

Media release

Fonterra announces 2015 Interim Results

Results Highlights

- Forecast Cash Payout for the 2014/15 Season of \$4.90 - \$5.00
 - Forecast Farmgate Milk Price \$4.70 per kgMS
 - Estimated full year dividend of 20-30 cents per share
- Revenue \$9.7 billion, down 14 per cent
- Reported EBIT \$483 million, up 16 per cent
- Normalised EBIT \$376 million, down 7 per cent
- Net profit after tax (NPAT) \$183 million, down 16 per cent
- Interim dividend of 10 cents per share
- Ingredients normalised EBIT \$299 million, up 2 per cent
- Consumer and foodservice normalised EBIT \$116 million, up 23 per cent
- International Farming normalised EBIT (\$27) million

Forecast Cash Payout

Fonterra Co-operative Group today announced its half-year results.

Chairman John Wilson said that given the results achieved in the first half of the year and the continued volatility in international prices, the Co-operative was holding its forecast Farmgate Milk Price at \$4.70 per kgMS.

“However, our forecast dividend has been lowered to 20-30 cents per share, resulting in a forecast Cash Payout of \$4.90 - \$5.00. The Board has declared a 10 cent interim dividend.

“These half-year results are below our farmers’ expectations, in a period when the Farmgate Milk Price is low and we are reducing the forecast dividend range.

“Our half-year results are a snapshot of tough conditions in dairy with variable production, demand and pricing. There was also the challenge of generating profit from inventory made in the previous financial year when the cost of milk was higher, but sold in the first quarter of the financial year when global dairy prices were falling.

“In New Zealand, milk production got off to an excellent start. A very dry summer in most regions curtailed production in the last three weeks of January, with the Co-operative reducing its milk volume forecast to slightly below last season’s production.

“Our current milk supply forecast for the 2014/15 season has increased to 1,551 million kgMS, two per cent below the 2013/14 season.

“Oversupply from dairy producing regions around the world in the early months of the financial year saw the trade-weighted GlobalDairyTrade price index hit a five-year low in December. Supply outweighed demand and buyers undervalued milk, which was reflected in prices that declined to unsustainable levels. Lower commodity prices placed downward pressure on our Farmgate Milk Price in the first half. This was partially offset by currency, with a benefit of approximately 30 cents

per kgMS to the forecast Farmgate Milk Price, as at 31 January.

“Volatility continues to influence international dairy commodity prices and given this, we recommend caution with regards to on-farm budgets,” said Mr Wilson.

Net profit after tax is down 16 per cent to \$183 million. Normalised EBIT is also down 7 per cent to \$376 million, compared with the same period last year.

Business Performance

The first half has been subdued for the Co-operative, due to high volatility and challenging global market conditions, resulting in a 14 per cent decrease in revenue, CEO Theo Spierings said.

“In the first quarter, opportunities to improve ingredients, consumer and foodservice gross margins were restricted until carryover inventory from the previous financial year was cleared.

“There is often a lag between when product is produced and when it is sold. During the first quarter, the value of our ingredients inventory was relatively high as it was mostly produced when Whole Milk Powder (WMP) prices were higher, ranging between USD2,700 to USD4,700 per MT.

“However, these higher inventory costs were not recovered due to rapidly falling Whole Milk Powder (WMP) prices in the first quarter of this financial year, which dropped to a low of around USD2,400 per MT.

“This gap between the value of inventory and selling prices created a margin squeeze in the first quarter. This contrasts with the first quarter last year when the value of inventory was based on a lower milk cost, and was sold at a higher price.

“In the second quarter this year earnings for ingredients improved, benefiting from the lower cost of milk.

“Our consumer and foodservice business in Asia and China source all of their milk from New Zealand and benefited from the lower value of milk, particularly in the second quarter.

“Our Australian and Chilean consumer and foodservice businesses source their milk in market. Their earnings were significantly impacted by higher milk prices within each of these milk pools which squeezed margins. In Australia, Chile and Brazil, the prices paid for milk are influenced by in-market dynamics rather than global prices, so our businesses in these markets have faced higher input costs.

“Meanwhile our Sri Lanka business has turned around and improved earnings after rebuilding the market share lost, following the temporary suspension of our operations last year.

“Despite some challenges, our consumer and foodservice business overall achieved volume growth and improved pricing, together delivering a \$91 million increase in our gross margin. Normalised EBIT for consumer and foodservice for the first half was \$116 million, an increase of 23 per cent on the prior comparable period,” said Mr Spierings.

Outlook

“Our first half year results combined with the current market conditions mean that our expectations for the full year have resulted in an updated forecast dividend range of 20 to 30 cents per share (based on our policy of paying 65 to 75 per cent of net profit after tax),” said Mr Spierings. “We are maintaining our current forecast Farmgate Milk Price.

“We are strongly committed to the V3 Strategy we formulated three years ago, which has been a huge change for the Co-op. The strategy is creating sustainable returns through the integration of our ingredients multi-hubs and targeted consumer and foodservice positions in our key markets. We remain uniquely placed in the world with our global reach, asset footprint, and integrated grass-to-glass supply chain.

“But the change so far has not been easy. Capital structure change was a necessity. However, the precautionary recall last year, and recent contamination threat have been unwelcome distractions. These events remind us that the world is constantly changing and we have to be agile and responsive so we can remain ahead. We have the building blocks in place to deliver on our vision and strategy for the long term.

“We have a single-minded focus on delivering results: increasing sales volumes, reducing complexity, and taking costs out to maximise returns. To accelerate delivery on strategy, my team and I are leading a comprehensive business transformation programme. It will firmly embed the best features of entrepreneurial thinking, such as effectiveness, efficiency and agility.

“This will require some tough decisions. We are committed to improving performance. We have made good progress so far but we need to increase the pace of change,” said Mr Spierings.

The record date for the interim dividend is 10 April, and the payment date is 20 April.

The dividend reinvestment plan (DRP), under which eligible shareholders and unit holders can elect to reinvest all or part of their cash dividends in additional shares or units, will be made available in respect of the 2015 interim dividend. The Board has determined that shares and units will be issued at a 2.5% discount on the average closing price for the period 8-14 April 2015.

– ENDS –

Note: currency is New Zealand dollars unless otherwise stated.

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About Fonterra

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

The [farmer-owned](#) New Zealand co-operative is the largest processor of milk in the world, producing more than two million tonnes of dairy ingredients, value added dairy ingredients, specialty ingredients and consumer products every year. Drawing on [generations of dairy expertise](#), Fonterra is one of the largest investors in dairy based [research and innovation](#) in the world. Our more than [18,000 staff](#) ensure we live up to exacting quality standards and deliver every day on our customer promise in more than 100 markets around the world.

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APPENDIX ONE

Fonterra has changed the way it structures its financial reporting. It is now focused on the Ingredients, Consumer and Foodservice, and International Farming businesses, to align with our global strategy.

Half-year financial highlights by business divisions

Ingredients

Milk collection across New Zealand for the season to 31 January 2015 was 1,150 million kgMS, three per cent up on the same period last season. Milk collection in Australia, which is our second largest milk pool, was 82 million kgMS, up six per cent. Ingredients sales volumes were flat as a result of lower sales to China which was offset by higher sales in other regions, but revenue was 23 per cent down reflecting the 45 per cent lower dairy commodity prices during the first half compared to the same period last year. Normalised EBIT for the first half was \$299 million, up two per cent relative to the comparable period. The ingredients segment includes group overheads. Operating costs were \$43 million higher mainly due to higher costs to support our global strategy and ensure efficient allocation of resources, and higher storage and distribution costs in the United States and New Zealand.

Consumer and Foodservice

Volume across our consumer and foodservice businesses was up 27 per cent to 840,000MT in the first half compared to the same period last year. On a like-for-like basis, excluding volumes for Brazil and Venezuela, which were not consolidated last year, volume was up three per cent. Revenue was up 22 per cent to \$3.3 billion and five per cent on a like-for-like basis, reflecting our ability to increase price points in some key markets. Normalised EBIT for the consumer and foodservice business in the first half was \$116 million, up 23 per cent compared to the same period last year. This was mainly due to improved pricing and strong volume growth in China, the recovery in Sri Lanka and a strong performance from our foodservice business in Asia. This was partially offset by higher input costs due to the higher cost of milk in Australia and in Chile in the first half compared to the same period last year. Operating expenses were \$4 million higher mainly because of higher investment in our China consumer business.

International Farming

We now have two farming hubs with a total of nine productive farms. A single farm has capacity for around 3,200-3,500 milking cows and a double farm has around 6,500 milking cows. In total we have 24,000 milking cows and 25,000 heifers and calves across all our farms. Milk production volumes increased significantly to 67,000 MT for the first half as a result of the new farms that have come on stream since the first half last year, equating to over five million kgMS of milk produced for the six months. Normalised EBIT in the first half was down \$29 million on the same period last year due to the higher livestock revaluation adjustment in the first half of last year not being repeated this year. Accounting standards require Fonterra to hold livestock on our balance sheet at fair value. The relatively thinly traded livestock market on China and the volatile local Chinese milk price contribute to fluctuations in Chinese livestock valuations. In addition we had a lower milk price in China which reflected the impact of higher local milk production.

APPENDIX TWO

Non-GAAP measures

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

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

- Fonterra calculates normalised EBIT by adding back net finance costs, taxation expense and normalisation adjustments to profit for the period.

- Normalisation adjustments are transactions that are unusual by nature or size such that they materially reduce the ability of users of the financial results to understand the underlying 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.
- Normalisation adjustments are determined on a consistent basis each year.

Reconciliation from the NZ IFRS measure of profit after tax to Fonterra's normalised EBIT

\$ million	Six month ended 31 January 2015	Six month ended 31 January 2014
Total EBIT	483	416
Net gain on Latin American strategic realignment	(129)	-
Time value of options	22	(13)
Total normalisation adjustments	(107)	(13)
Total normalised EBIT	376	403