

GLOBAL DAIRY UPDATE



Dairy for life



FROM THE CHAIRMAN & CEO



"Global dairy prices continue to reflect the imbalance between a surplus supply of milk and unstable demand."

– John Wilson



"In order to stay ahead in an increasingly volatile environment, we must remain focused on continually improving the way we deliver performance."

– Theo Spierings

OUR MARKETS



- Milk production growth from the major exporting countries of New Zealand and Australia was strong in the 2014/15 season. EU growth has increased, but growth in the US has slowed.

- Forecast Fonterra milk collection in New Zealand for the 2015/16 season -2%.



- Demand growth continues in the emerging markets of the Middle East, Africa and Asia (excluding China) while China import volumes remain subdued.

OUR PERFORMANCE



Business review

- In December 2014, we initiated a business transformation so we are best placed to respond to a rapidly changing global environment and achieve our full potential.

- We have signed a supply agreement that will help to fill our Darnum nutritional plant.

OUR CO-OP



Fonterra Co-op Support will help farmers deal with challenging conditions.

Grass Roots Fund supports sustainability initiative.

One of our farmers shares her Fonterra Milk for Schools story.



FROM THE **CHAIRMAN AND CEO**

John Wilson
Chairman

Global dairy prices continue to reflect the imbalance between a surplus supply of milk, and weak demand.

This is a global issue affecting the international dairy industry, and one with which dairy farmers globally are grappling. We are now seeing evidence that farmers in the major milk production regions – including New Zealand – are beginning to respond to the low milk payments by reducing their volumes.

However, although the rate of milk supply growth appears to be slowing, market commentators and our own analysis indicates that global dairy prices are unlikely to recover fully until next year – unless there is a significant change in supply or demand in the short term.

We are constantly monitoring the global situation, and looking at all the factors that are likely to impact our forecast Farmgate Milk Price across the current 2015/16 season, which is through to June 2016.

Given volatility and market uncertainty we will keep farmers updated as we move through the season.

On August 7, we announced that the forecast total payout available to farmers in the 2015/16 season will be \$4.25-\$4.35. It is made up of:

- Forecast Farmgate Milk Price \$3.85 per kilogram of milksolids (kgMS)
- Forecast earnings per share range of 40–50 cents per share.

In addition, we are making available 50 cents per shared-up kgMS produced from June to December to provide co-operative support to our farmers. Our Co-op is uniquely placed to help farmers due to our underlying strength.

As was announced some months ago, Fonterra management is reviewing the business to ensure it improves efficiency, generates increased cash flow, and successfully delivers on strategy. In response to a far more volatile dairy market than experienced historically, this is necessary and normal business practice and is also consistent with our peers globally.



Theo Spierings
CEO

In order to stay ahead in an increasingly volatile environment, we must remain focused on continually improving the way we deliver performance.

I have spent a lot of time on the business transformation, working with senior Fonterra people looking at our entire business and how we unlock value.

This work is across the entire business including procurement, manufacturing and capex. As part of this work, we have confirmed

new structures for some of our teams and more work in this area is underway. It has been unsettling for the people affected but we have to change to remain strongly competitive in today's global dairy market.

We announced that we will be providing Fonterra Co-operative Support in the form of a loan. This will be an additional 50 cents per shared-up kgMS to support farmers this season. It will be funded by one-off savings generated by changes the business is making, such as improving working capital.

Our chairman, John Wilson, and I officially opened our new site in Heerenveen in the Netherlands. This partnership with A-ware gives us cost-effective, reliable and continued access to high-quality whey and lactose to use in manufacturing high-value paediatric, maternal and sports nutrition products.



To view a chart that illustrates year-on-year changes in production –

MILK PRODUCTION GROWTH FROM THE MAJOR EXPORTING COUNTRIES OF NEW ZEALAND AND AUSTRALIA WAS STRONG IN THE 2014/15 SEASON. EU GROWTH HAS INCREASED, BUT GROWTH IN THE US HAS SLOWED

NEW ZEALAND

1%↑

Production increase from January to May 2015

New Zealand production increased 12% in May compared to the same month last year. This rate of growth was affected by the widespread drought in the previous year.

May is the last month of the season and a time when milk production approaches the seasonal low.

We are currently forecasting Fonterra New Zealand production to decrease by 2% in the 2015/16 season. Refer to page 6.

AUSTRALIA

3%↑

Production increase from January to June 2015

Australia production in June increased 1% compared to the same month last year.

Production in the year to June has increased 3%. This year to date growth was driven by favourable pasture growth conditions across most dairying regions, particularly Tasmania.

EUROPEAN UNION

0%

Production flat from January to May 2015

Production in the EU has increased since the quotas were lifted, increasing 2% in May compared to the same month last year. This growth was driven in particular by Ireland up 12%, Netherlands up 7% and the UK up 3%.

Production in the year to May is in line with last year, however the EU Commission is forecasting milk deliveries to increase 1% in 2015 which was lower than market expectations.

USA

1%↑

Production increase from January to June 2015

US production increased 1% in June compared to the same month last year.

Milk production in the year to June is up 1%. While the rate of growth has slowed, the United States Department of Agriculture estimates US production will increase by 1.3% in 2015.



To view a chart that illustrates year-on-year changes in exports –

DAIRY EXPORTS REMAIN VOLATILE BUT MOST MAJOR DAIRY EXPORTING COUNTRIES HAVE EXPERIENCED GROWTH IN DAIRY EXPORTS

NEW ZEALAND

2%↑

Export increase from January to May 2015

New Zealand exports decreased 2% in May compared to the same month last year. This decrease was impacted by butter down 39%, AMF down 16% and WMP down 7%.

Exports in the year to May remain 2% higher when compared to the same period last year, however this rate of growth has slowed.

AUSTRALIA

7%↑

Export increase from January to May 2015

The rate of Australia export growth has slowed, but increased 6% in May compared to the same month last year. This increase is driven primarily by WMP up 26% and cheese up 25%, but partially offset by whey powder and fluid and fresh dairy down 22% and 7% respectively.

Exports in the year to May increased 7% led by SMP up 25%, fluid and fresh dairy up 15% and cheese up 11%.

EUROPEAN UNION

2%↑

Export increase from January to April 2015

EU exports increased 1% in April compared to the same month last year. This increase was primarily due to fluid and fresh dairy increasing 20%.

Exports increased 2% in the year to April driven by SMP up 16%, infant formula up 11% and fluid and fresh dairy up 7%.

USA

10%↓

Export decrease from January to May 2015

US exports decreased 6% in May compared to the same month last year. Other than in April, the US has experienced negative growth in dairy exports since June 2014.

Exports in the year to May decreased 10%, reflecting a decrease across most of the major dairy categories. Contributing factors to this decline are higher domestic market prices and low global commodity prices.



To view a chart that illustrates year-on-year changes in imports –

DEMAND GROWTH CONTINUES IN THE EMERGING MARKETS OF THE MIDDLE EAST, AFRICA AND ASIA.

WHILE CHINA IMPORT VOLUMES REMAIN SUBDUED

ASIA

16%↑

Import increase from January to April 2015

Asia (excluding China) import volumes increased 13% in April compared to the same month last year, with increases seen across all major dairy categories. This is the ninth consecutive month of growth when compared to the same month the previous year.

Imports in the year to April remain strong, increasing 16% as a result of SMP up 30%, WMP up 21%, cheese up 15% and fluid and fresh dairy up 12%.

MIDDLE EAST & AFRICA

3%↑

Import increase from January to April 2015

Imports into the Middle East and Africa¹ increased 8% in April compared to the same month last year. This increase was largely due to powders with WMP up 27%. In addition, fluid and fresh milk was up 10%.

Imports in the year to April remain particularly strong for WMP up 30% (43,000 tonnes).

CHINA

24%↓

Import decrease from January to June 2015

China imports decreased 8% in June compared to the same month last year. While China imports decreased in June, it is the smallest year-on-year decrease seen in 10 months.

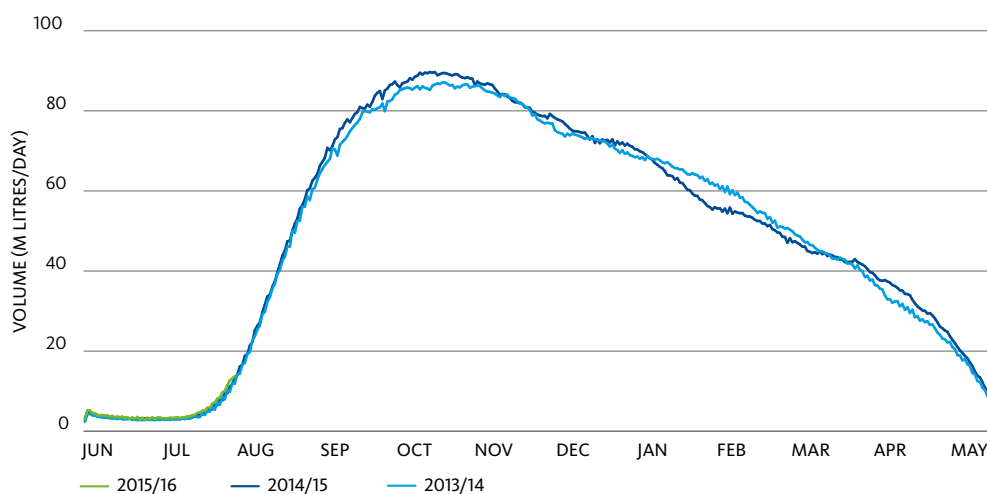
¹ Excluding Morocco and Algeria.

OUR MARKETS

OCEANIA MILK COLLECTION



To view a table that shows our detailed milk collection in New Zealand and Australia compared to the previous season –



NEW ZEALAND

Milk collection volumes across New Zealand are building as the season gets underway.

Fonterra milk collection in July reached 17 million kgMS, up 2 million kgMS on July last season.

Milk collection in New Zealand for the 2014/15 season (for the 12 months to 31 May) reached 1,614 million kgMS, 2% higher than the previous season.

NORTH ISLAND

4% ↑

Increase for the 2014/15 season compared to the previous season

North Island collection for the 2014/15 season reached 1,007 million kgMS, 4% above the previous season.

SOUTH ISLAND

1% ↓

Decrease for the 2014/15 season compared to the previous season

South Island milk collection for the 2014/15 season reached 607 million kgMS, 1% behind the previous season, impacted by continued challenging pasture growth conditions.

AUSTRALIA

5% ↑

Increase for the 2014/15 season compared to the previous season

Milk collection in Australia for the 12 months to 30 June reached 127 million kgMS, 5% higher than the previous season. Milk collection in July, the first month of the 2015/16 season, reached eight million kgMS. This is in line with July last season. Most Australian farmers are now preparing for spring calving and while the milk curve is not as pronounced as New Zealand, milk collection volumes will increase over the coming months.

New Zealand Milk Supply forecast

1,589M
KGMS

Decrease of 2% for the 2015/16 season

This reflects the likely impact of farmers using more traditional practices to manage their businesses within the limits of a low payout.

Based on DairyNZ information and assessment, farmers are reducing stocking rates and supplementary feeding to lower costs. In New Zealand we have the advantage of a

pasture-based system which allows farmers to lower costs.

It is still early in the season to accurately forecast the total milk collection. At this early stage, variations of +/- ~50m kgMS may occur due to weather dominated trends.

We will keep updating estimates as the season progresses.

OUR MARKETS

DAIRY COMMODITY PRICES



Last trading event

4 August 2015:

The **Fonterra volume sold was 46,198 MT**, with weighted average prices decreasing 15% compared to the last event. Of the Fonterra product sold, China was the largest buyer by region, followed by South East Asia then the Middle East and Africa.

9.3 % ↓

GDT Price Index

USD **1,815**

Average winning price per MT

9.3 % ↓

GDT Price Index for the financial year to date

Compared to the last trading event:

AMF

11.7 % ↓

USD 2,253/MT

BUTTER

6.1 % ↓

USD 2,293/MT

RENNET CASEIN

2.7 % ↓

USD 5,289/MT

CHEDDAR

0.2 % ↑

USD 2,663/MT

SMP

14.4 % ↓

USD 1,419/MT

BMP

5.1 % ↓

USD 1,700/MT

WMP

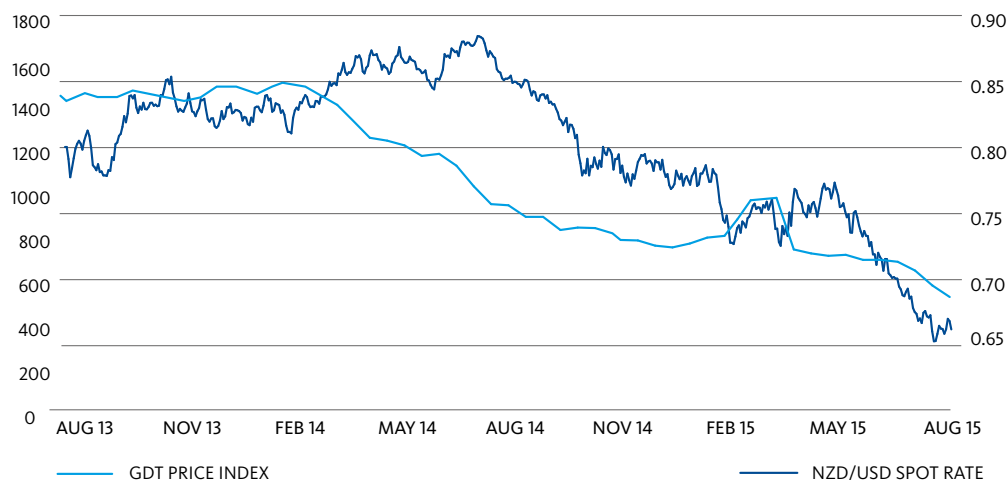
10.3 % ↓

USD 1,590/MT

Dairy commodity prices and New Zealand dollar trend

To view a table that summarises the latest results and provides a snapshot of the rolling year-to-date results –

The New Zealand dollar continues to fall against the US dollar and has reached new multi-year lows.



► The next trading event will be held on **18 August 2015**. Visit www.globaldairytrade.info for more information.



WE HAVE COMPLETED THE INITIAL PHASE OF THE BUSINESS TRANSFORMATION WE LAUNCHED IN DECEMBER 2014 AND ANNOUNCED AT OUR INTERIM RESULTS IN MARCH

The new environment of unprecedented global volatility is hitting the entire dairy industry and we need to be more responsive and efficient in order to perform effectively.

The key aims of the transformation are to ensure we are best placed to successfully deliver our strategy, increase focus on generating cash flow, and implement specific, sustainable measures for enhancing efficiency.

The initial phases identified potential areas, where efficiency and effectiveness gains can be made that will result in cash generation. These include significant initiatives in procurement, business operations and working capital.

Our leadership team is now building these opportunities into defined plans that will drive further improvement across the business, allow us to fund our growth strategy and deliver stronger results.

Overheads are one of the 14 workstreams within the business transformation.

The first round of consultation with staff to streamline business structures has now been confirmed. This involved central procurement, finance, information services, human resources, strategy and legal.

As a result, 523 roles will be disestablished at a cost of \$14 – \$15 million. At that level we expect on-going payroll savings of approximately \$55 – \$60 million per annum.

On 5 August we began consultation on new business structures for staff in administration roles, sales (ingredients and consumer), marketing, research and development, communications, health and safety, food safety and quality, group resilience and risk, property, procurement and change management.

We will provide an update when we complete consultation with these staff.

Three year nutritionals agreements for Darnum



We have signed a supply agreement that will help to fill our Darnum nutritionals plant with between 5,000 to 10,000 MT of nutritionals per annum.

Darnum will produce all three stages of infant formula, destined for China's growing infant formula market.

The three-year agreement was dependant on the Australian company and Darnum securing stringent Chinese certification, which is now achieved.

This supply agreement will help to triple our Fonterra Australia's existing exports of infant formula from five million 900 gram tins to 15 million tins.

With Fonterra product trials already complete, customer orders will start flowing late August / early September.

Meanwhile, the Beingmate contract will help secure the other capacity over time, with new volume projects underway.



Fonterra Co-op Support will help farmers deal with challenging conditions

We are providing Fonterra Co-operative Support in the form of a loan to help farmers deal with the challenging conditions. We continue to believe strongly in dairy and this farmer support is an investment in the future of the Co-op.

The Co-operative will provide Fonterra farmers the opportunity to apply for an additional payment equal to 50 cents per shared-up kgMS for production for the season. This payment, interest free for two seasons, will be paid back to the extent the Advance Rate or final Farmgate Milk Price goes above \$6.00 per kgMS.

The first phase of payments will relate to production from 1 June to 31 December 2015 and will begin in October and continue until May. Payments will total 50 cents per shared-up kgMS and will be phased from October as transformation savings are delivered.

Fonterra Co-operative Support for the first half of the season is estimated to be up to \$430 million, depending on take-up rates, and will be funded by one-off savings generated by changes the business is making, such as improving working capital.

We intend to continue this through the season and in December will review all relevant conditions including the global dairy market and progress on transformation, to ensure that it remains in the best interests of the Co-operative and our farmers to continue Fonterra Co-operative Support through the season.

The second phase of payments will be similar to the first phase and more details will be provided closer to that time.

One of our farmers shares her Fonterra Milk for Schools story



Julie and Brian Pirie have a farm in the Waikato and as Fonterra farmer shareholders they are passionate advocates for the Fonterra Milk for Schools programme.

They have seen first hand what the programme is doing for their community.

[To find out their story and hear what they have to say about the programme –](#)

Grass Roots Fund supports sustainability initiative at Wairakei School

Wairakei School recently opened its EnviroGroup Aquaponics project, which was partly funded through our Fonterra Grass Roots Fund.

Aquaponics is a food production system that combines conventional aquaculture such as raising aquatic animals including snails, fish, crayfish or prawns in tanks with hydroponics (cultivating plants in water) in a symbiotic environment.



Several years ago the school closed its swimming pool as community sponsorship allowed for all pupils to go for swimming lessons in local thermal pools. This left the question of what to do with the existing unused pool.



After doing some research, the school decided on the Aquaponics Project to further increase the school's commitment to sustainability.

The newly launched system is now home to goldfish and the first crop of vegetables.

Fish tanks and growing beds, both in recycled tanks, are located in a tunnel house in the emptied pool. The goldfish enjoy daily attention and feeding by pupils while their water is constantly cycled through the vegetable hydroponic beds.

The Fonterra Grass Roots Fund supports communities where we operate by funding their clever ideas, projects and initiatives. Visit the **Facebook page** for more information.

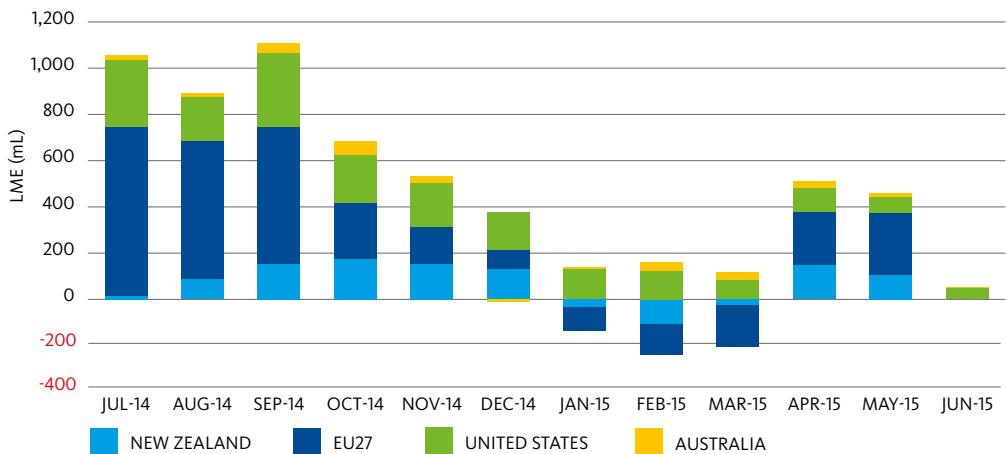
SUPPLEMENTARY INFORMATION

Global Dairy Market

The charts on the right illustrate the year-on-year changes in production, exports and imports for a range of countries that are important players in global dairy trade.

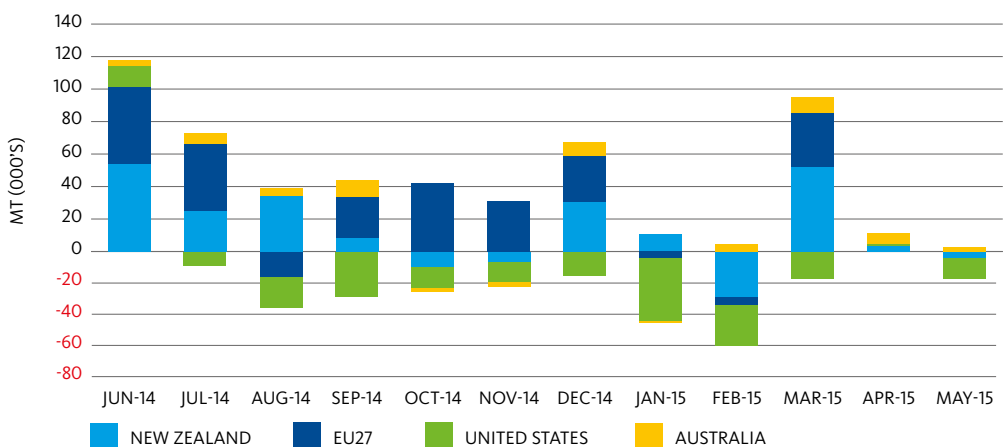
The absolute size of the bars represents the change in production, exports or imports, relative to the same period the previous year.

PRODUCTION



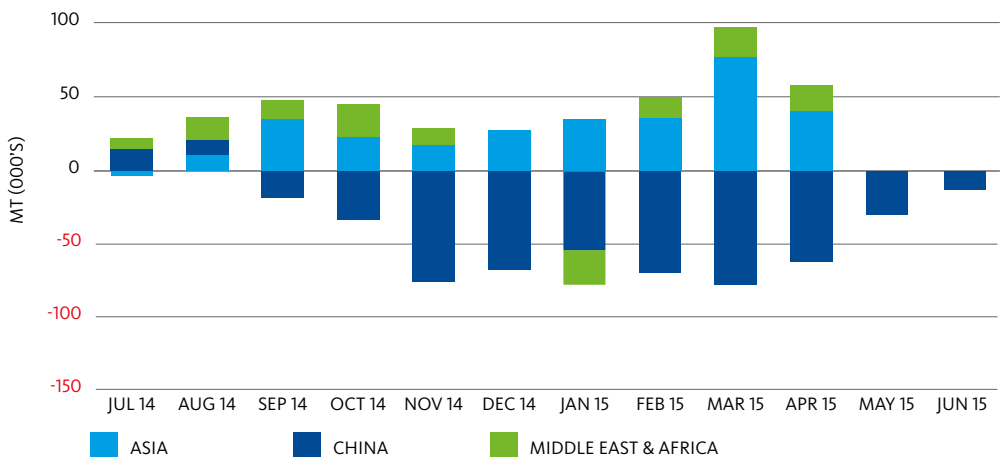
SOURCE: Government milk production statistics/GTIS trade data/Fonterra analysis.

EXPORTS



SOURCE: Government milk production statistics/GTIS trade data/Fonterra analysis.

IMPORTS



SOURCE: Government milk production statistics/GTIS trade data/Fonterra analysis.

SUPPLEMENTARY INFORMATION

Fonterra milk production

The table on the right shows Fonterra milk solids collected in New Zealand and Australia compared to the previous season.

MILK COLLECTION (MILLION KGMS)	JULY 2015	JULY 2014	MONTHLY CHANGE	SEASON- TO-DATE 2015/16	SEASON- TO-DATE 2014/15	SEASON- TO-DATE CHANGE
Total Fonterra New Zealand	16.6	14.8	12.2%	26.6	24.1	10.4%
North Island	15.1	13.3	13.5%	22.7	20.4	11.3%
South Island	1.5	1.5	-3.3%	3.9	3.7	5.4%
Fonterra Australia	7.8	7.6	1.6%	7.8	7.6	1.6%

GDT results

This table summarises the latest GDT results and provides a snapshot of the rolling year-to-date results.

	LAST TRADING EVENT (4 AUGUST 2015)	YEAR-TO-DATE (FROM 1 AUGUST 2015)
Fonterra Quantity Sold on GDT (Winning MT)	46,198	46,198
GDT Average Winning Price (USD MT/FAS)	1,815	1,815
Change in GDT Price Index over same period last year	-42%	-42%
Change in GDT Price Index from previous event	-9.3%	

GLOSSARY

AMF

Anhydrous Milk Fat.

BMP

Butter Milk Powder.

DIRA

Dairy Industry Restructuring Act 2001 (New Zealand).

Dry shares

Any shares held by a farmer shareholder in excess of the number of shares required to be held by that farmer shareholder in accordance with the minimum shareholding requirement for a season.

Farmgate Milk Price

The price for milk supplied in New Zealand to Fonterra by farmer shareholders.

GDT Price Index

All GDT price indices are chain-linked Fisher indices using winning quantities and winning prices. For the period prior to April 2010, the GDT Price Index and the anhydrous milk fat (AMF), SMP and WMP price indices use GDT prices and quantities where available, and USDA Dairy Market News prices and GTIS export volumes elsewhere. USDA Western Europe average price for butter oil is used for AMF prior to December 2009, USDA Oceania average price for SMP is used prior to April 2010 and USDA Oceania average price for WMP is used prior to August 2008.

Reference Commodity Products

The commodity dairy products used in the calculation of the Farmgate Milk Price, which are currently WMP, SMP, BMP, butter and AMF.

Season

New Zealand: A period of 12 months to 31 May in each year.

Australia: A period of 12 months to 30 June in each year.

Share Standard

The number of shares a farmer shareholder is required from time to time to hold as determined in accordance with the Constitution. The Fonterra Board may permit the Share Standard to be satisfied through the holding of both shares and vouchers.

SMP

Skim Milk Powder.

V3

Fonterra's growth strategy based on accelerating volume, value and velocity.

Voucher

A certificate that is provided to a farmer shareholder upon transfer of the Economic Rights of a wet share to the Fonterra Shareholders' Fund in accordance with the Trust Deed.

Wet shares

Any shares held by a farmer shareholder that are required to be held in accordance with the minimum shareholding requirement for a season.

WMP

Whole Milk Powder.