Market Announcement

16 March 2023

Fonterra profit up 50% in FY23 Interim Results

- Profit After Tax: NZ$546 million, up 50%
- Earnings per share: 33 cents per share
- Interim Dividend: 10 cents per share
- Return on Capital: 8.6%, up from 6.1%
- Forecast milk collections: 1,465 million kgMS, down 1%
- Forecast Farmgate Milk Price range: NZ$8.20 - $8.80 per kgMS
- Proposed capital return: approximately 50 cents per share and unit
- Upgraded full year forecast normalised earnings from 50-70 cents per share to 55-75 cents per share

Fonterra Co-operative Group Ltd today released its 2023 Interim Results which show the Co-op has delivered a half year Profit After Tax of $546 million, an earnings per share of 33 cents, and a decision to pay an interim dividend of 10 cents per share alongside a forecast Farmgate Milk Price range of $8.20 - $8.80 per kgMS.

The Co-op also upgraded its full year forecast normalised earnings from 50-70 cents per share to 55-75 cents per share and announced a proposed tax free capital return to farmer owners and unit holders of around 50 cents per share, subject to completion of the sale of its Chilean Soprole business.

Fonterra CEO Miles Hurrell says the results for the first half of the year show the Co-op is performing well, with profit up 50 per cent, against a backdrop of ongoing market volatility.

“Our Co-op’s scale and diversification across channels and markets has enabled us to navigate through disruption and make the most of favourable market conditions in a number of areas.

“While milk powder prices have softened recently, impacting our forecast Farmgate Milk Price range, protein prices have been high, and this is reflected in the lift in earnings we’re reporting today.

“Our improved earnings and strong balance sheet have enabled us to pay an interim dividend of 10 cents per share which is positive news for our farmer owners and unit holders. We also expect to be able to pay a strong full year dividend, in addition to our proposed capital return.

“The outlook for high quality sustainable New Zealand dairy remains positive. We have a clear strategy and are well-positioned to take advantage of this demand,” says Mr Hurrell.

Strong performance and sales

The Co-op has delivered a Profit After Tax of $546 million, up $182 million compared to the same time last year, and a Return on Capital for the last 12 months of 8.6%, up from 6.1% in the comparable period.

“This lift in earnings is thanks to our Co-op’s scale and ability to move our farmer owners’ milk into products and markets where we’re seeing favourable prices.

“With whole milk powder prices down, we moved more milk into skim milk powder and cream products to optimise our Farmgate Milk Price.

“We also made the most of favourable margins in our cheese and protein portfolios, by moving a higher proportion of current season milk into these products which has benefited our earnings.

“Our ability to capture these higher margins is reflected in our Ingredients channel performance, with normalised EBIT up $494 million, or 118%, on the same time last year to $911 million.

“Our Consumer and Foodservice channels benefited from improved in-market prices, with Foodservice normalised EBIT up $81 million, or 95%, to $166 million. However, higher input costs and ongoing pressure on margins have impacted overall Consumer channel performance.

“Our domestic consumer business, Fonterra Brands New Zealand (FBNZ), has been under margin pressure for some time and is not improving as fast as planned. Performance of our Asia consumer brands has been impacted by weakening currency in the markets they operate, higher interest rates and a declining economic environment in some South East Asian markets.

“For these reasons, we have revised down the valuation of FBNZ by $92 million and our Asia consumer brands Anlene, Chesdale and Anmum by $70 million.

“As a result of market conditions and the impact of impairments, our overall Consumer channel normalised EBIT is down $177 million to a loss of $94 million.

“This year our reportable segments have been updated to reflect an organisational change to better support our strategy. Group Operations is shown as a separate segment and the previous results of the AMENA and Asia Pacific segments are now combined into the new Global Markets segment.

“Group Operations represents the business activities that collect and process New Zealand milk through to selling the products to our customer-facing regional business units, Global Markets and Greater China.

“Group Operations normalised EBIT increased $412 million to $501 million, due to higher Ingredient prices, in particular proteins and cheese, relative to the products portfolio that informs the Farmgate Milk Price.

“Looking at our customer-facing regional business units, Global Markets normalised EBIT was down 4% to $267 million. Global Markets’ Ingredients channel in-market earnings increased by $145 million, mainly due to higher sales volumes and improved pricing. However, this was offset by the impairments and increased operating costs in its Consumer channel.

“Greater China normalised EBIT decreased 1% to $215 million, with the Foodservice channel showing resilience to market disruption from COVID-19. However, this was offset by the Consumer channel, which included a proportion of the Anlene brand impairment.

“We continue to exercise financial discipline with a focus on delivering returns, while managing higher costs and ongoing market disruption.

“Our Total Group normalised operating expenses are up from $1.1 billion to $1.4 billion due to the New Zealand consumer business and Asia brands impairments, increased costs including inflation and foreign exchange, and last year having a one-off favourable item.

“Since year end we have improved our net debt and working capital position through improved earnings and clearing the higher year-end inventory.

“Severe storms and flooding across the North Island in January and February temporarily delayed some product getting onto ships. We remain focussed on inventory management, which seasonally peaks through February and March.

"Our improved earnings and strong balance sheet put us in a position to pay an interim dividend of 10 cents per share," says Mr Hurrell.

Capital returns

"We're pleased to be providing an update on the proposed capital return to our farmer owners and unit holders.

"We have previously stated an intention to return around NZ$1 billion to shareholders by FY24, subject to the outcome of reviews of our ownership of Fonterra Australia and our Chilean Soprole business. We have subsequently made the decision to retain full ownership of Fonterra Australia.

"Following completion of the sale of Soprole, we intend to reduce debt and return around 50 cents per share and unit, which is approximately $800 million.

"We are aiming for a record date for the proposed tax free capital return in late September 2023, with cash to be received by our farmer owners and unit holders the following month.

"Implementation of the capital return will require a Scheme of Arrangement to be voted on by shareholders, and approval by the High Court, which is a common process for this type of transaction.

"More information on this process will be provided to our farmer owners and unit holders in due course.

"Fonterra remains committed to a strong balance sheet as well as an "A" band credit rating.

"The sale of Soprole remains subject to satisfaction of conditions previously announced, including commencement of an irrevocable public tender offer process in Chile for the outstanding shares in Soprole not already owned by Fonterra," says Mr Hurrell.

Progress towards 2030 targets

Mr Hurrell says Fonterra has continued to make strong progress towards its 2030 targets through our strategic choices to focus on New Zealand milk, be a leader in sustainability and be a leader in dairy innovation and science.

<u>Focus on New Zealand milk</u>

"A sustainable supply of New Zealand milk is fundamental to achieving our 2030 goals. Our new Flexible Shareholding capital structure supports a sustainable milk supply and a stable balance sheet, while protecting farmer ownership and control.

"Fonterra has been working with the Government to make relevant changes to the Dairy Industry Restructuring Act (DIRA) to support the new structure. These legislative changes were passed by Parliament in November 2022 and the transition to our new capital structure will occur on 28 March 2023."

"As previously announced, Fonterra has allocated up to $300 million for a package of measures aimed at supporting liquidity as farmers transition to Flexible Shareholding. This includes new market maker arrangements that are designed to support liquidity over the long term.

"We also recognise that during the transition phase, further liquidity support may be appropriate, and we have approved an on-market share buyback that will commence on 28 March 2023 and is expected to continue until 9 June 2023.

"The Transitional Buyback will be structured in a way that gives the Co-operative capacity to buy back shares throughout the entire 11-week period. This involves having capacity to buy shares in each week as well as additional flexibility to accommodate different levels of liquidity across the period. Fonterra can buy up to a maximum of 75 million co-operative shares as part of this buyback," says Mr Hurrell.

<u>Be a leader in sustainability</u>

"Our Co-op is continuing to make sustainability improvements both on-farm and off-farm to retain our competitive edge.

"At last year's Annual Meeting, we signalled to farmers that the Co-op will announce a target for our on-farm (scope 3) emissions.

"Having a target will help us secure and retain high value customers and enable the Co-op and our farmer owners to meet regulatory requirements and access finance.

"We acknowledge making change on-farm is not easy. Over the coming months, we will be talking with our farmer owners about how collectively we'd achieve a target.

"At the same time, we're continuing to invest in R&D and new technologies to help reduce emissions on-farm. We currently have 18 methane reduction projects underway and 30 active trials of potential solutions.

"This includes a new private-public partnership joint venture announced in November through which Government and partners from across the food and fibre sectors will work together to reduce methane emissions.

"We're also making progress in our work to transition our manufacturing sites out of coal by 2037. At our Waitoa site we're converting one of our boilers to wood biomass. Scheduled to be operating later this year, the new boiler will reduce the site's annual emissions by 48,000 tonnes of CO_{2e}, the equivalent of taking 20,000 cars off New Zealand's roads," says Mr Hurrell.

Be a leader in dairy innovation and science

"We have portfolios of innovation projects underway to help achieve the value targets set out in our 2030 strategy.

"These are in the areas of improving product performance, exploring science backed nutritional solutions, transforming customer experience, and sustainable value change transformation.

"Recent progress includes our partnership with PolyJoule, a Massachusetts Institute of Technology (MIT) spin-off, to trial the world's first industrial scale organic battery. It has been installed at our Waitoa manufacturing site to improve energy security.

"We've also established a new start-up company with Royal DSM to accelerate the development and commercialisation of fermentation-derived proteins with dairy-like properties," says Mr Hurrell.

FY23 Outlook

Fonterra has a forecast Farmgate Milk Price Range of $8.20 - $8.80 per kgMS and Mr Hurrell says the Co-op will continue to watch changes in the market closely.

"The outlook for dairy remains positive with high demand for New Zealand's quality, sustainable dairy nutrition, and global milk supply likely to continue be constrained. We'll be out in May with our opening forecast Farmgate Milk Price for the 2023/24 season.

"We have full year forecast normalised earnings of 55 – 75 cents per share, with a mid point of 65 cents per share," says Mr Hurrell.

"There are a number of risks we continue to watch, including the impact of recent weather events in New Zealand on supply chain and milk production.

"Our Co-op's scale, diversity and strong balance sheet positions us well to manage these challenges and we will continue to prioritise higher value products and channels to deliver sustainable returns for farmer owners and unitholders."

ENDS

Non-GAAP financial information

Fonterra uses several non-GAAP measures when discussing financial performance. Non-GAAP measures are not defined or specified by NZ IFRS.

Management believes that these measures provide useful information as they provide valuable insight on the underlying performance of the business. They may be used internally to evaluate the underlying performance of business units and to analyse trends. These measures are not uniformly defined or utilised by all companies. Accordingly, these measures may not be comparable with similarly titled measures used by other companies. Non-GAAP financial measures should not be viewed in isolation nor considered as a substitute for measures reported in accordance with NZ IFRS. Non-GAAP measures are not subject to audit unless they are included in Fonterra's audited annual financial statements.

Please refer to the non-GAAP measures section in Fonterra's 2023 Interim Report for reconciliation of NZ IFRS to non-GAAP measures, and the Glossary for definitions of non-GAAP measures referred to by Fonterra.

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