

FONTERRA FARMGATE MILK PRICE STATEMENT

31 MAY 2012

1 INTRODUCTION

THIS FARMGATE MILK PRICE STATEMENT:

- outlines the way that Fonterra Co-operative Group Limited ('Fonterra') has calculated the Fonterra Farmgate Milk Price for the milk season that ended on 31 May 2012 (2012 Season); and
- sets out information about the Fonterra Farmgate Milk Price.

A report by Fonterra's external auditors to confirm that the Fonterra Farmgate Milk Price (Farmgate Milk Price) for the 2012 Season has been derived in accordance with the Principles, Methodologies and Detailed Rules in Fonterra's Farmgate Milk Price Manual is attached to this Statement following section 7.

The purpose of this Statement is to help farmer shareholders and other interested

parties better understand the Farmgate Milk Price. This statement covers the following:

- Section 2 sets out the final Farmgate Milk Price for the 2012 Season. It also describes the way the Farmgate Milk Price relates to the Co-operative's financial year ended 31 July 2012.
- Section 3 provides an overview of the Farmgate Milk Price. It also sets out the revenue and cost components of the Farmgate Milk Price for the last three seasons.
- Section 4 describes the key factors that influence revenue. This is the most significant factor that affects the Farmgate Milk Price from season to season.
- Section 5 describes the costs that go into the Farmgate Milk Price.

- Section 6 describes how adjustments can be made to the Farmgate Milk Price Manual, and sets out recently approved adjustments that will take effect from the 2013 Season.
- Section 7 contains a glossary of terms used in this Statement.

There are five attachments that provide further detail, for the last three seasons, on the most significant factors that impact the Farmgate Milk Price.

Numbers in this Statement have been rounded and, as a result, some tables may not exactly total or sum to 100%.

A Farmgate Milk Price Statement will be made available each year with the Co-operative's annual results on www.fonterra.com and Fencepost. A hard copy can be requested by phoning the Supplier Services Team on 0800 65 65 68.

2 THE FARMGATE MILK PRICE FOR THE 2012 SEASON

The Farmgate Milk Price Manual sets out the way to calculate the total amount to be paid by the Co-operative for milk supplied to Fonterra in New Zealand in a season. Fonterra's Milk Price Panel advises the Fonterra Board on matters concerning the Farmgate Milk Price Manual, including the calculation of the Farmgate Milk Price. For the 2012 Season, the Fonterra Board has determined that this amount is NZD 9.082 billion.

The Farmgate Milk Price is described in this Statement as the total amount calculated under the Farmgate Milk Price

Manual of NZD 9.082 billion. For ease, this total amount is divided by Fonterra's total New Zealand milk supply (1.493 billion kgMS), to arrive at an average price of NZD 6.08 per kgMS.

The total amount calculated under the Manual of NZD 9.082 billion is used for payments for New Zealand milk supplied in the 2012 Season. It includes payments for milk supplied by farmer shareholders, milk supplied on contract, and a portion of the premiums paid for winter milk. However, it excludes premium payments for specialty milk, and the remaining

portion of the premiums paid for winter milk.¹

The cost of New Zealand sourced milk sold as disclosed in Fonterra's most recent financial statements is NZD 9.033 billion. The NZD 49 million difference between this amount and the NZD 9.082 billion calculated under the Manual arises because the financial statements report the cost of milk for the financial year being the 12 months ended 31 July 2012, while the Farmgate Milk Price for the season is based on the 12 months ended 31 May 2012.

3 FARMGATE MILK PRICE OVERVIEW

3.1 RATIONALE FOR FARMGATE MILK PRICE

The Co-operative currently collects around 89% of New Zealand's milk production.

Because Fonterra purchases such a large proportion of New Zealand's total milk, there isn't a '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. This enables total returns to be allocated between payments for milk and returns on the share capital invested by farmer shareholders in the Co-operative.

¹ 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 over and above this total amount. For the 2012 Season, this amount was NZD 22 million.

3.2 FARMGATE MILK PRICE METHODOLOGY

Since the financial year ended 31 July 2009, the Farmgate Milk Price has been calculated in accordance with the Farmgate Milk Price Manual.

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

- Determining the revenue that the Co-operative would earn if the equivalent of all the milk Fonterra collects was converted into commodity specifications of whole milk powder (WMP), skim milk powder (SMP) and their by-products, which are buttermilk powder (BMP), butter, and anhydrous milkfat (AMF). These products are referred to in the Manual as 'Reference Commodity Products'. Prices primarily reflect US dollar prices achieved on the twice-monthly GlobalDairyTrade (GDT) trading events, converted to New Zealand dollars using Fonterra's actual average monthly foreign-exchange conversion rate.²
- Deducting costs, including the cost of transporting raw milk to factories, and the cost of efficiently manufacturing Reference Commodity Products and then transporting them to the point of export from New Zealand, along with selling and administration expenses. They also include amounts

for depreciation of fixed assets and an appropriate return on investment, including investment in working capital.

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

3.3 RATIONALE FOR REFERENCE COMMODITY PRODUCTS

Manufacture of the Reference Commodity Products comprised around 75 percent of Fonterra's total New Zealand ingredients production in the 2012 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 decade 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 the Co-operative from value-add products (such as infant formula and specialised protein products) and branded products.

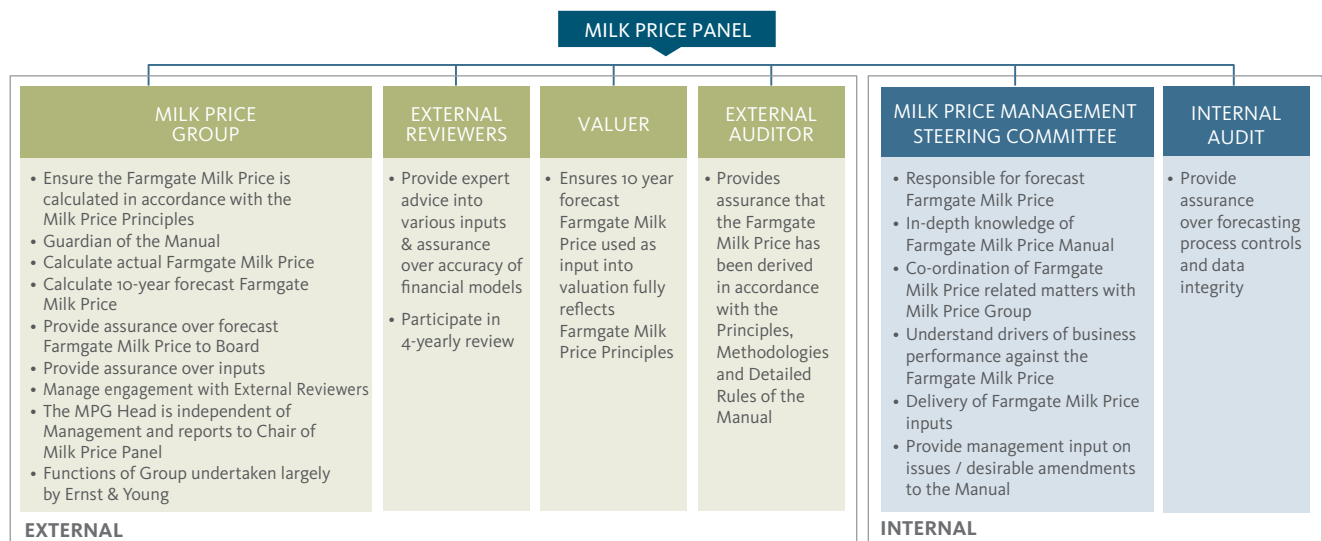
These types of products earn premiums over and above the returns to standard commodity ingredients. It is therefore appropriate that these premiums are recognised in Fonterra's earnings rather than in the Farmgate Milk Price.

3.4 DIRA 'DEFAULT' PRICE

The Farmgate Milk Price is also used to determine the 'default' price paid by independent processors for milk obtained from Fonterra under DIRA. The Co-operative is required under DIRA to supply independent processors up to 600 million litres of raw milk in total each season (just under 5 percent of the milk collected by Fonterra).

The DIRA regulated price is set at the Farmgate Milk Price, adjusted to exclude the portion of winter milk premiums paid from the aggregate amount calculated under the Manual. Independent Processors tend to demand proportionately more of their milk during 'shoulder' early spring and autumn periods compared to Fonterra's actual seasonal pattern of milk supply because their demand profile tends to be 'flatter' than Fonterra's actual milk collections. This imposes extra costs on Fonterra, since it effectively pays more for milk during the shoulder periods than it does for milk collected during peak production in late spring.³ Fonterra is able to recover a portion of these additional costs by charging a premium of 10 cents per kgMS on the adjusted Farmgate Milk Price for milk supplied under the Regulations.

FIGURE 1: FARMGATE MILK PRICE GOVERNANCE



² For WMP, SMP and AMF, which comprised 89% of revenue in the 2012 Milk Price, all prices were sourced from GDT. Butter is not currently sold on GDT, and comprises 9% of Milk Price revenue.

³ Higher effective payments for milk supplied in shoulder periods are a consequence of the Capacity Charge, which results in farmers with above average ratios of shoulder milk to peak milk receiving a higher average milk price.

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FARMGATE MILK PRICE OVERVIEW CONTINUED

3.5 FARMGATE MILK PRICE GOVERNANCE

The Fonterra Board is accountable for the overall setting of the Farmgate Milk Price. However, as shown in Figure 1 on the previous page, it has put in place a governance structure to ensure robustness and to provide farmer shareholders and other interested parties with assurance around the application of the Manual.

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 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; John Wilson who is a farmer-elected Fonterra director; and Richard Punter and Paddy Boyle who are nominees of the Council.

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 providing recommendations to the Board on changes to the Manual and assurance to the Board that the Farmgate Milk Price each year has been calculated in accordance with the Manual.

The Milk Price Group administers the Manual day to day. The head of this group is appointed by the Board, must be independent of Fonterra, and reports directly to the Milk Price Panel. The group is largely resourced by Ernst & Young. An internal Fonterra unit, the Milk Price Management Steering Committee, co-ordinates with the Milk Price Group to provide management input on Farmgate Milk Price matters, while Fonterra's Internal Audit function provides assurance over the integrity of data sourced from Fonterra's systems. The Farmgate Milk Price is also audited each year by Fonterra's external auditors, PwC.

3.6 COMMERCE COMMISSION MILK PRICE OVERSIGHT

Under Subpart 5 of DIRA, which was passed into law in July 2012, the Commerce Commission will be required to undertake annual reviews of both the Farmgate Milk Price Manual, and the final Farmgate Milk Price for a season, commencing with the 2012/2013 Season. Prior to passage of the legislation, the Commerce Commission undertook a 'dry run' review of the Farmgate Milk Price Manual and of the forecast 2012 Farmgate Milk Price as at 31 January 2012. The purpose of the review was to assess the extent to which the Commerce Commission considered the Milk Price methodology and Fonterra's application of the methodology to be consistent with the purpose and principles of the Milk Price regime now contained in Subpart 5 of DIRA. As a consequence of the review, two minor amendments have been made to the Manual, and two adjustments will be made to inputs into the Farmgate Milk Price for the 2013 Season. These changes are outlined in section 6.

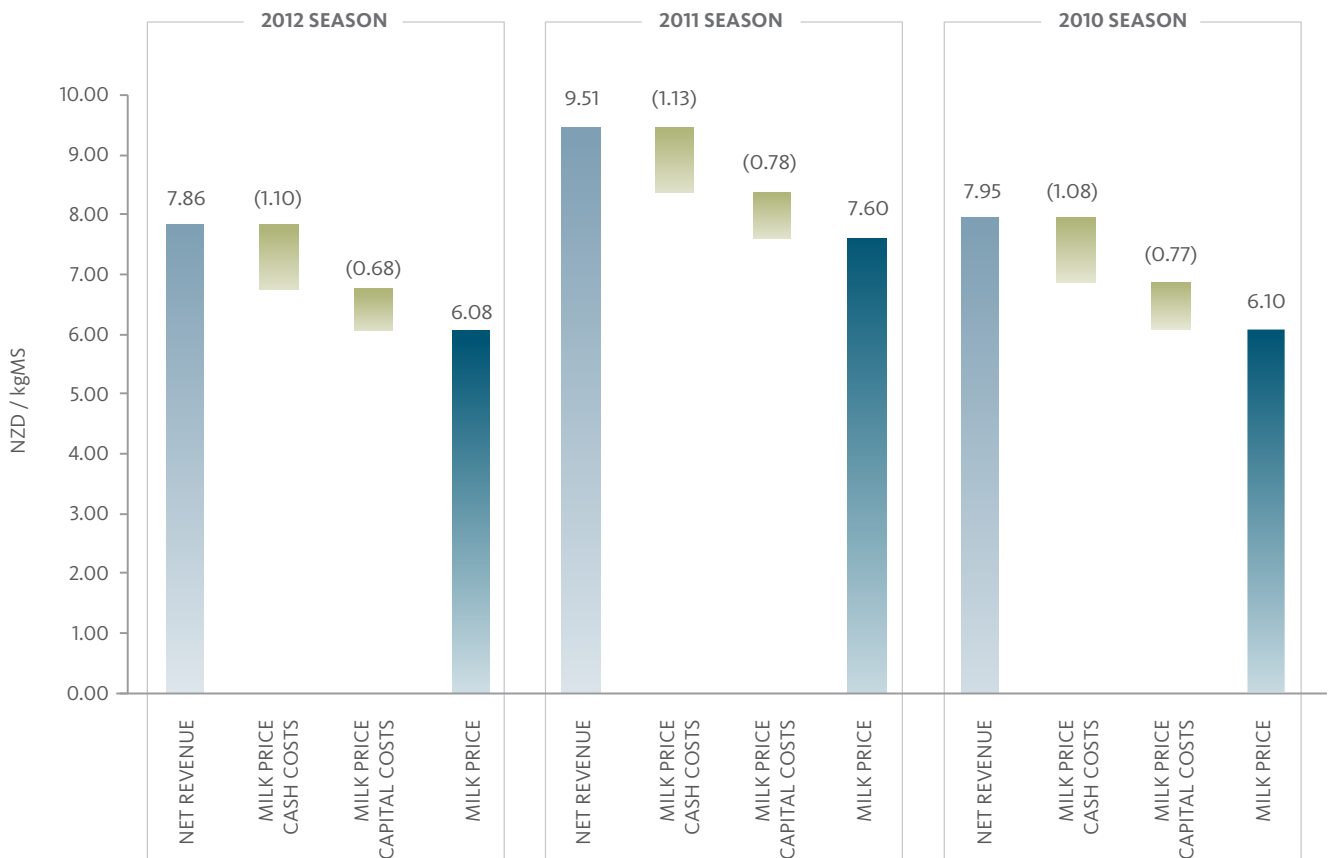
The Commission's final report was released on 27 August 2012, and is available at <http://www.comcom.govt.nz/review-of-fonterra-s-farm-gate-milk-price/>.

TABLE 1: FARMGATE MILK PRICE SUMMARY

SEASON	2012		2011		2010		2012/2011	2011/2010
	NZD BN	\$/kgMS	NZD BN	\$/kgMS	NZD BN	\$/kgMS	% CHANGE \$/kgMS	% CHANGE \$/kgMS
FARMGATE MILK PRICE REVENUE	12.4	8.29	13.1	9.76	10.5	8.17	(15.1)	19.5
LACTOSE	(0.6)	(0.42)	(0.3)	(0.25)	(0.3)	(0.22)	68.0	13.6
NET REVENUE	11.7	7.86	12.8	9.51	10.2	7.95	(17.4)	19.6
FARMGATE MILK PRICE CASH COSTS	(1.6)	(1.10)	(1.5)	(1.13)	(1.4)	(1.08)	(2.7)	4.6
FARMGATE MILK PRICE CAPITAL COSTS*	(1.0)	(0.68)	(1.1)	(0.78)	(1.0)	(0.77)	(12.8)	1.3
TOTAL COSTS	(2.7)	(1.78)	(2.6)	(1.91)	(2.4)	(1.85)	(6.8)	3.2
FARMGATE MILK PRICE	9.1	6.08	10.2	7.60	7.8	6.10	(20.0)	24.6
MILK COLLECTIONS (MILLION kgMS)		1,493		1,346		1,286	10.9	4.7

* Includes depreciation, tax and capital charge

FIGURE 2: CHANGES IN THE FARMGATE MILK PRICE: SEASONS 2010-2012



3.7 SUMMARY OF FARMGATE MILK PRICE REVENUE AND COST

Table 1 summarises the Farmgate Milk Price for the milk supplied in the 2010, 2011 and 2012 Seasons. Table 1 on the previous page and Figure 2 above show that changes in the Farmgate Milk Price over the last three seasons have been

driven almost entirely by changes in commodity prices converted into New Zealand dollars. Key determinants of the movements in average costs between the 2011 and the 2012 Seasons are explained in section 5.

4 FARMGATE MILK PRICE REVENUE

4.1 SUPPLY, PRODUCTION, SALES VOLUMES

Farmgate Milk Price Revenue reflects a combination of milk supplied during the season, product mix, sales volumes and prices in New Zealand dollars. Farmgate Milk Price Revenue is the most significant driver of the Farmgate Milk Price.

Figure 3 on the following page shows the relationship between when milk is collected during a season (the light blue line), the volume of products manufactured from that milk (the dark blue line) and when that product is

shipped (the light green line). The key points to note are as follows:

- Milk supplied during the 2012 Season was 1.493 billion kgMS. Attachment 1 provides information on milk collected each quarter for each of the last three seasons.
- This amount of milk is then converted into Reference Commodity Products. The mix between the various products that goes into the Farmgate Milk Price was updated on a forward-looking basis during the Season to reflect Fonterra’s projected mix between WMP and SMP, and between butter

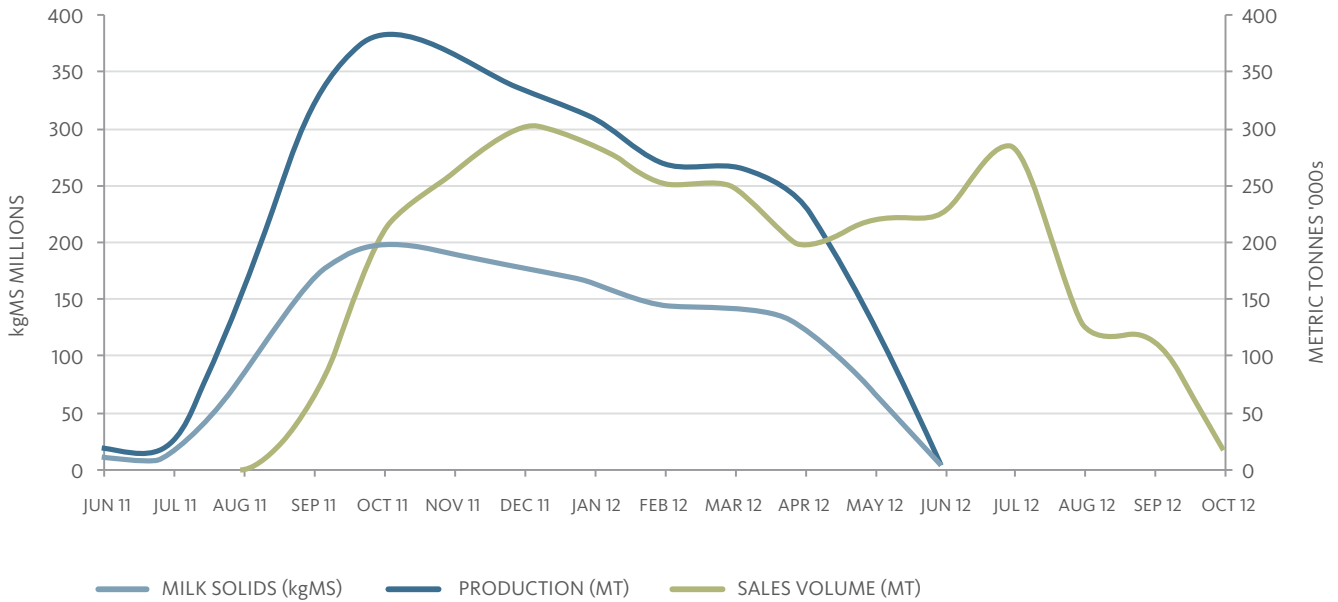
and AMF. (Production of BMP is a residual amount.) Attachment 1 provides Farmgate Milk Price production by quarter for each Reference Commodity Product for the last three seasons.

- Product sales reflect Fonterra’s actual shipments of Reference Commodity Products manufactured from milk supplied during the season. Figure 3 shows the normal 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

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FARMGATE MILK PRICE REVENUE CONTINUED

FIGURE 3: TIMING OF SUPPLY, PRODUCTION & SALES VOLUMES

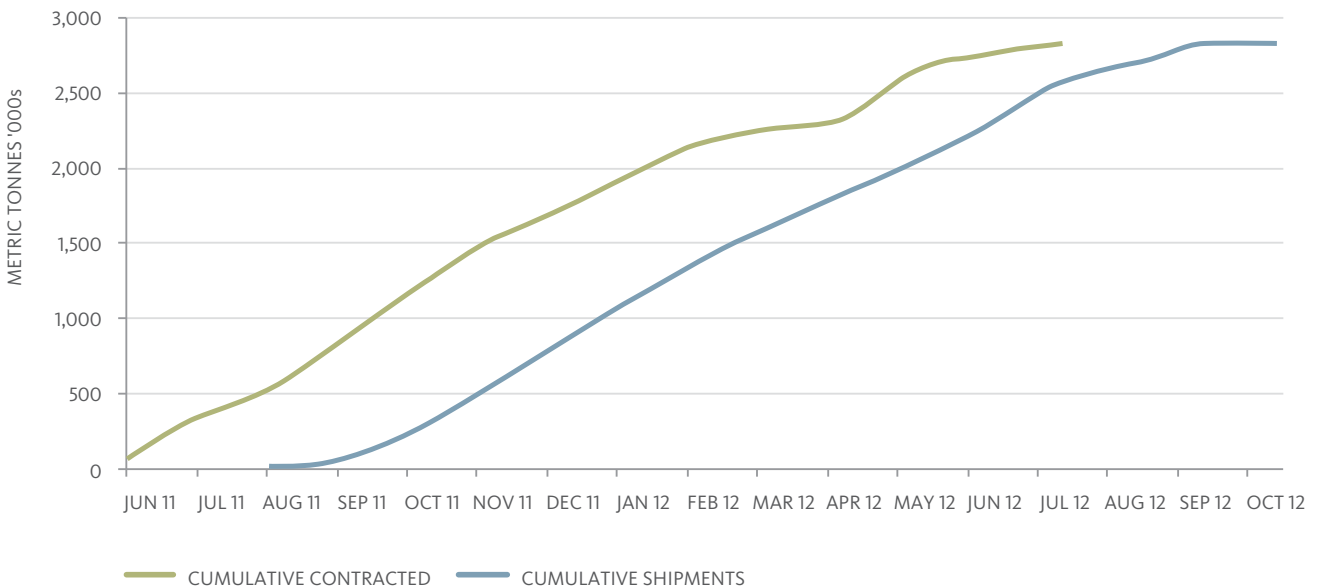


commence until August at the earliest. Shipments are normally complete by the end of October in the following year, again as illustrated in Figure 3. Attachment 2 sets out sales volumes by quarter for each of the last three seasons.

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 below 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 that are typical for the sale of commodity products from New Zealand. To ensure this is the case, contracts with more than eight months between when a price is set and shipment

FIGURE 4: LAG BETWEEN WHEN PRICES ARE STRUCK AND SHIPMENTS



occurs are not taken into account in determining shipment prices.⁴

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

4.2 PRICES

For the 2012 Season, GDT was the sole source of prices for WMP, SMP and AMF, and was the primary reference point for

BMP. Non-GDT contracts that Fonterra entered into were used to establish prices for all butter shipments (as butter is not currently sold through GDT), and some shipments of 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 (2,517,000 MT) accounted for 89% of the Farmgate Milk Price production of Reference Commodity Products (2,819,000 MT) in the 2012 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 below shows the weighted average USD contract prices of Reference Commodity Products for the last three seasons. Table 2 shows that prices for milk powders decreased slightly between the 2011 Season and the 2012 Season (5.4 % on a weighted average basis), but that the decrease in prices for cream products (butter and AMF) was significantly higher (22.2 % on a weighted average basis). Average USD prices per MT for each Reference Commodity Product by quarter for each of the last three seasons are set out in Attachment 4.

TABLE 2: WEIGHTED AVERAGE USD PRICE 2010-2012 SEASONS

Weighted Average Price (USD) per MT

SEASON	2012	2011	2010	2012/2011 % CHANGE	2011/2010 % CHANGE
WMP	3,359	3,606	2,905	(6.8)	24.1
SMP	3,285	3,321	2,658	(1.1)	24.9
BUTTER	3,546	4,344	3,033	(18.4)	43.2
AMF	3,825	5,258	3,368	(27.3)	56.1
BMP	3,163	3,259	2,234	(2.9)	45.9

The Manual provides for the conversion of notional USD Milk Price receipts for each month to NZD 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% of the net recognised foreign currency trade receivables and payables. It also requires hedging of up to 100% 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 on the next page shows the average foreign exchange conversion rate (USD:NZD) for the Farmgate Milk Price revenue for each quarter in the 2012 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, shows that the

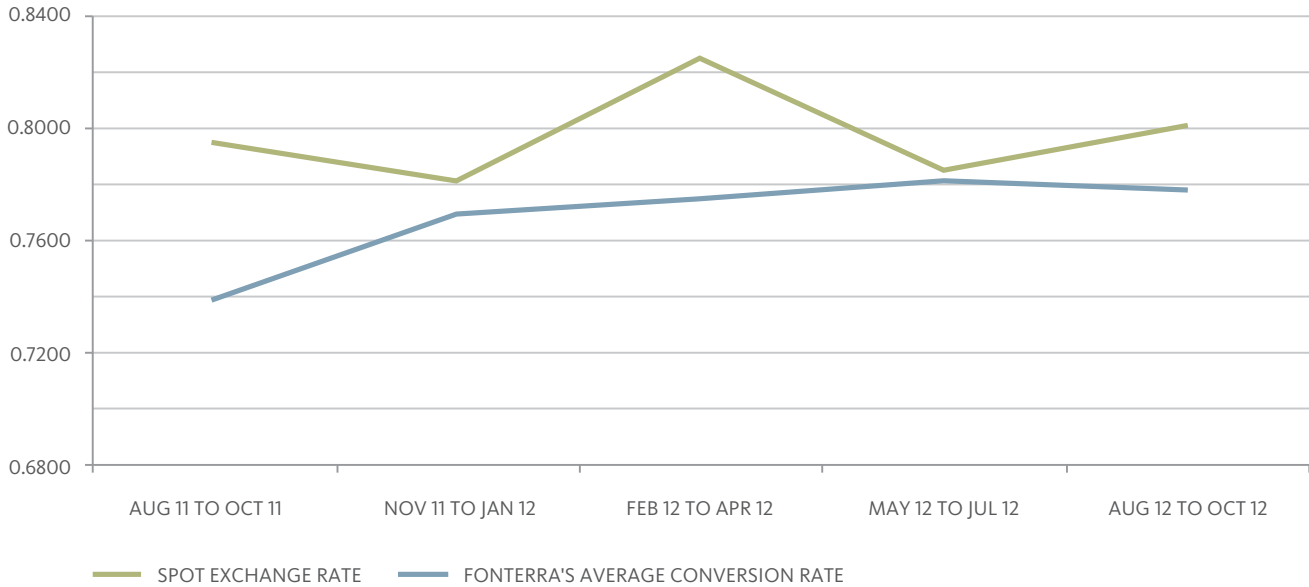
Co-operative's hedging policy resulted in an average foreign exchange conversion rate for the 2012 Season of USD:NZD exchange rate 0.7706 against a spot rate of 0.7965. Attachment 5 also provides equivalent information by quarter for the 2010 and 2011 Seasons. Although the data over the last 3 years shows Fonterra achieving a better rate through its 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.

⁴ From the financial year ending 31 July 2013, only contracts with prices set no earlier than 5 months prior to shipment will be taken into account.

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FARMGATE MILK PRICE REVENUE CONTINUED

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



As at 31 July 2012, Fonterra had foreign exchange contracts in place in respect of approximately 60% of the USD-equivalent operating cash flow exposure expected to impact on the Milk Price for the 2013 Season. At a spot exchange rate of 0.8089, these contracts would result in an average USD:NZD conversion rate of 78.0 cents.⁵

4.3 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 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 3 below provides the basis for the cost of purchased lactose in the 2012, 2011 and 2010 Seasons.

TABLE 3: PURCHASED LACTOSE & PRICE

SEASON	2012	2011	2010	2012/2011	2011/2010
				% CHANGE	% CHANGE
PURCHASED LACTOSE ('000 METRIC TONNES)	310	275	260	12.7	5.8
AVERAGE PRICE (USD) PER MT	1558	848	717	83.7	18.3

⁵ 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

5

FARMGATE MILK PRICE COSTS

5.1 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 site footprint, which includes more than 20 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 with operating parameters that reflect manufacturers' specifications and Fonterra's per unit costs.

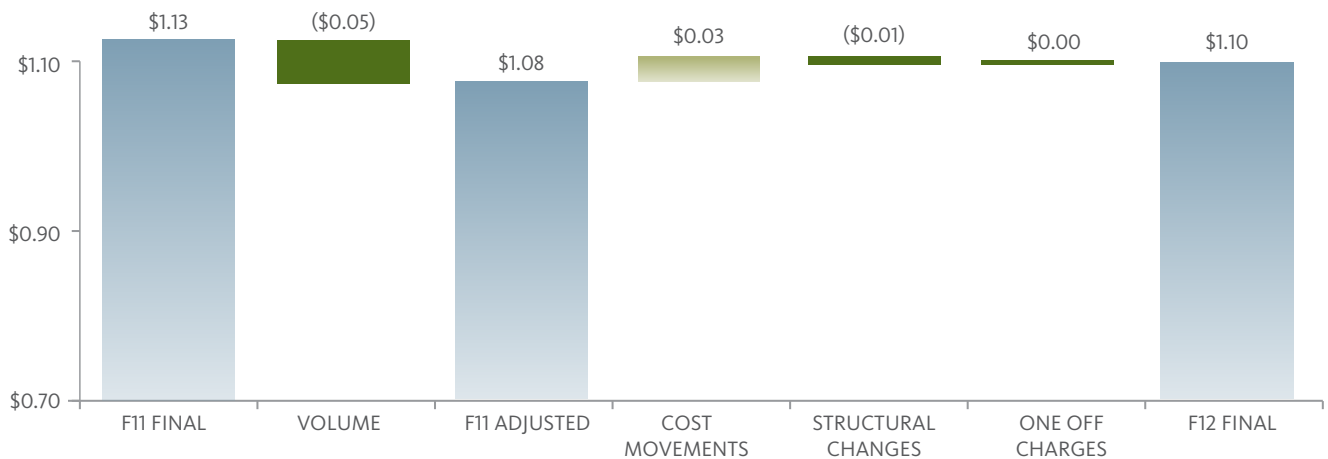
- Overhead and selling costs that are typical of a commodity-only business that sells product from New Zealand. Overhead costs are calculated by

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 an equivalent platform to GDT with an offshore supporting network.

Table 4 and Figure 6 summarise the major categories of cash costs, and the sources of movements in each category between the 2011 and 2012 Seasons.

TABLE 4: SUMMARY OF MOVEMENTS IN CASH COSTS

NZD MILLION	F11	VOLUME/ PRODUCT MIX EFFECT	COST MOVEMENTS	STRUCTURAL CHANGES	ONE-OFF CHARGES	F12	% CHANGE DUE TO COST	TOTAL % CHANGE
SALES COST	145	7	-	(35)		117	0.0	(19.3)
VARIABLE MANUFACTURING & SUPPLY CHAIN COSTS	618	66	20	-		704	2.9	13.9
FIXED MANUFACTURING/ SITE OVERHEADS & SUPPLY CHAIN COSTS	191	-	6	-		197	3.3	3.3
OTHER COSTS INCLUDING COLLECTION	563	20	21	22	(4)	622	3.7	10.5
TOTAL CASH COSTS	1,517	94	47	(13)	(4)	1,640	2.9	8.1





FARMGATE MILK PRICE COSTS CONTINUED

The movements in costs shown on the previous page reflect the following:

- The volume-related impact on fixed cost recoveries of the 10% increase in milk supply over the 2011 Season. (Average costs in the 2011 Season would have been 5c lower, at \$1.08 per kgMS, if the higher 2012 volume of milk had been supplied.)
- An average increase of 3.1% due to cost inflation.
- A change in the approach to calculating sales costs for the 2012 Season. Previously, sales costs were calculated on a basis that assumed the Notional Milk Price Business paid a commission to a third party sales agent, and that the agent's costs reflected Fonterra's cost structure plus a profit margin. This approach was becoming increasingly inconsistent with the increasing reliance placed on prices achieved on GDT, and was therefore adjusted at the beginning of the 2012 Season to be consistent with an assumption that most Milk Price product is sold on GDT. The revised approach reflects an assumption that the Notional Milk Price Business sells 90% of its product on GDT, at the commission rates charged by GDT to third party sellers, and that it also maintains an in-market structure to service its customers.
- The reclassification as farm to factory milk collection costs of certain costs previously classified as inter-site diversion costs.
- A net decrease of NZD 4 million in 'one-off' costs in 2012 relative to the 2011 Season. One-off costs in respect of the Christchurch earthquake were incorporated in 2011. In 2012 a provision was included for one-off costs that could reasonably be expected to have been incurred as a consequence of higher-than-forecast peak milk supply and the failure in October 2011 of the Maui gas pipeline.

5.2 FARMGATE MILK PRICE CAPITAL COSTS

The Co-operative operates a range of

powder plants with capacities from more than 25 tonnes per hour to approximately one tonne per hour. No two of these plants are exactly alike. Some make only a few products, while others are used to manufacture a range of products, including higher-value products.

It would be a major exercise to adjust the costs actually incurred in all these plants to exclude the costs relating to the production of higher value products. Also, the capital costs associated with some of Fonterra's smaller and older plants are not representative of the full costs of using modern plants to manufacture commodity milk powders.

To address these issues, both operating and plant-related capital costs are calculated by reference to 'standard' plants with capacities equal to Fonterra's actual average daily capacities for each type of plant, and which reflect current technology of the type typically employed across the industry.⁶ These 'standard' plants are less efficient than Fonterra's newest manufacturing plants, such as the ED4 drier installed at Fonterra's Edendale manufacturing site in Southland in 2009, and the newly-commissioned plant at Darfield in Canterbury, but are 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.
- The capital charge is also calculated in a manner that results in its aggregate amount growing each year approximately in line with milk supply and capital goods inflation, so 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. However, this variation did not exceed 2 cents per kgMS between the 2010 and 2012 Seasons.
- 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 each year of the WACC charges on fixed assets and net working capital.

Table 5 right shows capital costs and the aggregate book value of the Farmgate Milk Price fixed asset base and monthly average net working capital for the 2010, 2011 and 2012 Seasons. The primary determinant of the variation in average net working capital balances between years is differences in the percentages of the final Farmgate Milk Price paid to suppliers in each month during the year.

Three matters are relevant to a comparison of capital costs between 2012 and 2011:

- The improvement in asset utilisation resulting from the significant increase in milk supply in the 2012 Season by itself resulted in a reduction in capital costs when expressed on a dollars per kgMS basis.
- As explained below, the WACC reduced from 8.5% in 2011 to 7.7% in 2012. By itself, this change resulted in a reduction of NZD 48 million in the WACC charge on fixed assets, a reduction of NZD 15 million in the WACC charge on net working capital, and a reduction of NZD 6 million in the tax charge.
- The company tax rate reduced from 30% to 28%, resulting in a further reduction of NZD 20 million in the tax charge.

⁶ The average daily processing capacity of the standard WMP and SMP plants is approximately 1.9 million litres. As a consequence of the review year updates (see section 6), incremental and replacement plants incorporated in the asset base from the 2013 Season will have an average daily processing capacity of approximately NZD 2.4 million litres.

TABLE 5: AGGREGATE BOOK VALUE OF FIXED ASSET BASE AND MONTHLY AVERAGE NET WORKING CAPITAL

SEASON NZD MILLION	2012	2011	2010
DEPRECIATION	218	203	200
WACC CHARGE - FIXED ASSETS	469	498	455
WACC CHARGE - NET WORKING CAPITAL	138	130	132
TAX	193	225	209
TOTAL FIXED ASSETS (BOOK VALUE)	6,121	5,915	5,357
AVERAGE NET WORKING CAPITAL	2,244	1,570	1,301

In aggregate the improvement in asset utilisation resulted in a reduction of 4 cents per kgMS in average capital costs, and the change in WACC and tax rate resulted in a further reduction of 6 cents per kgMS.

5.3 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.⁷ The methodology applied through to the 2012 Season provided for input parameters into the WACC to be updated every four years. Consequently, the WACC was held constant at 8.5% between the 2009 and 2011 Seasons, and reflected market interest rates as of mid 2008. From the 2012 Season, the methodology has been 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%. The purpose of this change was to avoid potentially significant step changes each four years in the Farmgate Milk Price capital charge (which could be either positive or negative, depending on market conditions).

Application of the same approach employed in the 2012 Season would have resulted in a WACC of 7.3% being used for the 2013 Season. As a consequence, however, of addressing matters raised by the Commerce Commission in its 'dry run' review relating to the calculation of the assumed cost of debt, a WACC of 7.5% will be used for the 2013 Season.

6 FARMGATE MILK PRICE MANUAL

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

The Manual allows for adjustments to be made where circumstances change. An example of this is 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

reviews of certain 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 has recently been completed. The review has resulted in a number of minor amendments, none of which, either on its own or in aggregate, will have a material impact on the Farmgate Milk Price for the 2013 Season.

A material impact on the Farmgate Milk Price is considered to be 2.4 cents per kgMS (in aggregate or for any individual change).

The Board approved a number of minor

amendments to the Manual in July 2012, and an updated version of the Manual is now available on Fonterra.com. Two amendments – the incorporation in Part C of a provision to allow for additional costs in calculating the cost of debt, and an amendment to clarify that 'sales phasings' cannot be adjusted retrospectively – address matters raised by the Commerce Commission in its 'dry run' review of the Farmgate Milk Price. The adjustment to the cost of debt is reflected in the WACC for the 2013 Season of 7.5%, as reported above, and will result in a reduction in the Farmgate Milk Price of 1 cent per kgMS in the 2013 Season. None of the other amendments will result in a substantive change in the Farmgate Milk Price.

⁷ See for example the various papers at <http://www.comcom.govt.nz/cost-of-capital/>

7

GLOSSARY

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

AMF means anhydrous milk fat.

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 dated 21 September 2011.

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

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

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

Independent processors means entities who are independent of Fonterra and process raw milk.

kgMS means kilograms of milk solids.

Manual means Fonterra's Farmgate Milk Price Manual.

Methodologies means the methodologies for calculating the Farmgate Milk Price as 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.

Reference Commodity Products are defined in the Manual.

USD means United States dollars.

WACC means weighted average cost of capital.

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.



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 21 September 2011 (the 'Manual') by the Milk Price Group ('MPG') in establishing the F12 Season's Milk Price of \$6.08 (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 International Standards on Assurance Engagements (NZ) and Standards on Assurance Engagements. 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. 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 in the areas of other audit related services and transaction and other advisory services. Partners and employees of our firm may deal with Fonterra on normal terms within the ordinary course of trading activities of Fonterra. We are not aware of any relationships between our firm and Fonterra Co-operative Group Limited, the Milk Price Panel and the MPG that, in our professional judgement, may reasonably be thought to impair our independence.

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 \$6.08. 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
25 September 2012

Auckland

Numbers in this Statement (including in the following Attachments) have been rounded and, as a result, some tables may not exactly total or sum to 100%.

ATTACHMENT 1: MILK COLLECTED & PRODUCTION VOLUMES

2012 SEASON	MILK COLLECTED (MILLION kgMS)	PRODUCTION ('000 MT) FINISHED PRODUCT				
		WMP	SMP	BUTTER	AMF	BMP
JUN 2011 TO AUG 2011	103	141	29	11	10	3
SEPT 2011 TO NOV 2011	567	562	305	112	69	26
DEC 2011 TO FEB 2012	487	578	186	80	55	20
MAR 2012 TO MAY 2012	336	487	65	39	30	12
TOTAL	1,493	1,768	585	242	164	60

2011 SEASON	MILK COLLECTED (MILLION kgMS)	PRODUCTION ('000 MT) FINISHED PRODUCT				
		WMP	SMP	BUTTER	AMF	BMP
JUN 2010 TO AUG 2010	95	139	20	6	11	3
SEPT 2010 TO NOV 2010	522	547	262	105	58	23
DEC 2010 TO FEB 2011	434	468	199	88	47	19
MAR 2011 TO MAY 2011	296	409	70	32	33	11
TOTAL	1,346	1,563	551	232	149	56

2010 SEASON	MILK COLLECTED (MILLION kgMS)	PRODUCTION ('000 MT) FINISHED PRODUCT				
		WMP	SMP	BUTTER	AMF	BMP
JUN 2009 TO AUG 2009	91	119	29	8	12	3
SEPT 2009 TO NOV 2009	515	514	280	116	54	23
DEC 2009 TO FEB 2010	438	439	226	88	57	20
MAR 2010 TO MAY 2010	242	329	59	29	28	9
TOTAL	1,286	1,401	593	241	150	55

ATTACHMENT 2: SALES VOLUMES

2012 SEASON	SHIPMENTS ('000 MT) OF FINISHED PRODUCT				
SHIPMENT PERIOD	WMP	SMP	BUTTER	AMF	BMP
AUG 2011 TO OCT 2011	188	58	7	12	3
NOV 2011 TO JAN 2012	512	187	79	52	24
FEB 2012 TO APR 2012	442	139	65	43	15
MAY 2012 TO JUL 2012	500	131	54	41	11
AUG 2012 TO OCT 2012	126	69	37	16	7
TOTAL	1,768	585	242	164	60

2011 SEASON	SHIPMENTS ('000 MT) OF FINISHED PRODUCT				
SHIPMENT PERIOD	WMP	SMP	BUTTER	AMF	BMP
AUG 2010 TO OCT 2010	223	50	18	30	9
NOV 2010 TO JAN 2011	418	171	65	37	18
FEB 2011 TO APR 2011	506	159	61	33	14
MAY 2011 TO JUL 2011	320	121	46	32	9
AUG 2011 TO OCT 2011	96	50	42	16	5
TOTAL	1,563	551	232	149	56

2010 SEASON	SHIPMENTS ('000 MT) OF FINISHED PRODUCT				
SHIPMENT PERIOD	WMP	SMP	BUTTER	AMF	BMP
AUG 2009 TO OCT 2009	203	92	21	34	11
NOV 2009 TO JAN 2010	384	197	77	50	20
FEB 2010 TO APR 2010	373	155	59	37	12
MAY 2010 TO JUL 2010	365	100	50	25	8
AUG 2010 TO OCT 2010	76	49	34	4	3
TOTAL	1,401	593	241	150	55

ATTACHMENT 3:

AVERAGE NUMBER OF MONTHS PRIOR TO SHIPMENT THAT PRICES WERE STRUCK

2012 SEASON	AVERAGE NUMBER OF MONTHS PRIOR TO SHIPMENT				
SHIPMENT PERIOD	WMP	SMP	BUTTER	AMF	BMP
AUG 2011 TO OCT 2011	3.3	2.7	2.1	3.1	2.5
NOV 2011 TO JAN 2012	3.5	3.0	2.8	3.2	2.8
FEB 2012 TO APR 2012	3.5	3.2	3.5	3.6	3.0
MAY 2012 TO JUL 2012	3.2	2.9	2.9	3.1	2.6
AUG 2012 TO OCT 2012	3.4	3.3	2.7	3.1	3.1
VOLUME-WEIGHTED ANNUAL AVERAGE	3.4	3.0	3.0	3.2	2.8

2011 SEASON	AVERAGE NUMBER OF MONTHS PRIOR TO SHIPMENT				
SHIPMENT PERIOD	WMP	SMP	BUTTER	AMF	BMP
AUG 2010 TO OCT 2010	3.6	2.9	2.4	4.2	3.0
NOV 2010 TO JAN 2011	3.6	3.3	2.5	3.7	2.7
FEB 2011 TO APR 2011	3.8	3.6	2.6	3.5	3.0
MAY 2011 TO JUL 2011	4.0	3.5	3.0	3.4	2.6
AUG 2011 TO OCT 2011	3.1	4.4	2.3	3.1	3.1
VOLUME-WEIGHTED ANNUAL AVERAGE	3.7	3.5	2.6	3.6	2.8

2010 SEASON	AVERAGE NUMBER OF MONTHS PRIOR TO SHIPMENT				
SHIPMENT PERIOD	WMP	SMP	BUTTER	AMF	BMP
AUG 2009 TO OCT 2009	3.5	3.7	2.1	3.1	4.2
NOV 2009 TO JAN 2010	3.8	3.7	3.6	3.7	4.2
FEB 2010 TO APR 2010	3.7	3.2	2.4	3.1	4.0
MAY 2010 TO JUL 2010	4.1	2.9	2.6	3.2	3.2
AUG 2010 TO OCT 2010	3.5	3.0	2.1	4.2	3.6
VOLUME-WEIGHTED ANNUAL AVERAGE	3.8	3.4	2.8	3.4	4.0

The tables on the following page supplement that above by providing information on the average percentages of sales contracted in each of months 1 to 8 prior to shipment in the 2012 Season.

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

2011 SEASON: AVERAGE % OF SALES CONTRACTED IN EACH OF MONTHS 1 – 8 PRIOR TO SHIPMENT					
MONTHS BEFORE SHIPMENT	WMP	SMP	BUTTER	AMF	BMP
1	3%	6%	12%	4%	8%
2	22%	28%	40%	27%	40%
3	26%	28%	33%	25%	28%
4	20%	19%	10%	16%	13%
5	16%	7%	4%	10%	6%
6	6%	7%	1%	6%	2%
7	4%	3%	0%	9%	0%
8	4%	2%	0%	3%	3%

2010 SEASON: AVERAGE % OF SALES CONTRACTED IN EACH OF MONTHS 0 – 8 PRIOR TO SHIPMENT					
MONTHS BEFORE SHIPMENT	WMP	SMP	BUTTER	AMF	BMP
0	1%	1%	3%	1%	0%
1	6%	6%	14%	5%	1%
2	28%	27%	31%	26%	20%
3	20%	25%	23%	28%	23%
4	14%	19%	15%	21%	21%
5	9%	10%	8%	13%	16%
6	9%	6%	2%	5%	10%
7	8%	2%	2%	2%	5%
8	5%	3%	1%	1%	3%

The contract tenor calculated using the “Average % of Sales Contracted in each of Months 1 – 8 prior to Shipment” tables may not reconcile with those in the “Average Number of Months Prior to

Shipment” tables, due to the difference in volumes used to calculate weightings.

In 2011 the method of calculation was revised to exclude all sales contracted in

the month of shipment, on the basis that these sales in almost all instances were not contracted on terms that would be achievable by a business that did not have offshore warehouses.

ATTACHMENT 4: AVERAGE USD PRICES

2012 SEASON	USD PER MT OF FINISHED PRODUCT				
SHIPMENT PERIOD	WMP	SMP	BUTTER	AMF	BMP
AUG 2011 TO OCT 2011	3,663	3,594	4,081	4,837	3,430
NOV 2011 TO JAN 2012	3,436	3,376	3,829	4,115	3,176
FEB 2012 TO APR 2012	3,503	3,386	3,728	3,867	3,330
MAY 2012 TO JUL 2012	3,147	3,085	3,337	3,376	3,107
AUG 2012 TO OCT 2012	2,925	2,957	2,836	3,167	2,683
ANNUAL WEIGHTED AVERAGE (INCLUDING DOWNGRADE ADJUSTMENT)	3,359	3,285	3,546	3,825	3,163

2011 SEASON	USD PER MT OF FINISHED PRODUCT				
SHIPMENT PERIOD	WMP	SMP	BUTTER	AMF	BMP
AUG 2010 TO OCT 2010	3,513	3,003	3,943	4,548	2,902
NOV 2010 TO JAN 2011	3,346	3,034	4,104	4,821	3,010
FEB 2011 TO APR 2011	3,579	3,290	4,449	5,529	3,323
MAY 2011 TO JUL 2011	3,992	3,700	4,677	6,022	3,738
AUG 2011 TO OCT 2011	3,803	3,800	4,365	5,507	3,702
ANNUAL WEIGHTED AVERAGE (INCLUDING DOWNGRADE ADJUSTMENT)	3,606	3,321	4,344	5,258	3,259

2010 SEASON	USD PER MT OF FINISHED PRODUCT				
SHIPMENT PERIOD	WMP	SMP	BUTTER	AMF	BMP
AUG 2009 TO OCT 2009	1,999	1,965	1,850	2,178	1,482
NOV 2009 TO JAN 2010	2,553	2,415	2,248	2,812	1,930
FEB 2010 TO APR 2010	3,091	2,885	3,526	4,291	2,659
MAY 2010 TO JUL 2010	3,433	3,136	3,724	4,494	3,035
AUG 2010 TO OCT 2010	3,654	3,246	3,691	4,694	3,228
ANNUAL WEIGHTED AVERAGE (INCLUDING DOWNGRADE ADJUSTMENT)	2,905	2,658	3,033	3,368	2,234

ATTACHMENT 5: AVERAGE USD: NZD CONVERSION AND SPOT RATE

2012 SEASON	AVERAGE USD : NZD RATE	
SHIPMENT PERIOD	ACHIEVED CONVERSION	SPOT
AUG 2011 TO OCT 2011	0.7391	0.7956
NOV 2011 TO JAN 2012	0.7690	0.7805
FEB 2012 TO APR 2012	0.7742	0.8253
MAY 2012 TO JUL 2012	0.7804	0.7852
AUG 2012 TO OCT 2012 ⁸	0.7781	0.8019
REVENUE-WEIGHTED ANNUAL AVERAGE	0.7706	0.7965

2011 SEASON	AVERAGE USD : NZD RATE	
SHIPMENT PERIOD	ACHIEVED CONVERSION	SPOT
AUG 2010 TO OCT 2010	0.6927	0.7414
NOV 2010 TO JAN 2011	0.7041	0.7623
FEB 2011 TO APR 2011	0.7231	0.7630
MAY 2011 TO JUL 2011	0.7308	0.8169
AUG 2011 TO OCT 2011	0.7519	0.8269
REVENUE-WEIGHTED ANNUAL AVERAGE	0.7184	0.7777

2010 SEASON	AVERAGE USD : NZD RATE	
SHIPMENT PERIOD	ACHIEVED CONVERSION	SPOT
AUG 2009 TO OCT 2009	0.6330	0.7258
NOV 2009 TO JAN 2010	0.6531	0.7239
FEB 2010 TO APR 2010	0.6682	0.7047
MAY 2010 TO JUL 2010	0.6835	0.7007
AUG 2010 TO OCT 2010	0.6887	0.7178
REVENUE-WEIGHTED ANNUAL AVERAGE	0.6661	0.7120

⁸ The spot rate for August – October 2012 is the average daily rate between 1 August 2012 and 7 September 2012, when the Farmgate Milk Price Statement was finalised.