A STRONG CO-OPERATIVE...

FONTERRA INTERIM REPORT 2014
FONTERRA CO-OPERATIVE GROUP LIMITED

Fonterra
Dairy for life

...GETTING EVEN STRONGER.

Strategy

- Responding to growing consumer demand
- Emerging markets focus
- Driving volume and value

1 Volume:

- Growing ingredients and consumer volume
- Growing milk supply to meet demand
- Capacity investment to support growth

2 Value:

- Significant foodservice growth potential
- Expanding our markets for everyday nutrition
- Growing our brand presence in key emerging markets

3 Velocity:

- Accelerating capacity investments to create optionality
- Expanding our global view as market dynamics offer new opportunities

CONTENTS

This is Fonterra.

Our Farmer Shareholders and our people are working together for one purpose – to bring the best of trusted dairy nutrition to the world. All for one, that's the Co-operative way.

We began with core strengths of scale, quality and global reach. We are now going from strength to strength through our strategy to build sustainable returns by growing volumes and value. The trends we predicted yesterday are the source of our growth today. As demand keeps growing at an even faster pace, we are staying one step ahead to turn that demand into healthy, sustainable returns.

All of us together are making an even stronger Fonterra.

Fonterra

Dairy for life

VOLUME

Our scale and market reach support our goal to grow volumes to meet rising demand.

MILK SOLIDS

↑ 4%

GROUP SALES VOLUME

↓ 4%

Impacted by lower inventory levels as a result of prior season drought.

ASIA SALES VOLUME (EXCL SRI LANKA)

↑ 10%

VALUE

Value is driven by consumer demand for products which meet lifestyle and health needs.

REVENUE

$11.3B

NORMALISED EBIT

$403M

INTERIM EARNINGS PER SHARE

13CPS

Fonterra refers to normalised EBIT when discussing financial performance. Refer to pages 40 and 41 for further details on non-GAAP financial measures.

VELOCITY

We maximise our contribution by taking dairy to the world in the right format and in the right markets.

EUROPE
Our A-ware joint venture in the Netherlands taps into Europe's significant capacity in cheese. A-ware will sell the cheese to its customers while Fonterra accesses high quality whey protein and lactose for use in advanced nutrition applications.

CHINA
A second farming hub has been announced to be located in Ying County, Shanxi Province. The hub will comprise of five single farms with a combined capacity of 16,000 milking cows. It is expected to be in production in the second half of the 2014 calendar year and is an important step to producing one billion litres of milk in China by 2020.

BRAZIL
Our Dairy Partners Americas joint venture with Nestlé opened a $45 million dairy distribution centre, capable of handling more than 200,000 MT of dairy products destined for delivery across Brazil, an important market for Fonterra with rapid growth.

AUSTRALIA
Purchase of the Tasmanian yoghurt business Tamar Valley Dairy has been finalised, strengthening our position in the local industry. The acquisition complements our existing yoghurt portfolio and our existing manufacturing facilities at Spreyton and Wynyard in Tasmania.

NEW ZEALAND
The world's largest milk powder drier fires up at Darfield, our first greenfields development. Darfield Drier Two can produce more than 30 MT of Whole Milk Powder an hour and complements Darfield Drier One which came into production in 2012 when the first stage of the $500 million project was completed.

LETTER FROM THE **CHAIRMAN AND CHIEF EXECUTIVE**

Fonterra is on track to deliver our best ever returns to our Farmer Shareholders with a forecast Cash Payout of $8.75 for the Season.

"The numbers confirm dairy is not only an important part of a healthy diet, but also a healthy economy."

The forecast Cash Payout comprises a forecast Farmgate Milk Price of $8.65 per kgMS and an estimated full year dividend of 10 cents per share. It compares favourably with last season's final Cash Payout of $6.16. It reflects strong milk powder prices which, on average, are currently ahead by around US$1,200 per metric tonne compared to last season.

A strong dairy outlook and Fonterra's plans to profit from the continued rise in global dairy demand gives the Board confidence to maintain its 65 to 75 per cent dividend payout policy. It has declared an interim dividend of five cents per share, equivalent to 50 per cent of our forecast dividend for the current financial year. This is in line with our approach in the prior year and with our expectation that earnings tend to be more heavily weighted to the first half.

Our current forecast Cash Payout represents a $13.8 billion injection into the New Zealand economy. With an estimated 50 cents in every $1 of payout spent by farmers locally, the benefits will be felt in both urban and rural communities[1]. Statistics New Zealand has also reported that dairy helped to drive New Zealand's terms of trade in the December quarter to their highest levels since 1973.

The numbers confirm dairy is not only an important part of a healthy diet, but also a healthy economy.

Market trends have mirrored those we identified during our 2012 strategy refresh and they are occurring at an increasing pace. Demand from emerging markets is accelerating, especially for milk powder and this is contributing to the stronger pricing we are currently seeing. The growth we projected in 'out-of-home' dairy consumption (foodservice) is also occurring year-on-year, reflecting the changing lifestyles among the rising middle classes across China, parts of Asia, Africa, the Middle East and Latin America. The busier consumers' lives become, the more they turn to easy to prepare meals or to the convenience of 'out-of-home' dining.

1 New Zealand Institute of Economic Research, Report to Fonterra and Dairy NZ – *Dairy's role in sustaining New Zealand – the sector's contribution to the economy*, December 2010.

We also predicted that the rising purchasing power of the emerging middle classes would see families less concerned about getting basics on the table and more about the nutritional choices they can make to achieve better health. Again, we are seeing rising demand deliver volume growth, especially for our branded products which support bone and muscle health, mobility, healthier ageing and child development.

All the trends confirm to us that we are on the right track with our V3 Strategy with its focus on increasing volumes and value in everyday nutrition, advanced nutrition and foodservice.

We are consistently building our market share in growth markets through our branded and foodservice products with the aim of higher volumes delivering higher value for us over time. Even with the current constraints on margin arising from higher input costs, we continue to make good progress in maintaining and growing brand loyalty which contributes to profits and ultimately the dividend.

Six month snapshot

Milk volumes collected for the Season to date increased by four per cent on the prior year to 1,120 million kgMS, with ideal production conditions in many parts of the country contributing to record volumes collected across the October–November peak period.

We processed as much of these record flows into the higher returning milk powder product streams as we could. However, our current asset footprint, coupled with the fact that the peak was longer than usual given the excellent conditions meant that around 25 per cent had to be processed into cheese, casein and other products which earned negative returns over the period. This divergence between product mix returns accounts for our strong forecast Farmgate Milk Price being lower than that calculated in the Farmgate Milk Price Manual.

Our strategy emphasises driving more milk volumes into higher value uses such as branded consumer and foodservice products. However, the dairy commodity prices constrained margins in these areas.

Passing higher costs on to customers and consumers is not always good business – and, in some markets, regulation prevents price rises. There is also the need to strike a balance between passing on costs now and setting the stage for long-term growth by building market share and customer loyalty. This is especially important when we are introducing new products or entering new product segments. Our strategy is clear that emerging markets offer very good growth opportunities for our consumer and foodservice volumes. It is important for the long-term to keep focused on building those volumes. Higher input costs have had a short-term impact on margins, but keeping our pricing competitive has enabled us to continue to build volumes in key markets like China, the Middle East and Southeast Asia.

Our Asia business maintained volume growth of 10 per cent (excluding Sri Lanka), driven by new product launches and foodservice growth. In our key markets in Asia the strength of our Anlene™, Anmum™ and Anchor™ brands allowed us to maintain or improve our market positions. Soprole also delivered volume growth.

For the Co-operative the past six months has been a period of mixed fortunes. We are poised to deliver record Farmgate Milk Price returns, achieving a 21 per cent growth in revenue to $11.3 billion. But we have also seen earnings per share 54 per cent lower at 13 cents, caused mainly by lower margins.

Being disciplined with operating expenses, which were flat for the period, contributed to our ability to offset some rising input costs.

However, volatility is a fact of life in dairy and we remain very focused on delivering a consistently strong Farmgate Milk Price as well as stable and growing earnings over the medium to long-term.

Anchor™ UHT processing line at the Co-operative's new $120 million UHT milk processing site at Waitoa.

Farmgate Milk Price Maths

In December 2013, the Board announced that it was maintaining the forecast Farmgate Milk Price at $8.30 per kgMS, which was 70 cents less than the price calculated under the Farmgate Milk Price Manual at that time.

In February 2014, the Board increased the forecast Farmgate Milk Price to $8.65 per kgMS. With the Farmgate Milk Price calculated under the Farmgate Milk Price Manual at $9.35 per kgMS, the 70 cent gap between the two prices remained.

Both the December and February decisions were made in the Co-operative's best interests. It is not appropriate to forecast a Farmgate Milk Price that is higher than we can afford to pay and would require borrowing. That is why the Fonterra Board exercised its discretion to pay a lower price than specified in the Farmgate Milk Price Manual when it is warranted. That the Board chose to do this in the current Season does not foreshadow that it will do so in the future.

The calculation of the Farmgate Milk Price under the Farmgate Milk Price Manual is based on processing and manufacturing milk powder and related streams such as butter and anhydrous milk fat (AMF) – also called Reference Commodity Products. The choice of reference product is deliberate. It is based on the fact that powders account for more than half the global trade in dairy products, that most new investment in New Zealand has been in milk powder related assets and that in the medium-term the highest returns are expected to come from powders.

The calculation is also based on the production costs for a theoretical efficient manufacturer of Fonterra's size and scale. This theoretical and efficient manufacturer model effectively sets up a highly competitive benchmark against which Fonterra measures its actual performance.

Using that methodology delivered a forecast $9.00 per kgMS Farmgate Milk Price in December, compared to the forecast $8.30 per kgMS by the Board. Behind the 70 cent difference is the cost of higher than usual milk flows across a longer than usual peak and the significant divergence between the returns from Reference Commodity Products and returns on Non-Reference Commodity Products such as cheese and casein.

Even with significant investments in driers in recent years, our fixed asset base, coupled with the longer peak and higher flows not only limited our options for processing milk into the highest returning products but did so over a longer than usual period. Our product mix returns reflect this reality.

During the first half of the Season, Fonterra was able to process around 75 per cent of milk flows into Reference Commodity Products but around 25 per cent was converted to Non-Reference Commodity Products such as cheese and casein.

However, Reference Commodity Products prices during the period were significantly ahead of those for cheese, casein and other Non-Reference Commodity Products. In some cases the selling prices were lower than the cost of the milk used to produce them. As a result, we had the 70 cent gap between the current forecast Farmgate Milk Price and the price determined by the Farmgate Milk Price Manual.

While the price gap between Reference Commodity Products and Non-Reference Commodity Products has more recently narrowed, it is too late in the Season to make up for the large differential experienced earlier in the Season. As a result, the 70 cent gap currently remains. The strength of the Farmgate Milk Price Manual is that it enables this high level of transparency, something which should give confidence to Farmer Shareholders, suppliers and Unit holders alike.

The underlying basis for the Farmgate Milk Price Manual remains sound in that milk powders, butter milk powder and AMF will support the highest sustainable Farmgate Milk Price in the medium-term. That is why the vast majority of capital investment in new plants for the past decade has involved milk powder plants. Work will continue to maximise our current milk powder plants' efficiency while accelerating planned investments to expand capacity. This strategy will, over time, reduce volatility in the earnings of our ingredients operations and help deliver the highest sustainable returns.

"Our strategy is clear that emerging markets offer very good growth opportunities for our consumer and foodservice volumes. It is important for the long-term to keep focused on building those volumes."

Ambition and Action

Dairy markets are always volatile which is why we take a long-term view. Our V3 Strategy has accurately predicted growing demand for dairy trade and that in China, Southeast Asia, Latin America and areas of the Middle East and Africa, demand will outstrip supply growth. While growth in domestic milk production will increase along with consumption, imports from Fonterra and others will continue to have a significant role in meeting demand.

It has been clear from the past six months that the trends we picked in demand and demographics in our strategy are moving faster than expected. We are responding by moving faster too with initiatives to better manage price volatility and increase value so we can deliver a sustainable Farmgate Milk Price and sustainable dividends.

PROGRESS ON OPTIMISING GLOBAL INGREDIENTS SALES AND OPERATIONS

We need to ensure our Farmer Shareholders can confidently grow supply. We are also competing assertively for new suppliers. Delivering the most competitive Farmgate Milk Price, a sustainable dividend return and greater financial tools for our farmers will enable both paths to higher milk volumes.

Plant Manager Karl Haystead, Fonterra Chairman John Wilson and Programme Manager Sarah Davenport with some of the Anchor™ UHT cream and milk products that will be produced at the Co-operative's new UHT processing site at Waitoa.

WE HAVE FIVE PRIORITIES:

1. Optimise our global ingredients sales and operations footprint
2. Grow significantly in everyday nutrition
3. Continue our foodservice growth momentum
4. Capture high margins in advanced nutrition
5. Enable growth by expanding beyond New Zealand to selectively invest in milk pools, matching demand with the best market opportunities.

Delivering the highest sustainable Farmgate Milk Price simply means a focus on making the products in New Zealand which earn the best returns over time.

This is exactly what we have done since Fonterra was formed. We have consistently invested in growing the capacity that counts, especially in milk powders. Since 2001, we have invested $1.8 billion in capacity growth across our sites. This includes:

- $327 million invested in Edendale's Driers Three and Four, this increased capacity by 41 MT an hour.
- $164 million invested in a third drier at Clandeboye, this added 25 MT an hour to capacity.
- Darfield One and Two Driers, which have delivered additional 45 MT an hour in capacity in an overall project worth approximately $500 million.

In December 2013, we also announced a $235 million investment in expanded drier capacity at Pahiatua which will be operating by September 2015.

The projects are in a long line of investments over a decade to more closely match our New Zealand asset footprint with the forecast demand in milk powder and the growth in milk production in New Zealand.

As a result 59 per cent of our capacity is now devoted to powders versus 44 per cent in 2004. Each year we come closer to the powders-favouring asset footprint ideal laid out in the Farmgate Milk Price Manual.

The numbers tell the story. Ten years ago (2004 financial year), we produced 0.6 million MT of Whole Milk Powder. In the 2013 financial year, we produced 1.0 million MT and forecast volumes for 2014 are closer to 1.2 million MT. Our investments have kept us closely aligned to demand.

We will continue down this path, but at a faster pace, ensuring assets come on stream ahead of expected increases in milk production.

Investing ahead of the milk growth curve will give us much greater flexibility to take the best advantage of relative market prices, including during the peak. It will also accommodate growth from existing suppliers and new volume from joining suppliers.

The cost benefits of higher flexibility and a less volatile earnings profile, will outweigh any short-term risk of excess capacity. Even with fast-tracked investments, adding capacity will take time so we also have a programme in place to increase throughput in existing plants, especially the older legacy sites.

"Taking this global perspective with manufacturing assets and building milk pools in the right locations is a win-win for Fonterra and our Farmer Shareholders."

Fonterra foodservice slice-on-slice cheese during production at Eltham.

Not all capacity expansions will favour powders. Strong growth in foodservice, along with growing demand for everyday nutrition, justifies tactical investment in new plant to meet that demand. We have announced investments of approximately $262 million to support our strategy to continue our foodservice growth momentum. These investments include:

- $72 million at our Clandeboye mozzarella plant in 2013 to double the capacity of the existing plant in Canterbury to produce individual quick frozen (IQF) grated mozzarella.
- Our $32 million expansion to double our cream cheese capacity at Te Rapa in the Waikato.
- The $126 million investment in new Ultra Heat Treated (UHT) capacity in the same region.
- The $32 million expansion at Eltham to meet demand for higher value slice-on-slice cheese used in foodservice restaurants.

PROGRESS ON GROWING CONSUMER AND FOODSERVICE

We continue to make good headway with our consumer and foodservice focused priorities. In Asia and Latin America we continue to focus on growth, supported by new product launches and foodservice growth. We have continued to build consumer loyalty, achieving volume growth for our Anchor™, Anlene™ and Anmum™ brands. Anchor™ UHT was successfully launched in China to meet everyday nutrition demands and the rollout of the Anmum™ paediatric formula in China is also progressing well.

We continue to drive our foodservice momentum through the capacity investments detailed above in cream cheese and UHT.

PROGRESS ON DEVELOPING MULTIPLE MILK HUBS, WHILE GROWING NEW ZEALAND SUPPLY

We are in a competitive market for milk, so retaining and growing our New Zealand supply is always a priority. Returning the highest sustainable Farmgate Milk Price is crucial to encouraging supply growth and loyalty, as good returns enable our Farmer Shareholders to cover their rising costs and to invest in their farms and futures. Our initiatives to better manage price volatility and increase value are designed to give suppliers the confidence to grow, while our programmes to support and promote sustainable farming also enable that growth to be achieved with minimal environmental impacts.

Progress on our V3 Strategy is also crucial to supply growth because our Farmer Shareholders can see predicted demand turn into sustainable payouts. To support on-farm growth we are successfully offering more flexible supply contracts which offer staged payment options for Shares. Giving suppliers more time to fully back production with Shares gives them more financial flexibility.

This year we have also provided more financial flexibility for Farmer Shareholders by piloting a Guaranteed Milk Price (GMP) scheme enabling them the ability to lock in the price paid for a percentage of their milk. It involves 328 participants supplying 15 million kgMS for a guaranteed $7.00 per kgMS. The pilot attracted such a high level of support that applications were received to supply 37 million kgMS. Participants were scaled back to 40 per cent of their original application.

Even with the current record forecast, feedback from participating farmers to date has been they value the income

certainty the GMP has provided from the start of the Season, enabling them to confidently make decisions around servicing debt or making capital investments on-farm. We will evaluate the pilot ahead of the new season.

Milk sourced in New Zealand will always be our top priority. Collecting, processing and selling Farmer Shareholders' milk for the best price for the best Farmgate returns is at the very heart of the Co-operative's principles.

It is important, however, that we also maintain our global view of both manufacturing and milk supply. We are part of a global dairy market where the dynamics are changing. It is crucial we take the global view, understand where we have a natural competitive advantage and identify opportunities to build volume and value using other milk pools.

Fonterra CEO Theo Spierings at a Fonterra Milk for Schools celebration at Three Kings School in Auckland.

A current example is our A-ware joint venture in the Netherlands which is a new cheese and dairy ingredients plant. Europe has a natural competitive advantage in cheese. A-ware will sell the cheese to its customers while Fonterra will have access to high quality whey protein and lactose for use in advanced nutrition applications.

Taking this global perspective with manufacturing assets and building milk pools in the right locations is a win-win for Fonterra and our Farmer Shareholders. Their milk will go into the highest returning products in New Zealand where we have significant powder expertise and global market share, while milk from other attractive milk pools will also generate returns for them, paid through the dividend.

Reputation, Review, Rebuild

All of our strategic priorities are being advanced against the backdrop of work being done to further strengthen our food safety and quality systems. The reviews of last year, following the precautionary recall of WPC80 product, confirmed that our systems are robust, but that we also have opportunities to make them even more so.

Recommendations from our internal management review and the independent review commissioned by the Board have been distilled into 36 initiatives across seven streams of work which are being progressed.

We take compliance with food safety regulations extremely seriously. Our customers and consumers need to know that New Zealand's food quality and safety regulations are being robustly applied by food manufacturers and enforced by New Zealand authorities.

New Zealand, for example, has a trusted role in global food chains and we are proud to be part of that, but keeping market doors open needs constant attention as consumers look to their governments to ensure the food on their tables remains safe. We are committed to our food export sector's need to achieve new levels of safety and traceability supported by robust regulation and government expertise.

As we come into the second half of the financial year we remain confident in our strategy and its implementation. While dairy volatility remains a fact of life, demand forecasts remain in line with our expectations.

John Wilson
CHAIRMAN

Theo Spierings
CHIEF EXECUTIVE

GROUP OVERVIEW

Higher global dairy prices driven by sustained demand, especially in China and emerging markets, have enabled the Co-operative to forecast a Cash Payout of $8.75 for the Season.

The best ever returns for farmers and the New Zealand economy have been predominantly generated by the strong prices achieved by milk powders driven by strong demand for dairy products.

This included 110,000 MT exported to China alone in December 2013, creating a new record for single destination shipments in a single month.

Sustained high prices, especially for milk powders, saw revenue increase by 21 per cent to $11.3 billion, but these also led to higher input costs. Gross margin percentage fell 614 basis points to 13 per cent. Normalised EBIT for the six months was 41 per cent lower than the comparative period, driven mainly by the impact of lower returns from product mix in our NZ Milk Products business. This compares to the very strong earnings in the first half of last year.

The increasing pressure on margins was also evident in our consumer and foodservice businesses. Here the balance needed to be struck between passing on rising costs immediately or continuing to build our market presence and volumes to secure long-term growth. Taking the longer-term view has constrained profitability during this run of strong commodity pricing, but we are positioning ourselves for the future with volumes in Asia up 10 per cent excluding Sri Lanka.

Operating expenses were flat, with offsetting movements across the Group. The effective tax rate has increased from 11 per cent to 19 per cent due to the lower interim dividend which created a corresponding reduction in the tax credit. Net profit after tax was 53 per cent lower at $217 million.

Operating cash flow improved by $404 million to a cash outflow of $19 million. Fonterra's production cycle typically results in a cash outflow at half year. Reduced earnings were more than offset by a positive working capital impact, the result of a larger difference between the Advance Rate paid to farmers for current Season milk and the forecast full year milk price. This difference means the cash we have received from sales in the first half is higher relative to the cash that we have paid for milk, compared to the previous year.

Our gearing ratio is 44.6 per cent compared to 40.0 per cent at 31 January 2013. The change is a result of lower earnings, the Supply Offer (which increased debt and decreased share capital), and increased investment spending, including acquiring a strategic nine per cent stake in Australian dairy company Bega.

The strong dairy outlook and Fonterra's plans to profit from the continued rise in demand gives the Board confidence to maintain a 65 to 75 per cent payout ratio and, as a result, it has declared an interim dividend of 5.0 cents per share. This interim dividend represents 50 per cent of our forecast dividend for the current financial year, consistent with our approach in the prior year, and in line with our expectation that earnings are more heavily weighted to the first half.

KEY FINANCIALS

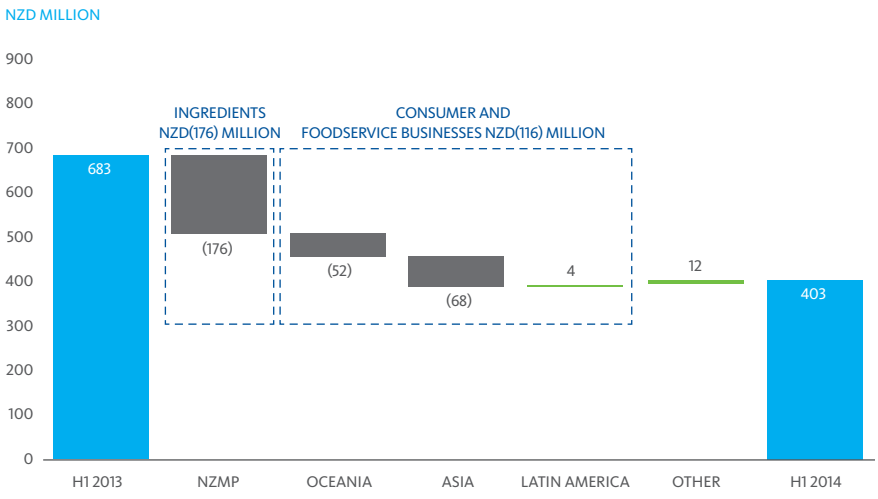
NZD MILLION	SIX MONTHS ENDED 31 JAN 2014	SIX MONTHS ENDED 31 JAN 2013	CHANGE
Total volume[1] ('000 MT)	**1,988**	2,067	(4%)
Revenue	**11,292**	9,334	21%
Gross margin	**1,407**	1,736	(19%)
Gross margin percentage	***12.5%***	*18.6%*	
Operating expenses	**(1,159)**	(1,164)	
EBIT	**416**	669	(38%)
Normalised EBIT[2]	**403**	683	(41%)
Normalised EBIT percentage	***3.6%***	*7.3%*	
Net profit after tax	**217**	459	(53%)
Earnings per share (cents per share)[3]	**13**	28	(54%)
Milk collected financial year to date (million kgMS)	**1,098**	1,051	4%
Milk collected Season to date (million kgMS)	**1,120**	1,075	4%
Operating cash flows	**(19)**	(423)	96%
Investing cash flows	**(522)**	(438)	(19%)
Economic debt to debt plus equity ratio (gearing)	***44.6%***	*40.0%*	

1 Total volume includes intercompany volumes.

2 Normalised EBIT for the six months ended 31 January 2013 has been restated from $693 million to $683 million. The $10 million normalisation adjustment relates to net foreign exchange gains.

3 Earnings per share for the six months ended 31 January 2013 has been restated for the impact of the non-cash Bonus issue of Shares, issue date 24 April 2013.

NORMALISED EBIT – KEY PERFORMANCE DRIVERS



REVENUE GROWTH

↑ 21%

TO $11.3 BILLION

NZ MILK PRODUCTS

NZ Milk Products comprises the core New Zealand milk supply chain from collection, manufacturing and logistics through to the end sale of dairy products to business customers and the Fonterra regional businesses. It also includes international milk sourcing, dairy nutrition-related joint ventures and the Co-operative's corporate activities.

Volume

Milk collection across New Zealand for the Season to 31 January 2014 reached 1,120 million kgMS, four per cent higher than the same period last year.

Rain through December and early January helped maintain milk production above last season's level with the North Island four per cent higher and the South Island five per cent higher for the Season to 31 January 2014.

The record milk volumes for the first half of the Season did not translate into increased sales volume as NZ Milk Products began the year with low inventory levels as a result of the previous season's drought. With strong demand, especially from China but also other customers globally, record volumes were shipped from New Zealand in the second quarter. However, total volumes sold for the period were lower than the prior year given reduced start of season stocks. Our ability to make and ship record volumes during the period to capture high commodity prices, reflects our ongoing investment in supply chain efficiencies.

Value

Revenue in our NZ Milk Products business was up 35 per cent as a result of strong dairy commodity prices. However this was more than offset by the increase in input costs. The Farmgate Milk Price is driven predominantly by milk powder prices and Whole Milk Powder was up 60 per cent for the six month period.

Two key factors affected the earnings of the NZ Milk Products business in the first half:

- With the strong growth in milk production volumes, we were unable to optimise production over the peak period, resulting in production inefficiencies and higher wastage.
- Strong prices for Reference Commodity Products, which inform the Farmgate Milk Price, resulted in high input costs for Non-Reference Commodity Products that could not be recovered. The significant divergence between price movements of Reference Commodity Products and Non-Reference Commodity Products had a negative impact on returns from product mix.

NORMALISED EBIT – KEY DRIVERS

Normalised EBIT for the first half was $236 million, 43 per cent lower than the same period last year. The first half saw a continuation of strong milk powder prices and high demand, however EBIT was impacted by pressure on price relativities with the return from product mix being $116 million lower than the same period last year.

The Co-operative processes around 25 per cent of milk collected into Non-Reference Commodity Product streams primarily in the form of cheese and casein. The relative increase in the price of Reference Commodity Products was significantly higher than the increase in the price of Non-Reference Commodity Products. This resulted in a margin squeeze for Non-Reference Commodity Products after milk input costs rose disproportionately against the sales price. In some product streams the selling price was lower than the input costs. This had a negative impact on earnings.

Product mix gross margin was $116 million lower than the same period last year due to a $560 million negative product mix impact. This included adjustments of inventory values to net realisable value, offset in part by the Farmgate Milk Price adjustment.

In December last year, the Board decided to maintain the forecast Farmgate Milk Price at $8.30 per kgMS as a result of significant stream return volatility. This decision reflected the reality that it was not possible to lift milk powder production above current levels because of the nature of Fonterra's existing production facilities in New Zealand.

NZMP REVENUE

$9.1B

Maintaining the Farmgate Milk Price at 70 cents per kgMS lower than that calculated under the Farmgate Milk Price Manual helped offset the negative product mix returns. This resulted in a first half normalised EBIT being $519 million higher than had the reduction not been applied. This was due to a combination of a lower cost of goods and a reduced need to write down inventory values to expected future selling value.

The contribution from liquid milk was $75 million lower than last year as a result of actual (spot) milk prices being significantly higher than the annual forecast Farmgate Milk Price and the pricing on our long-term customer contracts.

Gross margin was also unfavourably impacted by production challenges resulting from the high levels of milk received over the peak milk period at a cost of $76 million. The high volume of milk meant we incurred production inefficiencies, had to dispose of some milk by-products and incurred increased transport costs to move milk to available processing plants. In addition, higher milk volumes in the first half resulted in the use of some factories with a less optimal product mix for longer periods than normal.

Included in the result were price premiums achieved above dairy commodity prices of $116 million. While this was $5 million lower than the previous period, it was a good result in an environment of strong dairy prices.

The NZ Milk Products segment includes all of the Fonterra Group's corporate costs which contributed to a nine per cent increase in the segment's operating expenses. The increase was largely a result of one-off legal settlements.

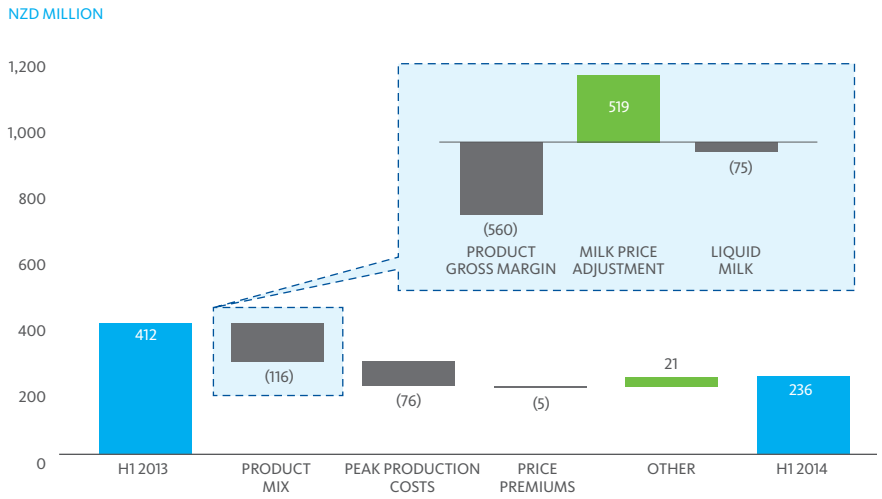
KEY FINANCIALS

NZD MILLION	SIX MONTHS ENDED 31 JAN 2014	SIX MONTHS ENDED 31 JAN 2013	CHANGE
Total volume[1] ('000 MT)	**1,441**	1,474	(2%)
Revenue	**9,117**	6,762	35%
Gross margin	**617**	797	(23%)
Gross margin percentage	**6.8%**	11.8%	
Operating expenses	**(480)**	(442)	9%
Normalised EBIT[2]	**236**	412	(43%)
Normalised EBIT percentage	**2.6%**	6.1%	

1 Total volume includes intercompany volumes.

2 Normalised EBIT for the six months ended 31 January 2013 has been restated from $422 million to $412 million. The $10 million normalisation adjustment relates to net foreign exchange gains.

NORMALISED EBIT – KEY PERFORMANCE DRIVERS



INVESTING IN GREATER PRODUCTION AND ASSET FLEXIBILITY

Increased milk volumes are welcome and reflect farmer confidence in Fonterra's future. Work is well advanced to further increase processing capacity with Darfield Two, the world's largest milk powder drier, being successfully commissioned in August and the Waitoa UHT facility due to be operational shortly.

Additional investments in capacity have also been announced, including a new drier at Pahiatua. There is an inevitable time lag to implement capacity growth, especially into areas that will give us greater flexibility to take advantage of relative market pricing. However, work is under way to maximise current and future capacity by accelerating planned investments.

OCEANIA

Oceania encompasses consumer and 'out-of-home' foodservice businesses in Australia and New Zealand, and a dairy processing and manufacturing business that collects approximately 17 per cent of Australia's milk supply. It also includes RD1, a rural supplies retailer in New Zealand.

Kapiti™ Kikorangi Blue was the standout performer this year at the 2014 NZ Champions of Cheese Awards, winning the New World Champion Favourite Cheese Award, voted for by the New Zealand public.

Volume

Total sales volume of 411,000 MT was down 13 per cent on the prior period, partially due to the sale of the Norco liquid distribution business in the prior period. Excluding this impact, volumes were down nine per cent as a result of lower ingredients export volumes, decreased nutritional volumes, and reduced yoghurt volumes in Australia. Despite a tough trading environment, volume in New Zealand was up four per cent and revenue grew six per cent following a lift in prices to partially recover significant increases in commodity costs.

RD1 NORMALISED EBIT

↑11%

Value

Oceania normalised EBIT was 53 per cent lower than the comparative period, at $46 million. This business is undergoing a significant transformation and has been impacted by strong competition, higher input costs and lower export sales out of Australia. Significant progress has been made in lowering operating costs and streamlining our brands portfolio.

Normalised EBIT fell 39 per cent in Australia. The key driver was weaker gross margin performance in the everyday nutrition business, as competitive pressure constrained our ability to pass on higher input costs. The yoghurt and dairy dessert category was the largest contributor to the decrease. This category remains difficult but is a key part of our turnaround plan.

The purchase of the Tamar Valley Dairy business, including advanced production facilities, gives us the opportunity to create value through new products, and more efficient production. We also acquired a strategic nine per cent stake in Australian dairy company Bega. Fonterra has a long-standing partnership with Bega and has confidence in the strategy it is pursuing. There has recently been

substantial consolidation activity in the Australian dairy industry and these two investments gave the Co-operative the opportunity to participate.

Our Australian ingredients business was impacted by some short-term reductions in its volume related to the WPC80 incident. This business is currently realigning its product mix with a greater focus on the export markets where it can benefit from the significant demand for dairy products.

Our consumer brands business in New Zealand felt the impact of a temporary disruption in the supply chain, higher input costs as a result of the increase in commodity prices, and a competitive environment that has made it difficult to recover those increases.

RD1 continued to perform well, delivering growth of 11 per cent in normalised EBIT over the prior period, with farmer spending boosted by the strong forecast Farmgate Milk Price.

RD1 opened three new stores in the first half as we match our footprint to the growing dairying locations around New Zealand.

Tip Top™ was negatively impacted by bad weather in January during the peak sales period combined with rising commodity costs. However, the underlying business continues to perform well, maintaining market leadership in ice cream. Our all-natural colours and flavours products have been very well received across the trade and with our customers.

KEY FINANCIALS

NZD MILLION	SIX MONTHS ENDED 31 JAN 2014	SIX MONTHS ENDED 31 JAN 2013	CHANGE
Total volume[1] ('000 MT)	**411**	471	(13%)
Revenue	**1,825**	2,018	(10%)
Gross margin	**344**	423	(19%)
Gross margin percentage	***18.8%***	*21.0%*	
Operating expenses	**(311)**	(357)	(13%)
Normalised EBIT	**46**	98	(53%)
Normalised EBIT percentage	***2.5%***	*4.9%*	

1 Total volume includes intercompany volumes.

RD1 store in Matamata.

ASIA

Asia comprises Fonterra's consumer and foodservice businesses in Asia, Africa, the Middle East and Greater China. Asia brands cover a wide range of consumer and customer needs ranging from everyday dairy nutrition under Anchor™, Fernleaf™ and Ratthi™, to advanced nutrition offerings under Anlene™ and Anmum™. The business also includes China farms.

Volume

We continue to drive volume growth through our V3 Strategy with a focus on foodservice and meeting the nutritional needs of a growing emerging middle class. Volume growth of three per cent was constrained by our Sri Lanka business, which was significantly impacted by a temporary suspension of its market operations. We have implemented a sustained programme to rebuild consumer confidence and we are making good progress in that regard. Excluding Sri Lanka, volume growth was up 10 per cent across Asia.

Volume growth in ASEAN was up nine per cent mainly in foodservice and mobility, with Indonesia being a key growth region. Our advanced nutrition business, comprising the Anlene™ and Anmum™ brands, had volume growth of five per cent, with strong growth in Indonesia as a result of supply issues being resolved. We are investing in a blending and packaging facility in Indonesia to cater for future growth.

Volumes were up 15 per cent in China driven by growth in China farms and foodservice.

Value

Normalised EBIT for the six months was $32 million, which was 68 per cent lower than the same period last year and 66 per cent lower on a constant currency basis. Key drivers of this were significantly higher input costs as a result of the high dairy commodity prices, a negative currency impact and the challenging market conditions in Sri Lanka. Operating costs were maintained through a strong focus on cost control where possible.

Passing on higher input costs to consumers puts volume growth at risk, so a balance had to be struck between supporting market share and reflecting current price volatility in commodities. Price increases were implemented across most of the ASEAN region, which partially offset the significant increase in input costs.

The strength of our Anlene™, Anmum™ and Anchor™ brands throughout this region has allowed us to largely maintain or improve our strong market share positions in all key markets, while we see signs of contraction in category size within some markets.

A key market for Fonterra in this region is Sri Lanka where earnings were impacted by the temporary suspension of our operations in August 2013. Sri Lanka is our largest market by volume; it accounted for 27 per cent of volume in Asia (excluding China) last year. The sales volume from Sri Lanka was 33 per cent lower than last year and this had a significant impact on earnings in the first half. However, Fonterra remains committed to Sri Lanka where Anchor™ continues to be a market leader. The strength of our brand equity in this country has become apparent with most of our products having regained their previous market share levels.

FOODSERVICE VOLUME GROWTH

↑10%

Foodservice volumes grew 10 per cent in Asia (excluding China) reflecting the strength of our foodservice business model. Our chef led approach, where we work closely with customers to help them understand the benefits our products provide, continues to secure brand loyalty. This is supported by increased investment in production capacity to help meet this growing demand, and is a great example of making progress in our strategy to create long-term value in the face of short-term margin pressure.

In China, we have made good progress in key product launches this year, despite some initial delays as we worked through the initial recovery stages of the WPC80 precautionary recall. In August last year, our China business successfully launched Anchor™ UHT and it is now available in 1,300 stores across the Yangtze River Delta with a market share of over five per cent, which is ahead of our target.

A pilot of the full range of Anmum™ paediatric formula was launched in the cities of Chengdu and Guangzhou late last year.

The team has adopted an integrated sales strategy to introduce Anmum™ infant formula in China, both online and in-store, enabling it to have a greater reach. Anmum™ is now available in more than 100 physical stores and also nationwide through T-mall, one of the country's top e-retailers.

Good progress has also been made in the first half in expansion of our farming operations with the first farming hub now complete. In addition, we have achieved strong pricing on that milk, due to local shortages and customers recognising the importance of the quality and food safety that our farms provide.

China farms benefited from strong demand for milk and higher prices for raw milk in China. Included in this is a revaluation of the animal herd which was partially offset by higher herd-related operating costs.

KEY FINANCIALS

NZD MILLION	SIX MONTHS ENDED 31 JAN 2014	SIX MONTHS ENDED 31 JAN 2013	CHANGE
Total volume[1] ('000 MT)	**192**	186	3%
Revenue	**1,054**	1,049	
Gross margin	**280**	362	(23%)
Gross margin percentage	***26.6%***	*34.5%*	
Operating expenses	**(281)**	(280)	
Normalised EBIT	**32**	100	(68%)
Normalised EBIT percentage	***3.0%***	*9.5%*	

1 Total volume includes intercompany volumes.

Anchor™ continues to be a market leader in Sri Lanka.

LATIN AMERICA

Latin America encompasses Soprole, the market-leading integrated dairy business in Chile, and an investment in Dairy Partners Americas, a 50/50 joint venture with Nestlé covering several markets in Latin America including Brazil, Venezuela, Ecuador, Colombia and Argentina. Latin America also includes an in-market ingredients sourcing and sales business, a foodservice business in the Caribbean and an investment in Dairy Industries (Jamaica) Limited, a 50/50 joint venture with GraceKennedy Group offering a range of dairy consumer products.

Volume

Latin America had volume growth of one per cent for the first half, driven by our Soprole business in Chile, which increased three per cent with volume growth in retail cheese sales and milk powder sales to the Government Health programme.

Volume growth in cheese was driven by innovations in pre-packed cheese, which have been well accepted by the market in a high growth category.

Value

The key driver in the improved normalised EBIT from the prior year was a significant 67 per cent increase in earnings from our Dairy Partners Americas (DPA) joint venture. The largest improvement within DPA was from the chilled and liquids branded business in Venezuela which managed to reduce losses incurred as a result of high inflation impacting input costs. This was achieved through price increases across our product portfolio. These are positive improvements in what continues to be a politically and economically challenging market.

The DPA Brazil chilled and liquids business has experienced higher raw material prices and operating overheads which have not been recovered. This resulted in lower margins and profitability in a highly competitive market.

The DPA Manufacturing business also improved earnings as it achieved greater cost recoveries.

In constant currency terms Soprole achieved a 12 per cent increase in revenue. However, reported revenue was up three per cent due to the weaker Chilean peso and strong New Zealand dollar. Soprole's normalised EBIT decreased 19 per cent to $43 million in New Zealand dollars. This was in part due to the impact of the weaker Chilean peso when translating earnings to New Zealand dollars and EBIT in constant currency was 12 per cent lower than the comparable period. Excluding the currency impact, gross margin declined despite the increase in volume and pricing, this was due to higher input milk costs and competitive pricing in the softening Chilean economy. However, the strength of the Soprole brand has meant the margin squeeze has been less pronounced than in our other consumer businesses.

SOPROLE REVENUE CONSTANT CURRENCY

↑12%

The cheese category is underdeveloped in Chile, with Chileans consuming less cheese than in other parts of South America, and is showing strong growth. Supermarkets have traditionally offered predominantly wheel cheese and Soprole is benefiting from consumers switching to pre-packed cheese as a result of new innovations in sliced cheese and packaging. Volume has more than doubled in the past three years.

Operating expenses have also increased as a result of higher advertising and promotion support, and higher storage and distribution costs whilst we transition to our new state-of-the-art distribution centre. This new facility means a more efficient centralised distribution model, which is expected to help drive future cost savings and allow for continued expansion in future periods.

Our Southern Cone ingredients business benefited from improved pricing for dairy ingredients and a return to profitability, while the Caribbean business had slightly lower earnings due to higher commodity prices in cheese and cream.

KEY FINANCIALS

NZD MILLION	SIX MONTHS ENDED 31 JAN 2014	SIX MONTHS ENDED 31 JAN 2013	CHANGE
Total volume[1] ('000 MT)	**188**	187	1%
Revenue	**570**	559	2%
Gross margin	**148**	148	
Gross margin percentage	***26.0%***	*26.5%*	
Operating expenses	**(101)**	(94)	7%
Normalised EBIT	**71**	67	6%
Normalised EBIT percentage	***12.5%***	*12.0%*	

1 Total volume includes intercompany volumes.

CONSOLIDATED INTERIM FINANCIAL STATEMENTS

For the six months ended 31 January 2014

Contents:

DIRECTORS' STATEMENT

FOR THE SIX MONTHS ENDED 31 JANUARY 2014

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 six months ended 31 January 2014.

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

The Directors consider the financial statements of the 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 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 Group, and to prevent and detect fraud and other irregularities.

The Directors hereby approve and authorise for issue the financial statements for the six months ended 31 January 2014 presented on pages 22 to 39. For and on behalf of the Board:

JOHN WILSON
Chairman
25 March 2014

DAVID JACKSON
Director
25 March 2014

INCOME STATEMENT

FOR THE SIX MONTHS ENDED 31 JANUARY 2014

		GROUP $ MILLION		
		SIX MONTHS ENDED		YEAR ENDED
	NOTES	31 JAN 2014 UNAUDITED	31 JAN 2013 UNAUDITED	31 JUL 2013 AUDITED
Revenue from sale of goods		11,292	9,334	18,643
Cost of goods sold	1	(9,885)	(7,598)	(15,611)
Gross profit		1,407	1,736	3,032
Other operating income		98	58	105
Selling and marketing expenses		(307)	(320)	(622)
Distribution expenses		(251)	(261)	(514)
Administrative expenses		(391)	(378)	(766)
Other operating expenses		(210)	(205)	(354)
Net foreign exchange gains/(losses)		32	9	(7)
Share of profit of equity accounted investees		38	30	63
Profit before net finance costs and tax	2	416	669	937
Finance income		7	16	25
Finance costs		(154)	(168)	(294)
Net finance costs		(147)	(152)	(269)
Profit before tax		269	517	668
Tax (expense)/credit		(52)	(58)	68
Profit for the period		217	459	736
Profit for the period is attributable to:				
Equity holders of the Parent		206	449	718
Non-controlling interests		11	10	18
Profit for the period		217	459	736

	GROUP $		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2014 UNAUDITED	RESTATED[1] 31 JAN 2013 UNAUDITED	31 JUL 2013 AUDITED
Earnings per share:			
Basic and diluted earnings per share	0.13	0.28	0.44

1 Restated for impact of the non-cash Bonus issue of Shares, issue date 24 April 2013.

The accompanying notes form part of these interim financial statements.

STATEMENT OF COMPREHENSIVE INCOME

FOR THE SIX MONTHS ENDED 31 JANUARY 2014

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2014 UNAUDITED	31 JAN 2013 UNAUDITED	31 JUL 2013 AUDITED
Profit for the period	**217**	459	736
Items that may be reclassified subsequently to profit or loss:			
Cash flow hedges:			
– Net fair value gains	**276**	221	116
– Transferred and reported in revenue from sale of goods	**(179)**	(185)	(317)
– Tax (expense)/credit on cash flow hedges	**(27)**	(10)	56
Net investment hedges:			
– Net fair value gains/(losses) on hedging instruments	**3**	6	(5)
– Tax (expense)/credit on net investment hedges	**(1)**	(2)	2
Available-for-sale investments:			
– Net fair value losses on available-for-sale investments	**(2)**	–	–
Foreign currency translation losses attributable to equity holders	**(98)**	(39)	(45)
Foreign currency translation reserve transferred to income statement	**–**	(1)	(7)
Share of equity accounted investees' movements in reserves	**(7)**	–	(1)
Total items that may be reclassified subsequently to profit or loss	**(35)**	(10)	(201)
Items that will not be reclassified subsequently to profit or loss:			
Foreign currency translation (losses)/gains attributable to non-controlling interests	**(2)**	–	1
Total items that will not be reclassified subsequently to profit or loss	**(2)**	–	1
Total other comprehensive expense recognised directly in equity	**(37)**	(10)	(200)
Total comprehensive income for the period	**180**	449	536
Attributable to:			
Equity holders of the Parent	**171**	439	517
Non-controlling interests	**9**	10	19
Total comprehensive income for the period	**180**	449	536

The accompanying notes form part of these interim financial statements.

STATEMENT OF FINANCIAL POSITION

AS AT 31 JANUARY 2014

	NOTES	GROUP $ MILLION AS AT 31 JAN 2014 UNAUDITED	31 JAN 2013 UNAUDITED	31 JUL 2013 AUDITED
ASSETS				
Current assets				
Cash and cash equivalents		**812**	530	330
Trade and other receivables		**2,653**	2,441	2,054
Inventories		**6,617**	4,644	3,078
Tax receivable		**32**	18	26
Derivative financial instruments	10	**203**	356	100
Other current assets		**60**	68	58
Total current assets		**10,377**	8,057	5,646
Non-current assets				
Property, plant and equipment		**4,917**	4,671	4,807
Equity accounted investments		**445**	458	449
Intangible assets		**2,799**	2,876	2,858
Deferred tax assets		**156**	88	217
Available-for-sale investments	10	**72**	–	–
Derivative financial instruments	10	**188**	142	127
Other non-current assets		**317**	254	269
Total non-current assets		**8,894**	8,489	8,727
Total assets		**19,271**	16,546	14,373
LIABILITIES				
Current liabilities				
Bank overdraft		**3**	17	1
Borrowings	9	**2,107**	1,144	1,569
Trade and other payables		**1,664**	1,476	1,491
Owing to suppliers		**4,216**	1,599	711
Tax payable		**20**	20	23
Derivative financial instruments	10	**76**	256	149
Provisions		**47**	85	82
Other current liabilities		**50**	11	52
Total current liabilities		**8,183**	4,608	4,078
Non-current liabilities				
Borrowings	9	**3,966**	3,914	3,108
Derivative financial instruments	10	**369**	414	346
Provisions		**75**	87	76
Deferred tax liability		**5**	112	6
Other non-current liabilities		**10**	9	11
Total non-current liabilities		**4,425**	4,536	3,547
Total liabilities		**12,608**	9,144	7,625
Net assets		**6,663**	7,402	6,748
EQUITY				
Subscribed equity		**5,807**	6,282	5,807
Retained earnings		**1,192**	1,240	1,249
Foreign currency translation reserve		**(362)**	(247)	(266)
Cash flow hedge reserve		**(12)**	89	(82)
Available-for-sale reserve		**(2)**	–	–
Total equity attributable to equity holders of the Parent		**6,623**	7,364	6,708
Non-controlling interests		**40**	38	40
Total equity		**6,663**	7,402	6,748

The accompanying notes form part of these interim financial statements.

STATEMENT OF CHANGES IN EQUITY

FOR THE SIX MONTHS ENDED 31 JANUARY 2014

	ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT							
GROUP $ MILLION	SUBSCRIBED EQUITY	RETAINED EARNINGS	FOREIGN CURRENCY TRANSLATION RESERVE	CASH FLOW HEDGE RESERVE	AVAILABLE-FOR-SALE RESERVE	TOTAL	NON-CONTROLLING INTERESTS	TOTAL EQUITY
As at 1 August 2013	**5,807**	**1,249**	**(266)**	**(82)**	**–**	**6,708**	**40**	**6,748**
Profit for the period	–	206	–	–	–	206	11	217
Other comprehensive (expense)/income for the period	–	(7)	(96)	70	(2)	(35)	(2)	(37)
Total comprehensive income/(expense) for the period	–	199	(96)	70	(2)	171	9	180
Transactions with equity holders in their capacity as equity holders:								
Dividend paid to equity holders of the Parent	–	(256)	–	–	–	(256)	–	(256)
Dividend paid to non-controlling interests	–	–	–	–	–	–	(9)	(9)
As at 31 January 2014 (unaudited)	**5,807**	**1,192**	**(362)**	**(12)**	**(2)**	**6,623**	**40**	**6,663**
As at 1 August 2012	5,690	1,078	(211)	63	–	6,620	35	6,655
Profit for the period	–	449	–	–	–	449	10	459
Other comprehensive (expense)/income for the period	–	–	(36)	26	–	(10)	–	(10)
Total comprehensive income/(expense) for the period	–	449	(36)	26	–	439	10	449
Transactions with equity holders in their capacity as equity holders:								
Dividend paid to equity holders of the Parent	–	(287)	–	–	–	(287)	–	(287)
Equity instruments issued	611	–	–	–	–	611	–	611
Equity instruments surrendered	(1)	–	–	–	–	(1)	–	(1)
Equity transaction costs	(18)	–	–	–	–	(18)	–	(18)
Dividend paid to non-controlling interests	–	–	–	–	–	–	(7)	(7)
As at 31 January 2013 (unaudited)	6,282	1,240	(247)	89	–	7,364	38	7,402
As at 1 August 2012	5,690	1,078	(211)	63	–	6,620	35	6,655
Profit for the year	–	718	–	–	–	718	18	736
Other comprehensive (expense)/income for the year	–	(1)	(55)	(145)	–	(201)	1	(200)
Total comprehensive income/(expense) for the year	–	717	(55)	(145)	–	517	19	536
Transactions with equity holders in their capacity as equity holders:								
Dividend paid to equity holders of the Parent	–	(546)	–	–	–	(546)	–	(546)
Equity instruments issued	611	–	–	–	–	611	–	611
Equity instruments cancelled	(475)	–	–	–	–	(475)	–	(475)
Equity instruments surrendered	(1)	–	–	–	–	(1)	–	(1)
Equity transaction costs	(18)	–	–	–	–	(18)	–	(18)
Dividend paid to non-controlling interests	–	–	–	–	–	–	(14)	(14)
As at 31 July 2013 (audited)	5,807	1,249	(266)	(82)	–	6,708	40	6,748

The accompanying notes form part of these interim financial statements.

CASH FLOW STATEMENT

FOR THE SIX MONTHS ENDED 31 JANUARY 2014

		GROUP $ MILLION		
		SIX MONTHS ENDED		YEAR ENDED
	NOTES	31 JAN 2014 UNAUDITED	31 JAN 2013 UNAUDITED	31 JUL 2013 AUDITED
Cash flows from operating activities				
Profit before net finance costs and tax		416	669	937
Adjustments for:				
Foreign exchange (gains)/losses		(1)	2	1
Depreciation and amortisation		273	264	530
Movement in provisions		313	223	(17)
Other		(62)	(15)	(16)
		523	474	498
(Increase)/decrease in working capital:				
Inventories		(3,853)	(1,857)	(43)
Trade and other receivables		(729)	(193)	38
Amounts owing to suppliers		3,505	511	(410)
Payables and accruals		176	2	68
Other movements		(24)	9	(8)
Total		(925)	(1,528)	(355)
Cash generated from operations		14	(385)	1,080
Net taxes paid		(33)	(38)	(83)
Net cash flows from operating activities		(19)	(423)	997
Cash flows from investing activities				
Cash was provided from:				
– Proceeds from sale of Group entities and other business operations		11	5	5
– Proceeds from disposal of property, plant and equipment		5	3	22
– Other cash inflows		–	–	5
Cash was applied to:				
– Acquisition of Group entities and other business operations		(18)	(49)	(49)
– Acquisition of available-for-sale investments		(78)	–	–
– Acquisition of property, plant and equipment		(394)	(316)	(701)
– Acquisition of intangible assets		(47)	(74)	(147)
– Advances made to equity accounted investees		–	–	(2)
– Other cash outflows		(1)	(7)	(1)
Net cash flows from investing activities		(522)	(438)	(868)
Cash flows from financing activities				
Cash was provided from:				
– Proceeds from borrowings	9	2,093	1,292	3,188
– Proceeds from issue of equity instruments		–	652	653
– Proceeds from settlement of borrowing derivatives		4	–	3
– Interest received		7	18	26
– Other cash inflows		2	–	–
Cash was applied to:				
– Interest paid		(154)	(180)	(334)
– Repayment of borrowings	9	(638)	(1,078)	(3,268)
– Settlement of borrowing derivatives		(10)	(9)	–
– Surrendered/cancelled equity instruments		–	–	(475)
– Dividends paid to non-controlling interests		(9)	(6)	(14)
– Dividends paid to equity holders of the Parent		(256)	(287)	(546)
– Equity transaction costs		–	(18)	(18)
– Other cash outflows		–	–	(1)
Net cash flows from financing activities		1,039	384	(786)
Net increase/(decrease) in cash and cash equivalents		498	(477)	(657)
Cash and cash equivalents at the beginning of the period		329	991	991
Effect of exchange rate changes on cash balances		(18)	(1)	(5)
Cash and cash equivalents at the end of the period		809	513	329
Reconciliation of closing cash balances to the statement of financial position:				
Cash and cash equivalents		812	530	330
Bank overdraft		(3)	(17)	(1)
Closing cash balances		809	513	329

The accompanying notes form part of these interim financial statements.

CONDENSED STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

FOR THE SIX MONTHS ENDED 31 JANUARY 2014

a) General information

Fonterra Co-operative Group Limited (Fonterra 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.

These consolidated interim financial statements of Fonterra, as at and for the six months ended 31 January 2014, comprise Fonterra and its subsidiaries (together the Group) and the Group's interest 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.

b) Basis of preparation

These consolidated interim financial statements comply with New Zealand Generally Accepted Accounting Practice (NZ GAAP) and have been prepared in accordance with New Zealand Equivalent to International Accounting Standard 34: Interim Financial Reporting. These consolidated interim financial statements also comply with International Accounting Standard 34: Interim Financial Reporting. These statements should be read in conjunction with the consolidated financial statements for the year ended 31 July 2013.

These consolidated interim financial statements are presented in New Zealand dollars ($), which is the Company's functional currency. All financial information has been rounded to the nearest million, except where otherwise stated.

Interim income tax is calculated based on the best estimate of the full year effective tax rate taking into account profit before tax, the tax effect of distributions to Shareholders and the impact of recognition and de-recognition of deferred tax.

The preparation of interim financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates. In preparing these consolidated interim financial statements, the significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those applied to the consolidated financial statements for the year ended 31 July 2013.

c) 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 these consolidated interim financial statements.

d) Accounting for forecast Milk Price

The accounting policies for the financial statement items affected by the forecast Milk Price are set out below. These accounting policies incorporate clarifications about how the forecast Milk Price is accounted for.

Amounts owing to suppliers

Amounts owing to suppliers are amounts Fonterra owe to Shareholder suppliers and contract milk suppliers for the collection of milk, which includes end of season adjustments, offset by amounts owing from Shareholder suppliers for services provided to them by Fonterra.

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 Milk Price as determined by the Board, applied on a monthly basis, 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.

New Zealand sourced cost of milk

New Zealand sourced cost of milk includes the cost of milk supplied by Shareholder suppliers, supplier premiums paid, and the cost of 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 Shareholder suppliers comprises the volume of milk solids supplied at the Milk Price as determined by the Board for the relevant season. In making that determination the Board takes into account the Farmgate Milk Price calculated in accordance with the principles set out in the Farmgate Milk Price Manual which is independently audited. The Farmgate Milk Price calculated in accordance with the Farmgate Milk Price Manual broadly represents the maximum sustainable amount an efficient New Zealand based manufacturer of milk powders could afford to pay for milk and still make an adequate return on capital.

The Fonterra Board has announced a forecast Milk Price different than that calculated in accordance with the Farmgate Milk Price Manual. Inventory, amounts owing to suppliers, and New Zealand sourced cost of milk reflect the forecast Milk Price determined by the Board.

e) Accounting policies

The same accounting policies are followed in these consolidated interim financial statements as were applied in the Group's financial statements for the year ended 31 July 2013, with the exception of the new or changed policies explained below.

Available-for-sale investments

An accounting policy for available-for-sale investments has been adopted, addressing a new category of investment in financial assets for the Group. Available-for-sale investments are non-derivative financial assets that are either designated to this category or not classified as financial assets at fair value through profit or loss, held-to-maturity investments or loans and receivables. Investments in this category are included in non-current assets unless management intends to dispose of the investment within 12 months.

Available-for-sale investments are initially recognised on settlement date, at fair value plus directly attributable transaction costs, and subsequently remeasured to fair value with any resulting gain or loss recognised in other comprehensive income.

On disposal or impairment, any gains or losses in other comprehensive income are reclassified to the income statement.

e) Accounting policies continued

New and amended standards adopted by the Group

The Group adopted the following new and amended New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) during the period, with effect from 1 August 2013, none of which had a material impact on the Group's financial statements:

- NZ IFRS 10: Consolidated Financial Statements
- NZ IFRS 11: Joint Arrangements
- NZ IFRS 12: Disclosure of Interests in Other Entities
- NZ IFRS 13: Fair Value Measurement
- Other minor improvements and amendments to NZ IFRS and NZ IAS

NOTES TO THE FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED 31 JANUARY 2014

1 COST OF GOODS SOLD

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2014 UNAUDITED	31 JAN 2013 UNAUDITED	31 JUL 2013 AUDITED
Opening inventory	**3,078**	2,981	2,981
Cost of Milk:			
– New Zealand sourced	**9,519**	5,382	8,635
– Non-New Zealand sourced	**714**	573	996
Other purchases	**3,191**	3,306	6,077
Closing inventory	**(6,617)**	(4,644)	(3,078)
Total cost of goods sold	**9,885**	7,598	15,611

2 PROFIT BEFORE NET FINANCE COSTS AND TAX

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2014 UNAUDITED	31 JAN 2013 UNAUDITED	31 JUL 2013 AUDITED
The following items have been included in arriving at profit before net finance costs and tax:			
Operating lease expense	**34**	36	72
Research and development costs	**44**	40	94
Donations	**1**	–	2
Research and development grants received from government	**(2)**	(2)	(4)
Total employee benefits expense	**904**	892	1,735
Included in employee benefits expense are:			
– Contributions to defined contribution plans	**30**	28	58

3 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 Management Team, which is the Group's chief operating decision maker.

During the year ended 31 July 2013, transactions between segments were based on estimated market prices. During the six months ended 31 January 2014, transactions between segments were based on estimated market prices adjusted for the difference between the Milk Price calculated in accordance with the Farmgate Milk Price Manual and that determined by the Board.

REPORTABLE SEGMENT	DESCRIPTION
New Zealand Milk Products (NZMP)	Represents the collection, processing and distribution of New Zealand milk, global sales and marketing of New Zealand and non-New Zealand milk products (including North Asia), Global Brands & Nutrition, Co-operative Affairs and Group Services.
Oceania (formerly 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). It includes foodservice sales in Australia and New Zealand (except for foodservice sales to Quick Service Restaurants), and RD1.
Asia (formerly Asia/AME)	Represents FMCG operations in Asia (excluding North Asia), Africa and the Middle East, and foodservice sales in Asia/AME and China. It includes international farming ventures in China.
Latin America (Latam)	Represents FMCG operations in Chile and equity accounted investments in South America. It includes international farming ventures in South America.

3 SEGMENT REPORTING CONTINUED

a) Segment income

	GROUP $ MILLION					
	NZMP	OCEANIA	ASIA	LATAM	ELIMINATIONS	TOTAL GROUP
Segment income statement						
Six months ended 31 January 2014 (unaudited)						
External revenue	8,157	1,522	1,052	561	–	11,292
Inter-segment revenue	960	303	2	9	(1,274)	–
Revenue from sale of goods	9,117	1,825	1,054	570	(1,274)	11,292
Cost of goods sold	(8,500)	(1,481)	(774)	(422)	1,292	(9,885)
Segment gross profit	617	344	280	148	18	1,407
Selling and marketing expenses	(47)	(71)	(161)	(28)	–	(307)
Distribution expenses	(90)	(92)	(24)	(45)	–	(251)
Administrative and other operating expenses	(343)	(148)	(96)	(28)	14	(601)
Segment operating expenses	(480)	(311)	(281)	(101)	14	(1,159)
Net other operating income	52	11	35	14	(14)	98
Net foreign exchange gains/(losses)	34	–	(2)	–	–	32
Share of profit of equity accounted investees	26	2	–	10	–	38
Segment earnings before net finance costs and tax	249	46	32	71	18	416
Normalisation adjustments	(13)	–	–	–	–	(13)
Normalised segment earnings before net finance costs and tax	236	46	32	71	18	403
Normalisation adjustments						13
Finance income						7
Finance costs						(154)
Profit before tax for the period						269
Profit before tax for the period includes the following amounts:						
Depreciation	(165)	(37)	(8)	(14)	–	(224)
Amortisation	(37)	(10)	(2)	–	–	(49)
Other income from equity accounted investees	1	1	–	14	–	16
Normalisation adjustments consist of the following amounts:						
Time value of options	(13)	–	–	–	–	(13)
Total normalisation adjustments[1]	(13)	–	–	–	–	(13)
Segment asset information:						
As at and for the six months ended 31 January 2014						
Equity accounted investments	221	33	–	191	–	445
Capital expenditure	252	56	91	18	–	417

1 The $13 million normalisation adjustment relates to net foreign exchange gains.

	GROUP $ MILLION					
	NZMP	OCEANIA	ASIA	LATAM	ELIMINATIONS	TOTAL GROUP
Segment income statement						
Six months ended 31 January 2013 (unaudited)						
External revenue	6,052	1,676	1,048	558	–	9,334
Inter-segment revenue	710	342	1	1	(1,054)	–
Revenue from sale of goods	6,762	2,018	1,049	559	(1,054)	9,334
Cost of goods sold	(5,965)	(1,595)	(687)	(411)	1,060	(7,598)
Segment gross profit	797	423	362	148	6	1,736
Selling and marketing expenses	(42)	(79)	(172)	(27)	–	(320)
Distribution expenses	(95)	(107)	(19)	(40)	–	(261)
Administrative and other operating expenses	(305)	(171)	(89)	(27)	9	(583)
Segment operating expenses	(442)	(357)	(280)	(94)	9	(1,164)
Net other operating income	32	6	20	9	(9)	58
Net foreign exchange gains/(losses)	10	1	(2)	–	–	9
Share of profit of equity accounted investees	25	1	–	4	–	30
Segment earnings before net finance costs and tax	422	74	100	67	6	669
Normalisation adjustments	(10)	24	–	–	–	14
Normalised segment earnings before net finance costs and tax	412	98	100	67	6	683
Normalisation adjustments						(14)
Finance income						16
Finance costs						(168)
Profit before tax for the period						517
Profit before tax for the period includes the following amounts:						
Depreciation	(164)	(38)	(7)	(13)	–	(222)
Amortisation	(33)	(7)	(2)	–	–	(42)
Other income from equity accounted investees	1	1	–	10	–	12
Normalisation adjustments consist of the following amounts:						
Costs associated with closure of Cororooke plant in Australia[1]	–	24	–	–	–	24
Time value of options[2]	(10)	–	–	–	–	(10)
Total normalisation adjustments	(10)	24	–	–	–	14
Segment asset information:						
As at and for the six months ended 31 January 2013						
Equity accounted investments	215	29	–	214	–	458
Capital expenditure	302	91	21	13	–	427

1 Of the $24 million normalisation adjustment, $21 million related to administrative and other operating expenses and $3 million to cost of goods sold.

2 The $10 million normalisation adjustment relates to net foreign exchange gains. This was not presented as a normalisation adjustment in the 31 January 2013 interim financial statements, but has been presented as such in these interim financial statements for consistency with the Group's approach from 2014 onwards.

3 SEGMENT REPORTING CONTINUED

a) Segment income CONTINUED

	GROUP $ MILLION					
	NZMP	OCEANIA	ASIA	LATAM	ELIMINATIONS	TOTAL GROUP
Segment income statement						
Year ended 31 July 2013 (audited)						
External revenue	12,358	3,101	2,057	1,127	–	18,643
Inter-segment revenue	1,559	644	2	8	(2,213)	–
Revenue from sale of goods	13,917	3,745	2,059	1,135	(2,213)	18,643
Cost of goods sold	(12,666)	(2,989)	(1,357)	(832)	2,233	(15,611)
Segment gross profit	1,251	756	702	303	20	3,032
Selling and marketing expenses	(89)	(150)	(324)	(59)	–	(622)
Distribution expenses	(188)	(203)	(42)	(81)	–	(514)
Administrative and other operating expenses	(615)	(324)	(153)	(51)	23	(1,120)
Segment operating expenses	(892)	(677)	(519)	(191)	23	(2,256)
Net other operating income	69	11	24	24	(23)	105
Foreign exchange losses	(7)	–	–	–	–	(7)
Share of profit of equity accounted investees	59	3	–	1	–	63
Segment earnings before net finance costs and tax	480	93	207	137	20	937
Normalisation adjustments	14	49	2	–	–	65
Normalised segment earnings before net finance costs and tax	494	142	209	137	20	1,002
Normalisation adjustments						(65)
Finance income						25
Finance costs						(294)
Profit before tax for the year						668
Profit before tax for the year includes the following amounts:						
Depreciation	(320)	(83)	(14)	(27)	–	(444)
Amortisation	(68)	(13)	(4)	(1)	–	(86)
Other income from equity accounted investees	3	2	–	24	–	29
Normalisation adjustments consist of the following amounts:						
Costs associated with closure of Cororooke plant in Australia	–	30	–	–	–	30
Restructuring costs associated with the Group Strategy Right-Sizing	14	19	5	–	–	38
Other	–	–	(3)	–	–	(3)
Total normalisation adjustments[1]	14	49	2	–	–	65
Segment asset information:						
As at and for the year ended 31 July 2013						
Equity accounted investments	218	31	–	200	–	449
Capital expenditure	683	144	70	29	–	926

1 Of the $65 million normalisation adjustments, $47 million related to operating expenses and $18 million to cost of goods sold.

b) Revenue

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2014 UNAUDITED	31 JAN 2013 UNAUDITED	31 JUL 2013 AUDITED
Entity wide products and services:			
Consumer goods	**2,263**	2,406	4,717
Ingredients and other revenue	**9,029**	6,928	13,926
Revenue from sale of goods	**11,292**	9,334	18,643

	GROUP $ MILLION							
	EUROPE	CHINA	REST OF ASIA	AUSTRALIA	NEW ZEALAND	USA	REST OF WORLD	TOTAL
Geographical segment external revenue:								
Six months ended 31 January 2014 (unaudited)	**584**	**3,149**	**2,755**	**847**	**1,054**	**609**	**2,294**	**11,292**
Six months ended 31 January 2013 (unaudited)	513	1,283	2,553	1,019	968	704	2,294	9,334
Year ended 31 July 2013 (audited)	1,096	2,500	5,216	1,850	1,986	1,415	4,580	18,643

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

c) Non-current assets

	GROUP $ MILLION						
	NZMP		OCEANIA		ASIA	LATAM	TOTAL
	NEW ZEALAND	REST OF WORLD	NEW ZEALAND	AUSTRALIA			
Geographical segment reportable non-current assets:							
As at 31 January 2014 (unaudited)	**4,201**	**357**	**1,377**	**1,051**	**1,052**	**512**	**8,550**
As at 31 January 2013 (unaudited)	4,044	289	1,467	1,024	864	571	8,259
As at 31 July 2013 (audited)	4,199	303	1,350	1,047	940	544	8,383

	GROUP $ MILLION		
	AS AT		
	31 JAN 2014 UNAUDITED	31 JAN 2013 UNAUDITED	31 JUL 2013 AUDITED
Reconciliation of geographical segment non-current assets to total non-current assets:			
Geographical segment non-current assets	**8,550**	8,259	8,383
Deferred tax asset	**156**	88	217
Derivative financial instruments	**188**	142	127
Total non-current assets	**8,894**	8,489	8,727

4 CONTINGENT LIABILITIES

In the normal course of 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.

In early August 2013, Fonterra publicly announced a potential food safety issue with three batches of Whey Protein Concentrate (WPC80) produced at the Hautapu manufacturing site and initiated a precautionary product recall.

In late August 2013, the New Zealand Government confirmed that the Clostridium samples found in WPC80 were not Clostridium botulinum and were not toxigenic, meaning the consumers of products containing the relevant batches of WPC80 were never in danger from Clostridium botulinum.

In January 2014, Danone formally initiated legal proceedings against Fonterra in relation to the WPC80 precautionary recall.

Fonterra is working through the detail of Danone's claims. Based on current information available and the claims made to date, Fonterra will vigorously defend its position. Uncertainty exists regarding the outcome of the proceedings. Fonterra has provided $11 million which represents the maximum contractual liability to Danone.

The warranty claims made by the purchaser of the Group's former Western Australia dairy business are no longer outstanding, as at 31 January 2014.

The Directors believe that these claims, legal proceedings and arbitrations 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 interim financial statements that require provision or disclosure.

The Group has no other contingent liabilities as at 31 January 2014 (31 January 2013: nil; 31 July 2013: nil).

5 SUBSCRIBED EQUITY INSTRUMENTS

Subscribed equity instruments include Co-operative Shares and Units in the Fonterra Shareholders' Fund (the Fund).

Co-operative Shares, including Shares held within the Group

	CO-OPERATIVE SHARES (THOUSANDS)
Balance at 1 August 2013	**1,597,834**
Shares issued	–
Shares surrendered	–
Balance at 31 January 2014 (unaudited)	**1,597,834**
Balance at 1 August 2012	1,501,784
Shares issued prior to the launch of TAF	25,886
Shares surrendered prior to the launch of TAF	(99)
Total number of Shares on issue prior to the launch of TAF	1,527,571
Shares issued on the launch of TAF	89,809
Balance at 31 January 2013 (unaudited)	1,617,380
Balance at 1 August 2012	1,501,784
Shares issued prior to the launch of TAF	25,886
Shares surrendered prior to the launch of TAF	(99)
Total number of Shares on issue prior to the launch of TAF	1,527,571
Shares issued on the launch of TAF	89,809
Bonus issue[1]	40,427
Shares cancelled[2]	(59,973)
Balance at 31 July 2013 (audited)	1,597,834

1 On 27 February 2013, Fonterra announced a non-cash Bonus issue of one Share for every 40 Shares held. The Bonus issue increased the number of Shares on issue by 40.4 million. The record date for the Bonus issue was 12 April 2013 and the issue date was 24 April 2013.

2 Shares cancelled following the Supply Offer (refer to Fonterra Shareholder suppliers Supply Offer below).

Co-operative Shares may only be held by a Shareholder supplying milk to the Company in a Season (Shareholder supplier) and Fonterra Farmer Custodian Limited (the Custodian). Rights attaching to Co-operative Shares include:

- voting rights when backed by milk supply[1];
- the right to receive the share-backed milk price on each kilogram of milksolids produced by the Shareholder supplier[1];
- rights to any distributions declared by the Board; and
- rights to share in any surplus on liquidation of the Company.

1 These rights are also attached to vouchers when backed by milk supply (subject to limits).

5 SUBSCRIBED EQUITY INSTRUMENTS CONTINUED

Shareholder suppliers

The Company maintains a Share Standard that requires a Shareholder supplier to hold one Co-operative Share[1] for each kilogram of milksolids supplied to the Company by that Shareholder supplier. This is measured as an average over the three preceding Seasons[2] production (excluding milk supplied under contract supply in that Season). Shareholder suppliers are permitted to hold more or fewer Co-operative Shares than required by the Share Standard in certain circumstances[1]. Shareholder suppliers supplying under contract must hold at least 1,000 Co-operative Shares.

In addition to Co-operative Shares held under the Share Standard, Shareholder suppliers are able to hold further Co-operative Shares up to 100 per cent of production (where production is defined as the minimum number of Co-operative Shares a Shareholder supplier is required to hold under the Share Standard). No Shareholder supplier (including its related parties) is allowed to hold interests in Co-operative Shares, not backed by milk supply, exceeding five per cent of the total number of Co-operative Shares on issue.

New Shareholder suppliers have a number of alternatives in meeting the requirements of the Share Standard[1]. This includes purchasing the required Shares over a three year period, with one third of the required holding of Co-operative Shares to be held in the first Season, two thirds in the second Season, with the Share Standard to be met in the third Season.

Voting rights in the Company are dependent on milk supply supported by Co-operative Shares[3]. A Shareholder supplier is entitled on a poll or postal vote, to one vote per 1,000 kilograms of milksolids if that Shareholder supplier holds a Co-operative Share[3] for each of those kilograms of milksolids. The amount of milksolids that support voting rights are measured at 31 May, the Season end date[4]. As at the Season end date, 31 May 2013, the aggregate milksolids eligible for voting was 1,424,000,000 kilograms of milksolids (31 May 2012: 1,463,000,000 kilograms of milksolids).

Shareholder suppliers are able to buy and sell Co-operative Shares directly on the Fonterra Shareholders' Market. Shareholders may elect to sell the Economic Rights of some of their Co-operative Shares to the Fund, subject to an individual limit set by the Board within an overall individual limit set out in the Company's constitution. On the sale of an Economic Right of a Co-operative Share to the Fund, a Shareholder supplier transfers the legal title to the Co-operative Share to the Custodian. Where the Co-operative Share transferred was backed by milk supply, the Shareholder supplier is issued a voucher by the Custodian (subject to limits).

1 The Fonterra Board may permit the Share Standard to be satisfied through the holding of both Co-operative Shares and vouchers.
2 This requirement commenced from 1 June 2013. Prior to this date, the requirement was based on kilograms of milksolids supplied for the previous Season.
3 These rights are also attached to vouchers when backed by milk supply (subject to limits).
4 Aggregate milksolids eligible for voting at Season end date are adjusted for Shareholder suppliers who have joined the Company or are no longer supplying milk to the Company in the period between the Season end date and the record date for the meeting at which the vote is to be held.

Fonterra Shareholder suppliers Supply Offer

In May 2013, Fonterra provided its Shareholder suppliers with an opportunity to sell Economic Rights of Shares backed by milk supply to the Fund, and to sell to Fonterra the resulting Units (Supply Offer).

Under this Supply Offer, Shareholder suppliers sold the Economic Rights of 60 million Co-operative Shares to the Custodian, resulting in the issuance of 60 million Units in the Fund. Fonterra acquired the 60 million Units via the New Zealand Stock Exchange (NZX) and immediately redeemed these, resulting in the transfer of 60 million Co-operative Shares to Fonterra by the Custodian. Fonterra subsequently cancelled these Shares. As a result of this redemption, the Supply Offer did not ultimately affect the total number of Units on issue.

The Custodian

The Custodian holds legal title of Co-operative Shares of which the Economic Rights have been sold to the Fund on trust for the benefit of the Fund. At 31 January 2014, 106,414,814 Co-operative Shares (31 January 2013: 95,689,327; 31 July 2013: 107,969,310) were legally owned by the Custodian, on trust for the benefit of the Fund.

UNITS	UNITS (THOUSANDS)
Balance at 1 August 2013	**107,969**
Units issued	**5,680**
Units surrendered	**(7,234)**
Balance at 31 January 2014 (unaudited)	**106,415**
Balance at 1 August 2012[1]	–
Units issued	95,734
Units surrendered	(45)
Balance at 31 January 2013 (unaudited)	95,689
Balance at 1 August 2012[1]	–
Units issued[2]	169,470
Units surrendered[3]	(61,501)
Balance at 31 July 2013 (audited)	107,969

1 The Fund commenced issuing Units on 30 November 2012.
2 Includes 60 million Units issued under the Supply Offer.
3 Includes 60 million Units redeemed by Fonterra under the Supply Offer.

5 SUBSCRIBED EQUITY INSTRUMENTS CONTINUED

Units are issued by the Fund. In respect of the Co-operative Shares which it holds, the Custodian is required under trust to pass to the Fund the following rights of those Co-operative Shares:

- the right to receive any dividends declared by the Fonterra Board;
- the right to any other distributions made in respect of Co-operative Shares; and
- rights to share in any surplus on liquidation of Fonterra.

The Fund then attaches these rights to Units it issues.

A Shareholder supplier who holds a Unit can require the Fund to effectively exchange it for a Co-operative Share held by the Custodian. The Custodian relinquishes legal ownership of that Co-operative Share (provided that completion of this transaction would not put that Shareholder supplier in breach of the limits on Co-operative Share ownership explained above). A Unit is cancelled by the Fund, as all Units in the Fund must be backed by a Co-operative Share held by the Custodian.

Dividends paid

All Co-operative Shares, including those held by the Custodian on trust for the benefit of the Fund, are eligible to receive a dividend if declared by the Board. On 24 September 2013, the Board of Directors declared a final dividend of 16.0 cents per Share (totalling $256 million), paid on 18 October 2013 to all Co-operative Shares on issue at 10 October 2013.

6 PROPERTY, PLANT AND EQUIPMENT

	GROUP $ MILLION		
	SIX MONTHS TO		YEAR ENDED
	31 JAN 2014 UNAUDITED	31 JAN 2013 UNAUDITED	31 JUL 2013 AUDITED
Additions	**370**	355	776
Disposals	**(5)**	(9)	(22)
Capital commitments	**324**	267	189

7 EQUITY ACCOUNTED INVESTMENTS

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

		OWNERSHIP INTERESTS (%)		
		AS AT		
SIGNIFICANT EQUITY ACCOUNTED INVESTEES	COUNTRY OF INCORPORATION	**31 JAN 2014**	31 JAN 2013	31 JUL 2013
DPA Manufacturing Holdings Limited[1]	Bermuda	**50**	50	50
Dairy Partners Americas Brasil Limitada[1]	Brazil	**50**	50	50
Ecuajugos S.A.[1]	Ecuador	**50**	50	50
DMV Fonterra Excipients GmbH & Co KG[1]	Germany	**50**	50	50
Dairy Industries (Jamaica) Limited[1]	Jamaica	**50**	50	50
DairiConcepts, L.P.[1]	USA	**50**	50	50
DairiConcepts Management, L.L.C.[1]	USA	**50**	50	50
Lacven Corporation[1]	Barbados	**25**	25	25
International Nutritionals Limited	New Zealand	**50**	50	50

1 Balance date 31 December.

8 BUSINESS COMBINATIONS

There were no material business combinations during any of the periods presented.

9 BORROWINGS

	GROUP $ MILLION		
	SIX MONTHS TO		YEAR ENDED
	31 JAN 2014 UNAUDITED	31 JAN 2013 UNAUDITED	31 JUL 2013 AUDITED
Opening balance	**4,677**	4,949	4,949
New issues			
Bank loans	**1,146**	1,228	2,386
Finance leases	**18**	–	–
Commercial paper	**679**	64	834
Medium-term notes	**250**	–	–
	2,093	1,292	3,220
Repayments			
Bank loans	**(141)**	(557)	(1,937)
Finance leases	**(4)**	(3)	(4)
Commercial paper	**(490)**	(200)	(611)
Medium-term notes	**(3)**	(318)	(751)
	(638)	(1,078)	(3,303)
Other movements			
Amortisation of discount	**6**	2	18
Changes in fair value	**(14)**	(30)	(95)
Changes due to foreign currency translation	**(51)**	(77)	(112)
	(59)	(105)	(189)
Closing balance	**6,073**	5,058	4,677
Included within the statement of financial position as follows:			
Current borrowings	**2,107**	1,144	1,569
Non-current borrowings	**3,966**	3,914	3,108
Total borrowings	**6,073**	5,058	4,677

	GROUP $ MILLION		
	AS AT		
	31 JAN 2014 UNAUDITED	31 JAN 2013 UNAUDITED	31 JUL 2013 AUDITED
Net interest bearing debt position			
Total borrowings	**6,073**	5,058	4,677
Cash and cash equivalents	**(812)**	(530)	(330)
Interest bearing advances included in other non-current assets	**(113)**	(125)	(121)
Bank overdraft	**3**	17	1
Net interest bearing debt	**5,151**	4,420	4,227
Value of derivatives used to manage changes in hedged risks and other foreign exchange movements on debt	**219**	464	240
Economic net interest bearing debt[1]	**5,370**	4,884	4,467

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

	GROUP		
	AS AT		
	31 JAN 2014 UNAUDITED	31 JAN 2013 UNAUDITED	31 JUL 2013 AUDITED
Net tangible assets per security[2]			
$ per listed debt security on issue	**3.67**	4.30	3.70
$ per equity instruments on issue	**2.42**	2.80	2.43
Listed debt securities on issue (million)	**1,053**	1,053	1,053
Equity instruments on issue (million)	**1,598**	1,617	1,598

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

10 FAIR VALUE AND FINANCIAL INSTRUMENTS

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 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. 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.

Financial assets held as available-for-sale investments

Financial assets in this category are listed equity investments that are intended to be held for an indefinite period of time. The fair value of financial assets in this category is based on quoted prices in active markets.

Valuation techniques for determining fair values

All derivative instruments are measured and recognised at fair value. The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Financial instruments are either priced with reference to a quoted market price for that instrument or by using a valuation model. Where the fair value is calculated using a valuation model, the methodology used is to calculate the expected cash flows under the terms of each specific contract and then discount these values back to the present value. These models use as their basis independently sourced market parameters including, for example, interest rate yield curves, commodity prices, option volatilities and currency rates. The calculation of fair value of any financial instrument may also require adjustment to reflect the impact of credit risk.

Fair value disclosures

The fair values of financial liabilities, where the carrying value and fair value differ, are calculated by reference to quoted market prices where that is possible, and otherwise are calculated by discounting future cash flows at current market interest rates adjusted for estimated credit margins for similar financial instruments.

Set out below is a comparison of the carrying amounts and fair values of financial instruments as at 31 January 2014:

	GROUP $ MILLION						
	AS AT 31 JAN 2014 UNAUDITED						
	LOANS AND RECEIVABLES	OTHER AMORTISED COST	HELD FOR TRADING	AVAILABLE-FOR-SALE	DERIVATIVES IN HEDGE RELATIONSHIPS	CARRYING VALUE	FAIR VALUE
Financial assets							
Cash and cash equivalents	812	–	–	–	–	812	812
Trade and other receivables (excluding prepayments)	2,593	–	–	–	–	2,593	2,593
Available-for-sale investments	–	–	–	72	–	72	72
Long-term advances	113	–	–	–	–	113	111
Derivative assets – current	–	–	115	–	88	203	203
Derivative assets – non-current	–	–	76	–	112	188	188
Total financial assets	3,518	–	191	72	200	3,981	3,979
Financial liabilities							
Bank overdraft	–	(3)	–	–	–	(3)	(3)
Owing to suppliers	–	(4,216)	–	–	–	(4,216)	(4,216)
Total payables and accruals (excluding employee entitlements)	–	(1,442)	–	–	–	(1,442)	(1,442)
Borrowings							
– Commercial paper	–	(625)	–	–	–	(625)	(625)
– Bank loans	–	(1,689)	–	–	–	(1,689)	(1,689)
– Finance leases	–	(186)	–	–	–	(186)	(203)
– Retail bonds	–	(947)	–	–	–	(947)	(978)
– Medium-term notes	–	(2,591)	–	–	–	(2,591)	(2,815)
– Capital notes	–	(35)	–	–	–	(35)	(34)
Derivative liabilities – current	–	–	(33)	–	(43)	(76)	(76)
Derivative liabilities – non-current	–	–	(54)	–	(315)	(369)	(369)
Total financial liabilities	–	(11,734)	(87)	–	(358)	(12,179)	(12,450)
Total financial instruments	3,518	(11,734)	104	72	(158)	(8,198)	(8,471)

Fair value hierarchy

All financial instruments for which a fair value is recognised are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- 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 assets or liabilities that are not based on observable market data (unobservable inputs).

The following table shows the fair value hierarchy for financial instruments measured at fair value:

	GROUP $ MILLION
	AS AT
	31 JAN 2014 UNAUDITED
Derivative assets	9
Available-for-sale investments	72
Prices quoted in active markets (Level 1)	**81**
Derivative assets	382
Derivative liabilities	(445)
Valuation techniques based on observable market data (Level 2)	**(63)**
Total financial instruments at fair value	**18**

Fonterra does not have any financial instruments measured at fair value which fall into Level 3 of the fair value hierarchy.

The Group's policy is to recognise transfers between the levels of the fair value hierarchy as of the date of the event or circumstances that caused the transfer.

There were no transfers between any of the items in Level 1 or Level 2 of the fair value hierarchy during the period.

11 SUBSEQUENT EVENTS

On 25 March 2014, the Board declared an interim dividend of 5.0 cents per Share, to be paid on 17 April 2014 to all Co-operative Shares on issue at 10 April 2014.

There were no other material events subsequent to 31 January 2014 that would impact these interim financial statements.

NON-GAAP MEASURES

Fonterra uses several non-GAAP measures when discussing financial performance. For further details and definitions of non-GAAP measures used by Fonterra, refer to the Glossary on page 41. These are non-GAAP measures and are not prepared in accordance with NZ IFRS.

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

Reconciliations for the NZ IFRS measures to certain non-GAAP measures referred to by Fonterra are detailed below:

Reconciliation from the NZ IFRS measure of profit for the period to Fonterra's normalised EBITDA

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2014	31 JAN 2013	31 JUL 2013
Profit for the period	**217**	459	736
Add: Depreciation	**224**	222	444
Add: Amortisation	**49**	42	86
Add: Net finance costs	**147**	152	269
Add/(less): Taxation expense/(credit)	**52**	58	(68)
Total EBITDA	**689**	933	1,467
Add: Costs associated with closure of Cororooke plant in Australia	**–**	24	30
Add: Costs associated with Group Strategy Right-Sizing	**–**	–	38
Less: Time value of options[1]	**(13)**	(10)	–
Less: Other	**–**	–	(3)
Total normalisation adjustments	**(13)**	14	65
Normalised EBITDA	**676**	947	1,532

1 This was not presented as a normalisation adjustment in previous periods. Previous periods have been restated to incorporate time value of options as a normalisation adjustment for consistency with the Group's approach from 2014 onwards.

Reconciliation from the NZ IFRS measure of profit for the period to Fonterra's normalised EBIT

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2014	31 JAN 2013	31 JUL 2013
Profit for the period	**217**	459	736
Add: Net finance costs	**147**	152	269
Add/(less): Taxation expense/(credit)	**52**	58	(68)
Total EBIT	**416**	669	937
(Less)/add: Normalisation adjustments (as detailed above)	**(13)**	14	65
Total normalised EBIT	**403**	683	1,002

Reconciliation from the NZ IFRS measure of profit for the period to Fonterra's normalised earnings per share

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2014	31 JAN 2013	31 JUL 2013
Profit for the period	**217**	459	736
(Less)/add: Normalisation adjustments (as detailed above)	**(13)**	14	65
Add/(less): Tax on normalisation adjustments	**4**	(4)	(17)
Total normalised earnings	**208**	469	784
Less: Share attributable to non-controlling interests	**(11)**	(10)	(20)
Net normalised earnings attributable to equity holders of the Parent	**197**	459	764
Weighted average number of Shares (thousands of Shares)	**1,597,834**	1,553,615	1,615,311
Normalised earnings per share ($)	**0.12**	0.30	0.47

GLOSSARY

NON-GAAP MEASURES

Fonterra refers to non-GAAP financial measures throughout the Interim Report, and these measures are not prepared in accordance with NZ IFRS. The definitions below explain how Fonterra calculates the non-GAAP measures referred to throughout the Interim Report.

Average net assets	is calculated as net interest bearing debt and total equity less deferred tax averaged over a rolling 13 month period.
Constant currency	means a measure that eliminates the effect of exchange rate movements. Constant currency variances are calculated by taking the current period financial measure in local currency less the prior period financial measure in local currency and dividing this by prior period financial measure in local currency using the prior period local currency to the New Zealand dollar exchange rate.
Contribution margin	is calculated as segmental gross profit less distribution, selling and marketing expenses.
EBIT	means earnings before interest and tax (EBIT) and is calculated as profit for the period before net finance costs and tax.
EBIT margin	is calculated as profit for the period before net finance costs and tax and divided by revenue.
EBITDA	means earnings before interest, tax, depreciation and amortisation and is calculated as profit for the period before net finance costs, tax, depreciation and amortisation.
Economic debt to debt plus equity ratio	is calculated as net interest bearing debt divided by net interest bearing debt plus equity. Net interest bearing debt includes the effect of debt hedging, and equity excludes the cash flow hedge reserve.
Farmgate Milk Price	means the base price that Fonterra pays for milk supplied to it in New Zealand for a season. The season refers to the 12 month milk season of 1 June to 31 May.
Net tangible assets	means total assets less total liabilities less intangible assets.
Normalisation adjustments	means transactions that are unusual by nature or size so that they materially reduce the ability of users of the financial results to understand the ongoing performance of the Group or operating segment to which they relate. Unusual transactions by nature are the result of a specific event or set of circumstances that are outside the control of the business, or relate to the major acquisitions or disposals of an asset/group of assets or business. Unusual transactions by size are those that are unusually large in a particular accounting period that is not expected to repeat regularly to the same extent in future periods.
Normalised EBIT	means profit for the period before net finance costs, tax and normalisation adjustments.
Normalised EBIT margin	means profit for the period before net finance costs, tax and normalisation adjustments divided by revenue.
Normalised EBITDA	means profit for the period before net finance costs, tax, depreciation, amortisation and normalisation adjustments.
Normalised segment earnings	means segmental profit for the period before depreciation, amortisation, net finance costs, tax expense, and normalisation adjustments.
Payout	means the total cash payment to Shareholder suppliers. It is the sum of the Farmgate Milk Price (kgMS) and the dividend per share. Both of these components have established policies and procedures in place on how these are determined.
Retentions	means net profit after tax attributable to Shareholder suppliers divided by the number of Shares at 31 May, less dividend per share.
Return on Capital Employed	means normalised EBIT divided by capital employed. Capital employed is calculated as monthly average net assets excluding net debt, derivatives, taxes, and investments (other than equity accounted investments).
Segment earnings	means segmental profit for the period before net finance costs, tax and normalisation adjustments.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COVER PHOTO: Fonterra Darfield site.

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