140	16.9%	738	119	16.1%	138	18.7%
Consumer Total	6,877	557	8.1%	668	9.7%	6,078	588	9.7%	698	11.5%

1. Includes inter-segment revenue: ANZ $781 million, Asia/AME nil, Latam $4 million; (2010: ANZ $570 million, Asia/AME nil, Latam $7 million).
2. Normalised segment earnings before net finance costs and tax, and including share of profit of equity accounted investees.
3. Segment normalised EBIT as a percentage of revenue.
4. Normalised earnings before interest, tax, depreciation and amortisation, and including share of profit of equity accounted investees.
5. 2010 has been restated to exclude indirect allocations previously recharged from Standard & Premium Ingredients.

The consumer businesses collectively achieved sales of $6.9 billion in 2011, up 13.1 per cent. Sales growth was driven by price rises and volume growth in most regions.

Total consumer EBITDA of $668 million was 4.3 per cent lower than last year, reflecting difficult trading conditions. However, EBITDA margin compression in those more mature markets was offset in part by solid growth from our Asian operations where margins were sustained despite higher commodity prices.

The ANZ and Asia/AME consumer operations source some products from the Standard & Premium Ingredients segment. A transfer pricing regime based on market prices governs the price charged for dairy products manufactured for our consumer businesses.

AUSTRALIA/NEW ZEALAND

	2011	2010
Total revenue growth[1]	14.6%	(0.4%)
External revenue growth	10.7%	3.8%
External volume growth	0.7%	3.6%
Total gross profit growth[1]	(4.1%)	5.3%
Normalised EBIT[2] growth	(16.8%)	22.2%
Normalised EBITDA[2] growth	(13.5%)	19.6%
Sales & marketing as a percentage of revenue[3]	4.3%	4.9%

1. Includes inter-segment transactions.

2. Adjusted for non-recurring items.

3. Calculated as percentage of total external segment revenue.

PERFORMANCE

The ANZ business had a challenging year. Although revenue grew 14.6 per cent to $4.4 billion, normalised EBITDA of $333 million was 13.5 per cent lower than last year.

The trading environment was impacted by a combination of local factors in the Australia and New Zealand retail markets and the indirect impact of global dairy ingredients prices on input costs. Consumers remained cautious in their food shopping behaviour with increasing focus on value and promotional initiatives.

Focus on higher margin products in Australia like cheese, butter and yoghurt, has helped the business support profitability. In New Zealand, the consumer products are more diversified with Fonterra Brands New Zealand (FBNZ) holding strong market positions across all dairy categories including liquid milk. The New Zealand operations experienced a decline in volumes resulting from price increases that reflected the cost of higher commodity prices. In February 2011, FBNZ froze the price at which it sells liquid milk to retailers, absorbing any further cost increases until January 2012.

Tip Top is a division of ANZ specialising in ice cream manufacture and is one of New Zealand's most trusted brands. Tip Top lifted its performance to deliver strong sales growth and an improvement in its operating EBIT before a $3 million impact from product losses arising from the Christchurch earthquake (some of which are the subject of ongoing claims).

The ANZ segment includes a division that collects milk from Australian farmers and manufactures dairy ingredients primarily for the export market. This division performed strongly, exceeding the prior year's earnings on the back of higher dairy ingredients prices.

ANZ is a success story for Fonterra with a cumulative average growth rate in normalised EBIT of 11.5[1] per cent over the past three years. As a result, Fonterra has one of the largest dairy consumer businesses in Australia and New Zealand with leading market shares in its target product categories. Given its primary exposure to mature markets and the particularly difficult conditions this year, ANZ has done well relative to some of its peers in Australia and New Zealand.

1. Calculated using unaudited management results for the 12 months to 31 July 2008.

CORE MARKETS AND NEW PRODUCTS

In Australia and New Zealand, our brands hold leading positions in cheese, spreads, yoghurts and dairy desserts, as well as leading positions in milk, flavoured milk and ice cream in New Zealand. Many of our brands are household names. Our businesses build on this success by adding innovative products in faster-growing, higher margin categories and by creating new brands that fill gaps in the market.

Recent new product launches have exceeded expectations with further range and geographical extensions under development.

Highlights include:

- The launch of Kapiti Yoghurt, which was a successful entry into gourmet yoghurts in New Zealand
- Ski® Activ® yoghurt introduced in March 2011, the first product of its kind in Australia containing a unique combination of a prebiotic plus a probiotic, proven to help manage and prevent digestive discomfort. The new product is a result of 25 years research by Fonterra scientists to perfect the probiotic strain
- The launch of the Mammoth Supply Co.™ brand, positioned at supplying 'real man food' for New Zealand men.

ASIA/AFRICA, MIDDLE EAST

	2011	2010
Total revenue growth[1]	9.8%	(9.9%)
External revenue growth	9.8%	(7.7%)
External volume growth	2.2%	3.1%
Total gross profit growth[1]	1.9%	9.1%
Normalised EBIT[2] growth	12.0%	38.3%
Normalised EBITDA[2] growth	11.4%	35.7%
Sales & marketing as a percentage of revenue[3]	15.6%	18.2%

1. Includes inter-segment transactions.
2. Adjusted for non-recurring items.
3. Calculated as percentage of total external segment revenue.

PERFORMANCE

Over the past five years the Asia/AME businesses have focused on profitable high growth categories that meet key consumer needs. This year's results reflect further progress with Asia/AME delivering a 9.8 per cent increase in sales to $1.7 billion and a continued improvement in gross profit despite the challenging operating environment.

Most of Asia/AME's sales are in local market currencies, and some of these weakened against the New Zealand dollar during the year. Asia/AME achieved a 17 per cent improvement in sales recorded in local currencies, before translation to the New Zealand dollar.

Revenue growth mainly reflected increased prices, roll-out of higher value products under the Anmum™ and Anlene™ brands in selected markets, and strong performance in the Foodservices division that markets to hotels, restaurants and bakeries. Higher market shares in fast-growing emerging markets in Asia also helped boost volumes, which were up 2.2 per cent over the previous period.

Normalised EBITDA improved 11.4 per cent to $195 million reflecting significant growth across all of our core brands. This growth was underpinned by increased concerns among consumers about bone health, and the impact of rising consumer incomes on demand for dairy products.

Anlene™ recorded an overall market share of 62 per cent of the high-calcium milk powder category and is the number one high-calcium brand across Asia. Anmum™ and Anchor™ also continue to perform strongly in their markets following strong marketing campaigns this year.

CORE MARKETS AND NEW PRODUCTS

Asian markets remained very strong with double digit sales growth in Sri Lanka, Middle East, Malaysia, Thailand, Hong Kong and Taiwan. One of the main drivers of growth is Asia/AME's leadership in nutritional dairy and foodservice solutions.

In the markets of Malaysia, Indonesia, Philippines and Thailand we are a clear leader in adult nutrition through our bone health brand, Anlene™. Over recent years, intensive research and marketing has positioned calcium-rich Anlene™ as a key adjunct to the prevention of osteoporosis (bone mass loss) due to age. In 2011, we expanded the Anlene™ proposition to include joint health by launching Anlene Total™ which includes glucosamine, an amino sugar essential for joint cartilage. Glucosamine is usually sold in tablet form but was developed as an ingredient at Fonterra's Research Centre in Palmerston North. Anlene Total™ was launched in Indonesia and Taiwan in April 2011.

In Malaysia and Indonesia, all added sugar was eliminated from our flagship premium nutritional powder Anmum Essential™ for children, while ensuring that the taste Asian consumers enjoy was not compromised. We have also reduced sugars in other 'Growing Up Milk' categories in line with our objective of improving the nutritional value of products we sell.

Asia/AME's expansion continued into new geographical areas with sales in China increasing by 77 per cent and sales in Vietnam up 39 per cent, creating a promising platform for future growth.

LATIN AMERICA

	2011	2010
Total revenue growth[1]	12.5%	(7.5%)
External revenue growth	13.0%	(2.4%)
External volume growth	0.6%	0.3%
Total gross profit growth[1]	13.8%	9.1%
Normalised EBIT[2] growth	–	12.2%
Normalised EBITDA[2] growth	1.4%	9.5%
Sales & marketing as a percentage of revenue[3]	10.3%	10.1%

1. Includes inter-segment transactions.
2. Adjusted for non-recurring items.
3. Calculated as percentage of total external segment revenue.

PERFORMANCE

The Latam segment includes Soprole, an integrated dairy business in Chile majority owned by Fonterra, and Dairy Partners Americas (DPA), a joint venture with Nestlé covering several markets in Latin America. Fonterra's share of DPA's profit is treated as profit from equity accounted investees.

Soprole's revenue grew 12.5 per cent to $830 million compared to the previous year, driven by growth in key categories like yoghurt, milk, cheese and dessert categories. During the same period, Latam's normalised EBITDA increased 1.4 per cent to $140 million.

DPA had a challenging year driven by static volumes and higher cost of milk and other input costs which were not fully recovered through price increases. Fonterra's earnings from its investment in DPA include royalty income from its consumer operations, share of profit, and a return on the capital invested in manufacturing assets. Key areas of exposure for DPA are volatility of foreign exchange rates and inflation, particularly in markets such as Venezuela.

Earnings from the DPA manufacturing business were broadly similar to the prior year.

CORE MARKETS AND NEW PRODUCTS

Soprole is the market leader in Chile and was recognised as the 2010 Signature Chilean Corporate Brand by the Marketing Hall of Fame. Continued innovation, together with increased marketing, helped consolidate Soprole's leadership in the consumer market, where it maintains the number one or two position across all major dairy categories.

In 2011, Soprole developed the Next Tránsito and Gold Creme yoghurt brands, expanded the impulse desserts range through products like Manjarate® Frutired and Manjarate® Tofee and launched sparkling juid Frutix.

During the year, Soprole completed the construction of its Margarine and Dairy Blends plant, and expanded capacity at its San Bernardo site.

Fonterra confirmed in March 2011 that Soprole had withdrawn a proposal to merge its business with Nestlé Chile's liquid and chilled dairy business. The application was withdrawn by the parent companies Nestlé S.A. and Fonterra after having assessed the conditions to continue with the application were not appropriate, and there are no plans to present a new application to the Chilean authorities.

Soprole has continued to focus on growing its consumer business in Chile where it already has a very strong position in the market and has been posting strong growth in local currency in recent years.

DPA's performance was mixed across its priority markets of Brazil, Venezuela, Ecuador, Argentina and Columbia.

GROUP CASH FLOWS

	2011	2010	CHANGE $M	CHANGE %
Net cash flows from operating activities	1,184	1,479	(295)	(19.9)
Net cash flows from investing activities	(488)	(354)	(134)	(37.9)
Net cash flows from financing activities	(433)	(1,154)	721	62.5

Net operating cash flows were $1.2 billion in 2011 compared with $1.5 billion in 2010. Lower operating cash flows reflect a larger increase in working capital requirements than last year, with more inventory on hand at the end of the year. Payments to suppliers also increased, reflecting a higher Farmgate Milk Price and greater volume of milksolids. This was partially offset by higher revenue from dairy ingredient prices during the year.

Net cash outflows from investing activities were $488 million or $134 million higher than last year. Capital expenditure (including property, plant and equipment, and intangibles) was $623 million, compared with $492 million in the prior year. Investments mainly related to expanded production capacity in our primary markets of New Zealand and Australia, along with supply chain and systems improvements. Investments were also made to improve manufacturing flexibility and to acquire more efficient tankers. Strategic investments in equity accounted investees and subsidiaries were $55 million compared with $62 million last year. This year included the acquisition of the remaining 50 per cent of RD1. The largest divestment during the year was the sale of our Western Australia dairy operations.

Financing cash flows were an outflow of $433 million which was $721 million lower than the previous period. The lower cash outflow was largely attributable to the first full year effect of the dividend policy which was introduced in 2010.

CAPITAL EMPLOYED AND DEBT TO DEBT PLUS EQUITY RATIO

	2011	2010	CHANGE $M	CHANGE %
Average net assets[1]	10,772	10,433	339	3.2
Equity attributable to Shareholders	6,503	5,631	872	15.5
Net interest bearing debt	3,766	4,268	(502)	(11.8)
Return on net assets	9.3%	8.7%	-	0.6 pts
Economic net interest bearing debt	4,331	4,494	(163)	(3.6)
Equity less cash flow hedge reserve	6,025	5,526	499	9.0
Debt to debt plus equity ratio	38.5%	43.6%	-	5.1 pts
Economic debt to debt plus equity ratio	41.8%	44.9%	-	3.1 pts

1. 13 month average net assets excluding net debt and deferred tax.

Group equity attributable to Shareholders was $6.5 billion as at 31 July 2011, compared with $5.6 billion as at 31 July 2010. The improvement in equity was due to higher retained earnings ($396 million), net share subscriptions ($245 million) and an increase in the cash flow hedge reserve ($375 million), partially offset by negative movements in the foreign currency translation reserve of $144 million. Net share subscriptions resulted from $404 million new equity issued and $159 million equity surrendered.

The Group's gearing ratio (based on net interest-bearing debt to net interest-bearing debt plus total equity excluding the cash flow hedge reserve) was 38.5 per cent as at 31 July 2011, compared with 43.6 per cent as at 31 July 2010. The economic gearing ratio (including the impact of debt hedging) was 41.8 per cent, compared with 44.9 per cent 12 months earlier.

Total borrowings decreased from the previous year primarily due to a combination of cash raised from share issues and retained earnings.

RETURNS TO FULLY SHARED UP FARMERS

DIVIDEND

In March 2011, the Board declared an interim dividend of 8 cents per share (totalling $110 million), that was paid on 20 April 2011 on all shares held on 31 March 2011. A final dividend of 22 cents per share was declared on 21 September 2011, payable on 20 October 2011. The total annual dividend of 30 cents per share is 3 cents per share higher than in 2010.

Fonterra's dividend policy targets a payout ratio of 65-75 per cent of adjusted Distributable Profit (after taking into account non-recurring items and other factors). The policy also gives the Board discretion to have regard to other commercial considerations it considers to be relevant. The dividend of 30 cents per share is consistent with this policy, and reflects 69 per cent of an adjusted Distributable Profit of 44 cents per share. This amount is considered by the Board to be an appropriate measure of sustainable normalised earnings per share after taking into account non-recurring items, non-cash adjustments (such as the tax effect of retentions) and other factors as provided for in Fonterra's dividend policy.

PAYOUT

As a co-operative, Fonterra refers to the total returns to its farmer Shareholders as Payout. Fonterra's Payout comprises a Farmgate Milk Price per kgMS and Distributable Profit per share. Payout is used as a comparison with returns from other New Zealand dairy co-operatives. It assumes a Fonterra farmer Shareholder is 100 per cent shared up for the season (i.e. owning one share for each kgMS produced).

Payout (before retentions) was $8.25 in 2011, $1.55 or 23.1 per cent higher than in the 2010 season. Cash Payout, defined as Farmgate Milk Price plus Dividend, was $7.90 in 2011, $1.53 or 24.0 per cent higher than 2010.

	2011			2010		
	$M	MILLION	$	$M	MILLION	$
Profit attributable to Shareholders	754	1,377 Shares	0.55	669	1,343 Shares	0.50
Add tax effect of retentions	146	1,377 Shares	0.10	131	1,343 Shares	0.10
Distributable Profit	**900**	**1,377 Shares**	**0.65**	**800**	**1,343 Shares**	**0.60**
Farmgate Milk Price	10,035	1,320 kgMS	7.60	7,664	1,256 kgMS	6.10
Payout (before retentions) to farmers[1]	**10,935**		**8.25**	**8,464**		**6.70**
Distributable Profit	900	1,377 Shares	0.65	800	1,343 Shares	0.60
Less retentions	(487)	1,377 Shares	(0.35)	(438)	1,343 Shares	(0.33)
Annual Dividend	**413**		**0.30**	**362**		**0.27**
Farmgate Milk Price	10,035	1,320 kgMS	7.60	7,664	1,256 kgMS	6.10
Cash Payout to farmers[1]	**10,448**		**7.90**	**8,026**		**6.37**

1. For a 100 per cent shared-up farmer (i.e. owns one share for each kgMS produced).

CO-OPERATIVE SHARES

Fonterra farmer Shareholders purchase or redeem Co-operative shares at a price determined annually by the Board. For the 2011 year, the price was unchanged from 2010 at $4.52 per share. For more information on the valuation method used to determine the Co-operative share price, see Note 7: Capital and Reserves in the Financial Statements, or Note 5: Co-operative Shares in the Summary Financial Statements.

INTRODUCTION

The Board and management of Fonterra are committed to achieving the highest standard of corporate governance and leadership.

To support our role as a Board, we have developed governance systems that reflect Fonterra's unique characteristics and requirements as a significant New Zealand based co-operative competing in the global dairy market.

WE FOCUS ON GOVERNANCE IN A WAY THAT PROMOTES:

- the interests of our supplying Shareholders
- transparency, giving our supplying Shareholders and other stakeholders the information they need to assess our performance
- effective risk management to ensure that Fonterra meets its business objectives and all legal requirements
- a good balance between the roles and functions of the Board and management, and
- communication with important stakeholder groups, including employees, customers, farmers, governments and the communities within which Fonterra works.

OUR BOARD

The Board has 13 members – nine elected from the Shareholder base and four appointed by the Board and ratified at the Annual Meeting by Shareholders.

The Appointed Directors are selected to ensure that the Board has the full complement of skills and competencies needed to lead an enterprise of Fonterra's size, sophistication and complexity. They bring to the Board perspectives and experience to augment the direct industry knowledge and other expertise provided by the Elected Directors.

As the Elected Directors must be Shareholders, they will have a supplier relationship with Fonterra and generally will not be classified as independent under best practice definitions. The Appointed Directors, however, do meet the NZX criteria for independence – and are expected by Fonterra to maintain independence for the length of their term.

All Directors comply with the legislative requirements for disclosing interests and with Fonterra's in-house Securities Code of Conduct which regulates both Directors and management in their personal dealings with Fonterra securities and those of related companies. Fonterra does not have executive Directors.

BOARD EFFECTIVENESS

It is important that all members of the Board are appropriately informed of the Group's activities and have access to operations and management.

Directors are supplied with detailed monthly performance reports and analysis in advance of all Board meetings, together with papers on any significant commercial initiatives, and information on the Group's competitive position and general economic indicators.

The Board also makes a point of meeting away from head-office on a semi-regular basis so that our Directors can broaden their understanding of the business through direct contact with managers and customers. Directors also regularly visit key markets to gain a better understanding of the global dairy market.

Following appointment to the Board, Directors undertake an induction programme to familiarise themselves with the Group. Areas covered include:

- the Fonterra Constitution
- business strategy and planning
- an overview of key financial metrics to monitor business performance, and
- an overview of material areas of the Fonterra business, through meetings with key executives.

All Directors have access to Fonterra's General Counsel, who is responsible for advising the Board on all governance matters. The Board can also seek external advice as required.

BOARD ROLE AND CHARTER

Our Board is responsible for leadership, direction and oversight of the Group and is accountable to Shareholders for overall performance of the Co-operative. Specific functions in the discharge of this responsibility are:

- review of the dividend policy and declaration of the interim and final dividend
- declaration of the Farmgate Milk Price and Distributable Profit
- declaration of the actual co-operative share price from the commencement of each season (the Fair Value Share price)
- reviewing and approving the Group strategy and business plans
- appointing the CEO and reviewing the CEO's performance
- delegating authority to management, and monitoring the exercise of that authority
- engaging in the development of the strategic plan and setting the strategy for the Group and for the major business units within the Group
- approving significant acquisitions and disposals outside management's delegated authorities, and
- overseeing the Board Committees and the areas covered by each of those Committees.

The Board Charter outlines the key values and practices of Fonterra and provides a reference point for the Board as a whole, and for individual Directors, in the execution of their duties. The Charter is reviewed regularly, as are the Committee Charters (see *www.fonterra.com* for the Charter documents).

Board meetings

The Board meets formally at least seven times a year and calls additional meetings to deal with specific issues as they arise. Between full Board meetings, the Board uses Committees and Working Groups to advance its work programme and to enhance the efficiency and effectiveness of its decision-making. The Board also this year held a special two day planning and strategy session.

BOARD COMMITTEES

COMMITTEE	MEMBERSHIP	PURPOSE
Audit, Finance and Risk Committee (AFRC)	David Jackson (Chair) Colin Armer Malcolm Bailey Ian Farrelly Greg Gent John Waller	To assist the Board in fulfilling its corporate governance responsibilities in relation to Fonterra's risk management and internal control frameworks, financial reporting, audit activities and treasury matters.
Appointments, Remuneration and Development Committee (AR&D)	Sir Henry van der Heyden (Chair) Colin Armer John Ballard Ian Farrelly John Monaghan Ralph Waters John Wilson David Jackson (observer)	To assist the Board in fulfilling its corporate governance responsibilities in relation to the recruitment, retention, remuneration and development of Directors, executives and other employees, and to promote a safe and healthy working environment.
Supplier Relations Committee (SRC)	Colin Armer (Chair) Malcolm Bailey Ian Farrelly Nicola Shadbolt Jim van der Poel	To assist the Board in fulfilling its corporate governance responsibilities in relation to the supply of milk from Shareholders, and to seek to resolve Shareholder complaints before reference to the Milk Commissioner.
Fair Value Share Review Committee (FVSRC)	John Waller (Chair) Greg Gent David Jackson John Monaghan John Wilson Jim van der Poel	To assist the Board in fulfilling its corporate governance responsibilities in relation to the Fair Value Share process, including the adequacy of the information provided to the Valuer and the determination of Restricted Market Value.
External Relations Committee (ERC)[1]	John Monaghan (Chair) Malcolm Bailey Colin Armer Greg Gent Jim van der Poel John Wilson	To support Fonterra management to build aspiration with stakeholders for New Zealand to be the centre of dairying excellence in the world, including regulatory frameworks and infrastructure, and creating a shared agenda for Fonterra's success.
Capital Structure Committee (CSC)[2]	John Wilson (Chair) Greg Gent David Jackson John Monaghan Nicola Shadbolt Jim van der Poel John Waller	To assist the Board in fulfilling its corporate governance responsibilities in relation to the implementation of Trading Among Farmers.

1. Formerly the Government and Trade Relations Committee.

2. Established as a Board Committee on 26 October 2010. Previously a sub-committee of the FVSRC.

Board and Committee attendance

	BOARD							
	REGULAR	SPECIAL	AFRC	AR&D	SRC	FVSRC	ERC	CSC
Colin Armer	7/7	3/3	6/6	7/7	1/1		2/2	
Malcolm Bailey	7/7	3/3	6/6		5/5		2/2	
John Ballard	6/7	2/3		7/7				
Ian Farrelly	7/7	3/3	6/6	7/7	4/5			
Greg Gent	7/7	3/3	6/6			6/7	2/2	7/7
David Jackson	7/7	3/3	6/6			7/7		6/7
John Monaghan	7/7	3/3		5/7		5/7	2/2	7/7
Nicola Shadbolt	7/7	3/3			5/5			7/7
Sir Henry van der Heyden	7/7	3/3		7/7				
Jim van der Poel	7/7	3/3			5/5	7/7	1/2	7/7
John Waller	6/7	3/3	5/6			7/7		6/7
Ralph Waters	7/7	2/3		7/7				
John Wilson	7/7	3/3		6/7		7/7	1/2	7/7
Total meetings	7	3	6	7	5	7	2	7

DIRECTORS' REMUNERATION COMMITTEE (DRC)

In accordance with the Constitution, Shareholders elect an independent committee of six Shareholders to consider and make recommendations to the Annual Meeting on Elected Director remuneration. The members of the DRC are Rodney Wilson (Chair), Murray Holdaway, Murray King, Scott Montgomerie, Philip Wilson and Gerard Wolvers. The Board reviews the DRC's performance against its Terms of Reference but, given the independent nature of the committee, would refer any matters of concern to an Annual or Special Meeting of Shareholders.

The Board sets the remuneration of Appointed Directors.

SHAREHOLDERS' COUNCIL

One of the Board's most important relationships is with the Shareholders' Council. The Council, which is established under the Fonterra Constitution, is independent of the Board and comprises 35 Shareholder-elected councillors, each representing a different ward. The Council reviews the Board's statement of intentions for the performance and operations of the Group and publishes an Annual Report, commenting on these matters. The Council and the Board meet regularly, as do the Chairs of the Board and the Council and the Chairs of their respective Committees.

COMMUNICATIONS

Fonterra is committed to maintaining and improving dialogue with our Shareholder base to ensure that the objectives of both the Group and the Shareholders are understood. We run an extensive Shareholder and supplier relations programme, managed by the Group Director Supplier and External Relations and the Chief Financial Officer. We also provide channels for electronic communication through the *www.fonterra.com* and Fencepost websites.

Shareholder/supplier meetings

A schedule of regular meetings with Shareholders and suppliers is held across the country each year. Often these are run in conjunction with the Shareholders' Council, Area Managers and the Fonterra Farmer Network.

In addition, the Board consults with supplying Shareholders on specific issues as they arise. This year, for example, a number of special meetings were held to discuss the Trading Among Farmers initiative, reinforcing the Board's commitment to maintaining a constructive and open engagement with our Shareholders.

www.fonterra.com and Fencepost

Presentations on the development of the business are available on the *www.fonterra.com* website. The Group also uses email alerts, including regular updates from the Chairman and a monthly Shareholder Update.

The Fencepost website enables Fonterra suppliers, their employees and business partners to transact online with Fonterra and access information and tools on milk production and quality, online statements and up to the minute news and weather. This site is also used to provide information on the business to suppliers.

Annual Meeting

The Board views the Annual Meeting of Shareholders, which is held at a different venue around New Zealand each year, as an opportunity to communicate directly with Shareholders and ensures that adequate time is provided at these meetings for Shareholders to raise issues or ask questions from the floor.

Annual Report

The Group's Annual Report including financial statements, and Annual Review, together with the half-year reports and other material announcements, are designed to present a balanced and clear view of Fonterra's activities and prospects and are available on the website, *www.fonterra.com*.

Other disclosures

Information on the Group's performance and the expected Payout, the Fair Value Share, annual and half-year financial results, Director changes, and other significant matters is advised to the market through NZX in accordance with the Disclosure Policy. Shareholders and other stakeholders receive regular updates on these and other issues relevant to them.

Fonterra also makes presentations to the Valuer (appointed by the Shareholders' Council to determine the Fair Value range for the Co-operative share price), analysts, rural professionals and financial commentators to coincide with the publication of the Group's half-year and full-year results.

MILK PRICE PANEL

The Board has created the Milk Price Panel for the purpose of providing assurances to it as to the governance of the Farmgate Milk Price and the proper application of the Farmgate Milk Price Manual and the Milk Price Principles.

The Panel does not determine the Farmgate Milk Price as this is a decision for the Board.

The Panel's composition is designed to ensure a large measure of independence. It consists of two Appointed Directors, one Elected Director and two appropriately qualified persons nominated by the Shareholders' Council, at least one of whom must be independent. The Chair must be one of the Appointed Director members.

The Panel is currently chaired by John Waller. Other Board members are David Jackson and John Wilson. The Shareholders' Council appointees are Richard Punter and Patrick Boyle.

KEY POLICIES

Disclosure Policy

The Board affirmed Fonterra's commitment to promoting a well-informed and efficient market in its listed debt securities by signing off a new Fonterra Group Disclosure Policy in December 2010.

The Policy applies to all Directors and Officers of Fonterra and its subsidiaries, all Shareholders' Councillors and all employees (including contractors, consultants, advisers or secondees).

The objectives of the Policy are to ensure Fonterra continues to provide timely and accurate information and fully comply with the NZX continuous disclosure regime and with the Securities Markets Act and applicable market rules.

Audit independence policy

The auditor is appointed by the Shareholders at the Annual Meeting. Fonterra encourages the rotation of the lead external audit partner in the relationship in accordance with best practice. AFRC approval is required, under the Group's auditor independence policy, for certain activities the auditor may undertake for the Group. The AFRC will not approve the auditor performing any tasks which have the potential to create a conflict except in exceptional circumstances and then only if appropriate safeguards are in place.

Ethics framework

The Board is committed to maintaining high ethical standards across the Group, in all aspects of the business in all parts of the world. Fonterra's Code of Business Conduct – *The Way We Work* – provides practical guidelines on how to apply Fonterra's values in everyday work situations and when working with customers, Shareholders, suppliers and the wider community. This document is available in several languages, to facilitate its accessibility to Fonterra's global employee base.

During the year, *The Way We Work* was rewritten into simple, straightforward language and re-issued to employees. An independently run telephone, e-mail and web-based Hotline provides individuals with a confidential channel to raise difficult ethical issues. In the 2011 financial year, 15 calls were raised with the Hotline. All were fully investigated and appropriate action taken. None was sufficiently serious that it could not be dealt with through internal governance and disciplinary procedures.

COMPLIANCE WITH GOVERNANCE STANDARDS

As Fonterra does not list equity securities, not all of the provisions in the NZX Corporate Governance Best Practice Code are directly applicable. However, the Board recognises the Code's relevance to the Company and seeks to comply, but notes the following areas where its practices diverge from the Code.

- Appointments to the Board/Nomination Committee (paragraphs 2.2 and 3.10-3.12 of the Code). Under Fonterra's Constitution, the Shareholders' Council conducts the election process for Directors. To the extent the Board is responsible for appointing Directors the AR&D Committee satisfies the role of a nomination committee. The AR&D Committee does not have a majority of Appointed Directors due to the proportion of farmer-elected Directors on the Board
- Director Remuneration (paragraph 2.7). Fonterra does not run a performance-based equity security compensation plan. In particular, this is not possible as Appointed Directors are effectively debarred from share ownership as a usual condition of their appointment is that they do not have a supplier relationship with the Company.

The Board has also reviewed compliance with the Principles for Corporate Governance issued by the Financial Markets Authority. While the Board believes it complies with the Principles, there are some points of divergence from specific Guidelines.

- Audit Committee membership (Guideline 3.4). The majority of members are not independent, due to the proportion of farmer-elected Directors on the Board
- Management representation (Guideline 4.4). The CEO and CFO do not certify in the published accounts their compliance with generally accepted accounting practice in New Zealand. The Board is directly and legally responsible for these documents, and obtains all relevant assurances from management or other parties.

FONTERRA'S BOARD OF DIRECTORS HAS 13 MEMBERS – NINE ELECTED FROM THE SHAREHOLDER BASE AND FOUR APPOINTED BY THE BOARD AND RATIFIED BY SHAREHOLDERS AT THE ANNUAL MEETING.

SIR HENRY VAN DER HEYDEN has been Fonterra Chairman since 2002. He is also Chairman of the Appointments, Remuneration and Development Committee.

Sir Henry is a Director of Auckland International Airport Ltd, Independent Egg Producers Ltd, Elevation Capital Management Ltd, Pascaro Investments Ltd and Manuka Ltda. He is a member of Rabobank's Food Agribusiness Advisory Board of Australia, the New Zealand Business Forum and the Director Remuneration Committee of Zespri International.

COLIN ARMER was elected to the Board in 2006 and is Chairman of the Supplier Relations Committee, the International Farming Ventures Group, and Milk Payments Working Group. He also sits on the Audit, Finance and Risk Committee, the Appointments, Remuneration and Development Committee and the External Relations Committee.

Colin is a Director of Dairy Holdings Ltd. Colin and his wife, Dale, have extensive dairy farming interests in both the North and South Island.

MALCOLM BAILEY was elected to the Board in 2004, and sits on the Audit, Finance and Risk Committee, Supplier Relations Committee, the External Relations Committee and the Milk Payments Working Group. Malcolm also represents Fonterra on Dairy Companies Association NZ, and is a member of the International Food and Agriculture Trade Policy Council.

He is also a Director of Embryo Technologies Ltd, Hawke's Bay Dairies (2002) Ltd, Hopkins Farming Group Ltd, and Agrico Holdings Ltd. Malcolm's dairy farming interests are as a shareholder in the Hopkins Farming Group and he lives on a 200 hectare dairy support block near Feilding.

JOHN BALLARD was appointed in July 2006. He is an Appointed Director. He serves on the Appointments, Remuneration and Development Committee.

John has served on the Boards of several listed companies including Woolworths Ltd, CSR Ltd, Rinker Ltd, Email Ltd and Southcorp Ltd where he was CEO. He is currently Chairman of Elders Ltd, a Director of Magellan Financial Fund Ltd, a Director of International Ferro Metals Ltd and Chairman of the Advisory Board of Pacific Equity Partners. His farming interests extend to a property producing milk-fed veal in New South Wales.

IAN FARRELLY was elected to the Board in 2007 following a 20 year career in the banking industry. He is a member of the Audit, Finance and Risk Committee, the Appointments, Remuneration and Development Committee, the Supplier Relations Committee and the Milk Payments Working Group.

Ian is also a Director of First Mortgage Managers Ltd, Spectrum Dairies Ltd and F.D. Lands Ltd. He runs a 400 hectare calf rearing farm in Te Awamutu, owns a 50 per cent share in three Waikato dairy farms and also has ownership in dairy farms in Canterbury.

GREG GENT has been a Board member since Fonterra's formation. Greg is a member of the Audit, Finance and Risk Committee, the Capital Structure Committee, the Fair Value Share Review Committee, the Milk Payments Working Group, the External Relations Committee and the International Farming Ventures Group.

Greg is also Chairman of FMG Insurance Ltd, a Director of Equestrian Sports NZ Inc and a Director of the Northland District Health Board.

DAVID JACKSON was appointed to the Board in September 2007. He is an Appointed Director. David is Chairman of the Audit, Risk and Finance Committee and serves on the Fair Value Share Review Committee, the Capital Structure Committee and the Milk Price Panel. As Chairman of the Audit, Finance and Risk Committee, he is an observer on the Appointments, Remuneration and Development Committee.

David serves on the Boards of several companies including Pumpkin Patch Ltd, Nuplex Industries Ltd and The New Zealand Refining Company Ltd. He spent more than 30 years with accounting firm Ernst & Young in a variety of roles. He served as Chairman of the Board of Management for Ernst & Young Ltd New Zealand from 1999 to 2002.

JOHN MONAGHAN was elected to the Fonterra Board in 2008. John is Chairman of the External Relations Committee and is a member of the Appointments, Remuneration and Development Committee, the Fair Value Share Committee and the Capital Structure Committee. He is also a Director of CentrePort Ltd and CentrePort Properties Ltd. He has farming interests in the Wairarapa and Canterbury regions.

NICOLA SHADBOLT was elected to the Board in 2009. She serves on the Capital Structure Committee, the Supplier Relations Committee, the Milk Payments Working Group and the International Farming Ventures Group.

Nicola is also Professor in Farm and Agribusiness Management at Massey University, and co-author of *Farm Management in New Zealand*. She is a Director of five farming and forestry equity partnerships that include two dairy farms in the Manawatu. Nicola is a Fellow of the New Zealand Institute of Primary Industry Management.

JIM VAN DER POEL was elected to the Board in 2002 and serves on the Fair Value Share Review Committee, the External Relations Committee, the Supplier Relations Committee, the Milk Payments Working Group, the Capital Structure Committee and the International Farming Ventures Group.

He is also Chairman of the Spectrum Group of Companies and a trustee of the Asia NZ Foundation. Jim has won a number of industry awards including the AC Cameron Award, 2002 Nuffield Scholarship, Sharemilker of the Year and the Dairy Exporter Primary Performer Award. Jim and his wife Sue live at Ngahinapouri in the Waikato and have farming interests in Waikato, Canterbury and the United States.

JOHN WALLER was appointed to the Board in February 2009. He is an Appointed Director. John chairs the Fair Value Share Review Committee and the Milk Price Panel, and is a member of the Audit, Finance and Risk Committee, and the Capital Structure Committee.

John is Chairman of the BNZ and the Eden Park Redevelopment Board and of the Eden Park Trust Board. He is a Director of National Australia Bank Ltd, BNZ Investments Ltd, Haydn & Rollett Ltd, National Equities Ltd, Alliance Group Ltd, Sky Network Television Ltd and Donaghy's Ltd. John was a partner at PricewaterhouseCoopers for over 20 years. He was a member of their Board and led their Advisory practice for many years.

RALPH WATERS was appointed to the Board in July 2006. He is an Appointed Director, and serves on the Appointments, Remuneration and Development Committee.

Ralph also serves as Chairman of Fletcher Building Ltd and as a Director of Westpac New Zealand Ltd and Woolworths Ltd. He was Chief Executive of Fletcher Building from May 2001 until his retirement in August 2006. Before joining Fletcher Building, Ralph was Managing Director of the Australian publicly-listed company Email Ltd, and has also held a number of engineering and managerial positions in London and the Middle East.

JOHN WILSON was elected to the Board in 2003. He is Chairman of the Capital Structure Committee and serves on the Appointments, Remuneration and Development Committee, and the Milk Price Panel and the Fair Value Share Review Committee.

John is also the Chairman of South Auckland Independent Testing Society Ltd and a member of the Institute of Directors. In 2000 he was awarded the Nuffield Scholarship. John lives on his dairy farm near Te Awamutu and also manages a dairy farming business based in Geraldine, South Canterbury, which he owns jointly.

EXECUTIVE COMMITTEE

ANDREW FERRIER has been Chief Executive of Fonterra Co-operative Group since September 2003, bringing with him a background of generating stronger performances from companies in both the consumer products sector and the commodities market. He has more than 25 years experience at senior executive level, with 17 years as a Chief Executive.

GARY ROMANO joined the dairy industry in 1997 with the New Zealand Dairy Group of Companies, after working for Alcoa of Australia, The Boston Consulting Group and Dairy Partners Americas. In the dairy industry he has had significant experience in both manufacturing and supply chain where he has led teams responsible for driving to achieve world class standards of productivity, quality, safety, cost effectiveness, service and environmental performance.

JONATHAN MASON joined Fonterra in February 2009 as Chief Financial Officer (CFO). He came from US-based Cabot Corporation, where he was Executive Vice President and CFO from 2006, and also worked in a variety of financial management positions at International Paper and ExxonMobil Corporations from 1985 to 2000. Before moving to New Zealand for Fonterra, Jonathan had also worked here when he was CFO for Carter Holt Harvey from 2000 to 2005.

JENNIFER KERR has worked in senior human resources roles in the oil industry for Mobil in the US and Europe and in the leisure industry in the UK for Whitbread. On her return to New Zealand, Jennifer started up her own consultancy, Jennifer Kerr and Associates, before joining Fonterra in July 2006.

ANDREI MIKHALEVSKY joined Fonterra in February 2007. Previously he was Global President of the flavours division in the German listed company Symrise, a leading manufacturer of flavours, fragrances and sensory ingredients. Andrei spent seven years with Georgia Pacific and related companies, including heading the North American retail business, and 22 years in executive positions with the Campbell Soup Company. He resides in the United States with offices in Chicago and Auckland.

JOHN DOUMANI joined Fonterra in 2007 after a 25 year career in international business and consumer brands. Most recently he was President International of the Campbell Soup Company. Prior to joining Campbell's, John was Managing Director of Meadow Lea Foods and he had 13 years experience with Johnson & Johnson. He is based in Australia.

MARK WILSON has more than 35 years experience in the consumer goods sector in Asia, the Pacific, South America, and Europe. Before joining Fonterra in February 2008, he managed Danone's nutrition business across Asia and the Pacific. From 1995 to 1998 he was CEO of Dumex, before becoming President and Chief Executive Officer of the Danish listed East Asiatic Company from 1998 to 2007. He is based in Hong Kong.

KELVIN WICKHAM has over 22 years experience in the dairy industry. He was responsible for furthering Fonterra's overseas markets and partnerships and the development of GlobalDairyTrade™ before taking this new position on the Executive Committee. This role reflects the importance Fonterra places on delivering sustainable co-operative performance and includes Milk Supply, Sustainability, RD1 Ltd, International Farming, Corporate Marketing, Government Relations and Trade Strategy.

FROM LEFT – STANDING

MARK WILSON
Managing Director, Asia/Africa, Middle East

ANDREI MIKHALEVSKY
Managing Director, Global Ingredients and Foodservices

GARY ROMANO
Managing Director, Fonterra Trade and Operations

JOHN DOUMANI
Managing Director, Australia/New Zealand

KELVIN WICKHAM
Group Director, Supplier and External Relations

FROM LEFT – SEATED

JONATHAN MASON
Chief Financial Officer

ANDREW FERRIER
Chief Executive

JENNIFER KERR
Group Director, Human Resources

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FINANCIAL STATEMENTS

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DIRECTORS' STATEMENT
FOR THE YEAR ENDED 31 JULY 2011

The Directors of Fonterra Co-operative Group Limited (Fonterra or the Company) are pleased to present to Shareholders the financial statements for Fonterra and its subsidiaries (together the Group) and the Group's interest in its equity accounted investees for the year ended 31 July 2011.

The Directors are responsible for presenting financial statements for each financial year which give a true and fair view of the financial position for the Company and Group and of the financial performance and cash flows for that period.

The Directors consider the financial statements of the Company and Group have been prepared using accounting policies which have been consistently applied and supported by reasonable judgements and estimates, and that all relevant financial reporting and accounting standards have been followed.

The Directors believe that proper accounting records have been kept which enable, with reasonable accuracy, the determination of the financial position of the Company and Group and facilitate compliance of the financial statements with the Financial Reporting Act 1993.

The Directors consider that they have taken adequate steps to safeguard the assets of the Company and Group, and to prevent and detect fraud and other irregularities.

The Directors hereby approve and authorise for issue the financial statements for the year ended 31 July 2011 presented on pages 47 to 99. For and on behalf of the Board:

SIR HENRY VAN DER HEYDEN
Chairman
21 September 2011

DAVID JACKSON
Director
21 September 2011

INCOME STATEMENT
FOR THE YEAR ENDED 31 JULY 2011

	NOTES	GROUP $ MILLION		PARENT $ MILLION	
		31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Revenue from sale of goods		**19,871**	16,726	**10,257**	7,952
Dividends received		**–**	–	**495**	458
Total revenue		**19,871**	16,726	**10,752**	8,410
Cost of goods sold	1	**(16,861)**	(13,975)	**(10,257)**	(7,952)
Gross profit		**3,010**	2,751	**495**	458
Other operating income		**165**	277	**53**	62
Selling and marketing expenses		**(596)**	(590)	**(12)**	(3)
Distribution expenses		**(487)**	(474)	**–**	–
Administrative expenses		**(700)**	(632)	**(218)**	(186)
Other operating expenses		**(336)**	(303)	**(66)**	(19)
Net foreign exchange losses	3	**(91)**	(7)	**–**	–
Operating profit	2	**965**	1,022	**252**	312
Finance income	4	**32**	21	**375**	301
Finance costs	4	**(438)**	(334)	**(372)**	(279)
Net finance (costs)/income		**(406)**	(313)	**3**	22
Share of profit of equity accounted investees	11	**63**	56	**–**	–
Profit before tax		**622**	765	**255**	334
Tax credit/(expense)	5	**149**	(80)	**183**	92
Profit for the year		**771**	685	**438**	426
Profit for the year is attributable to:					
Shareholders of the Parent		**754**	669	**438**	426
Non-controlling interests		**17**	16	**–**	–
Profit for the year		**771**	685	**438**	426

		GROUP $	
		31 JULY 2011	31 JULY 2010
Earnings per share:			
Basic and diluted earnings per share	25	**0.55**	0.51

The accompanying notes form part of these financial statements

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 JULY 2011

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Profit for the year	**771**	685	**438**	426
Cash flow hedges:				
– Net fair value gains/(losses)	**1,384**	584	**(36)**	(53)
– Transferred and reported in revenue from sale of goods	**(863)**	(631)	**–**	–
– Tax (expense)/credit on cash flow hedges	**(146)**	18	**10**	15
Net investment hedges:				
– Net fair value gains on hedging instruments	**49**	65	**–**	–
– Tax expense on net investment hedges	**(14)**	(19)	**–**	–
Foreign currency translation losses attributable to Shareholders	**(164)**	(150)	**–**	–
Foreign currency translation reserve transferred to income statement	**(15)**	19	**–**	–
Foreign currency translation attributable to non-controlling interests	**(4)**	(2)	**–**	–
Share of equity accounted investees' movements in reserves	**7**	–	**–**	–
Other comprehensive income/(expense) recognised directly in equity	**234**	(116)	**(26)**	(38)
Total comprehensive income for the year	**1,005**	569	**412**	388
Attributable to:				
Shareholders of the Parent	**992**	555	**412**	388
Non-controlling interests	**13**	14	**–**	–
Total comprehensive income for the year	**1,005**	569	**412**	388

The accompanying notes form part of these financial statements

STATEMENT OF FINANCIAL POSITION
AS AT 31 JULY 2011

	NOTES	GROUP $ MILLION		PARENT $ MILLION	
		AS AT 31 JULY 2011	AS AT 31 JULY 2010	**AS AT 31 JULY 2011**	AS AT 31 JULY 2010
ASSETS					
Current assets					
Cash and cash equivalents		**785**	559	**570**	345
Trade and other receivables	8	**2,279**	2,088	**9,423**	8,215
Inventories	9	**3,277**	2,870	**–**	–
Tax receivable		**29**	18	**–**	–
Derivative financial instruments	19(g)	**1,100**	488	**1,088**	478
Other current assets		**90**	64	**–**	–
Total current assets		**7,560**	6,087	**11,081**	9,038
Non-current assets					
Property, plant and equipment	10	**4,326**	4,356	**222**	207
Investment in subsidiaries		**–**	–	**6,895**	6,895
Equity accounted investments	11	**429**	458	**–**	–
Intangible assets	12	**2,748**	2,756	**66**	46
Deferred tax asset	16	**116**	100	**403**	287
Derivative financial instruments	19(g)	**154**	214	**154**	214
Other non-current assets		**197**	198	**10**	28
Total non-current assets		**7,970**	8,082	**7,750**	7,677
Total assets		**15,530**	14,169	**18,831**	16,715
LIABILITIES					
Current liabilities					
Bank overdraft		**23**	25	**–**	–
Borrowings	15	**444**	902	**53**	397
Trade and other payables	13	**1,350**	1,251	**7,343**	5,770
Owing to suppliers		**1,679**	1,138	**1,729**	1,138
Tax payable		**19**	33	**–**	–
Derivative financial instruments	19(g)	**58**	113	**41**	103
Provisions	14	**67**	92	**29**	19
Other current liabilities		**6**	4	**–**	–
Total current liabilities		**3,646**	3,558	**9,195**	7,427
Non-current liabilities					
Borrowings	15	**4,206**	4,022	**3,799**	3,959
Derivative financial instruments	19(g)	**718**	496	**718**	496
Provisions	14	**106**	110	**79**	85
Deferred tax liability	16	**295**	293	**–**	–
Other non-current liabilities		**18**	23	**–**	–
Total non-current liabilities		**5,343**	4,944	**4,596**	4,540
Total liabilities		**8,989**	8,502	**13,791**	11,967
Net assets		**6,541**	5,667	**5,040**	4,748
EQUITY					
Co-operative shares		**5,261**	5,016	**5,261**	5,016
Retained earnings		**943**	547	**(157)**	(230)
Foreign currency translation reserve		**(217)**	(73)	**–**	–
Cash flow hedge reserve		**516**	141	**(64)**	(38)
Total equity attributable to Shareholders of the Parent		**6,503**	5,631	**5,040**	4,748
Non-controlling interests		**38**	36	**–**	–
Total equity		**6,541**	5,667	**5,040**	4,748

The accompanying notes form part of these financial statements

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 JULY 2011

	ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT						
GROUP $ MILLION	CO-OPERATIVE SHARES	RETAINED EARNINGS	FOREIGN CURRENCY TRANSLATION RESERVE	CASH FLOW HEDGE RESERVE	TOTAL	NON-CONTROLLING INTERESTS	TOTAL EQUITY
As at 1 August 2009	4,557	26	12	170	4,765	40	4,805
Profit for the year	–	669	–	–	669	16	685
Other comprehensive expense for the year	–	–	(85)	(29)	(114)	(2)	(116)
Total comprehensive income/(expense) for the year	–	669	(85)	(29)	555	14	569
Transactions with Shareholders in their capacity as Shareholders:							
Dividends paid to Shareholders of the Parent	–	(107)	–	–	(107)	–	(107)
Co-operative shares issued	617	–	–	–	617	–	617
Co-operative shares surrendered	(158)	–	–	–	(158)	–	(158)
Purchase of non-controlling interest	–	(41)	–	–	(41)	(6)	(47)
Dividends paid to non-controlling interests	–	–	–	–	–	(12)	(12)
As at 31 July 2010	5,016	547	(73)	141	5,631	36	5,667
As at 1 August 2010	**5,016**	**547**	**(73)**	**141**	**5,631**	**36**	**5,667**
Profit for the year	**–**	**754**	**–**	**–**	**754**	**17**	**771**
Other comprehensive income/(expense) for the year	**–**	**7**	**(144)**	**375**	**238**	**(4)**	**234**
Total comprehensive income/(expense) for the year	**–**	**761**	**(144)**	**375**	**992**	**13**	**1,005**
Transactions with Shareholders in their capacity as Shareholders:							
Dividends paid to Shareholders of the Parent	**–**	**(365)**	**–**	**–**	**(365)**	**–**	**(365)**
Co-operative shares issued	**404**	**–**	**–**	**–**	**404**	**–**	**404**
Co-operative shares surrendered	**(159)**	**–**	**–**	**–**	**(159)**	**–**	**(159)**
Dividends paid to non-controlling interests	**–**	**–**	**–**	**–**	**–**	**(11)**	**(11)**
As at 31 July 2011	**5,261**	**943**	**(217)**	**516**	**6,503**	**38**	**6,541**

PARENT $ MILLION	CO-OPERATIVE SHARES	RETAINED EARNINGS	CASH FLOW HEDGE RESERVE	TOTAL EQUITY
As at 1 August 2009	4,557	(549)	–	4,008
Profit for the year	–	426	–	426
Other comprehensive expense for the year	–	–	(38)	(38)
Total comprehensive income/(expense) for the year	–	426	(38)	388
Transactions with Shareholders in their capacity as Shareholders:				
Dividends paid to Shareholders	–	(107)	–	(107)
Co-operative shares issued	617	–	–	617
Co-operative shares surrendered	(158)	–	–	(158)
As at 31 July 2010	5,016	(230)	(38)	4,748
As at 1 August 2010	**5,016**	**(230)**	**(38)**	**4,748**
Profit for the year	**–**	**438**	**–**	**438**
Other comprehensive expense for the year	**–**	**–**	**(26)**	**(26)**
Total comprehensive income/(expense) for the year	**–**	**438**	**(26)**	**412**
Transactions with Shareholders in their capacity as Shareholders:				
Dividends paid to Shareholders	**–**	**(365)**	**–**	**(365)**
Co-operative shares issued	**404**	**–**	**–**	**404**
Co-operative shares surrendered	**(159)**	**–**	**–**	**(159)**
As at 31 July 2011	**5,261**	**(157)**	**(64)**	**5,040**

The accompanying notes form part of these financial statements

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 JULY 2011

	NOTES	GROUP $ MILLION		PARENT $ MILLION	
		31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Cash flows from operating activities					
Cash was provided from:					
– Receipts from customers		**19,490**	16,549	**10,311**	7,996
– Dividends received		**63**	55	**–**	–
– Tax received		**5**	32	**–**	–
Cash was applied to:					
– Payments to creditors and employees		**(7,528)**	(6,784)	**(280)**	(231)
– Payments for milk purchased		**(10,780)**	(8,322)	**(9,632)**	(7,410)
– Tax paid		**(66)**	(51)	**–**	–
Net cash flows from operating activities	17	**1,184**	1,479	**399**	355
Cash flows from investing activities					
Cash was provided from:					
– Proceeds from disposal of property, plant and equipment		**9**	22	**–**	–
– Proceeds from settlement of net investment hedges		**20**	50	**–**	–
– Proceeds from sale of Group entities and other business operations		**184**	222	**–**	23
– Net loans from Group entities		**–**	–	**507**	562
Cash was applied to:					
– Acquisition of property, plant and equipment		**(488)**	(437)	**(25)**	(105)
– Acquisition of intangible assets		**(135)**	(55)	**(27)**	(17)
– Outflows on settlement of net investment hedges		**(23)**	(39)	**–**	–
– Acquisition of Group entities and other business operations		**(55)**	(14)	**–**	–
– Purchase of non-controlling interests		**–**	(48)	**–**	–
– Advances made to equity accounted investees		**–**	(50)	**–**	–
– Acquisition of other non-current assets		**–**	(5)	**–**	(1)
Net cash flows from investing activities		**(488)**	(354)	**455**	462
Cash flows from financing activities					
Cash was provided from:					
– Proceeds from borrowings		**3,648**	2,960	**1,535**	1,036
– Proceeds from issue of Co-operative shares		**368**	590	**368**	590
– Proceeds for Co-operative shares not yet issued		**25**	20	**25**	20
– Proceeds from settlement of borrowing derivatives		**21**	13	**–**	–
– Interest received		**32**	21	**20**	13
Cash was applied to:					
– Interest paid		**(397)**	(304)	**(353)**	(181)
– Repayment of borrowings		**(3,548)**	(3,549)	**(1,699)**	(1,443)
– Outflows on settlement of borrowing derivatives		**(46)**	(37)	**–**	–
– Surrender of Co-operative shares		**(160)**	(158)	**(160)**	(158)
– Dividends paid to non-controlling interests		**(11)**	(12)	**–**	–
– Dividends paid to Shareholders of the Parent		**(365)**	(107)	**(365)**	(107)
– Value Return paid to Shareholder Suppliers		**–**	(591)	**–**	(591)
Net cash flows from financing activities		**(433)**	(1,154)	**(629)**	(821)
Net increase/(decrease) in cash and cash equivalents		**263**	(29)	**225**	(4)
Cash and cash equivalents at the beginning of the year		**534**	542	**345**	349
Effect of exchange rate changes on cash balances		**(35)**	21	**–**	–
Cash and cash equivalents at the end of the year		**762**	534	**570**	345
Reconciliation of closing cash balances to the statement of financial position:					
Cash and cash equivalents		**785**	559	**570**	345
Bank overdraft		**(23)**	(25)	**–**	–
Closing cash balances		**762**	534	**570**	345

Parent undertakes financing activities for the Group. As a result receipts and payments for operating and financing activities (including dividends) are settled on a net basis and presented in investing activities as net loans from Group entities.

There were no material non-cash transactions during the year ended 31 July 2011, or the year ended 31 July 2010.

The accompanying notes form part of these financial statements

a) General information

Fonterra Co-operative Group Limited (Fonterra, Parent, the Co-operative or the Company) is a co-operative company incorporated and domiciled in New Zealand. Fonterra is registered under the Companies Act 1993 and the Co-operative Companies Act 1996, and is an issuer for the purposes of the Financial Reporting Act 1993. Fonterra is also required to comply with the Dairy Industry Restructuring Act 2001.

The consolidated financial statements are for the Company, its subsidiaries (together referred to as the Group) and the Group's interests in its equity accounted investees.

The Group is primarily involved in the collection, manufacture and sale of milk and milk derived products and is a profit-oriented entity.

On 30 June 2010, Shareholders approved changes to the Company's constitution that will allow the Board to take steps to implement changes to Fonterra's capital structure that would permit trading of shares among Shareholders. Refer to Note 7 for further information.

b) Basis of preparation

These financial statements comply with New Zealand Generally Accepted Accounting Practice (NZ GAAP), and have been prepared in accordance with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS), as appropriate for profit-oriented entities. These financial statements also comply with International Financial Reporting Standards (IFRS).

These financial statements are prepared on a historical cost basis except for derivative financial instruments and the hedged risks on certain debt instruments, which are recognised at their fair values.

These financial statements are presented in New Zealand dollars ($), which is the Company's functional and presentation currency, and rounded to the nearest million.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions of accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimation uncertainty, requiring judgement in applying accounting policies, that have the most significant effect on the amounts recognised in the financial statements, are described in the following notes:

- Note 14 Provisions
- Note 19 Financial risk management – fair value of certain financial instruments

c) Basis of consolidation

Subsidiaries
Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date that control is transferred to the Group. They are de-consolidated from the date control ceases.

The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Acquisition-related costs are expensed as incurred. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree, over the fair value of the Group's share of the identifiable net assets acquired, is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets acquired, the difference is recognised in the income statement.

Non-controlling interests are allocated their share of profit for the year in the income statement and are presented within equity in the statement of financial position, separately from equity attributable to Shareholders. The effects of all transactions with non-controlling interests that change the Group's ownership interest but do not result in a change in control are recorded in equity. Where control is lost, the remaining interest in the investment is re-measured to fair value and any surplus or deficit arising from that re-measurement is recognised in the income statement.

Equity accounted investees (associates and jointly controlled entities)
Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Jointly controlled entities are those entities over whose activities the Group has joint control, established by contractual agreement and requiring unanimous consent for strategic, financial and operating decisions. Equity accounted investees are initially recognised at cost (including any goodwill identified on acquisition). Subsequent to initial recognition they are accounted for using the equity method in the consolidated financial statements.

The consolidated financial statements include the Group's share of the profit or loss after tax of equity accounted investees, after adjustments to align to the accounting policies of the Group, from the date that significant influence or joint control commences until the date that significant influence or joint control ceases. When the Group's share of losses exceeds its interest in an equity accounted investee, the carrying amount of that interest is reduced to nil and no further losses are recognised except to the extent the Group has an obligation or has made payments on behalf of the investee. Dividends receivable from equity accounted investees reduce the carrying amount of the investment.

Transactions eliminated on consolidation
Intra-group transactions, balances, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

d) Foreign currency

Foreign currency transactions
Foreign currency transactions are translated into the respective functional currencies of Group entities using the exchange rate at the dates of transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation, using the exchange rates at the balance date, of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in other comprehensive income as qualifying cash flow or qualifying net investment hedges.

Translation of the financial statements into the presentation currency
Where the Company's presentation currency differs from the functional currency of an entity, the assets and liabilities of the operation are translated from the functional currency into the presentation currency at the exchange rates at the balance date. The income and expenses of these entities are translated at rates approximating the exchange rates at the dates of the transactions. Exchange differences arising on the translation of the financial statements of these entities and of borrowings and other currency instruments designated as hedges of such investments are recognised directly in the foreign currency translation reserve. When an entity is partially disposed of or sold, the exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.

e) Financial assets and liabilities

A financial asset or liability is recognised if the Group becomes a party to the contractual provisions of the asset or liability. A financial asset or liability is recognised initially at its fair value plus, in the case of a financial asset or liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the instrument. Financial assets and liabilities carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in the income statement.

After initial recognition, financial assets are measured at their fair values except for loans and receivables and held-to-maturity investments, which are measured at amortised cost less any provision for impairment. After initial recognition, financial liabilities are measured at amortised cost method except for financial liabilities at fair value through profit or loss.

In the separate financial statements of the Parent, investments in subsidiaries are stated at cost, less any impairment.

Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Financial liabilities are derecognised if the Group's obligations specified in the contract expire or are discharged or cancelled.

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis.

Financial assets are classified on initial recognition into the following categories: at fair value through profit or loss, held-to-maturity investments, loans and receivables, and available-for-sale. Financial liabilities are classified as either fair value through profit or loss, or financial liabilities measured at amortised cost. The classification depends on the purpose for which the financial assets and liabilities were acquired. Management determines the classification of its financial assets and liabilities at initial recognition. The Group has not had any held-to-maturity investments or available-for-sale financial assets in the periods covered by these financial statements.

Financial assets and financial liabilities at fair value through profit or loss
Financial assets and liabilities in this category are either designated as fair value through profit or loss, or classified as held for trading. All derivatives are classified as held for trading except when they are in cash flow, fair value, or net investment hedge relationships (refer to accounting policy j) below). Other financial assets and financial liabilities may be designated at fair value through profit or loss where this eliminates an accounting mismatch, or where they are managed on a fair value basis.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Trade and other receivables are classified as loans and receivables.

Financial liabilities measured at amortised cost
Financial liabilities measured at amortised cost are non-derivative financial liabilities with fixed or determinable payments that are not quoted in an active market. Trade and other payables, and debt instruments are classified as financial liabilities measured at amortised cost.

Financial guarantee contracts
Financial guarantee contracts are those contracts that require the issuer to make specific payments to reimburse the holder for a loss it incurs if a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. Financial guarantee contracts are recognised initially as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequently, the liability is measured at the higher of the best estimate of the expenditure required to settle the present obligation at the balance date, and the amount initially recognised less cumulative amortisation.

f) Cash balances

Cash balances include cash and cash equivalents comprising cash on hand, deposits held at call with banks, other short term highly liquid investments with original maturities of three months or less, and bank overdrafts.

g) Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

h) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortised cost using the effective interest method, with the hedged risks on certain debt instruments measured at fair value. Changes in fair value of those hedged risks are recognised in the income statement, except where they relate to borrowings classified as net investment hedges and are recorded directly in other comprehensive income.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after balance date.

i) Trade and other payables

Trade and other payables are carried at amortised cost.

j) Derivative financial instruments and hedging activities

The Group uses derivative financial instruments within predetermined policies and limits in order to reduce its exposure to fluctuations in foreign currency exchange rates and interest rates.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into (the trade date) and transaction costs are expensed immediately. They are subsequently remeasured to their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either:

- hedges of the fair value of recognised assets or liabilities, or a firm commitment (fair value hedges);
- hedges of a particular risk associated with a recognised liability or a highly probable forecast transaction (cash flow hedges); or
- hedges of a net investment in a foreign operation (net investment hedges).

The Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The full fair value of a hedging derivative is classified as a non-current asset or liability when maturity of the hedged item exceeds 12 months. It is classified as a current asset or liability when the maturity of the hedged item is less than 12 months.

Fair value hedges
Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recognised in the income statement, together with any changes in the fair value of the hedged asset or liability attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised and recognised in the income statement over the period to maturity.

Cash flow hedges
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised directly in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are transferred to the income statement when the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is recognised immediately in the income statement.

When the forecast transaction that is hedged results in the recognition of a non-financial asset (e.g. inventory or property, plant and equipment) the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset.

Net investment hedges
Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Gains and losses accumulated in equity are included in the income statement when all or part of a foreign operation is disposed of or sold.

k) Inventories

Inventories are stated at the lower of cost and net realisable value on a first in first out basis.

Net realisable value is the estimated selling price in the ordinary course of business, less the costs of completion and selling expenses.

The cost of dairy product manufactured from milk supplied in New Zealand is established by using the monthly Milk Price as the cost for raw milk supplied. In the case of manufactured inventories and work in progress, cost includes all direct costs plus that portion of the fixed and variable production overhead incurred in bringing inventories into their present location and condition.

l) Property, plant and equipment

Owned assets
Items of property, plant and equipment are measured at cost less accumulated depreciation and impairment losses. Cost includes the purchase consideration and those costs directly attributable to bringing the asset to the location and condition necessary for its intended use. Costs cease to be capitalised when substantially all the activities necessary to bring an asset to the location and condition for its intended use are complete. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of any replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

The assets' residual values and useful lives are reviewed and adjusted, if appropriate, at each financial year end.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount, and are recognised in the income statement.

Depreciation
Depreciation is calculated on a straight line basis to allocate the cost of the asset, less any residual value, over its estimated useful life. The range of estimated useful lives for each class of property, plant and equipment is as follows:

– Land	Indefinite
– Buildings and leasehold improvements	15 – 50 years
– Plant, vehicles and equipment	3 – 25 years

Leased assets
Leases of property, plant and equipment where the Group assumes substantially all the risks and rewards of ownership are classified as finance leases.

Assets under finance leases are recognised as property, plant and equipment in the statement of financial position. They are recognised initially at their fair value, or if lower, at the present value of the minimum lease payments. A corresponding liability is established and each lease payment allocated between the liability and interest expense using the effective interest method. The assets recognised are depreciated on the same basis as equivalent property, plant and equipment.

Leases that are not finance leases are classified as operating leases and the assets are not recognised on the Group's statement of financial position. Operating lease payments are recognised as an expense on a straight line basis over the term of the lease.

m) Intangible assets

Goodwill
Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary or equity accounted investee at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of equity accounted investees is included in equity accounted investments and is tested for impairment as part of the overall balance.

Goodwill is carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Goodwill is tested annually for impairment or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

Brands and other identifiable intangible assets
Brands and other intangible assets purchased by the Group are recognised if the asset is controlled through custody or legal rights and could be sold separately from the rest of the business. Brands and other intangible assets have a combination of both indefinite and finite useful lives. Items with indefinite useful lives are tested for impairment annually or whenever there is an indication that an asset may be impaired and carried at cost less accumulated impairment losses. Items with finite useful lives are carried at cost less accumulated amortisation and accumulated impairment losses, and are amortised on a straight line basis to allocate the cost over their licence period (18 – 25 years). Assets that have been impaired are reviewed for possible reversal of impairment at each balance date.

Computer software
Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Costs associated with developing or maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with the development of identifiable and unique software products controlled by the Group, and that will generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Costs include the employee costs incurred as a result of developing software and an appropriate portion of relevant overheads.

Computer software licences and development costs recognised as assets are amortised over their estimated useful lives, being three to ten years.

Research and development expenditure
All research expenditure is recognised in the income statement as incurred. Significant development expenditure is recognised as an asset when it can be demonstrated that the commercial production of the material or product, or use of the process, will commence.

Development expenditure recognised as an asset is stated at cost and amortised over the period of expected benefits on a straight line basis, not exceeding five years. Amortisation begins at the time that commercial production or use of the process commences. All other development expenditure is recognised in the income statement as incurred.

n) Impairment of financial assets

Assets carried at amortised cost
The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:

- Significant financial difficulty of the customer;
- A breach of contract, such as a default or delinquency in payments;
- For economic or legal reasons relating to the customer's financial difficulty, granting to the customer a concession that the Group would not otherwise consider;
- It becomes probable that the customer will enter bankruptcy or other financial reorganisation.

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate and is recognised in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the reversal of the previously recognised impairment loss is recognised in the income statement.

o) Impairment of non-financial assets

Intangible assets that have an indefinite useful life are not subject to amortisation and are tested for impairment annually or whenever there is an indication that an asset may be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the estimated recoverable amount of an asset is less than its carrying amount, the asset is written down to its estimated recoverable amount and an impairment loss is recognised in the income statement. The recoverable amount of an asset is the higher of its fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash inflows (cash-generating units).

Non-financial assets, other than goodwill, that have been impaired are reviewed for possible reversal of the impairment at each balance date.

p) Provisions

Provisions are recognised only in those circumstances where the Group has a present legal or constructive obligation as a result of a past event, when it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognised as a finance cost in the income statement.

q) Co-operative shares

Co-operative shares are classified as equity. Incremental costs directly attributable to the issue of co-operative shares are recognised as a deduction from equity.

r) Revenue recognition

Revenue from the sale of goods is recognised at the fair value of the consideration received or receivable, net of returns, discounts and allowances. Revenue is recognised when the amount of revenue can be reliably measured, significant risks and rewards of ownership of the inventory items have passed to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, and there is no continuing management involvement with the goods.

Dividend income is recognised when the right to receive payment is established.

s) New Zealand sourced cost of milk

New Zealand sourced cost of milk includes milk supplied by Shareholders, Supplier Premiums paid, and milk purchased from contract suppliers during the financial year. New Zealand sourced cost of milk is recognised in cost of goods sold.

New Zealand sourced cost of milk supplied by Shareholders comprises the volume of milk solids supplied at the Milk Price for the relevant season. The Milk Price for each season is calculated in accordance with the principles set out in the Milk Price Manual and is independently audited. The Milk Price broadly represents the maximum sustainable amount a New Zealand based manufacturer of milk powders could afford to pay for milk and still make an adequate return on capital.

Supplier Premiums are paid for speciality milks such as winter milk and colostrum.

t) Dividends

All shares are eligible to receive dividends if declared by the Board. Dividends are recognised as a liability in the Group's financial statements in the period in which they are declared by the Board.

u) Employee benefits

Employee benefits primarily include short term employee benefits, long term employee benefits and defined contribution pension plans.

Short term employee benefits include salaries, wages, annual leave and sick leave, and are expensed on an undiscounted basis as the relevant service is provided.

Long term employee benefits are measured at the present value of expected payments required using an appropriate pre-tax discount rate.

Contributions to defined contribution pension plans are recognised as an expense in the period they are due. The Group has no further payment obligations once the contributions have been paid.

v) Finance income and costs

Finance income comprises interest income on funds on deposit. Interest income is recognised as it accrues using the effective interest method.

Finance costs comprise interest expense on borrowings, unwinding of the discount on provisions, gains and losses on the revaluation of debt hedges and the hedged risks on certain debt instruments, and gains and losses relating to translation forward points on forward exchange contracts where revaluation gains and losses on those contracts are included within finance costs. Interest expense and the unwinding of the discount on provisions are recognised in the income statement using the effective interest method. Finance costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of that asset.

w) Tax

Tax expense comprises current and deferred tax. Tax expense, including the tax consequences of distributions to Shareholders is recognised in the income statement. The tax consequences of distributions to Shareholders are recognised in the year to which the distribution relates. Other than distributions to Shareholders, tax consequences of items recognised directly in equity are also recognised in equity.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the balance date, and any adjustment to tax payable or receivable in respect of previous years.

Deferred tax is recognised, using the balance sheet method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is measured at the tax rate that is expected to apply to the temporary differences when they reverse, based on laws that have been enacted or substantively enacted by the balance date.

Deferred tax is not recognised on the following temporary differences:

- The initial recognition of goodwill;
- The initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit; and
- Differences relating to investments in subsidiaries and equity accounted investees to the extent that the timing of the reversal is controlled by the Group and it is probable that they will not reverse in the foreseeable future.

Deferred tax assets are recognised to the extent it is probable that future taxable profits will be available against which the temporary differences can be utilised.

x) Earnings per share

Earnings per share is calculated as net profit attributable to equity holders of the Company, divided by the weighted average number of ordinary shares on issue during the year.

y) Comparative figures

Where a change in the presentational format of the financial statements has been made during the period, comparative figures have been restated accordingly. Where material, additional disclosure has been provided in the notes to the financial statements.

z) New and amended International Financial Reporting Standards

The accounting policies used are consistent with those used to prepare the consolidated financial statements for the year ended 31 July 2010.

New standards and amendments to existing standards which could be expected to have a material impact on the Group's financial statements, which were available for early adoption but have not been adopted, are stated below. At this time it is not possible to reasonably estimate the impact of adoption of these standards.

- NZ IFRS 9: Financial Instruments: Classification and Measurement is the first phase of the NZ IAS 39 replacement project and specifies how an entity should classify and measure financial assets and liabilities.
- NZ IFRS 10: Consolidated Financial Statements replaces the guidance on control and consolidation in NZ IAS 27 Consolidated and Separate Financial Statements.
- NZ IFRS 11: Joint Arrangements introduces criteria for determining the type of joint arrangement which focuses on the rights and obligations of the arrangement rather than the legal form.
- NZ IFRS 13: Fair Value Measurement explains how to measure fair value and enhances fair value disclosures.
- Amendments to NZ IAS 19: Employee Benefits incorporates amendments to the definition of short term employee benefits.

New standards and amendments to existing standards which will have a disclosure only impact on the financial statements are:

- Amendments to IAS 1: Presentation of Financial Statements
- Amendments to NZ IFRS 7: Financial Instruments - Disclosures
- NZ IFRS 12: Disclosure of Interest in Other Entities
- Financial Reporting Standard 44: New Zealand Additional Disclosures and Amendments to New Zealand Equivalents to International Financial Reporting Standards to Harmonise with International Financial Reporting Standards and Australian Accounting Standards (Harmonisation Amendments).

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NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 JULY 2011

1 COST OF GOODS SOLD

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Opening inventory	**2,870**	2,656	**–**	–
Cost of Milk:				
– New Zealand sourced	**10,235**	7,938	**10,257**	7,952
– Non-New Zealand sourced	**1,272**	1,029	**–**	–
Other purchases	**5,761**	5,222	**–**	–
Closing inventory	**(3,277)**	(2,870)	**–**	–
Closing balance	**16,861**	13,975	**10,257**	7,952

The cost of New Zealand sourced milk includes milk supplied by Shareholders, Supplier Premiums paid, and milk purchased from contract suppliers during the financial year. Prior periods have been restated on a consistent basis. This had no impact on the total cost of goods sold. Cost of non-New Zealand sourced milk, previously disclosed as other purchases, has been included in the Cost of Milk.

Parent Cost of Milk – New Zealand sourced includes milk purchased from Fonterra Group companies of $22 million (2010: $14 million).

2 OPERATING PROFIT

		GROUP $ MILLION		PARENT $ MILLION	
	NOTES	**31 JULY 2011**	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
The following items have been included in arriving at operating profit:					
Auditors' remuneration to the auditors of the Parent:					
– Audit fees		**4**	4	**2**	2
– Other audit related services[1]		**1**	2	**–**	1
– Other services[2]		**1**	1	**–**	–
Operating lease expense		**64**	54	**–**	–
Restructuring and rationalisation costs	14	**10**	9	**1**	–
Research and development costs		**90**	98	**5**	7
Gain on acquisition of business	18	**(23)**	–	**–**	–
Net gain on disposal of equity accounted investments	11	**–**	(127)	**–**	–
Net gain on disposal of business[3]		**(26)**	–	**–**	–
Net loss on disposal of property, plant and equipment		**–**	3	**1**	–
Receipt for amendments to equity accounted investee arrangements		**–**	(41)	**–**	–
Donations[4]		**6**	–	**4**	–
Government grant income		**(6)**	(6)	**(3)**	(4)
Total employee benefits expense		**1,549**	1,460	**113**	87
Included in employee benefits expense are:					
– Contributions to defined contribution plans		**51**	42	**1**	1

1. Other audit related services include services for financial and information technology controls assurance and other attest services.
2. Other services include financial reporting and advisory services.
3. On 21 March 2011, Fonterra completed the sale of its Western Australia dairy business. The transaction resulted in a pre-tax gain on sale of $26 million, which was recognised in other operating income, as part of the ANZ segment result. It also resulted in a tax credit of $26 million due to the derecognition of the net deferred tax liability associated with the assets and liabilities that were disposed of, which was recognised as a reduction to the tax expense for the year.
4. Group donations paid of $6 million includes $2 million received from employees and Shareholders by the Fonterra Communities Assistance Trust (an entity controlled by Fonterra Co-operative Group Limited) and paid by the Fonterra Communities Assistance Trust to charities associated with the Christchurch earthquake.

3 NET FOREIGN EXCHANGE (LOSSES)/GAINS

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Net foreign exchange gains on debt instruments designated in a fair value hedge relationship	**262**	311	**–**	–
Net foreign exchange losses on derivative instruments designated as a fair value hedge	**(266)**	(317)	**–**	–
Net foreign exchange gains on financial instruments classified as held for trading	**127**	85	**–**	–
Net foreign exchange losses on financial assets classified as loans and receivables	**(403)**	(196)	**–**	–
Net foreign exchange gains on financial liabilities measured at amortised cost	**188**	109	**–**	–
Other net foreign exchange gains	**1**	1	**–**	–
Net foreign exchange losses	**(91)**	(7)	**–**	–

4 NET FINANCE (COSTS)/INCOME

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Finance income	**32**	21	**375**	301
Interest expense on financial liabilities measured at amortised cost	**(358)**	(343)	**(292)**	(288)
Interest expense on derivatives classified as held for trading	**(39)**	(61)	**(39)**	(61)
Total interest expense calculated on an amortised cost basis	**(397)**	(404)	**(331)**	(349)
Change in fair value of forward points on cash flow hedges and net investment hedges	**(1)**	1	**–**	–
Change in fair value of hedged risks on debt instruments designated in a fair value hedge relationship	**6**	(82)	**6**	(82)
Change in fair value of derivative instruments designated as a fair value hedge[1]	**(33)**	141	**(33)**	141
Change in fair value of financial instruments classified as held for trading	**(13)**	10	**(14)**	11
Finance costs	**(438)**	(334)	**(372)**	(279)
Net finance (costs)/income	**(406)**	(313)	**3**	22

1. This includes the fair value impact of the basis risk adjustment inherent in the valuation of cross currency interest rate swaps that does not form part of the debt instrument hedging relationship.

5 TAX (CREDIT)/EXPENSE

	NOTES	GROUP $ MILLION		PARENT $ MILLION	
		31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Current tax expense/(credit)		**38**	118	**(71)**	(147)
Prior period adjustments to current tax		**(1)**	(24)	**(6)**	–
Deferred tax movements:					
– Origination and reversal of temporary differences	16	**(186)**	(67)	**(106)**	31
– Change to tax depreciation on buildings	16	**–**	61	**–**	4
– Change in New Zealand corporate tax rate	16	**–**	(8)	**–**	20
Tax (credit)/expense		**(149)**	80	**(183)**	(92)
Profit before tax		**622**	765	**255**	334
Prima facie tax expense at 30%		**187**	230	**77**	100
Add/(deduct) tax effect of:					
– Effect of tax rates in foreign jurisdictions		**(9)**	(16)	**–**	–
– Non-deductible expenses/additional assessable income		**35**	73	**8**	48
– Non-assessable income/additional deductible expenses		**(43)**	(90)	**(158)**	(155)
– Losses of overseas Group entities not recognised/(recognised)		**3**	(37)	**–**	–
– Prior year (over)/under provision		**(1)**	(24)	**6**	–
– Tax effect of distributions to Shareholders		**(116)**	(109)	**(116)**	(109)
– Impact of change in tax rate[1]		**–**	(8)	**–**	20
– Origination and reversal of other temporary differences		**(205)**	–	**–**	–
– Effect of change to tax depreciation on buildings[2]		**–**	61	**–**	4
Tax (credit)/expense		**(149)**	80	**(183)**	(92)
Imputation credits:					
Opening balance				**9**	9
Imputation credits attached to dividends received				**–**	–
Closing balance				**9**	9
The imputation credits are available to the Shareholders of the Parent:					
– Through the Parent				**9**	9
– Through Group entities				**10**	10
				19	19
Dividend withholding payment credits:					
The dividend withholding payment credits are available to the Shareholders of the Parent:					
– Through the Parent				**–**	–
– Through Group entities				**1**	1
				1	1
Tax losses					
Gross tax losses available for which no deferred tax asset has been recognised		**61**	56	**–**	–

1. As a result of the change in the New Zealand corporate tax rate from 30% to 28% which was enacted on 27 May 2010 and will be effective from 1 August 2011, deferred tax expected to reverse in the year to 31 July 2012 or later has been measured using 28%.
2. As a result of the change in tax legislation which was enacted on 27 May 2010 and will be effective from 1 August 2011, the tax depreciation rate on buildings with an estimated useful life of 50 years or more will be reduced to nil. This reduction in the tax depreciation rate has significantly reduced the tax base of the Group's buildings as future tax deductions will no longer be available from the 2011/12 income year. This has resulted in an increase to the deferred tax liability of $61 million which was recognised in tax expense in the year ended 31 July 2010.

6 SEGMENT REPORTING

The Group operates predominantly in the international dairy industry.

The Group has four reportable segments that are defined by product type and geographic area to reflect how the Group's operations are managed.

The reportable segments presented reflect the Group's management and reporting structure as viewed by the Fonterra Executive Committee, which comprise the Group's chief operating decision makers.

Transactions between segments are based on estimated market prices.

REPORTABLE SEGMENT	DESCRIPTION
Standard and Premium Ingredients (formerly described as Commodities and Ingredients)	Includes New Zealand Milk Supply, New Zealand Manufacturing, Global Portfolio Optimisation, Global Trade (including the China Ingredients business), Global Supply Chain, Global Ingredients and Foodservices operations in North Asia, North America and Europe (including equity accounted investments and Global Formulated Foods), and Corporate.
ANZ	Represents Fast Moving Consumer Goods (FMCG) operations in New Zealand (including export to the Pacific Islands) and all FMCG and Ingredients operations in Australia (including Milk Supply and Manufacturing).
Asia/AME	Represents FMCG operations in Asia (excluding North Asia), Africa and the Middle East.
Latam	Represents FMCG operations in Chile and equity accounted investments in South America.

6 SEGMENT REPORTING CONTINUED

$ MILLION	NOTES	STANDARD AND PREMIUM INGREDIENTS	ANZ	ASIA/AME	LATAM	ELIMINATIONS	TOTAL GROUP
Segment income statement							
Year ended 31 July 2011							
External revenue		13,779	3,579	1,687	826	–	19,871
Inter-segment revenue		1,800	781	–	4	(2,585)	–
Revenue from sale of goods		15,579	4,360	1,687	830	(2,585)	19,871
Cost of Milk – New Zealand sourced		(10,235)	–	–	–	–	(10,235)
Other cost of goods sold		(4,131)	(3,451)	(1,088)	(558)	2,602	(6,626)
Cost of goods sold		(14,366)	(3,451)	(1,088)	(558)	2,602	(16,861)
Segment gross profit		1,213	909	599	272	17	3,010
Selling and marketing expenses		(93)	(154)	(264)	(85)	–	(596)
Distribution expenses		(155)	(244)	(35)	(53)	–	(487)
Administrative expenses		(415)	(164)	(88)	(46)	13	(700)
Other operating expenses		(203)	(99)	(25)	(17)	8	(336)
Segment operating expenses		(866)	(661)	(412)	(201)	21	(2,119)
Other operating income		118	39	2	27	(21)	165
Net foreign exchange losses		(75)	(13)	(3)	–	–	(91)
Share of profit of equity accounted investees		40	–	–	23	–	63
Segment earnings before net finance costs and tax		430	274	186	121	17	1,028
Non-recurring items		1	(22)	–	(2)	–	(23)
Normalised segment earnings before net finance costs and tax		431	252	186	119	17	1,005
Non-recurring items							23
Finance income							32
Finance costs							(438)
Tax expense							149
Profit for the year							771
Profit for the year includes the following amounts:							
Depreciation		(316)	(72)	(6)	(20)	–	(414)
Amortisation		(62)	(9)	(3)	(1)	–	(75)
Royalty income from equity accounted investees		–	–	–	21	–	21
Non-recurring items consist of the following amounts:							
Impact of Christchurch earthquakes and Japan earthquake and tsunami		14	4	–	–	–	18
Gain on disposal of Western Australia dairy business	2	–	(26)	–	–	–	(26)
Gain on acquisition of RD1	18	(23)	–	–	–	–	(23)
Impact of 2010 Chilean earthquake		–	–	–	(5)	–	(5)
Other		10	–	–	3	–	13
Total non-recurring items		1	(22)	–	(2)	–	(23)
Segment asset information:							
As at and for the year ended 31 July 2011							
Equity accounted investments		216	–	–	213	–	429
Capital expenditure		470	135	17	22	–	644

6 SEGMENT REPORTING CONTINUED

$ MILLION	NOTES	STANDARD AND PREMIUM INGREDIENTS	ANZ	ASIA/AME	LATAM	ELIMINATIONS	TOTAL GROUP
Segment income statement							
Year ended 31 July 2010							
External revenue		11,225	3,233	1,537	731	–	16,726
Inter-segment revenue		1,532	570	–	7	(2,109)	–
Revenue from sale of goods		12,757	3,803	1,537	738	(2,109)	16,726
Cost of Milk – New Zealand sourced		(7,938)	–	–	–	–	(7,938)
Other cost of goods sold		(3,843)	(2,855)	(949)	(499)	2,109	(6,037)
Cost of goods sold		(11,781)	(2,855)	(949)	(499)	2,109	(13,975)
Segment gross profit		976	948	588	239	–	2,751
Selling and marketing expenses		(79)	(158)	(279)	(74)	–	(590)
Distribution expenses		(149)	(244)	(31)	(50)	–	(474)
Administrative expenses		(360)	(162)	(83)	(41)	14	(632)
Other operating expenses		(177)	(95)	(25)	(10)	4	(303)
Segment operating expenses		(765)	(659)	(418)	(175)	18	(1,999)
Other operating income		265	8	2	20	(18)	277
Net foreign exchange (losses)/gains		(3)	2	(6)	–	–	(7)
Share of profit of equity accounted investees		33	–	–	23	–	56
Segment earnings before net finance costs and tax		506	299	166	107	–	1,078
Non-recurring items		(190)	4	–	12	–	(174)
Normalised segment earnings before net finance costs and tax		316	303	166	119	–	904
Non-recurring items							174
Finance income							21
Finance costs							(334)
Tax expense							(80)
Profit for the year							685
Profit for the year included the following amounts:							
Depreciation		(317)	(74)	(6)	(19)	–	(416)
Amortisation		(57)	(8)	(3)	–	–	(68)
Royalty income from equity accounted investees		3	–	–	20	–	23
Non-recurring items consist of the following amounts:							
Receipt for amendments to equity accounted investee arrangements		(41)	–	–	–	–	(41)
Gain on sale of Arla	11	(127)	–	–	–	–	(127)
Impact of Chilean earthquake		–	–	–	12	–	12
Other		(22)	4	–	–	–	(18)
Total non-recurring items		(190)	4	–	12	–	(174)
Segment asset information:							
As at and for the year ended 31 July 2010							
Equity accounted investments		231	–	–	227	–	458
Capital expenditure		378	74	13	27	–	492

6 SEGMENT REPORTING CONTINUED

$ MILLION	31 JULY 2011	31 JULY 2010
Entity wide products and services:		
Consumer goods	**5,248**	4,908
Ingredients and other revenue	**14,623**	11,818
Revenue from sale of goods	**19,871**	16,726

$ MILLION	EUROPE	CHINA	ASIA	AUSTRALIA	NEW ZEALAND	USA	REST OF WORLD	TOTAL
Geographical segment external revenue:								
Year ended 31 July 2011	**1,269**	**1,877**	**5,735**	**2,664**	**1,560**	**1,566**	**5,200**	**19,871**
Year ended 31 July 2010	1,287	1,227	4,952	2,387	1,337	1,622	3,914	16,726

Revenue is allocated to geographical segments on the basis of the destination of the goods sold.

$ MILLION	AUSTRALIA	NEW ZEALAND	USA	REST OF WORLD	TOTAL
Geographical segment reportable non-current assets:					
As at 31 July 2011	**1,011**	**4,901**	**124**	**1,664**	**7,700**
As at 31 July 2010	1,077	4,790	136	1,765	7,768

$ MILLION	AS AT 31 JULY 2011	AS AT 31 JULY 2010
Reconciliation of geographical segment non-current assets to total non-current assets:		
Geographical segment non-current assets	**7,700**	7,768
Deferred tax asset	**116**	100
Derivative financial instruments	**154**	214
Total non-current assets	**7,970**	8,082

7 CAPITAL AND RESERVES

GROUP AND PARENT	CO-OPERATIVE SHARES (THOUSANDS)
Balance at 1 August 2009	1,251,291
Issued	136,415
Surrendered	(34,863)
Balance at 31 July 2010	1,352,843
Balance at 1 August 2010	**1,352,843**
Issued	**89,458**
Surrendered	**(35,356)**
Balance at 31 July 2011	**1,406,945**

Co-operative shares

Each Shareholder supplying milk to the Company in a season is required to hold one Co-operative share (share) for each kilogram of milksolids obtainable from milk supplied to the Company by that Shareholder, excluding milk supplied by that Shareholder under contract supply or as unshared supply, in that season. This is known as the share standard. A Shareholder supplying under contract must hold at least 1,000 shares.

In addition, each Shareholder is able to hold further shares up to 20% of the share standard, so that they can hold shares of up to 120% of the number they are required to hold under the share standard.

The rights attaching to shares include:

- voting rights on a poll or postal ballot of one vote per 1,000 kilograms of milksolids obtainable from milk supplied to the Company by a Shareholder during the season preceding that in which a poll or postal ballot is taken, less milksolids supplied under contract supply or as unshared supply;
- rights to any dividends declared by the Board; and
- rights to share in any surplus on liquidation of the Company.

Shares are valued on the basis of a Restricted Share Value. The value of Fonterra shares is determined by the Board on an annual basis, for each season, after having regard to a value range determined by an independent valuer.

The use of a Restricted Share Value represents a constitutional change to the fair value method used before the 31 May 2009 valuation and was expected to result in a lower share valuation. To recognise the impact on the share price from such a change in valuation approach, there is a transition period to the new Restricted Share Value approach, during which the share is valued separately under the Restricted Share Value approach and the Fair Value approach. During the transition period the share price cannot fall below a base price. The current base price is $4.52 per share, but this could fall if the mid-point of the range determined by the Fair Value approach falls below $4.52. If the Restricted Share Value is less than the base price, then the base price at that time will be used as the share value. Once the Restricted Share Value is greater than the base price, the transition period is deemed to have ended and the Restricted Share Value will be used from that point onwards.

The Restricted Share Value for the 2011/12 season has been set by the Board at $4.52 per share (2010: Restricted Share Value of $4.52 per share).

Shareholders may elect, within the application period (which must run, as a minimum, from 15 December to 28 February) to purchase and surrender shares. Shareholders may also elect to purchase additional shares over and above the share standard during a period set by the Board (which is currently from 1 June to 30 September). Shareholders may elect to transact at the June price, which is the share price for the coming season, or under the default price mechanism. This mechanism sets a price range of +/- 7.5% of an interim share price set by the Board in the prior December. If the June price falls within the +/-7.5% price range, Shareholders will transact at the June price. If the June price is above or below the price range, Shareholders will transact at the upper or lower limit of the price range respectively.

If a Shareholder decreases supply during a season, the number of shares held will be re-apportioned between the number of minimum required shares (calculated using the share standard) and the number of any additional shares that may be held.

Shares held in excess of the number required to be held by the share standard can be surrendered at the election of the Shareholder. However shares representing greater than 120% of the number required by the share standard will automatically be surrendered, at the then prevailing share price.

7 CAPITAL AND RESERVES CONTINUED

Payment for the surrender of shares may be made at the option of the Company by:

- cash; or
- the issue of Capital Notes.

The Company also has the option to pay the surrender value in special circumstances by the issue of redeemable preference shares.

The expected cash outflow on redemption or repurchase of the shares is dependent on the share value at that time, the number of shares redeemed or repurchased and the instrument used to settle the obligation, and accordingly cannot be reliably estimated.

If a Shareholder increases supply during a season, any additional shares held will be used first to satisfy the increased minimum required shares under the share standard. If no, or insufficient, additional shares are held, the Shareholder must either:

- acquire the extra shares required under the share standard at the current season share price; or
- request unshared supply (if available).

If the Company decides to make unshared supply available, a Shareholder's entitlement to it cannot exceed 20% of that Shareholder's share standard for that season. If a Shareholder is granted unshared supply, they will not be required to purchase shares for the quantity elected. However, they will receive a lower milk payment for this unshared supply.

Shares acquired by Shareholders may be paid by:

- cash; or
- the redemption of any Capital Notes held (at the discretion of the Company).

On 30 June 2010 Shareholders approved constitutional changes that allow the Board to work towards implementation of capital structure changes which have the following key features:

- The establishment of a platform to enable share trading among Shareholder Suppliers at a well-discovered market price.
- The establishment of a Fonterra Shareholders' Fund that would acquire from Shareholders the right to receive dividends and the gain/loss from any change in the underlying value of the shares, whilst Shareholder Suppliers retain voting rights and the access to milk payments attached to the shares.

There is no current year impact to the Company's capital structure arising out of the approval granted on 30 June 2010.

Dividends paid

All shares are eligible to receive a dividend if declared by the Board. On 22 September 2010, the Board declared a dividend of 19.0 cents per share (totalling $255 million), paid on 20 October 2010 to the Shareholders on the share register at 31 May 2010.

On 23 March 2011, the Board declared an interim dividend of 8.0 cents per share (totalling $110 million), paid on 20 April 2011 to the Shareholders on the share register at 31 March 2011.

Foreign currency translation reserve

The foreign currency translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations as well as from the effective portion of translation or fair value changes of instruments that hedge the Group's net investment in foreign operations.

Cash flow hedge reserve

The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

8 TRADE AND OTHER RECEIVABLES

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010	**AS AT 31 JULY 2011**	AS AT 31 JULY 2010
Trade receivables	**2,141**	1,993	**1**	2
Less: provision for impairment of trade receivables	**(21)**	(36)	**–**	–
Trade receivables net of provision for impairment	**2,120**	1,957	**1**	2
Receivables from related parties[1]	**16**	20	**9,383**	8,178
Other receivables	**65**	59	**1**	–
Total receivables	**2,201**	2,036	**9,385**	8,180
Prepayments	**78**	52	**38**	35
Total trade and other receivables	**2,279**	2,088	**9,423**	8,215

1. There were no material provisions for impairment of receivables from related parties.

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Movement in the provision for impairment of trade receivables:				
Opening balance	**36**	57	**–**	–
Additional provisions	**5**	8	**–**	–
Utilised during the year	**(6)**	(3)	**–**	–
Unused amounts reversed	**(13)**	(22)	**–**	–
Foreign currency translation	**(1)**	(4)	**–**	–
Closing balance	**21**	36	**–**	–

9 INVENTORIES

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010	**AS AT 31 JULY 2011**	AS AT 31 JULY 2010
Raw materials	**609**	492	**–**	–
Finished goods	**2,783**	2,494	**–**	–
Impairment of finished goods	**(115)**	(116)	**–**	–
Total inventories	**3,277**	2,870	**–**	–
Other disclosures:				
Inventories stated at net realisable value	**1,882**	1,414	**–**	–
Amount of inventories pledged as security for liabilities	**–**	100	**–**	–
Amount of inventories recognised in cost of goods sold during the year	**16,861**	13,975	**–**	–

For the year ended 31 July 2009 and prior years, Fonterra used the annual Milk Price as a basis for valuing inventory. During the year ended 31 July 2010, Fonterra adopted the monthly Milk Price for valuing inventory. Had this change in accounting estimate been reflected in opening inventory for the year ended 31 July 2010, costs of goods sold for the year ended 31 July 2010 would have been $124 million lower than was reported. The impact of the adoption of a monthly Milk Price was reflected in the Standard and Premium Ingredients segment.

10 PROPERTY, PLANT AND EQUIPMENT

GROUP $ MILLION	NOTES	LAND	BUILDINGS AND LEASEHOLD IMPROVEMENTS	PLANT, VEHICLES AND EQUIPMENT	CAPITAL WORK IN PROGRESS	TOTAL
As at 31 July 2009						
Cost		286	1,414	4,630	431	6,761
Accumulated depreciation and impairment		–	(387)	(1,971)	–	(2,358)
Net book value		286	1,027	2,659	431	4,403
Net book value						
As at 1 August 2009		286	1,027	2,659	431	4,403
Additions[1]		4	–	–	438	442
Transfer from capital work in progress		–	121	424	(545)	–
Transfer of assets between classes		–	23	(23)	–	–
Transfer to intangible assets	12	–	–	–	(20)	(20)
Depreciation charge		–	(66)	(350)	–	(416)
Impairment losses		–	–	(2)	–	(2)
Disposals		(2)	(1)	(20)	–	(23)
Foreign currency translation		(2)	(8)	(13)	(5)	(28)
As at 31 July 2010		286	1,096	2,675	299	4,356
As at 31 July 2010						
Cost		286	1,545	4,902	299	7,032
Accumulated depreciation and impairment		–	(449)	(2,227)	–	(2,676)
Net book value		286	1,096	2,675	299	4,356
Net book value						
As at 1 August 2010		**286**	**1,096**	**2,675**	**299**	**4,356**
Additions[1]		**–**	**–**	**–**	**488**	**488**
Acquired as a result of business combinations		**6**	**8**	**6**	**1**	**21**
Transfer from capital work in progress		**29**	**77**	**326**	**(432)**	**–**
Transfer to intangible assets	12	**–**	**–**	**–**	**(8)**	**(8)**
Depreciation charge		**–**	**(66)**	**(348)**	**–**	**(414)**
Impairment losses		**–**	**–**	**–**	**(9)**	**(9)**
Disposals		**(23)**	**(31)**	**(50)**	**–**	**(104)**
Foreign currency translation		**1**	**(6)**	**(2)**	**3**	**(4)**
As at 31 July 2011		**299**	**1,078**	**2,607**	**342**	**4,326**
As at 31 July 2011						
Cost		**299**	**1,570**	**5,028**	**342**	**7,239**
Accumulated depreciation and impairment		**–**	**(492)**	**(2,421)**	**–**	**(2,913)**
Net book value		**299**	**1,078**	**2,607**	**342**	**4,326**

1. Additions include borrowing costs of $2 million (2010: $3 million) capitalised using a rate of 6.44% (2010: 4.19%).

Impairment losses of $9 million relate to the Standard and Premium Ingredients segment and were recorded in cost of goods sold in the income statement.

Impairment losses of $2 million recognised in the prior year relate to the Latam segment and were recorded in other operating expenses in the income statement.

The net book value of property, plant and equipment subject to finance leases for the Group is $150 million (31 July 2010: $141 million). Of that balance $5 million relates to land (31 July 2010: $5 million), $119 million relates to building and leasehold improvements (31 July 2010: $120 million), and $26 million relates to plant and equipment (31 July 2010: $16 million).

10 PROPERTY, PLANT AND EQUIPMENT CONTINUED

PARENT $ MILLION	NOTES	LAND	BUILDINGS AND LEASEHOLD IMPROVEMENTS	PLANT, VEHICLES AND EQUIPMENT	CAPITAL WORK IN PROGRESS	TOTAL
As at 31 July 2009						
Cost		11	81	82	31	205
Accumulated depreciation and impairment		–	(14)	(49)	–	(63)
Net book value		11	67	33	31	142
Net book value						
As at 1 August 2009		11	67	33	31	142
Additions[1]		–	–	–	108	108
Transfer from capital work in progress		–	51	30	(81)	–
Transfer to intangible assets	12	–	–	–	(10)	(10)
Depreciation charge		–	(3)	(10)	–	(13)
Disposals		–	–	(1)	–	(1)
Disposals to other Group entities		(6)	(10)	(3)	–	(19)
As at 31 July 2010		5	105	49	48	207
As at 31 July 2010						
Cost		5	116	96	48	265
Accumulated depreciation and impairment		–	(11)	(47)	–	(58)
Net book value		5	105	49	48	207
Net book value						
As at 1 August 2010		**5**	**105**	**49**	**48**	**207**
Additions[1]		**–**	**–**	**–**	**25**	**25**
Additions from other Group entities		**–**	**4**	**12**	**–**	**16**
Transfer from capital work in progress		**–**	**31**	**18**	**(49)**	**–**
Transfer to intangible assets	12	**–**	**–**	**–**	**(8)**	**(8)**
Depreciation charge		**–**	**(5)**	**(13)**	**–**	**(18)**
As at 31 July 2011		**5**	**135**	**66**	**16**	**222**
As at 31 July 2011						
Cost		**5**	**151**	**124**	**16**	**296**
Accumulated depreciation and impairment		**–**	**(16)**	**(58)**	**–**	**(74)**
Net book value		**5**	**135**	**66**	**16**	**222**

1. Additions include borrowing costs of $1 million (2010: $2 million) capitalised using a rate of 6.44% (2010: 4.19%).

The net book value of property, plant and equipment subject to finance leases for the Parent is $149 million (31 July 2010: $141 million). Of that balance $5 million relates to land (31 July 2010: $5 million), $119 million relates to building and leasehold improvements (31 July 2010: $120 million), and $25 million relates to plant and equipment (31 July 2010: $16 million).

11 EQUITY ACCOUNTED INVESTMENTS

A list of significant equity accounted investees is included in Note 23.

The movement in the carrying value of equity accounted investees is:

	GROUP $ MILLION	
	31 JULY 2011	31 JULY 2010
Opening balance	**458**	506
Share of profit after tax	**63**	56
Additional investments in existing equity accounted investees	**4**	14
Derecognised as a result of a business combination	**(10)**	–
Acquired as a result of a business combination	**20**	–
Impairment of equity accounted investments	**(2)**	–
Foreign currency translation	**(48)**	(63)
Dividends received	**(63)**	(55)
Share of equity accounted investees' reserve movements	**7**	–
Closing balance	**429**	458
Amount of goodwill in carrying value of equity accounted investees:		
Opening balance	**218**	241
Closing balance	**199**	218

In the year ended 31 July 2011, Fonterra completed the purchase of the remaining 50% of RD1 Limited, which resulted in RD1 Limited becoming a subsidiary of Fonterra. Further details are set out in Note 18.

In the year ended 31 July 2010, Fonterra disposed of its 25% interest in AFF P/S. Amongst the ongoing arrangements Fonterra will continue to licence the Anchor brand to AFF P/S and will continue to supply butter. The transaction and wider arrangements resulted in a net pre-tax gain of $127 million. The gain formed part of the Standard and Premium Ingredients segment and was included within other operating income for the year ended 31 July 2010.

The Group has provided financial guarantees to certain equity accounted investees as set out in Notes 19 and 22.

The Group's equity accounted investees have entered into non-cancellable operating leases, and the Group's share of the future aggregate minimum lease payments under these leases is $12 million (2010: $23 million).

The following amounts represent the aggregate assets, liabilities, revenue and profit of equity accounted investees:

	$ MILLION	
	AS AT AND FOR THE YEAR ENDED 31 JULY 2011	AS AT AND FOR THE YEAR ENDED 31 JULY 2010
Assets:		
Non-current assets	**908**	1,050
Current assets	**896**	1,021
Total assets	**1,804**	2,071
Liabilities:		
Non-current liabilities	**(415)**	(433)
Current liabilities	**(625)**	(735)
Total liabilities	**(1,040)**	(1,168)
Net assets	**764**	903
Revenue	**3,446**	3,242
Expenses (including interest and tax)	**(3,347)**	(3,157)
Profit after tax	**99**	85

12 INTANGIBLE ASSETS

		GROUP						PARENT
$ MILLION	NOTES	GOODWILL	BRANDS	SOFTWARE	SOFTWARE WIP	OTHER	TOTAL INTANGIBLES	SOFTWARE
As at 31 July 2009								
Cost		1,004	1,665	573	6	94	3,342	129
Accumulated amortisation and impairment		(2)	(89)	(371)	–	(88)	(550)	(83)
Net book value		1,002	1,576	202	6	6	2,792	46
Net book value								
As at 1 August 2009		1,002	1,576	202	6	6	2,792	46
Additions[1]		–	–	5	39	6	50	14
Transfer from capital work in progress	10	–	–	20	–	–	20	10
Transfer from work in progress		–	–	16	(16)	–	–	–
Amortisation		–	(6)	(58)	–	(4)	(68)	(14)
Transfer to other Group entities		–	–	–	–	–	–	(10)
Disposals		–	–	(2)	–	–	(2)	–
Foreign currency translation		(15)	(21)	–	–	–	(36)	–
As at 31 July 2010		987	1,549	183	29	8	2,756	46
As at 31 July 2010								
Cost		989	1,643	599	29	97	3,357	135
Accumulated amortisation and impairment		(2)	(94)	(416)	–	(89)	(601)	(89)
Net book value		987	1,549	183	29	8	2,756	46
Net book value								
As at 1 August 2010		987	1,549	183	29	8	2,756	46
Additions[1]		–	–	–	129	27	156	27
Acquired as a result of business combinations		30	–	3	–	14	47	–
Transfer from capital work in progress	10	–	–	8	–	–	8	8
Transfer from work in progress		–	–	55	(55)	–	–	–
Amortisation		–	(6)	(65)	–	(4)	(75)	(20)
Transfer from other Group entities		–	–	–	–	–	–	5
Disposals		(17)	(99)	–	–	(14)	(130)	–
Foreign currency translation		(1)	(11)	–	(2)	–	(14)	–
As at 31 July 2011		999	1,433	184	101	31	2,748	66
As at 31 July 2011								
Cost		1,001	1,532	664	101	122	3,420	181
Accumulated amortisation and impairment		(2)	(99)	(480)	–	(91)	(672)	(115)
Net book value		999	1,433	184	101	31	2,748	66

1. Additions include borrowing costs of $3 million (2010: nil) capitalised using a rate of 6.44% (2010: nil).

Amortisation, impairment losses and reversal of impairment losses are recognised in other operating expenses in the income statement.

12 INTANGIBLE ASSETS CONTINUED

Goodwill and other indefinite life intangibles

Goodwill

Goodwill for each cash generating unit (CGU) has been tested for impairment on a fair value less costs to sell basis. Testing was undertaken in May 2011 using external sources of information where appropriate. Cash flow forecasts used as inputs to determine fair value are based on the Group's three year plan, extrapolated for a further seven years, and then using a terminal year with a long term growth rate of between 2.0% and 3.0% (31 July 2010: between 2.0% and 3.0%). Management considers a ten year forecast period to be appropriate given the long term nature of the dairy industry. The discount rate applied to future cash flows was 9.5% (31 July 2010: 9.5%).

There was a significant amount of headroom between the recoverable amount and the carrying value of goodwill by CGU and no impairment was recognised. No reasonably possible change in any of these assumptions would cause the carrying value of goodwill allocated to a CGU to exceed its recoverable amount.

Of those CGUs tested, the goodwill of the Fonterra Brands New Zealand CGU is considered significant in the context of the carrying value of goodwill for the Group. For the Fonterra Brands New Zealand CGU the carrying value of goodwill is $618 million (31 July 2010: $616 million) and the carrying value of indefinite life brands attributable to the CGU is $307 million (31 July 2010: $307 million). These brands are tested for impairment on an individual asset basis (see below).

Indefinite life brands

Of the total brands held, 91% ($1,299 million) have indefinite useful lives (31 July 2010: 91%, $1,412 million). In concluding that a brand has an indefinite life, management considers its intention to acquire, hold and support brands through advertising and promotional spending for an indefinite period.

Individual indefinite life brands are tested annually for impairment through a value-in-use test using a discounted cash flow methodology.

13 TRADE AND OTHER PAYABLES

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010	**AS AT 31 JULY 2011**	AS AT 31 JULY 2010
Trade payables	**664**	536	**–**	–
Accruals	**352**	377	**26**	29
Amounts due to related parties	**8**	7	**7,242**	5,660
Other payables	**112**	105	**56**	66
Total trade and other payables (excluding employee entitlements)	**1,136**	1,025	**7,324**	5,755
Employee entitlements	**214**	226	**19**	15
Total trade and other payables	**1,350**	1,251	**7,343**	5,770

14 PROVISIONS

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Restructuring and rationalisation provisions				
Opening balance	**13**	14	**3**	3
Additional provisions	**8**	14	**1**	3
Unused amounts reversed	**(3)**	(5)	**(2)**	(3)
Charged to income statement	**5**	9	**(1)**	–
Foreign currency translation	**(1)**	(1)	**–**	–
Utilised during the year	**(10)**	(9)	**(1)**	–
Closing balance	**7**	13	**1**	3
Legal claims provisions				
Opening balance	**86**	68	**85**	67
Additional provisions	**6**	44	**6**	44
Unused amounts reversed	**(5)**	(21)	**(5)**	(21)
Charged to income statement	**1**	23	**1**	23
Foreign currency translation	**(4)**	(4)	**(3)**	(4)
Utilised during the year	**–**	(1)	**–**	(1)
Closing balance	**83**	86	**83**	85
Other provisions				
Opening balance	**103**	139	**16**	24
Additional provisions	**39**	58	**15**	10
Unused amounts reversed	**(28)**	(40)	**(2)**	(7)
Charged to income statement	**11**	18	**13**	3
Foreign currency translation	**(7)**	(5)	**(1)**	–
Utilised during the year	**(24)**	(49)	**(4)**	(11)
Closing balance	**83**	103	**24**	16
Total provisions	**173**	202	**108**	104
Included within the statement of financial position as follows:				
Current liabilities	**67**	92	**29**	19
Non-current liabilities	**106**	110	**79**	85
Total provisions	**173**	202	**108**	104

The nature of the provisions are as follows:

- The provision for restructuring and rationalisation includes obligations relating to planned changes throughout the business to improve efficiencies and reduce costs. None of the provisions are individually significant. The value of the obligation is based on project plans, and the provisions are expected to be utilised in the next year.
- The legal claims provisions include obligations relating to tax, customs and duties and legal matters arising in the normal course of business. None of the provisions are individually significant. The timing and amount of the future obligations are uncertain, as they are contingent on the outcome of a number of judicial proceedings. The amount recognised has been based on management's best estimate of the amount that will be required to settle the obligation. The outcome of most of the obligations is not expected to be determined within the next year, and therefore most of the provision is classified as non-current.
- Other provisions arise in the normal course of business and relate to provisions for areas such as employee benefit provisions. None of the provisions are individually significant. The value of the obligation is based on management's best estimate of the amount that will be required to settle the obligation, and the majority of the provisions are expected to be utilised in the next year.

15 BORROWINGS

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010	**AS AT 31 JULY 2011**	AS AT 31 JULY 2010
Current				
Commercial paper	**50**	244	**50**	244
Bank loans	**337**	445	**–**	1
Finance leases	**7**	8	**3**	3
Medium term notes	**50**	205	**–**	149
Total current borrowings	**444**	902	**53**	397
Non-current				
Bank loans	**154**	178	**150**	150
Finance leases	**172**	186	**147**	153
Capital notes	**35**	35	**35**	35
Retail bonds	**940**	937	**940**	937
Medium term notes	**2,905**	2,686	**2,527**	2,684
Total non-current borrowings	**4,206**	4,022	**3,799**	3,959
Total borrowings	**4,650**	4,924	**3,852**	4,356

– Finance leases are secured over the related item of property, plant and equipment (Note 10).

– Included within bank loans is nil (31 July 2010: $129 million) of borrowings secured over inventories (Note 9).

– Capital notes are unsecured subordinated borrowings.

– All other borrowings are unsecured and unsubordinated.

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010	**AS AT 31 JULY 2011**	AS AT 31 JULY 2010
Opening balance	**4,924**	5,794	**4,356**	5,004
New issues				
Bank loans	**2,298**	2,051	**569**	127
Finance leases	**–**	75	**–**	75
Commercial paper	**817**	612	**817**	612
Retail bonds	**–**	150	**–**	150
Medium term notes	**533**	72	**149**	72
	3,648	2,960	**1,535**	1,036
Repayments				
Bank loans	**(2,396)**	(2,223)	**(555)**	(127)
Finance leases	**(9)**	(5)	**(6)**	(1)
Commercial paper	**(990)**	(710)	**(990)**	(710)
Medium term notes	**(153)**	(611)	**(148)**	(605)
	(3,548)	(3,549)	**(1,699)**	(1,443)
Other movements				
Amortisation of discount	**7**	13	**7**	13
Changes in fair value	**(6)**	82	**(6)**	82
Changes due to foreign currency translation	**(375)**	(376)	**(341)**	(336)
	(374)	(281)	**(340)**	(241)
Closing balance	**4,650**	4,924	**3,852**	4,356

15 BORROWINGS CONTINUED

	GROUP $ MILLION	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010
Net interest bearing debt position		
Total borrowings	4,650	4,924
Cash and cash equivalents	(785)	(559)
Interest bearing advances included in other non-current assets	(122)	(122)
Bank overdraft	23	25
Net interest bearing debt	3,766	4,268
Value of derivatives used to manage changes in hedged risks and other foreign exchange movements on debt	565	226
Economic net interest bearing debt[1]	4,331	4,494

1. Economic net interest bearing debt reflects the effect of debt hedging in place at balance date.

Net interest bearing debt is managed on a Group basis.

	GROUP	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010
Net tangible assets per security[1]		
$ per listed debt security on issue	3.60	2.76
$ per Co-operative share on issue	2.70	2.15
Listed debt securities on issue (million)	1,053	1,053
Co-operative shares on issue (million)	1,407	1,353

1. Net tangible assets represents total assets less total liabilities less intangible assets.

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010	AS AT 31 JULY 2011	AS AT 31 JULY 2010
Finance leases – minimum lease payments				
Not later than one year	19	21	15	15
Later than one year and not later than five years	86	80	59	61
Later than five years	169	203	168	185
	274	304	242	261
Future finance charges on finance leases	(95)	(110)	(92)	(105)
Present value of finance leases	179	194	150	156
The present value of finance leases is as follows:				
Not later than one year	7	8	3	3
Later than one year and not later than five years	47	33	22	17
Later than five years	125	153	125	136
Total present value of finance leases	179	194	150	156

16 DEFERRED TAX

	NOTES	GROUP $ MILLION		PARENT $ MILLION	
		AS AT 31 JULY 2011	AS AT 31 JULY 2010	**AS AT 31 JULY 2011**	AS AT 31 JULY 2010
Deferred tax					
Property, plant and equipment		**(156)**	(186)	**5**	15
Intangible assets		**(295)**	(391)	**(18)**	(13)
Derivative financial instruments		**(236)**	(72)	**25**	15
Employee entitlements		**52**	56	**7**	4
Inventories		**16**	29	**–**	–
Receivables, payables and provisions		**34**	53	**11**	13
New Zealand tax losses		**387**	292	**373**	253
Offshore tax losses		**39**	39	**–**	–
Other		**(20)**	(13)	**–**	–
Total deferred tax		**(179)**	(193)	**403**	287
Movements for the year					
Opening balance		**(193)**	(202)	**287**	327
Recognised in the income statement	5	**186**	67	**106**	(31)
Change in New Zealand corporate tax rate	5	**–**	8	**–**	(20)
Recognised directly in other comprehensive income		**(160)**	(5)	**10**	15
Change to tax depreciation on buildings	5	**–**	(61)	**–**	(4)
Foreign currency translation		**(12)**	–	**–**	–
Closing balance		**(179)**	(193)	**403**	287
Included within the statement of financial position as follows:					
Deferred tax assets		**116**	100	**403**	287
Deferred tax liabilities		**(295)**	(293)	**–**	–
Total deferred tax		**(179)**	(193)	**403**	287
Balance expected to be recovered or settled:					
Within the next 12 months		**(119)**	80	**43**	32
After the next 12 months		**(60)**	(273)	**360**	255
Total deferred tax		**(179)**	(193)	**403**	287

17 OPERATING CASH FLOWS

	NOTES	GROUP $ MILLION		PARENT $ MILLION	
		31 JULY 2011	31 JULY 2010	31 JULY 2011	31 JULY 2010
Profit for the year		**771**	685	**438**	426
Non-cash items					
Amortisation of intangible assets	12	**75**	68	**20**	14
Depreciation of property, plant and equipment	10	**414**	416	**18**	13
Movement in deferred tax		**(14)**	(9)	**(116)**	40
Gain on disposal of investments	2	**–**	(127)	**–**	–
Gain on acquisition of business	18	**(23)**	–	**–**	–
Gain on disposal of business	2	**(26)**	–	**–**	–
Loss on disposal of property, plant and equipment	2	**–**	3	**1**	–
Share of profit of equity accounted investees	11	**(63)**	(56)	**–**	–
Impairment of property, plant and equipment	10	**9**	2	**–**	–
Other non-cash items		**–**	(9)	**1**	1
Total non-cash items		**372**	288	**(76)**	68
(Increase)/decrease in working capital					
Inventories		**(407)**	(214)	**–**	–
Trade and other receivables		**(191)**	(140)	**(2)**	(17)
Other current assets (including derivative financial instruments)		**(638)**	194	**(610)**	132
Tax balances		**(25)**	28	**–**	–
Amounts owing to suppliers		**541**	(69)	**591**	(69)
Trade and other payables		**99**	119	**(9)**	8
Other current liabilities (including derivative financial instruments)		**(53)**	(105)	**(62)**	(112)
Provisions		**(25)**	(51)	**10**	(18)
Increase in working capital		**(699)**	(238)	**(82)**	(76)
Items classified as investing and financing activities		**740**	744	**119**	(63)
Net cash flows from operating activities		**1,184**	1,479	**399**	355

18 BUSINESS COMBINATIONS

On 1 July 2011, the Group completed the purchase of the remaining 50% of RD1 Limited. The Group has recorded a gain of $23 million relating to this business combination. This gain represents the difference between the carrying value of the Group's equity accounted investment in RD1 at the time of acquisition of the remaining 50%, and the fair value of that pre-existing interest. This gain was recognised in other operating income, in the Standard and Premium Ingredients segment result. This transaction is not considered material and therefore no further disclosure has been made.

There were no material business combinations during the year ended 31 July 2010.

19 FINANCIAL RISK MANAGEMENT

Overview

Global financial and commodity markets remain volatile. The nature of Fonterra's business is such that managing risks in the foreign exchange, interest rate, commodity, credit and liquidity markets is critical to minimising the volatility in returns to Shareholders.

The Board has overall responsibility for the establishment and oversight of the Group's financial risk management framework. The Board:

- has established risk management policies and procedures to identify, analyse and, where appropriate, manage the risks faced by the Group;
- has approved a Treasury Policy that covers appropriate risk limits and controls (including, but not limited to, delegated authority levels and authorised use of various financial instruments); and
- monitors risks and adherence to approved limits.

The Group's overall financial risk management programme focuses primarily on maintaining a prudent risk profile that provides flexibility to implement the Group's strategies, while ensuring the optimisation of the return on assets. Risk management is predominantly carried out by a central treasury department (Group Treasury), which ensures compliance with the risk management policies and procedures set by the Board.

During the year in order to manage financial risks, the key risk management activities undertaken by the Group included, but were not limited to, the following:

Capital structure

Fonterra continues to work towards establishing trading among farmers. Should necessary changes to the Dairy Industry Restructuring Act 2001 (DIRA) to give effect to this be approved by the government, the Company's obligations under DIRA to redeem Co-operative shares will be removed. These capital structure changes are significant steps for Fonterra, and further detail is given in Note 7 and the capital management section below.

Bank facility renewal

Fonterra's banking facilities are renewed at least annually. On 31 July 2011, Fonterra had $3,715 million (31 July 2010: $3,687 million) of undrawn committed facilities. For further details refer to liquidity risk below in section 19(d).

Debt to debt plus equity ratio

For the 12 months to 31 July 2011, the Board set a target debt to debt plus equity ratio of 45% to 50%. As a result of the above activities and close management of the financial risks faced by Fonterra, the economic debt to debt plus equity ratio has reduced from 44.9% at 31 July 2010 to 41.8% at 31 July 2011. For more details refer to the capital management section below in section 19(e).

a) Foreign exchange risk

The Group operates internationally and is exposed to foreign exchange risk on sales, purchases, investments and borrowings that are denominated in foreign currencies. Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities and net investments in foreign operations.

The main impacts of foreign exchange movements on the Group arise from:

- transaction risk – variations in the New Zealand dollar value of the Group's sales receipts and other cash flows; and
- translation risk – the value of the Group's investment in foreign operations and the Group's foreign currency debt.

Approximately 67% (31 July 2010: 77%) of the Group's net foreign exchange exposure is against the United States dollar.

The Group's objective is to ensure foreign exchange exposure is managed in a prudent manner in order to reduce volatility on the returns to Shareholders and Shareholder Suppliers.

In respect of transaction hedging the Group's policy is to hedge 100% of the net recognised foreign currency trade receivables and foreign currency trade payables, and up to 100% of forecast cash receipts from sales for a period of up to 18 months. The level of hedging undertaken is influenced by current exchange rates and the time until the expected cash flows occur, within the limits approved by the Board. The Group seeks to designate items in a hedge relationship where it is practical to do so; therefore some derivative instruments entered into as economic hedges may not be in a designated hedge relationship for accounting purposes.

In respect of translation hedging, the Group hedges its material net translation exposure. Group Treasury uses forward foreign exchange contracts, currency options and cross currency interest rate swaps to hedge its foreign exchange risk. The Group's investments in foreign operations are hedged by a combination of derivative instruments and borrowings in the relevant currencies.

19 FINANCIAL RISK MANAGEMENT CONTINUED

Exposure to foreign currency risk
The significant notional unhedged exposures to foreign currencies are as follows:

		GROUP $ MILLION		PARENT $ MILLION	
		AS AT 31 JULY 2011	AS AT 31 JULY 2010	**AS AT 31 JULY 2011**	AS AT 31 JULY 2010
USD	United States dollar	**34**	10	**(7,469)**	(9,399)
EUR	Euro	**80**	95	**(190)**	(127)
AUD	Australian dollar	**1,002**	983	**(654)**	(258)
GBP	Great Britain pound	**3**	5	**(67)**	(72)
JPY	Japanese yen	**79**	11	**–**	(1)
BRL	Brazilian real	**199**	104	**–**	(84)
CLP	Chilean peso	**303**	264	**(55)**	(14)
CNY	Chinese yuan	**39**	18	**–**	–
SGD	Singapore dollar	**473**	174	**(234)**	(245)

Parent carries economic hedge derivative contracts for risks that sit elsewhere in the Group.

Included in the analysis above are derivative contracts with notional balances of $5,860 million (31 July 2010: $7,845 million) in respect of forecast and actual sale transactions.

Foreign exchange sensitivity
A 10% movement in the value of the New Zealand dollar against the key currencies to which the Group is exposed would result in the following post-tax (using appropriate tax rates) increase/(decrease) to equity and profit. A 10% movement in exchange rates is considered reasonably possible over the short term given historical fluctuations in the value of the New Zealand dollar.

	GROUP $ MILLION				PARENT $ MILLION			
	31 JULY 2011		31 JULY 2010		**31 JULY 2011**		31 JULY 2010	
	EQUITY	**PROFIT**	EQUITY	PROFIT	**EQUITY**	**PROFIT**	EQUITY	PROFIT
Impact of a 10% strengthening of the NZD	**(46)**	**3**	158	(29)	**(37)**	**–**	(44)	–
Impact of a 10% weakening of the NZD	**132**	**(21)**	(37)	(59)	**46**	**–**	53	–

The Parent has no sensitivity to foreign exchange movements in the income statement as gains and losses are passed to a subsidiary through a novation agreement.

b) Interest rate risk
The Group's interest rate risk arises from its borrowings and funds on deposit. Borrowings issued and funds on deposit held at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk.

The Group borrows a mixture of fixed and variable rate debt in a range of currencies. The Group actively hedges its repricing profile using interest rate swaps in accordance with its Treasury Policy in order to manage the volatility of finance costs. The Group's benchmark is to ensure between 20% and 55% of interest payments are fixed depending upon the maturity of the debt.

Exposure to interest rate risk
Sensitivities to interest rate risk have been assessed on the basis of a 100 basis point movement in interest rates. A 100 basis point movement is considered reasonably possible over the short term. Sensitivities are presented net of tax, using appropriate tax rates.

Fair value sensitivity analysis
A change in interest rates impacts the fair value of the Group's interest rate derivatives and where changes in hedged risks on certain debt instruments are recognised at fair value. The fair value sensitivity to a 100 basis point movement in interest rates (based on financial assets and liabilities held at the balance date) is as follows:

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Fair value gain/(loss) from 100 bp increase	**74**	63	**74**	63
Fair value gain/(loss) from 100 bp decrease	**(81)**	(68)	**(81)**	(68)

19 FINANCIAL RISK MANAGEMENT CONTINUED

Cash flow sensitivity analysis

A change in the interest rates would also impact on interest payments and receipts on the Group's floating rate debt instruments (including the floating leg of any interest rate derivatives). The cash flow sensitivity to a 100 basis point movement in interest rates (based on financial assets and liabilities held at the balance date) is as follows:

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
One year cash flow impact of 100 bp increase	**(15)**	(13)	**(15)**	(11)
One year cash flow impact of 100 bp decrease	**15**	13	**15**	11

c) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers and derivative financial instruments.

The Group operates a policy of only entering into contracts for sale with customers whose credit limits are in accordance with the Group's delegated authorities approved by the Board. For export customers located outside of New Zealand credit risk mitigant tools such as letters of credit may be utilised in conjunction with credit limits.

The analysis of Group trade and other receivables (excluding prepayments) is as follows:

		PAST DUE BUT NOT IMPAIRED			
$ MILLION	NEITHER PAST DUE NOR IMPAIRED	LESS THAN 1 MONTH PAST DUE	MORE THAN 1 MONTH BUT LESS THAN 3 MONTHS PAST DUE	MORE THAN 3 MONTHS PAST DUE	TOTAL
As at 31 July 2011	**1,807**	**230**	**113**	**51**	**2,201**
As at 31 July 2010	1,712	217	57	50	2,036

Parent has no trade and other receivables that are past due (31 July 2010: nil).

The Group does not hold collateral or security in relation to credit risk and has no undue concentrations of credit risk.

The Group has a policy to limit its exposure to credit risk by entering into transactions only with financial counterparties that have a credit rating of at least 'A-' from Standard & Poor's or equivalent. Given this high credit rating threshold, management does not expect these counterparties to fail to meet their obligations. Exceptions to this policy are authorised in accordance with the Board-approved Financial Risk Management Standard.

The Group has assessed trade and other receivables requiring specific impairment at balance date. As a result $21 million (31 July 2010: $36 million) has been provided against these balances. This represents 0.11% (31 July 2010: 0.22%) of the total revenue from sale of goods.

The maximum credit risk on cash and cash equivalents, trade and other receivables, derivative financial instruments and other investments is best represented by their carrying values.

d) Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group has a policy in place to ensure that it has sufficient cash or facilities on demand to meet expected operational expenses for a period of at least 80 days, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. In such situations back-up funding lines are maintained and as set out in the Company's constitution, the Company can defer payments to Supplier Shareholders if necessary.

Group Treasury manages the Group's liquidity by retaining cash and marketable securities, the availability of funding from an adequate amount of committed credit facilities and the ability to close out market positions. At balance date the Group had undrawn lines of credit totalling $3,715 million (31 July 2010: $3,687 million), and the Parent had undrawn lines of credit of $2,003 million (31 July 2010: $2,024 million). The liquidity and refinancing risks are also managed by ensuring that Fonterra can maintain access to funding markets throughout the world. To that end, Fonterra maintains debt issuance programmes in a number of key markets and manages relationships with international investors. Illustrations of this are the recent US Private Placement issue, with a maturity of 10 years and a nominal amount of USD 75 million, an inaugural issue in Australia of AUD 300 million with a maturity of five years, and an issue in Hong Kong of CNY 300 million with a maturity of three years.

19 FINANCIAL RISK MANAGEMENT CONTINUED

Exposure to liquidity risk

	AS AT 31 JULY 2011					
GROUP $ MILLION	CARRYING AMOUNT	CONTRACTUAL CASH FLOWS	3 MONTHS OR LESS	3–12 MONTHS	1–5 YEARS	MORE THAN 5 YEARS
Non-derivative financial assets						
Cash and cash equivalents	785	785	785	–	–	–
Trade and other receivables (excluding prepayments)	2,201	2,201	2,201	–	–	–
Long term advances	122	154	10	31	72	41
Total non-derivative financial assets	3,108	3,140	2,996	31	72	41
Non-derivative financial liabilities						
Borrowings						
– Commercial paper	(50)	(50)	(50)	–	–	–
– Bank loans	(491)	(507)	(52)	(301)	(154)	–
– Finance leases	(179)	(274)	(5)	(14)	(86)	(169)
– Capital notes	(35)	(43)	–	(1)	(7)	(35)
– Retail bonds	(940)	(1,234)	(21)	(52)	(1,161)	–
– Medium term notes	(2,955)	(3,888)	(70)	(142)	(2,415)	(1,261)
Bank overdraft	(23)	(23)	(23)	–	–	–
Owing to suppliers	(1,679)	(1,679)	(1,679)	–	–	–
Trade and other payables (excluding employee entitlements)	(1,136)	(1,081)	(1,081)	–	–	–
Financial guarantees issued[1]	–	(104)	(104)	–	–	–
Total non-derivative financial liabilities	(7,488)	(8,883)	(3,085)	(510)	(3,823)	(1,465)
Derivative financial instruments						
Gross settled derivatives						
– Inflow	–	17,598	9,045	6,041	1,571	941
– Outflow	–	(17,467)	(8,687)	(5,333)	(2,011)	(1,436)
Total gross settled derivative financial instruments	477	131	358	708	(440)	(495)
Net settled derivatives	1	234	(7)	22	74	145
Total financial instruments	(3,902)	(5,378)	262	251	(4,117)	(1,774)

1. Maximum cash flows under guarantees provided by the Group for equity accounted investees.

19 FINANCIAL RISK MANAGEMENT CONTINUED

Exposure to liquidity risk (continued)

GROUP $ MILLION	AS AT 31 JULY 2010 CARRYING AMOUNT	CONTRACTUAL CASH FLOWS	3 MONTHS OR LESS	3–12 MONTHS	1–5 YEARS	MORE THAN 5 YEARS
Non-derivative financial assets						
Cash and cash equivalents	559	559	559	–	–	–
Trade and other receivables (excluding prepayments)	2,036	2,035	2,035	–	–	–
Long term advances	122	149	1	11	45	92
Total non-derivative financial assets	2,717	2,743	2,595	11	45	92
Non-derivative financial liabilities						
Borrowings						
– Commercial paper	(244)	(247)	(97)	(150)	–	–
– Bank loans	(623)	(670)	(45)	(429)	(196)	–
– Finance leases	(194)	(303)	(6)	(14)	(80)	(203)
– Capital notes	(35)	(43)	–	(1)	(7)	(35)
– Retail bonds	(937)	(1,306)	(21)	(52)	(1,073)	(160)
– Medium term notes	(2,891)	(3,928)	(78)	(283)	(1,912)	(1,655)
Bank overdraft	(25)	(25)	(25)	–	–	–
Owing to suppliers	(1,138)	(1,138)	(1,138)	–	–	–
Trade and other payables (excluding employee entitlements)	(1,025)	(973)	(973)	–	–	–
Financial guarantees issued[1]	–	(61)	(61)	–	–	–
Total non-derivative financial liabilities	(7,112)	(8,694)	(2,444)	(929)	(3,268)	(2,053)
Derivative financial instruments						
Gross settled derivatives						
– Inflow	–	17,710	9,214	5,579	1,668	1,249
– Outflow	–	(18,115)	(9,107)	(5,335)	(1,995)	(1,678)
Total gross settled derivative financial instruments	80	(405)	107	244	(327)	(429)
Net settled derivatives	13	299	(12)	24	97	190
Total financial instruments	(4,302)	(6,057)	246	(650)	(3,453)	(2,200)

1. Maximum cash flows under guarantees provided by the Group for equity accounted investees.

19 FINANCIAL RISK MANAGEMENT CONTINUED

Exposure to liquidity risk (continued)

	AS AT 31 JULY 2011					
PARENT $ MILLION	CARRYING AMOUNT	CONTRACTUAL CASH FLOWS	3 MONTHS OR LESS	3–12 MONTHS	1–5 YEARS	MORE THAN 5 YEARS
Non-derivative financial assets						
Cash and cash equivalents	570	570	570	–	–	–
Trade and other receivables (excluding prepayments)	2	2	2	–	–	–
Long term advances	2	3	–	–	–	3
Total non-derivative financial assets	574	575	572	–	–	3
Non-derivative financial liabilities						
Borrowings						
– Commercial paper	(50)	(50)	(50)	–	–	–
– Bank loans	(150)	(155)	(2)	(3)	(150)	–
– Finance leases	(150)	(242)	(4)	(11)	(59)	(168)
– Capital notes	(35)	(43)	–	(1)	(7)	(35)
– Retail bonds	(940)	(1,234)	(21)	(52)	(1,161)	–
– Medium term notes	(2,527)	(3,338)	(19)	(119)	(1,941)	(1,259)
Owing to suppliers	(1,729)	(1,729)	(1,729)	–	–	–
Trade and other payables (excluding employee entitlements)	(82)	(41)	(41)	–	–	–
Financial guarantees issued[1]	–	(716)	(716)	–	–	–
Total non-derivative financial liabilities	(5,663)	(7,548)	(2,582)	(186)	(3,318)	(1,462)
Derivative financial instruments						
Gross settled derivatives						
– Inflow	–	17,253	8,722	6,019	1,571	941
– Outflow	–	(17,118)	(8,359)	(5,312)	(2,011)	(1,436)
Total gross settled derivative financial instruments	481	135	363	707	(440)	(495)
Net settled derivatives	2	234	(7)	22	74	145
Total financial instruments	(4,606)	(6,604)	(1,654)	543	(3,684)	(1,809)

1. Maximum cash flows under guarantees provided by the Parent for subsidiaries.

Amounts due to and from consolidated Group entities that are repayable on demand (refer to Notes 8, 13 and 22) have been excluded from the above table.

19 FINANCIAL RISK MANAGEMENT CONTINUED

Exposure to liquidity risk (continued)

PARENT $ MILLION	AS AT 31 JULY 2010					
	CARRYING AMOUNT	CONTRACTUAL CASH FLOWS	3 MONTHS OR LESS	3–12 MONTHS	1–5 YEARS	MORE THAN 5 YEARS
Non-derivative financial assets						
Cash and cash equivalents	345	345	345	–	–	–
Trade and other receivables (excluding prepayments)	2	2	2	–	–	–
Long term advances	19	22	–	1	19	2
Total non-derivative financial assets	366	369	347	1	19	2
Non-derivative financial liabilities						
Borrowings						
– Commercial paper	(244)	(247)	(97)	(150)	–	–
– Bank loans	(151)	(167)	(5)	(6)	(156)	–
– Finance leases	(156)	(261)	(4)	(11)	(61)	(185)
– Capital notes	(35)	(43)	–	(1)	(7)	(35)
– Retail bonds	(937)	(1,306)	(21)	(52)	(1,073)	(160)
– Medium term notes	(2,833)	(3,872)	(24)	(283)	(1,912)	(1,653)
Owing to suppliers	(1,138)	(1,138)	(1,138)	–	–	–
Trade and other payables (excluding employee entitlements)	(95)	(51)	(51)	–	–	–
Financial guarantees issued[1]	–	(424)	(424)	–	–	–
Total non-derivative financial liabilities	(5,589)	(7,509)	(1,764)	(503)	(3,209)	(2,033)
Derivative financial instruments						
Gross settled derivatives						
– Inflow	–	17,834	9,239	5,678	1,668	1,249
– Outflow	–	(18,237)	(9,132)	(5,432)	(1,995)	(1,678)
Total gross settled derivative financial instruments	81	(403)	107	246	(327)	(429)
Net settled derivatives	12	301	(9)	23	97	190
Total financial instruments	(5,130)	(7,242)	(1,319)	(233)	(3,420)	(2,270)

1. Maximum cash flows under guarantees provided by the Parent for subsidiaries.

Amounts due to and from consolidated Group entities that are repayable on demand (refer to Notes 8, 13 and 22) have been excluded from the above table.

19 FINANCIAL RISK MANAGEMENT CONTINUED

e) Capital management

The Board's objective is to maximise Shareholder returns over time by maintaining an optimal capital structure. The Group provides returns to Shareholders through a Milk Price, dividends, and changes in the Company's share price. In order to maintain an appropriate capital structure, the Board may decide to retain profits within the Group.

The Board undertook a review of the capital structure in 2009, which identified a series of changes as set out in Note 7. These changes are intended to strengthen the statement of financial position, primarily by removing redemption risk and providing a framework for ongoing retentions.

The Board closely monitors the Group's debt to debt plus equity ratio. This ratio is calculated as net interest bearing debt divided by total capital. Net interest bearing debt is calculated as disclosed in Note 15. Total capital is calculated as equity, as presented on the statement of financial position (excluding the cash flow hedge reserve), plus net interest bearing debt. The economic debt to debt plus equity ratio as at 31 July 2011 was 41.8% (31 July 2010: 44.9%), which is below the Board's target of 45%-50%.

The Group is not subject to externally imposed capital requirements.

f) Dairy commodity price risk

Dairy commodity price risk is the risk of volatility in profit or loss from a movement in dairy commodity prices to which the Group may be exposed.

Dairy commodity price risk arises from transactions for the sale and purchase of a variety of milk and milk derived products.

The Group manages its dairy commodity price risk by adopting a product mix that management considers best reflects the demand trends in dairy product markets globally. Sales contracts for future production of varying lengths are also used to enable the Group to sell its products at prices and times that management considers will maximise revenue.

The Group has also commenced on a limited scale direct trading in dairy commodity derivatives. Due to the limited market for the types of dairy commodity derivatives, such activity is only a small component of management's strategy for managing commodity price risk. Fonterra aims to use its industry knowledge to obtain the best price for future sales, so as markets for such derivatives grows, the scope of such commodity risk management activities may increase.

Commodity price risk sensitivity analysis

The table below summarises the impact on dairy commodity derivatives for increases/decreases of dairy commodity prices on the Group's post-tax profit for the year. The analysis is based on the assumption that dairy based commodity derivative prices had increased/decreased by 10% with all other variables held constant:

	GROUP $ MILLION	
	31 JULY 2011 PROFIT	31 JULY 2010 PROFIT
Impact of 10% increase in quoted dairy commodity prices	–	(1)
Impact of 10% decrease in quoted dairy commodity prices	–	1

g) Financial instrument fair values and classifications

Basis for determining fair values

The fair value of interest rate swaps and cross currency interest rate swaps is based on accepted valuation methodologies. The fair value of these instruments is calculated by discounting estimated future cash flows based on the terms and maturity of each contract, at market interest rates.

The fair values of financial liabilities are calculated by discounting the future contractual cash flows at current market interest rates that are available for similar financial instruments.

Fair values at balance date have been assessed using a range of market interest rates between 0.05% and 7.00% (31 July 2010: 0.01% and 6.90%) across all currencies in which the Group holds financial instruments.

Fair values are allocated to a fair value hierarchy based on the following:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

19 FINANCIAL RISK MANAGEMENT CONTINUED

GROUP $ MILLION	AS AT 31 JULY 2011					
	LOANS AND RECEIVABLES	OTHER AMORTISED COST	HELD FOR TRADING	DERIVATIVES IN HEDGE RELATIONSHIPS	CARRYING VALUE	FAIR VALUE
Financial assets						
Cash and cash equivalents	785	–	–	–	785	785
Trade and other receivables (excluding prepayments)	2,201	–	–	–	2,201	2,201
Long term advances	122	–	–	–	122	128
Derivative assets – current	–	–	302	798	1,100	1,100
Derivative assets – non-current	–	–	32	122	154	154
Total financial assets	3,108	–	334	920	4,362	4,368
Financial liabilities						
Bank overdraft	–	(23)	–	–	(23)	(23)
Owing to suppliers	–	(1,679)	–	–	(1,679)	(1,679)
Total payables and accruals (excluding employee entitlements)	–	(1,136)	–	–	(1,136)	(1,136)
Borrowings						
– Commercial paper	–	(50)	–	–	(50)	(50)
– Bank loans	–	(491)	–	–	(491)	(491)
– Finance leases	–	(179)	–	–	(179)	(201)
– Retail bonds	–	(940)	–	–	(940)	(1,042)
– Medium term notes	–	(2,955)	–	–	(2,955)	(3,238)
Capital notes	–	(35)	–	–	(35)	(30)
Derivative liabilities – current	–	–	(41)	(17)	(58)	(58)
Derivative liabilities – non-current	–	–	(110)	(608)	(718)	(718)
Total financial liabilities	–	(7,488)	(151)	(625)	(8,264)	(8,666)
Total financial instruments	3,108	(7,488)	183	295	(3,902)	(4,298)

Included in the table above are the following instruments that have fair value changes recognised in the statement of financial position:

Level 1 fair value hierarchy						
Derivative assets	–	–	–	–	–	–
Derivative liabilities	–	–	(1)	–	(1)	(1)
Total level 1 fair value hierarchy	–	–	(1)	–	(1)	(1)
Level 2 fair value hierarchy						
Derivative assets	–	–	334	920	1,254	1,254
Derivative liabilities	–	–	(150)	(625)	(775)	(775)
Total level 2 fair value hierarchy	–	–	184	295	479	479
Total instruments recognised in the statement of financial position at fair value	–	–	183	295	478	478

19 FINANCIAL RISK MANAGEMENT CONTINUED

	AS AT 31 JULY 2010					
GROUP $ MILLION	LOANS AND RECEIVABLES	OTHER AMORTISED COST	HELD FOR TRADING	DERIVATIVES IN HEDGE RELATIONSHIPS	CARRYING VALUE	FAIR VALUE
Financial assets						
Cash and cash equivalents	559	–	–	–	559	559
Trade and other receivables (excluding prepayments)	2,036	–	–	–	2,036	2,036
Long term advances	122	–	–	–	122	130
Derivative assets – current	–	–	134	354	488	488
Derivative assets – non-current	–	–	32	182	214	214
Total financial assets	2,717	–	166	536	3,419	3,427
Financial liabilities						
Bank overdraft	–	(25)	–	–	(25)	(25)
Owing to suppliers	–	(1,138)	–	–	(1,138)	(1,138)
Total payables and accruals (excluding employee entitlements)	–	(1,025)	–	–	(1,025)	(1,025)
Borrowings						
– Commercial paper	–	(244)	–	–	(244)	(245)
– Bank loans	–	(623)	–	–	(623)	(623)
– Finance leases	–	(194)	–	–	(194)	(213)
– Retail bonds	–	(937)	–	–	(937)	(1,032)
– Medium term notes	–	(2,891)	–	–	(2,891)	(3,203)
Capital notes	–	(35)	–	–	(35)	(30)
Derivative liabilities – current	–	–	(89)	(24)	(113)	(113)
Derivative liabilities – non-current	–	–	(112)	(384)	(496)	(496)
Total financial liabilities	–	(7,112)	(201)	(408)	(7,721)	(8,143)
Total financial instruments	2,717	(7,112)	(35)	128	(4,302)	(4,716)

Included in the table above are the following instruments that have fair value changes recognised in the statement of financial position:

Level 1 fair value hierarchy						
Derivative assets	–	–	1	–	1	1
Derivative liabilities	–	–	–	–	–	–
Total level 1 fair value hierarchy	–	–	1	–	1	1
Level 2 fair value hierarchy						
Derivative assets	–	–	165	536	701	701
Derivative liabilities	–	–	(201)	(408)	(609)	(609)
Total level 2 fair value hierarchy	–	–	(36)	128	92	92
Total instruments recognised in the statement of financial position at fair value	–	–	(35)	128	93	93

19 FINANCIAL RISK MANAGEMENT CONTINUED

PARENT $ MILLION	AS AT 31 JULY 2011					
	LOANS AND RECEIVABLES	OTHER AMORTISED COST	HELD FOR TRADING	DERIVATIVES IN HEDGE RELATIONSHIPS	CARRYING VALUE	FAIR VALUE
Financial assets						
Cash and cash equivalents	570	–	–	–	570	570
Trade and other receivables (excluding prepayments)	9,236	–	–	–	9,236	9,236
Long term advances	2	–	–	–	2	2
Derivative assets – current	–	–	1,088	–	1,088	1,088
Derivative assets – non-current	–	–	110	44	154	154
Total financial assets	9,808	–	1,198	44	11,050	11,050
Financial liabilities						
Owing to suppliers	–	(1,729)	–	–	(1,729)	(1,729)
Total payables and accruals (excluding employee entitlements)	–	(7,324)	–	–	(7,324)	(7,324)
Borrowings						
– Commercial paper	–	(50)	–	–	(50)	(50)
– Bank loans	–	(150)	–	–	(150)	(150)
– Finance leases	–	(150)	–	–	(150)	(169)
– Retail bonds	–	(940)	–	–	(940)	(1,042)
– Medium term notes	–	(2,527)	–	–	(2,527)	(2,799)
Capital notes	–	(35)	–	–	(35)	(30)
Derivative liabilities – current	–	–	(41)	–	(41)	(41)
Derivative liabilities – non-current	–	–	(113)	(605)	(718)	(718)
Total financial liabilities	–	(12,905)	(154)	(605)	(13,664)	(14,052)
Total financial instruments	9,808	(12,905)	1,044	(561)	(2,614)	(3,002)

Included in the table above are the following instruments that have fair value changes recognised in the statement of financial position:

Level 2 fair value hierarchy						
Derivative assets	–	–	1,198	44	1,242	1,242
Derivative liabilities	–	–	(154)	(605)	(759)	(759)
Total level 2 fair value hierarchy	–	–	1,044	(561)	483	483
Total instruments recognised in the statement of financial position at fair value	–	–	1,044	(561)	483	483

19 FINANCIAL RISK MANAGEMENT CONTINUED

	AS AT 31 JULY 2010					
PARENT $ MILLION	LOANS AND RECEIVABLES	OTHER AMORTISED COST	HELD FOR TRADING	DERIVATIVES IN HEDGE RELATIONSHIPS	CARRYING VALUE	FAIR VALUE
Financial assets						
Cash and cash equivalents	345	–	–	–	345	345
Trade and other receivables (excluding prepayments)	7,998	–	–	–	7,998	7,998
Long term advances	19	–	–	–	19	19
Derivative assets – current	–	–	472	6	478	478
Derivative assets – non-current	–	–	66	148	214	214
Total financial assets	8,362	–	538	154	9,054	9,054
Financial liabilities						
Owing to suppliers	–	(1,138)	–	–	(1,138)	(1,138)
Total payables and accruals (excluding employee entitlements)	–	(5,755)	–	–	(5,755)	(5,755)
Borrowings						
– Commercial paper	–	(244)	–	–	(244)	(245)
– Bank loans	–	(151)	–	–	(151)	(151)
– Finance leases	–	(156)	–	–	(156)	(171)
– Retail bonds	–	(937)	–	–	(937)	(1,032)
– Medium term notes	–	(2,833)	–	–	(2,833)	(3,147)
Capital notes	–	(35)	–	–	(35)	(30)
Derivative liabilities – current	–	–	(103)	–	(103)	(103)
Derivative liabilities – non-current	–	–	(119)	(377)	(496)	(496)
Total financial liabilities	–	(11,249)	(222)	(377)	(11,848)	(12,268)
Total financial instruments	8,362	(11,249)	316	(223)	(2,794)	(3,214)

Included in the table above are the following instruments that have fair value changes recognised in the statement of financial position:

Level 2 fair value hierarchy						
Derivative assets	–	–	538	154	692	692
Derivative liabilities	–	–	(222)	(377)	(599)	(599)
Total level 2 fair value hierarchy	–	–	316	(223)	93	93
Total instruments recognised in the statement of financial position at fair value	–	–	316	(223)	93	93

The timing of the maturity of the release of the Parent and Group's cash flow hedge reserve is:

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Current	**740**	218	**(13)**	(9)
Non-current	**(23)**	(23)	**(76)**	(44)
Total carrying value	**717**	195	**(89)**	(53)

19 FINANCIAL RISK MANAGEMENT CONTINUED

The fair value of derivatives in hedge relationships by type of hedging relationship is:

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Cash flow hedge	**732**	259	**(97)**	(61)
Fair value hedge	**(464)**	(162)	**(464)**	(162)
Net investment hedge	**27**	31	**–**	–
Total carrying value of derivatives in hedge relationships	**295**	128	**(561)**	(223)

20 CONTINGENT LIABILITIES

The Group and Parent have no contingent liabilities as at 31 July 2011 (31 July 2010: nil).

In the normal course of its business, Fonterra, its subsidiaries and equity accounted investees are exposed to claims, legal proceedings and arbitrations that may in some cases result in costs to the Group. The Directors believe that these have been adequately provided for and disclosed by the Group and that there are no additional legal proceedings or arbitrations that are pending at the date of these financial statements that require provision or disclosure.

21 COMMITMENTS

Capital and intangible asset expenditure commitments

Capital and intangible asset expenditure contracted for at balance date but not recognised in the financial statements are as follows:

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010	**AS AT 31 JULY 2011**	AS AT 31 JULY 2010
Buildings	**4**	9	**–**	–
Plant, vehicles and equipment	**223**	132	**4**	3
Intangible assets	**4**	8	**1**	5
Total capital commitments	**231**	149	**5**	8

Operating lease commitments

The Group leases premises, plant and equipment. The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010	**AS AT 31 JULY 2011**	AS AT 31 JULY 2010
Less than one year	**74**	62	**–**	–
One to five years	**161**	130	**–**	–
Greater than five years	**41**	58	**–**	–
Total operating lease commitments	**276**	250	**–**	–

22 RELATED PARTY TRANSACTIONS

Equity accounted investees (refer to Note 23) and key management personnel are related parties of the Group. Key management personnel include the Board and the Executive Committee.

Transactions were entered into and year end balances arose from transactions with related parties as follows:

Key management personnel remuneration

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	31 JULY 2011	31 JULY 2010
Short term employee benefits	20	14	19	12
Long term employee benefits	5	4	4	3
Directors' remuneration	2	2	2	2
Total key management personnel remuneration	27	20	25	17

Revenue from the sale of goods

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	31 JULY 2011	31 JULY 2010
Sale of goods				
Equity accounted investees	81	145	–	–
Other Group entities	–	–	10,257	7,952
	81	145	10,257	7,952

Goods sold to related parties are primarily commodity products and are provided under normal trade terms.

Other operating income

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	31 JULY 2011	31 JULY 2010
Sale of services				
Equity accounted investees	5	6	–	–
Other Group entities	–	–	52	38
	5	6	52	38
Royalty income				
Equity accounted investees	21	23	–	–

Services provided to related parties include management fees and are provided under normal trade terms. Royalty income received from related parties is provided under normal trade terms.

22 RELATED PARTY TRANSACTIONS CONTINUED

Purchases of goods and services

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Purchases of goods				
Equity accounted investees	**75**	176	**–**	–
Other Group entities	**–**	–	**23**	15
Key management personnel	**247**	199	**247**	199
	322	375	**270**	214
Purchases of services				
Equity accounted investees	**2**	3	**–**	–
Other Group entities	**–**	–	**3**	2
	2	3	**3**	2

Goods purchased from related parties are primarily commodity products, which are acquired under normal trade terms.

Services purchased from related parties are primarily commissions paid and are under normal trade terms.

In addition Shareholder Directors may engage in transactions with other Group entities under normal trade terms.

Transfers of property, plant & equipment and intangible assets

	PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010
Additions of property, plant & equipment from other Group entities	**16**	–
Disposals of property, plant & equipment to other Group entities	**–**	(19)
Additions of intangible assets from other Group entities	**5**	–
Disposals of intangible assets to other Group entities	**–**	(10)
Total	**21**	(29)

The Parent entered into transactions with other Group entities to acquire and dispose of property, plant and equipment and intangible assets. These transactions were at the net book value of the assets transferred.

Dividends received

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Equity accounted investees	**63**	55	**–**	–
Other Group entities	**–**	–	**495**	458
	63	55	**495**	458

22 RELATED PARTY TRANSACTIONS CONTINUED

Balances arising from the sale or purchase of goods or services

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010	**AS AT 31 JULY 2011**	AS AT 31 JULY 2010
Receivables[1]				
Equity accounted investees	**16**	20	**–**	–
Other Group entities	**–**	–	**142**	109
	16	20	**142**	109
Payables				
Equity accounted investees	**8**	7	**–**	–
Other Group entities	**–**	–	**6**	6
Key management personnel[2]	**41**	33	**41**	33
	49	40	**47**	39

1. There were no material provisions for impairment on the receivables from related parties.
2. Payables to key management personnel relate to amounts owing for milk supplied to the Group by farmer Shareholder Directors.

Balances arising from financing arrangements

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010	**AS AT 31 JULY 2011**	AS AT 31 JULY 2010
Receivables				
Equity accounted investees	**90**	126	**–**	17
Receivables from other Group entities	**–**	–	**9,241**	8,071
	90	126	**9,241**	8,088
Payables				
Payables to other Group entities	**–**	–	**7,236**	5,654
Payables to key management personnel	**1**	1	**–**	1
	1	1	**7,236**	5,655

Payables to key management personnel relate to unsecured bonds held by Directors or members of the Fonterra Executive Committee.

Interest income/(expense) from financing arrangements

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Interest income				
Equity accounted investees	**4**	4	**–**	–
Other Group entities	**–**	–	**355**	288
	4	4	**355**	288
Interest expense				
Other Group entities	**–**	–	**(11)**	(11)
	–	–	**(11)**	(11)

Loans to related parties other than equity accounted investees are unsecured and repayable in cash on demand. Loans to equity accounted investees are unsecured and repayable over varying terms of between two years and 14 years.

22 RELATED PARTY TRANSACTIONS CONTINUED

Financial guarantees

The Group has provided financial guarantees for several equity accounted investees. The aggregate drawn down amount of equity accounted investees' liabilities for which the Group is jointly and severally liable is $38 million (31 July 2010: $61 million). The Parent has provided financial guarantees for other Group entities. The amounts drawn down under those guaranteed facilities are $613 million (31 July 2010: $424 million).

Co-operative share transactions with Directors

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2011	31 JULY 2010	**31 JULY 2011**	31 JULY 2010
Co-operative shares issued/(surrendered)				
Issued	**3**	5	**3**	5
Surrendered	**(3)**	(2)	**(3)**	(2)
Net movement	**–**	3	**–**	3
Dividends paid to Directors	**3**	3	**3**	3

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010	**AS AT 31 JULY 2011**	AS AT 31 JULY 2010
Balances arising from transactions with Directors				
Receivable from Directors	**–**	–	**–**	–
Payable to Directors	**–**	–	**–**	–

23 GROUP ENTITIES

All subsidiaries and equity accounted investees are involved in the marketing, distribution, processing, technology or financing of dairy products. All Group entities have a balance date of 31 July unless otherwise indicated. Subsidiaries and equity accounted investees with different balance dates from that of the Group are due to legislative requirements in the country the entities are domiciled. Equity accounted investees may also have a different balance date due to alignment with their other investor's balance date or to align with the milk season.

The New Zealand Companies Office has given exemptions for a number of Fonterra's subsidiaries to maintain balance dates different to that of the Group.

The Group holds investments in certain countries that have some limited restrictions on the repatriation of funds back to the Parent. This does not result in any significant restriction on the flow of funds for the Group.

23 GROUP ENTITIES CONTINUED

The significant subsidiaries and equity accounted investees of the Group are listed below:

OVERSEAS SUBSIDIARIES	COUNTRY OF INCORPORATION	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2011	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2010
Fonterra Australia Pty Limited	Australia	**100**	100
Fonterra Brands (Australia) Pty Limited	Australia	**100**	100
Fonterra (Brasil) Limitada[1]	Brazil	**100**	100
Soprole S.A.[1]	Chile	**99.9**	99.8
Fonterra Commercial Trading (Shanghai) Company Limited	China	**100**	100
Tangshan Fonterra San Lu Dairy Farm Limited	China	**85**	85
PT Fonterra Brands Indonesia	Indonesia	**100**	100
Fonterra (Italy) SpA	Italy	**100**	100
Fonterra Brands (Japan) Limited	Japan	**100**	100
Fonterra Brands (Malaysia) Sdn Bhd	Malaysia	**100**	100
Fonterra (Ing.) Limited	Mauritius	**51**	51
Fonterra (Mexico) S.A. de C.V.[1]	Mexico	**100**	100
Fonterra (Europe) Coöperatie U.A.	Netherlands	**100**	100
Fonterra Brands Phils. Inc.	Philippines	**100**	100
Saudi New Zealand Milk Products Company Limited[2]	Saudi Arabia	**100**	100
Fonterra Brands (Singapore) Pte Limited	Singapore	**100**	100
Fonterra Brands (New Young) Pte Limited	Singapore	**51**	51
Fonterra (SEA) Pte Limited	Singapore	**100**	100
Fonterra Brands Lanka (Private) Limited	Sri Lanka	**100**	100
Fonterra Brands (Thailand) Limited	Thailand	**100**	100
Fonterra (USA) Inc	USA	**100**	100
Fonterra (Venezuela) S.A.[1]	Venezuela	**100**	100
Fonterra Brands (Viet Nam) Company Limited	Vietnam	**100**	100

1. Balance date 31 December.
2. During the year ended 31 July 2010 the ownership interest in this entity was increased from 49% to 100%. Previously this entity was included within overseas subsidiaries with 50% or less ownership.

NEW ZEALAND SUBSIDIARIES	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2011	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2010
Anchor Ethanol Limited	**100**	100
Canpac International Limited	**100**	100
Fonterra Brands (New Zealand) Limited	**100**	100
Fonterra Brands (Tip Top) Limited	**100**	100
Fonterra Limited	**100**	100
Fonterra (New Zealand) Limited	**100**	100
New Zealand Dairy Board	**100**	100
NZAgbiz Limited	**100**	100
RD1 Limited[1]	**100**	50
ViaLactia Biosciences (NZ) Limited	**100**	100

1. During the year ended 31 July 2011 the Group acquired the remaining 50% ownership interest of RD1 Limited as set out in Note 18. For the year ended 31 July 2010, RD1 Limited was accounted for as an equity accounted investee. RD1 Limited has a balance date of 31 May.

23 GROUP ENTITIES CONTINUED

The ownership interest of the following entities is 50% or less. However, they have been consolidated on the basis that the Group controls them based on its capacity to govern the financing and operating policies of the entities so as to obtain benefits from their activities.

OVERSEAS SUBSIDIARIES 50% OR LESS OWNERSHIP	COUNTRY OF INCORPORATION	OWNERSHIP INTERESTS (%)	
		AS AT 31 JULY 2011	AS AT 31 JULY 2010
Fonterra (Japan) Limited	Japan	**50**	50
Fonterra Brands (Middle East) L.L.C.	UAE	**49**	49

The ownership interest of the following entities is 50% or less and the Group is not considered to exercise a controlling interest. These entities are therefore accounted for as equity accounted investees.

OVERSEAS EQUITY ACCOUNTED INVESTEES	COUNTRY OF INCORPORATION	OWNERSHIP INTERESTS (%)	
		AS AT 31 JULY 2011	AS AT 31 JULY 2010
DPA Manufacturing Holdings Limited[1]	Bermuda	**50**	50
Dairy Partners Americas Brasil Limitada[1]	Brazil	**50**	50
Ecuajugos S.A.[1]	Ecuador	**50**	50
DMV Fonterra Excipients GmbH & Co KG[1]	Germany	**50**	50
Dairy Industries (Jamaica) Limited[1]	Jamaica	**50**	50
Dairiconcepts, L.P.[1]	USA	**50**	50
Dairiconcepts Management, L.L.C.[1]	USA	**50**	50
Corporacion Inlaca, C.A.[1]	Venezuela	**25**	25

1. Balance date 31 December.

NEW ZEALAND EQUITY ACCOUNTED INVESTEES	OWNERSHIP INTERESTS (%)	
	AS AT 31 JULY 2011	AS AT 31 JULY 2010
International Nutritionals Limited[1]	**50**	–

1. Balance date 31 May. International Nutritionals Limited is 50% owned by RD1 Limited. RD1 Limited became a subsidiary during the year as set out in Note 18.

24 SUBSEQUENT EVENTS

On 21 September 2011, the Board of Directors declared a final dividend of 22 cents per share payable on 20 October 2011 to the Shareholders on the share register at 31 May 2011.

There were no other material events subsequent to 31 July 2011 that would impact these financial statements.

25 EARNINGS PER SHARE

	GROUP	
	31 JULY 2011	31 JULY 2010
Basic and diluted earnings per share attributable to equity holders of the Company ($)	**0.55**	0.51
Earnings attributable to equity holders of the company (millions)	**754**	669
Weighted average number of shares (thousands of shares)	**1,375,904**	1,310,849

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF FONTERRA CO-OPERATIVE GROUP LIMITED

Report on the Financial Statements

We have audited the financial statements of Fonterra Co-operative Group Limited and its subsidiaries on pages 47 to 99, which comprise the statements of financial position as at 31 July 2011, the income statements, statements of comprehensive income, statements of changes in equity and cash flow statements for the year then ended, and the notes to the financial statements that include a summary of significant accounting policies and other explanatory information for both the Company and the Group. The Group comprises the Company and the entities it controlled at 31 July 2011 or from time to time during the financial year.

Directors' Responsibility for the Financial Statements

The Directors are responsible for the preparation of financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate and for such internal controls as the Directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand) and International Standards on Auditing. These standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider the internal controls relevant to the Company and the Group's preparation of financial statements that give a true and fair view of the matters to which they relate, in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company and the Group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

We carry out other assignments on behalf of the Company and the Group in the areas of other audit related services, international accounting standard advisory services, transaction services and taxation compliance services. Partners and employees of our firm may deal with the Company and the Group on normal terms within the ordinary course of trading activities of the Company and the Group. These matters have not impaired our independence as auditors of the Company and the Group.

Opinion

In our opinion, the financial statements on pages 47 to 99:

(i) comply with generally accepted accounting practice in New Zealand;

(ii) comply with International Financial Reporting Standards; and

(iii) give a true and fair view of the financial position of the Company and the Group as at 31 July 2011, and their financial performance and cash flows for the year then ended.

Report on Other Legal and Regulatory Requirements

We also report in accordance with Sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993. In relation to our audit of the financial statements for the year ended 31 July 2011:

(i) we have obtained all the information and explanations that we have required; and

(ii) in our opinion, proper accounting records have been kept by the Company and the Group as far as appears from an examination of those records.

Restriction on Distribution or Use

This report is made solely to the Company's shareholders, as a body, in accordance with Section 205(1) of the Companies Act 1993. Our audit work has been undertaken so that we might state to the Company's shareholders those matters which we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's shareholders, as a body, for our audit work, for this report or for the opinions we have formed.

PricewaterhouseCoopers

Chartered Accountants
21 September 2011

Auckland

PricewaterhouseCoopers, 188 Quay Street, Private Bag 92162, Auckland 1142, New Zealand
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EQUITY SECURITIES HELD AT BALANCE DATE

In accordance with NZX Limited Listing Rule 10.5.5(c), the following table identifies the Equity Securities in which each Director and their Associated Persons have a relevant interest as at 31 July 2011. The figure alongside each Director includes beneficially held securities, holdings by Associated Persons and joint holdings with Associated Persons.

	CO-OPERATIVE SHARES
Colin Armer	16,968,713
Malcolm Bailey	3,690,585
Ian Farrelly	2,077,433
Greg Gent	427,885
John Monaghan	986,760
Nicola Shadbolt	353,162
Sir Henry van der Heyden	462,000
Jim van der Poel	7,223,709
John Wilson	3,690,116

CO-OPERATIVE STATUS

In accordance with Section 10 of the Co-operative Companies Act 1996, the Directors of Fonterra unanimously resolved on 21 September 2011 that the Company was, for the year ended 31 July 2011, a co-operative company. The opinion was based upon the fact that:

- Throughout that period the principal activities of the Company have been the activities stated in Clause 1.2 of the Company's constitution:
  - the manufacture and sale of butter, cheese, dried milk, casein, or any other product derived from milk or milksolids supplied to the Company by its Shareholders
  - the sale to any person of milk or milksolids supplied to the Company by its Shareholders
  - the collection, treatment, and distribution for human consumption of milk or cream supplied to the Company by its Shareholders
- Each of the Company's principal activities are co-operative activities (as defined in Section 3 of the Co-operative Companies Act 1996)
- Throughout that period not less than 60% of the voting rights attaching to shares in the Company have been held by transacting Shareholders (as defined in Section 4 of the Co-operative Companies Act 1996).

REMUNERATION OF DIRECTORS

The fees paid to each Director in the 12 month period from 1 August 2010 to 31 July 2011 are scheduled below:

	FEES $
Colin Armer	156,034
Malcolm Bailey	151,293
John Ballard	134,023
Ian Farrelly	134,023
Greg Gent	134,023
David Jackson	157,529
John Monaghan	156,034
Nicola Shadbolt	134,023
Sir Henry van der Heyden	295,575
Jim van der Poel	134,023
John Waller	156,034
Ralph Waters	134,023
John Wilson	138,764

SUBSIDIARY COMPANY DIRECTORS

The following companies were subsidiaries of Fonterra as at 31 July 2011. Directors as at that date are listed; those who resigned during the year are denoted with an R. Alternate Directors are denoted with an A.

616059 Limited:
C P Caldwell, S C R Deschamps, M W Smith (R)

Anchor Ethanol Limited:
C P Caldwell, P D Washer, M W Smith (R)

Canpac International Limited:
C P Caldwell, S J Gajzago, M W Smith (R)

Civil Whey Distributors Limited:
C P Caldwell, B D Mealings, B P D Taylor, S J Gajzago (R)

Dairy Industry Superannuation Scheme Trustee Limited:
M A Apiata-Wade, B J Kerr, D M Marshall, T P McGuinness, D W C Scott, A K Williams, P D Wynen, A G Wilding (R)

Dairy Transport Logistics Limited:
G J Cochrane, K Harris, G A Hoddinott, J P Minkhorst

Fantastic Food Limited:
J A Luskie, P J W McClure

Fencepost.com Limited:
C P Caldwell, J P Minkhorst, M W Smith (R)

Fonterra (APV) Limited:
C P Caldwell, S C R Deschamps, M W Smith (R)

Fonterra (Asia) Limited:
C P Caldwell, M W Smith

Fonterra (International) Limited:
C P Caldwell, P D Washer, M W Smith (R)

Fonterra (Kotahi) Limited:
C P Caldwell, J P Coote

Fonterra (Middle East) Limited:
C P Caldwell, P D Washer, K K Gupta (R), M W Smith (R)

Fonterra (New Zealand) Limited:
C P Caldwell, P D Washer, D K Mallinson (R), M W Smith (R)

Fonterra (Number One) Limited:
C P Caldwell, S C R Deschamps, M W Smith (R)

Fonterra Brands (China Holdings) Limited:
C P Caldwell, T L Tan, M W Smith (R)

Fonterra Brands (New Zealand) Limited:
C P Caldwell, D K Mallinson, M W Smith (R)

Fonterra Brands (The Pastryhouse) Limited:
C P Caldwell, D K Mallinson, M W Smith (R)

Fonterra Brands (Tip Top Investments) Limited:
C P Caldwell, D K Mallinson, M W Smith (R)

Fonterra Brands (Tip Top) Limited:
C P Caldwell, D K Mallinson, M W Smith (R)

Fonterra Brands Investments (NZ) Limited:
C P Caldwell, D K Mallinson, M W Smith (R)

Fonterra Brands Limited:
C P Caldwell, J P Mason, M W Smith (R)

Fonterra Commodities Limited:
C P Caldwell, P D Washer, M W Smith (R)

Fonterra Corporate Research and Development Limited:
C P Caldwell, M W Smith

Fonterra Dairy Solutions Limited:
C P Caldwell, R McNickle, K K Gupta (R), M W Smith (R)

Fonterra Enterprises International Limited:
C P Caldwell, S C R Deschamps, M W Smith (R)

Fonterra Enterprises Limited:
C P Caldwell, J P Minkhorst, M W Smith (R)

Fonterra Equities Limited:
C P Caldwell, S C R Deschamps, M W Smith (R)

Fonterra Farming Ventures Limited:
C P Caldwell, J P Minkhorst, S C R Deschamps (R), M W Smith (R)

Fonterra Finance Corporation Limited:
C P Caldwell, S C R Deschamps, M W Smith (R)

Fonterra Holdings (Americas) Limited:
C P Caldwell, K J Murray, M W Smith (R)

Fonterra Holdings (Argentina) Limited:
C P Caldwell, K J Murray, M W Smith (R)

Fonterra Holdings (Brazil) Limited:
C P Caldwell, K J Murray, M W Smith (R)

Fonterra Holdings (Ecuador) Limited:
C P Caldwell, K J Murray, M W Smith (R)

Fonterra Holdings (Venezuela) Limited:
C P Caldwell, K J Murray, M W Smith (R)

Fonterra Insurance Limited:
C P Caldwell, J P Mason, M W Smith (R)

Fonterra Investments (China) Limited:
C P Caldwell, T L Tan, M W Smith (R)

Fonterra IP Limited:
C P Caldwell, S C R Deschamps, M W Smith (R)

Fonterra Limited:
C P Caldwell, P D Washer, M W Smith (R)

Fonterra Manufacturing (Americas) Limited:
C P Caldwell, K J Murray, M W Smith (R)

Fonterra PGGRC Limited:
C P Caldwell, J P Minkhorst, M W Smith (R)

SUBSIDIARY COMPANY DIRECTORS CONTINUED

Fonterra Research Centre Limited:
C P Caldwell, M W Smith

Fonterra TM Limited:
C P Caldwell, S C R Deschamps, M W Smith (R)

Food Solutions Group 2000 Limited:
C P Caldwell, S C R Deschamps, M W Smith (R)

General Foods Corporation (N.Z.) Limited:
C P Caldwell, D K Mallinson, M W Smith (R)

Glencoal Energy Limited:
C P Caldwell, B D Mealings, S J Gajzago (R), M W Smith (R)

Global Dairy Trade Holdings Limited:
C P Caldwell, J P Mason

Kapiti Fine Foods Limited:
C P Caldwell, D K Mallinson, M W Smith (R)

Kotahi GP Limited:
C P Caldwell, J P Coote

MIH Limited:
C P Caldwell, J P Minkhorst

New Zealand Dairy Board:
C P Caldwell, P D Washer, M W Smith (R)

New Zealand Milk (Australasian Holdings) Limited:
C P Caldwell, J P Mason, M W Smith (R)

New Zealand Milk (Denmark) Limited:
C P Caldwell, M P Campbell, M W Smith (R)

New Zealand Milk (International) Limited:
C P Caldwell, J P Mason, M W Smith (R)

New Zealand Milk Brands Limited:
C P Caldwell, S C R Deschamps, M W Smith (R)

NZAgbiz Limited:
C P Caldwell, J P Minkhorst, M W Smith (R)

NZM (Dairy Holdings) Limited:
C P Caldwell, K K Gupta, M W Smith (R)

Peters Ice Cream Company (N.Z.) Limited:
C P Caldwell, D K Mallinson, M W Smith (R)

Promak No. 2 Limited:
C P Caldwell, S C R Deschamps, M W Smith (R)

Promak Technology (NZ) Limited:
C P Caldwell, S C R Deschamps, M W Smith (R)

RD1 Limited:
J P Minkhorst, K A Wickham, P D Gentry (R), G A Jacobs (R), N Kuzemko (R), R L Norton (R)

Sovenz Limited:
C P Caldwell, S C R Deschamps, M W Smith (R)

Tangshan Dairy Farm (NZ) Limited:
C P Caldwell, T L Tan, M W Smith (R)

ViaLactia Biosciences (NZ) Limited:
C P Caldwell, J P Minkhorst, M W Smith (R)

ViaLactia Bovine Limited:
C P Caldwell, J P Minkhorst, M W Smith (R)

ViaLactia Clover Limited:
C P Caldwell, J P Minkhorst, M W Smith (R)

Whareroa Co-Generation Limited:
C P Caldwell, B D Mealings, S J Gajzago (R), M W Smith (R)

A.C.N. 008 668 602 Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

A.C.N. 009 163 268 Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

A.C.N. 009 235 492 Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

A.C.N. 111 834 489 Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

A.C.N. 113 345 430 Pty Ltd [Australia]:
B S Donnison, P L Thorn

Anchor Foods (Malaysia) Sdn Bhd (in liquidation) [Malaysia]:
M F Bin Wahab, D J McKay, M W Smith, K K Gupta (A)

Anchor Foods Limited [United Kingdom]:
G R Sharma, M W Smith

Anmum (Malaysia) Sdn. Bhd. [Malaysia]:
M F Bin Wahab, D A Ross, M W Smith, K K Gupta (A), D J McKay (R)

Arctic Foods Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

Australasian Food Holdings Pty Limited [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

Bonlac Finance Pty Limited [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

Bonlac Staff Retirement Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, G P Nicholson (R), P L Thorn (R), M J West (R)

Bonland Cheese Trading Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

Comercial Dos Alamos S.A. [Chile]:
H Covarrubias Lalanne, P C Muzzio, J M Porraz-Lando, J F Silva Barroilhet, S Tagle Perez

Comercial Santa Elena S.A. [Chile]:
H Covarrubias Lalanne, P C Muzzio, J M Porraz-Lando, J F Silva Barroilhet, S Tagle Perez

SUBSIDIARY COMPANY DIRECTORS CONTINUED

Dairy Enterprises (Chile) Limitada [Chile]:
M P Campbell, A J Duncan, K J Murray, M W Smith, E A Teisaire, C Bussi (A), J C Gumucio Schönthaler (A), L O Herrera Larraín (A), A Montaner Lewin (A), S Obach González (A)

Dairy Enterprises International (Chile) Limited [Cayman Islands]:
M P Campbell, E A Teisaire

Dairy Fresh Pty. Ltd. [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

Dairymas (Malaysia) Sdn Bhd [Malaysia]:
M F Bin Wahab, D A Ross, M W Smith, K K Gupta (A), D J McKay (R)

Dommeldal Dairy B.V. [Netherlands]:
A Kent, M W Smith

Fazenda MIH Ltda [Brazil]:
A Z Fortuna, F Jorge

Fonterra (Brasil) Ltda [Brazil]:
M M Pérez Ortiz

Fonterra (Canada), Inc. [Canada]:
C P Caldwell, B Kipping, G Vita, M P J Bates (R)

Fonterra (Central America) S.A. [Panama]:
M d R García de Pullin, B T Willis

Fonterra (Centro America) S.A. [Guatemala]:
M d R García de Pullin, M M Pérez Ortiz, B T Willis

Fonterra (China) Limited [Hong Kong]:
C P Caldwell, P P Coppes, T L Tan, P A Turner, M W Smith (R), K A Wickham (R)

Fonterra (CIS) Limited Liability Company [Russian Federation]:
A Rozanov

Fonterra (Europe) Coöperatie U.A. [Netherlands]:
K Liekelema, M W Smith

Fonterra (Europe) GmbH [Germany]:
K Liekelema

Fonterra (France) SAS [France]:
K Liekelema

Fonterra (Ing.) Limited [Mauritius]:
Lee G, P D Washer, B M Ryan (R)

Fonterra (Italy) S.P.A. [Italy]:
B B Anderson, P Pennati, M W Smith

Fonterra (Japan) Limited [Japan]:
P G Brown, C P Caldwell, R M Kennerley, K Kumagai, H Ono, K Ueta, D T Moore (R), S Yoshifuku (R)

Fonterra (Latam) Ltd [Bermuda]:
C P Caldwell, P D Washer, N Kuzemko (R), G Roper (R), M W Smith (R)

Fonterra (Logistics) Ltd [United Kingdom]:
T H D Kühn, G R Sharma

Fonterra (Mexico) S.A. de C.V. [Mexico]:
C P Caldwell, M M Pérez Ortiz, P D Washer, M I Arana Soriano (A), L Barona Mariscal (A), G A Castro Palafox (A), E A Teisaire (R), B T Willis (R)

Fonterra (Pacific) Inc. [United States]:
C P Caldwell, M W Smith, G Vita, M P J Bates (R)

Fonterra (SEA) Pte. Ltd. [Singapore]:
G N Kane, M W Smith

Fonterra (Switzerland) SA [Switzerland]:
G Roper, M W Smith

Fonterra (Thailand) Limited [Thailand]:
G N Kane, K Vunthanadit

Fonterra (USA) Inc [United States]:
C P Caldwell, M W Smith, G Vita, M P J Bates (R)

Fonterra (Yutian) Dairy Farm Company Limited [China]:
J P Minkhorst, P J Moore, P A Turner

Fonterra Australia Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

Fonterra Brands (Americas), Inc. [United States]:
M W Smith, G Vita, M P J Bates (R)

Fonterra Brands (Asia Holdings) Pte. Ltd [Singapore]:
K K Gupta, M A Wilson

Fonterra Brands (Australia) Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

Fonterra Brands (Centram), S.A. [Panama]:
M P J Bates, M W Smith

Fonterra Brands (China) Ltd [Hong Kong]:
M W Smith, T L Tan, D A Matthews (R)

Fonterra Brands (Far East) Limited [Hong Kong]:
K K Gupta, M A Wilson

Fonterra Brands (Guangzhou) Ltd [China]:
T L Tan, P A Turner, K A Wickham

Fonterra Brands (Guatemala), S.A. [Guatemala]:
M P J Bates, M W Smith

Fonterra Brands (Hong Kong) Limited [Hong Kong]:
K K Gupta, D A Ross, M W Smith

Fonterra Brands (Japan) Limited [Japan]:
C P Caldwell, R M Kennerley

Fonterra Brands (Malaysia) Sdn Bhd [Malaysia]:
M F Bin Wahab, D A Ross, M W Smith, K K Gupta (A), D J McKay (R)

Fonterra Brands (Mauritius Holdings) Limited [Mauritius]:
K K Gupta, J Jingree, S K Jogoo, M W Smith

Fonterra Brands (New Young) Pte. Ltd. [Singapore]:
A J Bruce, Y Lin, Lin C, Ling J, M W Smith, M A Wilson, A M Fitzsimmons (A), K K Gupta (R), D A Ross (R) (A)

SUBSIDIARY COMPANY DIRECTORS CONTINUED

Fonterra Brands (Singapore) Pte. Ltd [Singapore]:
K K Gupta, M A Wilson

Fonterra Brands (Thailand) Ltd [Thailand]:
S Aramthip, A M Fitzsimmons, C Phaonimmongkol, M W Smith, M A Wilson, D A Ross (R)

Fonterra Brands (Trading Singapore) Pte. Ltd (in liquidation) [Singapore]:
K K Gupta, M A Wilson

Fonterra Brands (Viet Nam) Company Limited [Viet Nam]:
K K Gupta, M W Smith

Fonterra Brands Lanka (Private) Limited [Sri Lanka]:
J H P Gallage, A R R Kasireddy, M W Smith, K K Gupta (R), J H P Gallage (R) (A)

Fonterra Brands Phils. Inc [Philippines]:
C Guillermo, K K Gupta, M Magtoto, C M Mendoza, R A Mendoza, M W Smith, M A Wilson

Fonterra Commercial Trading (Shanghai) Company Limited [China]:
W F Chu, M W Smith, T L Tan, P A Turner, K A Wickham, Kwok H Y (R)

Fonterra Egypt Limited [Egypt]:
A Anwar, M W Smith

Fonterra Foods Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

Fonterra Foodservices (USA), Inc. [United States]:
M W Smith, G Vita, M P J Bates (R)

Fonterra Holdings (Mexico), S.A. de C.V. [Mexico]:
M M Pérez Ortiz, P D Washer, M I Arana Soriano (A), L Barona Mariscal (A), E A Teisaire (R), B T Willis (R)

Fonterra Holdings (Thailand) Limited [Thailand]:
G N Kane, K Vunthanadit

Fonterra Ingredients Australia Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

Fonterra Investments Netherlands Coöperatie U.A. [Netherlands]:
FTC Trust B.V., A Kent, A A Mikhalevsky, D T Moore

Fonterra Investments Pty Limited [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

Fonterra Milk Australia Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

Fonterra Servicios, S.A. de C.V. [Mexico]:
M M Pérez Ortiz, P D Washer, M I Arana Soriano (A), L Barona Mariscal (A), M W Smith (R), E A Teisaire (R), B T Willis (R)

Fonterra Tangshan Dairy Farm (HK) Limited [Hong Kong]:
M W Smith, P A Turner

Fonterra Venezuela, S.A. [Venezuela]:
F C Ortega Becea, M M Pérez Ortiz, M W Smith, M P de Alexandre (A), O N de Massiani (A), S Guevara Camacho (A)

Halve Maan Zuivel B.V. [Netherlands]:
A Kent, M W Smith

Inversiones Dairy Enterprises S.A. [Chile]:
M P Campbell, A J Duncan, J C Gumucio Schönthaler, A Montaner Lewin, K J Murray, M W Smith, J P Egaña Bertoglia (A), S Obach González (A)

Key Ingredients, Inc. [United States]:
C P Caldwell, M W Smith, G Vita, M P J Bates (R)

Krabbebosschen Zuivel B.V. [Netherlands]:
A Kent, M W Smith

Mainland Dairies Pty. Ltd. [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

Mainland Foodservice Pty Limited [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

MIH Holdings Brasil Ltda [Brazil]:
A Z Fortuna, F Jorge

Milk Products Holdings (Middle East) EC [Bahrain]:
M W Smith, M A Wilson

Milk Products Holdings (North America) Inc. [United States]:
C P Caldwell, M W Smith, G Vita, M P J Bates (R)

Murrumbidgee Dairy Products Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

New Tai Milk Products Co Ltd [Taiwan]:
T H Deane, G N Kane, Lee G, C Lee, M Lee, J Lee, T L Tan, P D Washer, Kwok H Y (R), B M Ryan (R), B T Willis (R)

New Zealand Milk (Australasia) Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

New Zealand Milk (Barbados) Ltd [Barbados]:
M P J Bates, M W Smith

New Zealand Milk (LATAM) Ltd [Bermuda]:
C P Caldwell, K J Murray, M W Smith (R)

Newdale Dairies (Private) Limited [Sri Lanka]:
J H P Gallage, A R R Kasireddy, M W Smith, K K Gupta (R), J H P Gallage (R) (A)

NZAgbiz Australia Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

NZMP (AEM) Ltd [United Kingdom]:
T H D Kühn, G R Sharma

Ooijevaarsnest Zuivel B.V. [Netherlands]:
A Kent, M W Smith

Pax Zuivel B.V. [Netherlands]:
A Kent, M W Smith

PT Fonterra Brands Indonesia [Indonesia]:
M Handoyo, M W Smith

SUBSIDIARY COMPANY DIRECTORS CONTINUED

Recombined Dairy Systems A/S [Denmark]:
T H D Kühn, K Liekelema, G R Sharma

Saudi New Zealand Milk Products Company Limited [Saudi Arabia]:
J C Fryer, K P Williams (R)

Sociedad Agrícola y Lechera Praderas Australes S.A. ("Pradesur") [Chile]:
H Covarrubias Lalanne, J M Porraz-Lando, J F Silva Barroilhet

Sociedad Procesadora de Leche Del Sur S.A. [Chile]:
E Alcalde Undurraga, A Cussen Mackenna, J Milic Barros, K J Murray, S Obach González, G Varela Alfonso, J M Alcalde Undurraga (A), J P Matus Pickering (A), A Montaner Lewin (A), S Oddo Gómez (A), J P Orellana Pavón (A), C Perez-Cotapos Subercaseaux (A), G M Cowan (R), J R Valente Vias (R), S Diez Arriagada (R) (A), O Ferrari García (R) (A), G Grez Jordán (R) (A), G Jiménez Barahona (R) (A), J E Montero León (R) (A)

Solid Fresh Food & Beverage (M) Sdn. Bhd. [Malaysia]:
M F Bin Wahab, D A Ross, M W Smith, K K Gupta (A), D J McKay (R)

Solid Milk Industries Sdn. Bhd [Malaysia]:
M F Bin Wahab, D J McKay, M W Smith, K K Gupta (A)

Soprole Inversiones SA [Chile]:
G Bitran Dicowsky, M P Campbell, J R Valente Vias, G Varela Alfonso, A Walker Prieto, S Diez Arriagada (A), R Fernández Robinson (A), C Herrera Barriga (A), R Sepúlveda Seminario (A), R Tisi Lanchares (A), M P Campbell (R), G M Cowan (R), A J Duncan (R), F Léniz Cerda (R), K J Murray (R), R Sepúlveda Seminario (R), M W Smith (R), J P Egaña Bertoglia (R) (A), O Ferrari García (R) (A), J C Gumucio Schönthaler (R) (A), L O Herrera Larraín (R) (A), A Montaner Lewin (R) (A), J E Montero León (R) (A), S Obach González (R) (A)

Soprole S.A. [Chile]:
G Bitran Dicowsky, M P Campbell, J R Valente Vias, G Varela Alfonso, A Walker Prieto, S Diez Arriagada (A), R Fernández Robinson (A), C Herrera Barriga (A), R Sepúlveda Seminario (A), R Tisi Lanchares (A), G M Cowan (R), F Léniz Cerda (R), A Montaner Lewin (R), R Sepúlveda Seminario (R), O Ferrari García (R) (A), J C Gumucio Schönthaler (R) (A), G Jiménez Barahona (R) (A), J E Montero León (R) (A)

Susumas Sdn Berhad (in liquidation) [Malaysia]:
M F Bin Wahab, D J McKay, M W Smith, K K Gupta (A)

Tangshan Fonterra San Lu Dairy Farm Ltd [China]:
P J Moore, T L Tan, P A Turner, Zhang J L, Wu J S (R)

Unilac Australia Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

United Milk Tasmania Pty Limited [Australia]:
C P Caldwell, D K Mallinson, M W Smith (R)

REMUNERATION FRAMEWORK

Fonterra operates a Pay for Performance approach to remuneration for salaried employees. We aim to provide competitive salaries in the markets in which we operate with incentives and increases to remuneration being based on the performance of individuals and the organisation.

Our remuneration framework for salaried staff is based on a "total remuneration" approach meaning packages include fixed remuneration (e.g. salary and benefits) and variable remuneration (e.g. Short Term Incentive plan (STI)).

To ensure Fonterra remains competitive in the relevant labour market, the framework is based on relevant market information obtained from independent remuneration consultants. The framework is designed to reward exceptional performance taking into account factors such as internal equity and budget constraints.

All elements of the framework contribute to building an overall atmosphere of recognition, innovation and challenge.

Remuneration is important for attracting talent into the organisations, but it is not the only consideration. Attracting and retaining talent also depends on people leadership practices which build an emotional connection to the organisation including: opportunities to get involved in work that offers learning and growth; believing that they are working for an organisation that is making a meaningful contribution; feeling like their work matters and is appreciated and receiving praise and recognition from colleagues and peers. Fonterra's annual employee survey measures how successful we are at providing these non-financial rewards to employees and action plans address the gaps while the *This is Fonterra* project informs, excites and connects employees to our vision and strategy.

SHORT TERM INCENTIVE (STI) PLANS

Every permanent salaried employee in Fonterra worldwide is invited to participate in the annual STI plans.

STI plans are an important communication device signalling to employees what is important to Fonterra and how success in Fonterra is measured and rewarded. At the commencement of each year a series of Key Performance Indicators (KPIs) are identified and agreed. These KPIs include important financial measures from our three year strategic plan and also include our goals around Health & Safety and other important operational and qualitative measures.

Incentive programmes drive Fonterra's performance by:

- Aligning the objectives of the Company to ensure collaboration and a one team approach to achieve Fonterra's goals
- Establishing targets which are challenging yet achievable
- Linking specific levels of reward to individual, team and Company performance
- Providing great opportunities when Fonterra's business and people are successful.

At the end of each operating year, performance against the KPIs is determined and independently reviewed and approved by the Appointments, Remuneration and Development Committee (AR&DC).

MEDIUM TERM INCENTIVE (MTI) PLAN

For certain key executives, Fonterra operates a MTI plan. This plan is by invitation only and is designed to motivate, reward and retain key executives.

The plan operates over a one year cycle but any payments are made over a three year period to maximise retention of key executives. Any payments made under the MTI plan are approved by the AR&DC.

BENEFITS

As Fonterra operates a total remuneration approach benefits are only provided when required by legislation or typical in a particular market. However, Fonterra works hard with suppliers to offer employees discounted products and services. In the year ended 31 July 2011, New Zealand based salaried employees were offered significantly discounted life insurance and income protection to help employees take care of their families when they can't.

FIXED REMUNERATION	STI PLANS	MTI PLAN
– Provides "stable" base level of reward	– All salaried employees eligible	– Restricted to key executives
– External and internal relativities and budget constraints taken into account	– Comprehensive range of financial and non-financial measures	– One year scheme vested over a three year period to encourage retention
– Typically set at market median (for local market) using independent external benchmark data	– When targets are exceeded total remuneration will be above market median	
– Varies based on employee skills and performance	– Highest performance receive an additional multiplier, lowest performance receive no STI payment	

BASE REMUNERATION

The Group operates in a number of countries where remuneration market levels differ widely. During the year ended 31 July 2011, the number of employees, not being Directors of Fonterra, who received remuneration and the value of other benefits exceeding $100,000 was as follows:

REMUNERATION RANGE ($)		NEW ZEALAND[1]	OFFSHORE[2]	CESSATIONS[3]	TOTAL
100,000	110,000	635	250	28	913
110,001	120,000	260	261	25	546
120,001	130,000	151	222	15	388
130,001	140,000	107	133	9	249
140,001	150,000	83	89	10	182
150,001	160,000	76	80	12	168
160,001	170,000	65	76	8	149
170,001	180,000	53	71	9	133
180,001	190,000	39	53	2	94
190,001	200,000	32	34	6	72
200,001	210,000	21	25	8	54
210,001	220,000	17	29	6	52
220,001	230,000	21	25	4	50
230,001	240,000	11	20	3	34
240,001	250,000	5	21	3	29
250,001	260,000	12	8	4	24
260,001	270,000	6	10	2	18
270,001	280,000	7	19	1	27
280,001	290,000	5	17	1	23
290,001	300,000	9	15	–	24
300,001	310,000	5	7	3	15
310,001	320,000	5	4	3	12
320,001	330,000	4	11	2	17
330,001	340,000	4	2	–	6
340,001	350,000	6	13	2	21
350,001	360,000	2	4	2	8
360,001	370,000	6	5	1	12
370,001	380,000	4	3	2	9
380,001	390,000	7	3	2	12
390,001	400,000	3	5	2	10
400,001	410,000	1	3	–	4
410,001	420,000	1	6	–	7
420,001	430,000	2	4	–	6
430,001	440,000	2	2	1	5
440,001	450,000	1	4	–	5
450,001	460,000	2	–	–	2
460,001	470,000	3	2	1	6
470,001	480,000	2	3	1	6
480,001	490,000	2	5	–	7
490,001	500,000	–	3	1	4
500,001	510,000	1	–	1	2
510,001	520,000	1	4	1	6
520,001	530,000	2	–	–	2
530,001	540,000	1	–	2	3
540,001	550,000	4	2	1	7
550,001	560,000	–	1	–	1
560,001	570,000	2	1	–	3
570,001	580,000	–	2	–	2
590,001	600,000	–	3	–	3

BASE REMUNERATION CONTINUED

REMUNERATION RANGE ($)		NEW ZEALAND[1]	OFFSHORE[2]	CESSATIONS[3]	TOTAL
600,001	610,000	–	2	–	2
610,001	620,000	–	1	–	1
620,001	630,000	2	2	–	4
640,001	650,000	1	–	–	1
650,001	660,000	2	1	–	3
660,001	670,000	1	2	–	3
670,001	680,000	–	1	1	2
680,001	690,000	–	2	–	2
690,001	700,000	–	1	–	1
710,001	720,000	–	2	–	2
720,001	730,000	–	1	–	1
730,001	740,000	–	2	–	2
740,001	750,000	1	1	1	3
750,001	760,000	–	1	1	2
760,001	770,000	–	1	–	1
770,001	780,000	1	1	–	2
780,001	790,000	1	2	–	3
790,001	800,000	1	1	–	2
800,001	810,000	2	1	–	3
820,001	830,000	–	1	–	1
840,001	850,000	–	1	–	1
850,001	860,000	–	–	1	1
870,001	880,000	–	–	1	1
880,001	890,000	–	1	–	1
900,001	910,000	–	–	1	1
910,001	920,000	–	1	–	1
920,001	930,000	1	–	–	1
950,001	960,000	–	1	–	1
980,001	990,000	1	–	–	1
1,080,001	1,090,000	–	1	–	1
1,130,001	1,140,000	1	–	–	1
1,140,001	1,150,000	1	1	–	2
1,190,001	1,200,000	–	1	–	1
1,220,001	1,230,000	–	1	–	1
1,280,001	1,290,000	–	1	–	1
1,300,001	1,310,000	–	1	–	1
1,330,001	1,340,000	2	–	–	2
1,360,001	1,370,000	–	1	–	1
1,430,001	1,440,000	–	1	–	1
1,490,001	1,500,000	–	–	1	1
1,560,001	1,570,000	–	1	–	1
1,640,001	1,650,000	1	–	–	1
1,990,001	2,000,000	1	–	–	1
2,050,001	2,060,000	–	1	–	1
2,510,001	2,520,000	–	1	–	1
2,640,001	2,650,000	1	–	–	1
4,990,001	5,000,000	1	–	–	1
Total		**1,710**	**1,601**	**191**	**3,502**

1. Includes employees employed in New Zealand during the reporting period.
2. Includes employees employed in an offshore operation during the reporting period. Amounts paid in foreign currency have been translated at the average conversion rate for the period.
3. Cessations include employees that have been terminated or retired during the period. The amounts paid to former employees include salary and bonuses for the current period, prior period bonuses that have been paid in the current period (which were accrued at 31 July 2010) and termination entitlements including those arising from employment arrangements entered into by legacy companies prior to the formation of Fonterra.

CURRENT CREDIT RATING STATUS

Standard & Poor's has rated the Company A+ with a rating outlook of stable. Fitch has rated the Company AA- with a rating outlook of stable. Retail Bonds have been rated the same as the Company by both Standard & Poor's and Fitch. Capital Notes which are subordinate to other Fonterra debt issued are rated A by Standard & Poor's and A+ by Fitch. The ratings were last affirmed in December 2010 by Standard & Poor's and in May 2011 by Fitch.

EXCHANGE RULINGS AND WAIVERS

NZX Limited (NZX) has ruled that Capital Notes do not constitute "equity securities" under its Listing Rules (Rules). This means that where Capital Notes are quoted on NZX's debt market (NZDX), the Company is not required to comply with certain Rules which apply to an issuer of quoted equity securities.

NZX has granted waivers from NZDX Rule 11.1.1 to enable Fonterra to decline to accept or register transfers of Capital Notes or Retail Bonds (NZDX listed debt securities FCGHA, FCG010 and FCG020) if such transfer would result in the transferor holding or continuing to hold Capital Notes or Retail Bonds with a face value or principal amount of less than $5,000 or if such transfer is for an amount of less than $1,000 or multiple thereof. The effect of these waivers is that the minimum holding amount in respect of the Capital Notes and Retail Bonds will at all times be $5,000 in aggregate and that Retail Bonds can only be transferred in multiples of $1,000.

NZX has also granted a waiver from NZDX Rule 5.2.3 in respect of Retail Bond FCG020 to enable that Bond to be quoted on the NZDX market even though it did not meet the requirement that at least 500 members of the public held at least 25% of the Bonds being issued.

ANALYSIS OF CAPITAL NOTE AND RETAIL BOND HOLDING

Analysis of Fonterra's Capital Note Holding as at 19 August 2011:

FCGHA Capital Notes

FROM – TO	HOLDER COUNT	%	HOLDING QUANTITY	%
1 – 1,000	10	1.1%	4,858	0.0%
1,001 – 5,000	26	2.9%	72,020	0.1%
5,001 – 10,000	360	40.0%	2,503,105	2.4%
10,001 – 100,000	457	50.8%	12,664,107	12.4%
100,001 and over	46	5.2%	87,275,164	85.1%

100,001 and over includes Fonterra Co-operative Group Limited's holding of 67,435,575.

Analysis of Fonterra's Retail Bond Holding as at 19 August 2011:

FCG010 $800 million Retail Bond issue

FROM – TO	HOLDER COUNT	%	HOLDING QUANTITY	%
1 – 999	–	–	–	–
1,000 – 4,999	–	–	–	–
5,000 – 9,999	955	11.2%	5,456,000	0.7%
10,000 – 99,999	6,656	77.7%	183,682,000	23.0%
100,000 and over	954	11.1%	610,862,000	76.3%

FCG020 $150 million Retail Bond issue

FROM – TO	HOLDER COUNT	%	HOLDING QUANTITY	%
1 – 999	–	–	–	–
1,000 – 4,999	–	–	–	–
5,000 – 9,999	38	9.2%	225,000	0.2%
10,000 – 99,999	314	75.6%	8,787,000	5.8%
100,000 and over	63	15.2%	140,988,000	94.0%

ENTRIES IN THE INTERESTS REGISTER

Directors' interests in transactions

General disclosures of interest

The following general disclosures of interest were made in the period from 1 August 2010 to 31 July 2011:

Colin Armer	Cessation of interest as a Director of Duorock Dairies Limited
Malcolm Bailey	Member of the International Food and Agricultural Trade Policy Council (IPC); Member of the Executive of the New Zealand United States Council Incorporated; Member of the Executive of The New Zealand International Business Forum Incorporated (IBF); Member of the Executive Committee of the Dairy Companies Association of New Zealand Incorporated (DCANZ)
Ian Farrelly	Advisor to Fortuna Group
John Monaghan	Director of CentrePort Limited, and its subsidiaries CentrePort Properties Limited, Central Stevedoring Limited and Port of Wellington (1988) Limited
Jim van der Poel	Director and shareholder of Green Valley Farms Limited
Ralph Waters	Non-executive Director of Woolworths Limited
John Wilson	Director and shareholder of RDGP Limited, LMGP Limited and Gordon GP Limited; Limited partner of Rangitata Dairies LP and Mangahana Farm LP

Specific disclosures

Nicola Shadbolt	Interest as the Principal Investigator for Massey University in a two year research contract, which expires on 1 July 2012, between Fonterra and Massey University regarding the International Farm Comparison Network. The contract value is not more than $20,000, payable by Fonterra to Massey University.

ENTRIES IN THE INTERESTS REGISTER CONTINUED

Securities dealings of Directors

The following entries were made in the Interests Register during the year.

New disclosures

Directors disclosed the following holding of Co-operative shares during the year:

	CO-OPERATIVE SHARES	
	HELD BY ASSOCIATED PERSONS	JOINTLY HELD WITH ASSOCIATED PERSONS
Malcolm Bailey (interest advised 27 July 2011)	150,000	–

Additional share purchases

Shareholders are able to make an election to acquire shares additional to the required end of season adjustments. Directors disclosed the following transactions associated with this provision:

	CO-OPERATIVE SHARES	
	HELD BY ASSOCIATED PERSONS	JOINTLY HELD WITH ASSOCIATED PERSONS
Colin Armer		
– Purchased for cash	69,262	9,731
John Monaghan		
– Purchased for cash	26,760	–
Sir Henry van der Heyden		
– Purchased for cash	6,280	–
Jim van der Poel		
– Purchased for cash	80,000	30,000

In all cases the allocations were made on 30 September 2010. The value upon allocation of these securities was $4.52 per Co-operative share.

End of season changes

Directors disclosed the following transactions associated with 2011 end of season adjustments:

	CO-OPERATIVE SHARES	
	HELD BY ASSOCIATED PERSONS	JOINTLY HELD WITH ASSOCIATED PERSONS
Colin Armer		
– Purchased for cash	219,391	–
– Surrendered for cash	271,833	–
Malcolm Bailey		
– Surrendered for cash	166,865	–
Ian Farrelly		
– Purchased for cash	122,539	–
Greg Gent		
– Purchased for cash	10,633	–
Jim van der Poel		
– Purchased for cash	60,492	–
John Wilson		
– Purchased for cash	139,813	101,268

ENTRIES IN THE INTERESTS REGISTER CONTINUED

In all cases the allocations or surrenders relate to the 2010/11 end of season adjustments. Adjustments related to production in the 2010/11 season were made on 30 June 2011 with deemed dates in accordance with the Constitution. The value upon allocation or surrender of these securities was $4.52 per Co-operative share.

Directors disclosed the following transactions which occurred as a result of elections made at the end of the 2010/11 season:

	CO-OPERATIVE SHARES	
	HELD BY ASSOCIATED PERSONS	JOINTLY HELD WITH ASSOCIATED PERSONS
Colin Armer		
– Purchased for cash	228,072	–
– Surrendered for cash	635,758	–
Malcolm Bailey		
– Purchased for cash	166,865	–
Ian Farrelly		
– Surrendered for cash	26,232	–
Greg Gent		
– Surrendered for cash	–	6,500
Sir Henry van der Heyden		
– Surrendered for cash	10,000	18,000
Jim van der Poel		
– Surrendered for cash	125,804	19,142
John Wilson		
– Surrendered for cash	–	73,869

Adjustments were made on 30 June 2011 with deemed dates in accordance with the Constitution. In all cases the value upon allocation or surrender of these securities was $4.52 per Co-operative share.

Retail Bond transactions
There were no transactions in Retail Bonds reported during the period from 1 August 2010 to 31 July 2011. Current interests held by Directors remain as follows:

	Details of Interest
David Jackson	Joint trustee in respect of 100,000 Bonds (FCG010)
John Waller	Joint trustee in respect of 210,000 Bonds (FCG010)

Other trading activities
On 1 August 2010, Associated Persons of Colin Armer acquired interests in 284,000 Co-operative shares at $4.52 per share upon commencing supply.

On 30 June 2011, Associated Persons of Jim van der Poel acquired interests in 101,617 Co-operative shares at $4.52 per share.

On 30 June 2011, 1,737,379 Co-operative shares which were jointly held by John Wilson and Associated Persons, were transferred to Associated Persons of John Wilson.

On 1 July 2011, 1,194,709 Co-operative shares which were jointly held by John Wilson and Associated Persons, were transferred to Associated Persons of John Wilson.

Loans to Directors
A loan was made to Associated Persons of Ian Farrelly on 20 July 2011 by way of financial assistance, as generally available to shareholders for the acquisition of shares in June 2011, relating to 2010/11 end of season adjustments and 2011/12 new season elections. The total amount of loan is $478,903 and interest is calculated on a daily basis and compounded monthly and charged at the prevailing Fringe Benefit Tax interest rate plus a margin of 1% (initially 5.90% + 1% = 6.90%). If not repaid earlier, the amounts outstanding will be processed as a deduction from the September, paid October, milk payment and subsequent milk payments until the share debt and accrued interest charges are paid. The Board approved such loans to Directors at their meeting on 24 May 2011.

ENTRIES IN THE INTERESTS REGISTER CONTINUED

Directors' remuneration

The Directors' Remuneration Committee, comprising six Shareholders elected in accordance with the Constitution, makes recommendations for Shareholder approval as to the level of Directors' fees.

At the Annual Meeting of Shareholders held on 18 November 2010, Shareholders approved, on the recommendation of the Directors' Remuneration Committee, the following amounts of remuneration to apply to Elected Directors from the date of that Annual Meeting of Shareholders.

Chairman	$315,000 p.a.
Directors	$140,000 p.a.
Discretionary additional payments to the Chairmen of permanent Board Committees (except if the Chairman is the Fonterra Chairman)	$25,000 p.a.

The Board has approved payment of the discretionary additional payment, at the prevailing approved rate, to the Chairmen of permanent Board Committees.

The Board has discretion to set the fees for Directors appointed under clause 12.4 of the Constitution. In the period to 31 July 2011, the Board applied the same remuneration levels as above to the Appointed Directors.

In general, fees paid by subsidiary or associate companies in respect of Fonterra Directors or employees appointed by Fonterra as Directors of those companies are payable directly to Fonterra.

Directors' indemnity and insurance

Fonterra has given indemnities to, and has effected insurance for, Directors and executives of the Company and its related companies, in accordance with Section 162 of the Companies Act 1993, and Fonterra's Constitution, which, except for specific matters that are expressly excluded, indemnify and insure Directors and executives against monetary losses as a result of actions undertaken by them in the course of their duties. Among the matters specifically excluded are penalties and fines that may be imposed for breaches of law.

FIVE YEAR SUMMARY

	JULY 2011	JULY 2010	JULY 2009	JULY 2008[1]	MAY 2007
SHAREHOLDER RETURNS					
Payout ($ per kgMS)					
Farmgate Milk Price[2]	**7.60**	6.10	4.72	7.59	3.87
Distributable Profit[3]	**0.65**	0.60	0.49	0.31	0.59
Payout (before retentions)	**8.25**	6.70	5.21	7.90	4.46
Less retentions	**(0.35)**	(0.33)	(0.01)	(0.24)	–
Payout[4,5]	**7.90**	6.37	5.20	7.66	4.46
Fair Value Share price ($) set for the next season	**4.52**	4.52	4.52	5.57	6.79
Total Shareholder return[6]	**6.6%**	6.0%	(10.2%)	(16.9%)	12.5%
OPERATING PERFORMANCE					
Average commodity prices (USD per MT FOB)					
Whole Milk Powder	**3,841**	3,313	2,379	4,605	2,687
Skim Milk Powder	**3,521**	3,020	2,205	4,325	2,748
Butter	**4,583**	3,573	2,343	3,755	1,848
Cheese	**4,285**	3,819	3,114	4,894	2,806
Source: Oceania Export Series, Agricultural Marketing Service, US Department of Agriculture					
Average NZD/USD spot exchange rate applying throughout the year[7]	**0.77**	0.71	0.60	0.77	0.68
Fonterra's average NZD/USD conversion rate[8]	**0.72**	0.67	0.67	0.74	0.67
Revenue ($ million)					
Ingredients and other revenue	**14,623**	11,818	10,987	14,267	9,755
Consumer revenue	**5,248**	4,908	5,048	5,245	3,932
Total revenue	**19,871**	16,726	16,035	19,512	13,687
Dairy ingredients manufactured in New Zealand (000s MT)	**2,143**	2,058	2,021	2,021	2,082
Total ingredients sales volume (000s MT)	**2,486**	2,392	2,310	2,633	2,458
Segment profit ($ million)[9]					
Standard & Premium Ingredients	**430**	506	584	340	918
ANZ	**274**	299	240	220	200
Asia/AME	**186**	166	63	(39)	49
Latam	**121**	107	106	129	58
Eliminations	**17**	–	(3)	(36)	41
Segment profit	**1,028**	1,078	990	614	1,266
Non-recurring items	**(23)**	(174)	(32)	145	23
Normalised segment earnings	**1,005**	904	958	759	1,289
Profit for the year attributable to Shareholders ($ million)[10]	**754**	669	599	272	862

1. On 24 January 2008 Fonterra's Board resolved to change the Company's balance date to 31 July from 31 May, consequently the financial period for 2008 was a 14 month period to 31 July 2008.
2. From the beginning of the 2009 season the Farmgate Milk Price has been determined in accordance with the Farmgate Milk Price Manual and is independently audited.
3. On 18 November 2009 Shareholders approved stages one and two of the capital structure changes. As a result of the changes to the capital structure all shares are eligible to receive a dividend if declared by the Board. Previously in addition to the Farmgate Milk Price, returns to Shareholder Suppliers were by way of the Value Return payment. Distributable Profit per share for the years ended 31 July 2010 and 31 July 2011 has been calculated as Distributable Profit divided by the number of shares on issue as at 31 May. For the years ended 31 July 2009 and prior Distributable Profit was calculated per kgMS.
4. Average Payout for a 100% share-backed supplier.
5. Payout to Shareholder Suppliers for 2007 is based on the actual Payout calculation and does not incorporate subsequent adjustments relating to the transition to New Zealand Equivalents to International Financial Reporting Standards.
6. Total Shareholder Return reflects movements in the Fonterra Fair Value Share (FVS) price plus a return on investment, represented by dividends paid or Value Return payments per share. In 2009 as part of the capital structure changes the FVS price has been valued on a restricted market basis. The FVS has been held at a base price of $4.52 until the price based on a restricted market value catches up. In 2010 and 2011 this has meant that Total Shareholder Returns only reflect dividends paid and do not include any movements in the FVS.
7. Average spot exchange rate is the average of the daily spot rates for the financial period.
8. Fonterra's average conversion rate is the rate that Fonterra has converted net US dollar receipts into NZ dollars based on the hedge cover in place.
9. Represents segment profit before unallocated finance income, finance costs and tax. 2007 and 2008 have been restated to be on a consistent basis with 2009, 2010 and 2011.
10. Profit after tax attributable to Shareholders for 2009, 2008 and 2007 has been restated to recognise the tax effects of distributions to Shareholders within tax expense in the income statement. This was previously recorded directly in equity.

	JULY 2011	JULY 2010	JULY 2009	JULY 2008[1]	MAY 2007
CAPITAL EMPLOYED ($ million)					
Total assets employed	**15,530**	14,169	14,117	14,439	13,494
Average net assets[11]	**10,772**	10,433	10,975	10,702	10,333
Total equity	**6,541**	5,667	4,805	4,269	4,978
Equity excluding cash flow hedge reserve	**6,025**	5,526	4,635	4,357	4,829
Net interest bearing debt	**3,766**	4,268	5,166	5,860	4,971
Economic net interest bearing debt[12]	**4,331**	4,494	5,221	5,931	5,250
Return on net assets[11]	**9.3%**	8.7%	9.2%	7.4%	12.7%
Headline debt to debt plus equity ratio[13]	**38.5%**	43.6%	52.7%	57.4%	50.7%
Economic debt to debt plus equity ratio[13]	**41.8%**	44.9%	53.0%	57.6%	52.1%
STAFF EMPLOYED					
Total staff employed (000s, permanent full time equivalents)	**16.8**	15.8	15.6	15.9	16.4
New Zealand	**10.8**	9.8	9.5	9.5	10.0
Overseas	**6.0**	6.0	6.1	6.4	6.4

	MAY 2011	MAY 2010	MAY 2009	MAY 2008	MAY 2007
SEASON STATISTICS[14]					
Total NZ milk collected (million litres)	**15,427**	14,746	14,764	13,862	14,340
Highest daily volume collected (million litres)	**76.8**	72.3	73.7	71.6	70.5
NZ Shareholder supply milksolids collected (million kgMS)	**1,320**	1,256	1,227	1,183	1,243
NZ contract and tactical supply milksolids collected (million kgMS)	**26**	30	54	9	3
NZ milksolids collected (million kgMS)	**1,346**	1,286	1,281	1,192	1,246
Total number of Shareholders at 31 May	**10,485**	10,463	10,537	10,724	10,921
Total number of sharemilkers at 31 May	**3,928**	3,733	3,990	3,946	3,857
Total number of shares at 31 May (million)	**1,377**	1,343	1,216	1,261	1,280

11. Return on net assets (RONA) is derived by dividing profit before non-recurring items, finance costs and tax (as reported in financial statements, with exception of the 14 month period ended 31 July 2008) by 13 month average net assets (excluding net debt and deferred tax). 2008 RONA is based on unaudited management results for the 12 months to 31 July 2008.
12. Economic net interest bearing debt reflects the effect of debt hedging in place at balance date.
13. Headline debt to debt plus equity ratio is before taking account of the effect of debt hedging. Economic debt to debt plus equity includes the effect of debt hedging.
14. All Season statistics are based on the 12 month milk Season of 1 June – 31 May.

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