

Market Announcement

23 MAY 2019

Fonterra provides strategy, milk price and earnings updates

- Key third-quarter financial performance numbers:
 - Sales volumes: 16.6 billion LME, up 4%
 - Revenue: \$15 billion, up 1%
 - Gross margin: \$2.2 billion, down 3%
 - Normalised operating expenses: \$1.8 billion, down \$73 million
 - Normalised EBIT: \$522 million, down 9%
 - Capital expenditure: \$419 million, down 28%
- Revised forecast earnings per share range: 10-15 cents from 15-25 cents per share
- 2018/19 forecast Farmgate Milk Price range: \$6.30 - \$6.40 per kgMS
- Opening 2019/20 forecast Farmgate Milk Price range: \$6.25 - \$7.25 per kgMS
- 2019/20 Advance Rate Schedule has been set off \$6.75 per kgMS

Fonterra Co-operative Group Limited today gave an update on its strategy review and shared timeframes for turning around the Co-op's performance. At the same time, it announced its third-quarter business update, revised forecast earnings range, narrowed the range for its 2018/19 forecast Farmgate Milk Price, and gave an opening forecast Farmgate Milk Price range for the 2019/20 season.

Fonterra Chief Executive Miles Hurrell said that good progress is being made on the strategy review and reiterated that the benefits from those changes will take time to flow through into the Co-op's financial performance.

"I appreciate that our farmers and unit holders want clarity on our new strategy and expect a decent return on their investment.

"We're on-track to share our new strategy in September. In the meantime, we're getting on and making decisions to reduce complexity and simplify our business so we can focus on where we have competitive advantages.

"Farmers and unit holders can expect to see some fluctuation in our earnings over the next couple of years and there will be one-off transactions and adjustments (some positive, some negative) as we reset the business and deliver on our new strategy.

"We are committed to keeping people updated as we make progress. Today's update is:

- We are commencing a strategic review of our two wholly-owned farm-hubs in China
- We have agreed with our partner Nestle to review options for the future ownership of our Dairy Partners Americas (DPA) Brazil joint venture, including a potential sale of respective stakes
- We are closing our Dennington site in Australia.

"These decisions relate to our new strategic direction – in particular, prioritising our New Zealand milk supply and simplifying our global portfolio, which, as we have said previously, requires us to review every part of business to ensure it meets the needs of the Co-op today."

Commenting on the strategic review of its China farms, Mr Hurrell said China remains a key market for Fonterra.

“We have contributed to China’s dairy industry by developing high quality model farms and showing there is a valuable opportunity for fresh milk in China’s consumer market, and this continues to be an attractive prospect.

“However, this does not necessarily mean that we need to continue to have large amounts of capital tied up in farming hubs.

“On DPA Brazil, which is a joint venture distributing chilled dairy products throughout Brazil, the review into future ownership options and whether to sell is expected to be completed by the end of 2019,” said Mr Hurrell.

“Yesterday, we also started talking to the team at our Dennington factory in Australia about the tough call we’re making to close the site. The Australian Ingredients business continues to feel the impact of the drought and other significant changes that mean there is excess manufacturing capacity in the Australian dairy industry.

“This is not a one-off for this season, it’s the new norm for the Australian dairy industry and we need to adapt. We need to get the most value from every drop of our farmers’ milk and, with the reduced milk pool in Australia, we must put it into our highest returning products and most efficient assets. Dennington is over 100 years old and not viable in a low-milk pool environment.

“We have 98 employees at Dennington and this decision will be incredibly hard for them. Our top priority is to support our people.”

Business performance and revised earnings guidance

Fonterra’s revenue for the nine months to 30 April 2019 was \$15 billion, up 1% on the same period last year, and sales volumes were 16.6 billion liquid milk equivalent (LME), up 4%. However, normalised EBIT was down 9% to \$522 million.

In Ingredients, sales volumes for the first nine months were up 10% to 16.3 billion LME, gross margin was down to 8.6% from 9.6% and EBIT was down \$64 million to \$602 million.

In Consumer and Foodservice sales volumes were down 1% to 3.8 billion LME, gross margin was down to 22.8% from 23.6% and normalised EBIT was down \$62 million to \$266 million.

Fonterra Chief Executive Miles Hurrell said the New Zealand Ingredients business is performing as expected but Australia Ingredients continues to face challenges and it is taking longer than planned to lift performance in some parts of the Co-op’s Consumer and Foodservice business.

“Due to the challenges in Australia Ingredients and tightening relative price differences between reference products, or those products that inform the Farmgate Milk Price, and non-reference products – that’s all our other products, we are reducing the forecast full year normalised EBIT for the whole Ingredients business to \$645 - \$725 million, down from the \$750 - \$850 million range we shared at our Interim Results.

“Consumer and Foodservice improved its performance in the third quarter relative to the first half. Due to our performance in Latin America we have lowered our forecast normalised EBIT from \$475 - \$525 million to \$400 - \$430 million for this part of the Co-op.

“Our China Foodservice recovered as demand for butter bounced back. This helped pricing and in-market inventory return to more normal levels. There was good demand for Anchor Food Professionals UHT culinary cream and the team at our Waitoa UHT factory have been working hard to get shipments up to our China foodservice customers.

“Our Oceania Consumer and Foodservice business continued to perform well with Australia’s spreads category, including Western Star butter, contributing significantly to gross margin.”

Mr Hurrell said that there are some increased risks in the fourth quarter to the Co-op’s previous forecast earnings – in particular, the recovery in key markets is slower than expected and there are tightening price relativities between non-reference and reference products along with the on-going challenges in Australia Ingredients.

As a result, Fonterra is revising its earnings guidance range from 15 - 25 cents per share to 10 - 15 cents per share.

2019/20 opening season forecast Farmgate Milk Price and updated 2018/19 forecast Farmgate Milk Price range.

Chairman John Monaghan said, as farmers get ready to start the new season on 1 June, the forecast 2019/20 Farmgate Milk Price range will be \$6.25 - \$7.25 per kgMS.

“This is a realistic opening forecast. We are having to look out more than a year into the future which is difficult, but what the information available is continuing to show us is that demand remains strong across key trading partners and this is reflected in GDT prices.

“We are giving farmers a wide range for the opening forecast milk price. It will be narrowed as the season goes on. The 2019/20 Advance Rate Schedule has been set off \$6.75 per kgMS.

“Weather plays a significant role in determining global milk volumes, and therefore price. We are forecasting our New Zealand collections to be 1,520 million kgMS for the new season, which is up slightly on the current season. There’s still a lot of water to go under the bridge before we’ll have a clear view of what the season holds for both our Co-op’s production and global dairy supply.”

Fonterra has also narrowed its 2018/19 forecast Farmgate Milk Price range from \$6.30 - \$6.60 per kgMS range by 20 cents to \$6.30 - \$6.40per kgMS.

This reflects favourable foreign exchange movements but slightly weaker than expected pricing for whole milk powder and skim milk powder.

The Co-op has now contracted the majority of its farmers’ milk for the current season and has greater certainty on the likely closing Farmgate Milk Price. This is also reflected in the tighter forecast range.

-ENDS-

For further information contact:

Fonterra Communications
24-hour media line
Phone: +64 21 507 072