

Market Announcement

7 December 2017

FONTERRA REVISES 2017/18 FORECAST FARMGATE MILK PRICE

Fonterra Co-operative Group Limited today reduced its forecast Farmgate Milk Price for the 2017/18 season from \$6.75 to \$6.40 per kgMS and updated the market on its financial results for the first three months of the 2018 financial year.

Chairman John Wilson says the lower forecast Farmgate Milk Price reflects a prudent approach to ongoing volatility in the global dairy market. The GlobalDairyTrade price for whole milk powder is a big influencer of the Farmgate Milk Price and it has declined by almost 10 percent since 1 August 2017.

“While the result of the arbitration with Danone has impacted our earnings guidance for the season, it has no influence on our forecast Farmgate Milk Price,” says Mr Wilson.

“What is driving this forecast is that despite demand for dairy remaining strong, particularly in China, other parts of Asia and Latin America, we are seeing strong production out of Europe and continued high levels of EU intervention stockpiles of Skim Milk Powder.

“This downward pressure on global prices is being partly offset by the lower NZ-US dollar exchange rate,” says Mr Wilson.

“Our strong financial position, customer order book at this point in the year, and confidence in demand means that the Board is able to increase the payments made in January by 10 cents per kgMS and will hold the Advance Rate through to the payments in May.

“In effect, our farmers will receive equal or higher payments for their milk over this period than were scheduled under the previous \$6.75 milk price.

Fonterra has also updated its full season New Zealand milk collection forecast due to ongoing challenging weather conditions. The Co-operative has reduced its forecast by 1 per cent to 1,525 million kgMS – the same volume as last season.

First Quarter Financial Results

Fonterra’s first quarter revenue of \$4 billion is up 4 per cent on the same period last year. Sales volumes are down 20 per cent to 3.9 billion liquid milk equivalent (LME), while the gross margin of 16.7 per cent is also down.

Chief Executive Theo Spierings says the first quarter financial results were generally as expected as the Co-operative started the year with record low inventory followed by the second year of low spring milk collections from New Zealand due to wet weather.

“This has challenged our Ingredients business where we had lower volumes to sell. As a result, sales were down 19 per cent to 3.6 billion LMEs compared to the same time last year.

The gross margin in Ingredients was in line with the second half of last year. However, when we compare it to the same period last year it was down from 12.1 per cent to 8.1 per cent, mainly due to the rise in commodity prices,” says Mr Spierings.

“Our Consumer and Foodservice business continued with strong sales volumes in our key markets across both Greater China and Asia with, overall, just a 3 per cent decline to 1.3 billion LMEs in total volume compared to the record levels at the same time last year.

“Gross margin in Consumer and Foodservice was 24 per cent. While this is down on the 31 per cent in the first quarter of 2017 when input costs were lower, it is up on the gross margin percentage in the last quarter of 2017. This positive trend demonstrates we can create more value in our Consumer and Foodservice business despite higher input costs and reflects the strength of our strategy of moving more volume into higher value.”

Mr Spierings says the Co-operative expected performance to be weighted to the second half of the year and remains confident in its full year forecasts following revisions after the recent Danone announcement.

“We are focused on continued tight operational and financial discipline and a keen eye on our customers’ needs to maximise sales opportunities.”

ENDS

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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. It is also a market leader with its own consumer dairy brands in New Zealand and Australia, Asia, Africa, the Middle East and Latin America. Fonterra is a farmer-owned co-operative and the largest exporter of milk in the world. It is one of the world’s largest investors in dairy research and innovation drawing on generations of dairy expertise to produce more than two million tonnes of dairy ingredients, value added dairy ingredients, specialty ingredients and consumer products for 140 markets.

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Dairy for life

PERFORMANCE REVIEW

Business Update

DECEMBER 2017
FONTERRA CO-OPERATIVE GROUP LIMITED

OUR CO-OPERATIVE

OUR POTENTIAL

OUR PERFORMANCE

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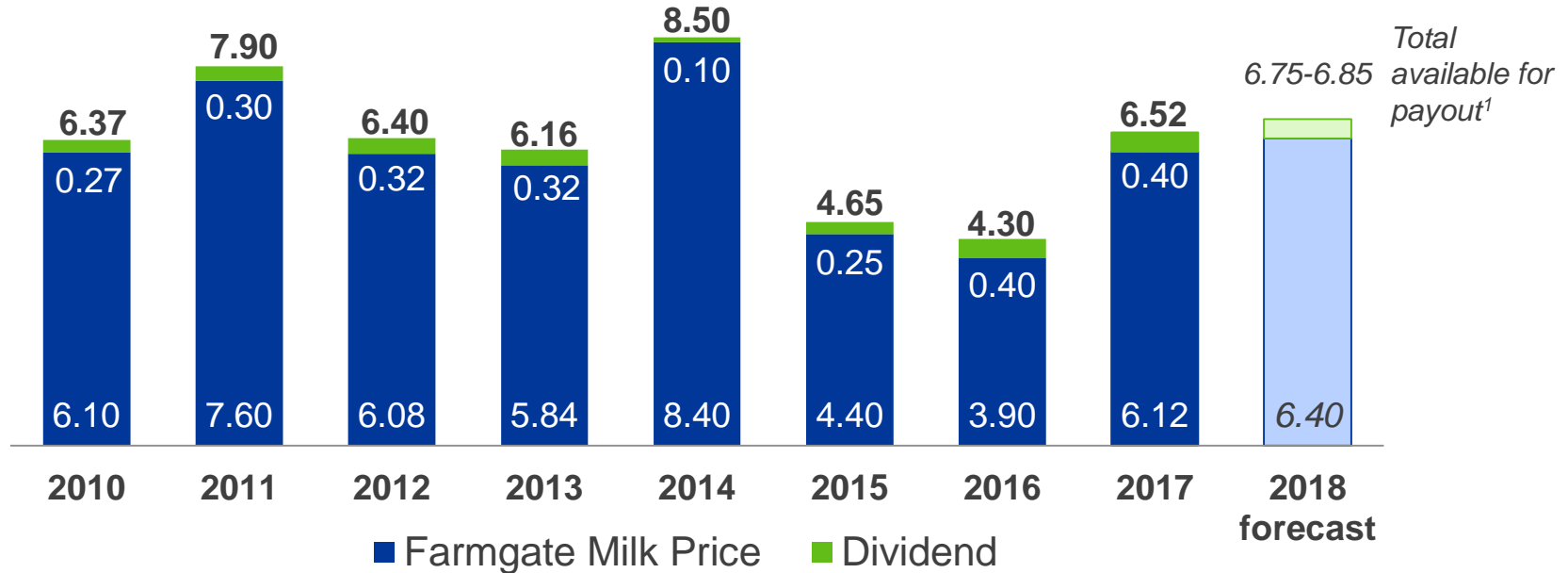
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Good season for our farmers

Forecasting a second year of solid results after two seasons of unusually low milk prices

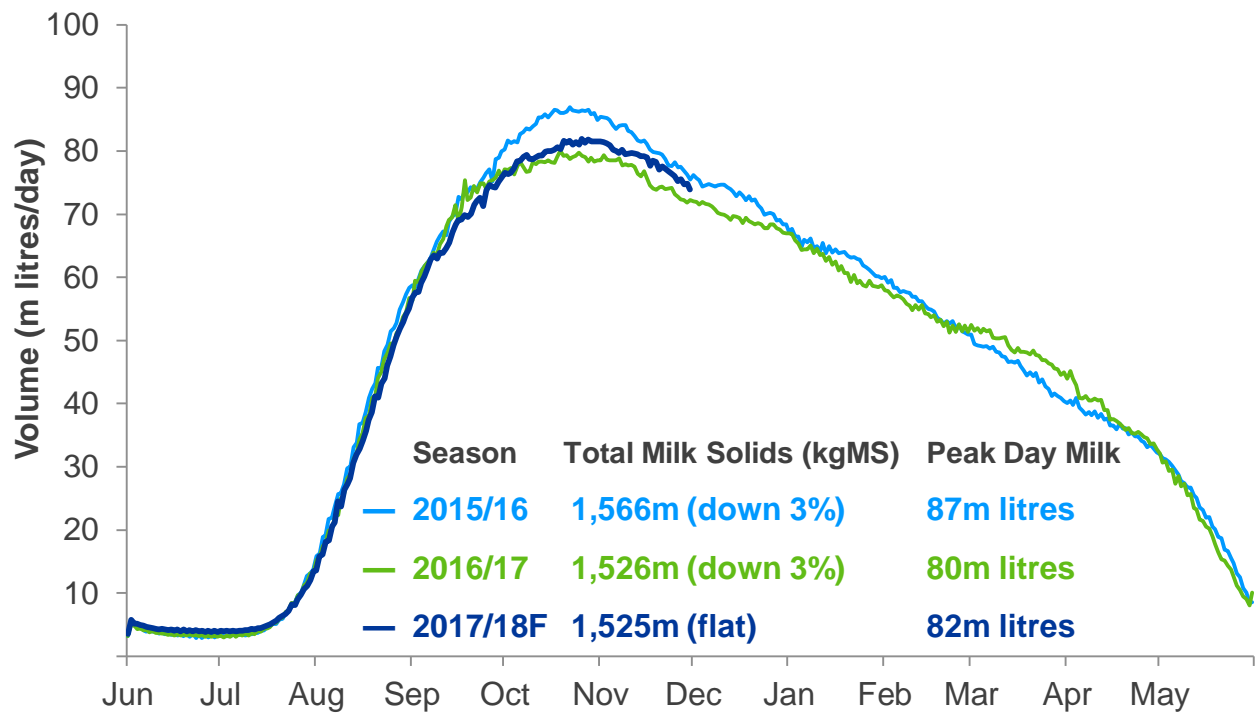


1. Total available for payout = Forecast Farmgate Milk Price + Forecast Earnings Per Share (EPS) of 45-55 cents; For farm budgeting purposes the likely dividend will be calculated in accordance with Fonterra policy of paying out 65-75 per cent of adjusted net profit after tax over time

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

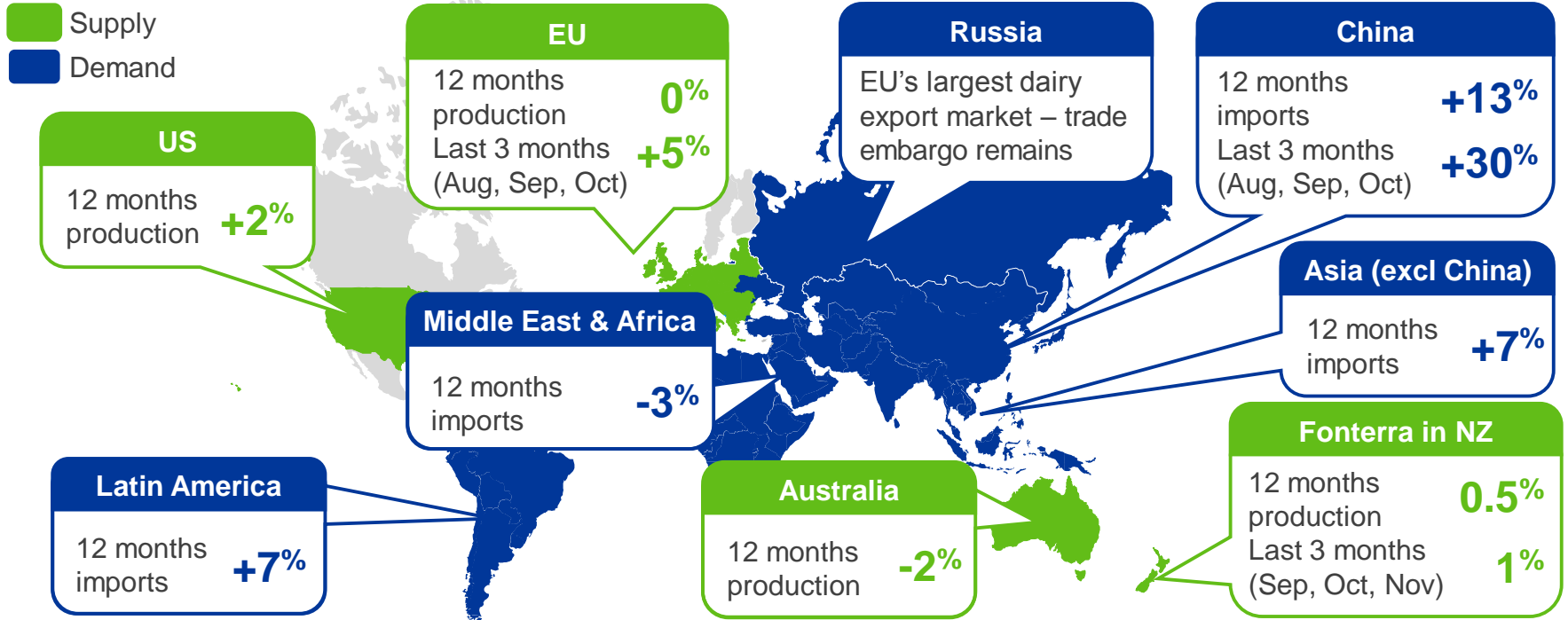
Low spring volumes – improved peak collection

Milk collection forecast for the season maintained



- Wet conditions have impacted milk production volumes through spring
- Volumes recovered in October with the quarter in line with last season
- Forecast reduced to 1,525m kgMS, same as last season
- Lower production volumes impacted costs and sales this quarter

Global dairy market – continued strong demand



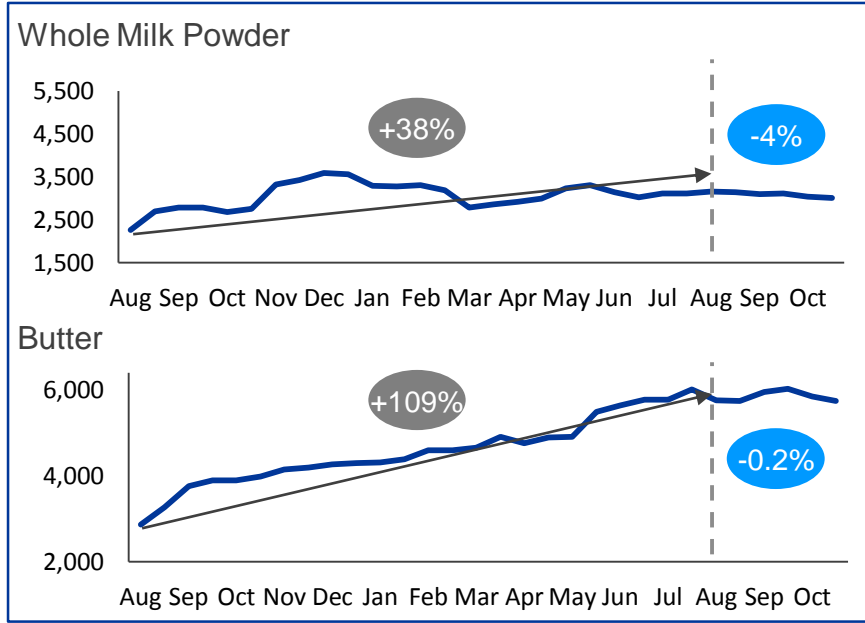
Note: All 12 month figures are rolling 12 months compared to previous comparable period: Australia (Oct), EU (Oct), United States (Oct), China (Oct), Asia (Aug), Middle East & Africa (Aug), Latin America (Aug)

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

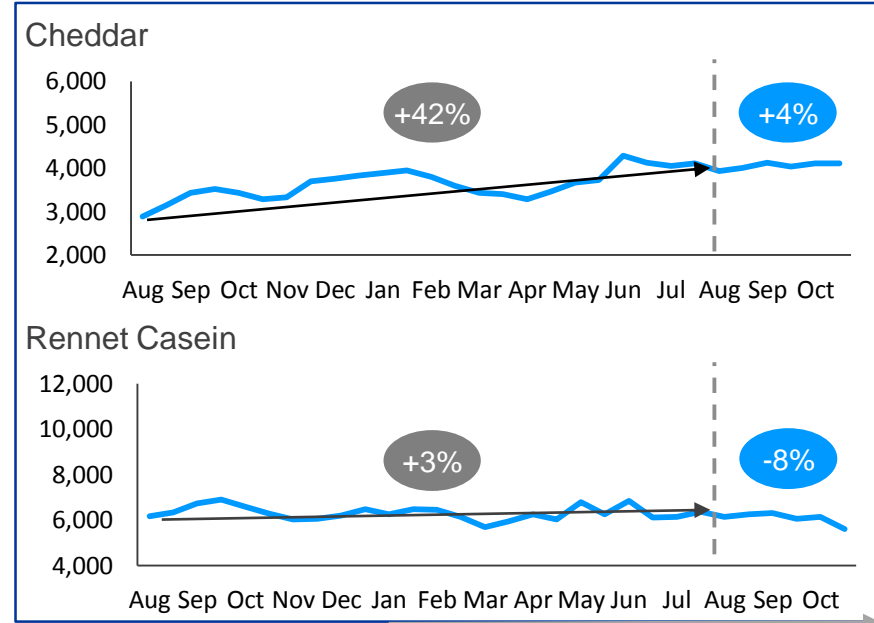
Dairy prices at higher levels

Currently neutral outlook for stream returns

Products informing the milk price



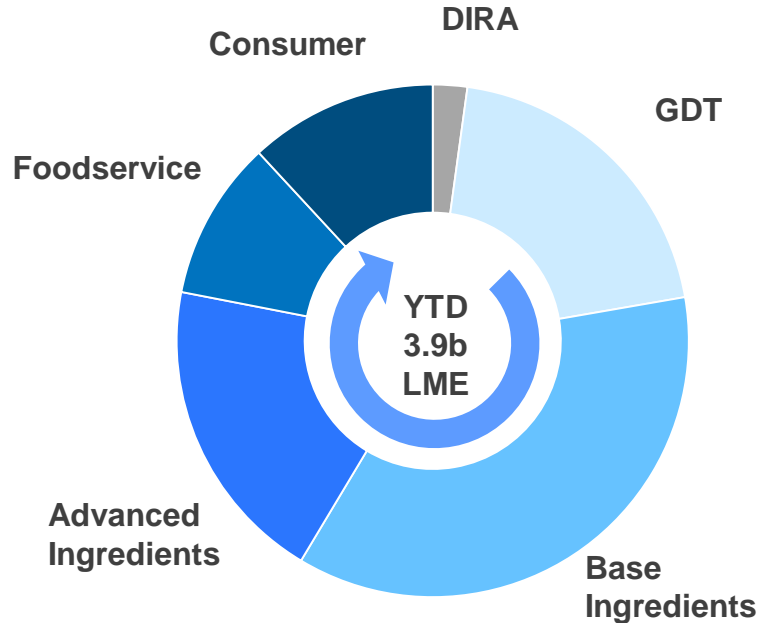
Other key products



Note: All prices in US dollars per MT; Changes shown for FY17 and Q1 FY18 respectively
 Source: GDT data

Continued focus on more volume to higher value

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



Note: Wheel shows percentage of total YTD external sales (LME)

Ingredients

- Lower sales due to low opening inventory and production phased to the end of the first quarter
- Advanced Ingredients target of additional 400m LME remains

Consumer & Foodservice

- Slightly below first quarter last year
- Growth in Greater China and Asia volumes
- Full year target of an additional 400m LME remains

FY18 Q1 performance summary

VOLUME (LME)

3.9B

↓ 20%

REVENUE

\$4.0B

↑ 4%

GROSS MARGIN

16.7%

↓ FROM 21.9%

OPEX

\$636M

↑ 2%

CAPEX

\$142M

↑ 22%

Ingredients

Volume (LME)

↓ 3.6B

DOWN 19%

Gross Margin

↓ 8.1%

FROM 12.1%

Consumer & Foodservice

Volume (LME)

↓ 1.3B

DOWN 3%

Gross Margin

↓ 24.0%

FROM 31.2%

China Farms

Volume (LME)

↑ 0.1B

UP 6%

Gross Margin¹

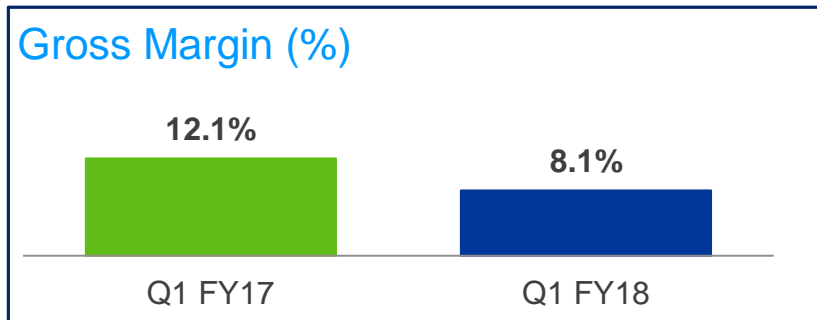
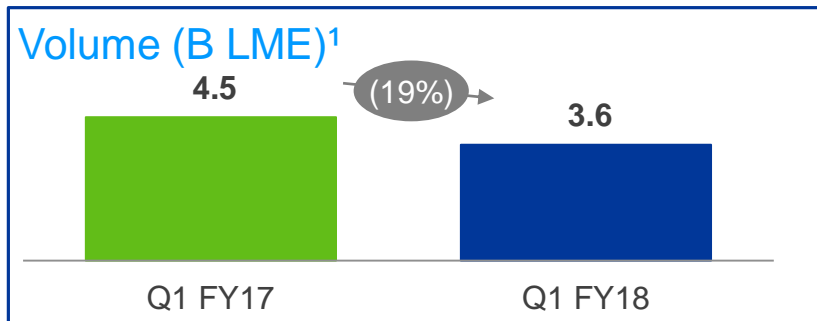
↑ 7.3%

FROM -11.6%

1. 2017 comparative impacted by one off sale of inventory below cost – gross margin excluding this input was 4%.
 Note: Volume is in billion LME. All changes are expressed relative to the first quarter of FY17

Ingredients

Challenging first quarter



1. Includes sales to other strategic platforms.

Note: Volume is in billion LME. All changes are expressed relative to the first quarter of FY17

Volume

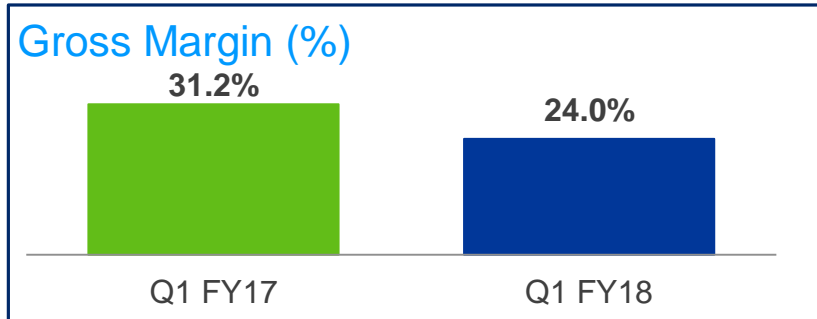
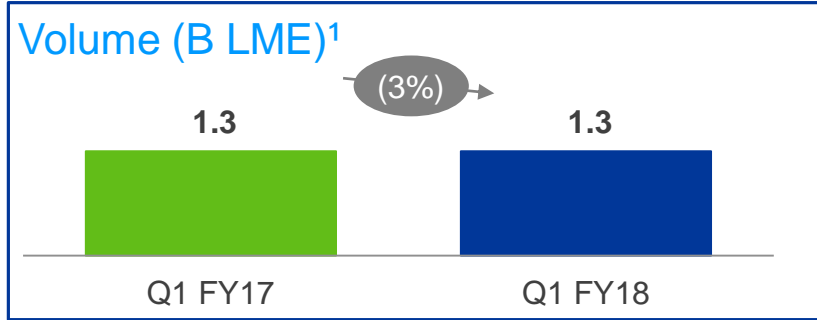
- Sales volumes lower due to low product levels
 - Record low opening inventory
 - Delayed product availability due to lower milk collection volumes early in the quarter

Value

- Lower margin percentage due to higher commodity prices
- Margins in line with second half of last year
 - Lower regulated return due to a decrease in the milk price model cost of capital
 - Pressure from fixed costs given lower volumes
- Slow start to price achievement
- Strong performance from Australia

Consumer & Foodservice

Solid first quarter



1. Includes sales to other strategic platforms; Q1 FY17 included sales from discontinued / transferred business in Oceania – on a like for like basis, Consumer and Foodservice volumes declined 2%

Note: Volume is in billion LME. All changes are expressed relative to the first quarter of FY17

Volume

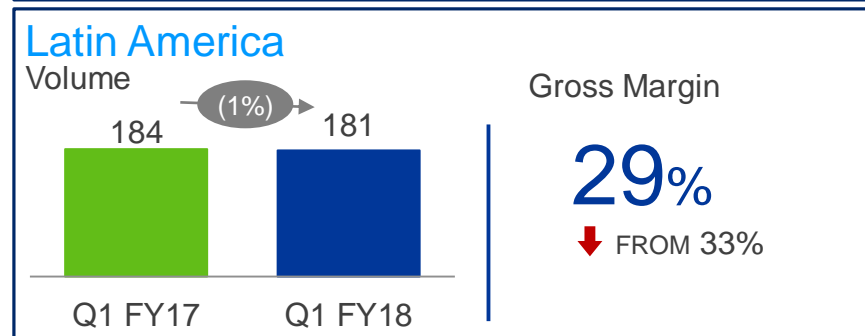
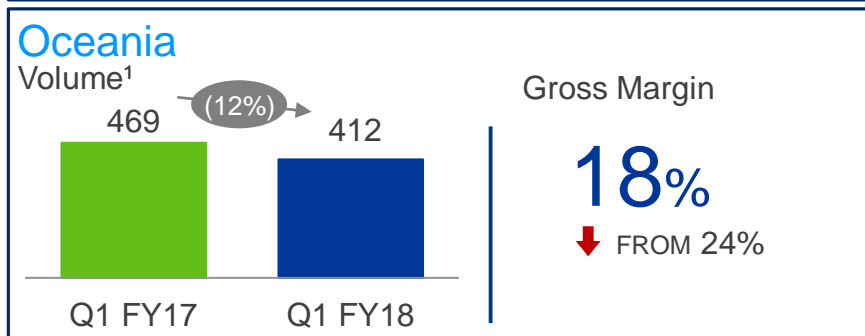
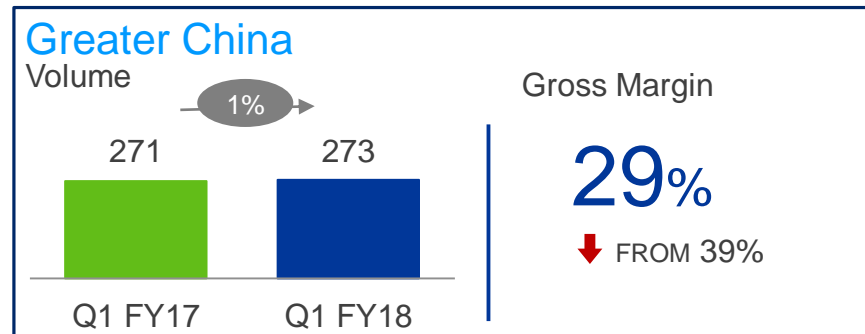
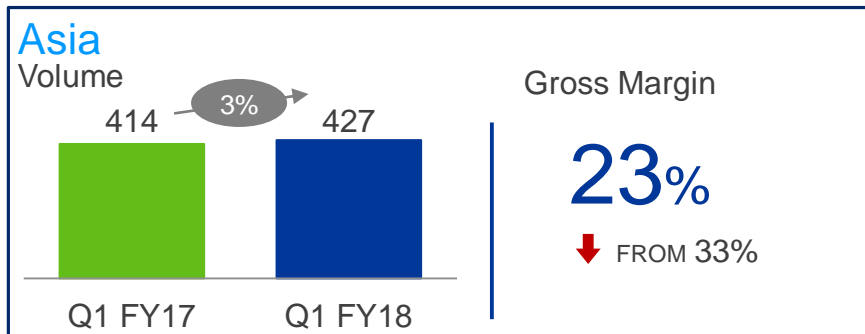
- Slight decline for the period with higher prices affecting consumer behaviour
- Greater China and Asia volumes both up
- Full year target of moving an additional 400m LME into higher value products remains

Value

- Higher input costs continue to put pressure on margins
- Gross margin percentage up on Q4 FY17 but down on Q1 FY17

Consumer and Foodservice

Continued growth in Greater China and Asia

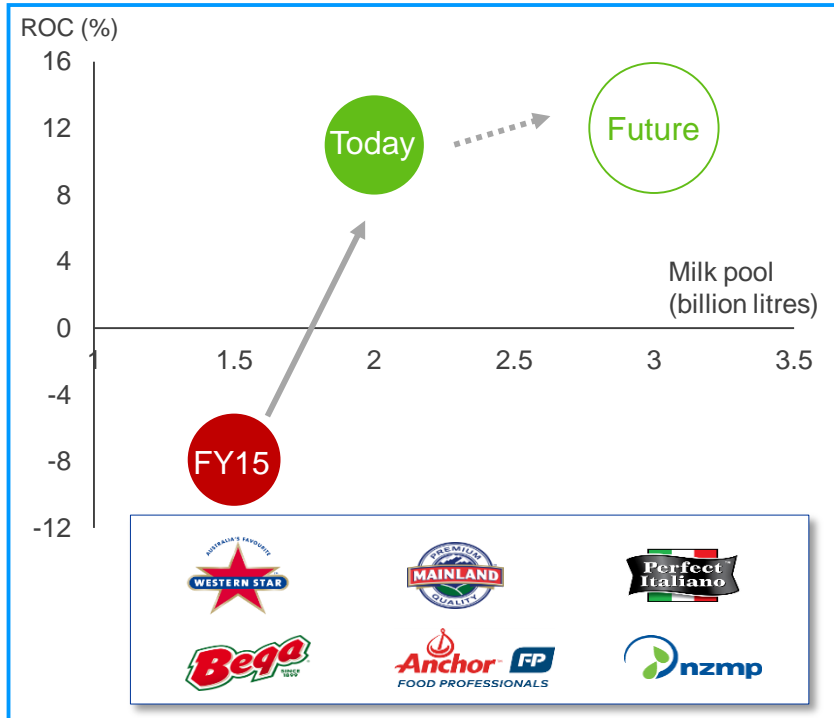


1. Q1 FY17 included sales from discontinued/transferred business in Oceania – on a like-for-like basis, Oceania volumes declined 8%.
 Note: All volumes include intercompany sales. Volume is in million LME. All changes are expressed relative to the first quarter of FY17

Australian growth plans to meet strong global demand



Growing volume and value in Australia



Our growth plans

- Fonterra Australia has reached full milk processing capacity at 2 billion litres
- Invest initial \$100m immediately to de-bottleneck plants in Australia
- Unlock 500 million litres of milk processing capacity
- Evaluating opportunity to introduce targeted co-op solution for Australian farmers
- Strongly aligned with our integrated cheese/whey/nutrionals milk pool strategy

Outlook

Outlook for balance of 2018

- Forecast Farmgate Milk Price of \$6.40 per kgMS
 - Global demand remains stable
 - Increased global supply placing pressure on prices, as reflected in GDT events since September
 - NZD weakening against USD, has provided some offset
 - Full year NZ milk collection forecast same as last year, 3% below initial forecast
- Reduced forecast earnings from 45-55 cents to 35-45 cents per share
 - Following the outcome of the WPC80 arbitration with Danone
 - Half year earnings expected to be down on last year with earnings weighted towards the second half of the year
 - Stream returns to remain neutral
 - Expect some strengthening in Consumer and Foodservice margins later in the year

Glossary

Acronyms and Definitions

AMF

Anhydrous Milk Fat

BMP

Butter Milk Powder

Base Price

Prices used by Fonterra's sales team as referenced against GDT prices and other relevant benchmarks

DIRA

Dairy Industry Restructuring Act 2001 (New Zealand)

GDT

GlobalDairyTrade, the online provider of the twice monthly global auctions of dairy ingredients

Gearing Ratio

Economic net interest bearing debt divided by economic net interest bearing debt plus equity excluding cash-flow hedge reserves

Farmgate Milk Price

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

Fluid and Fresh Dairy

The Fonterra grouping of skim milk, whole milk and cream – pasteurised or UHT processed, concentrated milk products and yoghurt

kgMS

Kilogram of milk solids, the measure of the amount of fat and protein in the milk supplied to Fonterra

LME (Liquid Milk Equivalent)

A standard measure of the amount of milk (in litres) allocated to each product based on the amount of fat and protein in the product relative to the amount of fat and protein in standardised raw milk

Non-Reference Products

All dairy products, except for Reference, produced by the NZ Ingredients business

Price Achievement

Revenue achieved over the base price less incremental supply chain costs above those set out in the Milk Price model

Reference Products

The dairy products used in the calculation of the

Farmgate Milk Price, which are currently WMP, SMP, BMP, butter and AMF

Regulated Return

The earnings component of Milk Price generated from a WACC return on an assumed asset base

Season

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

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

SMP

Skim Milk Powder

Stream Returns

The gross margin differential between Non-Reference Product streams and the WMP stream (based on base prices)

WACC

Weighted Average Cost of Capital

WMP

Whole Milk Powder

Glossary

Fonterra Strategic Platforms



Ingredients

The Ingredients platform comprises bulk and specialty dairy products such as milk powders, dairy fats, cheese and proteins manufactured in New Zealand, Australia, Europe and Latin America, or sourced through our global network, and sold to food producers and distributors in over 140 countries. It also includes Fonterra Farm Source™ retail stores.

Consumer

The Consumer platform comprises branded consumer products, such as powders, yoghurts, milk, butter, and cheese. Base products are sourced from the ingredients business and manufactured into higher-value consumer dairy products.

Foodservice

The Foodservice platform comprises a range of branded products and solutions for commercial kitchens, including bakery butter, culinary creams, and cheeses.

China Farms

The China Farms platform comprises the farming operations in China, which produce high quality fresh milk for the Chinese market.