



Market Announcement

6 May 2021

Fonterra starts consultation on capital structure options

Today Fonterra is starting a consultation process to seek farmer feedback on potential options to change its capital structure that could give farmers greater financial flexibility.

To allow its farmers to have open conversations and consider all options during consultation, the Co-operative is temporarily capping the size of the Fonterra Shareholders' Fund (the Fund) by suspending shares in the Fonterra Shareholders' Market (FSM) from being exchanged into units in the Fund.

This temporary cap will be effective once the current trading halt is lifted when the market opens tomorrow and will remain throughout the consultation process.

Chairman Peter McBride says the capital structure review seeks to ensure the sustainability of the Co-operative into the future.

"The Co-op's future financial sustainability relies heavily on our ability to maintain a sustainable New Zealand milk supply and protect farmer ownership and control.

"The decisions we've already taken in response to the findings of the review – like temporarily capping the size of the Fund – haven't been made lightly. We appreciate they will have come as a surprise, but they are necessary to keep all our options open while the Co-op's farmer shareholders have a free and frank conversation about our capital structure," says Mr McBride.

Some of the options the Co-operative is asking its farmers to consider include buying back the Fund. If the temporary cap was not in place, anyone holding 'dry shares' – those shares held in excess of the 'wet share' requirement linked to milk production – would have been able to exchange them into units in the Fund during consultation. This could have more than doubled the size of the Fund and made the option of buying it back unaffordable in the context of the Co-operative's current balance sheet targets.

Capital structure options the Co-op is consulting on

The Fonterra Board has spent a significant amount of time looking at a wide range of options, including staying with the current structure. Some of the alternative structures they've considered include:

- dual share structures, which would move from the current single Co-operative share to a compulsory supply share and a separate non-compulsory investment share
- unshared supply structures
- a traditional nominal share structure
- a split co-operative model

All options are explained in the attached booklet, which all Fonterra farmers will be receiving as part of the consultation.

After its analysis to date, and to help give the conversations with farmers some structure, the Board has put forward a preferred option – a “Reduced Share Standard with either No Fund or a Capped Fund.”

“We believe the best option for our Co-op is to move to a structure that reduces the number of shares a farmer would be required to have and either removes the Fund or caps it from growing further, to protect farmer ownership and control,” says Mr McBride.

Under this option, the minimum requirement for farmer owners would be one share for every four kgMS supplied to the Co-op, compared with the current requirement of one share for every kgMS supplied. At the other end of the scale, farmers could hold shares up to a maximum of four times their milk supply. But farmers will be encouraged to share their views on these and other features.

“This would make it easier for new farmers to join the Co-op and give more flexibility to existing farmers who may want to free up capital or who are working through succession.

“A key outcome of this change is that shares would be bought and sold between farmers in a farmer-only market.

“I want to be clear that these changes could impact the price at which shares in our Co-op are traded, and there may not be as much liquidity in the market. Ultimately the price for farmers’ shares would be determined by the performance of the Co-op and trading between farmers.

“We believe this is a more sustainable proposition over the longer term than the alternatives we are confronted with.

“This is the Board’s current thinking, but we are open minded about adjusting that direction based on farmer feedback on any of the options. We want to hear from as many of our farmers as possible. I strongly encourage all farmers to consider the information provided and participate in the consultation process that started today and continues over the coming months.”

Why the Co-op is looking at alternative capital structure options

Fonterra says the environment it is operating in has changed a lot over the last ten years. The Co-operative’s current structure was put in place when milk supply was growing rapidly in New Zealand. It now needs to be prepared for flat or potentially declining milk supply as a result of factors such as climate change impacts, regulatory changes, and alternative land uses.

“Our Co-op’s financial performance will always be the main determinant of our share of New Zealand milk. But we also know that a more flexible capital structure, that caters for the diversity and different aspirations within our Co-op, would support a sustainable future milk supply. This is critical for us to deliver our strategy, which prioritises New Zealand milk.”

Fonterra says declining milk volumes or more flexibility for farmers’ shareholding requirements could cause the Fund size to grow significantly. That would mean the thresholds that were put in place to help protect farmer ownership and control could be exceeded within the next few seasons.

“To stay within the Fund size thresholds, our Co-op would need to take action – such as buying back shares or units or increasing the thresholds to allow a greater degree of external investment. We don’t think either of these are ideal outcomes.

“Buy-backs create an uncertain demand on our capital, potentially impacting our ability to invest in strategy and growth. Under the scenarios that we’ve modelled, buy-backs could cost shareholders up to \$1.2 billion over the next ten seasons.”

Next steps

Over the coming months, the Co-operative’s farmers will have the chance to share their views through a series of meetings, webinars and other opportunities – and if the appetite for change remains – the Board

will do further work to refine the preferred option or options and have a second round of consultation. If the Board decides to seek change to the Co-operative's capital structure, it would likely aim for a farmer vote around the time of the Annual Meeting in November and the approval of 75% of votes from voting farmers would be required.

If the preferred outcome is to buy back the Fund, it would also require the approval of 75% of votes from voting unit holders.

As some aspects of Fonterra's current capital structure are reflected in the Dairy Industry Restructuring Act 2001 (DIRA), any vote is likely to be conditional on any necessary changes to legislation being passed. The DIRA enabled Fonterra to be formed so that an efficient co-operative of scale could lead New Zealand into global markets. The value Fonterra creates is returned to regional New Zealand, where it plays a strong role helping to sustain local communities and enhance their wellbeing.

"I appreciate there is a real sense of optimism in the Co-op with our improving financial performance and how we are travelling generally.

"But the issues raised through this review need to be addressed early. Waiting for the problem to be at our feet will limit our options and likely increase the cost of addressing them, at the expense of future opportunities for us," adds Mr McBride.

Other notes of importance

- *Share Standard compliance obligations for the 2021/22 season are now temporarily on hold for all supplying farmers holding a minimum of 1,000 shares and exiting farmers that are selling shares over three seasons in accordance with the Constitution – until a date to be advised. This is due to the uncertainty around what changes, if any, may occur to the Co-operative's capital structure. The date for resuming Share Standard compliance obligations will not be earlier than six months after the Co-operative has implemented a new capital structure or made an announcement that the capital structure review is not proceeding for the time being.*
- *The formal Compliance Date for the 2021/22 season has been set as 20 April 2022, which is consistent with previous seasons. However, as explained above, farmers holding a minimum of 1,000 shares will not be required to comply with the Share Standard for the 2021/22 season until a date to be advised.*
- *Compliance obligations are also temporarily on hold for those farmers who have not yet met their Share Standard compliance obligations for the current 2020/21 season. This is so that no farmers are required to trade for compliance purposes during the temporary cap, until a date to be advised.*
- *For contract suppliers, the purchase of units under the Contract Fee for Units Trust will also be put on hold while the temporary cap is in place or until such date as the Board advises.*
- *Shares in the FSM still have the same core rights as they did before the temporary cap. This includes rights to receive any dividends.*
- *During the temporary cap, the prices for units in the Fund and shares in the FSM may not be as closely aligned as they have been to date.*
- *Even if a price difference does emerge, given that no additional shares have been issued, the Co-operative's value on a per share basis has not been diluted.*
- *Also, because the compliance obligations for farmers holding at least 1,000 shares have been put on hold, there may be lower levels of trading. However, farmers will still be free to buy and sell shares in the FSM. The market maker, or registered volume provider, that has been active in making bids and offers on a minimum number of shares in the FSM since our current structure*

was implemented will continue to operate in the FSM, but the share price could move more on small volumes of trading in the FSM.

- *Anyone holding units in the Fund, which may include farmers, will be free to continue buying and selling units on the NZX or ASX given the temporary cap only applies to the exchange of shares in the FSM into units.*

Further information is available at www.fonterra.com/capitalstructure

Attachments

- Presentation
- Consultation Booklet
- Frequently Asked Questions

-ENDS-

For further information contact:

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