



Dairy for life

Fonterra Capital Structure Review

Owners Conversations - May 2021



**A strong farmer-owned Co-operative
is good for farmers and good for
New Zealand.**

**We have choices to make to protect
our Co-op for generations to come.**

Review process



How to contribute:

- Director roadshows
- Regional meetings
- Fonterra Co-operative Council
- www.fonterra.com/csfeedback
- Email - CS@fonterra.com
- Area Managers

We are here



Director Meetings



Further Regional Meetings



Review and address feedback



Refine options



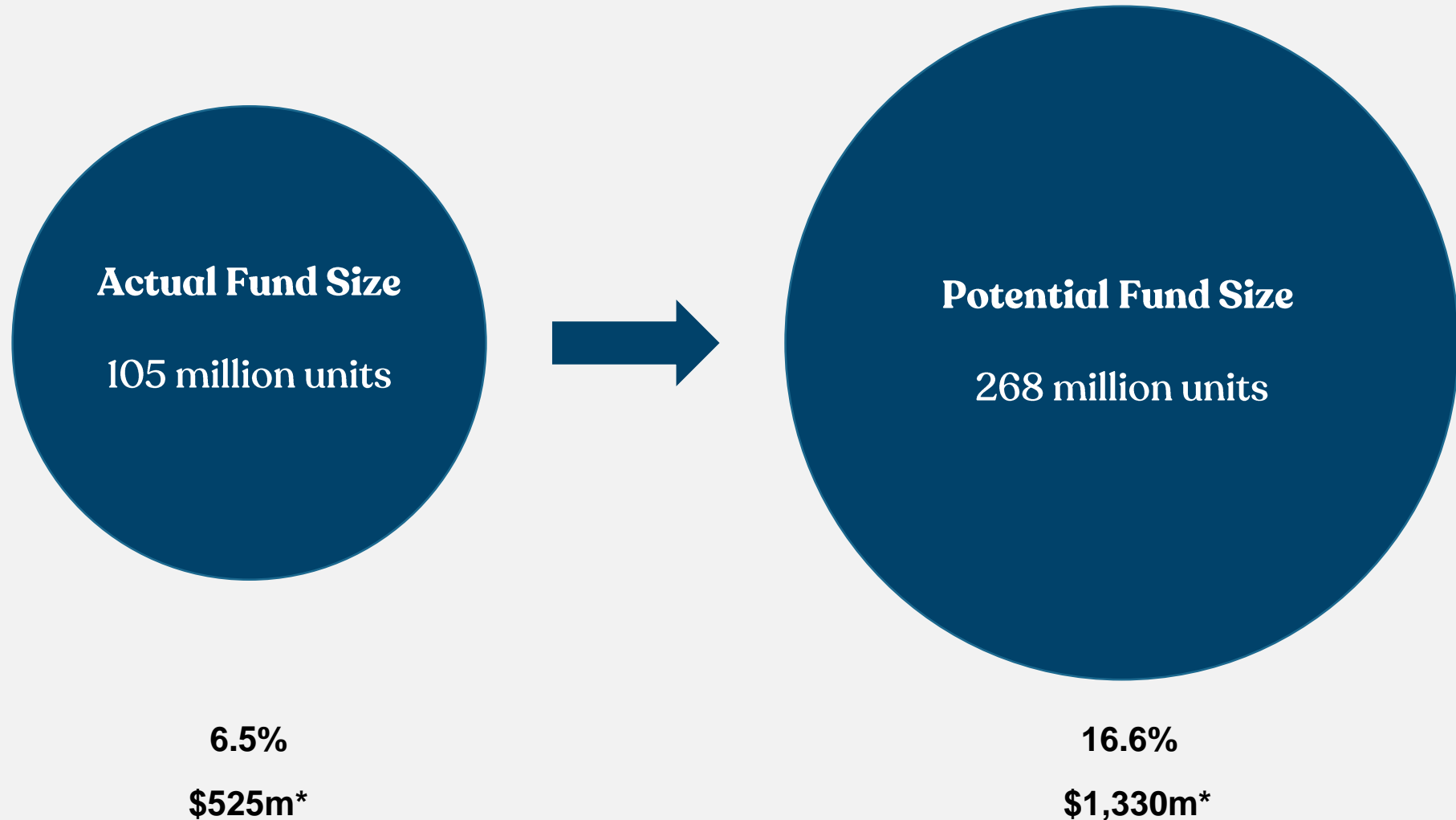
Further Consultation



Proceed with Preferred Option

(if change is recommended, then this would likely include a shareholder vote)

We've temporarily capped the Fund so we can have this conversation



*Based on a \$5 share price; Actual Fund Size and Potential Fund Size are as at 31 March 2021

What we'll cover today



- 1.
Our Context
and Co-op
Fundamentals**
- 2.
Our Options**
- 3.
Alternate
Capital
Structures and
Considerations**



1.
**Our Context
and Co-op
Fundamentals**

2.
Our Options

3.
**Alternate
Capital
Structures and
Considerations**



Dairy for life

Our Strategy



CONSUMER & MARKET TRENDS

SUSTAINABLE VALUE

CORE DAIRY

FOOD SERVICE

PAEDIATRICS

SPORTS & ACTIVE

MEDICAL & AGEING

Prioritising New Zealand milk



The Co-operative Difference

Innovation

To create superior value for our customers and our Co-operative

Efficiency

Unlock greater value from our scale efficiency and focus on execution

Sustainability

To do what is right for the long term good and meet consumer and community needs

Recap of changes made in 2019 strategy refresh

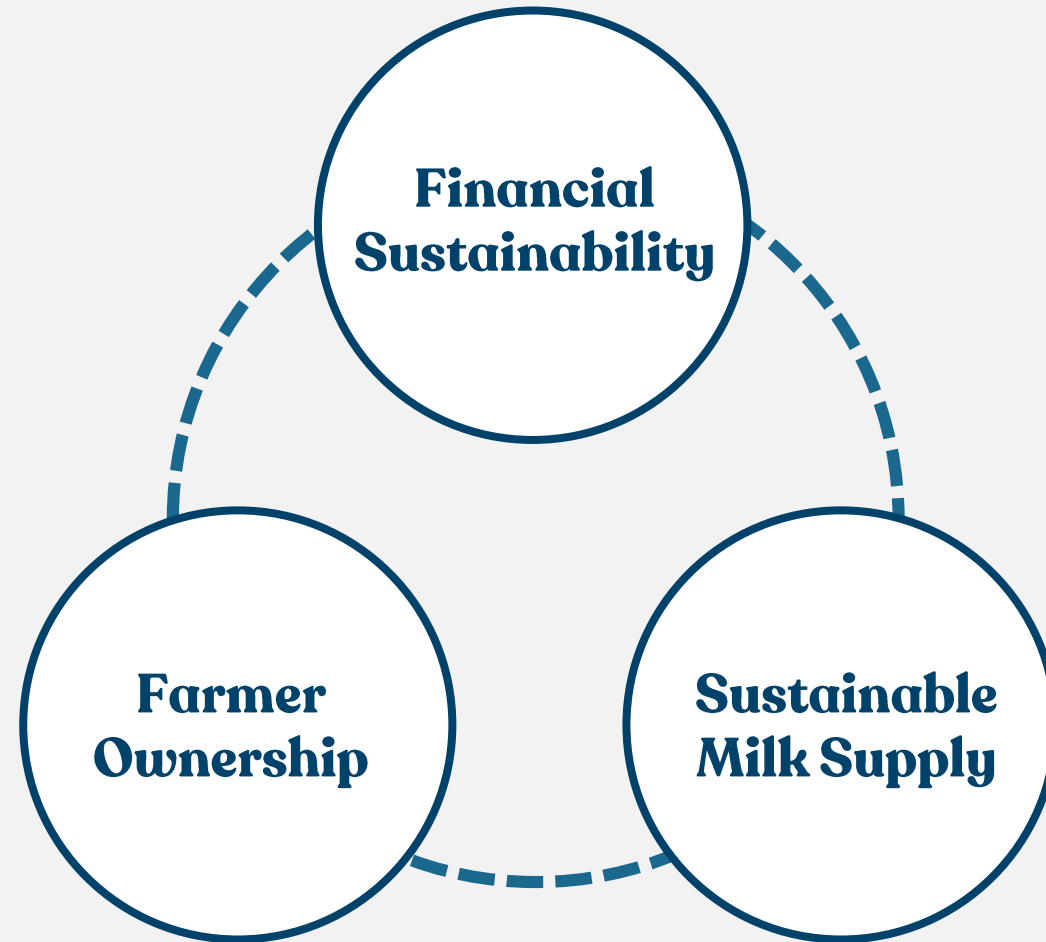


From

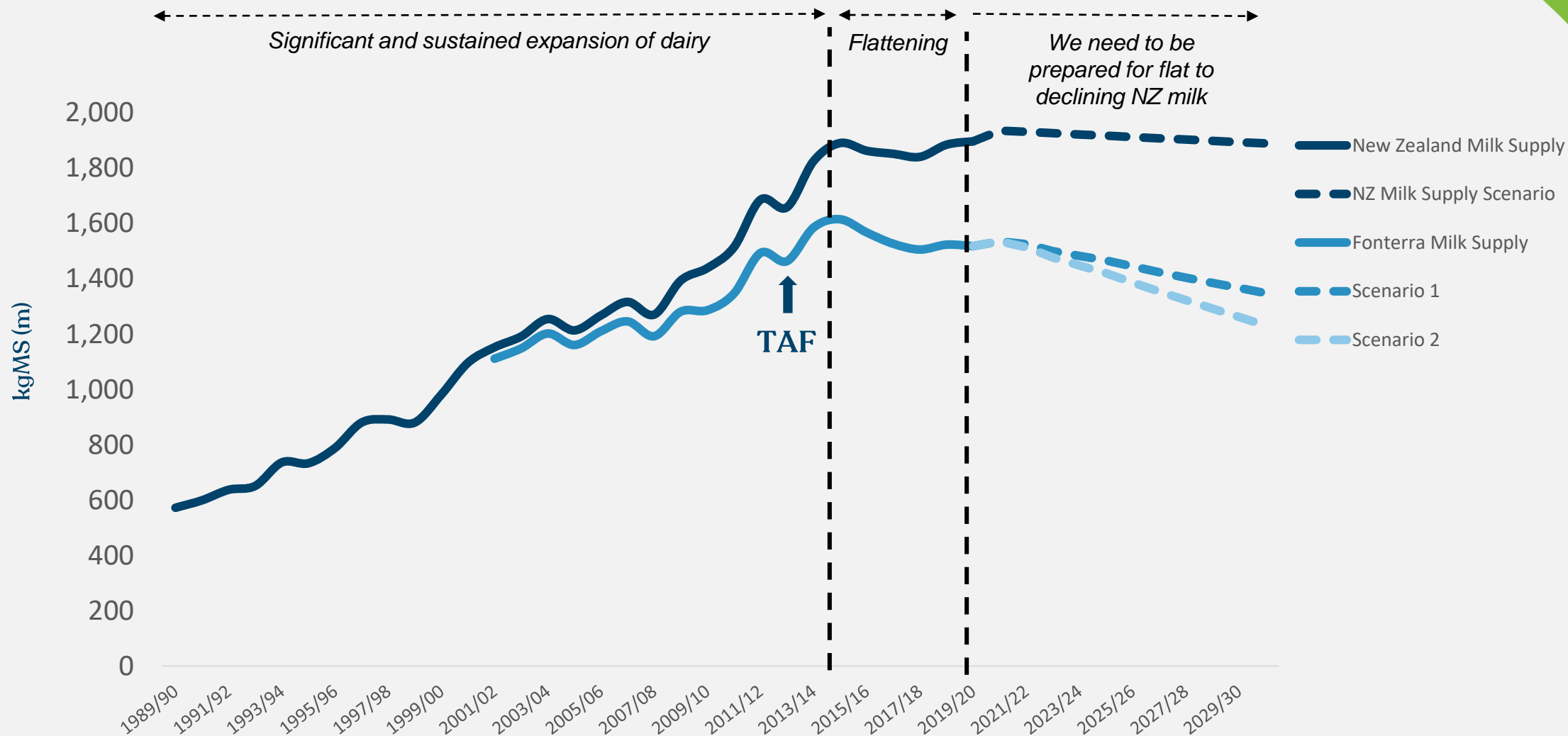
To

Volume	➡	Value
Global Milk Pools	➡	Prioritise New Zealand Milk + complementary components
Maximum volume into consumer	➡	Focus on key categories to deliver superior value
Dairy only	➡	Supplement with non-dairy where makes sense
Partner with cash investments	➡	Partner with IP and skills and lift R&D
Debt funded growth	➡	Conservative balance sheet
Global giant with HQ in New Zealand	➡	Celebrate Aotearoa New Zealand and take it to the world
Invest widely based on aggressive growth plans	➡	Divest non-core businesses and focus where we have a competitive advantage

These three factors are fundamental to our long-term success



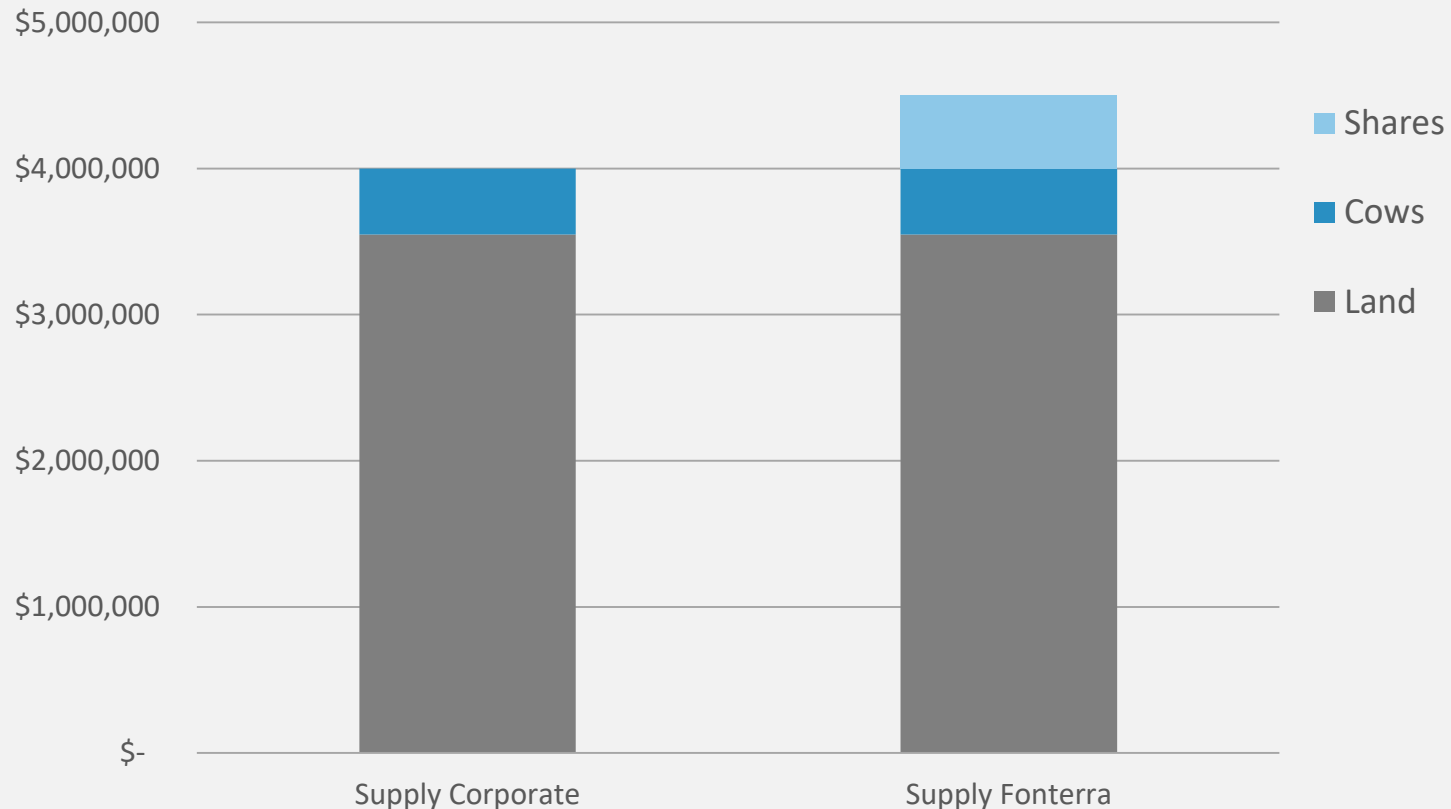
We need to be prepared for flat to declining NZ milk



The level of investment to be part of our Co-op can be challenging for some farmers



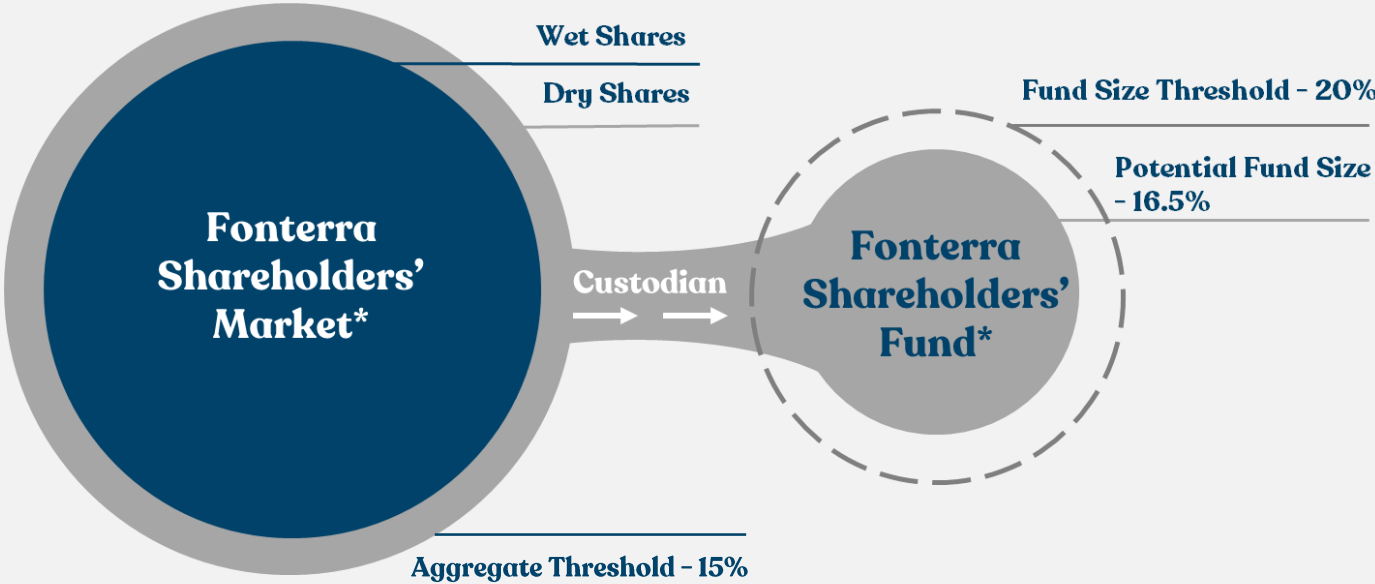
Amount Invested for a 100,000 kgMS Farmer





Under our current structure, the Fund size could grow if milk supply declines

- Under the current structure, dry shares can be exchanged into units in the Fund at any time
- When TAF was set up we created thresholds to protect farmer ownership and control
- We are approaching some of those thresholds today
- Declining milk or more flexibility for farmers could cause us to exceed those thresholds

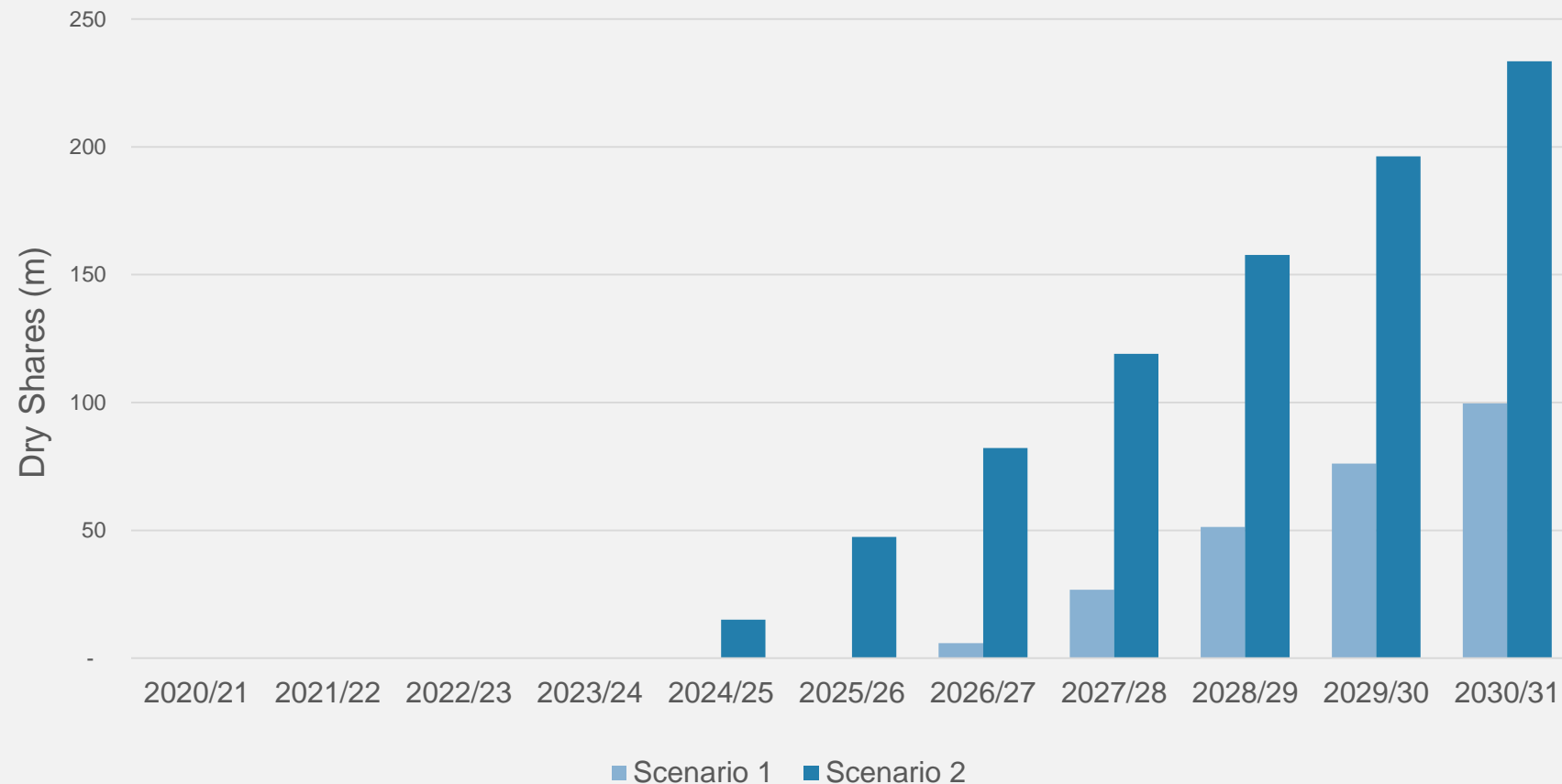


*Not to scale

Milk supply decline scenarios could cause the Fund to exceed the thresholds in our Constitution



**Cumulative Dry Shares in excess of Aggregate Threshold
(Milk Supply Scenarios)**





1.
**Our Context
and Co-op
Fundamentals**

2.
Our Options

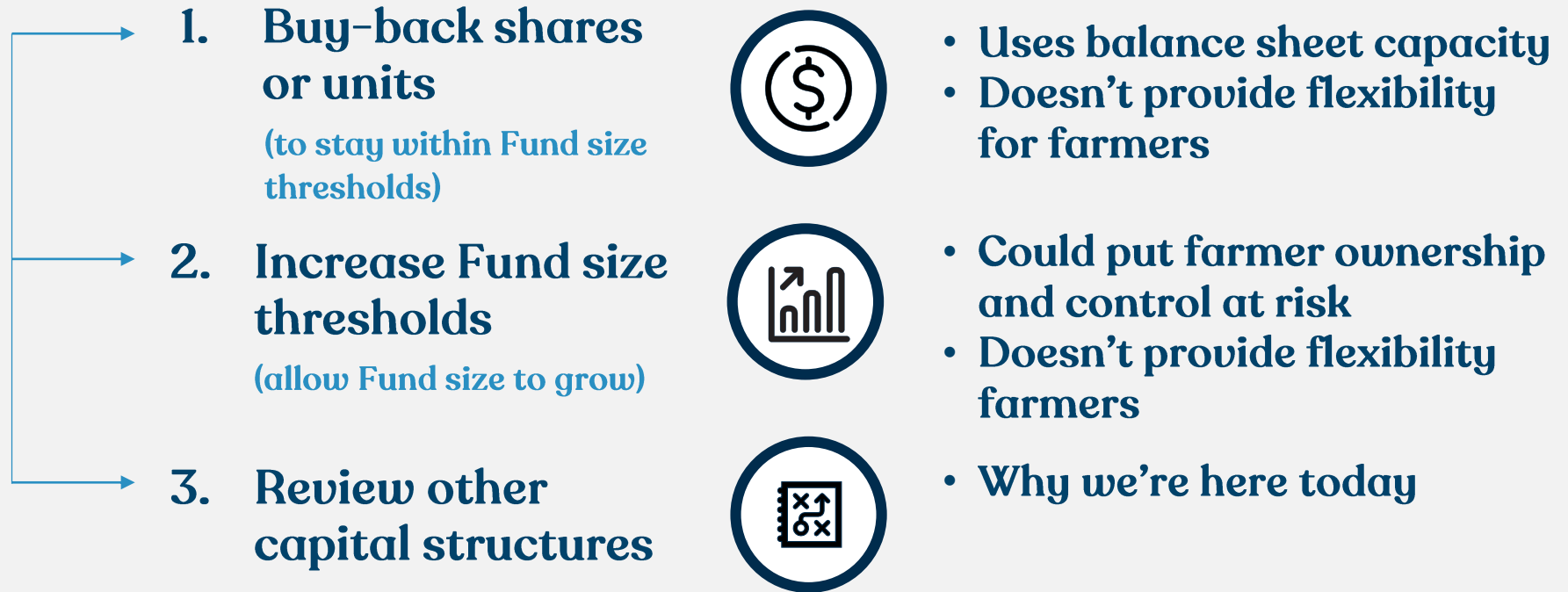
3.
**Alternate
Capital
Structures and
Considerations**

We have three possible paths to address this

Milk declines



Fund exceeds thresholds for farmer ownership





1.

**Our Context
and Co-op
Fundamentals**

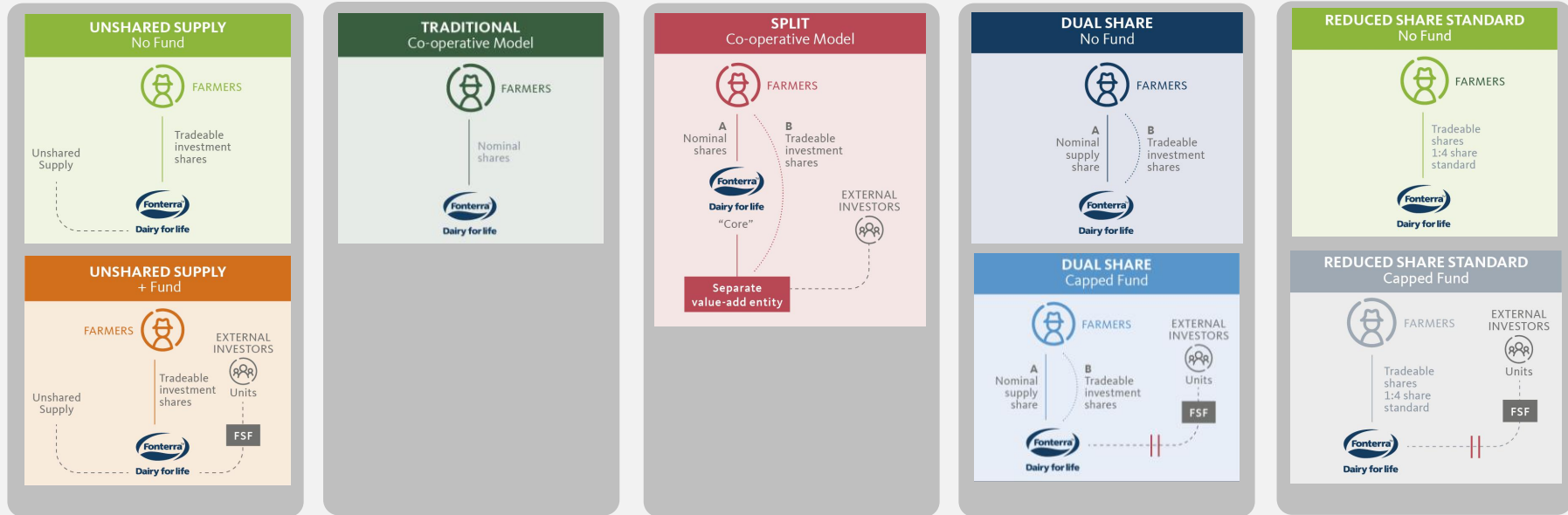
2.

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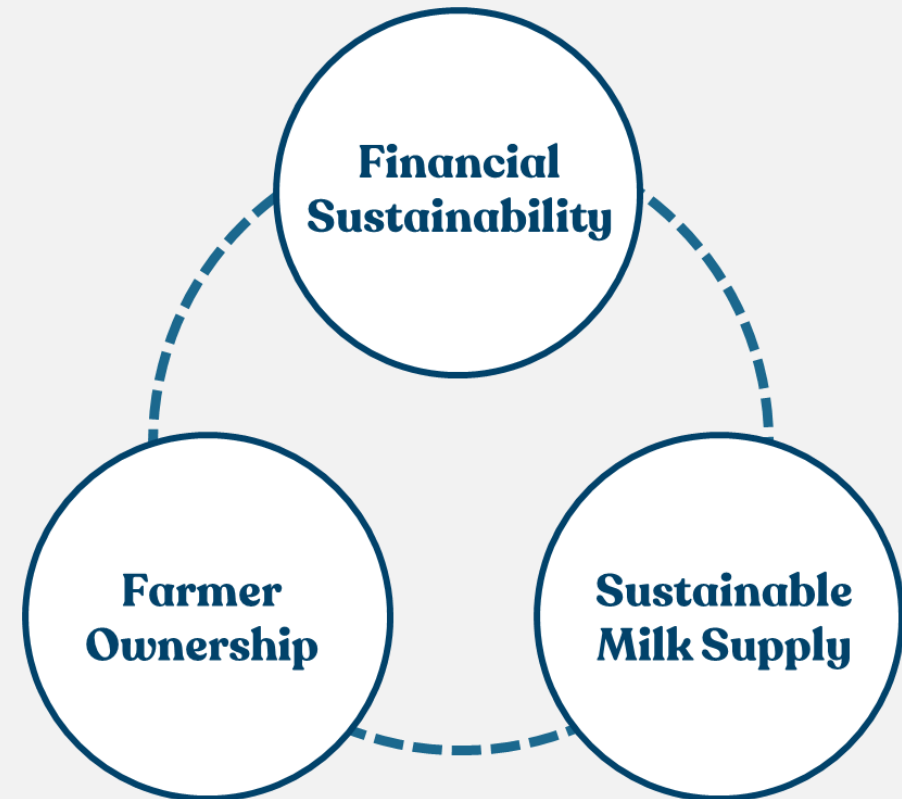
We have reviewed many different capital structure options



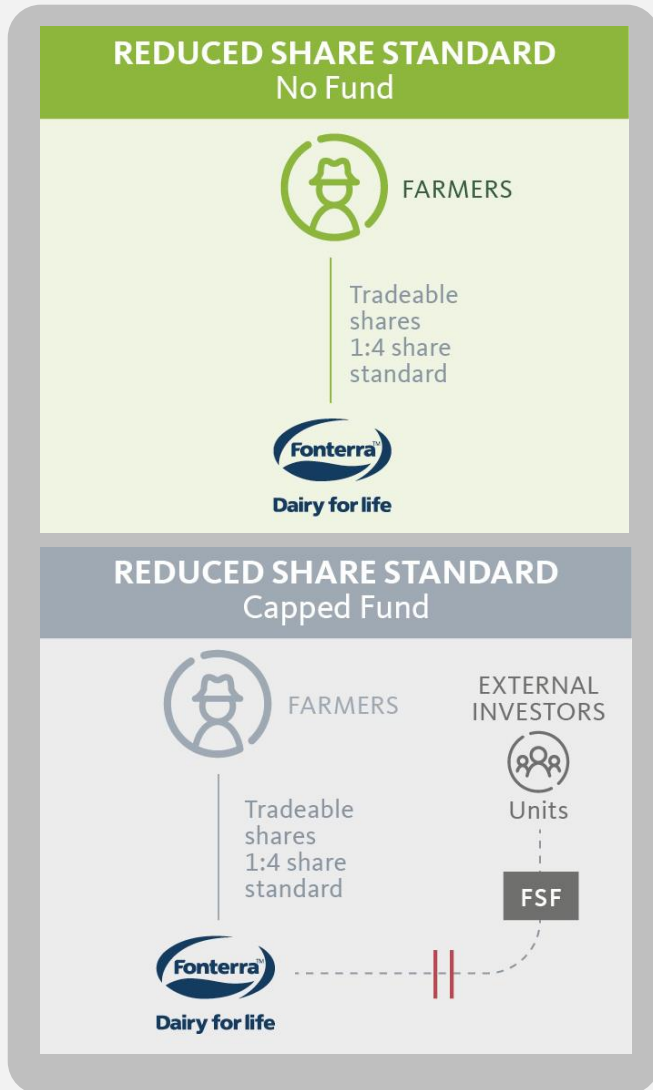
Farmer Ownership	✗	✓	✗	✓	✓
Sustainable Milk Supply	✓	✓	✓	✓	✓
Financial Sustainability	✗	✗	✓	✗	✓

Preferred Option: Reduced Share Standard, with either No Fund or Capped Fund

- Of the options that we reviewed, Reduced Share Standard with either No Fund or Capped Fund best met our three criteria
- This is because it:
 - Provides capital flexibility for farmers
 - Secures farmer ownership by removing or capping the Fund
 - Maintains balance sheet strength



How it could work



From

Limited flexibility

1:1 minimum share standard

Maximum share ownership 2x supply

Share/Unit exchangeability

Share price set in public and farmer markets

1 vote per 1000 kgMS supplied backed by shares

To

Increased flexibility

1:4 minimum share standard

Maximum share ownership 4x supply

Capped Fund or No Fund

Share price set in farmer-only market

1 vote per 1000 kgMS supplied backed by shares

Capping or removing the Fund means the Fonterra Shareholders' Market operates as a Farmer-only Market



Public Market

- Diverse range of participants
- Diversified portfolios allow risk mitigation
- Shares typically trade at a higher price

Farmer-only Market

- Homogenous group of participants
- Concentrated risk
- Higher yield required
- Shares typically trade at a lower price

Capped Fund versus No Fund



Capped Fund

Fund size is permanently capped

No offer is made to buy back the Fund

No unit holder vote required

No capital allocation required

FSF and FSM both operate but independently

Shares and units could trade at different prices

No Fund

Fund is removed

An offer is made to buy back the Fund

Requires approval of 75% of unit holders entitled to vote and voting

Capital is allocated to buy back the Fund

Only FSM operates

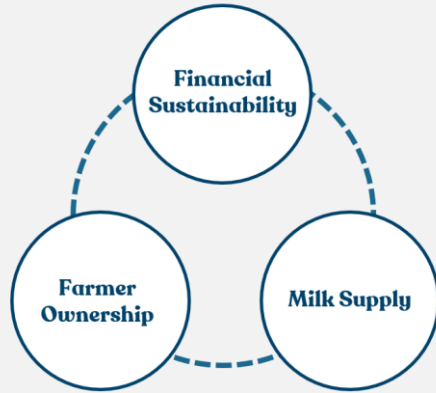
Share price only in the farmer-only market

Recap

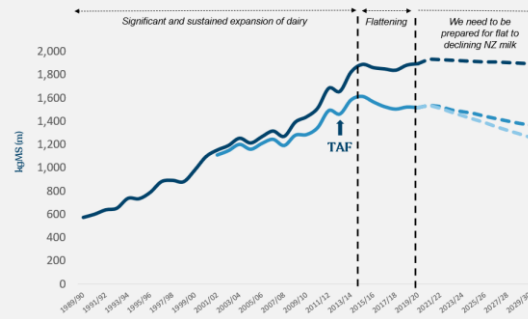


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Our fundamentals



We want to provide flexibility for farmers, and we need to plan for flat to declining milk



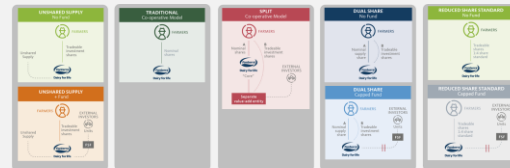
We have choice to make

Milk declines

Fund exceeds thresholds for farmer ownership

1. Buy-back shares (to stay within Fund size thresholds)
2. Increase the Fund size thresholds (allow Fund size to grow)
3. Review other capital structures

All options have trade offs



	1	2	3	4	5
Farmer Ownership	✗	✓	✗	✓	✓
Sustainable Milk Supply	✓	✓	✓	✓	✓
Financial Sustainability	✗	✗	✓	✗	✓

Our preferred option is Reduced Share Standard with either No Fund or Capped Fund



From	To
Limited flexibility	Increased flexibility
1:1 minimum share standard	1:4 minimum share standard
Maximum share ownership 2x supply	Maximum share ownership 4x supply
Share/Unit exchangeability	Capped Fund or No Fund
Share price set in public and farmer markets	Share price set in farmer-only market
1 vote per 1000 kgMS supplied backed by shares	1 vote per 1000 kgMS supplied backed by shares

Have your say



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Director Meetings



Further Regional Meetings



Review and address feedback



Refine options



Further Consultation



Proceed with Preferred Option

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Dairy for life

Discussion.



Thank You.

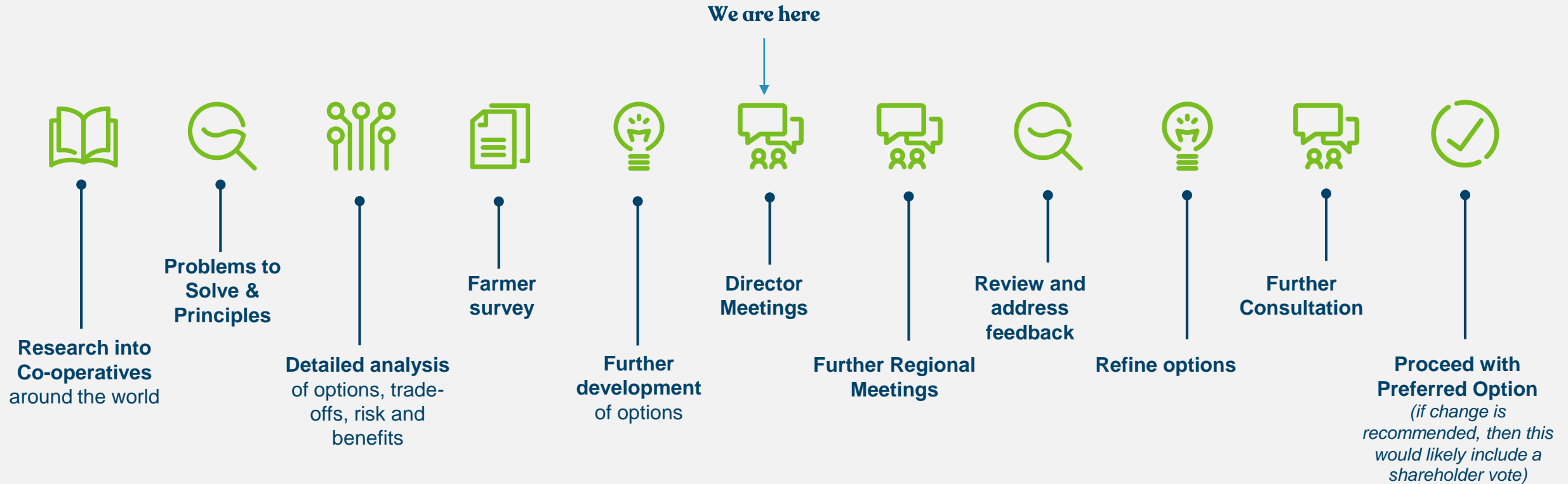
Appendix

We have set design principles which we used to assess the capital structure options

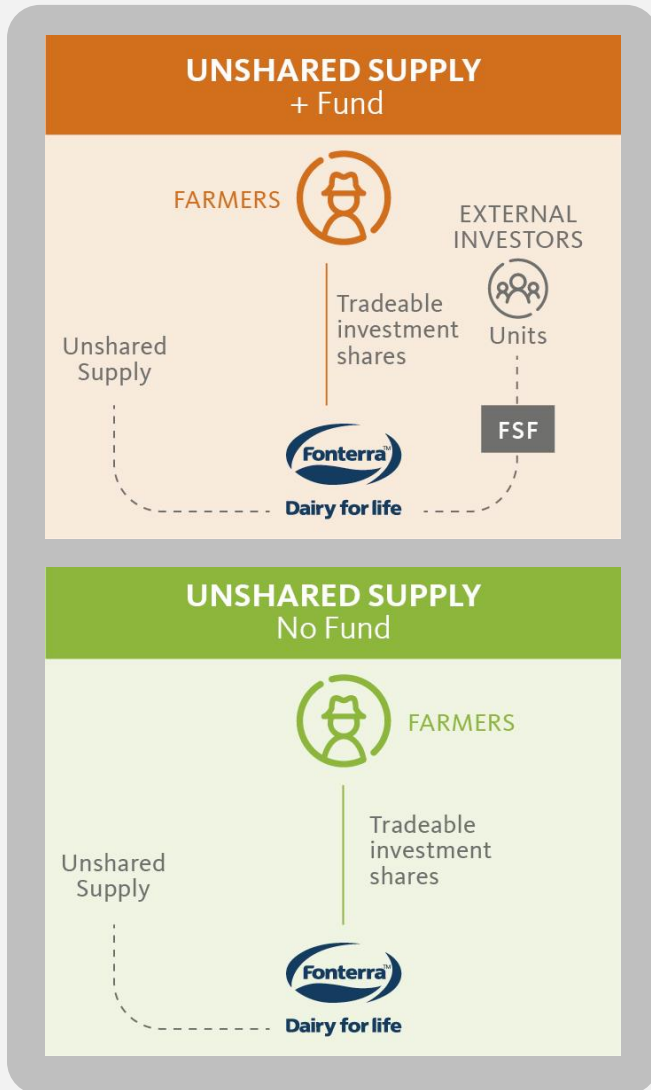
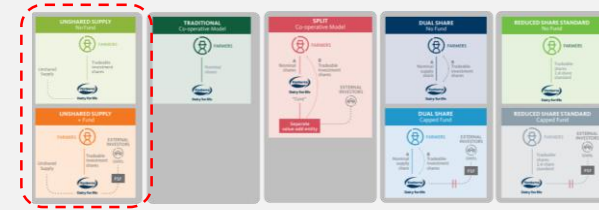


Financially Sustainable Co-op							
Ownership & Control	Sustainable Milk Supply	Protect Value	Align Incentives	Build Resilience	Transition Effectively	Access Capital	Simple
Does the structure preserve farmer ownership and control of the Co-operative for the long term?	Does the structure support our ability to attract and retain high quality, sustainable milk and provide financial flexibility for farmers?	Does the structure protect value for current Co-op members and allow farmers to transact their membership / shareholding in a way that is fair?	Does the structure align incentives between shareholders, unitholders and management, to maximise value?	Does the structure manage redemption risk and economic shocks in a way that makes the Co-operative resilient?	Is the transition to a potential new structure affordable, achievable and fair to unitholders and farmer shareholders?	Does the structure preserve balance sheet strength and provide access to capital at a reasonable cost in the future?	Is the structure simple to understand and simple to operate for both farmers and the Co-operative?

The stages of the review



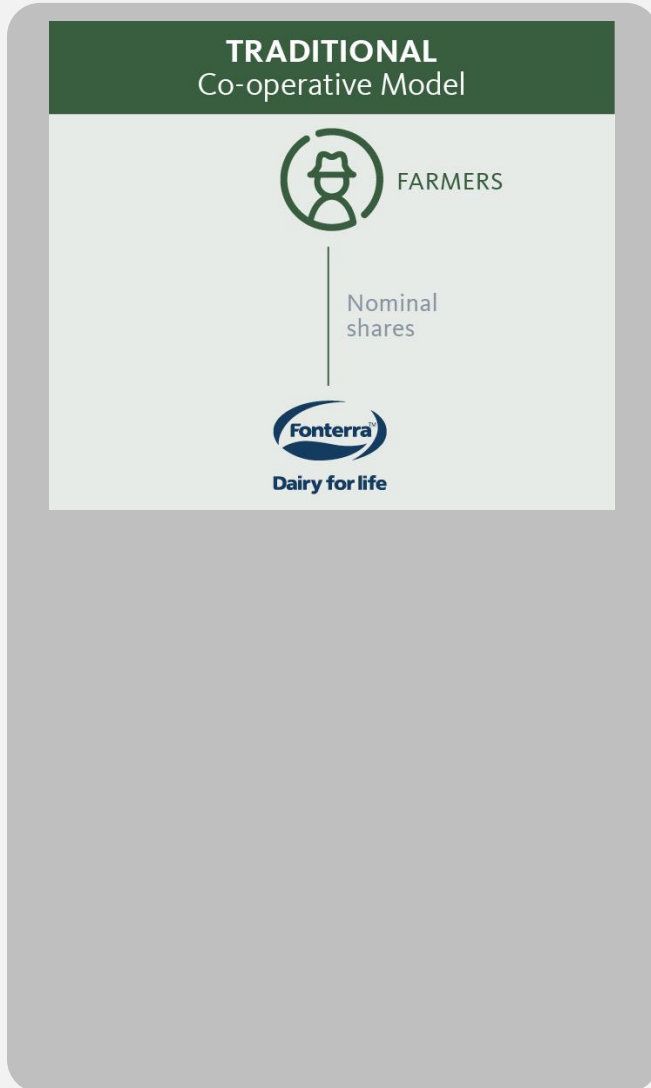
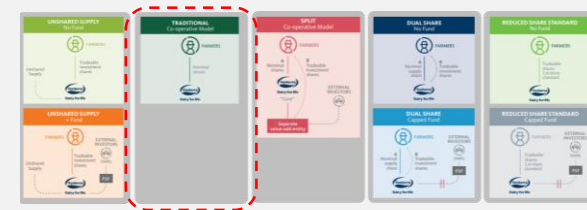
Unshared Supply



- Strong option for flexibility
- Less aligned to our Co-op Principles
- Creates incentives for farmers to become unshared suppliers to free up capital
- Could lead to concentration of ownership over time
- Creates additional dry shares, which if the Fund was retained, would cause Fund to exceed thresholds

Farmer Ownership	✗
Sustainable Milk Supply	✓
Financial Sustainability	✗

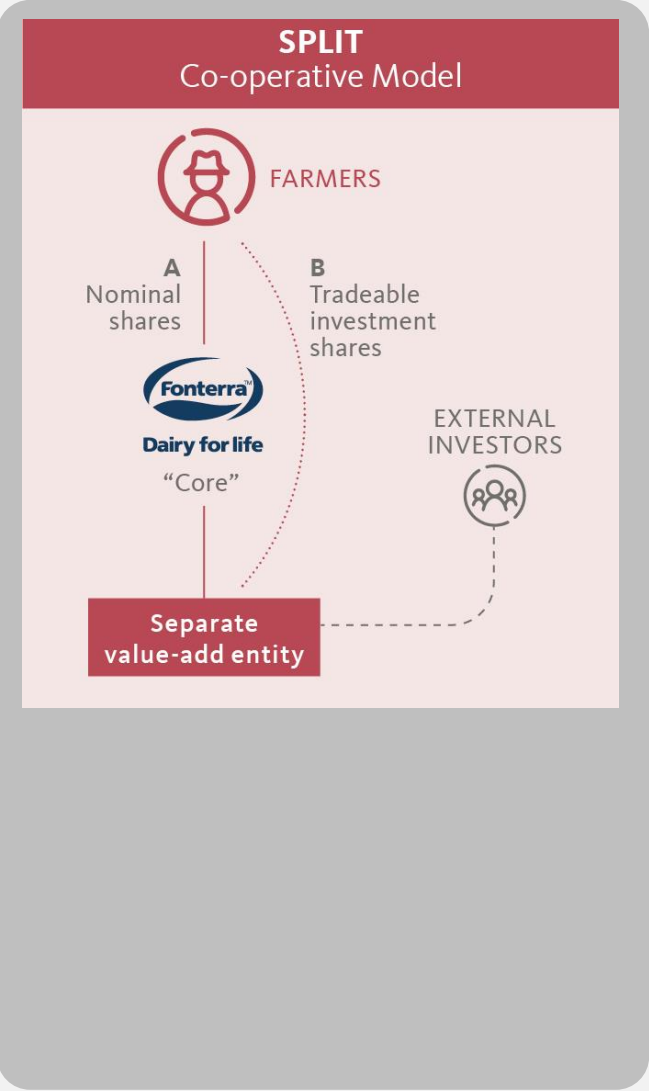
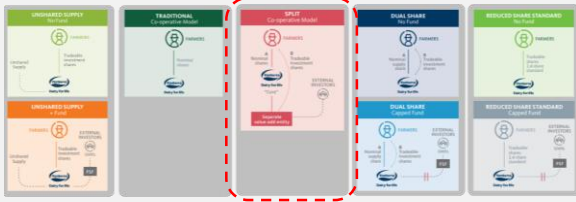
Traditional Co-op



- Nominal supply share
- Strong for attracting milk
- Strong on farmer ownership and control
- Requires significant capital to be returned to farmers
- Challenging in New Zealand regulatory context

Farmer Ownership	✓
Sustainable Milk Supply	✓
Financial Sustainability	✗

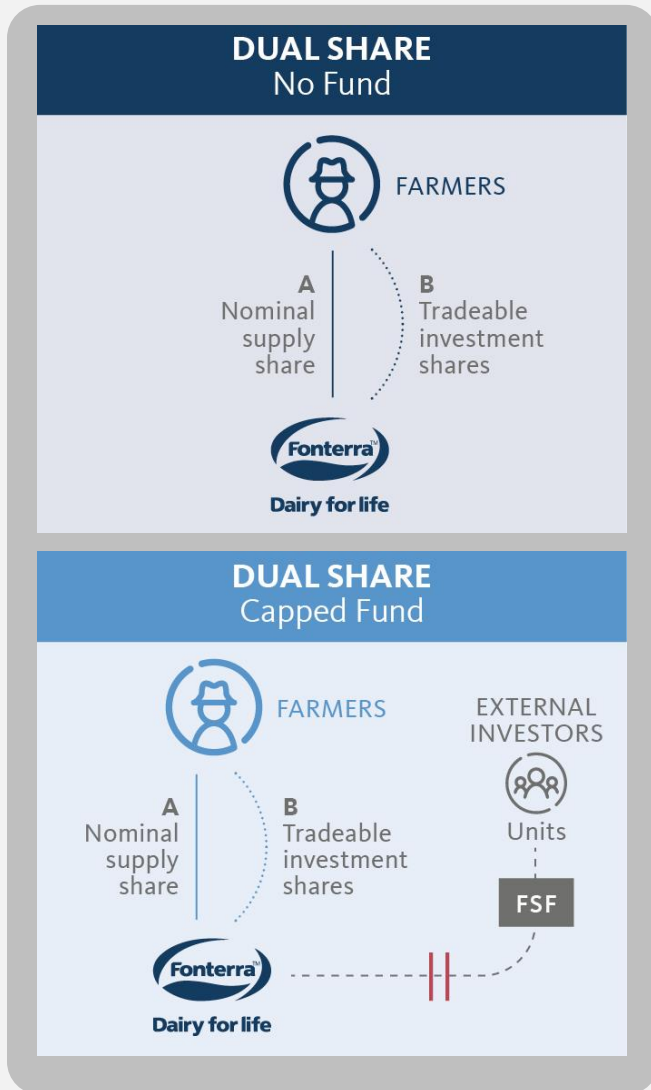
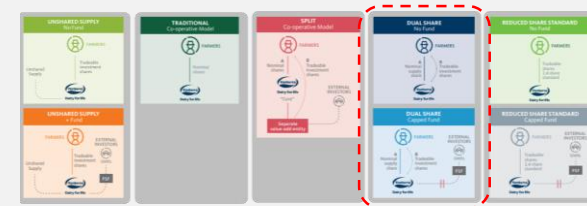
Split Co-op



- Splits Co-op into wholly owned processing entity and partially owned value-added entity
- Potential for misalignment between external investors and farmers
- Potential for pressure on ownership and control over time

Farmer Ownership	✗
Sustainable Milk Supply	✓
Financial Sustainability	✓

Dual Share



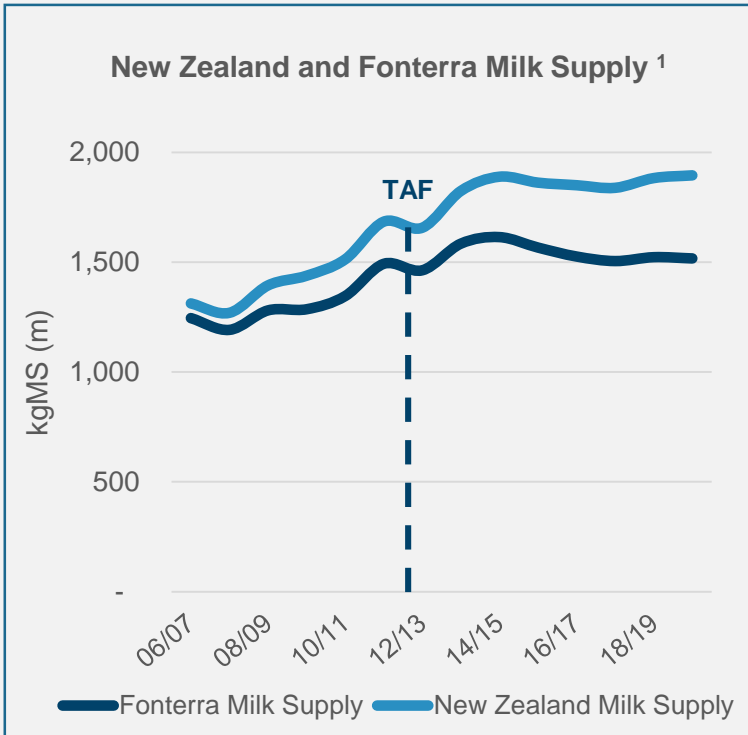
- Move to two classes of shares
- Nominal “A” supply share
- Optional “B” investment share
- Discretionary dividends paid on both A and B-shares. Dividend on supply shares capped at a level that reflects the risk on those supply shares. Any surplus dividend would be paid on the investment shares only.
- A-share likely to be considered debt for accounting purposes, and a ‘hybrid’ of 50% debt 50% equity for ratings purposes, therefore impacting balance sheet.

Farmer Ownership	✓
Sustainable Milk Supply	✓
Financial Sustainability	✗

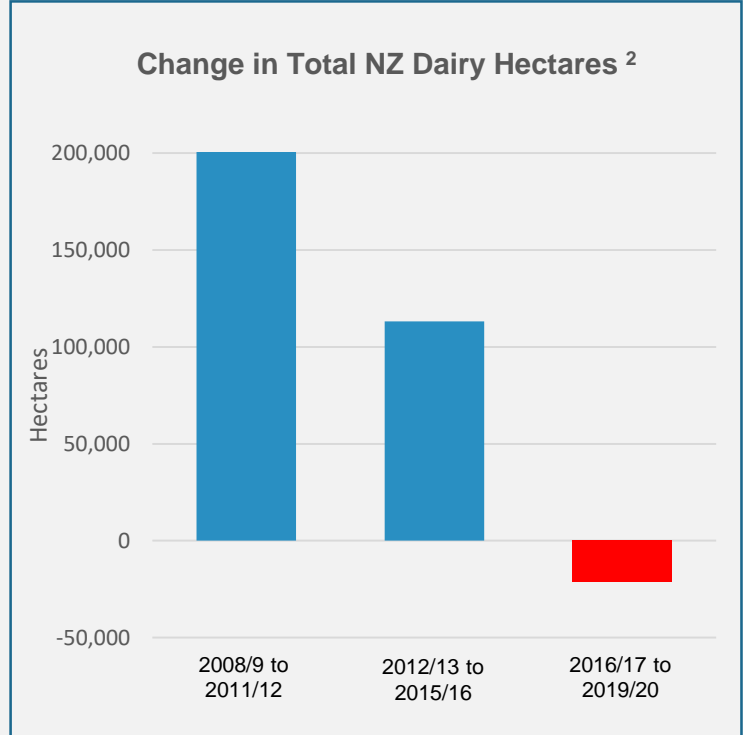


Our operating environment has changed a lot since Trading Among Farmers (TAF) was implemented

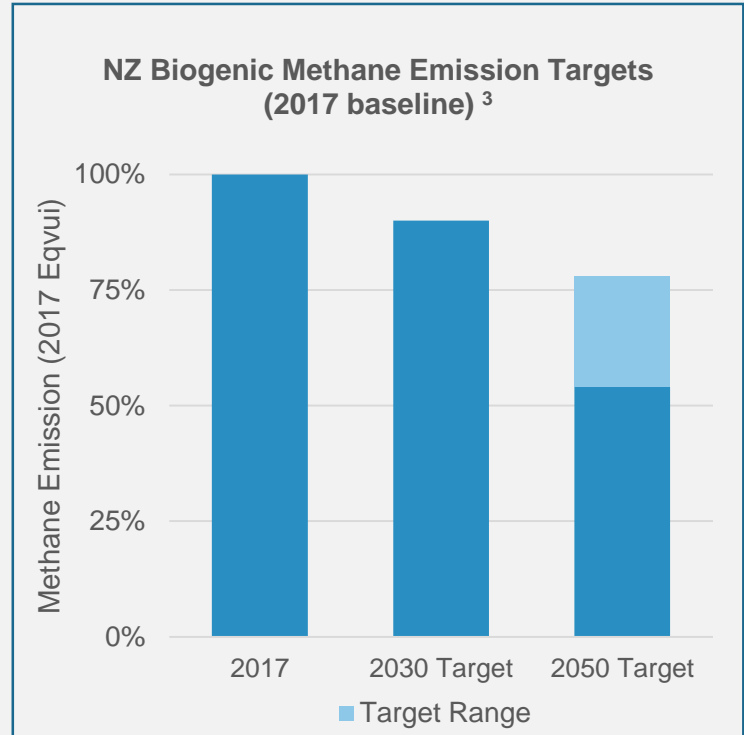
New Zealand milk growth has flattened



Fewer conversions and more land moving to alternative uses



Environmental limits are likely impact milk volumes



Source: 1) Dairy NZ – New Zealand Dairy Statistics 2019-20, Summary of milk production statistics for the last 35 seasons
 2) Dairy NZ – New Zealand Dairy Statistics 2019-20, Summary of herd statistics since 1975/76
 3) Dairy NZ - DairyNZ's position on the Zero Carbon Bill

Under our current structure, the Fund size could grow if milk supply declines

