Media release

18 November 2016

FONTERRA INCREASES FARMGATE MILK PRICE AND UPDATES ON Q1 PERFORMANCE

Fonterra Co-operative Group Limited today increased its 2016/17 forecast Farmgate Milk Price by 75 cents to $6.00 per kgMS.

When combined with the forecast earnings per share range for the 2017 financial year of 50 to 60 cents, the total payout available to farmers in the current season is forecast to be $6.50 to $6.60 before retentions.

Chairman John Wilson said the increase reflects improvements in pricing since September, following the gradual rebalancing of global supply and demand.

“We’ve seen falling production in the major exporting regions, particularly Europe and Australia, and an unprecedented decline in New Zealand milk supply due to wetter than normal spring conditions across most regions. On balance, demand continues to be firm. As a result there has been a steady improvement in global dairy commodity prices and this is reflected in the improved forecast.

“We are very mindful that farm incomes will be affected this year because of lower milk production so we will be doing everything possible to build on our good start to the financial year and deliver the highest possible total payout to our farmers,” said Mr Wilson.

First Quarter Performance Update

Fonterra’s first quarter revenue of $3.8 billion is up six per cent on the same period last year. Sales volumes are up two per cent to 4.9 billion litres liquid milk equivalent (LME), while the gross margin of 22 per cent remains largely unchanged.

Chief Executive Theo Spierings said the first quarter revenue gains reflected broad-based volume and margin growth across the business, and an ongoing focus on cost controls.

“Our operating expenses have reduced by two per cent to $621 million and we continue to keep a close rein on them, in line with the financial discipline shown last year,” he said.

The Co-operative has moved an additional 128 million litres LME into higher-value consumer and foodservice products compared with the same period last year.

“The consumer and foodservice business achieved an improved gross margin of 31 per cent, up from 28 per cent. This reflects the increasing strength of our brands in key markets and our focus on chef-led solutions in foodservice.”

Mr Spierings said while the first quarter performance was pleasing, the Co-operative’s earnings face emerging head-winds for the remainder of the financial year.

“Our current milk collection forecast is 1,460 million kilograms of milk solids (kgMS), down seven per cent on last season, and this is constraining sales.

“In addition there is a potential impact from the price of Milk Price reference products, such as whole milk powder, rising faster than non-reference products.”

Mr Spierings said that, given the Co-operative's stronger sales performance and lower production volumes, it continues to monitor its inventory and contracted sales position closely.

Chairman John Wilson said the Co-operative has had a strong start to the year.

"The unchanged earnings guidance range of 50 to 60 cents took into account the fact that a higher milk price had the potential to influence margins across the business. However, we do expect this volatility to continue which could impact both milk price and earnings guidance. We will keep our farmers and investors updated as we move through the year," he said.

- ENDS -

NOTE:

Fonterra is required to forecast its Farmgate Milk Price every quarter under the Dairy Industry Restructuring Act (DIRA).

Fonterra manufactures five commodity products that inform the Farmgate Milk Price – whole milk powder, skim milk powder, butter, anhydrous milk fat, and butter milk powder. These are called reference products. Non-reference products include cheese and casein.

For further information contact:

Dan Wrigley

Fonterra Communications

Phone: +64 21 820 679

Fonterra Communications

Phone: +64 21 507 072

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 processor 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.*

Fonterra
Dairy for life

PERFORMANCE REVIEW

Business Update

NOVEMBER 2016

OUR CO-OPERATIVE
OUR POTENTIAL
OUR PERFORMANCE

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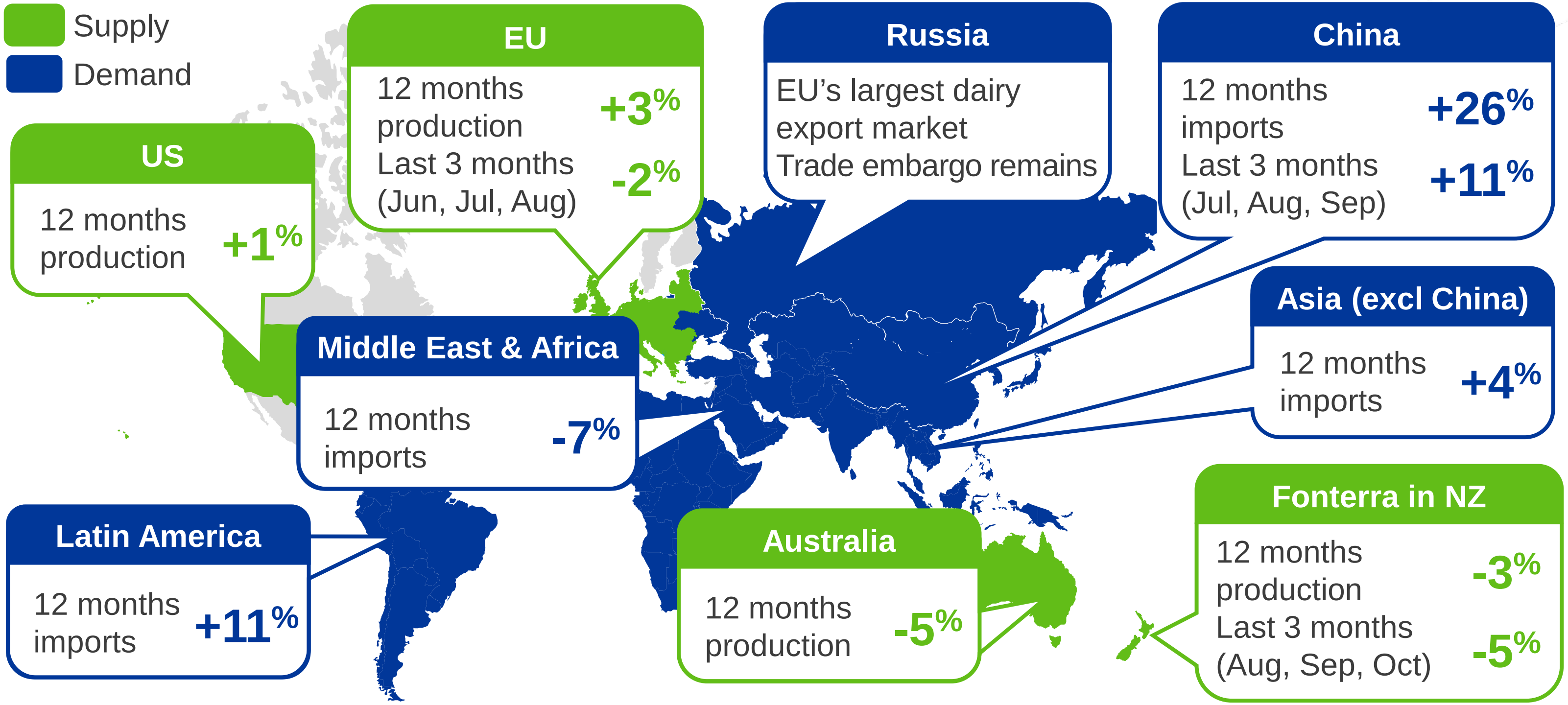
Our Co-Operative

Global dairy update – supply driven rebalancing

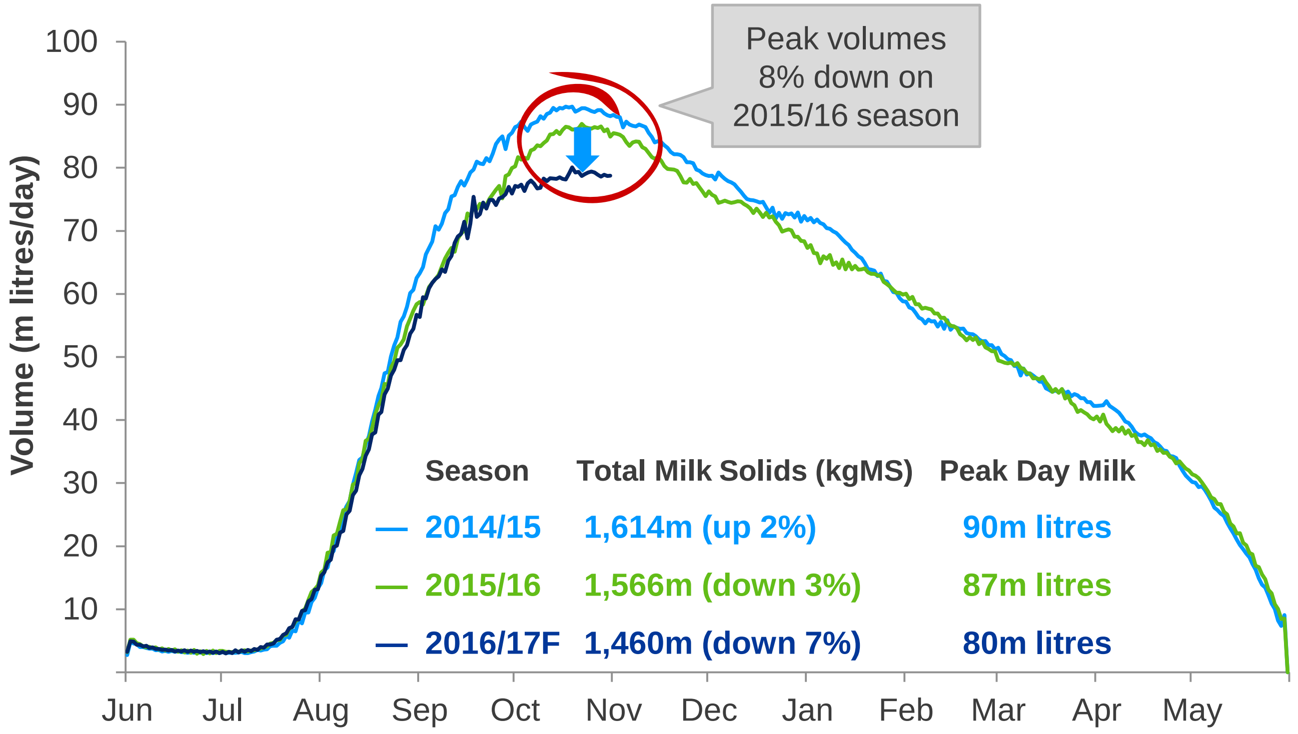


Note: All 12 month figures are rolling 12 months compared to previous comparable period: Australia (September), EU (August), United States (September), China (September), Asia (July), Middle East & Africa (July), Latin America (July), New Zealand (Fonterra only) (October)

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

Unprecedented decline in NZ supply

Weather-driven but outlook is for lower volume across season



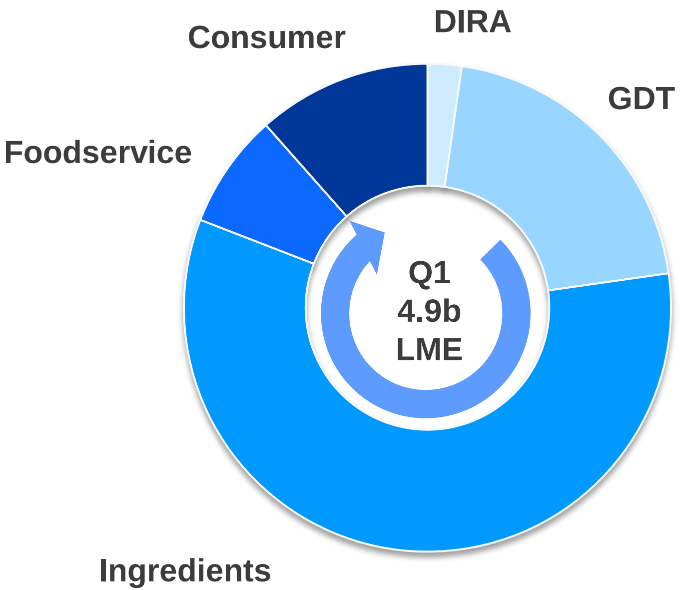
- Season forecast revised to 1,460m kgMS down 7% on last season
  - 5% decline season-to-date
- Driven predominantly by higher rainfall in central and northern North Island
  - North Island down 8%
  - South Island flat
- Impacting global prices and available supply

Our Potential

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



- GDT
  - Rebalanced volumes in response to lower production
- Ingredients
  - Lower collections
  - Actively managing availability to maximise returns:
    - Stream returns
    - Price achievement
- Consumer & Foodservice
  - Another strong quarter
  - 128M additional LME

Note: Wheel shows percentage of total FY16 external sales (LME) for illustration

Doing what we said we will in FY17

1 **Optimise** NZ milk	Optimisation & Price Achievement	• Optimising for lower volumes
	Fonterra story	• Launched 'Trusted Goodness'
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	Accelerate growth in our 8 strategic and leadership markets	• Volumes and margins up on last year • Gross margin increased due to strategic pricing in anticipation of higher milk prices
	Brazil transformation	• New structure delivering but tough market
	Maximise Beingmate partnership	• Darnum JV operational • Anmum volumes up 78%
6 **Selectively invest** in milk pools	China Farms – Downstream Value	• Integrating China businesses
	Australian endgame	• Turnaround delivering
7 **Align** our business and organisation	Disrupt	• Two new start-ups established
	Velocity / Engagement	• Additional Velocity benefits identified

Our Performance

FY17 Q1 performance summary

VOLUME (LME)	REVENUE	GROSS MARGIN	OPEX	CAPEX
4.9B	$3.8B	21.9%	$621M	$116M
↑ 2.0%	↑ 5.9%	↓ FROM 22.6%	↓ 1.7%	↓ 55%

Ingredients

Volume	↑	4.5B
	UP 2%	
Gross Margin	↓	12%
	FROM 15%	

Consumer & Foodservice

Volume	↑	1.3B
	UP 11%	
Gross Margin	↑	31%
	FROM 28%	

China Farms

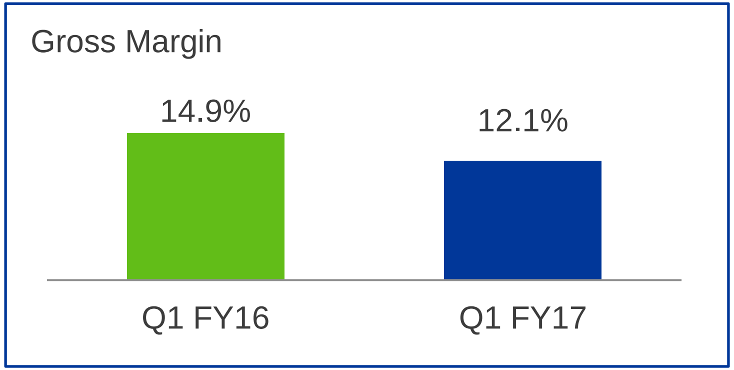
Volume	↑	0.1B
	UP 62%	
Gross Margin[1]	↓	-12%
	FROM -8%	

1. *Impacted by one-off sale of inventory below cost – gross margin excluding this impact was 4%*

Note: Volume is in billion LME; All changes are expressed relative to first quarter of FY16

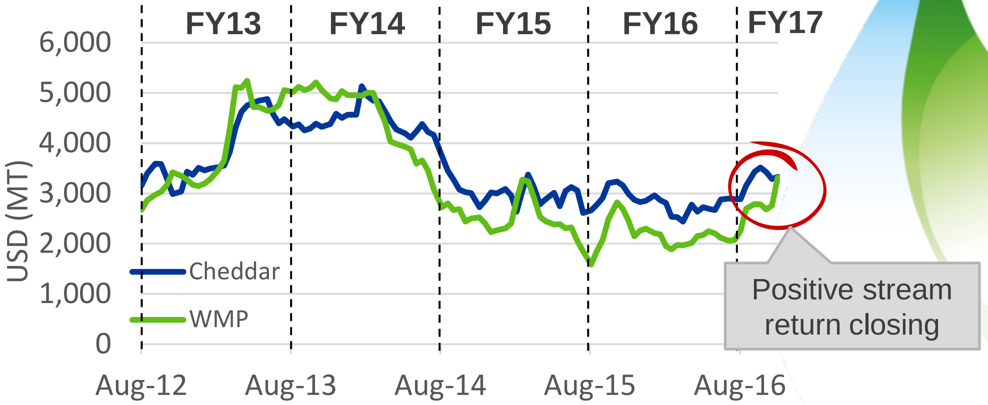
Ingredients – performance and outlook

Q1 performance



- Milk volumes lower but sales up due to selling from inventory
- Comparative quarter gross margin impacted by:
  - Change to milk price manual (5c per kgMS year-to-date)
  - Lower margins on bulk liquid sales

FY outlook

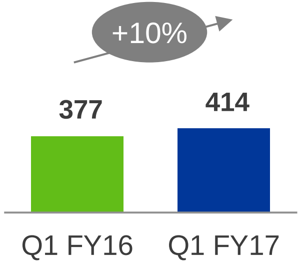


- Milk price model return on assets not impacted by lower volumes
- Improving operating performance relative to milk price model
- Stream returns will be impacted by WMP rising faster than non-milk price products
- Lower volumes putting pressure on price achievement

Consumer & Foodservice – 128M additional LME

Asia

Volume

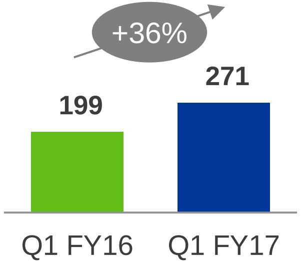


Gross Margin

33% ↑
FROM 31%

Greater China

Volume

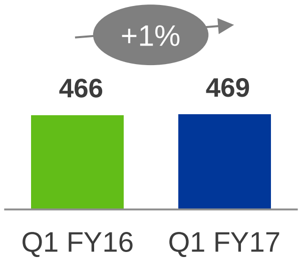


Gross Margin

39% ↑
FROM 32%

Oceania

Volume

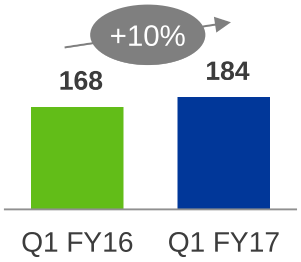


Gross Margin

24% ↑
FROM 19%

Latin America

Volume



Gross Margin[1]

33% ↓
FROM 35%

1. Latin America gross margin is down due to price competition in Brazil and reduced volumes in Venezuela
Note: Volume is in million LME; All changes are expressed relative to first quarter of FY16

Continued momentum in 2017

Forecast for 2016/17

- A forecast Farmgate Milk Price of $6.00 per kgMS reflects expected rebalancing
  - Reduced supply globally helping lift prices to more sustainable levels
  - Reflected in results of GDT auctions since September
  - Global short-term demand is stable
  - Volumes will continue to be under pressure

- Maintaining forecast earnings of 50-60 cents per share reflecting on-going solid business performance. Management remains focused on emerging headwinds
  - Unprecedented decline in NZ collection increases headwinds for Ingredients
  - Potential impact with WMP rising faster than non-milk price products
  - Consumer & Foodservice markets focused on strategic pricing in response to rising milk costs
  - Strong NZ dollar impacting translation of overseas earnings