



Market Announcement

23 May 2018

FONTERRA INCREASES FARMGATE MILK PRICE AND REVISES FORECAST EARNINGS

Fonterra Co-operative Group today increased its 2017/18 forecast Farmgate Milk Price by 20 cents to \$6.75 per kgMS.

Chairman John Wilson says the Co-operative's strong milk price reflects a global supply and demand picture that continues to be positive for farmers.

"Global dairy prices have risen since the start of the season. The price of Whole Milk Powder is particularly strong due to continued growth in demand from China and across Asia," says Mr Wilson.

"Our Co-operative's forecast milk collections here in New Zealand have increased to 1,500 million kgMS, up from the 1,480 million kgMS we reported at half year, thanks to improved farming conditions in March and April after a challenging spring and summer.

Commenting on what the higher forecast Farmgate Milk Price means for the business, Mr Wilson says the higher milk price is good news for farmers who are still recovering after the two years of lower milk prices in 2015 and 2016. However, the higher milk price puts pressure on Fonterra's earnings in a year which is already proving challenging due to the payment to Danone and the impairment of the Co-operative's Beingmate investment.

"As a result, we are revising our forecast normalised earnings per share guidance range down to 25-30 cents per share and our forecast dividend range for the full year down to 15-20 cents per share."

"The business' revised earnings forecast is disappointing for our shareholders and unitholders. However, the total forecast cash payout for farmers increases to \$6.90-\$6.95 per kgMS which is the third highest payout this decade."

Chief Executive Theo Spierings says the earnings challenge that comes with the higher milk price is compounded by the timing and significance of this particular increase.

"There is always a natural lag in being able to pass through an increase in our input costs. But this increase has been both rapid and late in the year, making it difficult for these higher costs to flow through into our sales for this financial year.

“Against this backdrop, we can see our sales margins are not where they need to be at this point in the year to achieve our original earnings forecast”.

Third Quarter Business Update

Fonterra’s revenue of \$14.8 billion for the first nine months of 2017/18 is up seven per cent on the same period last year, as a result of higher prices.

“In the first half of the year we felt the impact of the record low inventory followed by the low spring milk collections in New Zealand due to difficult weather conditions. This meant our sales teams had less product to sell. We were expecting our earnings to be weighted in the second half of the year and this has not transpired due to the rapid rise in our input costs late in the season into our value-add business.”

With total volumes down five per cent to 16 billion LMEs and gross margin down to 16 per cent from 18 per cent for the first nine months of the year, compared to the same period last year, Mr Spierings says the business has not delivered the third quarter results it had planned.

“With the increase in the price of milk fats we have also seen continued demand towards products with a lower fat composition, sustained competition in Greater China’s foodservice market and further constraints in some Asian markets limiting our ability to pass through costs,” says Mr Spierings.

These challenges, along with the Danone payment and the impairment of our Beingmate investment mean our gearing ratio is expected to be above our target 40-45 per cent range. We expect to be back within the target range next year,” continues Mr Spierings.

“While the strong milk price is good for our farmers, it does make the remainder of the year challenging for the business. We remain committed to maximising the total payout for our farmers and value for our unitholders by delivering the best possible earnings.”

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About Fonterra

We’re a global dairy nutrition company owned by more than 10,000 farmers and their families. We’ve built our expertise on the legacy of the thousands of farmers who’ve made New Zealand a world leader in dairy. With a can-do attitude and a collaborative spirit, we’re a world leading dairy exporter. Our 22,000 people share the goodness of dairy nutrition with the world through our innovative consumer, foodservice and ingredient solutions brands, and our farming and processing operations across four continents.



PERFORMANCE REVIEW

Business Update

MAY 2018
FONTERRA CO-OPERATIVE GROUP LIMITED

OUR CO-OPERATIVE

OUR POTENTIAL

OUR PERFORMANCE

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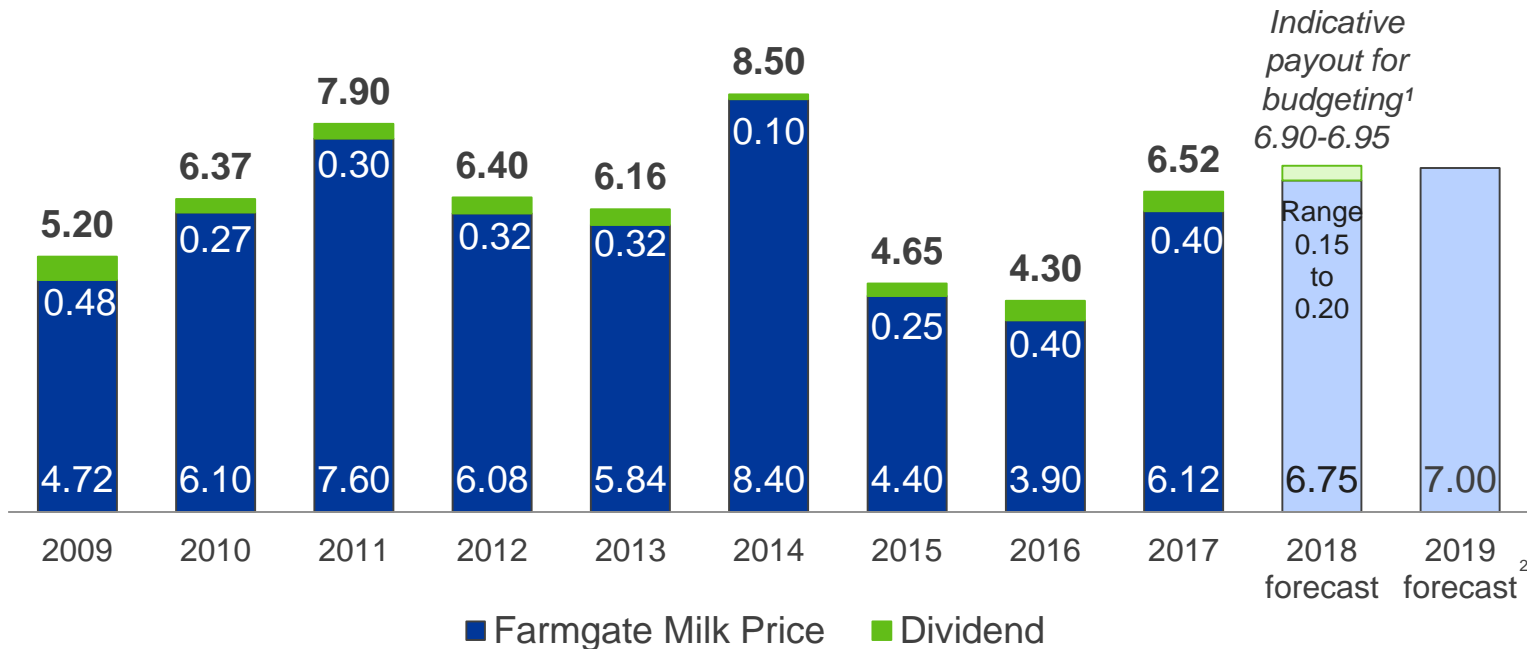
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Higher forecast pay-out for farmers

Improved Farmgate Milk Price, lower forecast dividend range

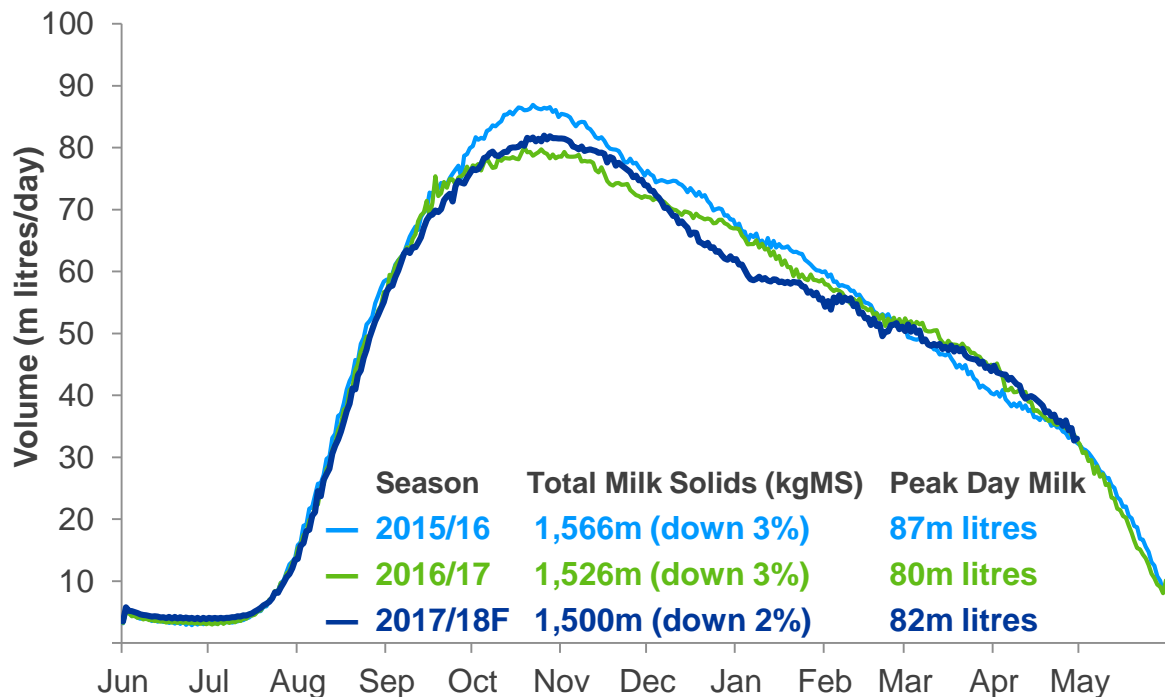


1. For farm budgeting purposes a target full year dividend range of 15-20 cents per share is assumed. The dividend will be calculated in accordance with Fonterra policy of paying out 65-75 per cent of adjusted net profit after tax over time. 2. The forecast earnings range for FY2019 will be provided at a later date.

Note: Farmgate Milk Price: \$ per kgMS; Dividend: \$ per share

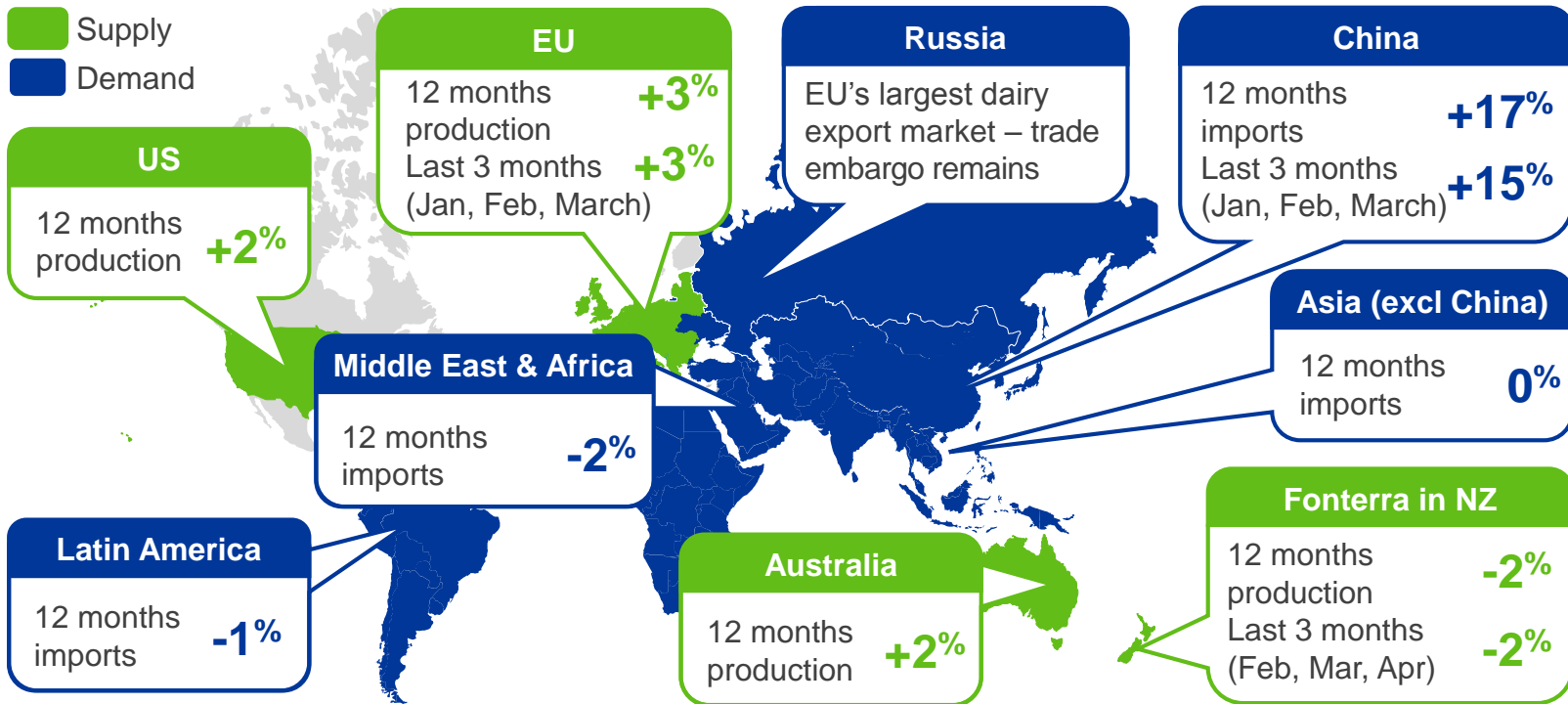
Strong late season collections

But lower overall volumes this season



- Season forecast increased to 1,500 million kgMS, from 1,480 million kgMS
- Driven by favourable late season conditions
- Full season forecast down 2% on last year due to difficult weather conditions impacting pasture growth

Strong dairy demand continues



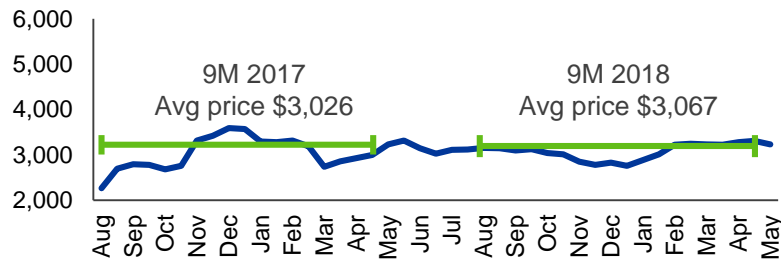
Note: All 12 month figures are rolling 12-months compared to previous comparable period: Australia (Mar), EU (Mar), United States (Feb), China (Mar), Asia (Jan), Middle East & Africa (Jan), Latin America (Jan)

Source: Government milk production statistics; GTIS trade data; Fonterra analysis

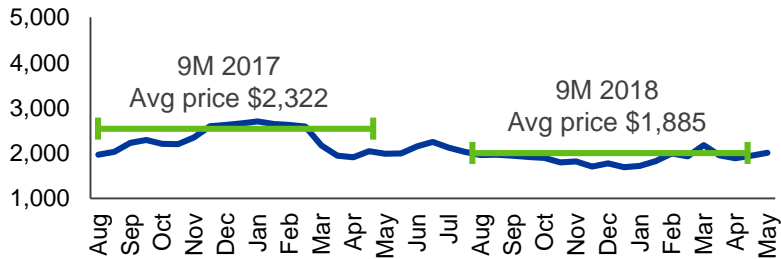
Strength in commodity prices supports a higher milk price

Continued margin pressure from higher prices, particularly for fat products

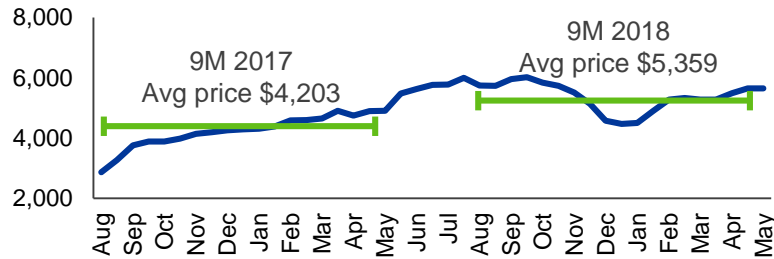
Whole Milk Powder



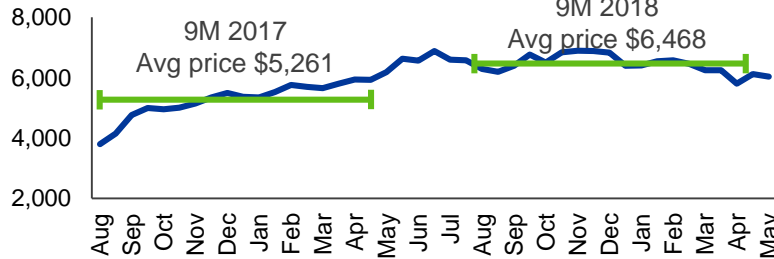
Skim Milk Powder



Butter



Anhydrous Milk Fat



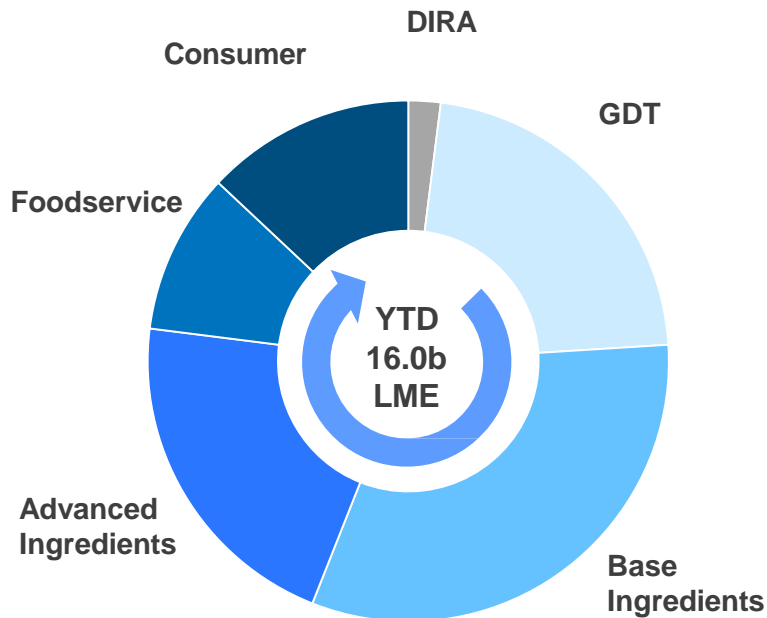
Note: All prices in US dollars per MT. 9M refers to the nine-month period ended 30 April.

Source: GDT data

Continued focus on Volume to higher Value

Growth in Q3 but revised full year target for additional LME

- 1 **Optimise**
NZ milk
- 2 **Build and grow**
beyond our current consumer positions
- 3 **Deliver**
on Foodservice potential
- 4 **Grow**
our Anlene™ business
- 5 **Develop**
leading positions in paed & maternal nutrition
- 6 **Selectively invest**
in milk pools
- 7 **Align**
our business and organisation



- Volumes down 5% to 16.0b LME comparable year-to-date
- Ingredients
 - Lower collections and opening inventory resulted in 5% lower sales volumes comparable year-to-date
- Consumer & Foodservice
 - Volume growth in three regions, but overall below expectations
 - Full year target of additional LME revised to 130M LME

FY18 nine-month performance summary

Strong commodity prices continue to put pressure on margins

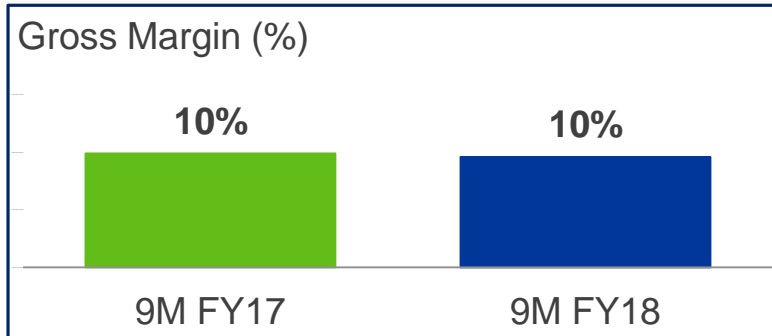
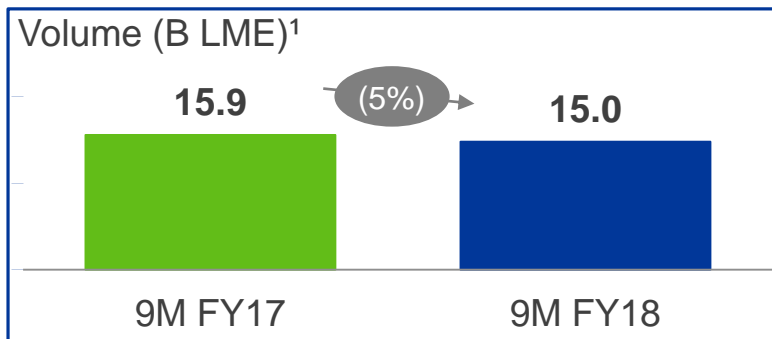
VOLUME (LME)	REVENUE	GROSS MARGIN	OPEX	CAPEX ¹
16.0B	\$14.8B	16%	\$1.9B	\$584M
↓ 5%	↑ 7%	↓ FROM 18%	↑ 2%	↑ 35%

Ingredients		Consumer & Foodservice		China Farms	
Volume	↓ 14.8B DOWN 5%	Volume	= 4.0B	Volume ²	↑ 0.2B UP 4%
Gross Margin	= 10%	Gross Margin	↓ 24% FROM 28%	Gross Margin	↓ -5% FROM 1%

1. Full year capex forecast range of \$800 - 850M 2. This is the volume of milk collections.
 Note: Volume is in billion LME; All changes are expressed relative to first nine-months of FY17

Ingredients

Strengthening commodity prices tightened margins in Q3



Volume

- Q3 volumes up 9% on last year
- Year-to-date volumes down 5% compared to last year due to:
 - Lower opening inventory and collections
 - Product mix

Value

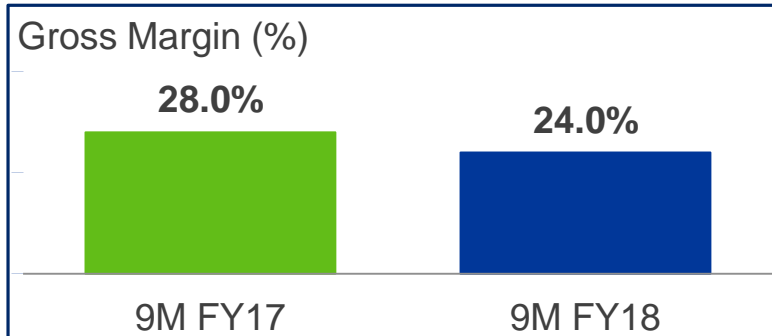
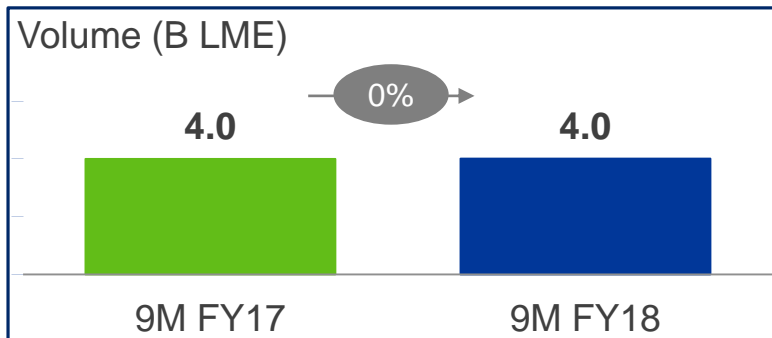
- Year-to-date margins in-line with last year
- Strengthening commodity prices tightened margins in Q3 due to:
 - The natural pricing lag inherent in our sales contracts in a rising milk price environment
 - Lower price achievement, in particular, increased competition from US and Europe in cheese and proteins

¹. Includes sales to other strategic platforms

Note: Volume is in billion LME. All changes are expressed relative to the first nine-months of FY17

Consumer & Foodservice

High input costs for fats continue to put pressure on volumes and margins



Volume

- Volume growth in three regions (up 3%) but down in Oceania (8%). Oceania impacted by NZ performance challenges
- Continued growth in Greater China, Q3 volumes up 12% but lower than anticipated
- Lower volumes from butter products than expected

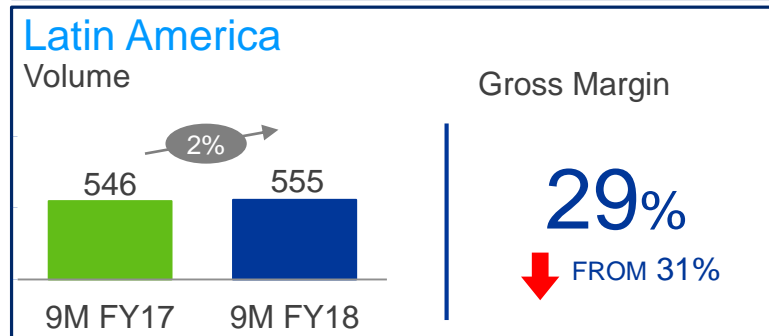
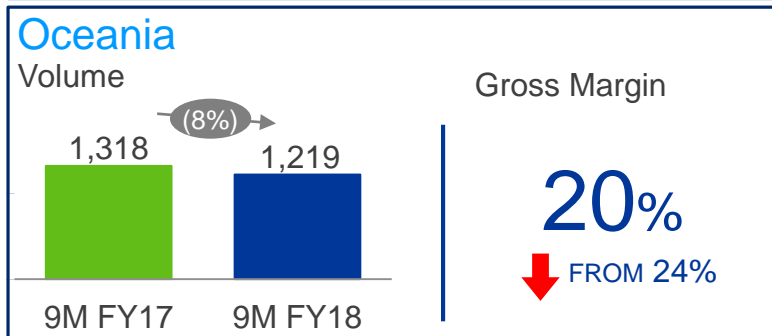
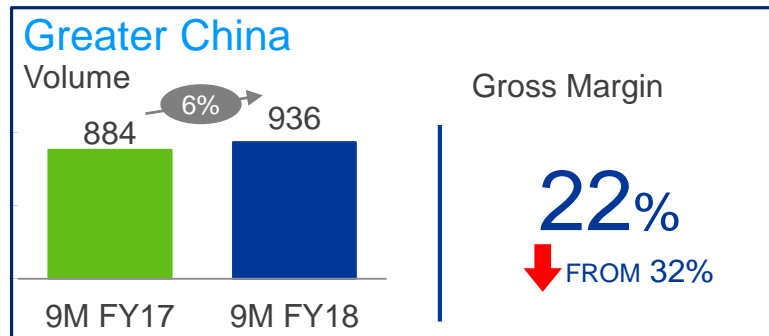
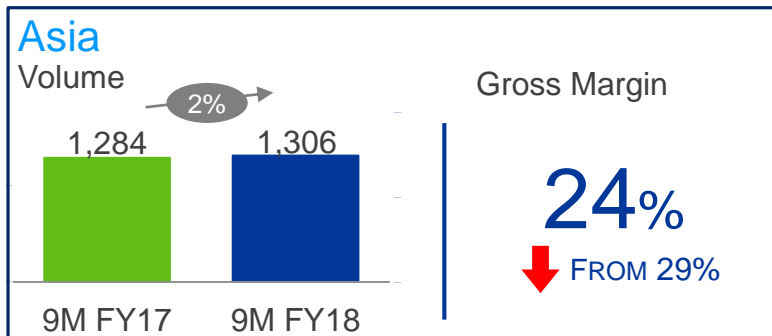
Value

- Sales growth of 6% year-to-date but continued pressure on margins from:
 - High input prices, especially fat products
 - Increased competition in Greater China Foodservice, including from European imports
- Further constraints on our ability to pass on higher input costs in some Asian markets

Note: Volume is in billion LME. All changes are expressed relative to the nine-months of FY17

Consumer and Foodservice

Continued growth in Greater China, Asia and LATAM



Note: Volume is in million LME. All changes are expressed relative to the nine-months of FY17

Beingmate update

Progress but challenges continue

- CEO appointment progressing
- Q1 result announced:
 - A small profit, including a one-off government grant
 - Lower sales, partly due to market-wide clearing of unregistered products as new regulations apply



1 Strategic rationale continues

- Infant formula market growth
- Regulatory opportunity
- Brand equity



2 Way forward

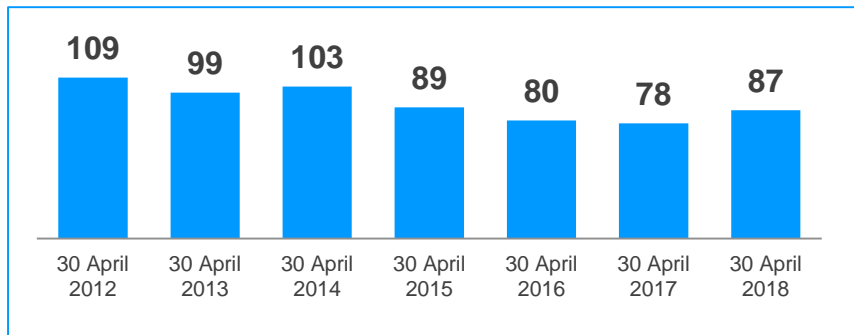
- Appointment of new CEO
- Implement business transformation
- Continue utilising existing governance structure

Financial strength and discipline

Solid credit rating reflects strong fundamentals

Credit Rating	Fitch	A (stable outlook)
	S&P	A- (stable outlook)
Debt Weighted Average Term to Maturity	As at 30 Apr 2018	3.8 years

Working capital days – 9 month average



Financial discipline continued

- Strong cash flow and liquidity
- Full year capex forecast range of \$800 - 850M
- Year-end gearing likely to be above 40-45% target range
 - due to abnormal items announced at interim and the lower earnings
 - returning within range next year
- Working capital days are up 9 days on last year due to higher commodity prices, reflected in higher inventory and receivables
- Year-end inventory volume expected to be in-line with last year

Summary and outlook for balance of 2018

Farmgate Milk Price to rise to \$6.75 per kgMS

- Strong dairy demand continues

Operating performance impacted by higher commodity prices

- Ingredients' lower margins in the third quarter are expected to continue due to pricing lags and lower price achievement
- Consumer and Foodservice' additional LME target revised down and gross margin forecast to remain at current levels
- Balance sheet and cash flows remain strong

Forecast cash payout range of \$6.90-\$6.95

- Forecast normalised earnings range of 25-30 cents per share
- Forecast full year dividend range of 15-20 cents per share

Glossary

Acronyms and Definitions

AMF

Anhydrous Milk Fat

BMP

Butter Milk Powder

Base Price

Prices used by Fonterra's sales team as referenced against GDT prices and other relevant benchmarks

DIRA

Dairy Industry Restructuring Act 2001 (New Zealand)

GDT

GlobalDairyTrade, the online provider of the twice monthly global auctions of dairy ingredients

Gearing Ratio

Economic net interest bearing debt divided by economic net interest bearing debt plus equity excluding cash-flow hedge reserves

Farmgate Milk Price

The price for milk supplied in New Zealand to Fonterra by farmer shareholders

Fluid and Fresh Dairy

The Fonterra grouping of skim milk, whole milk and cream – pasteurised or UHT processed, concentrated milk products and yoghurt

kgMS

Kilogram of milk solids, the measure of the amount of fat and protein in the milk supplied to Fonterra

LME (Liquid Milk Equivalent)

A standard measure of the amount of milk (in litres) allocated to each product based on the amount of fat and protein in the product relative to the amount of fat and protein in standardised raw milk

Non-Reference Products

All dairy products, except for Reference, produced by the NZ Ingredients business

Price Achievement

Revenue achieved over the base price less incremental supply chain costs above those set out in the Milk Price model

Reference Products

The dairy products used in the calculation of the Farmgate Milk Price, which are currently WMP, SMP, BMP, butter and AMF

Regulated Return

The earnings component of Milk Price generated from a WACC return on an assumed asset base

Season

New Zealand: A period of 12 months to 31 May in each year

Australia: A period of 12 months to 30 June in each year

SMP

Skim Milk Powder

Stream Returns

The gross margin differential between Non-Reference Product streams and the WMP stream (based on base prices)

WACC

Weighted Average Cost of Capital

WMP

Whole Milk Powder

Glossary

Fonterra Strategic Platforms

Ingredients

The Ingredients platform comprises bulk and specialty dairy products such as milk powders, dairy fats, cheese and proteins manufactured in New Zealand, Australia, Europe and Latin America, or sourced through our global network, and sold to food producers and distributors in over 140 countries. It also includes Fonterra Farm Source™ retail stores.

Consumer

The Consumer platform comprises branded consumer products, such as powders, yoghurts, milk, butter, and cheese. Base products are sourced from the ingredients business and manufactured into higher-value consumer dairy products.

Foodservice

The Foodservice platform comprises a range of branded products and solutions for commercial kitchens, including bakery butter, culinary creams, and cheeses.

China Farms

The China Farms platform comprises the farming operations in China, which produce high quality fresh milk for the Chinese market.