Northington Partners

FONTERRA CO-OPERATIVE COUNCIL

Fonterra Dairy for life

Review of FY24 Performance

Fonterra Co-operative Group

November 2024

Important Notice

Declarations

This report is dated 1 November 2024 and has been prepared by Northington Partners at the request of the Fonterra Co-operative Council (“**FCC**”) on behalf of Fonterra Co-operative Group Limited (“**Fonterra**”) for the purposes of s109LA of the Dairy Industry Restructuring Act 2001. The report is intended to provide Fonterra shareholders and unitholders with an independent review of Fonterra’s performance for FY24.

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The individuals responsible for preparing this report are Greg Anderson B.Com, M.Com (Hons), Ph.D, Jonathan Burke B.Com (Hons) and Mathew Rooza B.Com, CPA. Each individual has a wealth of experience in providing independent corporate finance advice to a wide range of clients.

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FY24 Highlights

1	**Continuation of Strong Earnings**	Fonterra reported FY24 earnings from continuing operations of 70 cents per share. This was at the top of its guidance (60 – 70 cents) and only marginally down on FY23's record earnings outcome of 75 cents. Although price relativities between reference and non-reference products eased compared to FY23 and led to materially lower performance in Ingredients, they did not narrow as much as expected and that outcome contributed to performance being at the top of the guidance range. Group EBIT from continuing operations of $1,560m was down ~11% on last year's record ($1,755m).
2	**Significantly Improved Consumer and Foodservice Performance Offsetting Weakening Ingredients**	Ingredients EBIT was down $657m (-42%) to $898m in FY24. The earnings decline was primarily due to lower margins resulting from narrower price relativities. A higher proportion of milk volumes was also allocated to higher value channels. Conversely, Consumer and Foodservice collectively contributed to a $462m increase in EBIT vs FY23. Consumer earnings increased to $199m, an improvement of $111m on last year when adjusting for the difference in net impairments ($244m in FY23 and $31m in FY24). Foodservice earnings were up $138m to $463m. Both channels were supported by increased volumes and higher margins (primarily due to the lower cost of milk).
3	**Lift in 2024/25 Farmgate Milk Price and Advance Rates**	Fonterra declared a final 2023/2024 Farmgate Milk Price (FGMP) of $7.83 per KgMS and a total dividend for the year of 55 cents per share, generating an effective total cash return of $8.38 per share backed kgMS for the season. Further strengthening in GDT prices and constrained global milk supply has resulted in Fonterra lifting its 2024/25 forecast FGMP midpoint by 50 cents to $9.00 per kgMS (~15% up on the final 2023/2024 Milk Price) with a range of $8.25 - $9.75 per kgMS. The higher milk price has also been accompanied by an uplift in Advance Payment Rates, ensuring that suppliers will be paid more for their milk earlier in the season. Fonterra's stronger balance sheet has enabled the Co-operative to enhance the Advance Rate over the past two seasons.
4	**Continued Balance Sheet Strengthening Supports Capital Returns**	Despite no significant asset sales in FY24, the strong underlying performance of the business and lower working capital requirements have resulted in further strengthening of the balance sheet, with net debt reducing by $0.6bn year on year to $2.6bn. This has resulted in the gearing ratio reducing to 24.0% (vs 28.8% in FY23 and a FY18-FY23 average of >40%, with a target of 30% - 40%). The reduction in net debt provides Fonterra with significant balance sheet flexibility and supports the increased total annual dividend to a record 55 cents per share for FY24 (40 cent total ordinary and 15 cent special dividend vs 50 cent total ordinary in FY23). This represents a total dividend payout of ~82% of earnings (vs current policy of 40% - 60%).
5	**Strategic Review Complete**	Some further detail on Fonterra's potential exit from Consumer and related businesses has been released. Fonterra has confirmed a strategic focus on Ingredients and Foodservice while providing some key financial targets for the retained business, including higher returns (10% – 12% return on capital vs 9% – 10% currently) and a higher dividend payout policy (60% – 80% of normalised earnings vs 40% – 60% currently). The high-level rationale for the potential exit of the Consumer and related businesses appears reasonable when viewed from a financial performance perspective, noting that the "In-scope" business comprises approximately 30% of the Co-operative's capital employed but only delivered approximately 17% of FY24 earnings.
6	**FY25 Earnings Outlook & Change in Tax Status**	The Fonterra Board has provided earnings guidance of 40 – 60 cents per share for the 2025 financial year. However, the recent exhaustion of NZ tax losses means that this is not comparable to historic earnings where dividends on supply backed shares were treated as a tax expense and utilisation of tax losses contributed to lower overall tax expenses (higher post tax earnings) at the Group level. Normalising for the change in Fonterra's tax status and higher expected digital transformation costs, the current FY25 outlook implies underlying performance broadly consistent with FY24.

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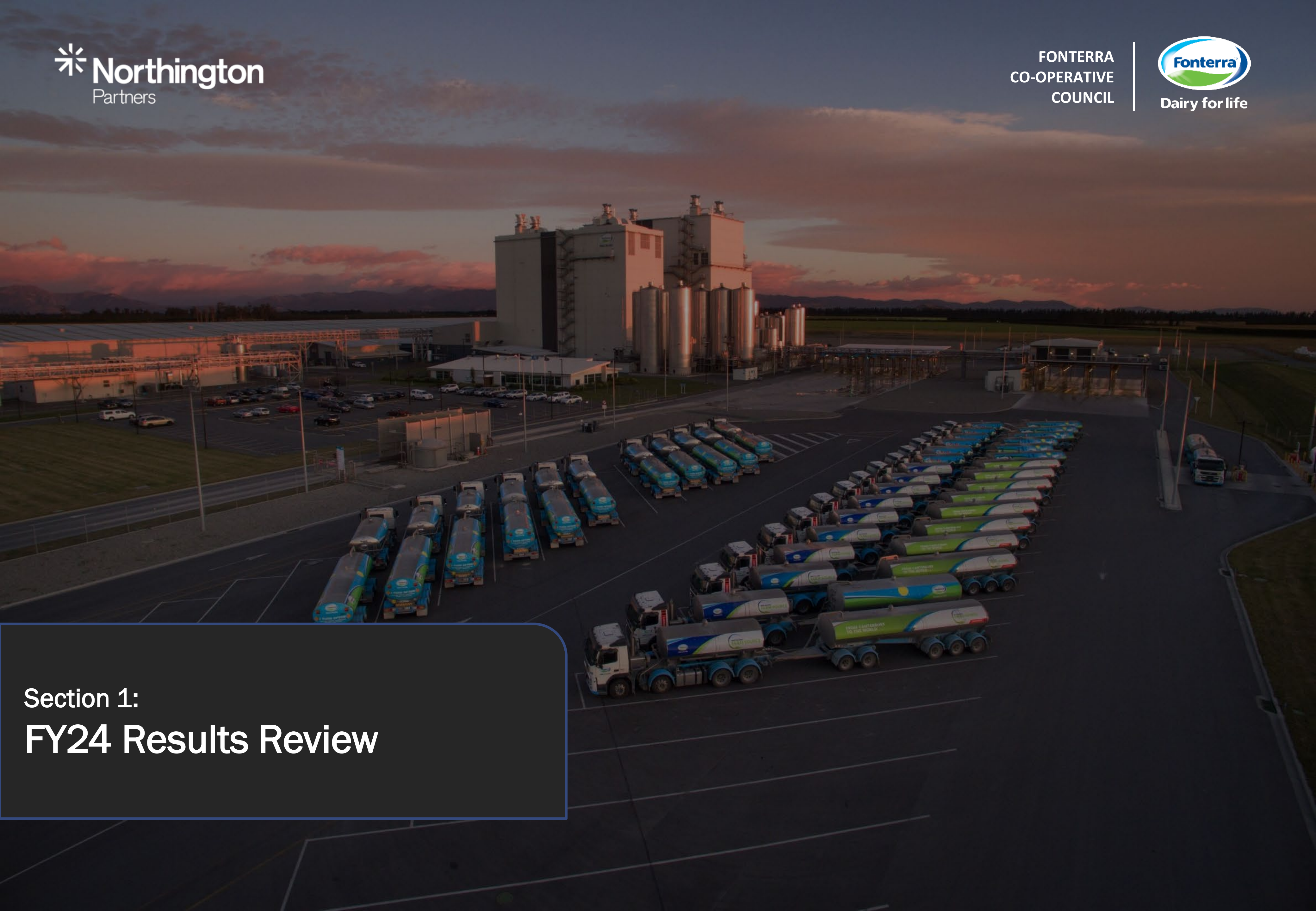


FONTERRA CO-OPERATIVE COUNCIL

Section 1:

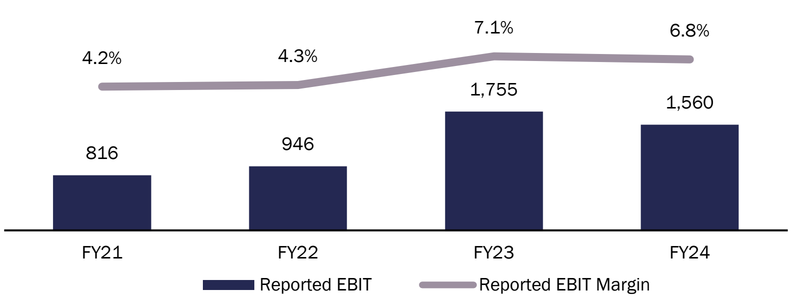
FY24 Results Review

Total Group Financial Performance

Fonterra reported FY24 earnings (EBIT) from continuing operations of $1,560m, a 11% reduction on FY23's record results.

NZ$ Million (Continuing Operations)	FY24	FY23	*% Change*
Sales Volume ('000 MT)	3,470	3,497	*(1%)*
Total Revenue	**22,822**	**24,580**	***(7%)***
Cost of Goods Sold	(19,000)	(20,399)	*(7%)*
Gross Profit	**3,822**	**4,181**	***(9%)***
Gross Margin	*16.7%*	*17.0%*	*n/a*
Impairments	(34)	(248)	*n/a*
Operating Expenses	(2,335)	(2,248)	*4%*
Other Items	107	70	*53%*
Reported EBIT	**1,560**	**1,755**	***(11%)***
Reported EBIT Margin	*6.8%*	*7.1%*	*n/a*
Net Finance Costs & Tax	(392)	(514)	*(24%)*
Net Profit After Tax (Continuing Ops)	1,168	1,241	*(6%)*
Net Profit After Tax (Discontinued Ops)	(40)	336	*n/a*
Total Group Net Profit After Tax	1,128	1,577	*(28%)*
Earnings Per Share (Continuing Ops)	$0.70	$0.75	*(7%)*
Dividend per Share	$0.55	$0.50	*10%*

Reported EBIT and Reported EBIT Margin (Continuing Operations)



Although down on FY23, Fonterra delivered a solid earnings result for FY24, with reported earnings before interest and tax (EBIT) and reported net profit after tax (NPAT) above long-term historical averages. Reported EBIT from continuing operations reduced by 11% to $1,560m.

Similar to FY23, Fonterra's results for FY24 are complicated by earnings relating to discontinued businesses, being DPA Brazil in FY24 and Hangu China farm and Soprole in FY23. We have therefore focused on the results for the continuing operations, as summarised in the adjacent table and commentary below.

- Flat sales volumes and lower product pricing contributed to a 7% reduction in revenue ($22,822m in FY24 vs $24,580m in FY23).
- Reduced price relativities compared to FY23's record levels contributed to reduced gross profits, albeit with margins remaining high (16.7% FY24 vs 17.0% FY23). A lower contribution from Ingredients was offset by higher margins and sales volumes in the Foodservice and Consumer channels.
- Excluding impairment expenses, operating expenses from continuing operations increased by $87m (4%), primarily reflecting increased IT & Digital transformation costs, technical and professional costs as well as ongoing inflationary pressures.
- Reported EBIT from continuing operations was down $195m (11%). When excluding impairments ($56m[1] in FY24 and $248m in FY23), EBIT was down 19% on FY23.
- The resulting reported NPAT for FY24 was $1,128m on a continuing and discontinued operation basis (67 cents per share), compared to an equivalent $1,577m in FY23 (95 cents per share) which benefited from gains on the sale of Soprole. FY24 NPAT benefited from a significant decline in finance costs due to recent divestments and the resulting reduction in debt costs.
- Earnings from continuing operations of 70 cents per share was at the top end of Fonterra's guidance (60 to 70 cents per share) and only marginally down on FY23's record earnings outcome of 75 cents.
- The Group declared a final ordinary dividend of 25 cents per share for FY24 and a special dividend of 15 cents per share, bringing the total FY24 dividend to 55 cents per share. This represents a 5 cents per share increase compared to FY23. Excluding the special dividend, the dividend corresponds to a 60% payout ratio, at the top of Fonterra's dividend policy payout range of 40% to 60%. The high dividend payout and 15 cent special dividend is reflective of Fonterra's current strong balance sheet driven by recent cash earnings strength.

[1] *FY24 Cost of Goods Sold includes impairments of $22m.*

Financial Performance by Channel & Segment

While the price differential between Non-Reference and Reference products contributed to lower performance in Ingredients, the lower cost of milk and firm end-product pricing led to significant margin & earnings improvement in the Consumer and Foodservice channels.

There was a material shift in the composition of operating earnings (EBIT) between channels in FY24 vs FY23:

EBIT from the Ingredients channel was down by $657m in FY24, reflecting the following key factors:

- Lower sales volumes and reduced margins, largely due to a reduction in price relativities between Non-Reference products and Reference Products;
- Lower regional margins in Australia (due to a higher milk price); and
- An increase in the cost of milk (as per the Milk Price calculation) due to changes in lactose prices.

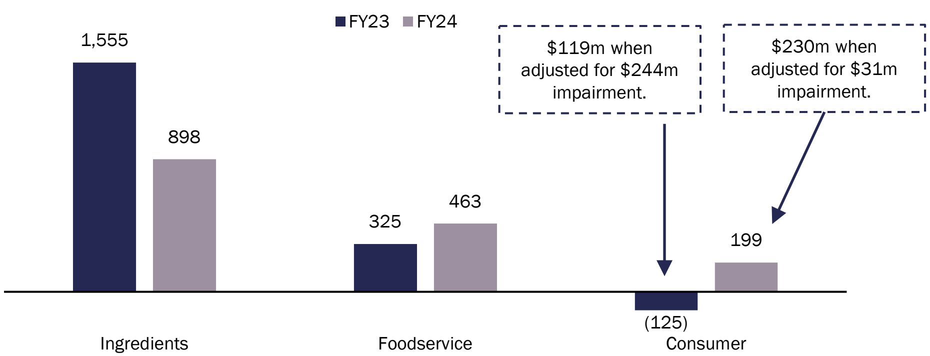
Conversely, EBIT for Foodservice and Consumer was up $138m and $111m respectively when adjusting for impairments in the Consumer channel in FY23 and FY24. Both segments benefited from:

- Favourable margins predominantly driven by a comparatively lower cost of milk as well as higher in-market pricing; and
- Increased sales volumes, mainly driven by UHT cream in the China Foodservice business as well as Consumer products in FBNZ, Sri Lanka and the Middle East.

Similar market dynamics led to a shift in earnings contributions across the three Segments:

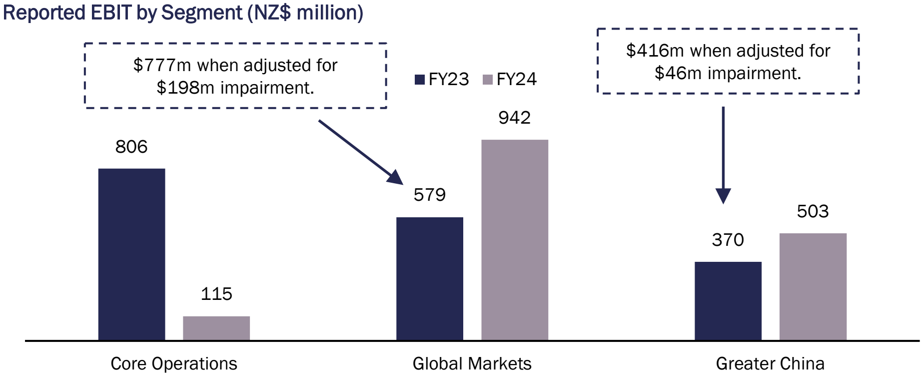
- Core Operations reported a $691m reduction in EBIT, largely reflecting lower margins in New Zealand milk processing (Ingredients).
- Global Markets earnings were up $170m (adjusting for impairments) to $947m, largely driven by improvements in the Consumer channel.
- Greater China delivered a $113m increase in EBIT (adjusting for impairments) to $529m, with a particularly strong pick-up in Foodservice across the region.

Reported EBIT by Channel (NZ$ million)



Note: Segment and Channel Information is available for continuing operations only

Reported EBIT by Segment (NZ$ million)



Note: FY24 includes impairments of $25m, $5m and $26m in Core Operations, Global Markets and Greater China respectively

Price Relativities

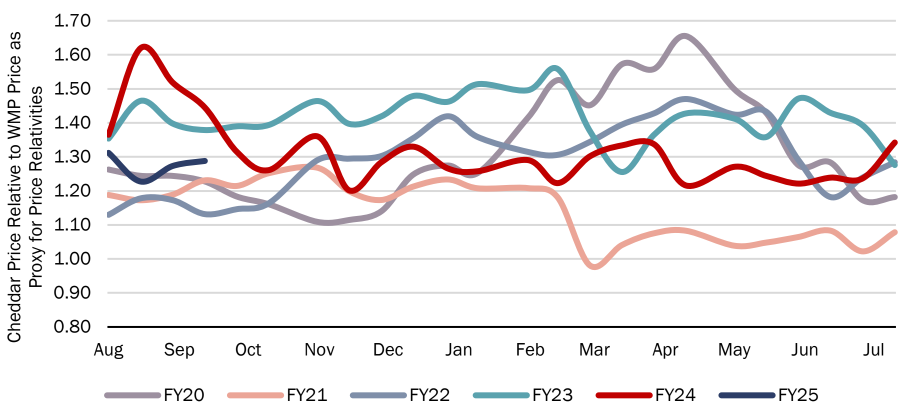
Although average price relativities eased in FY24 compared to the record levels observed in FY23, they remain high compared to historical levels. Price relativities were estimated to have contributed ~12cps to FY24 earnings vs ~40cps in FY23 and Fonterra's estimated long-run average of 0-5cps.

The price relativities between Reference and Non-Reference Products have a significant influence on Fonterra's profitability, particularly within the Ingredients channel. The bottom left chart summarises the price relativities by financial year using monthly GDT data for the prices of cheddar and WMP as proxies for Non-Reference and Reference products. This illustrates that although the average price relativity eased in FY24 to 1.3x when compared to FY23 (1.4x), it was still higher than long-term averages. The start of FY25 also indicates a slight reduction in price relativities compared to both FY24 and FY23.

While it is difficult to reliably identify specific factors which drive the changes through time, the price relativity must ultimately be underpinned by changing supply and demand dynamics between the product categories. Without any evidence for a structural change in the market, we would expect that over the long-run, the price relativities will revert to average levels.

As is the case with general commodity prices, Fonterra is effectively a 'price-taker' in relation to price relativities. Year-to-year volatility in earnings will therefore continue to be exposed to the underlying variability in this key driver of performance.

Historical Price Relativities (Non-Reference / Reference Product Prices)



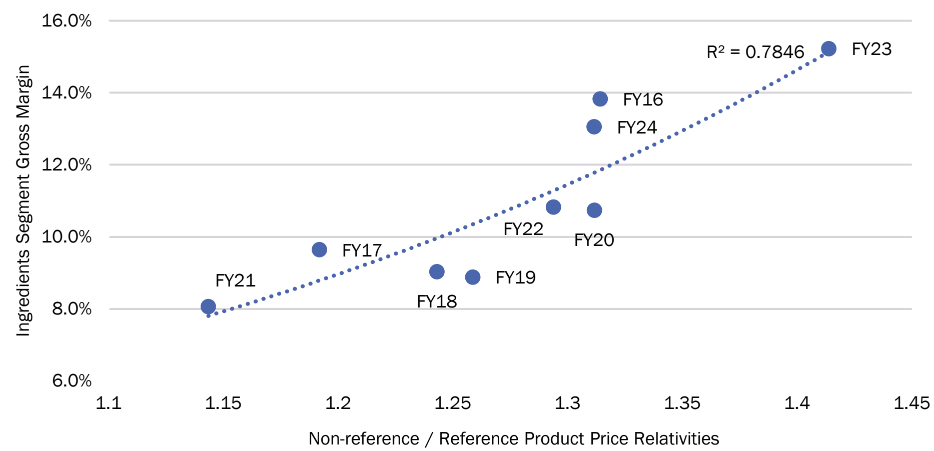
Source: Global Dairy Trade, adjusted forward 3 months to reflect shipment delay. WMP and Cheddar used as proxies for Reference & Non-Reference Products.

Fonterra management estimates that price relativities in FY24 contributed 12 cents per share to earnings, significantly down on FY23's 40 cents. This change explains the majority of the drop in the Ingredients channel contribution in FY24 - the 28 cent drop represents >$600m at the gross profit level vs the $657m decline in Ingredients EBIT observed in FY24.

Based on the monthly GDT prices for Non-Reference and Reference Products averaged over each financial year, the chart below shows a strong relationship between price relativities and the gross margins generated by the Ingredients channel. Nine years of monthly pricing data suggests that the price relativities have averaged 1.28x, consistent with the Ingredients segment delivering gross margins of ~11.0%. Our analysis further suggests that FY24 excess or "abnormal" price relativities were ~$300m (the gross margin difference of an average year at 11.0% and FY24 actual Ingredients gross margins of 13.1%), equivalent to approximately 14 cents per share (post tax). While this is similar to management's estimate of 12 cents, we have insufficient information to reconcile the difference.

If the price relativities do revert to long run averages, we expect that the gross margin achieved by the Ingredients channel will reduce (subject to the impacts of periodic volatility, Fonterra's cost reduction initiatives and any further improvement in the relative volume split between Reference and Non-Reference Products). We also note that price relativities for FY25 year to date suggest that margins for the Ingredients channel may continue to reduce compared to recent years.

Relationship Between Price Relativities and the Ingredients Segment Gross Margin



Return on Capital

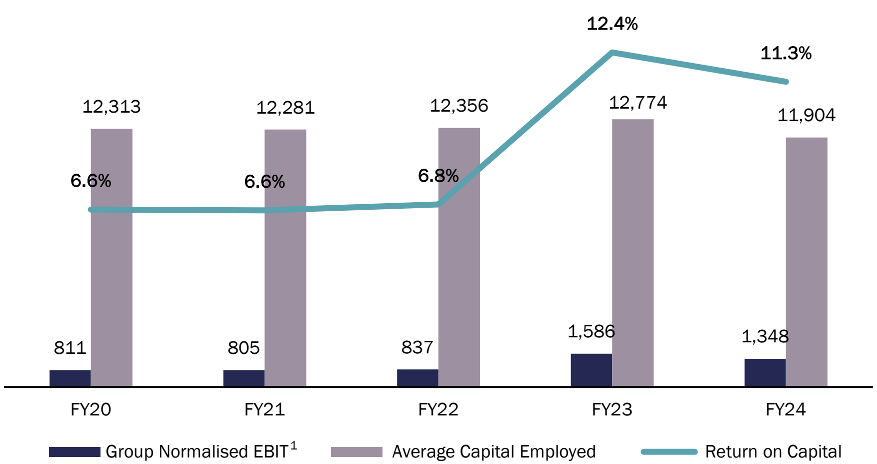
A continuation of strong earnings in FY24 resulted in a return on capital employed of 11.3%, down on 12.4% in FY23, but above the previous four-year average of 8.1% and significantly above the previous Long-Term Aspirations target of 7% - 8%.

Our review of Fonterra's financial performance since inception (published in November 2018) noted that the average post-tax return on capital employed ("**ROCE**") was approximately 6.0%, below the assessed benchmark range of 6.9% - 7.7%. The chart below summarises ROCE since FY20 and shows the dramatic improvement recorded in FY23 and FY24.

These results are based on Fonterra's approach to calculating ROCE; it reflects normalised EBIT and is based on the book value of equity. Normalised EBIT excludes the $66 million loss related to the disposal of DPA Brazil. FY24 impairments totaling $34 million, mainly recognised in the Group's Consumer channel, are however included in the calculation of normalised EBIT. Fonterra's FY24 ROCE was 11.3% vs 12.4% in FY23.

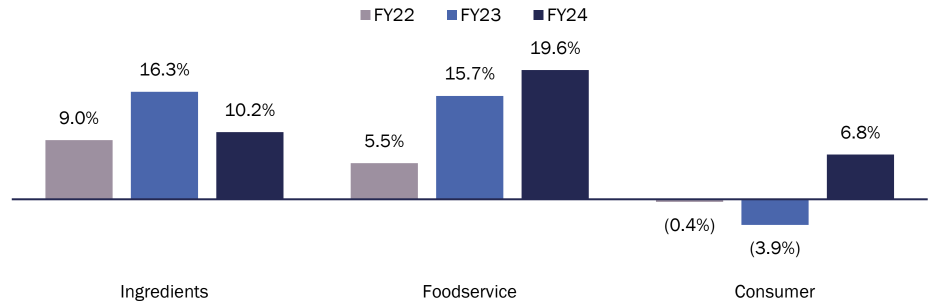
The reduction in FY24 ROCE reflects reduced earnings offset by the material reduction in average capital employed in FY24 ($870m or 7%) when compared to FY23. The lower capital employed is primarily due to the $804m capital return to shareholders in August 2023 following the Soprole sale. As discussed previously, FY24's decreased earnings is largely driven by lower profitability in the Ingredients channel, attributed mainly to the narrowing price relativity between Reference and Non-Reference Product prices when compared to FY23.

Historical Return on Capital (Based on Fonterra Estimates)



[1] Plus finance income on long term advances less notional tax charge

Historical Return on Capital by Channel (Based on Fonterra Estimates)



Fonterra provided a breakdown of return on capital by channel for the first time in FY23, along with the comparable data for FY22. In line with the earnings improvements previously discussed, the ROCE for both the Foodservice and Consumer channels were materially higher in FY24, with both channels supported by increased volumes and higher margins (primarily due to the lower cost of milk).

ROCE calculations reflect the impact of the impairments taken – that is, the channel earnings used in the calculation have not been normalised for the impairments.

Explanation

Return on Capital (ROC) or Return on Capital Employed (ROCE) is a measure of how well capital has been invested. As shown below, this is assessed by looking at the post-tax return from the assets as a proportion of their book value.

$$\text{ROCE} = \frac{\text{(Group Normalised EBIT + finance income on long term advances)} \times (1 - \text{notional tax rate})}{\text{Average Capital Employed (Seasonally-adjusted)}}$$

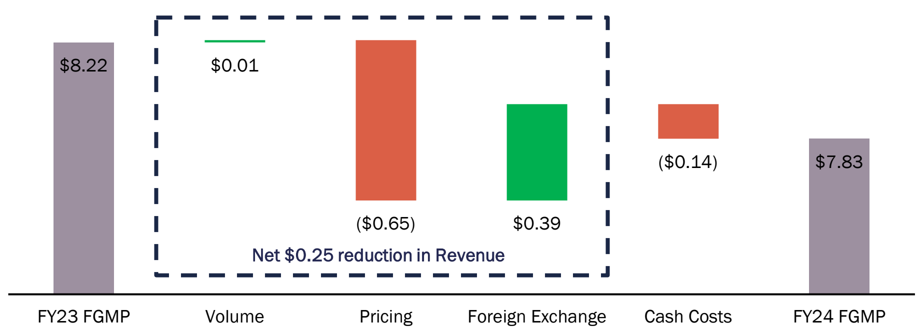
Final Milk Price

Fonterra declared a final 2023/2024 Farmgate Milk Price of $7.83 per kgMS and has increased its 2024/2025 forecast range to $8.25 - $9.75 per kgMS with a mid-point of $9.00 per kgMS[1].

Fonterra declared a final Farmgate Milk Price of $7.83 per kgMS for the 2023/2024 season, a decrease from $8.22 in the prior year. The reduction was largely attributed to weaker international demand for Reference Products which reduced pricing. As summarised in the chart below, reduced pricing had a negative impact of $0.65 per kgMS, partly offset by favourable foreign exchange movement resulting from on-going weakness in the New Zealand dollar ($0.39 per kgMS). A $147m inflationary increase in input costs also contributed to a $0.14 per kgMS decline.

At the time of the results announcement, Fonterra communicated strengthening GDT prices and constrained milk supply in key producing regions. The most recent GDT auctions have confirmed an improvement in market demand and have led to a $0.50 upgrade to the forecast 2024/2025 FGMP, now at $8.25 - $9.75 per kgMS with a mid-point of $9.00 per kgMS[1]. This forecast of $8.25 - $9.75 per kgMS positions it above Dairy NZ's current estimated national breakeven milk price of $8.15 per kgMS[2].

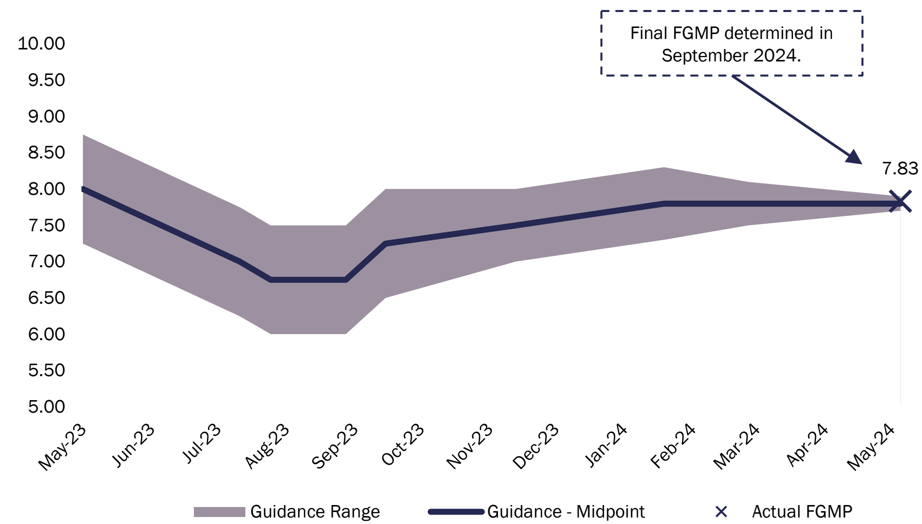
Normalised Earnings Per Share and Payout Ratio ($ per kgMS)



The graph below shows that the milk price guidance for FY24 issued to farmers in May 2023 was broadly in line with the final declared FGMP of $7.83. Downgrades in August were offset with upgrades during the remainder of the season. This is opposite to pattern observed in FY23, where an initial uplift was followed by downgrades over the course of the season.

The higher milk price has also been accompanied by an uplift in Advance Payment Rates, ensuring that suppliers will be paid more for their milk earlier in the season. Fonterra's stronger balance sheet has enabled the Co-operative to enhance the Advance Rate over the past two seasons. The Advance Rate of $7.00 for September 2024 represents 78% of the forecast 2024/2025 FGMP mid-point of $9.00 compered to ~70% for the corresponding period in 2023.

2023/2024 Farmgate Milk Price Guidance Range



[1] *As at 25 September 2024*
[2] *As at 11 October 2024*

Total Payout and Payout Ratio

Total payout to fully shared up farmers for FY24 has been bolstered by a dividend of 55 cents per share, which includes a special dividend of 15 cents per share.

Fonterra announced a final dividend of 25 cents per share for FY24 plus a special dividend of 15 cents per share, bringing the total dividend for the year to 55 cents per share. This is a marginal increase on the total dividend paid in FY23 of 50 cents per share (excluding the 50 cent capital return).

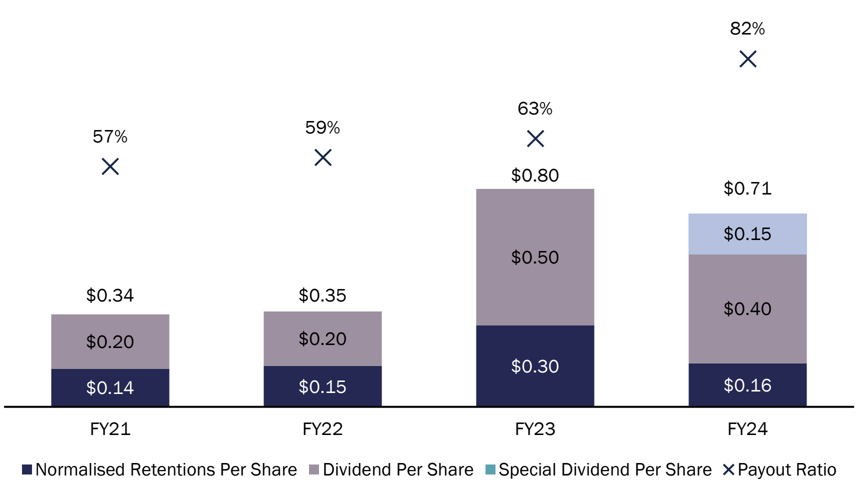
The adjusted NPAT used as the basis for the dividend calculation was $0.67 per share, meaning the 40 cents per share ordinary dividend corresponds to a payout ratio at the top end of the 40% - 60% dividend policy range. Fonterra noted that the special dividend is supported by the higher earnings over the last two years, combined with a strengthened balance sheet and leverage metrics within target levels. Including the special dividend, the total dividend of 55 cents per share corresponds to an 82% FY24 payout ratio.

Fonterra has subsequently updated its dividend policy to a payout target of 60% - 80% of reported net profit after tax that is attributable to Co-operative equity holders, excluding abnormal items (see page 24).

The chart below summarises the total payout per share since FY21 (see page 38 for further details). With a final 2023/2024 Farmgate milk price of $7.83 and the 55 cent total dividend, total payout reached $8.38 per share backed kgMS in FY24. The total cash return of $8.38 in FY24 was below the highest total payout achieved over the last ten years ($9.50 in FY22)[1] but above the historic ten-year (FY14-23) average total payout of $7.03.

Despite current earnings guidance for FY25 (40 – 60 cents per share) being down on FY24 (67 cents) largely due to the change in tax status and ongoing IT and transformation costs, FY25 ordinary dividends may only reduce modestly. This reflects the updated dividend policy along with Fonterra's strong capital position. If the higher milk price forecast for the current season is achieved, the total payout for FY25 is likely to increase to levels higher than those achieved over the last two years.

Normalised Earnings Per Share and Payout Ratio



Total Payout[1]

1. Per share backed kgMS

Financial Position

Fonterra's recent focus on capital management, along with its improved earnings performance and recent divestments (including DPA Brazil in FY24) have contributed to a strong balance sheet.

NZ$ Million	FY24	FY23	*% Change*
Assets			
Cash and Cash Equivalents	540	1,822	(70%)
Receivables	2,123	2,473	(14%)
Inventories	4,458	4,346	3%
Other Current Assets	374	854	(56%)
PP&E	6,400	6,343	1%
Intangible Assets	1,785	1,824	(2%)
Other Non-Current Assets	999	939	6%
Total Assets	**16,679**	**18,601**	***(10%)***
Liabilities			
Payables	2,573	2,373	8%
Owing to Suppliers	1,623	1,997	(19%)
Current Borrowings	1,032	785	31%
Capital Return Payable	-	804	0%
Other Current Liabilities	619	1,302	(52%)
Non-Current Borrowings	2,356	3,156	(25%)
Other Non-Current Liabilities	301	216	39%
Total Liabilities	**8,504**	**10,633**	***(20%)***
Net Assets	**8,175**	**7,968**	***3%***
Non-Controlling Interests	76	62	23%
Equity Attributable to Co-op	**8,099**	**7,906**	***2%***

Net Assets increased to $8,175 million at the end of FY24, representing an increase of $207 million (+3%) from the previous year.

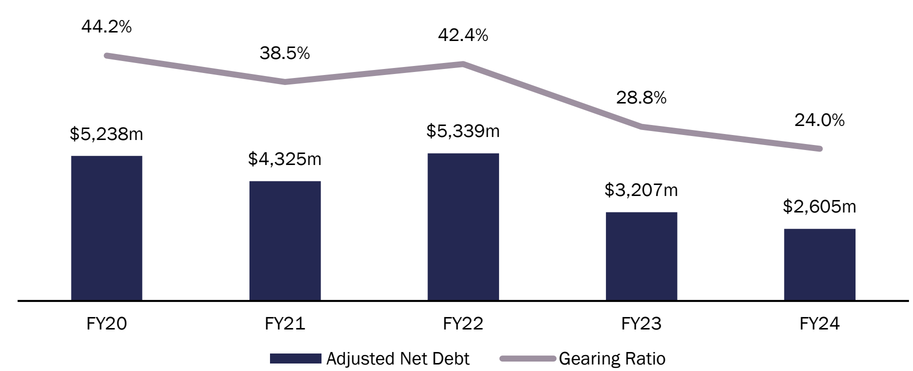
The Group's cash and cash equivalents decreased by $1,282 million (-70%) to $540 million, with FY23's balance of $1,822 million including the sale proceeds of Soprole which was completed in FY23. A capital return of $804 million in relation to the divestments were paid in August 2023, significantly contributing to the decrease of cash and cash equivalents in FY24.

Inventory values increased $112 million (3%) during FY24, now at $4,458 million. Fonterra estimates that based on a reduction of ~25,000 MT (-4%), the volume of inventory held at FY24 year end equates to a ~$200 million reduction. The higher closing milk price per MT in FY24 offsets the lower volume held, resulting in an increase in the balance sheet value.

Broader reductions in working capital days (89 in FY24 vs 91 in FY23) have also contributed to improved cash conversion and lower debt. Adjusted net debt has decreased by $602 million to $2,605 million with gearing levels correspondingly lower at 24.0% (vs 28.8% FY23). The gearing ratio is also significantly below Fonterra's policy range of 30% - 40% and historic average levels.

Further analysis of the ending net debt position is set out on the following page.

Adjusted Net Debt (NZ$ million) and Gearing Ratio (%)



Debt Position

Fonterra's net debt has decreased by a further $602m over FY24 due to strong earnings and decreased working capital. Gearing and leverage ratios are now well below target levels.

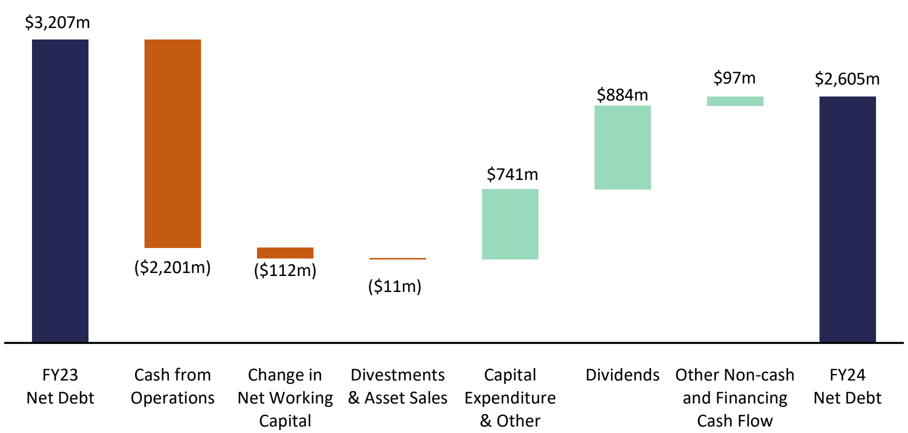
Net Debt decreased to $2,605 million at the end of FY24, representing a decrease of $602 million (-19%) from the previous year. Key contributors to the changes in net debt over the FY24 period are summarised as follows:

- Operating cash flows of $2,201 million are down $543 million on $2,744 million achieved in FY23 (albeit off a record earnings year).
- Investment in working capital has reduced by $112 million.
- Capital expenditure during FY24 increased only slightly ($32 million) compared to FY23 ($709 million).
- Dividends paid during FY24 includes the FY23 final dividend of $643 million and the FY24 interim dividend of $241 million, together totaling $884 million.
- We note that the $804m capital return that was paid in FY24 was included in the closing FY23 adjusted net debt as a payable.

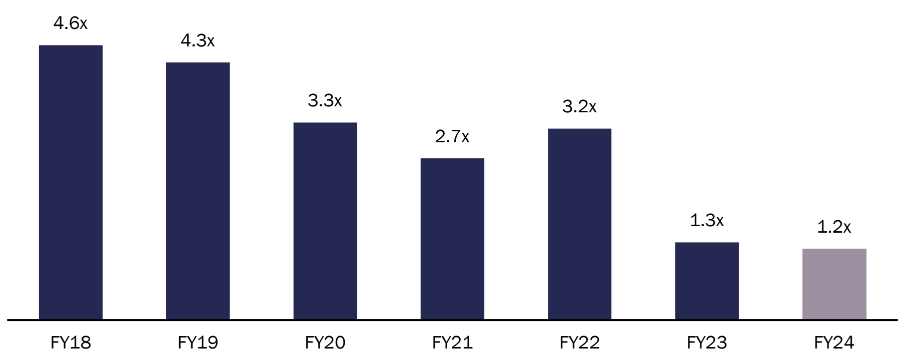
Fonterra's significantly reduced debt levels and improved gearing (24.0%) and debt / EBITDA ratios (1.2x) provide significant financial flexibility for future investment or capital returns.

- Fonterra's FY24 debt to EBITDA ratio decreased to 1.2x (1.3x at FY23), significantly below its target of <2.5x and historic levels.
- Along with the reduced gearing ratio (24.0%), we consider that the strong balance sheet provides scope for further growth investment or capital returns to shareholders even prior to the potential divestment of the Consumer and associated businesses (see Section 2). However, we expect that any decision on future capital returns will be deferred until the divestment process has been concluded.
- The improved debt position also supports the increased dividend payout target of 60% - 80% (vs 40% - 60%) and provides the scope to improve Advance Rates while still maintaining Fonterra's "A" band credit rating (a key influence on Fonterra's ability to access debt at attractive rates).

Net Debt Bridge (NZ$ million)



Debt / EBITDA[1]



1. Calculated as Adjusted Net Debt / Normalised EBITDA

Capital Expenditure & Divestments

Total capital invested during FY24 was $720 million, representing a decrease of $27 million compared to the prior year.

Capital investment for the last four years has been broken down into three broad categories:

1. Essential capital expenditure;
2. Growth capital expenditure; and
3. Other capital investment.

Most of the expenditure in FY24 was allocated to essential capital expenditure ($558 million) which generally reflects the maintenance and improvement of existing assets. Fonterra has further broken down this category into four sub-components categories, as shown in the chart below. Also included within the essential capital expenditure for FY24:

- $40 million spend on decarbonisation to support Fonterra's sustainability goals; and
- $54 million spend on wastewater assets to improve its environmental footprint.

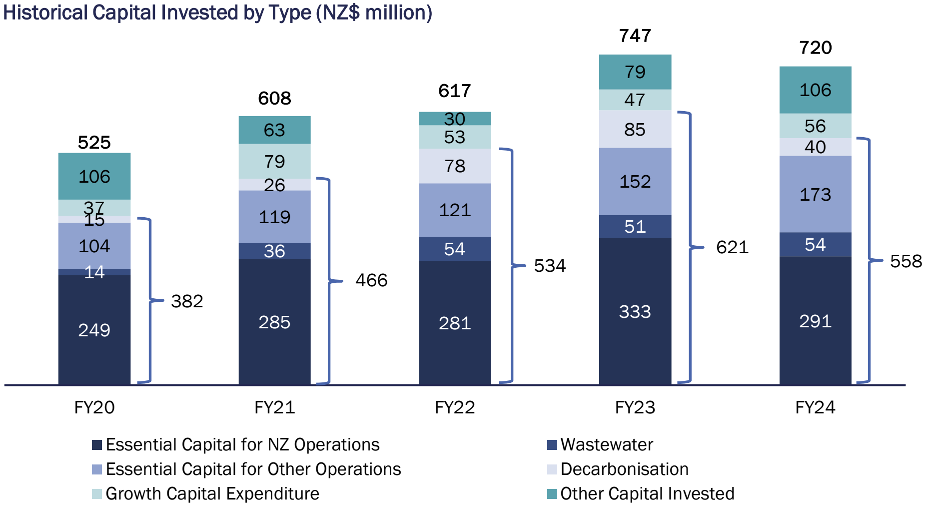
A total of $56 million was invested to support growth for the Foodservice and Ingredients business, including capacity expansion for high value products such as lactoferrin, probiotics and hyrdrolysates. Three new growth investments have also been announced; these are the $75 million high-value protein hub at Studholme, $150 million new UHT cream plant at Edendale and $150 million new cool store at Whareroa. These investments along with other growth initiatives are expected to contribute to a significant increase in growth capital expenditure over the next few years (see page 25).

The $106 million of other capital investment includes investments into the Ki Tua Equity Investment Fund, right-of-use assets and other equity investments.

As already mentioned, Fonterra completed the divestment of DPA Brazil in November 2023. This aligns with the Group's strategy to increase its focus on Core Operations (i.e. New Zealand milk collection and processing). The transaction resulted in a net loss on sale for FY24 of $66 million on both a pre-tax post-tax basis.

In May 2024, Fonterra announced a material change in its strategic direction which included the potential divestment of some or all of its global Consumer business together with Fonterra Oceania and Fonterra Sri Lanka. Our analysis of this potential divestment is included in Section 2 of our report.

Historical Capital Invested by Type (NZ$ million)



Summary of Recent Divestments (NZ$ million)

	FY24		FY23	
	Sale Price	Gain/(Loss)	Sale Price	Gain/(Loss)
DPA Brazil	240	(66)		
Soprole			1,066	349
China Farms (Hangu)			18	(12)
Total	**240**	**(66)**	**1,084**	**337**

Note: Gain / (Loss) on Sale is on a pre-tax basis

FY25 Outlook

Fonterra's opening EPS guidance for FY25 of 40c – 60c per share implies an underlying performance broadly consistent with FY24 when adjusting for the change in tax status and increased IT transformation costs.

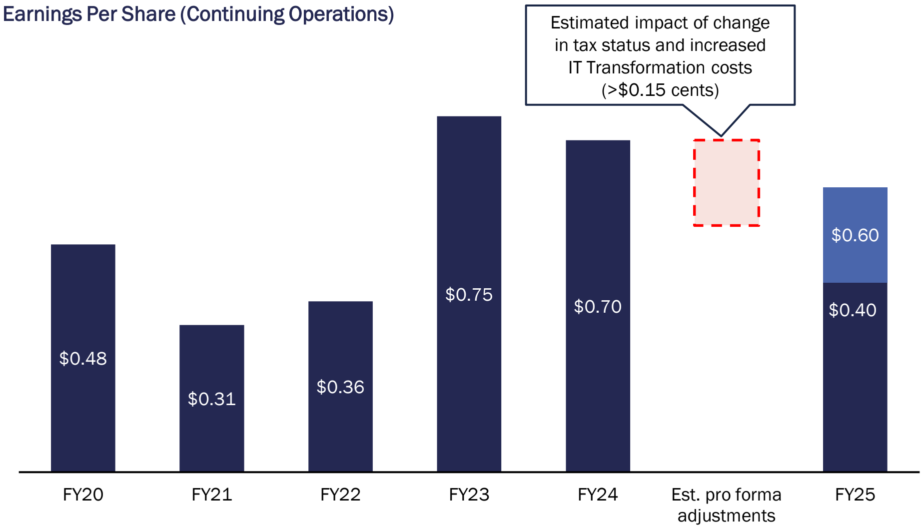
Fonterra's FY25 outlook reflects expectation of improved margins in the Consumer channel, with Ingredients and Foodservice expected to be stable.

While the 40 – 60 cent guidance range reflects a significant reduction on the 70 cents achieved in FY24, the FY25 forecast reflects a significant increase in non-operating related costs. These include:

- Fonterra has exhausted its New Zealand tax losses and is therefore subject to a change in tax status. This is expected to result in a significant increase in the future level of New Zealand tax paid, with Fonterra's effective tax rate expected to increase to ~25% (vs ~17% in FY24). We discuss the implications of this for shareholders on the following page; and
- Ongoing investment in IT & digital transformation costs are expected to be materially higher in FY25 relative to the $81 million in FY24. We understand that these costs may be as high as $250 million in FY25 (~10 cents per share higher than FY24).

Despite the lower earnings guidance, current expectations for underlying FY25 performance (i.e. EBIT before IT & digital transformation costs) appear to be in line with the FY24 outcome. Broker consensus estimates are also consistent with this view, with a current average FY25 EBIT forecast of $1,369 million[1] (vs $1,560 million from continuing operations in FY24 before allowing for ~$170 million of additional IT & digital transformation costs).

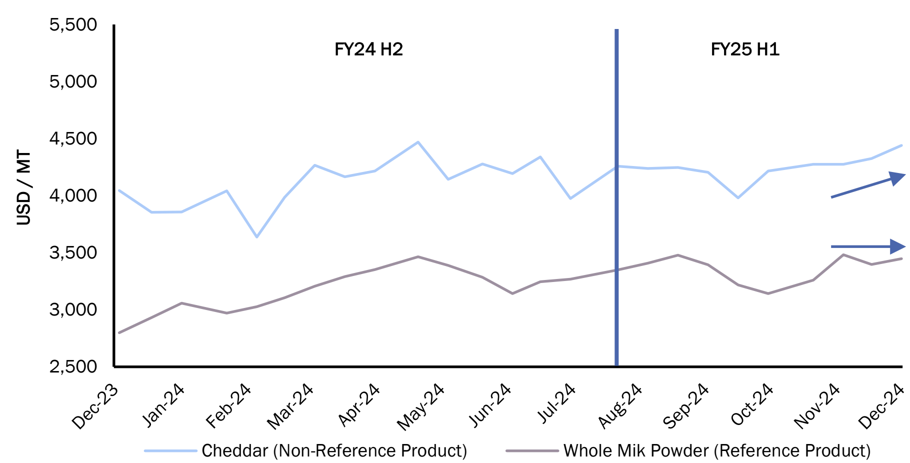
Earnings Per Share (Continuing Operations)



[1] *Capital IQ as at 25 October 2024*

As with previous years, price relativities will continue to have a significant influence on Fonterra's future performance. Consistent with management commentary, price relativities are expected to make a similar contribution to earnings in FY25 as they did in FY24 (12 cents per share).

FY25 Year-to-Date Price Relativities



Note: GDT prices are adjusted forward 3 months to reflect delay between GDT contracts struck and the shipment date (at which the invoice and revenue is recognised)

FY25 Change in Tax Status

Fonterra's exhaustion of New Zealand tax losses means it is changing how dividends are paid. While the change in tax status is unavoidable, there may be negative consequences for certain shareholders with available tax losses at the individual level.

Fonterra has advised that it has now exhausted its New Zealand tax losses, previously used to offset its tax liability. This means that from FY25, Fonterra expects to pay tax in New Zealand, generating imputation credits which can be applied to dividend distributions. To enable all shareholders to receive imputation credits, Fonterra is changing how it treats supply backed shares for tax purposes:

- Prior to FY25, dividends on supply backed shares were treated as a business expense paid by Fonterra to farmer suppliers. This tax deduction reduced the amount of tax payable by Fonterra.
- From FY25 onwards, dividends on supply backed shares will not be deducted for tax purposes by Fonterra. This change will increase the amount of tax payable by Fonterra but means that imputation credits will be able to be attached to dividends on all Fonterra shares and available to offset any tax payable by individual shareholders.

All else equal, this has the following impact on Fonterra's earnings:

- There is no impact on earnings prior to tax and therefore no impact on operating performance (as measured at the EBIT level);
- A higher tax expense results in reduced post-tax earnings, with a flow-on effect for reported earnings per share (as discussed on page 15);
- However, imputation credits can be attached to dividends on all shares and will be available to offset the tax payable at the shareholder level.

At an individual shareholder level, the implications of the tax change using a simplifying assumption of gross dividends of $1.00 per share are:

No impact on a tax paying shareholder with an effective tax rate at or above 28%. For example, relative outcomes for a shareholder with a 28% tax rate are as follows:

- Prior to FY25, the shareholder received a higher cash dividend ($1.00), but that payment is subject to tax at 28%. The post-tax cash benefit is $0.72.
- From FY25 onwards, Fonterra pays tax on the $1.00 at 28% and pays the net amount of $0.72 to the shareholder along with the associated imputation credits. The shareholder can apply the imputation credits to offset their tax payable. The post-tax cash benefit is $0.72.

Non-tax paying / loss making / low effective tax rate paying shareholder worse off in the dividend tax period.

- For shareholders with tax losses or an effective tax rate less than 28%, the ability to utilise imputation credits may be limited and they will not be able to claim a refund on excess imputation credits (although they can be accumulated for future benefit).
- For these shareholders, prior to FY25 the shareholder receives a higher cash dividend ($1.00) but this would reduce from FY25 onward ($0.72).
- With insufficient taxable income available to offset through the utilisation of imputation credits, this means the net cash received by the shareholder is lower when compared to prior FY25.

We note that these examples are only intended to be illustrative, is not tax advice and shareholders should seek their own advice in relation to the changes to Fonterra's tax status.

Tax Paying Shareholder (28% effective tax rate)

	Prior to FY25	FY25 onwards
Gross dividend per share (cents)	**$1.00**	**$1.00**
Imputation Credit	-	($0.28)
Cash Dividend	**$1.00**	**$0.72**
Tax Payable (28%)	($0.28)	($0.28)
Imputation Credit Utilised	-	$0.28
Net cash for shareholder	**$0.72**	**$0.72**

Shareholder with Tax Losses

	Prior to FY25	FY25 onwards
Gross dividend per share (cents)	**$1.00**	**$1.00**
Imputation Credit	-	($0.28)
Cash Dividend	**$1.00**	**$0.72**
Tax Payable (28%)	-	-
Imputation Credit Utilised	-	-
Net cash for shareholder	**$1.00**	**$0.72**

Operational Efficiency Metrics

Fonterra reports on two efficiency targets focusing on operating costs and manufacturing costs per kgMS. These efficiency metrics were introduced as part of Fonterra's drive to enhance efficiencies and reduce its cost base.

1. **Cash operating expenses per kgMS collected**

   Cash operating expenses represent the global overheads of the Group and include head office, selling, marketing, storage and distribution costs. In order to objectively assess cost efficiencies relative to varying milk volumes, the cash operating costs are assessed per kgMS of New Zealand and Australia milk solids collected.

   The total costs in FY24 were $2.1 billion (based on continuing operations, less depreciation, amortisation and impairments), implying a cost of $1.36 per kgMS vs $1.35 per kgMS in FY23. Performance in FY24 was impacted by the following:

   – Operating savings that were achieved were largely offset by the impact of inflation and product mix change with greater volumes shifted to higher cost products (Foodservice and Consumer); and

   – An increase of $59 million in IT & digital transformation costs to $81 million.

   Fonterra's revised targets (illustrated in the chart below) imply a ~23% reduction in nominal operating expenses on a per kgMS basis by FY27, to $1.05 per kgMS. However, this reduction is hard to reconcile on a like-for-like basis because it is significantly impacted by:

   – Increased IT & digital transformation costs in FY25 are expected to contribute to most of the increase (~$0.10 per kgMS), representing an increase of ~$160 million on FY24. However, these costs are not expected to continue indefinitely; and

   – The large decrease after FY25 is due to the assumed divestment of the Consumer business together with Fonterra Oceania and Fonterra Sri Lanka.

2. **Core Operations manufacturing cash costs per kgMS collected (a more appropriate measure of manufacturing efficiencies that the previous "Gross profit from Core Operations per kgMS" measure used)**

   This metric measures the manufacturing performance of Fonterra. It is aimed at measuring targeted efficiencies in the core New Zealand processing and manufacturing cost base to improve gross profit margins on each kgMS. These costs largely represent materials, labour, energy & packaging and the other costs directly incurred in processing milk products to the point of sale. The measure has intentionally excluded the cost of milk (i.e. the FGMP) which is out of Fonterra's control and is assessed per kgMS of New Zealand milk solids collected.

   The core manufacturing costs in FY24 were $3.8 billion, implying a cost of $2.58 per kgMS vs $2.63 per kgMS in FY23. The improved performance in FY24 benefited from the following:

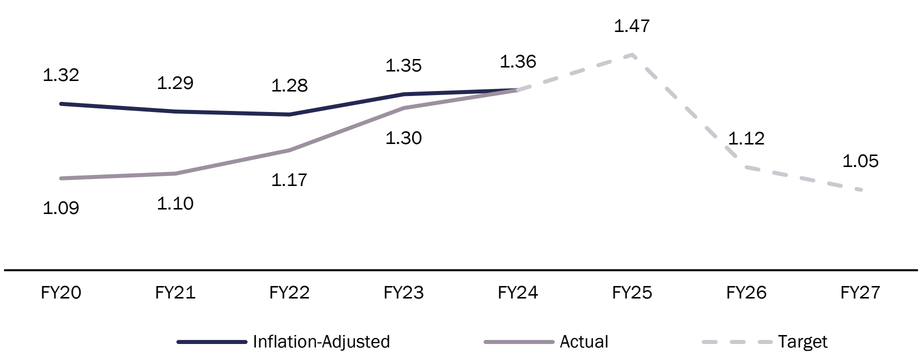
   – Procurement benefits for materials and inputs;

   – Shift in the product mix to lower cost products; and

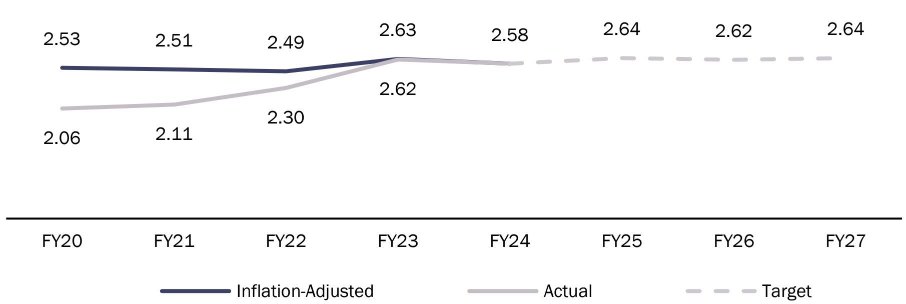
   – Efficiency gains through performance improvement programs partially offsetting inflation and labour cost increases.

   The information provided by Fonterra (illustrated in the chart below) implies a ~2% appreciation in nominal operating expenses on a per kgMS basis by FY27, to $2.64 per kgMS. This suggests ongoing manufacturing efficiencies are expected over the medium term when backing out an allowance for future inflation.

Cash Operating Expenses per kgMS



Core Operations Manufacturing Cash Costs per kgMS



Northington Partners

FONTERRA
CO-OPERATIVE
COUNCIL

Fonterra
Dairy for life

Section 2:

Strategic Update

Introduction

In May 2024, Fonterra announced a material change in its strategic direction which included the potential divestment of some or all of its global Consumer business together with Fonterra Oceania and Fonterra Sri Lanka. The Co-operative has subsequently provided further information on its revised strategy and key performance targets which replace the previous "Long-Term Aspirations" established in 2021.

Fonterra has announced a step-change in strategic direction with the intention of increasing focus on the Ingredients and Foodservice part of the business. This is expected to "grow further value for the Co-op by focusing on being a B2B dairy nutrition provider and working closely with customers through our high-performing Ingredients and Foodservice channels". As part of the revised strategy, the Co-operative is exploring the divestment of some or all of the global Consumer business as well as Fonterra Oceania and Fonterra Sri Lanka ("**In Scope Businesses**").

The In Scope Businesses comprise well known consumer brands in New Zealand and Australia including Anchor, Mainland, Kapiti, Perfect Italiano and Fresh'n Fruity as well as the Australian manufacturing and ingredients business. A summary of the make up of the In Scope Businesses is set out below.

This section provides a brief overview of the potential rationale and implications for divestment as well as Fonterra's updated strategic targets which replace the previous "Long-Term Aspirations" from 2021.

Fonterra's key rationale for the potential divestment includes:

- Ownership of these businesses is not required to fulfil Fonterra's core function of collecting, processing and selling milk.
- Prioritizing Ingredients and Foodservice channels and releasing capital from the In Scope Businesses would generate more value for shareholders.
- A divestment of these assets would help create a simpler, higher performing Co-operative with a focus on Fonterra's core business and doing what it does best.
- A divestment could allow a new owner with the right expertise and resources to unlock the full potential of these businesses on a global scale.

We note that it is likely to be some time before any decision to divest the In Scope Businesses is formalized. The degree to which Fonterra fully or partially exits the businesses will depend on the level of market interest and any decision to exit will likely involve shareholder consultation and approval.

In Scope Businesses: businesses, brands and manufacturing sites

Consumer

Oceania
- Fonterra Oceania (previously known as FBNZ and Fonterra Australia)

Sri Lanka

South East Asia
- Indonesia
- Malaysia
- Philippines
- Singapore
- Thailand
- Vietnam

Greater China
- China
- Taiwan
- Hong Kong

Rest of the World
- Americas[2]
- Middle East
- Africa

Oceania Brands[1]

Mainland, Fresh'n Fruity, Perfect Italiano, Western Star, Anchor, Bega, Primo, Kapiti, De Winkel, Galaxy, Mammoth Supply Co

Global Brands[1]

Anmum, Anchor, Ratthi, Anlene, Chesdale, Fernleaf

Foodservice

Oceania
- FBNZ and Fonterra Australia Foodservice

Sri Lanka

Ingredients

Oceania
- Fonterra Australia Ingredients

17 Manufacturing sites

New Zealand
- Takanini (Auckland)
- Bridge St (Eltham)
- Makomako Rd (Palmerston North)

Malaysia
- Dairymas
- Susumas

Indonesia
- Cikarang

Sri Lanka
- Biyagama

Australia
- Cobden
- Stanhope
- Darnum
- Spreyton
- Wynyard
- Tullamarine 1
- Tullamarine 2
- Campbellfield
- Bayswater

Middle East
- Dammam

[1] Key brands only. 'Anchor Food Professionals' is a Foodservice brand and excluded
[2] Americas includes Mexico and other Caribbean and Central American countries

High Level Summary of In Scope Businesses

The In Scope Businesses are a material component of the Co-operative, accounting for almost 30% of Fonterra's capital employed. Despite improved performance in FY24, these assets only contributed approximately 17% of EBIT for the year.

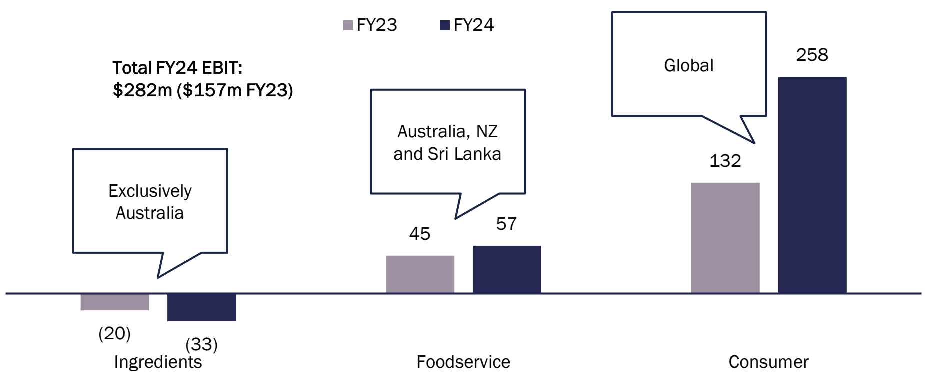
The In Scope Businesses represent significantly more than just the Consumer channel, with a material level of capital invested across the entire Australian dairy value chain (collections and processing through to consumer brands and foodservice), the NZ Consumer and Foodservice businesses, global consumer brands and Sri Lanka.

While limited information is currently available on the In Scope Businesses, the adjacent table and the FY23 and FY24 earnings breakdown below highlight some key metrics. These illustrate the considerable scale of the In Scope Businesses as well as their relative underperformance compared to the rest of the business (based on return on capital). Even after the improvement in the total EBIT contribution of $282m in FY24 (representing a ~80% improvement on FY23), the return on capital for the In Scope Businesses was just ~7%.

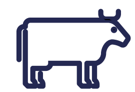
We note that the poor recent returns of the In Scope Businesses are materially impacted by the relative underperformance of Fonterra Australia. This is partly attributable to unsustainable prices for milk in Australia over the last three seasons as a result of the prevailing competitive landscape. Milk prices have become disconnected from global commodity prices, with the average Australian farmgate milk price for the 2023/2024 season over $2/kgMS higher than NZ. Excluding Australia, we suspect that the performance of the In Scope Businesses would be within Fonterra's previous return on capital targets (8% – 10%).

The inclusion of Fonterra Australia as part of the In Scope Businesses follows on from the strategic review of that business unit which was announced in 2021, but which did not lead to any divestment or significant restructuring. Wrapping the Australian business together with the broader global Consumer business could be more appealing to prospective purchasers and is likely to attract more interest than Fonterra Australia on a standalone basis.

In Scope Reported EBIT by Channel (NZ$ million)

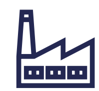


In Scope Businesses: FY24 Key Metrics



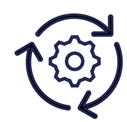
- **Australia provides 6.8% of Fonterra's total milk supply** (107 million kgMS)
- This represents approximately **16%** of Australia's total milk collections

- Combined businesses represent **14.3% of Fonterra's total sales volumes** (231 million kgMS)



- **$3.4bn (30%) of Fonterra's total capital employed** in combined businesses
- Significant majority of which is invested across processing / manufacturing in Australia and NZ

- $5.4bn revenue[1]
- **$282m EBIT** ($79m Australia & $203m NZ + rest of world) compared to total Group EBIT of $1,616m



- **<7% return on capital** (vs >13% for out of scope businesses)[2]

[1] Based on FY23, FY24 unavailable.
[2] Northington Partners' estimates based on Fonterra's overall return on capital of 11.3% and the relative levels of EBIT and capital employed by the In Scope Businesses. Assumes a consistent level of notional tax across businesses.

Potential Divestment Value and Capital Return

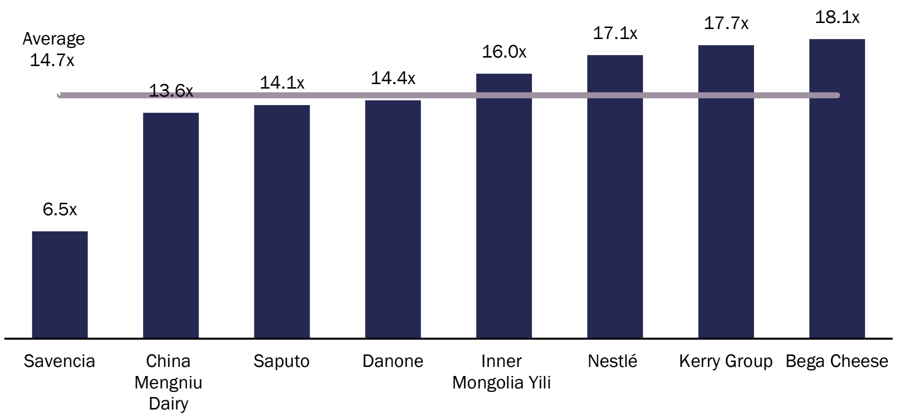
Given the value of the In Scope Businesses, the implications of the divestment for Fonterra and its shareholders are significant. We estimate that Fonterra could return up to $3bn of capital to shareholders assuming a full exit.

While the potential value of the In Scope Businesses is subject to market testing with potential purchasers and is highly uncertain until offers are received, a number of valuation reference points are available. Based on high-level analysis, we estimate that 100% of the In Scope Businesses may be worth in excess of $3bn:

- Comparable consumer dairy businesses broadly trade at average enterprise value (“**EV**”) to “forecast” EBIT multiples of >14.0x. While the comparable companies are large multinational nutrition businesses with distinct investment characteristics compared to the In Scope Businesses, we consider the evidence supports a valuation >$3bn (i.e. EV/FY24 EBIT multiple of >10.6x); and
- The book value of capital employed in the In Scope Businesses is $3.4bn, implying a multiple of approximately 12x FY24 EBIT.

It is possible that Fonterra may divest some or all of the In Scope Businesses or may decide to retain a shareholding (e.g. through an IPO or JV of the In Scope Businesses). In addition, ongoing milk supply arrangements or other transaction terms may impact on value. The EBIT of the In Scope Businesses is based on transfer pricing within Fonterra – if the contract milk supply arrangements used different pricing, this would impact on value. Therefore, the potential proceeds received by Fonterra may vary considerably depending on the final transaction structure and ongoing milk supply terms.

Comparable Companies EV / Forecast EBIT Multiples



Source: Capital IQ. See Appendix on page 47 for further details.

Based on Fonterra’s target debt levels (gearing ratio of 30% – 40% and debt to EBITDA of 2.0x-3.0x), the Resource Allocation Framework and the Company’s current debt position (see page 13), we think that the majority of any sale proceeds could be returned to shareholders while maintaining its “A” band credit rating.

A value of $3.0 - $3.4bn for 100% of the In Scope Businesses represents approximately $2.00 per share. While the level of capital that will be returned to shareholders following a successful divestment process will be influenced by a wide range of factors (including seasonal working capital requirements and expected capital expenditure), it could be material relative to the current share price.

Key Impacts of Potential Divestment

The divestment of the In Scope Businesses would see Fonterra focus on its international Ingredients and Foodservice businesses with no consumer facing brands – the emphasis would instead be on business customers and developing innovative dairy products.

Consistent with Fonterra's own rationale, we consider some of the potential benefits of divestment may include:

- Concentrates Fonterra's effort on its core business of collecting and processing milk while stabilising supply and improving processing efficiency.
- Creates a simplified co-operative with a focus on maximising returns from its core operations.
- Allows for an exit of the Australian business which has required significant investment at return levels lower than what have been achieved in Fonterra's other channels and markets.
- Prioritises investment in the Ingredients and Foodservice channels while releasing capital from the In Scope Businesses which would generate more value for shareholders.
- Provides the potential to achieve better return on capital in the remaining businesses.

For farmer shareholders, the sale of the In Scope Businesses would see the end of Fonterra's ownership of well-known brands but would be unlikely to result in a material reduction in milk sales volumes. Other than Australia (where milk collections and processing operations are also potentially being sold), it is likely Fonterra would continue to supply milk to the divested business through its Ingredients channel.

Potential Financial Consequences

Based on FY24 results, the pro forma impact of a 100% exit is shown in the adjacent table. This demonstrates:

- A 18% reduction in EBIT (to $1,278m) and 20% reduction in EPS (to $0.56 per share, assuming no change in debt levels or the number of shares on issue);
- Improved return levels on capital employed from 11.3% to ~13.0%, reflecting both a lower level of capital and higher returns from the out of scope businesses; and
- Even if the entire sale proceeds were returned to shareholders through a capital return, debt levels would remain well within target levels (i.e. 35% gearing and debt / EBITDA of 1.5x).

In addition, we consider that the potential sale should result in reduced capital expenditure currently required to support the In Scope Businesses.

We also note that the potential sale of the In Scope Businesses may result in an upward "re-rating" of the Fonterra share price depending on the price achieved and level of capital returned to shareholders. This is largely due to the potential scale of the capital return compared to the current share price (~50% of the farmers-only market price) while a sale would have less impact on earnings, only reducing by ~20% (based on FY24 pro-forma estimates).

Illustrative FY24 Pro Forma Financial Impact of In Scope Businesses Divestment

$m	FY24 (Continuing Operations)	Pro Forma Impact[1]	Pro Forma FY24 Excluding In Scope Businesses
EBIT	$1,560	($282)	$1,278
Net finance costs	($157)	-	($157)
Tax	($235)	$47	($188)
NPAT	$1,168	($235)	$933
Earnings per share	$0.70	($0.14)	$0.56
Return on capital employed	11.3%		~13.0%
Debt / EBITDA	1.2x		1.5x
Gearing (debt /(debt + equity))	24.0%		35.0%

Source: Northington Partners' estimates.

[1] Assumes that 100% of In Scope Businesses are sold and that the entire proceeds are returned to shareholders (i.e. no impact on debt levels) through a capital return and with no change in the total number of shares on issue.

Decision to Divest

More detailed information around the potential divestment of the In Scope Businesses will be provided as the strategic review process progresses. However, shareholders are expected to be consulted on any final decision and any material divestment will likely require shareholder approval.

More detailed information will be required to properly assess the merits of a potential exit from the In Scope Businesses. In addition to the potential benefits noted earlier, there may be some potential downsides from the divestment which need to be more fully addressed. These include:

- Less exposure to “value-add” consumer brands and their growth potential. However, historic growth has been limited which may be due to the brands not living up to their potential under Fonterra ownership. We also note that a value-add strategy can readily be pursued through the Ingredients and Foodservice channels on a B2B basis;
- Less diversified earnings streams and a reduced milk pool due to the divestment of Australia; and
- The potential loss of milk sales volumes if the potential divestment does not include milk supply arrangements with Fonterra or the buyer(s) subsequently moves away from Fonterra supply.

Fonterra has committed to engage in further consultation with shareholders in relation to any potential divestment. We therefore expect that more information will be provided in due course including details on transaction structure, transaction value, use of sale proceeds (including the level of capital return to shareholders), implications for the brands, manufacturing and people and the ongoing relationship between Fonterra and the purchaser (e.g. milk supply arrangements). We expect that more information will become available over the course of the remainder of FY25.

We also note that both the sale of the In Scope Businesses and any associated capital return are expected to require shareholder approval.

Updated Strategic Targets

As a result of the potential divestment of the In Scope Businesses, Fonterra withdrew its previous Long-Term Aspirations targets in May 2024 and has subsequently introduced new strategic targets for performance, investment and dividend policy.

As part of a significant reset of the business announced in 2019, Fonterra provided some key business targets for the following 3-5 years. Those targets were subsequently updated and amended in September 2021 with the publication of Long-Term Aspirations ("**LTAs**") which extended out to 2030 and included additional long-term earnings targets (EBIT and earnings per share). These have now been withdrawn (partly due to the potential sale of the In Scope Businesses) and have been replaced with new strategic targets.

The table below summarises the changes to the targets, illustrating:

- Higher return on capital targets of 10% - 12% vs 9% - 10% previously. However, the divestment of the lower returning In Scope Businesses should make this target more readily achievable (noting that the out of scope businesses returned >13% in FY24 vs <7% for the In Scope Businesses).
- A higher dividend payout policy of 60% - 80% of normalised profits vs 40% - 60% previously. Along with higher return targets, this should deliver higher dividends per share and we suggest that the change demonstrates confidence in the earnings outlook and strengthened balance sheet.
- Balance sheet targets (debt to EBITDA and gearing ratio) broadly consistent with previous LTA targets. This is not unexpected and will reflect the Co-operative's target of maintaining its "A" band credit rating (currently A- with S&P and A Fitch).

Although Fonterra has withdrawn its previous LTA earnings guidance, we estimate that the new targets imply long-term earnings per share performance in a similar range of 50 – 60 cents per share, despite the sale of the In Scope Businesses. This compares to Fonterra's current FY25 outlook of 40 – 60 cents per share which includes the In Scope Businesses. We estimate an implied FY25 earnings per share range of 30 - 50 cents excluding the In Scope Businesses (assuming the In Scope Businesses FY25 performance is consistent with FY24 and that Fonterra continues to supply milk solids to the In Scope Businesses at Ingredients' margins / kgMS comparable with FY24).

		Previous LTA Framework			
		FY24 Actual	FY18-23 Average	LTA Target[1]	Revised Long Term Target
Shareholder returns	Return on Capital	11.3%	8.6%	9% – 10%	10% – 12%
	Dividend Policy (% of earnings)	60% (excluding special div.)	n.a	40% – 60%	60% – 80%
Balance Sheet	Debt to EBITDA	1.2x	3.2x	<2.5x	2.0x – 3.0x
	Gearing Ratio	24%	42%	<35%	30% – 40%
Emissions reduction by 2030[2]	Absolute Scope 1 & 2 emissions	18.5%		50%	50%
	On-farm emissions intensity Scope 3	Not available		30%	30%

[1] Based on old LTA FY30 Targets
[2] From an FY18 base year

Long Term Capital Expenditure Outlook

Fonterra's long term capex outlook has moderated due to the potential sale of the In Scope Businesses. However, it remains high in the short-term relative to historic levels as the Co-operative looks to increase growth and sustainability investment.

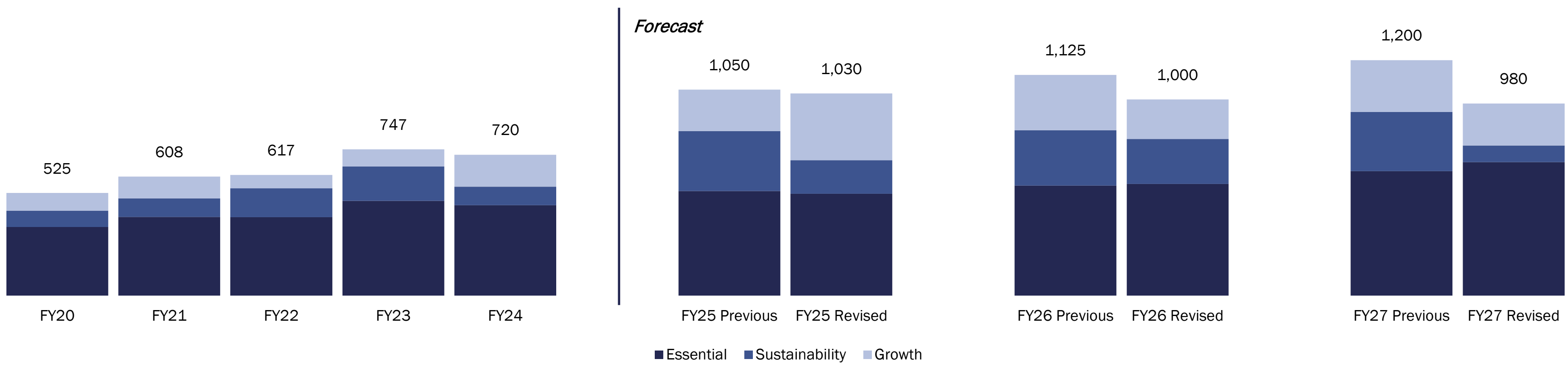
Following average capex over the last 5 years of ~$650m, Fonterra expects capex to increase by ~50% to an average of ~$1,000m over the period to FY27. We note that:

- Some catch-up in maintenance for existing plant (referred to as "essential" capex) is expected. Given the previous LTA included all of Fonterra's existing operations while the revised target excludes the In Scope Businesses from FY26 onwards, the updated projection suggests that Fonterra expects to spend more in the core NZ business in FY26 and FY27;
- The revised FY25 growth capex partially reflects recently announced growth projects including the $75m high value protein hub at Studholme, the $150m UHT cream plant at Edendale and the $150m cool store expansion at Whareroa. Overall, growth capex over the FY25 – FY27 period is largely unchanged despite the potential sale of the In Scope Businesses; and
- While capex to meet Fonterra's sustainability goals (made up of investment in "decarbonisation" and "regulatory requirements") seems to have reduced, it remains high compared to historical levels. We also note that some of this expenditure may have shifted beyond FY27 given other strategic priorities. Sustainability capex includes investment in key projects such as coal to electric / biomass boilers, improved refrigerants and wastewater collection.

The projections for the next three years represents a material increase in investment - ~$350 million more than average capital expenditure over the FY20 – FY24 period and twice the current depreciation charge (~$460 million). However, the FY27 capex is $220m lower than the previous LTA target which potentially reflects the capex that would have been required to support the In Scope Business or other investment reductions. We also suggest that:

- Growth capex enables Fonterra to grow the Ingredients and Foodservice business and develop new products for customers to support more value and earnings growth for the Co-operative (e.g. the new UHT cream plant);
- The essential capex is necessary to meet Fonterra's asset health targets and follows a period of relative under-investment. This capex may also contribute to improved processing and supply chain efficiencies through technology advancements (e.g. automation) and asset flexibility;
- Similarly, the material increase in decarbonisation and regulatory capital expenditure is essential to meet Fonterra's own sustainability targets as well as the increased ESG demands of its customers. While it is hard to determine the earnings or premium contribution from this investment, without it, Fonterra could lose the increasing number of customers who are seeking sustainably-sourced milk.

Capital Expenditure FY20 – FY30, LTA vs Revised Strategy (NZ$ million)



Section 3:

Flexible Shareholding

Competition for NZ Milk and Shareholder Flexibility

Fonterra's recent capital structure changes and strong financial performance should support greater flexibility for farmers while maintaining Fonterra's competitiveness for milk supply.

Given that Fonterra's revised strategy is designed to optimise the value of NZ milk volumes, maintaining stability in its future milk volumes will be critical to future performance. Fonterra's NZ milk collections have been relatively stable over the last five years, an outcome that is consistent with the overall market levelling off in terms of total milk production. This has resulted in Fonterra maintaining ~79% market share since FY21, but we note a modest decline in FY24. Long-term NZ milk volumes are also expected to remain broadly consistent with the current level, but with the potential for further small declines.

The potential for increased competition, including from new market entrants, could however impact on Fonterra's milk volumes. Any further declines would generate excess processing capacity and could have a negative impact on margins.

Recent changes to the minimum required shareholding (as outlined in the Appendix on page 40) should support a more sustainable supply of milk, particularly in an environment of increased competition from other processors who may not require farmers to invest capital to support supply (i.e. buy shares). However, restricting share trading to meet Fonterra's new minimum required shareholding in the farmer-only market means that farmers now set the price for shares and this has resulted in a larger disconnect between the Fonterra share price and the FSF unit price (currently a 20% – 25% difference)[1]. See page 29 for a recent history of relative prices between the shares and units.

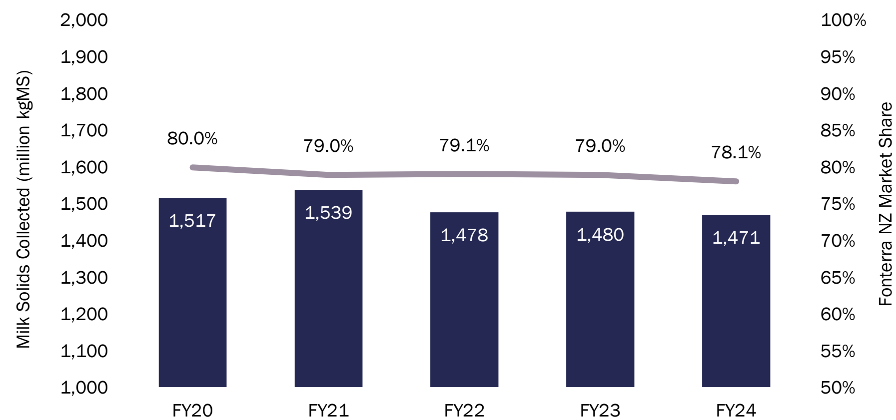
While the changes to the minimum required shareholding reduce the investment needed by farmers to continue to supply Fonterra, the investment in FCG shares remains material even at the minimum level. Fonterra must therefore ensure that the shares deliver long-term returns in line with the level of required investment and the risk profile of the business. The shares must be seen as a compelling, standalone investment opportunity rather than just a cost of remaining with the Co-op.

Any future loss of milk supply volumes could limit future earnings growth, but we also expect that it may provide some potential benefits, including:

- Reducing the requirement for Fonterra to collect milk from farmer suppliers that may be of marginal profitability (i.e. sub-optimal from a cost or volume basis, for instance, due to location and size); and
- Reduce the need to invest in processing capacity or provide the opportunity to shutdown marginal processing capacity and avoid capacity duplication with other milk processors.

Taking all factors into consideration, we consider that Fonterra's future collection volumes may decline further (through either or both of declines in total market collections and increased competition), but the net earnings impact may be limited and more than offset by Fonterra's other strategic objectives.

Fonterra NZ Milk Collections and Market Share



[1] *As of October 2024*

Flexible Shareholding

Farmer shareholding levels relevant to milk supply have changed since the introduction of Fonterra's flexible shareholding structure 18 months ago.

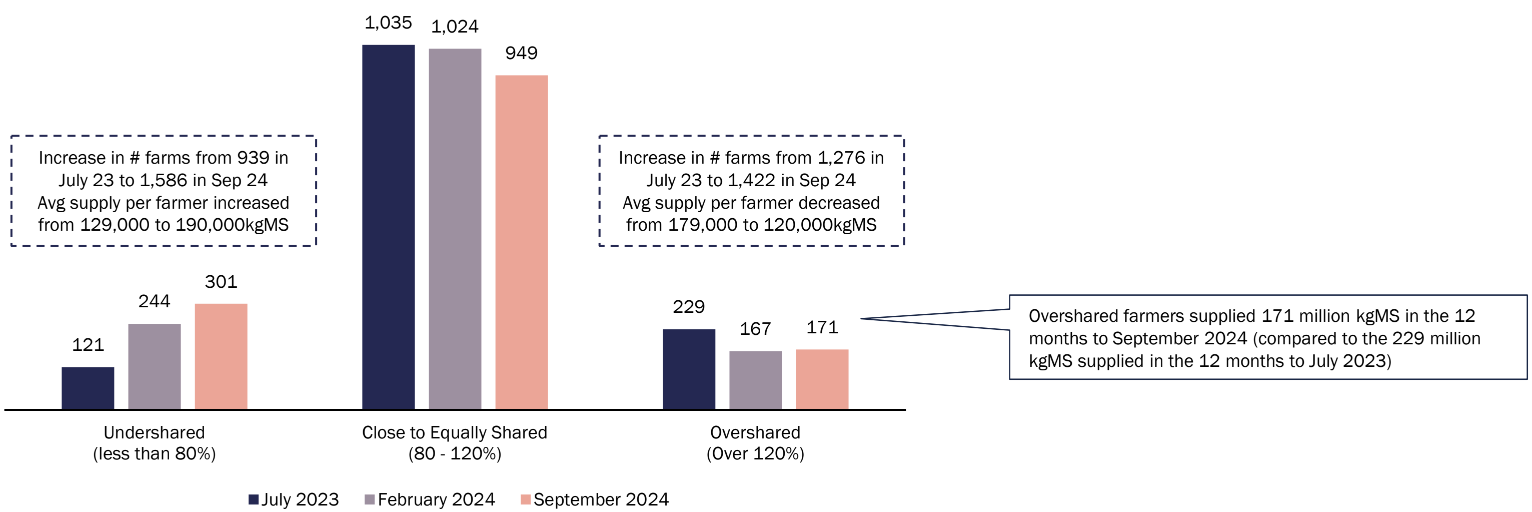
Fonterra's Flexible Shareholding was announced in May 2021 and introduced in April 2023. Since then, Fonterra is required to periodically disclose certain shareholding metrics including ceased-farmer holdings and the distribution of farmer shareholders relative to the Share Standard (1 share per kgMS supplied). The recent September 2024 disclosure confirms that Fonterra remained within its specified thresholds for the Flexible Shareholding metrics (shares on issue above the Share Standard, shares held by ceased farmers and shares held by the Fonterra Shareholders' Fund). However, the data also highlights movements in farmer shareholdings relative to the Share Standard since the first disclosure in July 2023.

Changes to the distribution of farmer milk supply relative to shareholding levels are summarised in the chart below. Farmers described as "undershared" are those that have shares less than 80% relative to the Share Standard, "close to equally shared" being those that are 80% – 120% of the Share Standard and "overshared" being those with more than 120% of the Share Standard. Over the 14-month period since July 2023, the data demonstrates significant compositional changes at the under and over shared ends of the spectrum.

While it is difficult to determine the drivers of changes in farmer shareholdings relative to milk supply, we note that:

- Milk supply from undershared farmers continues to increase, from 121 million kgMS in July 2023 to 301 million kgMS in September 2024. This reflects an increase in the number of farmers in this category (increased by ~650 to 1,588), as well as an increase in the average milk supply per farmer (increased from 129,000kgMS to ~190,000kgMS vs an overall average supply of 174,700kgMS). We expect that much of this increase reflects farm sales and new farmers (~250 since July 2023) as they begin the process of sharing up, as well as production growth (ie. increased average production relative to shares) and larger farmers sharing down also contributing to the change;
- The number of farms that are close to equally shared has decreased by 540 (10%) since July 2023, broadly consistent with reduced volumes; and
- Milk supply in the overshared category has decreased by ~58 million kgMS despite an increase of 150 farms in this category, but appears to have stabilized. There has been a significant decrease in average farm supply from this group, from 179,000kgMS to 120,000kgMS. This suggests that overshared farms are increasingly smaller farms.

Farmer Milk Supply Relative to Share Standard (million kgMS)



Restricted Market Discount

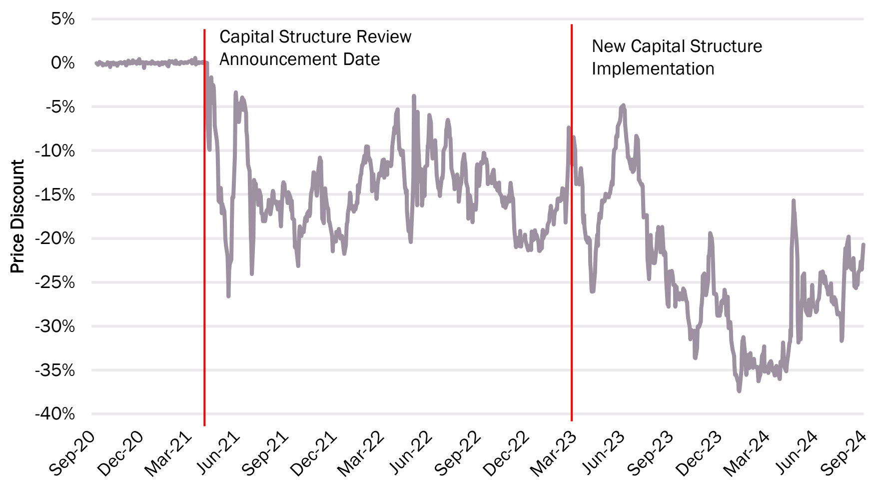
While the restricted market discount has reduced since Fonterra's strategic update in May, it still remains ~25%. This is consistent with the average discount since implementation in April 2023.

While the price of Fonterra shares (FCG) in the farmer-only market continues to trade at a significant discount compared to units in the Fonterra Shareholders' Fund (FSF), the discount has narrowed since the all-time highs seen at the beginning of 2024. Some of this is likely due to Fonterra's strategic update in May, the potential for a capital return and Fonterra's ongoing strong financial performance. However, the current discount (ranging between 20% and 25%) is still consistent with the average 25% discount that has prevailed since the new capital structure was implemented.

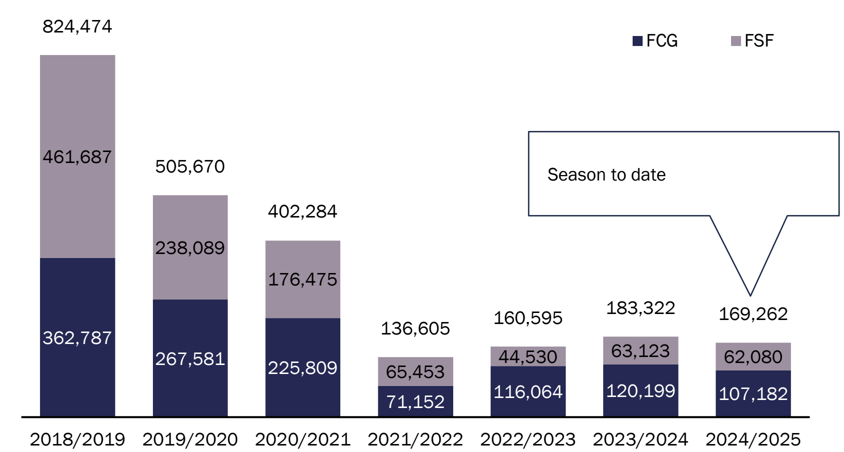
The discount is consistent with the broad level of restricted market discount expected at the time the revised capital structure was put to shareholders. We expect the volatility in the relative prices between FCG and FSF will continue.

While the discount has represented a relative loss in value for farmers who shared up before the announcement of the capital structure review, the change has made it easier for new suppliers to join the Co-op. Recent financial performance and the potential for a capital return, which would make the cost of buying shares lower (all else equal), should also make ownership more attractive and affordable (on a per kgMS basis).

Discount of FCG Share Price to FSF Unit Price[1]



Average Daily Trading Volume on NZX



[1] *Calculated as (FCG price per share / FSF price per share) - 1*

Source: Iress as at 30 September 2024

Appendix – Supporting Information

Continuing and Discontinuing Operations

NZ$ Million	FY23			FY24		
	Continuing Operations	Discontinued Operations	Total Group	Continuing Operations	Discontinued Operations	Total Group
Sales Volume (‘000 MT)	3,497	476	3,973	3,470	59	3,529
Total Revenue	24,580	1,466	26,046	22,822	172	22,994
Cost of Goods Sold	(20,399)	(1,048)	(21,447)	(19,000)	(106)	(19,106)
Gross Profit	**4,181**	**418**	**4,599**	**3,822**	**66**	**3,888**
Gross Margin (%)	17.0%	28.5%	17.7%	16.7%	38.4%	16.9%
Operating Expenses	(2,496)	(303)	(2,799)	(2,369)	(99)	(2,468)
Other Items	70	348	418	107	-	107
Reported EBIT	**1,755**	**463**	**2,218**	**1,560**	**(33)**	**1,527**
Reported EBIT Margin (%)	7.1%	31.6%	8.5%	6.8%	(19.2%)	6.6%
Normalisations	-	(337)	(337)	-	66	66
Normalised EBIT	1,755	126	1,881	1,560	33	1,593
Reported Net Profit After Tax	1,241	336	1,577	1,168	(40)	1,128
Normalisations (post tax adjustments)	-	(248)	(248)	-	66	66
Normalised Net Profit After Tax	1,241	88	1,329	1,168	26	1,194

FY24 Integrated Scorecard

	Key Performance Indicator (KPI)	FY22 Actual	FY23 Actual	FY24 Actual	FY24 Scorecard
People	Serious harm	8	5	3*	*4*
	Gender diversity (Band 12+)	37.6%	39.5%	40.1%*	*40.0%*
	Culture Measure	-	79	79	*-[1]*
Nature	GHG emissions (Scope 1,2)[2]	(11.2%)	(14.1%)	(18.5%) *	*(15.6%)*
	FEP adoption (New Zealand)	71%	85%	93%*	*92%*
	Water Improvement Plans in place	-	44.0%	100.0%*	*100.0%*
Relationships	Share of New Zealand milk collected for the season to 31 May	79.1%	79.0%	78.1%	*79.0%*
	Delivered in full, on time (DIFOT, ex-New Zealand)	51.6%	53.2%	70.8%	*80.0%*
Financial / Assets & Infrastructure	Cash operating expenses per kgMS (real)[3]	1.39	1.44	1.46	*1.37*
	Core Operations gross profit per kgMS (real)[4]	10.32	9.51	8.12	*8.52*
	Return on capital	6.8%	12.4%	11.3%*	*8.0% - 9.0%*
	Farmgate Milk Price ($)	9.30	8.22	7.83*	*7.25 – 8.75[5]*
Alignment Rights	Total shareholder return (share price plus dividend)	$2.73 ($0.20)	$3.20 ($1.00)[6]	$2.97[7] ($0.55)	*Not Available*
	On-farm profitability ($ per hectare)[8]	4,150	3,017	*Not Available*	*Not Available*

** Indicates that target was met*

1. No target set for FY24
2. Relative to FY18 Baseline. Scope 1&2 including farms under Fonterra operational control
3. Based on New Zealand milk solids
4. Excludes the cost of milk. Based on New Zealand milk solids
5. FY24 Scorecard reflects opening forecast price for 2024 season
6. Includes 50-cent per share capital return
7. FCG closing share price on 31 July 2024
8. DairyNZ Economic Survey 2022-2023 (Owner-Operator)

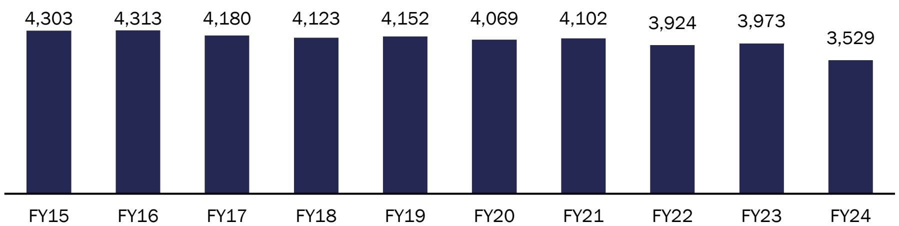
FY25 Integrated Scorecard

	Key Performance Indicator (KPI)	FY23 Actual	FY24 Actual	FY25 Scorecard
People	Serious harm[1]	18	16	*12*
	Percentage of Health, Safety and Wellbeing priority actions fully completed by due date	76%	77%	*95%*
	Culture Measure	79	79	*81*
Nature	GHG emissions (Scope 1,2)[2]	(14.1%)	(18.5%)	*(21.1%)*
	Absolute water reduction across manufacturing sites (15% by FY30)[2]	(6.7%)	(12.4%)	*(13.1%)*
Relationships	Share of New Zealand milk collected for the season to 31 May	79.0%	78.1%	*78%*
	Delivered in full, on time (DIFOT, ex-New Zealand)	53.2%	70.8%	*80%*
Financial / Assets & Infrastructure	Cash operating expenses per kgMS (real)[3]	1.35	1.36	*1.43*
	Core Operations manufacturing cash costs per kgMS (real)[4]	2.63	2.58	*2.57*
	Return on capital (FY)	12.4%	11.3%	*8% - 10%*
	Farmgate Milk Price ($)	8.22	7.83	*7.75 – 9.25*
Alignment Rights	Total shareholder return (12-month Value Weighted Average Price of Fonterra Co-operative Unit plus dividend)[5]	$2.82 ($1.00)	$2.58 ($0.55)	*Not Available*
	On-farm profitability ($ per hectare)[6]	3,017	Not Available	*Not Available*

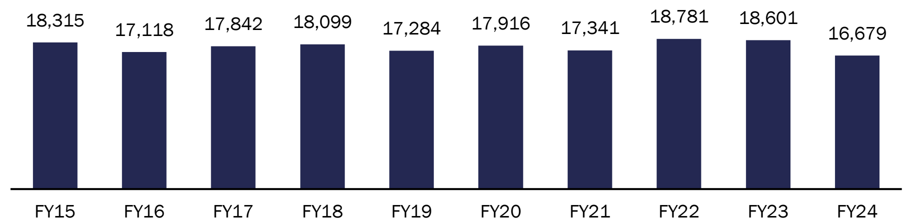
1. A broader definition, which also includes Contractors, has been adopted for FY25 resulting in an increased number of injuries captured under the revised definition
2. Relative to FY18 Baseline. Scope 1&2 including farms under Fonterra operational control
3. Based on New Zealand and Australia milk solids. FY25 includes IT and digital transformation costs
4. Based on New Zealand milk solids collected. Excludes the cost of milk
5. Value Weighted Average Price (VWAP) for the period 1 October to 30 September. As an indicator for FY25, VWAP for the 12months to 31 August 2024 was $2.58. FY23 dividend includes 50-cent per share capital return
6. DairyNZ Economic Survey 2022-2023 (Owner-Operator)

Historical Financial Information

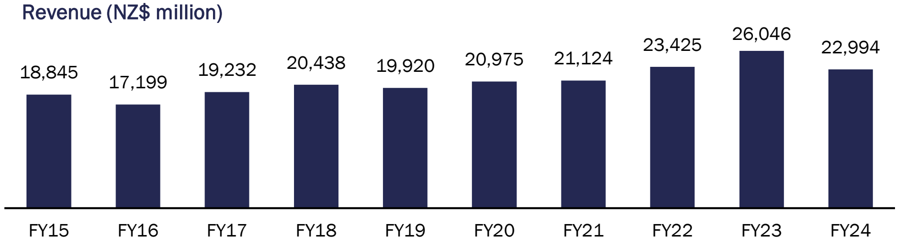
Sales Volume (‘000 MT)



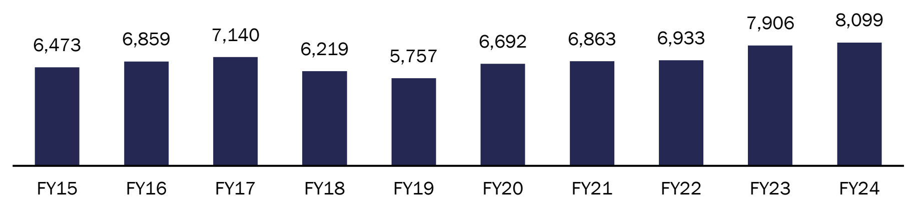
Total Assets (NZ$ million)



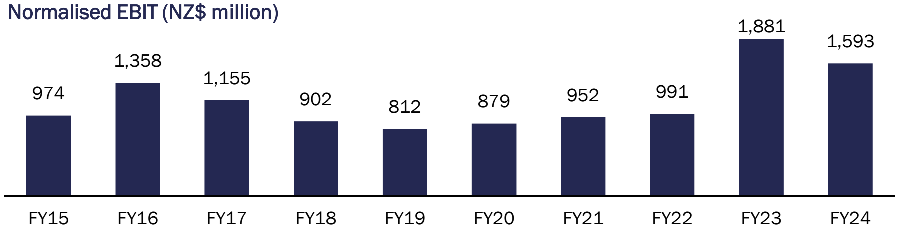
Revenue (NZ$ million)



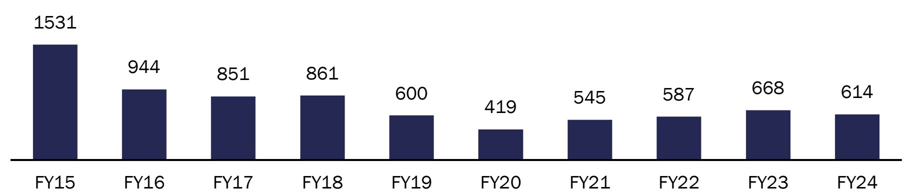
Total Equity (NZ$ million)[1]



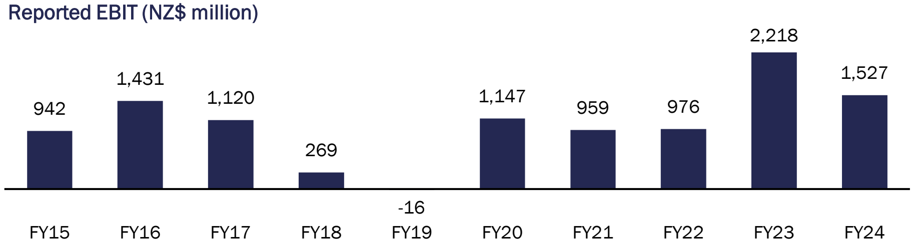
Normalised EBIT (NZ$ million)



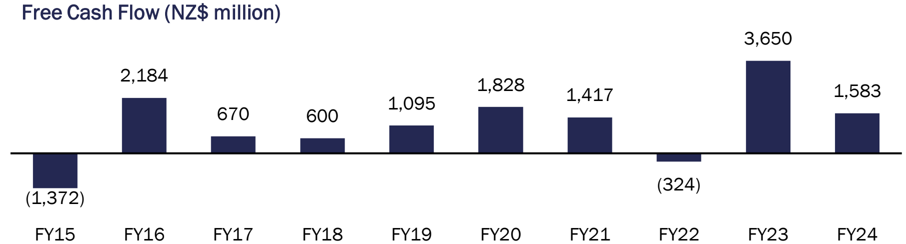
Capital Expenditure (NZ$ million)



Reported EBIT (NZ$ million)



Free Cash Flow (NZ$ million)

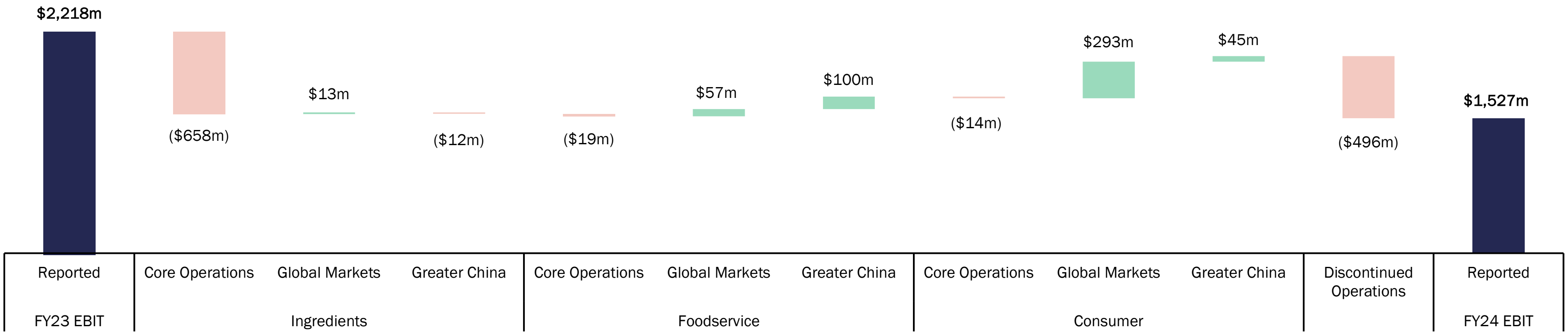


[1]*Excluding non-controlling interests*

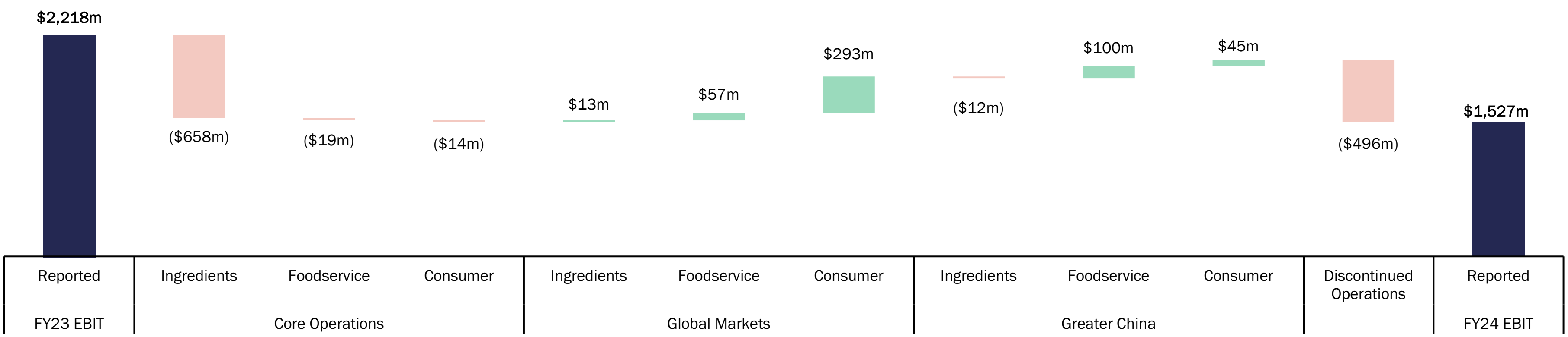
Note: Includes continued & discontinued operations where known

Reported EBIT Bridge by Segment and Channel

Reported EBIT Bridge by Channel



Reported EBIT Bridge by Segment



Summary of Normalisations

Impact of FY23 Normalisations

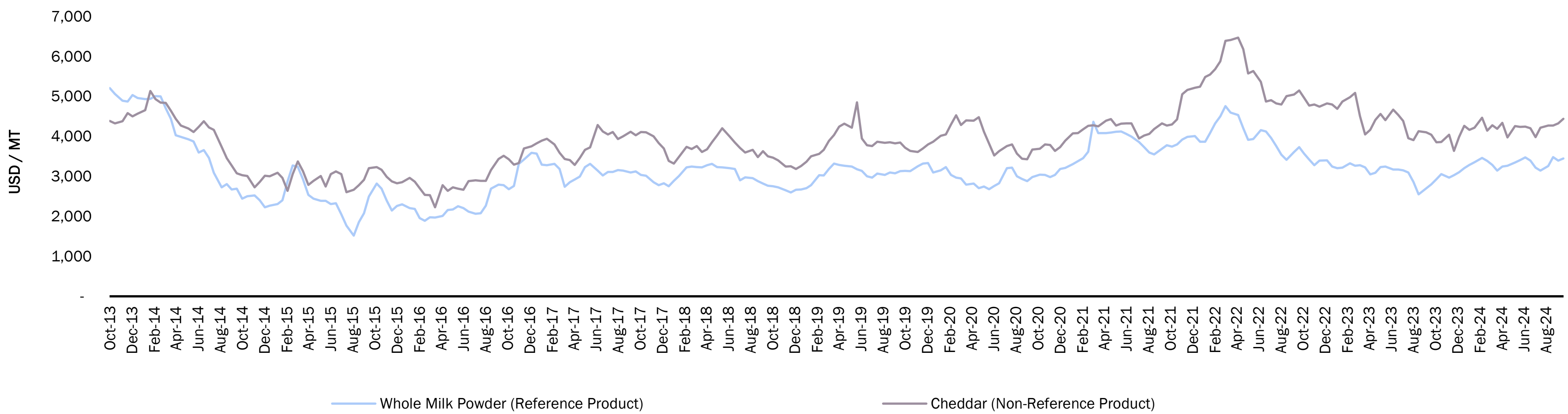
Item	Impact on EBIT		Impact on Gearing	
Loss on Sale of DPA Brazil	▲	$66m loss on sale	▼	Sale proceeds reduce Net Debt, while the loss on sale decreases Equity. All else equal, the net impact should be a reduction in Gearing.

Normalisation Adjustments to EBIT

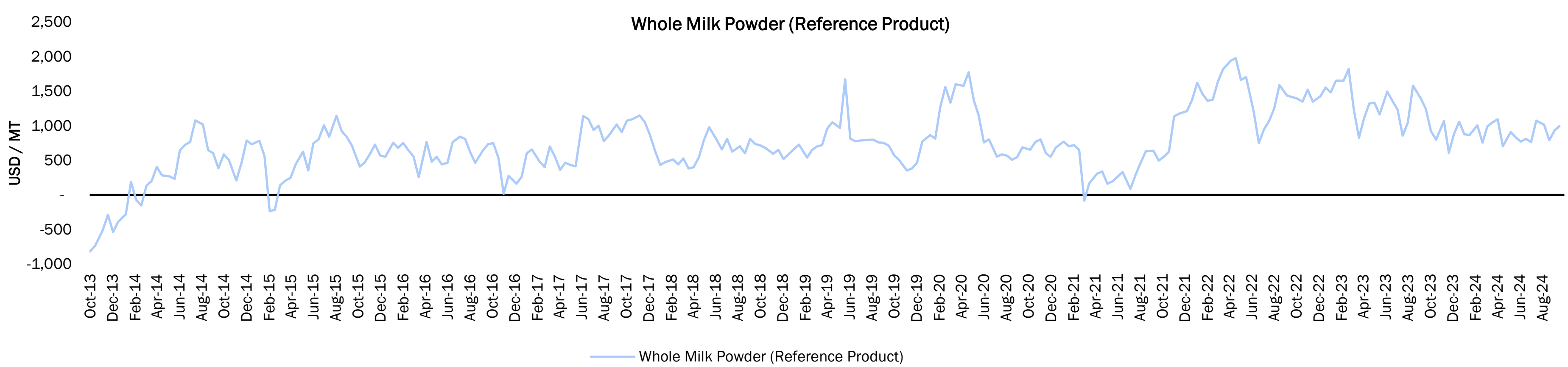
NZ$ million	FY20	FY21	FY22	FY23	FY24
Disposals	$543m	$23m	$42m	$337m	($66m)
Impairment	($232m)	($16m)	($57m)	-	-
Other / Strategy	($43m)	-	-	-	-
Total	**$268m**	**$7m**	**($15m)**	**$337m**	**($66m)**
Reported EBIT	**$1,147m**	**$959m**	**$976m**	**$2,218m**	**$1,527m**
Normalisations	($268m)	($7m)	$15m	($337m)	$66m
Normalised EBIT	**$879m**	**$952m**	**$991m**	**$1,881m**	**$1,593m**

Long Term Reference vs Non-Reference Price Relativities

Reference vs Non-Reference Price Relativity Proxies



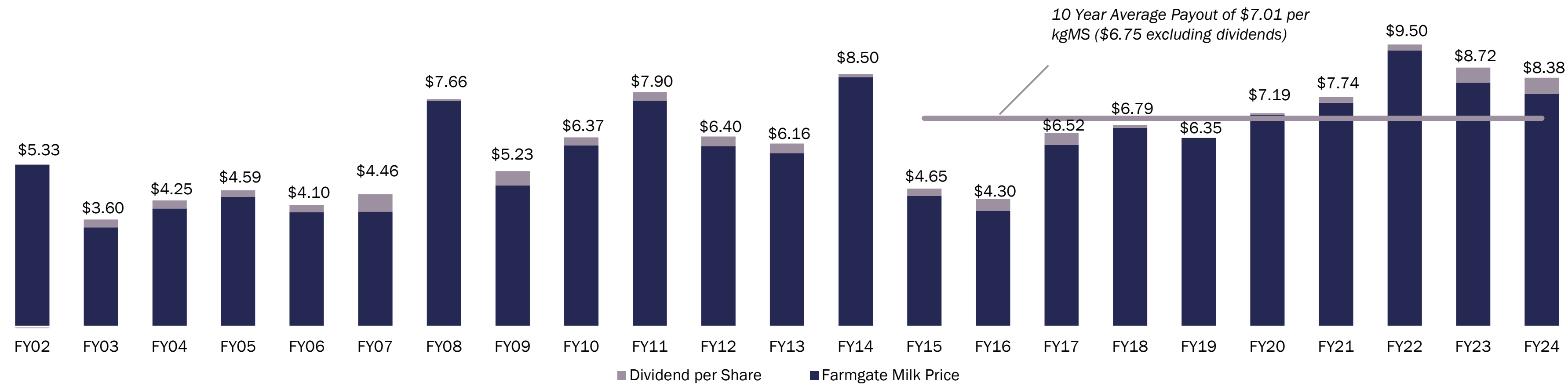
Price Margin between Reference and Non-Reference Proxies



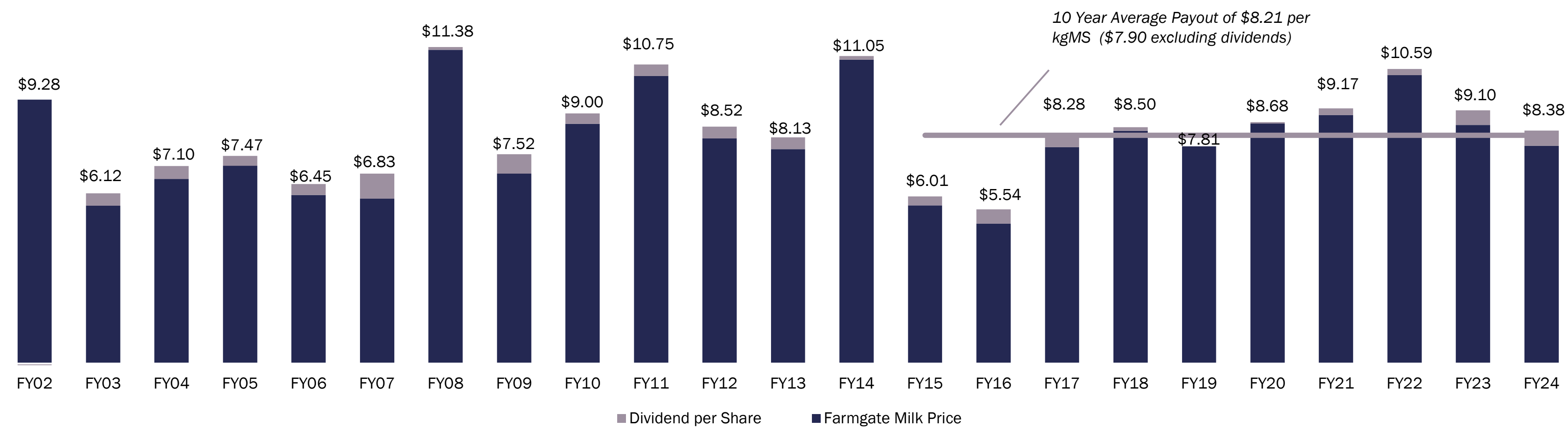
Source: GDT

Historical Total Payout

Total Payout (Nominal NZ$ per kgMS)



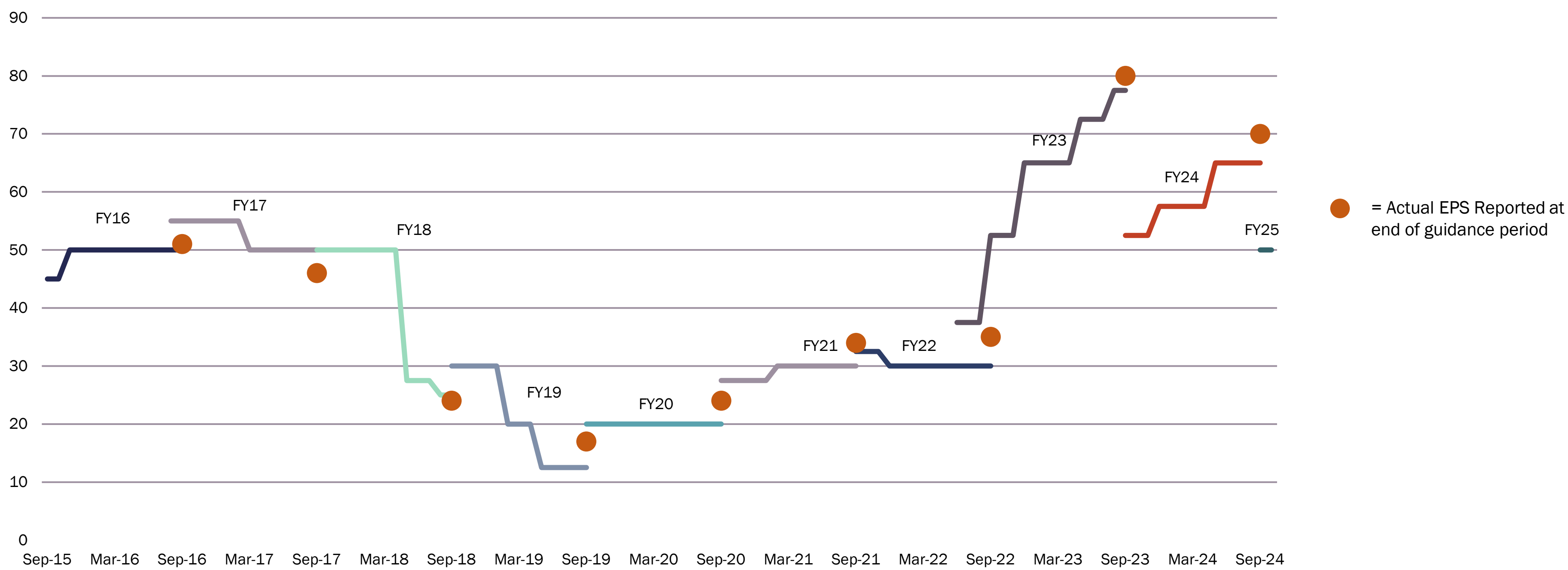
Total Payout[1] (Real NZ$ per kgMS)



Note: Figures reflect the average payout for a 100% share-backed supplier
[1]Adjustment made based on CPI average during relevant period, reflects price in today's dollars

Historical Earnings per Share Performance vs Guidance

Historical Earnings Per Share Guidance Midpoint vs Actual Reported



Flexible Shareholding Summary

A new Flexible Shareholding structure came into effect during FY23. The key changes between the old structure and the new structure are summarised in the table below.

Key Items	Old Structure	New Structure
Increased flexibility	Share minimum: 1:1 / 100%	Share minimum: 1:3 / 33%
Move to a farmer-only market with the Fund capped	Shares and units traded and exchanged between FSF and FCG.	Capped FSF, can only transfer units into shares
More types of farmers can hold shares	Supplying Farmer owners and sharemilkers if transferred	Addition of associated sharemilkers, contract milkers and farm lessors
Entry provision eased	Up to 3 seasons to enter Share-up & My Milk offered	Up to 6 seasons to enter No Share-up & My Milk
Exit provisions extended	Up to 3 seasons to exit, minimum 1/3 per year	Large extension for current and new supplying farmers
Same voting rights	1 vote per 1000 kgMS supplied (share-backed)	1 vote per 1000 kgMS supplied (share-backed)

Since Flexible Shareholding came into effect on 28th March 2023, there hasn't been any material change to the Group's shareholding structure. As at 31st July 2024, the Group was well within the specified thresholds for all three Flexible Shareholding metrics:

Metric	As at July 2023	As at July 2024	Threshold
Total Shares on Issue above the aggregate Share Standard	12.22%	13.13%	+/- 15.00%
Shares Held by Ceased Shareholders and Permitted Transfers	9.23%	10.19%	≤ 25.00%
Shares held for the Fonterra Shareholders' Fund ("Overall Limit")	6.67%	6.67%	≤ 10.00%

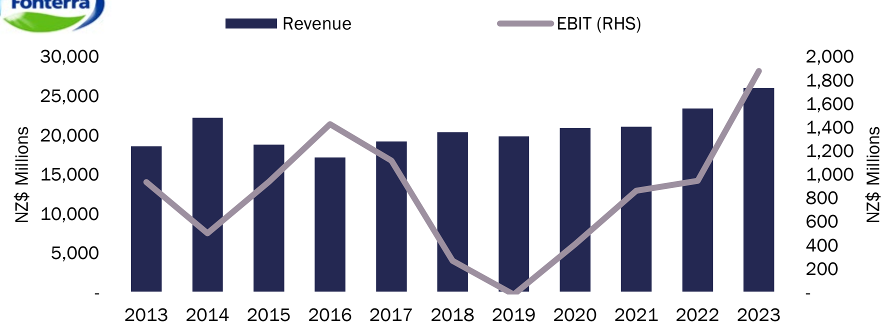
Comparable Company Performance

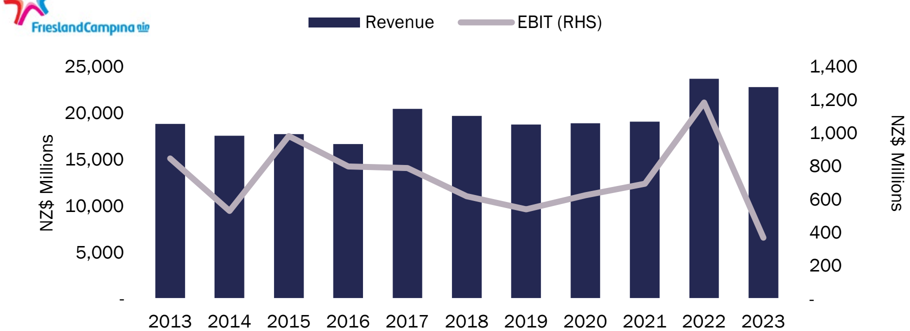
Fonterra is very different to other entities operating in the NZ dairy sector and to overseas dairy co-ops and companies. This is due to a range of factors including the DIRA regulatory regime, scale and product mix. Arguably the most comparable entities to Fonterra can be found overseas. This includes Arla and Friesland Campina, which are both farmer co-operatives (based in Denmark and the Netherlands respectively) with substantial commodity and consumer operations. However, neither company is subject to the same regulatory regime as Fonterra.

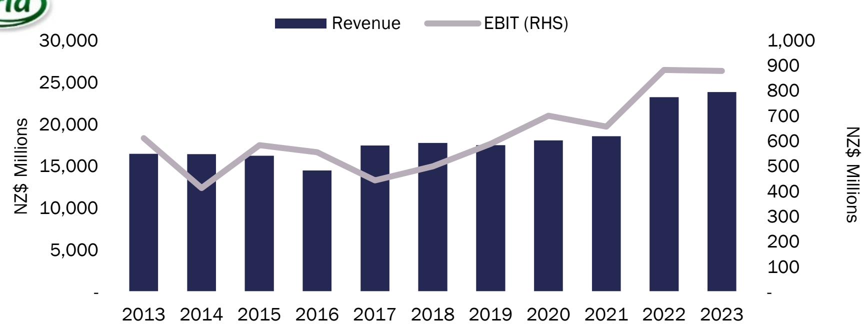
The comparisons on the following pages provide a high-level overview of revenue and earnings over time for companies in both dairy ingredients and value-add sectors, along with a single 'point in time' view of summary financial ratios. It is important to note that these comparisons do not take into account the differing mix of core dairy ingredients and value-add divisions for each company, which is a key driver of the differing margins and gearing.

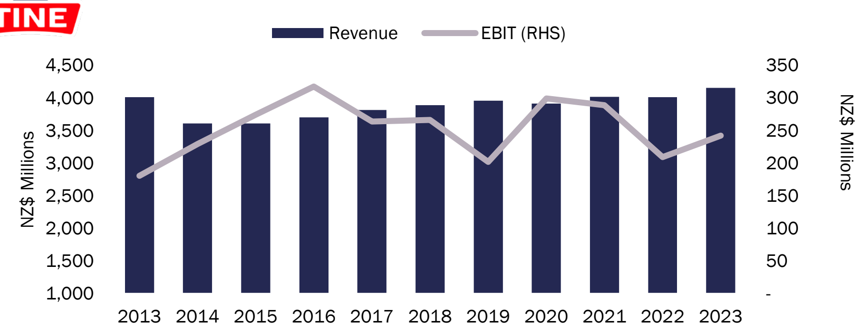
They also do not take into account different regulatory regimes for the other dairy co-operatives and the impact such regimes may have on margins, capital investment required and ultimate returns. Finally, the performance trends over time all reflect the currency exchange rates at the relevant time, and relative changes in those rates may affect the values presented.

Dairy Co-ops





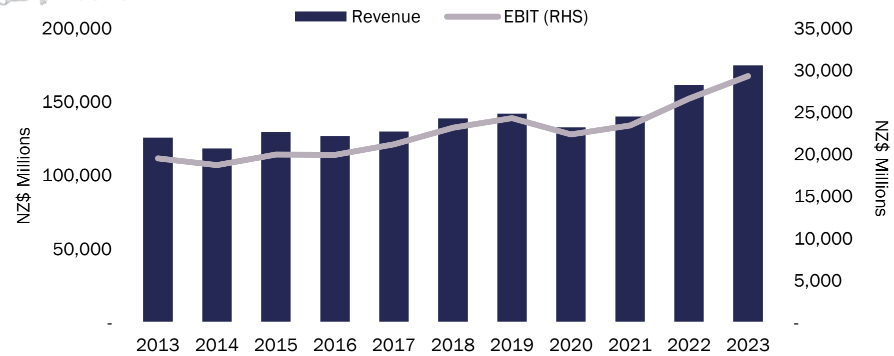


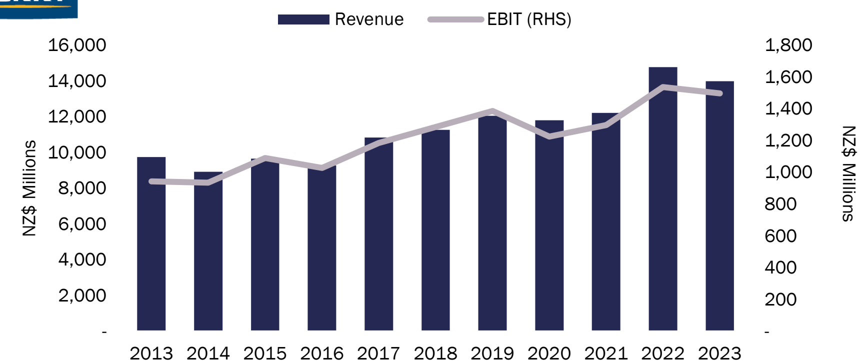


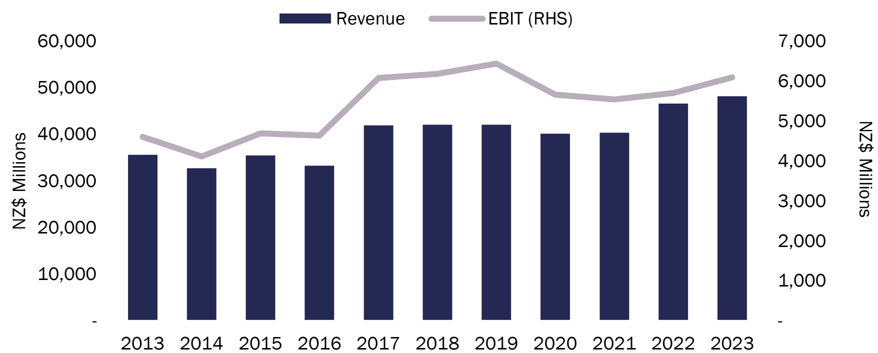
All figures are quoted in New Zealand dollars unless otherwise stated. Figures sourced from Capital IQ and Annual Reports
Note: Companies presented here have a December financial year end compared to Fonterra's July year end

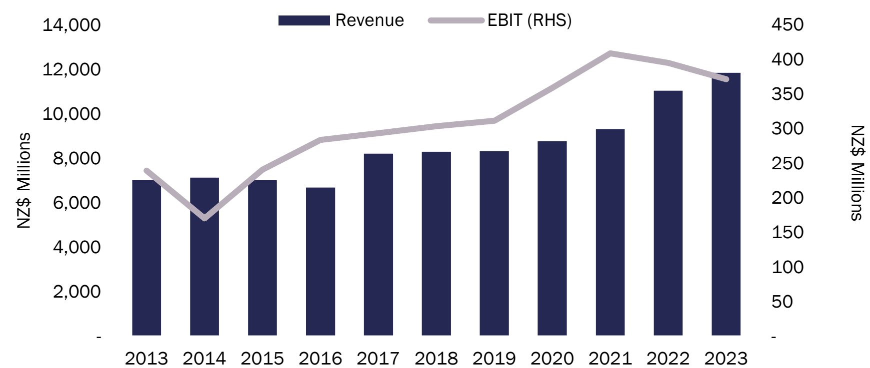
Comparable Company Performance (Continued)

Dairy Companies









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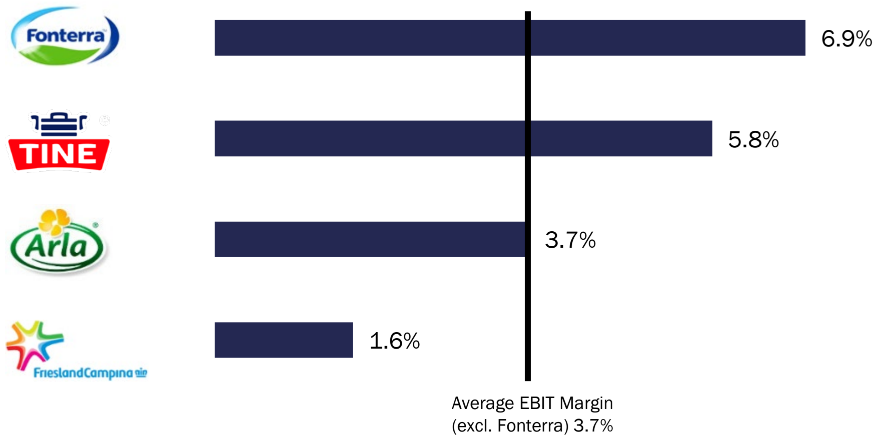
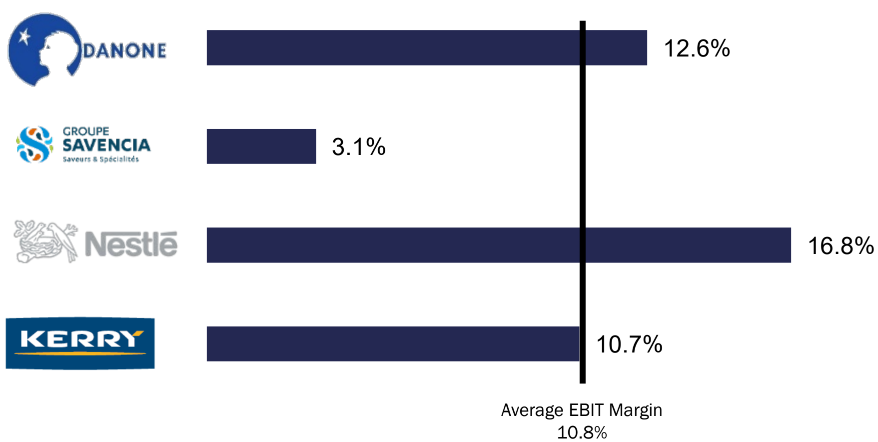
Note: Companies presented here have a December financial year end compared to Fonterra's July year end

EBIT Margin

Dairy Co-ops

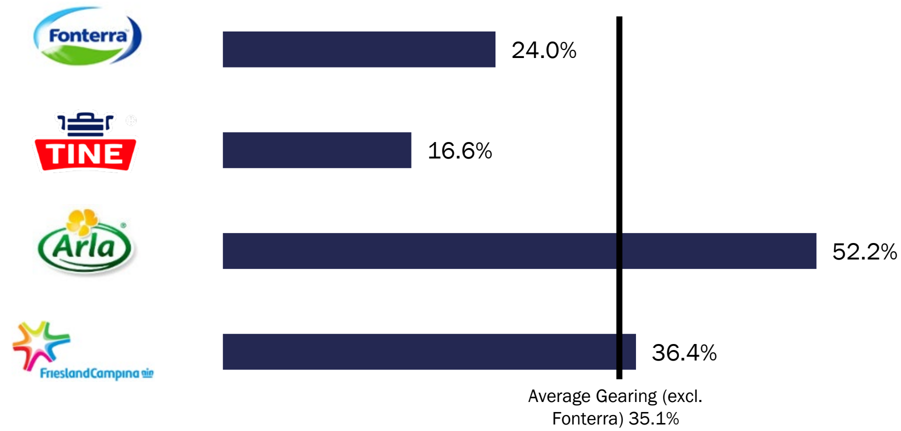


Dairy Companies

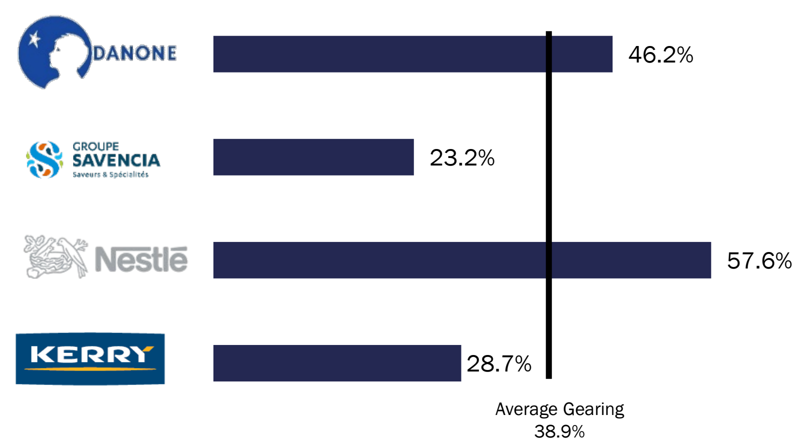


Gearing Ratio

Dairy Co-ops



Dairy Companies



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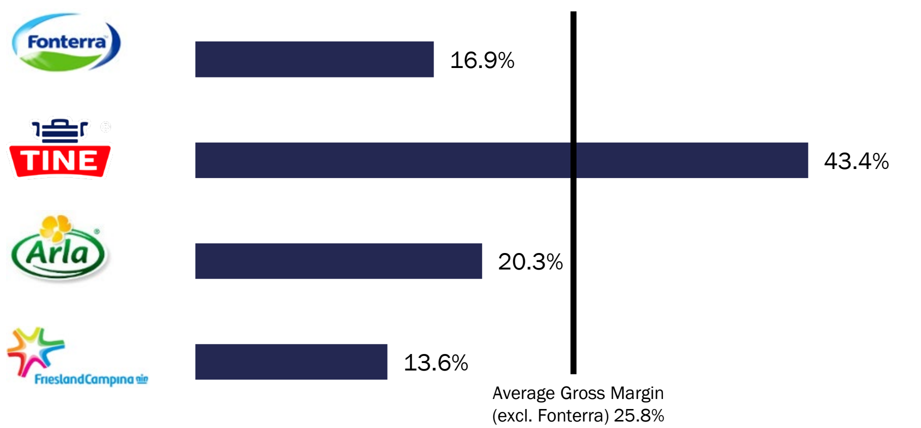
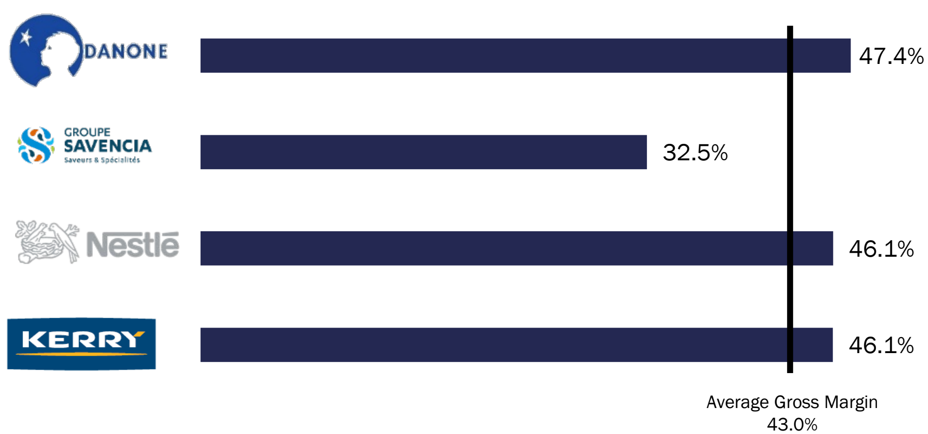
Gross Margin

Dairy Co-ops

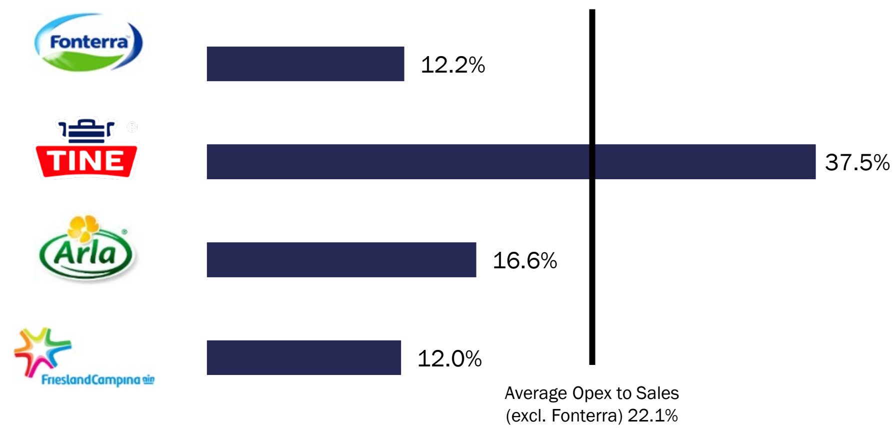


Dairy Companies



Operating Expenses to Sales

Dairy Co-ops



Dairy Companies

All figures are quoted in New Zealand dollars unless otherwise stated. Figures sourced from Capital IQ and Annual Reports
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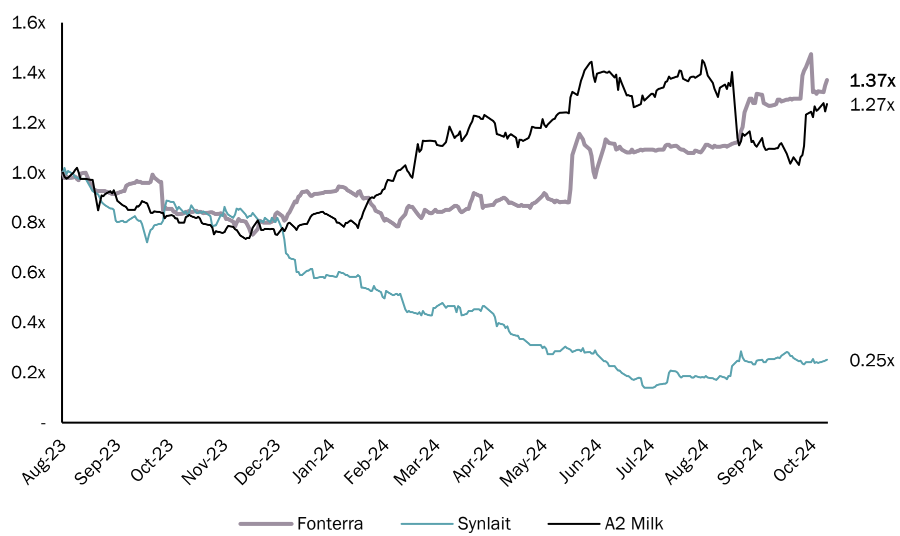
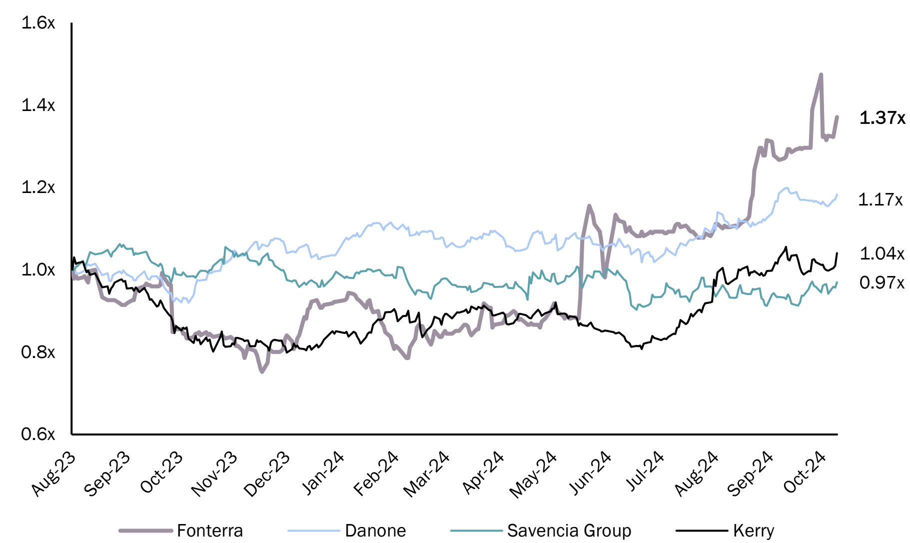
Share Price Performance – Dairy Competitors

- The share price data below provides comparisons to New Zealand and international dairy competitors to illustrate the performance of Fonterra's share price against some of the company's peers.
- Fonterra is the only entity within our Co-op set that is both a co-operative and a publicly listed company, therefore comparison of market pricing has only been completed against other publicly listed companies. Similar to prior analysis, it is important to note that this does not take into account any regulatory differences or local market conditions that may ultimately impact share price data. It also excludes dividends paid to shareholders or unitholders.
- The below chart demonstrates the performance of Fonterra Co-operative shares over the period from 1 August 2023 (start of FY24) to 9 October 2024 demonstrating a return of 37% over the period (excluding dividends but adjusting for the capital return which occurred in August 2023). This compares favourably to both Fonterra's domestic and international peers.

New Zealand Dairy Manufacturers



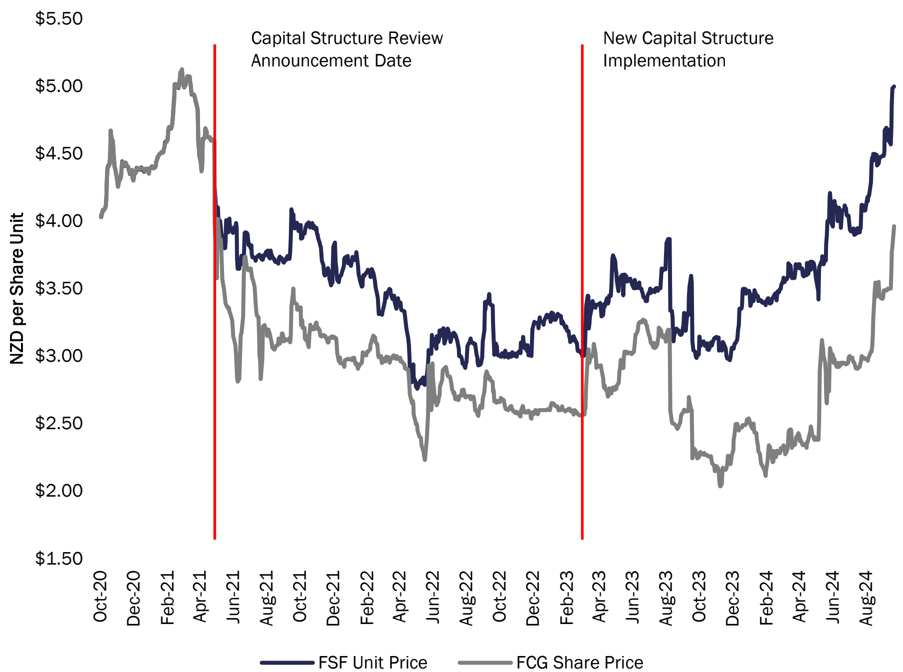
Global Dairy Competitors



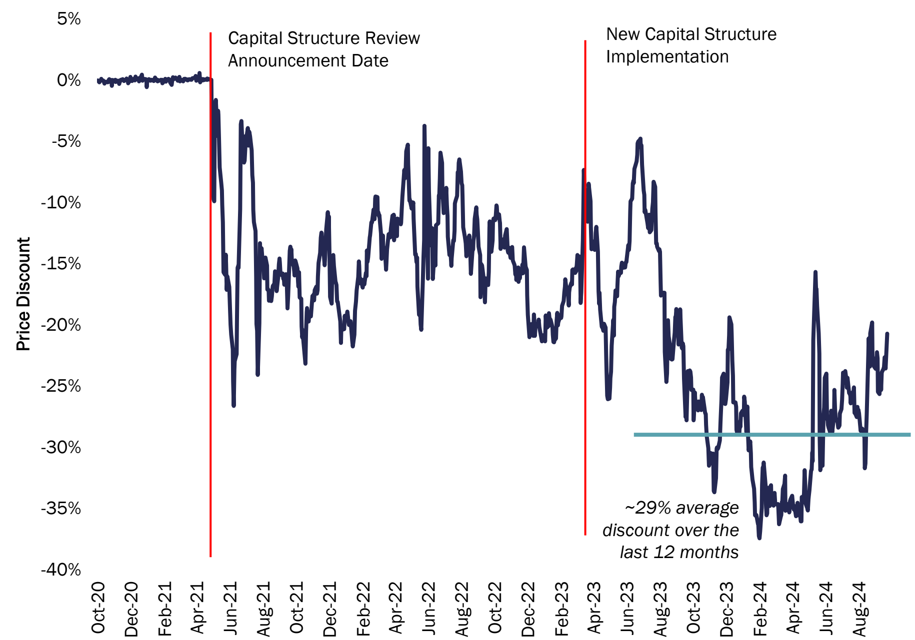
Daily price information has been rebased in NZD to 1 August 2023 for comparability between share price and local currency. Fonterra returns also adjusted for its August 2023 capital return
Source: Iress and Capital IQ as at 9 October 2024, Fonterra share price is represented by FCG.NZ

FSF and FCG Share Price Comparison

Daily Share Price Comparison[1]



Discount of FCG Share Price to FSF Unit Price[1]



[1]Uses daily volume-weighted average price (VWAP). Source: Iress as at 30 September 2024

Publicly Listed Companies

Ticker	Company Name	Domicile	Market Cap (NZD m)	Enterprise Value (NZD m)	NTM EBIT (NZD m)	EV / NTM EBIT
ENXTPA:SAVE	Savencia S.A.	France	1,219	2,617	404	6.5x
SEHK:2319	China Mengniu Dairy Company Limited	Cayman Islands	14,849	19,862	1,455	13.6x
TSX:SAP	Saputo Inc.	Canada	14,407	18,435	1,307	14.1x
ENXTPA:BN	Danone S.A.	France	73,704	91,420	6,347	14.4x
SHSE:600887	Inner Mongolia Yili Industrial Group Co., Ltd.	China	41,307	46,438	2,903	16.0x
SWX:NESN	Nestlé S.A.	Switzerland	406,368	518,274	30,282	17.1x
ISE:KRZ	Kerry Group plc	Ireland	27,814	31,066	1,752	17.7x
ASX:BGA	Bega Cheese Limited	Australia	1,747	2,131	118	18.1x
Average						**14.7x**
Median						**15.2x**

Source: Capital IQ as at 30 September 2024

Abbreviations & Definitions

Term	Definition
CAGR	Compound average growth rate
Capex	Capital expenditure
Co-op, Group or the Company	Fonterra Co-operative Group Limited
CY	Calendar year ending 31 December
DIRA	Dairy Industry Restructuring Act
DPA Brazil	Dairy Partners Americas Brazil
EBIT	Earnings before interest and tax
EBITDA	Earnings before interest, tax, depreciation and amortisation
EPS	Earnings per share
ESG	Environmental, social and governance
FCG	Shares in Fonterra Co-operative Group Ltd (FCG.NZ)
FGMP	Farmgate Milk Price
FSF	Shares in Fonterra Shareholders' Fund (FSF.NZ)
Fund	Fonterra Shareholders' Fund (FSF.NZ)
FY	Financial year ending 31 July
GDT	Global Dairy Trade
In Scope Businesses	Global Consumer business together with Fonterra Oceania and Fonterra Sri Lanka
kgMS	Kilograms of milk solids
LTAs	Long-Term Aspirations
MT	Metric tonnes
NPAT	Net profit after tax
Non-Reference Products	Products that are not included in the calculation of the Farmgate Milk Price
NTM	Next Twelve Months
NWC	Net working capital
NZD	New Zealand dollars
PP&E	Plant, property and equipment
Price Relativities	Refers to the difference in the weighted average price (in USD) between the Reference Product portfolio and Non Reference Product portfolio
Reference Products	Includes commodity products and groups that are included in the calculation of the Farmgate Milk Price
Share Standard	Means one share per one kgMS supplied
RHS	Right hand side (axis)
ROC or ROCE	Return on capital employed
SMP	Skim milk powder
TSR	Total shareholder return
USD	United States dollars
WACC	Weighted average cost of capital
WMP	Whole milk powder

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