



# PERFORMANCE REVIEW

# Annual Results 2016

SEPTEMBER 2016

OUR CO-OPERATIVE

OUR POTENTIAL

OUR PERFORMANCE

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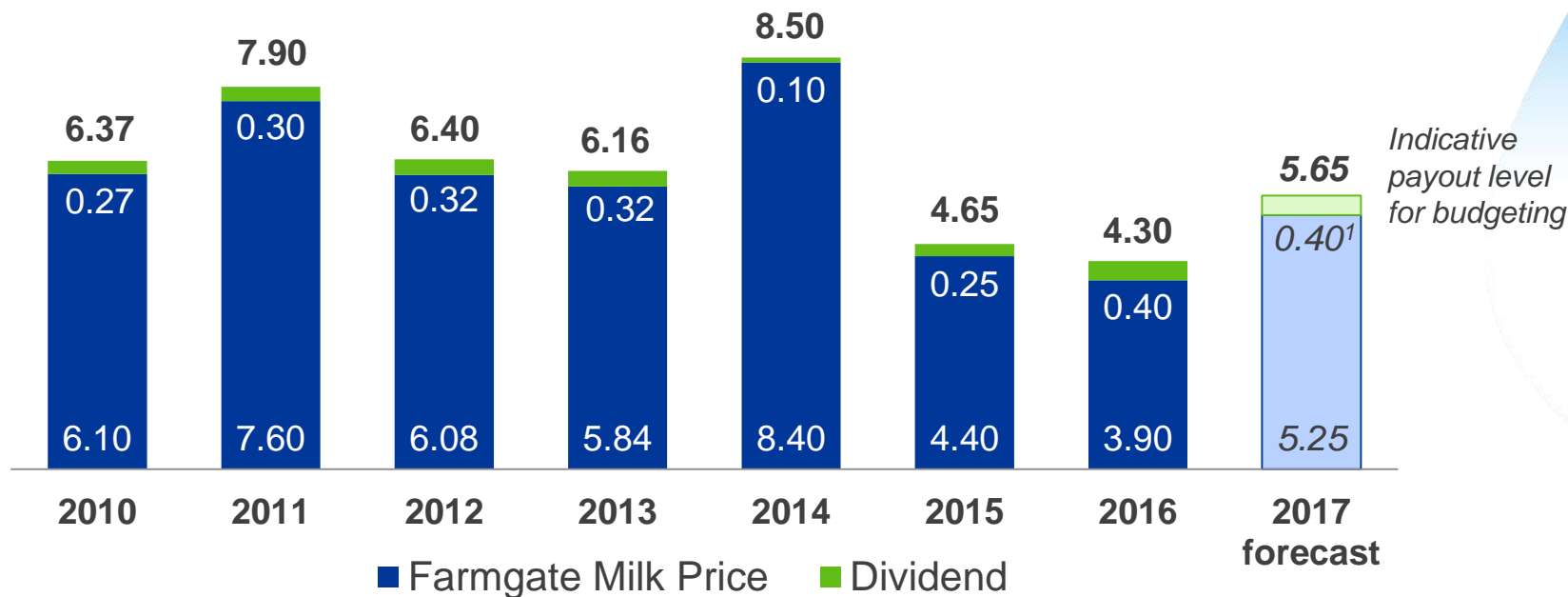
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## Our Co-Operative

# Very tough season for farmers

## But solid earnings growth and strong Co-operative

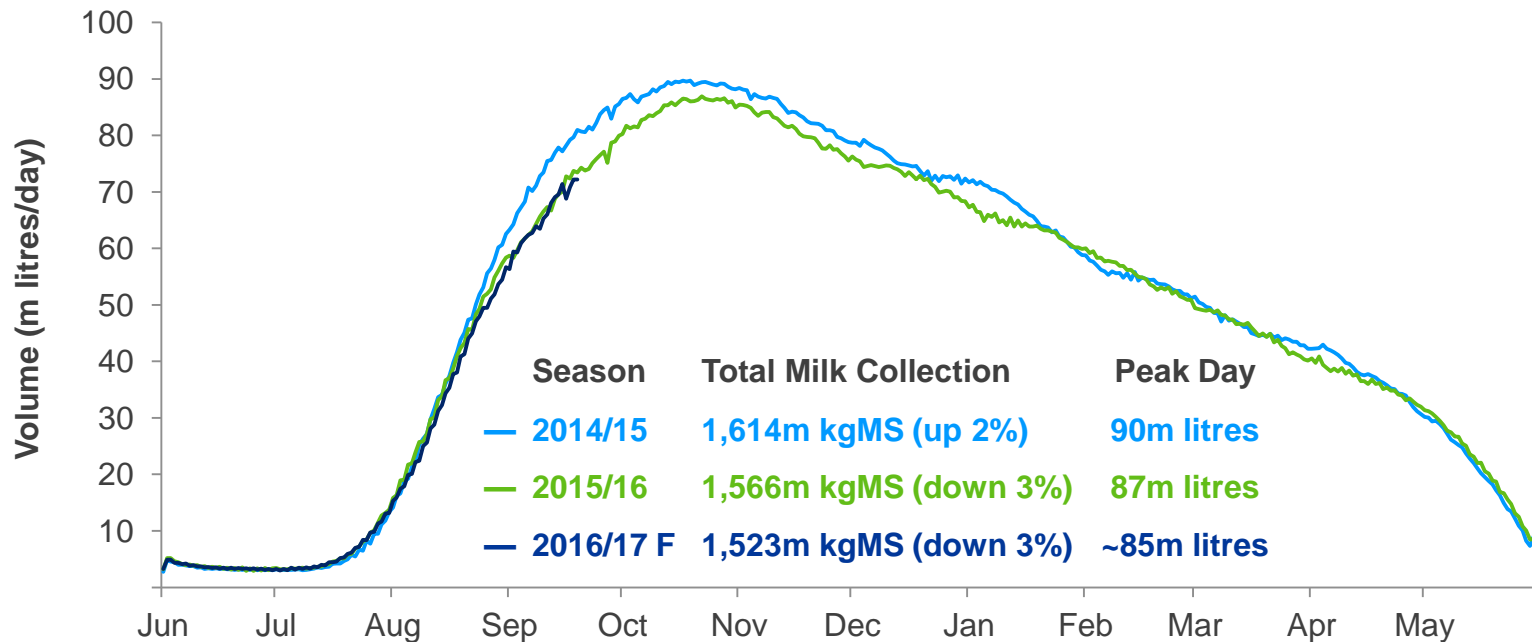


1. For farm budgeting purposes a 40 cent dividend is assumed (based on FY17 EPS forecast 50-60 cents)  
– this is consistent with Fonterra policy of paying out 65-75 per cent of adjusted net profit after tax over time

Note: Farmgate Milk Price: \$ per kgMS; Dividend: \$ per share

# NZ milk supply in second year of decline

Impacted by the low milk price environment



# Global factors driving milk price

## Cautious signs of recovery

**Balance  
returning**



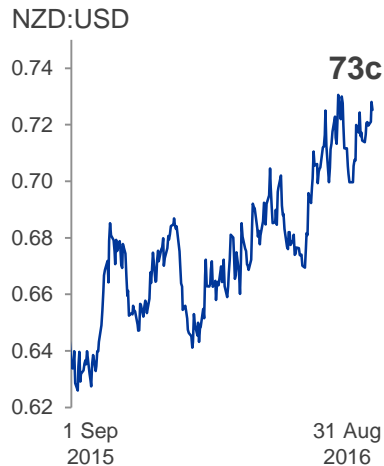
**Inventories  
adjusting**

**NZ**  
Record low inventory

**China**  
Customer inventories  
at normal levels

**EU**  
Intervention levels  
extended to 350k MT

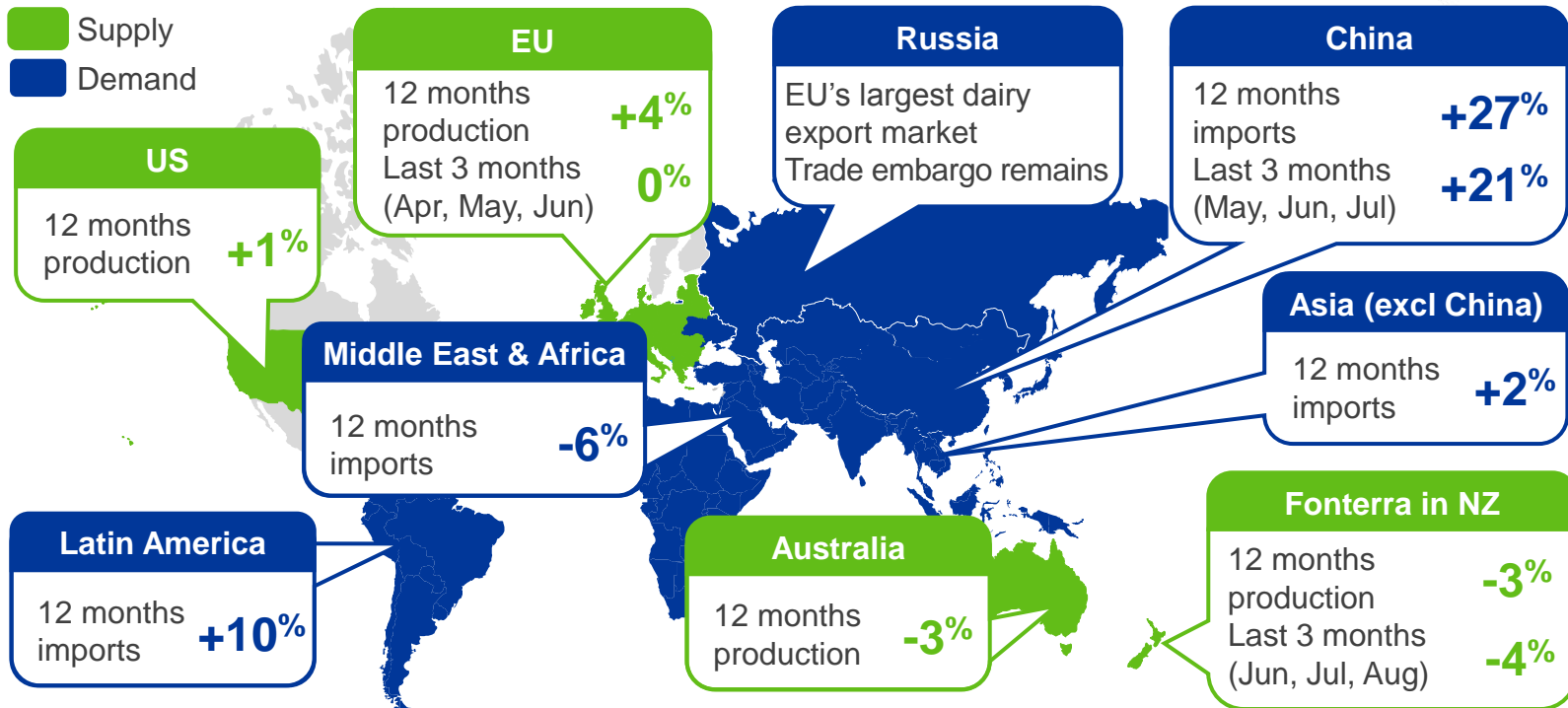
**But NZ dollar  
still strong<sup>1</sup>**



- Challenging milk price levels
- Globally and in New Zealand
- Prices starting to recover

1. NZD: USD exchange rate for 12 months to 31 Aug 16

# Global dairy market – strong long-term fundamentals

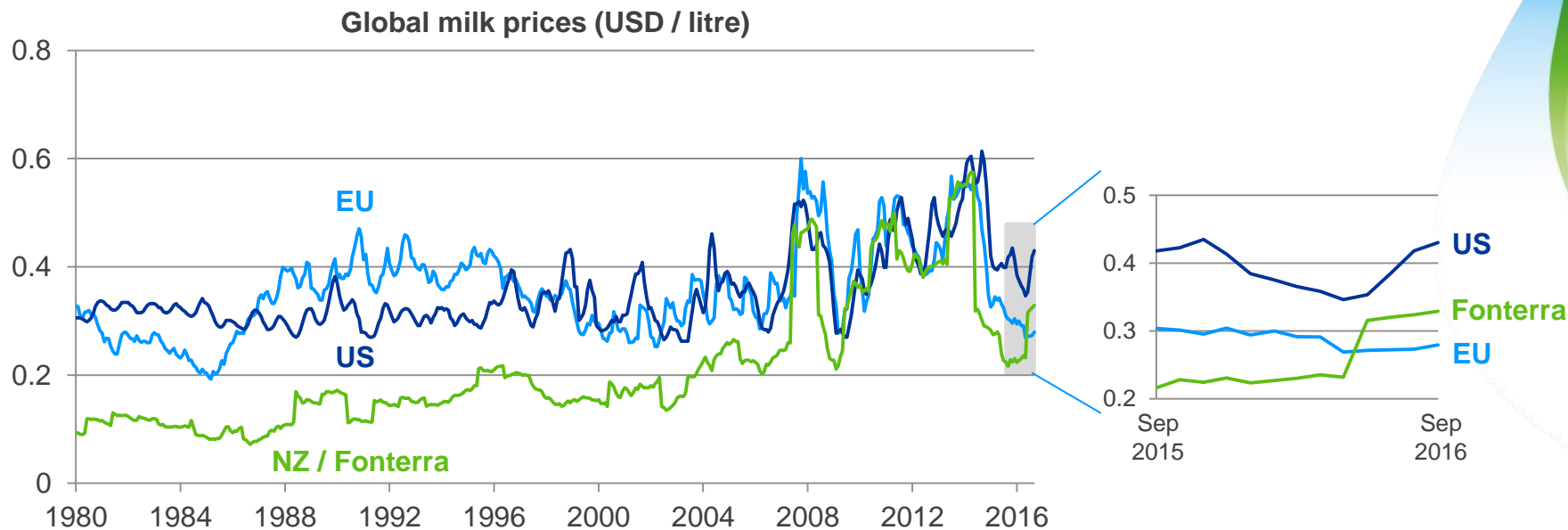


Note: All 12 month figures are rolling 12 months compared to previous comparable period: Australia (July), EU (June), United States (July), China (July), Asia (May), Middle East & Africa (May), Latin America (May), New Zealand (August)

Source: Government milk production statistics; GTIS trade data; Fonterra analysis

# Milk price in line with global markets

Closing gap NZ farmers are paid



Note: All prices are adjusted to a milk composition of 3.5% protein and 4.2% fat and for spot exchange rates

Source: DairyNZ (NZ to May 2014); Fonterra announced payout (milk price and dividend) (NZ from June 2014); USDA; European Milk Market Observatory (Netherlands milk price)



# Benefits from a strong Co-operative

## Competitive Milk Price

### Milk Price model put in place in 2009

- Changes to approaches used since then have resulted in structural increase

### Additional 36c to the Farmgate Milk Price<sup>1</sup>

- 2016 milk price would have been \$3.54 using model assumptions from 2009
  - \$560m additional to milk price

### Reflects improvements by Fonterra and in our operating environment

- Improved manufacturing performance
- Improved supply chain
- Lower manufacturing and capital costs

## Complemented by Co-op Initiatives



### Strong Co-operative balance sheet

- Early dividend & Co-op support loan



### Farm Source™ rewards & benefits

- Around \$30 million in savings for our farmers



### Enhanced digital offering & apps

- Co-op updates and timely milk collection info



### Business support on the ground

- Regional heads and technical reps



# Our Potential

## Global Context

- Future for dairy remains strong
- Low global commodity prices
- Unstable world

## Value Creation

- Transforming our business leads to strong results
- Strategy is working – more milk into higher value products
- Paying off – higher earnings and a stronger Co-op

## Trust

- Doing what we said we would do
- Investing in our communities and our future
- Very focused on future delivery

# Transformation is unlocking value

- ✓ Owner's mindset
- ✓ Business-led
- ✓ Relentless execution

**>4,000** *employees involved*

Initiatives<sup>1</sup>

**4,000**



Capex<sup>1</sup>

**\$944M**



Free Cash Flow<sup>1</sup>

**\$2.2B**



Debt

**-\$1.6B**



Working Capital

**-10 days**



Closing Inventory

**-21%**



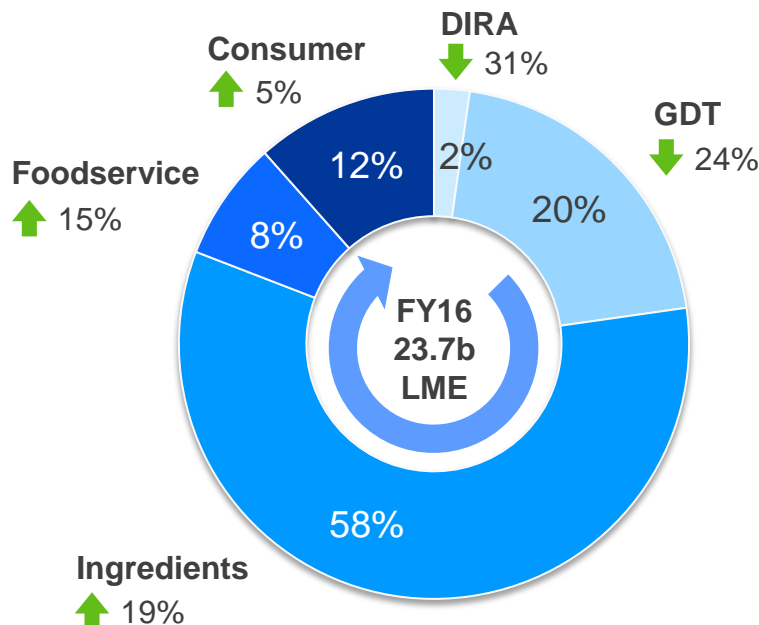
1. Actual figures shown – not movements

Note: Free Cash Flow is net operating cash flows less net investing cash flows; Debt is economic net interest bearing debt

# Delivering our strategy

## Volume to higher Value at Velocity

- 1 **Optimise**  
NZ milk
- 2 **Build and grow**  
beyond our current  
consumer positions
- 3 **Deliver**  
on Foodservice potential
- 4 **Grow**  
our Anlene™ business
- 5 **Develop**  
leading positions in  
paed & maternal nutrition
- 6 **Selectively invest**  
in milk pools
- 7 **Align**  
our business and organisation



**FY16 sales volume  
growth over FY15**

- GDT volume lower
- Ingredients
  - Optionality improved mix
  - Ingredients solutions for customers adding value
  - Lower operating costs
  - Return on capital of 13.4%
- Consumer and Foodservice
  - Added 380m more LMEs
  - 1 billion added in 2 years
  - Return on capital of 41.7%

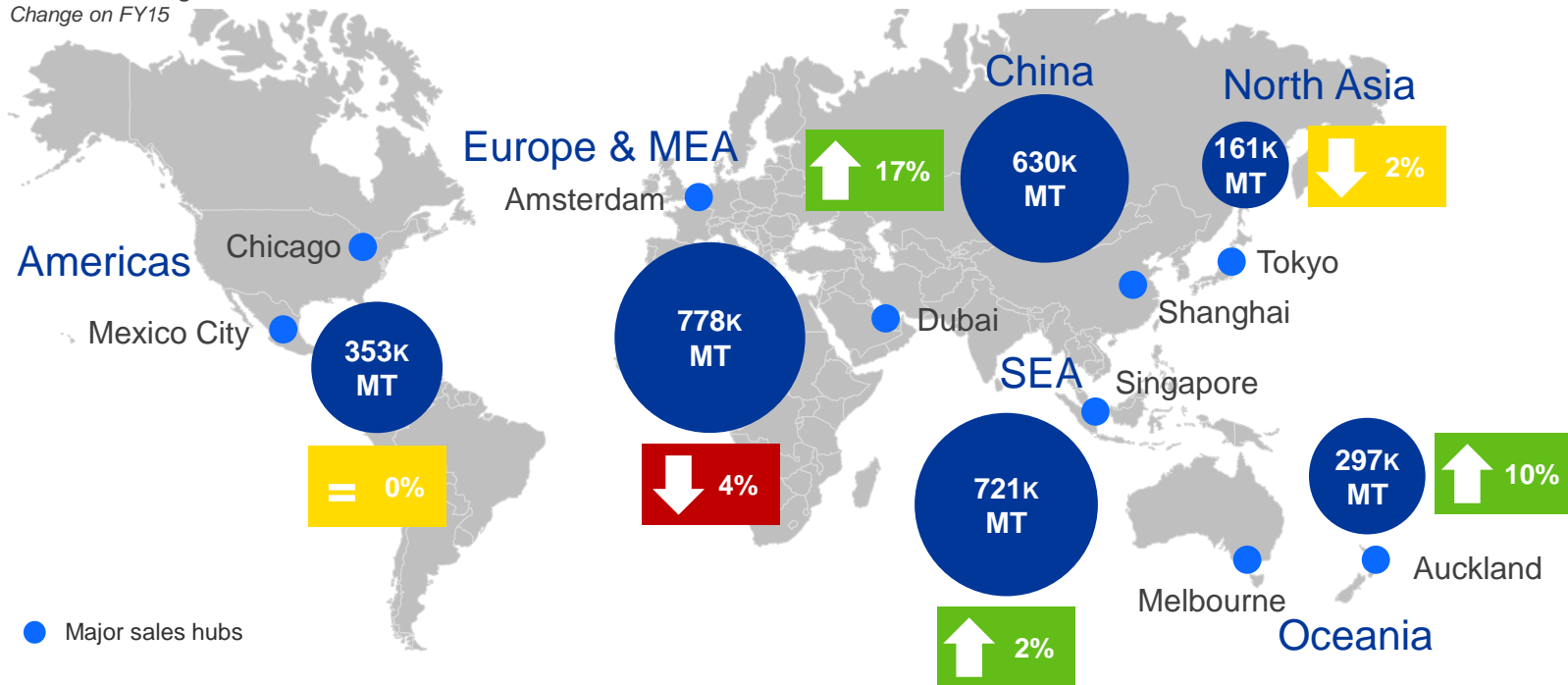
Note: Return on Capital (ROC) excludes goodwill, brands and equity accounted investments

Source: Wheel shows percentage of total FY16 external sales (LME) by strategic platform; Growth rates include intercompany sales to other strategic platforms

# Ingredients delivering value

Sustainable price achievement through global sales strategy

NZ & Australia Ingredients FY16 Sales Volumes  
Change on FY15



Note: FY16 sales (MT) and growth on FY15 are shown on the basis of the shipping destination for the product

# Australian business transformation

## Right foundation in place for sustainable returns

### Business transformation



*From ...*

- Disconnect between milk price and reality
- Loss-making brands and contracts
- Ingredients loss of \$92m

*To ...*

- Market connected milk price
- Sold non-strategic assets
- Ingredients normalised EBIT of \$63m

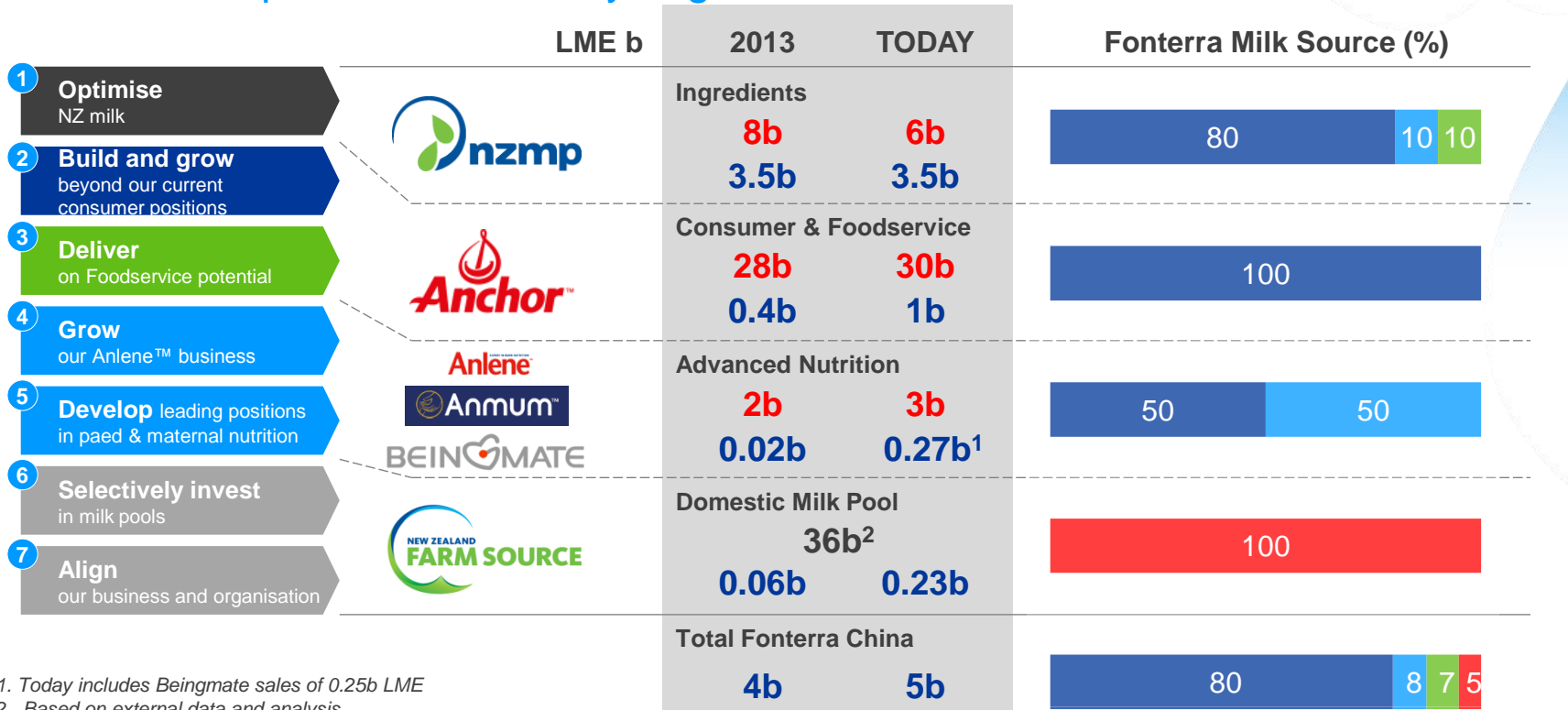
### Outlook for the future

- Profitable business
- Focus on cheese / whey / nutritionals
- Stanhope rebuild complete in 2017
- Grow our core consumer and foodservice brands
- Continue efforts to fill Darnum
- Strong position in the industry



# China opportunity

## Fonterra well positioned in every segment



1. Today includes Beingmate sales of 0.25b LME

2. Based on external data and analysis

Source: Euromonitor; Fonterra analysis

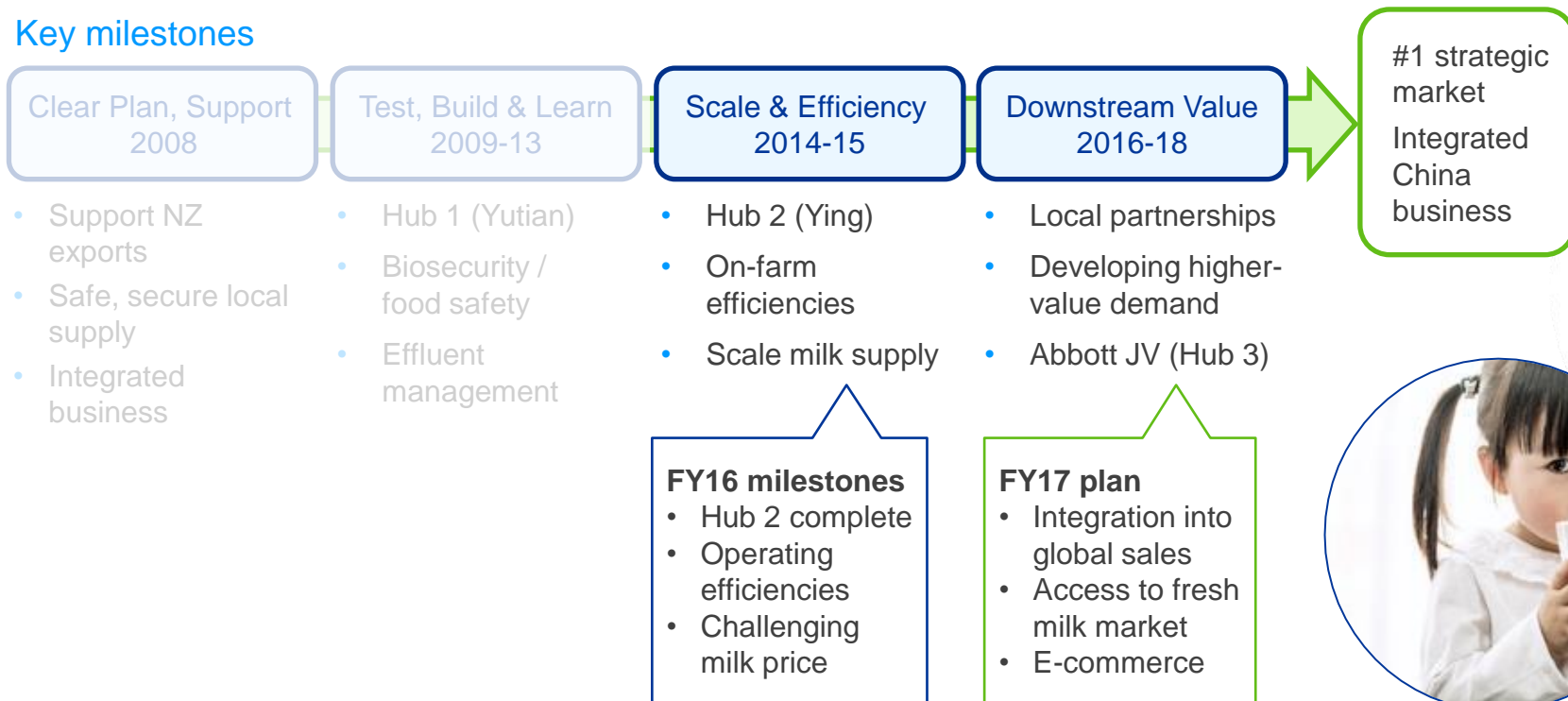


# China Farms

## Roadmap to integrated business in China following major industry change



### Key milestones





## Our Performance

# Continued strong business performance



## VOLUME

**23.7B LME**

↑ 4%

## REVENUE

**\$17.2B**

↓ 9%

## NORMALISED EBIT

**\$1,358M**

↑ 39%

## RETURN ON CAPITAL<sup>1</sup>

**12.4%**

↑ Up from 8.9%

## NET PROFIT AFTER TAX

**\$834M**

↑ 65%

## ANNUAL DIVIDEND / YIELD<sup>2</sup>

**40CPS 7.3%**

↑ 60%

### Ingredients

Volume (LME) <sup>3</sup>	↑	22.4B
Gross Margin	↑	14.3%
Normalised EBIT	↑	\$1,204M
Return on Capital <sup>1</sup>	↑	13.4%

### Consumer and Foodservice

Volume (LME) <sup>3</sup>	↑	4.9B
Gross Margin	↑	28.7%
Normalised EBIT	↑	\$580M
Return on Capital <sup>1</sup>	↑	41.7%

### China Farms

Volume (LME) <sup>3</sup>	↑	0.2B
Gross Margin	↑	(22.4%)
Normalised EBIT	↓	(\$59M)

1. Return on Capital (ROC) excludes goodwill, brands and equity accounted investments; Group ROC including these items was 9.2% in FY16 (FY15: 6.9%)

2. FY16 dividend over volume weighted average closing FCG share price (\$5.50) across the year; 3. Includes sales to other strategic platforms

# Value creation

Higher return on capital from gains on all business drivers



## RETURN ON CAPITAL

# 12.4%

↑ Up from 8.9%

GROSS MARGIN

## 21.1%

↑ Up from 17.4%

CAPEX

## \$944M

↓ 38%

OPEX

## \$2,528M

↓ 8%

WORKING CAPITAL

## 77 DAYS

↓ Down 10 days

NORMALISED EBIT

## \$1,358M

↑ 39%

DIVESTMENTS

## \$308M

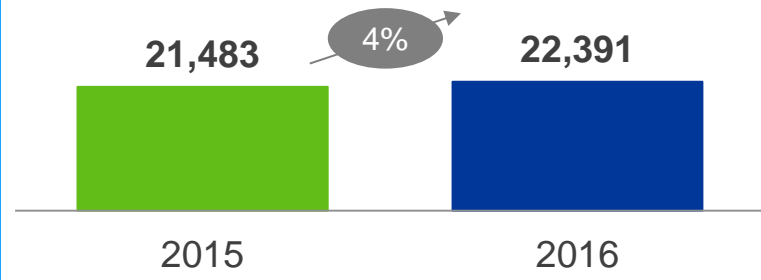
*Note: Return on Capital (ROC) excludes goodwill, brands and equity accounted investments; Group ROC including these items was 9.2% (2015: 6.9%)*

# Ingredients

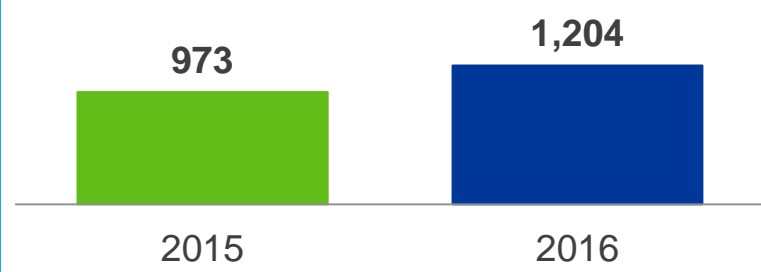
Return on capital of 13.4%



Volume (m LME)<sup>1</sup>



Normalised EBIT (\$m)



## Volume

- Strong sales volume despite lower milk collections and challenging global market
- Lower closing inventory
- Higher sales of non-reference products (e.g. cheese)

## Value

- Optimising product returns through optionality
- Ingredients solutions meeting customer needs
- Lower costs in manufacturing – improved yield, lower exception stocks, no peak costs
- Australia: \$63m normalised EBIT and reduced working capital

## Velocity

- Good working capital performance through focus on inventory and supply chain

1. Includes sales to other strategic platforms

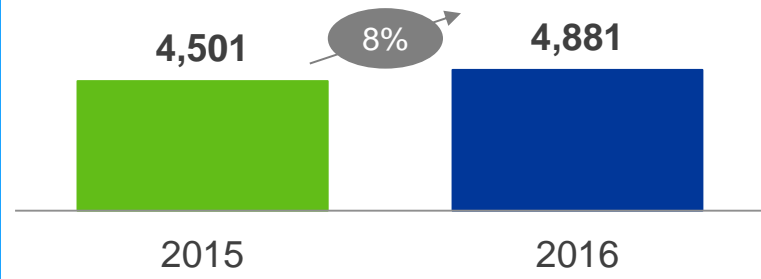
Note: Return on Capital (ROC) excludes goodwill, brands and equity accounted investments

# Consumer and Foodservice

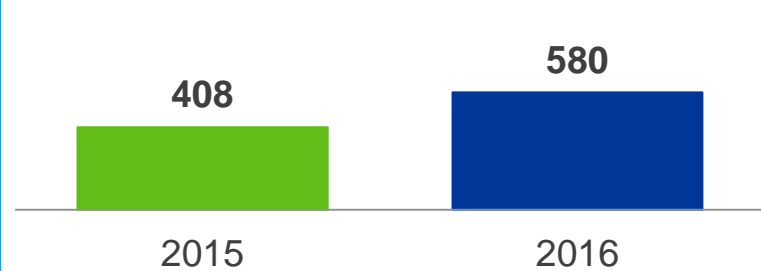
Return on capital of 41.7%



Volume (m LME)<sup>1</sup>



Normalised EBIT (\$m)



## Volume

- 380m more LME into higher-value (1b in last two years)
- Foodservice growth of 15%
- Strong innovation agendas driving more volume into higher-returning products

## Value

- Normalised EBIT significantly up in Oceania, Asia and Greater China
- Reduced capital base through divestments and lower working capital

## Velocity

- Turnaround of Australian business
- Operating efficiencies and improved go-to-market across all regions

1. Includes sales to other strategic platforms

Note: Return on Capital (ROC) excludes goodwill, brands and equity accounted investments

# Consumer and Foodservice

## Growth and margin expansion in both channels



### Consumer

Volume (m LME)<sup>1</sup>

**2,920**

5%

**3,066**

2015

2016

Gross Margin (%)

**27%**

**29%**

2015

2016

### Foodservice

Volume (m LME)<sup>1</sup>

**1,581**

15%

**1,815**

2015

2016

Gross Margin (%)

**22%**

**27%**

2015

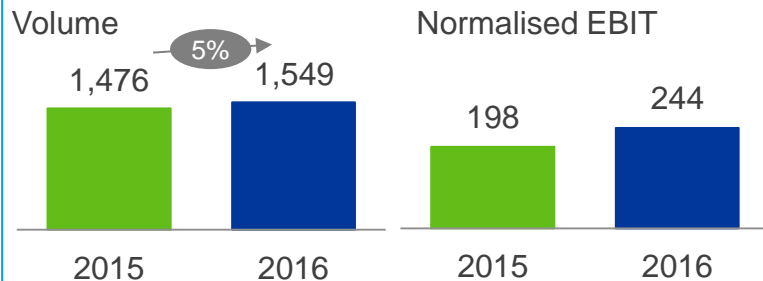
2016

1. Includes sales to other strategic platforms

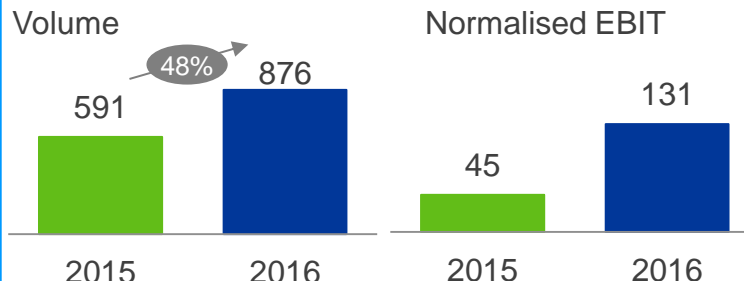
# Consumer and Foodservice

Further delivery of strategy – 1 billion more LME in last two years

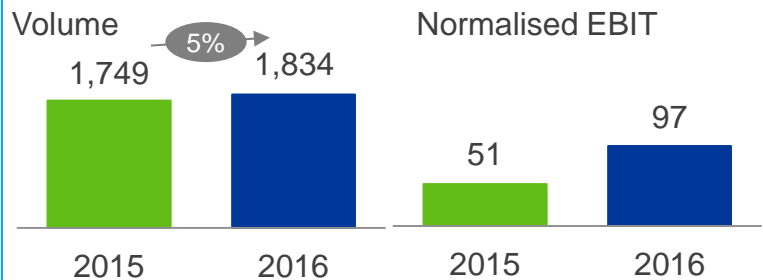
## Asia<sup>1</sup>



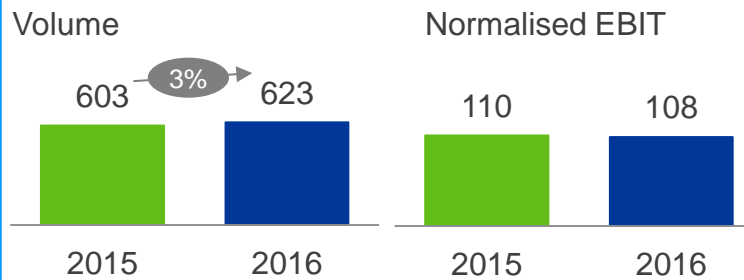
## Greater China



## Oceania



## Latin America<sup>2</sup>



1. FY15 figures adjusted for reclassification of the North Asia business from Foodservice to Ingredients (FY15: 82 million LME, \$4m normalised EBIT)

2. Excluding Venezuela, Latin America result: volume up 25 million LME to 611 million LME, normalised EBIT up \$20 million to \$99 million

Note: Volume shown is million LME (includes sales to other strategic platforms) and normalised EBIT is million NZ \$

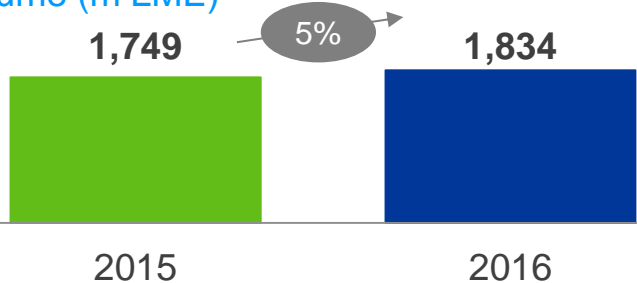


# Oceania – Consumer & Foodservice

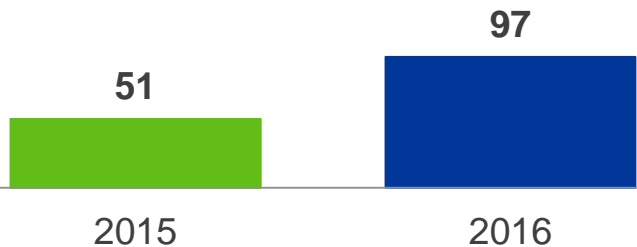
Good result – strong in NZ and return to profit in Australia



Volume (m LME)<sup>1</sup>



Normalised EBIT (\$m)



## Volume

- NZ volume growth in fresh milk, butter & powders
- Supported new product launches including Annum NZ, Kapiti Sorbet, Top Notch tubs
- Launch of Anchor micro-filtrated milk in Victoria and record Foodservice sales

## Value

- Best-in-class service levels with supermarkets
- Divestment of loss-making business in Australia

## Velocity

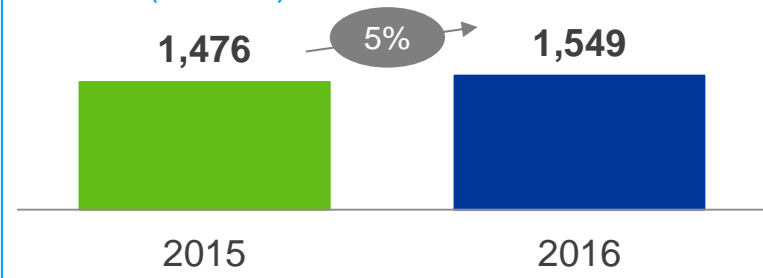
- Executing strategy faster in both markets
- Turnaround in performance in Australia

1. Includes sales to other strategic platforms

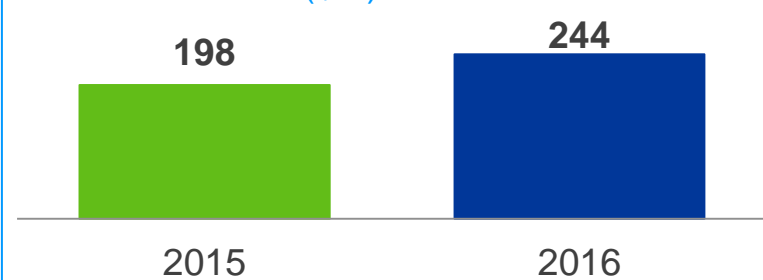
# Asia – Consumer & Foodservice

## Earnings up despite flat volumes

Volume (m LME)<sup>1 2</sup>



Normalised EBIT (\$m)



### Volume

- Sri Lanka volumes up 22%
- Foodservice growth of 10% across region<sup>2</sup>
- Launched low cost milk powder in Ethiopia

### Value

- Uplift from lower milk prices partially offset by price decreases across markets
- Increased advertising spend supporting key product launches in Sri Lanka, MEA, and Malaysia

### Velocity

- Supporting forward deployment initiative in Middle East for Ingredients

1. Includes sales to other strategic platforms

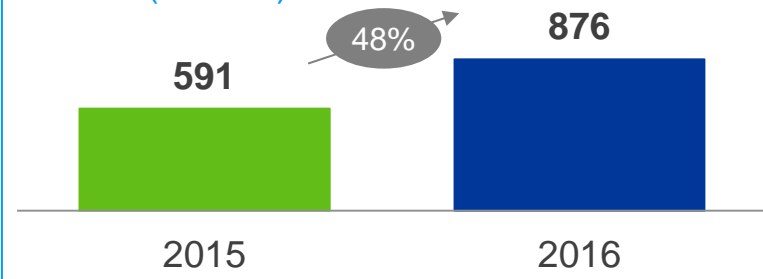
2. FY15 figures adjusted for reclassification of the North Asia business from Foodservice to Ingredients (FY15: 82 million LME, \$4m normalised EBIT)

# Greater China – Consumer & Foodservice

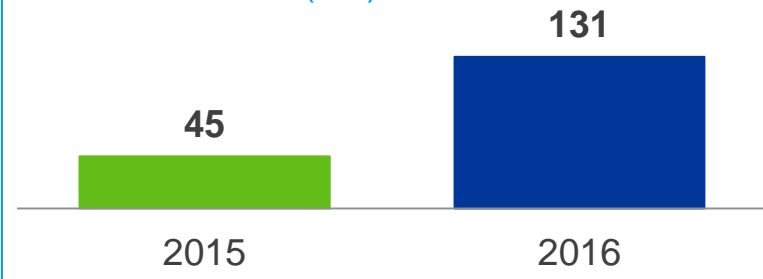
Ongoing growth & profitability with strong Foodservice contribution



Volume (m LME)<sup>1</sup>



Normalised EBIT (\$m)



## Volume

- Foodservice growing in all channels and markets on back of strong brands
- Strong position in the imported milk segment
- Annum distribution increased

## Value

- Strength across markets – Taiwan and Hong Kong both delivering strong results

## Velocity

- Focus on reducing costs across business
- Integrating businesses with China Farms

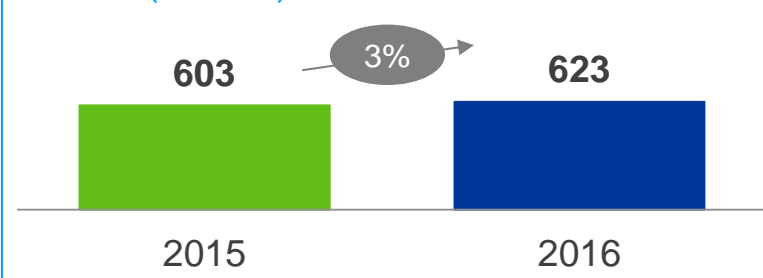
1. Includes sales to other strategic platforms

# Latin America – Consumer & Foodservice

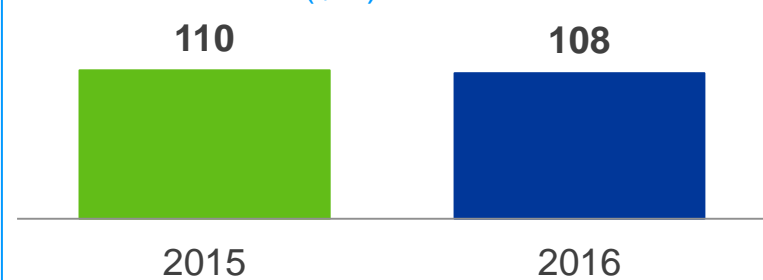
## Good result in challenging macro-economic environment



Volume (m LME)<sup>1</sup>



Normalised EBIT (\$m)



### Volume

- Sustained volume growth from Soprole driven by innovation agenda
- Volume growth and market share gains in Brazil
- Lower volume growth due to Venezuelan supply issues

### Value

- Implemented new go-to-market models in Soprole and Brazil – results now being seen
- High Brazil milk price impacted returns in second half
- Continued high-value from trading business in Caribbean

### Velocity

- Positive results from our Brazil transformation
- Reduced exposure of US dollars in Venezuela

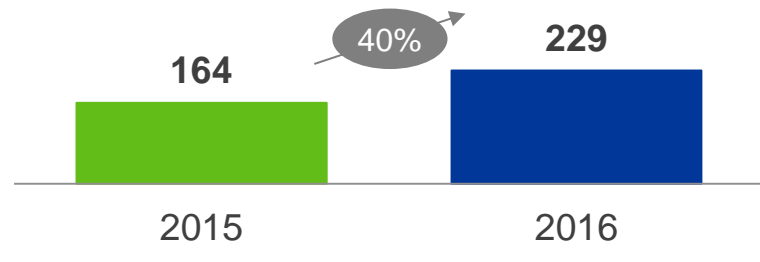
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Note: Excluding Venezuela, Latin America result: volume up 25 million LME to 611 million LME, normalised EBIT up \$20 million to \$99 million

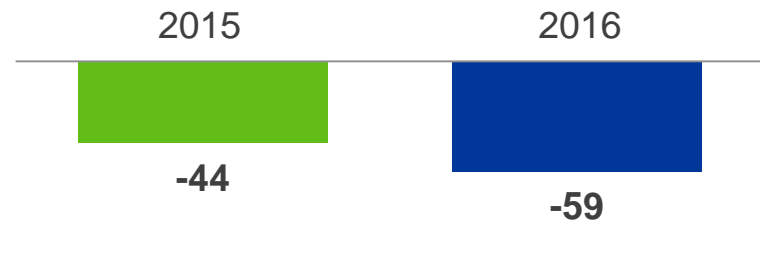
# China Farms

## Key to integrated dairy business

Volume (m LME)<sup>1</sup>



Normalised EBIT (\$m)



### Volume

- Increased milk volume sold by 40%
- Ying expansion now complete – further volume growth in FY17 and FY18 as herd establishes
- Building first farm at third hub (Abbott JV)

### Value




- Reduced cash costs by RMB 0.81 per litre
  - Lower feed, labour, effluent, overheads costs
- Low Chinese milk price continues to impact earnings

### Velocity

- Hubs 1 & 2 now complete – capex now at maintenance levels
- Plan to capture downstream value by integrating our farms into our brands and sales channels in China

# Return on capital

## Comparison to competitors<sup>1</sup>

	Revenue Mix		Total EBIT %	Asset Efficiency Ratio	Return on Capital		
	Ingredients	Consumer			2016	2015	2014
	63%	37%	8.3%	2.1	12.4% <sup>2</sup>	8.9%	4.7%
	43%	57%	5.1%	3.4	9.9% <sup>3</sup>	10.4%	8.9%
	13%	87%	3.9%	3.1	7.5% <sup>3</sup>	7.9%	9.7%

1. Arla and Friesland based on FY15 results (Dec year end), Fonterra based on FY16 results

2. Fonterra ROC as calculated for FY16 Annual Report

3. ROC for competitors calculated as NOPAT divided by Invested Capital. NOPAT defined as reported NPAT plus finance costs; Invested capital defined as two-year closing balance average of debt + equity – deferred tax

# Financial discipline

Strengthening balance sheet supports solid credit rating



GEARING<sup>1</sup>

44.3%

↓ Down from 49.7%

NET DEBT<sup>2</sup>

\$5.5B

↓ 23%

DEBT / EARNINGS<sup>3</sup>

2.8X

↓ Down from 4.7x

FREE CASH FLOW

\$2.2B

CREDIT RATING

A  
STABLE  
Fitch

A-  
STABLE  
S&P

1. Gearing ratio is economic net interest bearing debt divided by economic net interest bearing debt plus equity excluding cash flow hedge reserve

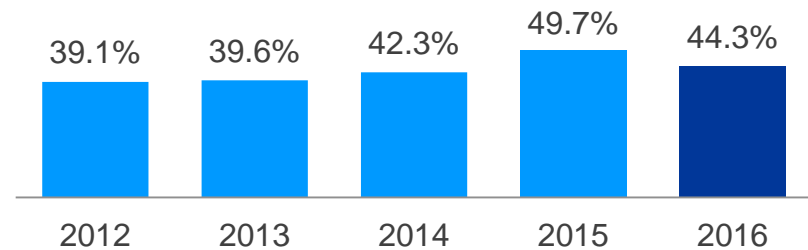
2. Economic net interest-bearing debt

3. Debt payback ratio is economic net interest bearing debt divided by EBITDA. Both debt and EBITDA are adjusted for the impact of operating leases

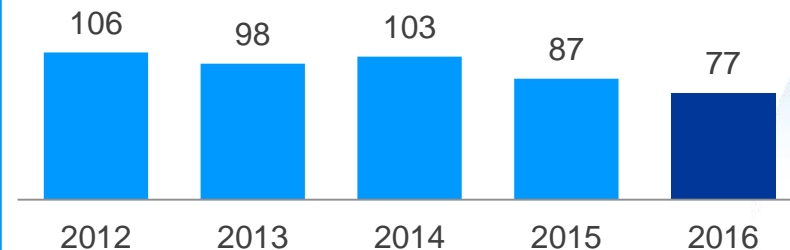
# Financial strength of the Co-op

## Strengthening balance sheet supports solid credit rating

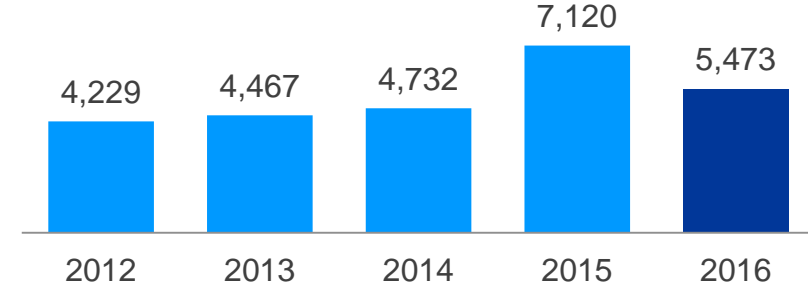
Gearing<sup>1</sup>



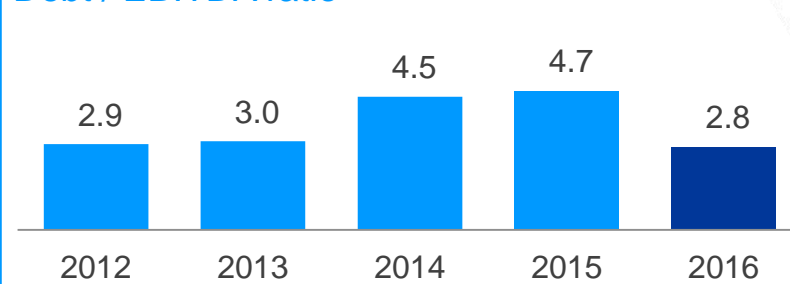
Working capital days<sup>2</sup>



Net debt<sup>3</sup>



Debt / EBITDA ratio<sup>4</sup>



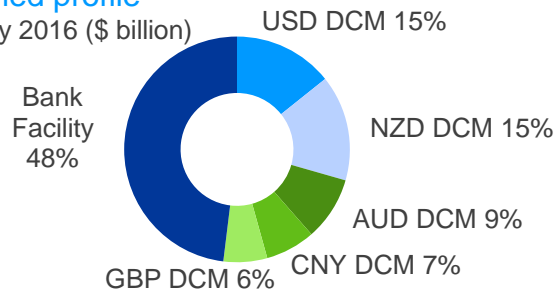
1. Gearing ratio is economic interest bearing debt divided by economic net interest bearing debt plus equity excluding cash flow hedge reserve; 2. Working capital days excludes amounts owing to suppliers; 3. Economic net interest-bearing debt (\$ million); 4. Ratio is economic net interest bearing debt divided by EBITDA. Both debt and EBITDA are adjusted for the impact of operating leases



# Diversified and prudent funding position

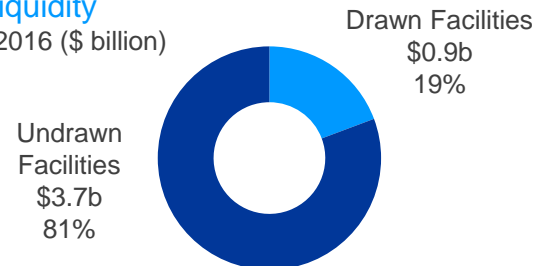
## Diversified profile<sup>1</sup>

At 31 July 2016 (\$ billion)



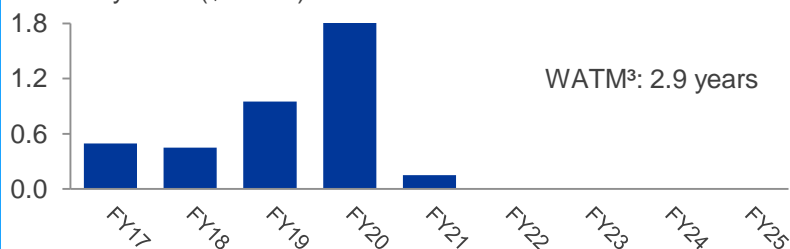
## Prudent liquidity

At 31 July 2016 (\$ billion)



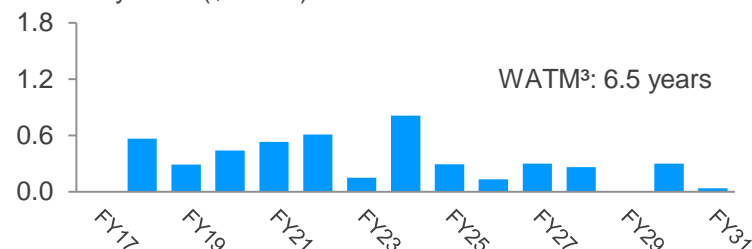
## Bank facility maturity profile

At 31 July 2016 (\$ billion)



## DCM maturity profile<sup>2</sup>

At 31 July 2016 (\$ billion)



1. Includes undrawn facilities and commercial paper

2. Excluding commercial paper

3. WATM is weighted average term to maturity



# Outlook

# Plan for FY17



# Our ambition is on track



	From (2015)	Ambition	2016
Revenue <sup>1</sup>	Ingredients \$0.7 / LME Consumer & Foodservice \$1.5 / LME	\$1.2 / LME	Ingredients \$0.6 / LME Consumer & Foodservice \$1.3 / LME
Gross Margin	17%	20%+	21%
Normalised EBIT	\$1.0b	50-100% uplift	39% uplift
Return on Capital <sup>2</sup>	8.9%	11-13%	12.4%
Gearing <sup>3</sup>	45-50%	40-45%	44.3%

1. Includes sales to other strategic platforms; 2. Return on Capital (ROC) excludes goodwill, brands and equity accounted investments; Group ROC including these items was 9.2% in FY16 (FY15: 6.9%); 3. Fonterra's target is to maintain its strong investment grade credit rating and debt payback & cash flow coverage metrics that support this

# Building momentum reflected in outlook for 2017



- Forecast for 2016/17:
  - A forecast Farmgate Milk Price of \$5.25 per kgMS
  - A forecast earnings performance of 50-60 cents per share
  - Reflects performance improvements across the business
- Global supply and demand to continue to change over course of this season
  - Expecting EU to revert to normal growth of 1% per annum
  - Fonterra inventory at historic low and milk supply forecast down
  - China imports in last 3 months are up 21% on last year
  - A supply or demand shock could significantly change the current outlook





# Supplementary Information

# Normalised EBIT reconciliation

\$ million	Year ended 31 July 2016	Year ended 31 July 2015
<b>Profit after tax</b>	<b>834</b>	<b>506</b>
Add: Net finance costs	<b>499</b>	<b>518</b>
Add/(Less): Taxation expense (credit)	<b>98</b>	<b>(82)</b>
<b>Total reported EBIT</b>	<b>1,431</b>	<b>942</b>
Add: Impairment of assets in Australia	<b>23</b>	<b>108</b>
Add: Restructuring and redundancy provisions	<b>-</b>	<b>33</b>
Less: Gain on DairiConcepts sale	<b>(68)</b>	<b>-</b>
Less: Gain on Latin America strategic realignment	<b>-</b>	<b>(129)</b>
(Less)/Add: Time value of options	<b>(28)</b>	<b>20</b>
<b>Total normalisation adjustments</b>	<b>(73)</b>	<b>32</b>
<b>Total normalised EBIT</b>	<b>1,358</b>	<b>974</b>