

Fonterra Co-operative Group Limited

Results for Announcement to the Market



Reporting Period	Six months ended 31 January 2014
Previous Reporting Period	Six months ended 31 January 2013

	31 January 2014 (NZD million)	31 January 2013 (NZD million)	Percentage Change
Revenue from sale of goods	11,292	9,334	21%
Net profit attributable to Shareholders of the company ¹	206	449	(54)%
Non-controlling interests	11	10	10%
Net profit for the period	217	459	(53)%

¹ Net profit attributable to shareholders of the company is equivalent to profit from ordinary activities after tax attributable to shareholders of the company (as required to be disclosed pursuant to Clause 1.2 of Appendix 1 of the NZSX and NZDX Listing Rules).

Interim/Final Dividend	Amount per Security (NZ cents)	Imputed Amount per Security (NZ cents)
Interim	5.0	nil

Record Date	Interim: 10 April 2014
Dividend Payment Date	Interim: 17 April 2014

Comments	On 25 March 2014, the Board of Directors declared an interim dividend of 5.0 cents per share payable on 17 April 2014 to Shareholders on the share register at 10 April 2014.
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To be followed by the balance of the information required in the report pursuant to Appendix 1.

26 March 2014

FONTERRA INTERIM PROFIT DOWN RECORD FORECAST CASH PAYOUT MAINTAINED

Click here to review the [Interim Results presentation and Interim Report](#).

Interim Results Highlights

- Forecast Cash Payout for the 2013/14 Season of \$8.75, up 42 per cent
 - Farmgate Milk Price \$8.65 per kgMS
 - Estimated full year dividend of 10 cents per share
- Revenue \$11.3 billion, up 21 per cent
- Normalised EBIT \$403 million, down 41 per cent
- Net profit after tax (NPAT) \$217 million, down 53 per cent
- Earnings per share 13 cents, down 54 per cent
- Interim dividend of five cents per share

Strong forecast Cash Payout

Fonterra Co-operative Group is on track to deliver the highest-ever returns to Farmer Shareholders and the New Zealand economy, with a forecast Cash Payout of \$8.75.

Chairman John Wilson said the forecast Cash Payout – comprising a forecast Farmgate Milk Price of \$8.65 per kgMS and an estimated dividend of 10 cents per share – is strong compared with last season's final Cash Payout of \$6.16 per kgMS.

"A forecast Cash Payout of \$8.75 represents a \$13.8 billion injection into the New Zealand economy. An estimated 50 cents in every \$1 of payout is spent by our farmers locally, meaning the benefits will be felt in urban as well as rural communities¹," said Mr Wilson.

"Our current Season forecast reflects sustained strong milk powder prices which, on average, are ahead by US\$1,200 per tonne compared to last season.

"Although we are forecasting the highest-ever Farmgate Milk Price returns and have achieved strong revenue growth, NPAT is down 53 per cent to \$217 million. Normalised EBIT is also down 41 per cent to \$403 million, compared with the very strong earnings in the first half of last year," said Mr Wilson.

Business Performance

The first half has been exceptional for the Co-operative, as a result of high volatility driven by record demand for milk powders, resulting in a 21 per cent increase in revenue, said CEO Theo Spierings.

"The Season saw record milk volumes collected across the October - November peak period, and milk volumes collected for the Season to date increased by four per cent on the prior year to 1,120 million kgMS.

"We processed as much of this milk into the higher returning milk powder product streams (Reference

Commodity Products) as we could. However, our current asset footprint meant that around 25 per cent had to be processed into cheese, casein and other Non-Reference Commodity Products which earned negative returns over the period,” said Mr Spierings.

The divergence between Reference Commodity Product and Non-Reference Commodity Product returns accounted for the Co-operative’s highest-ever forecast Farmgate Milk Price being 70 cents per kgMS less than that calculated in the Farmgate Milk Price Manual.

“The past six months has been a period of mixed fortunes for the Co-operative,” said Mr Spierings.

“Volatility is a fact of life in dairy. We are very focused on delivering a consistently strong Farmgate Milk Price, as well as stable and growing earnings over the medium to long term.

“Higher dairy commodity prices have put increasing pressure on margins in our consumer and foodservice businesses. We had to strike a balance between passing on rising costs immediately or continuing to build our market presence to secure long term growth.

“Taking the longer term view has constrained profitability during this run of strong commodity pricing, but we are positioning ourselves for the future with consumer and foodservice volumes in key strategic markets like Asia (up 10 per cent, excluding Sri Lanka which was affected by the temporary suspension of operations in August 2013).

“Being disciplined with operating expenses, which were flat for the period, contributed to our ability to offset some of the rising input costs,” he said.

Strategy Update

“Our V3 business strategy developed in 2012 has accurately predicted growing demand for dairy in emerging markets, and that demand would outstrip supply growth,” said Mr Spierings. “The past six months have shown that the trends identified in our strategy are moving faster than expected. We are focusing on five priorities:

- Optimising our global ingredients sales and operations footprint
- Growing significantly in everyday nutrition
- Continuing our foodservice growth momentum
- Capturing high margins in advanced nutrition
- Enabling growth by expanding beyond New Zealand to selectively invest in milk pools, matching demand with the best market opportunities.

“We need to ensure our farmers can confidently grow supply. We are in a competitive market for milk, so retaining and growing our New Zealand supply is always a priority. Returning the highest Farmgate Milk Price is crucial, as good returns enable our Farmer Shareholders to cover their rising costs and to invest in their farms and futures.

“To support on-farm growth we are successfully offering more flexible supply contracts which offer staged payment options for Shares. We have also provided more financial flexibility for Farmer Shareholders by piloting a Guaranteed Milk Price scheme, enabling them to lock in the price paid for a percentage of their milk. We will continue looking at new ways of providing financial flexibility over the course of this year.

“Delivering the highest shareholder returns means making the products which earn the best returns over time. Since our inception in 2001, we have consistently invested in growing the capacity that counts, especially in milk powders. We will continue down this path but at a faster pace, ensuring assets come on stream ahead of expected increases in milk production.

“We are bringing forward planned capital investments which will provide:

- Greater flexibility to take advantage of relative market prices;
- The additional capacity will reduce forced making of lower returning products;
- The ability to take higher volumes from existing suppliers and new volume from joining suppliers.

“This will result in additional capital expenditure of \$400 - \$500 million over the next three to four years.

“Even with fast-tracked investments, adding capacity will take time so we also have a programme in place to increase throughput in existing plant during the 2015 financial period.

“Milk sourced in New Zealand will always be our top priority. But it is also important we maintain our global view of both manufacturing and milk supply to ensure a win-win for Fonterra and our Farmer Shareholders,” said Mr Spierings.

Outlook

“Looking ahead, the outlook for dairy remains strong, and the business has plans in place to profit from the continued rise in global dairy demand,” said Mr Spierings.

“Global dairy commodity prices, however, remain volatile. While we are maintaining the current forecast Farmgate Milk Price, we will continue to review it and update the market, as required.”

The Board is therefore maintaining its 65 to 75 per cent dividend payout ratio. It has declared an interim dividend of five cents per share, equivalent to 50 per cent of the forecast dividend for the current financial year. The record date for the interim dividend is 10 April, and the payment date is 17 April.

1. New Zealand Institute of Economic Research, Report to Fonterra and Dairy NZ – “Dairy’s role in sustaining New Zealand the sector’s contribution to the economy”, December 2010.

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For further information contact:

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About Fonterra

Fonterra is a global leader in dairy nutrition – the preferred supplier of **dairy ingredients** to many of the world’s leading food companies. Fonterra is also a market leader with our own **consumer dairy brands** in Australia/New Zealand, Asia/Africa, Middle East and Latin America.

The **farmer-owned** New Zealand co-operative is the largest processor of milk in the world, producing more than two million tonnes of dairy ingredients, value added dairy ingredients, specialty ingredients and consumer products every year. Drawing on **generations of dairy expertise**, Fonterra is one of the largest investors in dairy based **research and innovation** in the world. Our more than **16,000 staff** work across the dairy spectrum from advising farmers on sustainable farming and milk production, to ensuring we live up to exacting quality standards and delivering every day on our customer promise in more than 100 markets around the world.



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APPENDIX ONE

Half year financial highlights by business divisions

NZ Milk Products’ total sales volume was down two per cent to 1,441,000 MT, reflecting the low inventory levels at the start of the Season as a result of the previous season’s drought. Gross margin in NZ Milk Products was down 23 per cent to \$617 million, mainly because of the unfavourable impact of production challenges resulting from the high levels of milk received over the peak period. Normalised EBIT was down 43 per cent to \$236 million, compared to \$412 million in the previous period.

Oceania's total sales volume was down 13 per cent to 411,000 MT compared to last year, partially because of the sale of the Norco liquid distribution business in the prior period. Excluding this impact, sales volume was down nine per cent due to lower ingredients exports volumes, decreased nutritional volumes, and reduced yoghurt volumes in Australia. Despite a tough trading environment, volume in New Zealand was up four per cent and revenue grew six per cent following a lift in prices to partially recover significant increases in commodity costs. Oceania's normalised EBIT was 53 per cent lower than the last period at \$46 million.

Asia delivered volume growth through new product launches in China, foodservice growth particularly in China and Indonesia, and China farms. Sales volume growth of three per cent to 192,000 MT was constrained by our Sri Lanka business, which was significantly impacted by a temporary suspension of its market operations. We have implemented a sustained programme to rebuild consumer confidence and are making good progress. Excluding Sri Lanka, sales volume growth was up 10 per cent across Asia. Normalised EBIT was \$32 million which was 68 per cent lower than the previous period.

Latin America had sales volume growth of one per cent for the first half, mainly because Soprole increased volume in retail cheese sales and milk powder sales to the Government Health programme. Our Dairy Partners Americas (DPA) joint venture achieved a 67 per cent increase in earnings, largely from an improvement from the chilled and liquids branded business in Venezuela which managed to reduce losses incurred as a result of high inflation impacting input costs. This was achieved through price increases across our product portfolio. The DPA Brazil chilled and liquids business has experienced higher raw material prices and operating overheads which have not been recovered, resulting in lower margins and profitability in a highly competitive market. The DPA Manufacturing business also improved earnings as it improved cost recoveries. Normalised EBIT for Latin America was \$71 million, up six per cent from the same period last year.

Non-GAAP measures

Fonterra uses several non-GAAP measures when discussing financial performance. For further details and definitions of non-GAAP measures used by Fonterra, refer to the Glossary in Fonterra's 2013 Annual Review. These are non-GAAP measures and are not prepared in accordance with NZ IFRS.

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

- Fonterra calculates normalised earnings by adding back depreciation, amortisation, net finance costs, taxation expense and normalisation adjustments to net profit for the period.
- Normalisation adjustments are transactions that are unusual by nature or size so that they materially reduce the ability of users of the financial results to understand the ongoing performance of the Group or operating segment to which they relate.
- Unusual transactions by nature are the result of a specific event or set of circumstances that are outside the control of the business, or relate to the major acquisitions or disposals of an asset/group of assets or business.
- Unusual transactions by size are those that are unusually large in a particular accounting period that is not expected to repeat regularly to the same extent in future periods.
- Normalisation adjustments are determined on a consistent basis each year.

Reconciliation of normalised earnings to reported profit

(\$M)	31 Jan 2014	31 Jan 2013
Profit for the period	217	459
Add: Net finance costs	147	152
Add: Taxation expense	52	58
Total EBIT	416	669
(Less)/add: Normalisation adjustments		
- Costs associated with closure of Cororooke plant in Australia	-	24
- Time value of options ¹	(13)	(10)
Total normalised EBIT	403	683

¹ This was not presented as a normalisation adjustment in previous periods. The previous period has been restated to incorporate time value of options as a normalisation adjustment for consistency in the Group's approach from 2014 onwards.