



# FARMGATE MILK PRICE STATEMENT

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# INTRODUCTION

The primary purpose of this Statement is to help Fonterra farmer shareholders, unit holders in the Fonterra Shareholders' Fund, and other interested parties better understand the Farmgate Milk Price.

This Farmgate Milk Price Statement:

- outlines the way that Fonterra Co-operative Group Limited (Fonterra) has calculated the Final Farmgate Milk Price for the milk season that ended on 31 May 2014 (2014 season);
- explains why, for the first time since the introduction of the Farmgate Milk Price in the 2009 season, Fonterra has paid a Final Farmgate Milk Price that differs from the Farmgate Milk Price calculated under the Farmgate Milk Price Manual; and
- sets out information about the adjustment to the Farmgate Milk Price (the Milk Price Adjustment) to arrive at the Final Farmgate Milk Price.

The appendices provide an overview of the Farmgate Milk Price and a report by Fonterra's external auditors which confirms that the Farmgate Milk Price for the 2014 season has been derived in accordance with the Principles, Methodologies and Detailed Rules in Fonterra's Farmgate Milk Price Manual. There are five attachments that provide further detail for the last three seasons on the most significant factors that impact the Farmgate Milk Price. A glossary of the terms used completes the report.

Numbers in this Statement have been rounded and, as a result, some tables may not exactly total or sum to 100 per cent. The information on the Farmgate Milk Price presented in this Statement is based on data used within the Milk Price Model, and not Fonterra's actual data.

A Farmgate Milk Price Statement will be made available each year with Fonterra's annual results on [www.fonterra.com](http://www.fonterra.com). A hard copy can be requested by phoning the Supplier Services Team on 0800 65 65 68.

# FINAL FARMGATE MILK PRICE FOR 2014 SEASON

This section sets out the Final Farmgate Milk Price for the 2014 season, comprising the Farmgate Milk Price less the Milk Price Adjustment. It also describes the way the Final Farmgate Milk Price relates to Fonterra's financial year ended 31 July 2014.

The Manual sets out the methodology for determining the base amount to be paid by Fonterra for milk supplied to Fonterra in New Zealand in a season. Fonterra's Milk Price Panel advises the Fonterra Board on matters concerning the Manual, including the calculation of the Farmgate Milk Price. For the 2014 season, the Farmgate Milk Price calculated according to the Manual is New Zealand Dollars (NZD) 14.151 billion. The Fonterra Board has agreed to an adjustment of NZD 842 million to the Farmgate Milk Price, resulting in a Final Farmgate Milk Price for the 2014 season of NZD 13.310 billion.

The Farmgate Milk Price is the total amount calculated under the Manual of NZD 14.151 billion. For convenience, the Manual also defines the 'Farmgate Milk Price per kgMS' as this total amount divided by Fonterra's total New Zealand milk supply (1.584 billion kilogram of milk solids (kgMS)), or NZD 8.93 per kgMS. When expressed on an equivalent basis, the Milk Price Adjustment is 53 cents per kgMS, and the Final Farmgate Milk Price is NZD 8.40 per kgMS.

The Final Farmgate Milk Price is the highest Milk Price paid by Fonterra in its history.

The Final Farmgate Milk Price of NZD 13.310 billion is used for payments for New Zealand milk supplied in the 2014 season. It includes payments for milk supplied by farmer shareholders, milk supplied on contract, and a portion of the premiums paid for Winter Milk. The total payment amount set by the Fonterra Board (NZD 13.329 billion) also includes Approved Adjustments (e.g. premium payments for Specialty Milk and the remaining portion of the premiums paid for Winter Milk).<sup>1</sup>

The cost of New Zealand sourced milk sold, as disclosed in Fonterra's most recent financial statements is NZD 13.226 billion. The NZD 84 million difference between this amount and the Final Farmgate Milk Price of NZD 13.310 billion primarily arises because the financial statements report the cost of milk acquired during the financial year comprising the 12 month period ending on 31 July 2014, plus the Approved Adjustments. In contrast, the Final Farmgate Milk Price for the season is the cost of milk supplied in respect of the 12 month period ending on 31 May 2014.

Further information on the Milk Price Adjustment of NZD 842 million is provided later in this statement. Unless otherwise specified, all figures and information provided in other sections refer to the Farmgate Milk Price, not the Final Farmgate Milk Price.

## FARMGATE MILK PRICE

\$8.93 /kgMS

## MILK PRICE ADJUSTMENT

\$0.53 /kgMS

## FINAL FARMGATE MILK PRICE

\$8.40 /kgMS

<sup>1</sup> A commodity manufacturer of milk powders is unlikely to pay premiums for Specialty Milk or to pay the level of premiums for Winter Milk that an integrated processor such as Fonterra would pay. These payments are therefore not funded from the total amount calculated under the Manual and are paid in addition to this total amount. For the 2014 season, these Approved Adjustments amounted to NZD 19 million.

# FARMGATE MILK PRICE REVENUE AND COSTS

The most significant factor that affects the Farmgate Milk Price from season to season is revenue. The first three subsections describe the key factors that influence revenue. The later subsections describe the costs that go into the Farmgate Milk Price.

Table 1 below summarises the Farmgate Milk Price for the milk supplied in the 2012, 2013 and 2014 seasons.

Both Table 1 and Figure 2 below show that changes in the Farmgate Milk Price over the last three seasons have been driven mainly by changes in commodity prices converted into New Zealand dollars.

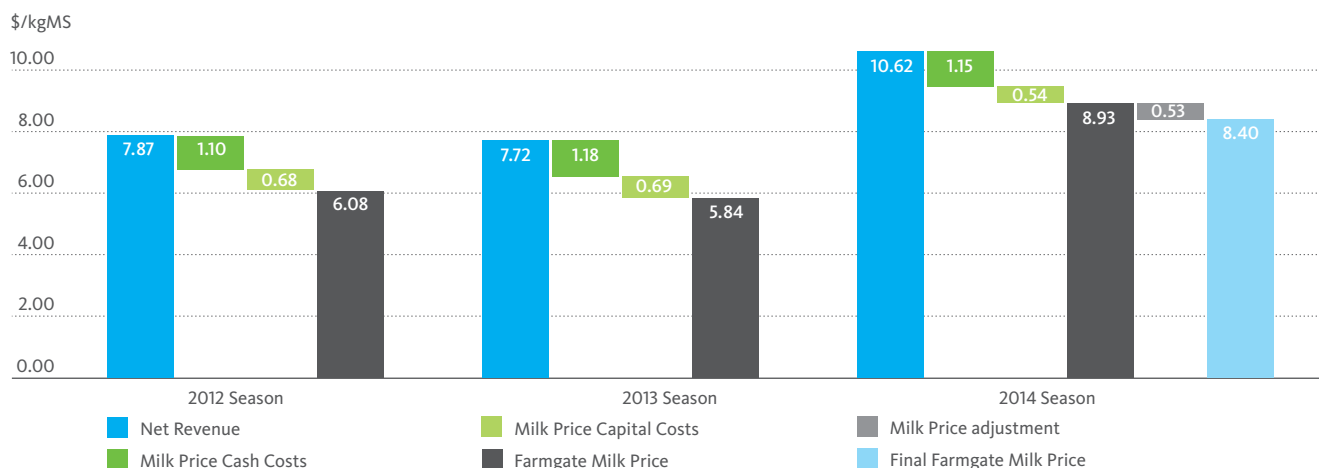
Key determinants of the movements in average costs between the 2013 and the 2014 seasons are explained later in this section.

**TABLE 1: FARMGATE MILK PRICE SUMMARY**

SEASON	2014 \$b	2014 \$kgMS	2013 \$b	2013 \$kgMS	2012 \$b	2012 \$kgMS	2014/2013 % CHANGE \$kgMS	2013/2012 %CHANGE \$kgMS
Farmgate Milk Price Revenue	17.5	11.04	12.1	8.24	12.4	8.29	34.0%	-0.6%
Lactose	(0.7)	(0.42)	(0.8)	(0.52)	(0.6)	(0.42)	-20.0%	23.0%
<b>Net Revenue</b>	<b>16.8</b>	<b>10.62</b>	<b>11.3</b>	<b>7.72</b>	<b>11.7</b>	<b>7.87</b>	<b>37.6%</b>	<b>-1.9%</b>
Farmgate Milk Price Operating Costs	(1.8)	(1.15)	(1.7)	(1.18)	(1.6)	(1.10)	-2.9%	7.6%
Farmgate Milk Price Capital Costs*	(0.9)	(0.54)	(1.0)	(0.69)	(1.0)	(0.68)	-21.7%	2.0%
<b>Total Costs</b>	<b>(2.7)</b>	<b>(1.69)</b>	<b>(2.7)</b>	<b>(1.88)</b>	<b>(2.7)</b>	<b>(1.78)</b>	<b>-9.8%</b>	<b>5.4%</b>
Farmgate Milk Price	14.2	8.93	8.5	5.84	9.1	6.08	52.9%	-4.0%
Million kgMS		1,584		1,463		1,493	8.3%	-2.0%

\* Includes depreciation, tax and capital charge

**FIGURE 2: CHANGES IN THE FARMGATE MILK PRICE: SEASONS 2012 – 2014**



# FARMGATE MILK PRICE REVENUE AND COSTS

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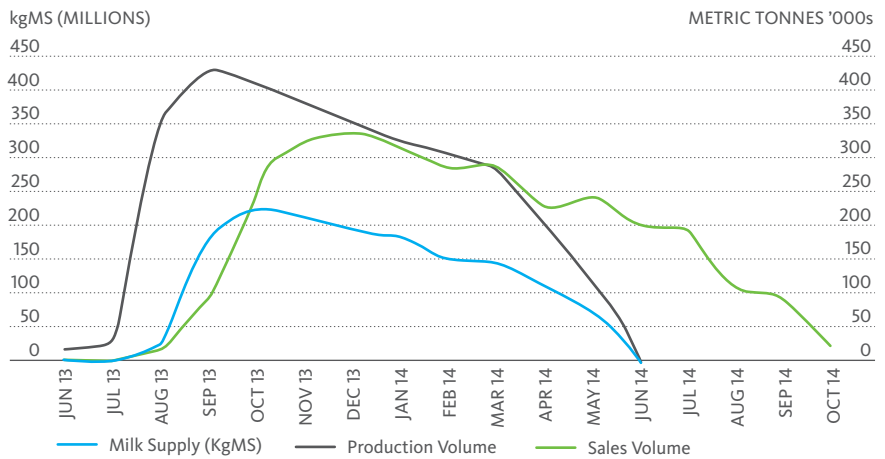
## SUPPLY, PRODUCTION AND SALES VOLUMES

Farmgate Milk Price Revenue varies according to the milk supplied during the season, product mix, sales volumes and prices in NZD. Farmgate Milk Price Revenue is the most significant driver of the Farmgate Milk Price.

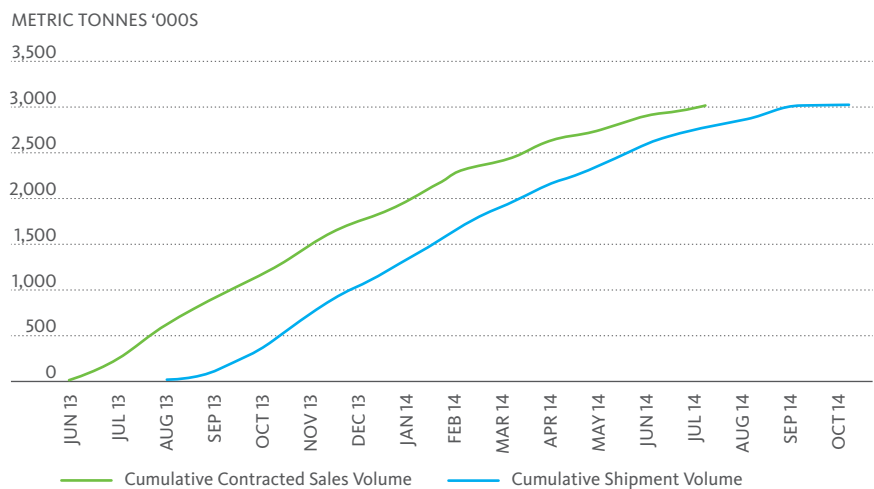
Figure 3, right, shows the relationship between when milk is collected during a season (the light-blue line), the volume of products manufactured from that milk (the black line) and when that product is sold (the light-green line). The key points to note are as follows:

- Milk supplied during the 2014 season comprised 1.584 billion kgMS. Attachment 1 provides information on milk supplied every quarter for each of the last three seasons.
- This amount of milk is assumed to be converted into Reference Commodity Products. The mix between the various products that goes into the Farmgate Milk Price is aligned to Fonterra’s actual mix between WMP and SMP, and between butter and AMF (production of BMP is a residual amount). Attachment 1 provides Farmgate Milk Price production by quarter for each Reference Commodity Product for the past three seasons.
- Sales volumes reflect the pattern of Fonterra’s actual shipments of Reference Commodity Products manufactured from milk supplied during the season. The timing of sales volumes shown in Figure 3 reflects the lag between production and shipment, as well as the fact that minimal milk is supplied in June and July. These factors mean that shipments of products manufactured from milk collected in a season (beginning 1 June) do not normally commence until August, at the earliest. Shipments are normally complete by the end of October in the

**FIGURE 3: TIMING OF SUPPLY, PRODUCTION AND SALES VOLUMES**



**FIGURE 4: LAG BETWEEN WHEN PRICES WERE STRUCK AND SHIPMENT**



following year, again as illustrated in Figure 3. Attachment 2 sets out sales volumes by quarter for each of the past three seasons.

Revenues are recognised when sales are invoiced, at the time of shipment. Sales prices included in the Farmgate Milk Price are always set prior to the month of shipment, primarily via GDT events. Figure 4 above shows the average lag between when prices are struck and when product is shipped. This matches Fonterra’s actual average lag for product that is sold on terms which are typical

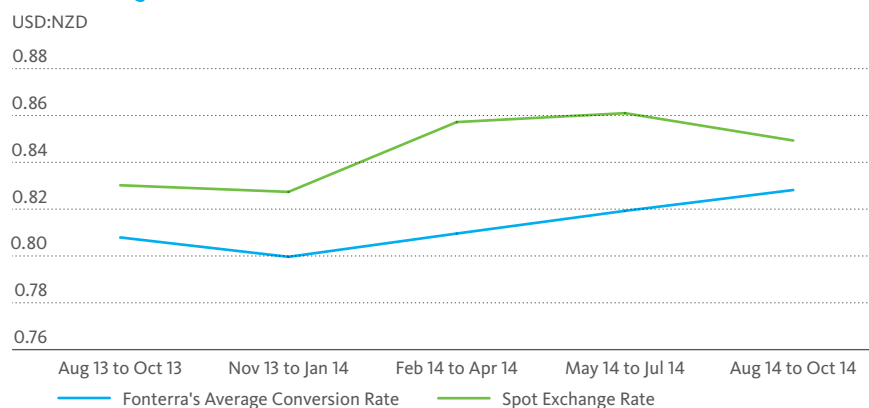
for the sale of commodity products from New Zealand. To ensure that this is the case, contracts with more than five months between when a price is set and shipment occurs are not taken into account in determining shipment prices.

Attachment 3 sets out the average number of months prior to shipment that prices were struck for each quarter over the last three seasons. Attachment 3 also sets out the average percentage of sales contracted in each month prior to shipment in the last three seasons.

**TABLE 2: WEIGHTED AVERAGE USD PRICE 2012 - 2014 SEASONS**

WEIGHTED AVERAGE PRICE (USD) PER MT	2014	2013	2012	2014/2013 % CHANGE	2013/2012 %CHANGE
WMP	4,824	3,394	3,359	42.1%	1.1%
SMP	4,504	3,625	3,285	24.3%	10.3%
Butter	3,920	3,550	3,546	10.4%	0.1%
AMF	4,853	3,450	3,825	40.7%	-9.8%
BMP	4,752	3,457	3,163	37.5%	9.3%
				36.2%	2.5%

**FIGURE 5: AVERAGE USD:NZD CONVERSION AND SPOT RATES BY SALES QUARTER**



**2014 SEASON PRICES WERE HIGHER THAN 2013 SEASON BY**

↑ 36.2%

**FX HEDGING GAINS INCREASED THE FARMGATE MILK PRICE BY**

↑ 46 cents

## PRICES

For the 2014 season, GDT was the sole source of prices for WMP, SMP and AMF, and was a primary reference point for BMP and butter. Non-GDT contracts that Fonterra entered into were also used to establish prices for butter and BMP.

Detailed rules in the Manual dictate which contracts can be taken into account. Contracts that are excluded, for example, include sales to Fonterra subsidiaries.

Attachment 1 highlights that WMP, SMP and AMF (2,707,000 MT) accounted for 90 per cent of the Farmgate Milk Price production of Reference Commodity Products (3,015,000 MT) in the 2014 season.

The average shipment prices incorporate provisions for the lower prices received for 'downgrade product'.

These are products that do not meet manufacturing specifications, some of which may only be suitable for use as stock feed.

Table 2 above shows the weighted-average United States Dollars (USD) contract prices of Reference Commodity Products for the last three seasons. It shows that prices for the reference products increased on average by 36.2 per cent between the 2013 season and the 2014 season, compared to an increase of 2.5 per cent between the 2013 season and the 2012 season. Average USD prices per MT for each Reference Commodity Product by quarter for the last three seasons are set out in Attachment 4.

The Manual provides for the conversion of notional USD Farmgate Milk Price receipts to NZD for each month at the average rate at which Fonterra actually

converts its USD-equivalent foreign-currency receipts for the month, taking into account the costs and benefits of Fonterra's hedging activities. Fonterra's policy is to hedge 100 per cent of net recognised foreign currency trade receivables and payables. It also requires hedging of up to 100 per cent of forecast cash receipts from sales for a period of up to 18 months within limits approved by Fonterra's Board. Fonterra uses both forward foreign-exchange contracts and currency options to hedge its foreign-exchange risk.

Figure 5 above shows the average foreign-exchange conversion rate (USD:NZD) for the Farmgate Milk Price Revenue for each quarter in the 2014 season, based on Fonterra's actual hedging contracts in place compared to the weighted-average spot rate that prevailed in the quarter. Figure 5, in conjunction with Attachment 5,

# FARMGATE MILK PRICE REVENUE AND COSTS

CONTINUED

shows that Fonterra's hedging policy resulted in an average foreign-exchange conversion rate for the 2014 season of USD:NZD exchange rate 0.8086 against a spot rate of 0.8430 USD:NZD. Attachment 5 also provides equivalent information by quarter for the 2012 and 2013 seasons. Although the data over the last three years shows Fonterra achieving a better rate through its use of hedging, the opposite situation can also occur. This was the case in the 2009 season, the data for which was published in the 2011 Farmgate Milk Price Statement.

As at 31 July 2014, Fonterra had foreign exchange contracts in place in respect of approximately 71 per cent of the USD-equivalent operating cash flow exposure expected to impact on the Farmgate Milk Price for the 2015 season. At a spot exchange rate of 0.8490, these contracts would result in an average USD:NZD conversion rate of 82.6 cents.<sup>2</sup>

## LACTOSE

Lactose is used as an ingredient in the manufacture of WMP, SMP and BMP to achieve a standard protein composition aligned to internationally recognised specifications. Most of the lactose content of milk powders is obtained from the milk supplied to Fonterra. However, a portion is purchased at international prices. Because the cost of purchased lactose depends on global prices and the exchange rate, it is presented in Table 1 as a deduction from Farmgate Milk Price Revenue.

Table 4, above right, provides the basis for the cost of purchased lactose in the 2014, 2013 and 2012 seasons.

**TABLE 3: EFFECT OF HEDGING POLICY ON THE FARMGATE MILK PRICE FOR THE 2012-2014 SEASONS**

SEASON	2014		2013		2012	
	MILK PRICE	SPOT	MILK PRICE	SPOT	MILK PRICE	SPOT
Average Conversion Rate (USD:NZD)	0.8086	0.8430	0.7986	0.8214	0.7706	0.8023
Milk Price (NZD/kgMS)	8.93	8.47	5.84	5.62	6.08	5.76
Gain/Loss from Hedging (NZD/kgMS)	0.46		0.22		0.32	

**TABLE 4: PURCHASED LACTOSE & PRICE**

SEASON	2014	2013	2012	2014/2013 % CHANGE	2013/2012 %CHANGE
Purchased Lactose ('000 Metric Tonnes)	331	297	310	11.4%	-4.4%
Average Price (USD) per MT	1,605	2,036	1,558	-21.1%	30.7%
Total Lactose Purchases (USD \$m)	531	604	483	-12.1%	25.0%

## FARMGATE MILK PRICE CASH COSTS

Farmgate Milk Price Cash Costs reflect:

- Fonterra's actual supply chain and collection costs.
- Costs associated with Fonterra's actual daily processing capacity, which is mapped to more than 20 reference manufacturing sites (some of which contain multiple plants) with associated overhead costs. The costs of operating these plants are based on daily processing capacities that match Fonterra's averages, and on operating parameters that reflect manufacturers' specifications and Fonterra's per-unit costs.
- Overhead and selling costs that are typical of a commodity-only business which sells product from New Zealand. Overhead costs are calculated by reference to Fonterra's

actual costs, but exclude costs that are attributable to the much broader scope of Fonterra's business. Selling costs reflect the sale of products through GDT with an offshore supporting network.

Table 5 and Figure 6 on page 7 summarise the major categories of cash costs and the sources of movements in each category between the 2013 and 2014 seasons.

The movements in costs shown above reflect the following:

- Milk supply increased by 8.3 per cent in the 2014 season compared to the 2013 season. By itself, this factor resulted in a decrease in cash costs per kgMS of 5.3 cents.
- Costs increased by an average of 3.1 per cent, or 3.5 cents per kgMS, due to inflationary factors.

<sup>2</sup> As noted above, Fonterra uses currency options as well as forward exchange contracts to hedge its foreign currency receipts. Use of options means the average hedged conversion rate may vary with the spot exchange rate.

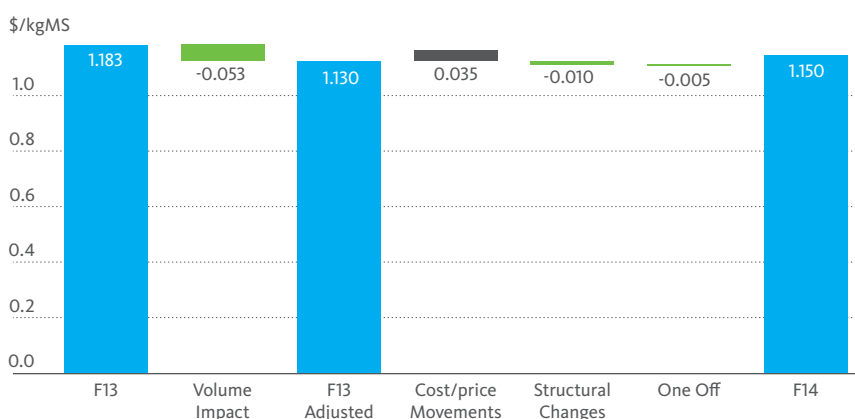


**TABLE 5: SUMMARY OF MOVEMENTS IN CASH COSTS**

\$ MILLION	F13	VOLUME IMPACT	COST / PRICE MOVEMENTS	STRUCTURAL CHANGES	ONE OFF	F14	% CHANGE DUE TO COST	TOTAL % CHANGE
Sales Costs	117	2	3	-	-	121	2.3%	3.8%
Variable manufacturing and supply chain costs	682	45	20	(5)	-	742	2.8%	8.8%
Fixed manufacturing (including repairs and maintenance)/site overheads and supply chain costs	339	-	14	(11)	-	343	4.2%	1.1%
Collection costs	336	11	15	-	-	362	4.4%	7.8%
Other costs	256	-	3	-	(8)	251	1.3%	-1.9%
<b>Total Cash Costs</b>	<b>1,730</b>	<b>57</b>	<b>56</b>	<b>(15)</b>	<b>(8)</b>	<b>1,819</b>	<b>3.1%</b>	<b>5.1%</b>
% movements		3.3%	3.1%	-0.9%	-0.5%			

- In the 2013 season, the provision for repairs and maintenance (R&M) costs was calculated by reference to Fonterra's average R&M costs over the preceding four years across all manufacturing sites, including sites predominantly used for the manufacture of products not included in the Farmgate Milk Price reference basket. In the 2014 season, this provision was calculated in a similar manner, but only by reference to Fonterra sites that were broadly similar to sites included in the Farmgate Milk Price calculation. This change resulted in a reduction of \$11 million, or 0.7 cents per kgMS, in the provision for R&M costs.
- In 2013 an allowance of \$8 million, or 0.5 cents per kgMS, was included for costs arising from some specific quality and regulatory issues faced by Fonterra. There were no costs of a similar nature in 2014.

**FIGURE 6: SOURCES OF MOVEMENTS IN AVERAGE CASH COSTS**



**FARMGATE MILK PRICE CAPITAL COSTS**

The Milk Price Model uses 'standard' plants to calculate both operating and plant-related capital costs. These plants have capacities that approximate Fonterra's average daily capacities for each type of plant and reflect current technology of the type typically employed across the industry.<sup>3</sup> The standard plants are smaller than Fonterra's newest large manufacturing plants, such as the ED4 drier installed at Fonterra's Edendale manufacturing site in Southland in 2009 and the DD2 drier installed at Fonterra's Darfield Site in Canterbury in 2013,

but are larger and more efficient than Fonterra's older smaller plants.

The basis for deriving the benchmark depreciation, tax costs and capital charge is set out in detail in the Manual. In broad terms:

- The capital charge on fixed assets is designed to recover the full cost (through a depreciation charge) of the manufacturing and other assets required to manufacture Reference Commodity Products over the assets' economic lives, and to generate a return at the benchmark Weighted Average Cost of Capital (WACC, see below) on the undepreciated balance each year.

<sup>3</sup> The average daily processing capacity of the standard WMP and SMP plants installed prior to the 2013 season is approximately 1.9 million litres. Incremental and replacement WMP and SMP plants incorporated in the asset base from the 2013 season have an average daily processing capacity of approximately 2.5 million litres.

# FARMGATE MILK PRICE REVENUE AND COSTS

CONTINUED

- The capital charge is calculated in a manner that results in its aggregate amount growing each year approximately in line with milk supply and capital goods inflation, as long as the WACC does not change. This means that changes in the average age of the asset base do not result in material year-on-year movements in the capital charge, and therefore in the Farmgate Milk Price.
- The Farmgate Milk Price cost base also includes a provision for a capital charge on the monthly net working capital balances implied by the sale and manufacture of the Reference Commodity Products, and by the phasing of Fonterra's payments for milk to its suppliers. Each of these items varies somewhat between years, resulting in some annual variation in this element of the capital charge.
- The WACC used to determine the capital charge is specified on an after-tax basis, so the Farmgate Milk Price cost base includes a separate provision for corporate tax. This amount is a relatively constant proportion of the WACC charges on fixed assets and net working capital each year.

Table 6 above right shows the capital costs and the aggregate book value of the Farmgate Milk Price fixed-asset base and monthly average net working capital for the 2012, 2013 and 2014 seasons.

Three matters are relevant to a comparison of capital costs between the 2014 and 2013 seasons:

- In the 2014 season the WACC rate was 6.8 per cent, down from the 7.4 per cent used in 2013. By itself, this change resulted in a reduction of NZD 28 million in the capital charge on fixed assets, a reduction of NZD 4 million in the charge on net working

**TABLE 6: AGGREGATE BOOK VALUE OF FIXED ASSET BASE AND MONTHLY AVERAGE NET WORKING CAPITAL**

\$ MILLION	2014	2013	2012
WACC Rate % (Post Tax)	6.8%	7.4%	7.7%
Depreciation	250	244	218
WACC Charge - Fixed assets	436	447	469
WACC Charge - Net working capital	26	134	137
Tax	151	191	193
Total Fixed Assets (book value)	6,437	6,098	6,121
Average Net Working Capital	887	1,601	2,244

capital, and a reduction of NZD 18 million in the tax charge. These reductions were substantially offset by an increase in capital costs due to the effects of the underlying methodology, which is designed to result in an aggregate capital charge that increases approximately in line with inflation and milk supply, holding other things equal.

- Revisions to the assumed replacement costs of Advanced Process Control systems and dry stores, and the removal of a small manufacturing site no longer used by Fonterra to manufacture commodity products, led to an increase of NZD137 million in the book value of fixed assets and an increase of NZD 8 million in the capital charge on fixed assets.
- The significantly lower WACC charge on net working capital in 2014 is mainly attributable to the impact of the record high 2014 Farmgate Milk Price on the average balance owing to farmers for the supply of milk during the season. Because suppliers payable are outstanding for twice as long as receivables, higher commodity prices have a significantly greater impact on suppliers payables balances, resulting in materially lower average net working capital balances.

## CALCULATION OF BENCHMARK WEIGHTED AVERAGE COST OF CAPITAL (WACC)

The WACC used to determine the Fixed Asset Capital Charges and the Net Working Capital Charge is calculated using the 'simplified Brennan Lally' methodology employed by the Commerce Commission.<sup>4</sup> The methodology applied through to the 2011 season provided for input parameters into the WACC to be updated every four years. Consequently, the WACC was held constant at 8.5 per cent between the 2009 and 2011 seasons, and reflected market interest rates as of mid 2008. From the 2012 season, the methodology was revised to be based on rolling five-year averages of market interest rates, including the five year New Zealand government stock rate, resulting in a reduction in the WACC to 7.7 per cent for the 2012 season, 7.4 per cent for the 2013 season and 6.8 per cent for the 2014 season. The 2015 season WACC will be 6.5 per cent.

<sup>4</sup> See, for example, the various papers at [www.comcom.govt.nz/cost-of-capital/](http://www.comcom.govt.nz/cost-of-capital/)

# FARMGATE MILK PRICE MANUAL CHANGES

Since the Manual was introduced in the 2009 season, various minor refinements have been made as practical issues were identified and addressed. Such refinements are to be expected given the importance to Fonterra of ensuring the Farmgate Milk Price approach is robust. Any modification to the Manual is required to be consistent with the Milk Price Principles which are set out in both the Manual and Fonterra's constitution.

The Manual itself also allows for adjustments to various parameters, for example the detailed rule that allows for the addition of new Reference Commodity Products if certain conditions established in the Manual are met. The Manual also provides for review of various aspects of the Manual to be carried out at least once every four years. These reviews can result in changes to the application of rules in the Manual or inputs into the Farmgate Milk Price. The first of these four-yearly reviews was completed in the 2012 season and the results were incorporated into the 2013 Farmgate Milk Price.

As noted in Appendix 1, the Commerce Commission's final report on the 2013/14 Manual was released on 16 December 2013.

The Board approved a number of amendments to the Manual in July 2014, and the updated version of the Manual is available on [www.fonterra.com](http://www.fonterra.com). Four of these amendments could be considered substantive, but they are not expected to have a material effect on the Farmgate Milk Price for the 2015 season:

- A new section 2.6 has been added to Part A, providing a commitment by Fonterra that in normal circumstances the Farmgate Milk Price and inputs into its calculation will evolve over time in a manner that could be achieved by a 'real world' dairy processor, and that Fonterra will disclose any change in approach to the application of the Manual where that change results in a materially different value of an input. This amendment codifies the approach that is in fact applied by Fonterra, with material changes having been disclosed to date in either the Farmgate Milk Price Statement or in publicly available material provided by Fonterra to the Commerce Commission.
- The Part B rule relating to repairs and maintenance (R&M) has been amended to provide that the provision for R&M costs is to be calculated by reference to Fonterra's actual R&M expenditure over the preceding four years on manufacturing sites that have fixed assets that are broadly comparable to sites assumed in the Milk Price. This aspect of the amended rule codifies the approach that has been applied in the 2014 season, and therefore will not have any impact on the Farmgate Milk Price for the 2015 season. The new rule also allows, but does not require, a provision to be separately calculated for R&M costs that do not vary directly with asset replacement costs, such as onsite engineering department costs.
- The Part B rule that sets out the consequences for the asset base of adding or removing commodities from the reference basket has been amended to accommodate the situation where a significant change in the reference basket may result in a material quantum of 'stranded' or written-off assets. The amended provision provides that costs arising due to the write-off of assets will not be passed through into the Farmgate Milk Price where this would result in the Milk Price being significantly 'out of the money' relative to the prices other New Zealand processors were able to pay. The amendment is intended to broadly align the treatment of assets written off as a consequence of a change in the reference basket with the treatment of assets written off due to a shortfall in milk supply.
- A new rule has been included in Part B to provide for the calculation of a 'specific risk premium', to provide an appropriate allowance for stranded asset risk. A related amendment has been made to Rule 40 in Part B relating to the calculation of the asset beta, the input which provides compensation (through the WACC) for risk. Rule 40 previously provided that the asset beta should include compensation for stranded asset risk. The rationale for these amendments is to address a technical issue raised by the Commerce Commission.

# CHANGES IN APPROACH TO THE CALCULATION

As noted above, Fonterra has included in the 2015 Manual an undertaking to disclose any changes to the application of the Manual that result in materially different values of any input into the Farmgate Milk Price calculation.

Fonterra has made minor refinements to its application of several rules for the 2014 season. The most significant of these refinements relates to the approach taken to establishing allowances for the loss of milk in the manufacturing process, which has resulted in an increase in the 2014 season Farmgate Milk Price of 1.5 cents per kgMS. None of the other amendments has had a material impact, either individually or in aggregate, on the quantum of the Farmgate Milk Price for the 2014 season.

For the 2015 season, a revised approach will be used to calculate provisions for a number of relatively minor costs, relating to effluent, cleaning, consumables, laboratory testing and water costs. Provisions for these costs have previously been drawn from Fonterra's product costing system. The previous approach effectively assumed that the relevant costs increased proportionately with production (i.e. that they did not have any 'fixed' component). For 2015, provisions have been established by drawing on the underlying determinants of cost. Because a portion of the relevant costs are fixed, and because the Farmgate Milk Price calculation assumes larger volumes of WMP and SMP, in particular, than Fonterra's actual production, this change in approach will result in a decrease in costs for the 2015 season of approximately 0.7 cents per kgMS.

# MILK PRICE ADJUSTMENT

For the first time since the introduction of the Farmgate Milk Price methodology in the 2009 season the Fonterra Board has decided on an aggregate payment for milk that is different to the amount calculated under the Manual. The difference between the Farmgate Milk Price and the Final Milk Price is NZD 842 million, or 53 cents per kgMS.

In the first half of FY14, returns to the product streams that inform the milk price under the Manual (Reference Commodity Products or RCPs) were significantly higher than returns to other commodity product streams (non-RCPs).<sup>5</sup> This was largely driven by a significant increase in Whole Milk Powder (WMP) prices from February 2013. A significant cause of this increase was a decline in domestic milk production in China in early 2013 coupled with continuing growing demand for milk products. This stimulated a significant increase in China's demand for imported WMP, which accounts for about one third of globally-traded volumes of that product. The increase in demand by China coincided with reduced milk production in New Zealand due to a deep late-summer drought and uncertainty over the drought's implications for milk production in FY14. New Zealand accounts for nearly 90 per cent of China's imported WMP

volumes and a substantial spike in WMP and other milk powder prices resulted. The meeting of demand and supply influences for WMP as noted above resulted in divergences in stream returns between RCP and non-RCP streams that were unprecedented, even compared to the period prior to January 2005 when variable stream returns for RCP products were higher than those for other products for an extended period.

The higher stream returns for products that inform the Milk Price led to a higher Farmgate Milk Price over the first half of the year. However, Fonterra's asset footprint impeded its ability to fully respond by switching production to milk powders. This was particularly the case because relative stream returns strongly favoured RCPs during Fonterra's peak milk collection period in October and November. In the North Island, which accounts for about 60 per cent of national production, Fonterra relies on non-RCP capacity to process more than 50 per cent of milk supplied over the peak period. In the South Island, which accounts for about 40 per cent annual production, Fonterra relies on non-RCP capacity to process approximately 25 per cent of milk supplied over the peak period.

Capacity constraints across the peak resulted in a material decrease in Fonterra's actual earnings in two ways:

- Fonterra's ability to respond by switching production from non-RCPs to more profitable RCPs was substantially constrained; and
- Physical capacity constraints meant Fonterra:
  - (i) had to incur additional costs to transport milk to plants that could process milk (including between the North and South Islands);
  - (ii) did not have sufficient capacity to process all milk components; and
  - (iii) had to resort to 'partial standardisation' of some milk powders, reducing returns for those products.

With no adjustment to the Farmgate Milk Price, Fonterra would have derived negative EBIT for its financial year ending 31 July 2014. Incurring a loss like this could put the Co-operative at risk of loss of confidence of its stakeholders. Accordingly, in early December 2013 (following extensive deliberation by the Fonterra Board), Fonterra signalled its intention to pay a Final Farmgate Milk Price that is lower than the price calculated under the Manual. The Fonterra Board subsequently confirmed this decision when approving the Final Farmgate Milk Price for 2014 season.

<sup>5</sup> The term 'stream' refers to a combination of commodity products that utilises all the components in a litre of milk. One such combination is WMP, Butter and BMP. Similarly, the term 'stream return' refers to the net return (revenue less costs) to a kilogram of milksolids allocated to the manufacture of a particular stream.

# APPENDIX 1

# FARMGATE MILK PRICE OVERVIEW

## RATIONALE FOR FARMGATE MILK PRICE

Fonterra currently collects around 87 per cent of New Zealand's milk production. Because Fonterra purchases such a large proportion of New Zealand's total milk, there is no 'market price' for milk that is independent of the price paid by Fonterra. As a result, since its formation in 2001, Fonterra has calculated a Farmgate Milk Price that enables total returns to be allocated between payments for milk and returns on the capital invested by Fonterra farmer shareholders and more recently by unit holders in the Fonterra Shareholders' Fund.

## FARMGATE MILK PRICE METHODOLOGY

Since the 2009 season, the Farmgate Milk Price has been calculated in accordance with the Manual by:

- Determining the revenue that Fonterra would earn if the equivalent of all the milk Fonterra collects was converted into commodity specifications of whole milk powder (WMP) and skim milk powder (SMP), and their by-products, which are butter, anhydrous milkfat (AMF) and buttermilk powder (BMP). These products are referred to in the Manual as 'Reference Commodity Products'. Prices primarily reflect USD prices achieved on the twice-monthly GlobalDairyTrade (GDT) trading events, converted to NZD using Fonterra's actual average monthly foreign-exchange conversion rate.<sup>6</sup>
- Deducting costs, including the cost of transporting raw milk to factories, and the cost of efficiently manufacturing Reference Commodity Products and then transporting them to the point of export from

New Zealand, along with selling and administration expenses. These costs also include amounts for depreciation of fixed assets and an appropriate return on investment, including investment in working capital.

The balance comprises the Farmgate Milk Price. While this is an aggregate amount, it is usually referred to on the basis of a Farmgate Milk Price per kgMS.

## RATIONALE FOR REFERENCE COMMODITY PRODUCTS

Manufacture of the Reference Commodity Products comprised more than 75 per cent of Fonterra's total New Zealand ingredients production in the 2014 season.

Almost all additional milk collected over the last decade in New Zealand by Fonterra and its competitors has been used to make milk powders. Because returns from the sale of milk powders and their by-products represent the 'marginal' returns that would drive the price of milk in a competitive market in New Zealand, the Farmgate Milk Price is based on these products. Returns from non-powder commodities, such as cheese and casein, have largely been irrelevant in driving investment in the dairy industry over the last 10 years and are therefore not taken into account in determining the Farmgate Milk Price.

The Farmgate Milk Price approach does not include any returns earned by Fonterra from specialised ingredients and consumer branded products. These types of products earn premiums over the returns to standard commodity ingredients. It is therefore appropriate that these premiums are recognised in Fonterra's earnings rather than in the Farmgate Milk Price.

## FARMGATE MILK PRICE GOVERNANCE

The Fonterra Board sets the total amount to be paid by Fonterra for all milk supplied to it in New Zealand in each season. For the 2014 season, this amount is made up of the Farmgate Milk Price, Approved Adjustments (e.g. premium payments for some winter milk and specialty milk such as organic milk) and the Milk Price Adjustment.

Both Fonterra's constitution and DIRA requires Fonterra to maintain the Manual, which sets out Fonterra's policies and methodology for determining the Farmgate Milk Price. The Manual must reflect the Milk Price Principles set out in Fonterra's constitution. The Farmgate Milk Price has been calculated in accordance with the Manual since the start of the 2009 season.

The Fonterra Board has established a robust governance structure to oversee the setting of the Farmgate Milk Price, which comprises the elements illustrated in the diagram at the bottom of page 13.

### 1 Milk Price Panel

The Milk Price Panel plays a key role. It has five members. Two are Fonterra-appointed directors (one of whom is the Chair), one a Fonterra farmer-elected director and two are appropriately qualified nominees of the Fonterra Shareholders' Council. The current members of the Panel are: John Waller (Chair) and David Jackson who are appointed Fonterra directors; Michael Spaans who is a farmer-elected Fonterra director; and Paddy Boyle and Richard Punter who are nominees of the Council. Richard Punter retires by rotation at the end of September 2014 and is replaced by Bill Donaldson.

<sup>6</sup> For WMP, SMP and AMF, which comprised 91 per cent of revenue in the 2014 Farmgate Milk Price, all prices were sourced from GDT. For Butter and BMP a mixture of GDT and non-GDT prices were used.

The Panel oversees the governance of the Farmgate Milk Price and the Manual, including changes to the Manual and verification by independent external experts of key parameters (such as resource usage rates, product yields and fixed manufacturing costs).

The Panel is responsible for:

- supervising the calculation of the of the Farmgate Milk Price and making a recommendation on it to the Fonterra Board;
- providing recommendations to the Fonterra Board on changes to the Manual; and
- providing assurance to the Fonterra Board that the Farmgate Milk Price has been calculated each year in accordance with the Manual.

## 2 Milk Price Group

The Milk Price Group is a working group established by Fonterra. The Head of the Milk Price Group is independent of Fonterra's management and reports directly to the Chair of the Milk Price Panel. The role of the Milk Price Group includes:

- ensuring that the Farmgate Milk Price is calculated in accordance with the Manual and making recommendations in respect of the Farmgate Milk Price to the Panel;
- considering any proposed amendments to the Manual, including those the Milk Price Group itself considers are appropriate, and ensuring they are in accordance with the Milk Price Principles in Fonterra's Constitution;
- providing assurance to the Fonterra Board over the calculation of the forecast of the Farmgate Milk Price;
- managing engagement with External Reviewers; and

- engaging with the Commerce Commission, including to ensure full disclosure of all material aspects of the Farmgate Milk Price derivation each year.

The functions of the Milk Price Group are contracted out to Ernst & Young and other technical experts who are not employees of Fonterra.

## 3 External Reviewers

External reviewers provide expert advice on various inputs, as well as assurance over the accuracy of financial models. In addition they participate in reviews of key parameters of the Farmgate Milk Price at regular intervals (which can be up to four years).

## 4 External Auditor

The external auditor audits the Farmgate Milk Price each year and provides assurance that the Farmgate Milk Price has been derived in accordance with the Milk Price Principles, Methodologies and Detailed Rules of the Farmgate Milk Price Manual. Fonterra's external auditor is PricewaterhouseCoopers.

## 5 Commerce Commission Milk Price Oversight

Subpart 5A of DIRA, which was passed into law in July 2012, gives the Commerce Commission an oversight role with respect to Fonterra's milk price. The purpose of Subpart 5A is to promote the setting of a milk price that provides an incentive to Fonterra

to operate efficiently, while providing for contestability in the market for the purchase of milk from farmers (section 150A). Each year, the Commission is required to review and report on the extent to which the Manual and Fonterra's actual milk price are consistent with this purpose:

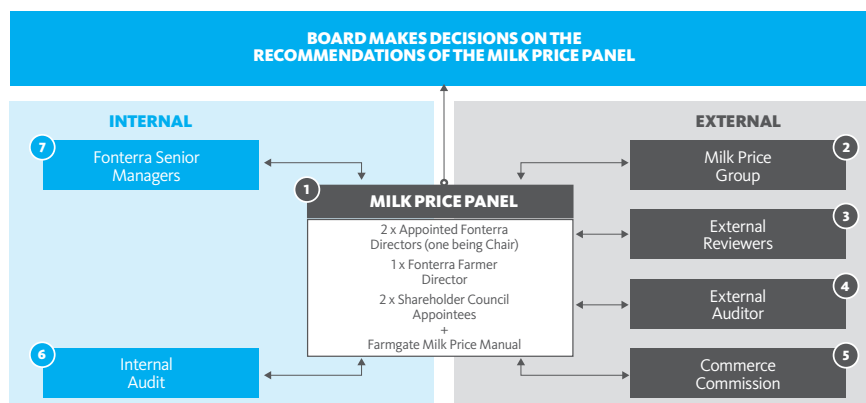
- The Commerce Commission's final report on the Manual for the 2013/14 season was released on 16 December 2013 and can be found at [www.comcom.govt.nz/regulated-industries/dairy-industry/review-of-fonterra-s-farm-gate-milk-price-and-manual/statutory-review-of-milk-price-manual/201314-season/](http://www.comcom.govt.nz/regulated-industries/dairy-industry/review-of-fonterra-s-farm-gate-milk-price-and-manual/statutory-review-of-milk-price-manual/201314-season/)
- The final report on the F14 Farmgate Milk Price calculation was released on 15 September 2014 and can be found at [www.comcom.govt.nz/regulated-industries/dairy-industry/review-of-fonterra-s-farm-gate-milk-price-and-manual/statutory-review-of-milk-price-calculation-2/review-of-milk-price-calculation-201314-season/](http://www.comcom.govt.nz/regulated-industries/dairy-industry/review-of-fonterra-s-farm-gate-milk-price-and-manual/statutory-review-of-milk-price-calculation-2/review-of-milk-price-calculation-201314-season/)

## 6 Internal Audit

Fonterra's internal audit team provides assurance over the forecasting process controls and data.

## 7 Fonterra Senior Managers

Fonterra senior managers provide internal oversight of the calculation of the actual and forecast Farmgate Milk Price in accordance with the Manual and detailed models and procedures.



Source: Fonterra

# APPENDIX 2

## INDEPENDENT ASSURANCE REPORT

### TO THE DIRECTORS OF FONTERRA CO-OPERATIVE GROUP LIMITED



#### SCOPE

We have audited the application of the Principles, Methodologies and Detailed Rules as defined in the Farmgate Milk Price Manual of 1 August 2013 (the 'Manual') by the Milk Price Group ('MPG') in establishing the F14 Season's Milk Price of \$8.93 (the 'Fonterra Farmgate Milk Price'). We have confirmed the balances contained in the Fonterra Farmgate Milk Price Statement are correctly extracted from the calculation of the Fonterra Farmgate Milk Price.

#### MILK PRICE GROUP'S RESPONSIBILITIES

The MPG is responsible for the calculation of the Fonterra Farmgate Milk Price based upon the Manual, ensuring the Fonterra Farmgate Milk Price has been derived in accordance with the Principles, Methodologies and Detailed Rules set out in the Manual. The MPG is also responsible for the preparation of the Fonterra Farmgate Milk Price Statement.

#### INDEPENDENT AUDITORS' RESPONSIBILITIES

We are responsible for expressing an independent opinion on whether the Fonterra Farmgate Milk Price has been derived in accordance with the Manual and that the Fonterra Farmgate Milk Price Statement includes information that has been correctly extracted, in all material respects, from the calculation of the Fonterra Farmgate Milk Price and reporting our opinion to you.

We conducted our independent assurance engagement in accordance with ISAE (NZ) 3000 Assurance engagements other than audits or reviews of historical financial information and SAE 3100 Compliance Engagements issued in New Zealand. Those standards require that we comply with ethical requirements and plan and perform our procedures to obtain reasonable assurance about whether, in all material respects, the calculation of the Fonterra Farmgate Milk Price is fairly stated in accordance with the Principles, Methodologies and Detailed Rules set out in the Manual, and that the balances contained in the Fonterra Farmgate Milk Price Statement are correctly extracted from the calculation of the Fonterra Farmgate Milk Price.

#### INHERENT LIMITATIONS

Our engagement includes examining, on a test basis, evidence relevant to the amounts used to derive the Fonterra Farmgate Milk Price. It also includes assessing the significant assumptions, estimates and judgements made by the MPG in the calculation of the Fonterra Farmgate Milk Price and ensuring the Principles, Methodologies and Detailed Rules applied are consistent with those set out in the Manual. Because of the inherent limitations, it is possible that fraud, error or non-compliance may occur and not be detected. As the procedures performed are undertaken on a test basis, our assurance engagement cannot be relied on to detect all instances where the Principles, Methodologies and Detailed Rules set out in the Manual have not been complied with. Our opinion expressed in this report has been formed on that basis.

We carry out other assignments on behalf of Fonterra Co-operative Group Limited (the 'Group') in the areas of other audit related services, transaction and other advisory services. Partners and employees of our firm may deal with the Group on normal terms within the ordinary course of trading activities of the Group. These matters have not impaired our independence as auditors of the Fonterra Farmgate Milk Price.

#### INDEPENDENT ASSURANCE OPINION

In our opinion the MPG has complied, in all material respects, with the Principles, Methodologies and Detailed Rules in the Manual in deriving the Fonterra Farmgate Milk Price of \$8.93. We have confirmed the balances contained in this Fonterra Farmgate Milk Price Statement are correctly extracted from the Fonterra Farmgate Milk Price calculation.

#### RESTRICTION ON DISTRIBUTION OR USE

This report is made solely to the members of the Board. Our report has been prepared at the request of Fonterra Co-operative Group Limited and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Group for this report, or for the opinions we have formed.

#### Chartered Accountants

Auckland  
23 September 2014



# ATTACHMENT 1

## MILK SUPPLIED AND PRODUCTION VOLUMES

2014 SEASON	MILK SUPPLIED (MILLION kgMS)	PRODUCTION (000 MT) FINISHED PRODUCT					
		WMP	SMP	BUTTER	AMF	BMP	TOTAL
JUN 13 TO AUG 13	121	168	35	11	13	4	231
SEP 13 TO NOV 13	621	740	254	108	61	24	1,187
DEC 13 TO FEB 14	530	663	187	93	46	20	1,009
MAR 14 TO MAY 14	313	453	58	37	29	11	588
<b>TOTAL</b>	<b>1,584</b>	<b>2,025</b>	<b>534</b>	<b>248</b>	<b>149</b>	<b>59</b>	<b>3,015</b>

2013 SEASON	MILK SUPPLIED (MILLION kgMS)	PRODUCTION (000 MT) FINISHED PRODUCT					
		WMP	SMP	BUTTER	AMF	BMP	TOTAL
JUN 12 TO AUG 12	117	171	24	9	13	3	221
SEP 12 TO NOV 12	598	642	294	119	63	25	1,143
DEC 12 TO FEB 13	498	541	232	86	64	22	945
MAR 13 TO MAY 13	251	340	63	31	27	10	472
<b>TOTAL</b>	<b>1,463</b>	<b>1,694</b>	<b>614</b>	<b>245</b>	<b>168</b>	<b>61</b>	<b>2,781</b>

2012 SEASON	MILK SUPPLIED (MILLION kgMS)	PRODUCTION (000 MT) FINISHED PRODUCT					
		WMP	SMP	BUTTER	AMF	BMP	TOTAL
JUN 11 TO AUG 11	103	141	29	11	10	3	194
SEP 11 TO NOV 11	567	562	305	112	69	26	1,074
DEC 11 TO FEB 12	487	578	186	80	55	20	919
MAR 12 TO MAY 12	336	487	65	39	30	12	632
<b>TOTAL</b>	<b>1,493</b>	<b>1,768</b>	<b>585</b>	<b>242</b>	<b>164</b>	<b>60</b>	<b>2,819</b>

# ATTACHMENT 2

## SALES VOLUMES

2014 SEASON	SHIPMENTS (000 MT) OF FINISHED PRODUCT					
	WMP	SMP	BUTTER	AMF	BMP	TOTAL SALES
AUG 13 TO OCT 13	309	66	5	14	8	402
NOV 13 TO JAN 14	676	169	86	40	15	986
FEB 14 TO APR 14	548	102	73	36	16	776
MAY 14 TO JUL 14	402	118	57	41	14	633
AUG 14 TO OCT 14	89	79	27	18	5	218
<b>TOTAL</b>	<b>2,025</b>	<b>534</b>	<b>248</b>	<b>149</b>	<b>59</b>	<b>3,015</b>

2013 SEASON	SHIPMENTS (000 MT) OF FINISHED PRODUCT					
	WMP	SMP	BUTTER	AMF	BMP	TOTAL SALES
AUG 12 TO OCT 12	197	57	16	17	10	297
NOV 12 TO JAN 13	559	225	70	54	19	928
FEB 13 TO APR 13	561	156	61	48	11	838
MAY 13 TO JUL 13	312	111	50	39	14	527
AUG 13 TO OCT 13	65	64	47	9	6	191
<b>TOTAL</b>	<b>1,694</b>	<b>614</b>	<b>245</b>	<b>168</b>	<b>61</b>	<b>2,781</b>

2012 SEASON	SHIPMENTS (000 MT) OF FINISHED PRODUCT					
	WMP	SMP	BUTTER	AMF	BMP	TOTAL SALES
AUG 11 TO OCT 11	188	58	7	12	3	268
NOV 11 TO JAN 12	512	187	79	52	24	854
FEB 12 TO APR 12	442	139	65	43	15	704
MAY 12 TO JUL 12	500	131	54	41	11	737
AUG 12 TO OCT 12	126	69	37	16	7	256
<b>TOTAL</b>	<b>1,768</b>	<b>585</b>	<b>242</b>	<b>164</b>	<b>60</b>	<b>2,819</b>

# ATTACHMENT 3

## AVERAGE NUMBER OF MONTHS PRIOR TO SHIPMENT THAT PRICES WERE STRUCK

2014 SEASON	AVERAGE NUMBER OF MONTHS PRIOR TO SHIPMENT				
	WMP	SMP	BUTTER	AMF	BMP
AUG 13 TO OCT 13	2.6	2.4	2.7	2.7	2.6
NOV 13 TO JAN 14	2.9	2.7	2.5	2.9	2.6
FEB 14 TO APR 14	2.8	2.6	2.9	2.7	2.7
MAY 14 TO JUL 14	2.7	2.5	2.5	2.6	2.4
AUG 14 TO OCT 14	3.3	3.0	2.7	2.9	3.2
	<b>2.8</b>	<b>2.6</b>	<b>2.6</b>	<b>2.8</b>	<b>2.6</b>

2013 SEASON	AVERAGE NUMBER OF MONTHS PRIOR TO SHIPMENT				
	WMP	SMP	BUTTER	AMF	BMP
AUG 12 TO OCT 12	2.7	2.9	2.5	3.0	2.7
NOV 12 TO JAN 13	2.7	3.0	2.5	3.1	3.1
FEB 13 TO APR 13	2.7	2.9	2.9	3.0	2.8
MAY 13 TO JUL 13	3.2	2.9	2.5	2.9	2.5
AUG 13 TO OCT 13	2.5	2.8	2.7	2.8	2.9
	<b>2.8</b>	<b>2.9</b>	<b>2.7</b>	<b>3.0</b>	<b>2.8</b>

2012 SEASON	AVERAGE NUMBER OF MONTHS PRIOR TO SHIPMENT				
	WMP	SMP	BUTTER	AMF	BMP
AUG 11 TO OCT 11	3.3	2.7	2.1	3.1	2.5
NOV 11 TO JAN 12	3.5	3.0	2.8	3.2	2.8
FEB 12 TO APR 12	3.5	3.2	3.5	3.6	3.0
MAY 12 TO JUL 12	3.2	2.9	2.9	3.1	2.6
AUG 12 TO OCT 12	3.4	3.3	2.7	3.1	3.1
	<b>3.4</b>	<b>3.0</b>	<b>3.0</b>	<b>3.2</b>	<b>2.8</b>

The tables on the next page supplement those above by providing information on the average percentages of sales contracted in each of months 1 to 8 prior to shipment in the 2012 to 2014 seasons.

# ATTACHMENT 3

## CONTINUED

### AVERAGE % OF SALES CONTRACTED IN EACH MONTH PRIOR TO SHIPMENT

2014 SEASON	AVERAGE % OF SALES CONTRACTED IN EACH MONTH PRIOR TO SHIPMENT				
	WMP	SMP	BUTTER	AMF	BMP
1	6%	11%	6%	6%	10%
2	39%	42%	41%	39%	36%
3	31%	25%	34%	29%	34%
4	16%	14%	17%	18%	16%
5	9%	7%	2%	8%	4%
6	0%	0%	0%	0%	0%
7	0%	0%	0%	0%	0%
8	0%	0%	0%	0%	0%

2013 SEASON	AVERAGE % OF SALES CONTRACTED IN EACH MONTH PRIOR TO SHIPMENT				
	WMP	SMP	BUTTER	AMF	BMP
1	7%	5%	13%	5%	5%
2	40%	33%	34%	32%	38%
3	33%	33%	36%	30%	32%
4	14%	21%	12%	21%	22%
5	8%	8%	5%	12%	3%
6	0%	0%	0%	0%	0%
7	0%	0%	0%	0%	0%
8	0%	0%	0%	0%	0%

2012 SEASON	AVERAGE % OF SALES CONTRACTED IN EACH MONTH PRIOR TO SHIPMENT				
	WMP	SMP	BUTTER	AMF	BMP
1	4%	9%	11%	6%	7%
2	35%	35%	33%	33%	38%
3	23%	26%	26%	28%	33%
4	15%	16%	19%	15%	17%
5	11%	6%	7%	11%	5%
6	5%	4%	2%	4%	1%
7	4%	2%	2%	2%	0%
8	3%	2%	0%	2%	0%

From the 2013 season forward shipments contracted more than five months prior to shipment are excluded from the Farmgate Milk Price calculation.

# ATTACHMENT 4

## AVERAGE USD PRICES

2014 SEASON	AVERAGE USD PRICE BY QUARTER (NET OF DOWNGRADES)				
	WMP	SMP	BUTTER	AMF	BMP
AUG 13 TO OCT 13	4,923	4,624	3,639	4,817	4,687
NOV 13 TO JAN 14	5,023	4,625	3,759	4,959	4,794
FEB 14 TO APR 14	4,950	4,938	3,985	5,417	5,050
MAY 14 TO JUL 14	4,434	4,363	4,283	4,654	4,595
AUG 14 TO OCT 14	3,949	3,792	3,530	3,961	4,231
	<b>4,824</b>	<b>4,504</b>	<b>3,920</b>	<b>4,853</b>	<b>4,752</b>

2013 SEASON	AVERAGE USD PRICE BY QUARTER (NET OF DOWNGRADES)				
	WMP	SMP	BUTTER	AMF	BMP
AUG 12 TO OCT 12	2,740	2,780	2,921	2,903	2,531
NOV 12 TO JAN 13	3,086	3,117	3,191	3,030	2,925
FEB 13 TO APR 13	3,271	3,511	3,431	3,214	3,552
MAY 13 TO JUL 13	4,219	4,608	4,189	4,219	4,317
AUG 13 TO OCT 13	5,144	4,726	3,767	4,871	4,562
	<b>3,394</b>	<b>3,625</b>	<b>3,550</b>	<b>3,450</b>	<b>3,457</b>

2012 SEASON	AVERAGE USD PRICE BY QUARTER (NET OF DOWNGRADES)				
	WMP	SMP	BUTTER	AMF	BMP
AUG 11 TO OCT 11	3,663	3,594	4,081	4,837	3,430
NOV 11 TO JAN 12	3,436	3,376	3,829	4,115	3,176
FEB 12 TO APR 12	3,503	3,386	3,728	3,867	3,330
MAY 12 TO JUL 12	3,147	3,085	3,337	3,376	3,107
AUG 12 TO OCT 12	2,925	2,957	2,836	3,167	2,683
	<b>3,359</b>	<b>3,285</b>	<b>3,546</b>	<b>3,825</b>	<b>3,163</b>

# ATTACHMENT 5

## AVERAGE USD:NZD CONVERSION AND SPOT RATE

Note that the spot data is based on the weighted average conversion rate that would have been achieved if the revenue collected during the shipping period was converted at the average spot rate in the month of collection. Data in previous Farmgate Milk Price Statements was based on the average spot in the month of shipment.

2014 SEASON	FONTERRA'S AVERAGE CONVERSION RATE	SPOT EXCHANGE RATE
AUG 13 TO OCT 13	0.8083	0.8283
NOV 13 TO JAN 14	0.7997	0.8263
FEB 14 TO APR 14	0.8078	0.8580
MAY 14 TO JUL 14	0.8194	0.8610
AUG 14 TO OCT 14	0.8285	0.8490
<b>REVENUE-WEIGHTED ANNUAL AVERAGE</b>	<b>0.8086</b>	<b>0.8430</b>

2013 SEASON	FONTERRA'S AVERAGE CONVERSION RATE	SPOT EXCHANGE RATE
AUG 12 TO OCT 12	0.7874	0.8191
NOV 12 TO JAN 13	0.8015	0.8357
FEB 13 TO APR 13	0.8026	0.8334
MAY 13 TO JUL 13	0.7919	0.7909
AUG 13 TO OCT 13	0.8043	0.8221
<b>REVENUE-WEIGHTED ANNUAL AVERAGE</b>	<b>0.7986</b>	<b>0.8214</b>

2012 SEASON	FONTERRA'S AVERAGE CONVERSION RATE	SPOT EXCHANGE RATE
AUG 11 TO OCT 11	0.7391	0.7721
NOV 11 TO JAN 12	0.7690	0.8121
FEB 12 TO APR 12	0.7742	0.7962
MAY 12 TO JUL 12	0.7804	0.8045
AUG 12 TO OCT 12	0.7781	0.8195
<b>REVENUE-WEIGHTED ANNUAL AVERAGE</b>	<b>0.7706</b>	<b>0.8023</b>

# GLOSSARY

In this Statement, unless the context otherwise requires, the following terms have the meanings set out next to them:

**AMF** means anhydrous milk fat.

**Approved Adjustments** means an amount approved by the Fonterra Board to be paid for milk in addition to, or to be subtracted from, the amount calculated under the Farmgate Milk Price Manual, but excludes the Milk Price Adjustment.

**BMP** means buttermilk powder.

**Detailed Rules** means the detailed rules for calculating the Farmgate Milk Price as set out in the Manual.

**DIRA** means the Dairy Industry Restructuring Act 2001, which authorised Fonterra's formation and regulates its activities.

**Farmgate Milk Price** means Fonterra's Farmgate Milk Price as determined under the Manual.

**Farmgate Milk Price Capital Costs** are defined in the Manual.

**Farmgate Milk Price Cash Costs** are defined in the Manual.

**Farmgate Milk Price Manual** or **Manual** means Fonterra's Farmgate Milk Price Manual.

**Final Farmgate Milk Price** means the aggregate amount approved by Fonterra's board as payment for Milk supplied in the 2014 season.

**Financial year** means Fonterra's financial year, which runs from 1 August to the following 31 July.

**Fonterra** means Fonterra Co-operative Group Limited.

**GlobalDairyTrade** or **GDT** means the electronic auction platform that is used to sell commodity dairy products.

**Independent Processors** means entities which are independent of Fonterra and process raw milk.

**kgMS** means kilograms of milksolids.

**Methodologies** means the methodologies for calculating the Farmgate Milk Price as set out in the Manual.

**Milk Price Adjustment** means the difference between the Farmgate Milk Price and the Final Farmgate Milk Price for the 2014 season.

**Milk Price Model** means the model used to calculate the Farmgate Milk Price set out in the Manual.

**Milk Price Principles** or **Principles** means the Milk Price Principles set out in Fonterra's Constitution.

**MT** means metric tonnes.

**NZD** means New Zealand dollars.

**Season** means the 12-month period from 1 June to the following 31 May.

**SMP** means skim milk powder.

**Specialty Milk** means milk that has special properties such as organic milk.

**Raw Milk Regulations** means the Dairy Industry Restructuring (Raw Milk) Regulations 2001 or, where applicable, the Dairy Industry Restructuring (Raw Milk) Regulations 2012.

**Reference Commodity Products** means the commodity products used to calculate the Farmgate Milk Price, comprising WMP, SMP, BMP, AMF and butter.

**USD** means United States dollars.

**Winter Milk** means milk supplied by farmers in the months of May, June and July.

**WMP** means whole milk powder.

Other capitalised terms used in this Statement have the meanings given to them in the Manual.



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