Market Announcement

21 May 2020

Fonterra provides performance and milk price updates

Third quarter summary

- Total Group Earnings Before Interest and Tax (EBIT): $1.1 billion, up from $378 million
- Total Group normalised EBIT: $815 million, up from $514 million
- Total Group normalised gross margin: $2.5 billion, up from $2.2 billion
- Normalised Total Group operating expenses: $1,665 million, down $148 million from $1,813 million
- Free cash flow: $698 million, up $1.4 billion
- Net debt: $5.7 billion, down from $7.4 billion
- Normalised Ingredients EBIT: $668 million, up from $615 million
- Normalised Foodservice EBIT: $208 million, up from $135 million
- Normalised Consumer EBIT: $187 million, up from $128 million
- Full year forecast underlying earnings: 15-25 cents per share
- 2019/20 forecast Farmgate Milk Price range: $7.10 - $7.30 per kgMS
- Opening 2020/21 forecast Farmgate Milk Price range: $5.40 - $6.90 per kgMS
- 2020/21 Advance Rate Schedule has been set off the mid-point of $6.15 per kgMS

Fonterra Co-operative Group Limited today announced its third-quarter business update, narrowed the range for its 2019/2020 forecast Farmgate Milk Price, and announced an opening forecast Farmgate Milk Price range for the 2020/2021 season.

Fonterra CEO Miles Hurrell says despite COVID-19 challenges, the Co-operative's total group normalised Earnings Before Interest and Tax (EBIT) for the nine months to 30 April is $815 million, an increase of $301 million on this time last year.

"The work done over the last year to strengthen our balance sheet, and the Co-op's ability to respond quickly has helped us manage the COVID-19 situation over the last few months. We're drawing on our global supply chain and diverse product and customer base to minimise disruptions for our customers and our business.

"COVID-19 has affected virtually every country, market and industry, and as a result, the global dairy market is volatile and the outlook is uncertain. This is a tough environment for everyone. As a New Zealand dairy Co-op, exporting 95% of our products, many of the markets we do business in have always been prone to sudden shocks and this can impact where, when and what we sell. However, the global nature of COVID-19 is like nothing we've experienced before. Like other businesses, we will feel the impact of COVID-19 and its flow-on effects but how and to what extent is still uncertain. We are drawing on all our experience in managing market volatility.

“I’m proud to lead a team who genuinely care and recognise the importance of our farmer owners, unit holders, customers and local communities. The way our Co-op has responded to COVID-19 has been a real highlight for me.”

Business performance and earnings guidance

Mr Hurrell says all three of Fonterra’s business units have delivered a good performance for the year to date, despite the negative impact COVID-19 had on the foodservice business in the third quarter.

“Our Ingredients business delivered a normalised EBIT of $668 million in the nine months to 30 April. This is up 9% from $615 million on this time last year, mainly due to improved margins.

“As we said at half-year, when the COVID-19 pandemic took hold, we had already contracted a high percentage of this season’s milk supply and this has helped minimise the impact of COVID-19 to date.

“Overall Foodservice EBIT for the year is $208 million, up 54% from $135 million – however, it was the part of our business that was most affected by COVID-19. Restaurants, bakeries and cafes in many of our markets were closed as a result of government enforced lockdowns and restrictions. This impacted our sales in the third quarter.

“In China, the foodservice sector started its recovery relatively quickly, although it is still not at 100%. We saw our sales in China fall in February, but they bounced back to more normal levels in March and this continued in April. We are now seeing the impact of COVID-19 across our foodservice businesses in Oceania, South East Asia and Latin America. We expect this impact to also show up in our fourth quarter results.

“While the consumer business benefited from a spike in sales as people stockpiled and bought food to cook at home, this was not sustained through the COVID-19 lockdowns. Overall, Consumer EBIT was $187 million, up 46% from $128 million on the same period last year. This was mainly due to cost savings across all regions and gross margin growth in Asia.”

Mr Hurrell says the Co-op has a strong balance sheet with good cashflow and is continuing to reduce debt.

The Co-op is on track to deliver on its gross margin target, with gross margin up $244 million on last year to $2.5 billion. It has also continued its focus on cost control and reduced Total Group operating expenses by $148 million on the same period last year.

Free cash flow is $698 million, up by $1.4 billion on last year, and net debt has reduced by 23% or $1.7 billion.

In talking about the remainder of the financial year, Mr Hurrell reaffirmed the FY20 forecast underlying earnings guidance of 15-25c per share.

"Based on the first nine month’s performance we would expect our full year underlying earnings* to be at the top half of this range. However, there are significant uncertainties in the last quarter – for example, how quickly the foodservice sector recovers, timing of shipments, and how the broader economic downturn will impact our business.

Updated 2019/2020 forecast Farmgate Milk Price range and 2020/21 opening season forecast Farmgate Milk Price range

Fonterra has narrowed its 2019/2020 forecast Farmgate Milk Price range for the season to $7.10 - $7.30 per kgMS, with a mid-point of $7.20 per kgMS.

This will see the Co-op contribute about $11 billion to the New Zealand economy through milk price for the year.

Chairman John Monaghan says the Co-op has narrowed its price range and reduced the mid-point of the range in response to a softening of demand relative to supply which is pushing down prices.

“One of the main drivers of the softening demand is that many foodservice businesses remain closed. On the supply side, the EU and the US have just been through the peak of their season and that milk is flowing into export markets and increasing competition for sales. As a result, prices are softening across the board.

“This supply and demand imbalance has impacted GlobalDairyTrade (GDT) prices for the products that determine our Farmgate Milk Price. In US dollar terms, GDT prices for Whole Milk Powder are down 17% since late January.

“Looking out to next season, a global recession will continue to reduce consumers’ purchasing power.

“It is not clear what impact government interventions in the EU and US will have on curbing their milk supply, however, we expect our competitors there to put more of their milk into the product types that determine our Milk Price, as they chase government support programmes and favour longer-life products.

“COVID-19 adds significant uncertainty into the process of forecasting what will happen with global dairy prices over the next 15 months.

“For that reason, we are setting the opening 2020/21 forecast Farmgate Milk Price range at $5.40 - $6.90 per kgMS. The wider range reflects the increased uncertainty we face in the coming season.

“This forecast is based on the information that’s available now. We will regularly update our farmers on changes or events that may impact our milk price as the season progresses.”

Healthy People and Healthy Environment

Mr Hurrell says despite all these challenges, the Co-op continues to focus on all three of its long-term goals – healthy people, healthy environment and healthy business.

“We remain committed to making progress, and some examples in the environment and people space include:

- Making an additional two million litres of ethanol available to help with the supply of hand sanitiser in New Zealand during the COVID-19 outbreak
- Redirecting Anchor milk from our in-school nutrition programme, Fonterra Milk for Schools, into communities throughout New Zealand as schools were closed during Level 4 lockdown.
- Making improvements to farmers’ payments to get money to them faster
- Continuing to make progress in switching from coal to wood pellets at our Te Awamutu manufacturing site
- 31% of supplying farms now have Farm Environment Plans, up from 23% at the start of the financial year
- Around 1000 farms have achieved Te Pūtake Level 2 through The Co-operative Difference programme after meeting high environment, animal, milk, people and community standards
- On-track to deliver farm-specific greenhouse gas emissions reports to every supplying farm this year.”

** As previously stated, the announced forecast earnings will continue to reflect only the underlying performance of the business. Fonterra will advise any one-off impacts of a transaction on its FY20 earnings when that transaction is announced, and will provide details of the overall impact of its divestment programme on FY20 earnings as part of its full-year financial statements*

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