Market Announcement

23 September 2021

New Flexible Shareholding structure proposed as best option for farmers and Co-op

Fonterra's Board has presented a revised capital structure proposal that it will discuss with farmers over the coming weeks before deciding whether to proceed to a shareholder vote.

The "Flexible Shareholding" structure is a progression on the preferred option put forward at the start of the consultation process in May, but with key changes based on farmer feedback and further expert advice:

- **New minimum shareholding requirement** would be set at 33% of milk supply (around 1 share per 3 kgMS), compared to the current compulsory requirement of 1 share per 1 kgMS. This is intended to strike a balance between providing a meaningful level of flexibility for those who need it, which is critical to maintaining a sustainable milk supply, while ensuring all farmers having some capital-backed supply.

- **New maximum shareholding requirement** would be set at 4x milk supply, compared to the current 2x milk supply. This is intended to strike a balance between supporting liquidity in the farmer-only market – by ensuring more capacity for farmers to buy shares from those who want to sell – while avoiding significant concentration of ownership.

- **More types of farmers could buy shares**, including sharemilkers, contract milkers and farm lessors. This is intended to recognise their connection to Fonterra, provide a pathway for future farmer owners and increase the number of potential participants in the farmer-only market by around 4,000 to support liquidity.

- **Exit provisions would be extended and entry provisions would be eased.** Existing shareholders would have up to 15 seasons initially to exit, reducing annually to 10 seasons, which would also support liquidity and give these farmers greater choice about how long they retain an investment in the Co-operative. Meanwhile any new entrants would have up to six seasons to achieve the 33% minimum shareholding requirement. This compares to a standard three seasons for both entry and exit under the current structure.

- **The Fonterra Shareholders' Fund (the Fund) would be capped** to protect farmer ownership and control. If greater flexibility was provided without making any other changes to the current structure, the thresholds relating to the size of the Fund could be exceeded relatively quickly. That's because farmers would be able to hold fewer shares and non-farmers would be able to invest more through the Fund.

- **The Fonterra Shareholders' Market (FSM) would continue to operate as a farmer-only market, but shares would no longer be able to be exchanged into units in the Fund.** As communicated in May, this means the share price may trade at a discount to the unit price, referred to as a restricted market discount. But aside from this initial adjustment, the farmer-only market should enable the Co-operative's share price to better reflect the higher costs of capital many farmers have compared to external investors with more diversified investment portfolios.

- **Additional measures to support liquidity** in the farmer-only market would be implemented, recognising there may be lower levels of trading, so the share price could move more on small volumes. The Co-operative has sourced expert advice to determine the measures it would take to support liquidity. This includes allocating up to $300 million to support liquidity as farmers transition to the proposed structure, through an on-market share buy-back programme and other tools.

Fonterra Chairman Peter McBride says changing the Co-operative's capital structure is a critical decision and not something the Board and senior management are taking lightly.

"We are confident that this proposal would support the sustainable supply of New Zealand milk that our long-term strategy relies on. One enables the other, and together they give our Co-operative the potential to deliver the competitive returns that will continue to support our families' livelihoods from this generation to the next.

"Our future success relies on our ability to maintain a sustainable milk supply in an increasingly competitive environment, and one that is rapidly changing due to factors such as environmental pressures, new regulations and alternative land uses.

"We see total New Zealand milk supply as likely to decline, and flat at best. Our share of that decline depends on the actions we take with our capital structure, performance, productivity and sustainability. If we do nothing, we are likely to see around 12-20% decline by 2030 based on the scenarios we have modelled.

"Farmers leave the Co-operative for different reasons, but one of the most influential ones is the high level of compulsory investment that's required to be part of our Co-operative. A capital structure with Flexible Shareholding would help to level the playing field with competitors, many of whom are foreign-backed and don't require farmers to invest capital.

McBride says the Co-operative's farmer owners staying stronger together is in everybody's interests.

"Analysis of potential milk supply scenarios we have developed shows that, based on our current operations, our Farmgate Milk Price could be 6-13 cents lower by 2030 if we make no changes to our capital structure and continue to lose market share at the rate we've seen over the past five seasons to May 2020."

Fonterra's Farmgate Milk Price sets a benchmark in New Zealand, so even farmers who don't supply the Co-operative benefit from it. For the 2020/21 season, Fonterra delivered $11.6 billion to the New Zealand economy through the final cash payout to farmers.

Under the Flexible Shareholding structure, farmer ownership and control would be protected by capping the Fund. This means shares in the farmer-only FSM would no longer be able to be exchanged into units.

The proposed changes would also protect against the uncertain and recurring risk to the Co-operative's balance sheet that would come with having to buy back shares or units to stay within thresholds related to the Fund size if milk supply declined under the current structure. Those thresholds exist to protect farmers' ownership and control of Fonterra.

Flexible Shareholding is detailed in a booklet that has been sent to all farmer owners, who will have a chance to discuss it further with Directors and senior management at upcoming meetings and webinars.

At this stage, the Co-operative is still aiming for a farmer vote at its Annual Meeting in December.

Before a vote could take place, at least 50% of Fonterra Co-operative Council members would need to support the final proposed changes. Ahead of a vote, voting documents would provide farmers with everything they need to know to assess the proposed changes they would be voting on. The approval of 75% of votes from voting farmers would then be required.

As some aspects of Fonterra's current capital structure are reflected in the Dairy Industry Restructuring Act 2001 (DIRA), any vote would be conditional on the necessary changes to legislation being passed.

Fonterra says it is continuing to consider unit holders' interests throughout this process and is consulting with the management company of the Fund, which communicates with unit holders directly.

Attachments

- Capital Structure Presentation
- Capital Structure Booklet

ENDS

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