MEDIA RELEASE

Fonterra
Dairy for life

23 March 2011

FONTERRA ON TRACK FOR ONE OF ITS BEST YEARS EVER

$293 MILLION HALF YEAR PROFIT REPORTED

Strong international dairy markets mean 2010/11 is shaping up as one of Fonterra's best years ever in terms of returns to its farmer shareholders, Fonterra said today.

Announcing the Co-operative's financial results for the half year to 31 January 2011, Fonterra confirmed its current forecast Payout range for the 2010/11 season of $7.90-$8.00 (before retentions) and $7.75-$7.80 (cash: Milk Price plus dividend).[1] This is unchanged from the 60 cents increase in the Payout range announced in late February 2011.

This forecast range means this year's Payout may surpass Fonterra's previous record in 2007/08 of $7.90 (before retentions) and $7.66 (cash comprising, at that time, Milk Price plus Value Return).

The 2010/11 forecast Payout range (before retentions) is based on a forecast Milk Price of $7.50 per kgMS and a Distributable Profit range of $550-$690 million, equating to 40-50 cents per share. Fonterra is currently targeting to pay a dividend of 25-30 cents per share out of Distributable Profit.

Fonterra's net profit after tax for the six months to 31 January 2011 was $293 million (21 cents per share[2]). This is the first time Fonterra has reported a profit for the half year.[3] As a consequence, there is no prior half year comparison.

Fonterra Chairman Sir Henry van der Heyden said the forecast Payout would be welcomed by farmers, many of whom have businesses that remain under pressure after several challenging years and a current season marked by some difficult weather conditions. "It is also good news for the New Zealand economy in the post-earthquake environment, underlining the importance of dairying to New Zealand's economic wellbeing."

Sir Henry said the current levels of dairy prices appear to reflect a change in supply and demand for food internationally.

"We are benefitting from a combination of demand growth from China and other Asian markets, and tighter international supply due to adverse weather conditions in many parts of the world. To date, these higher prices have more than offset the negative effects of a stronger New Zealand dollar against the US dollar, in which most international dairy sales are denominated."

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[1] Average returns for a farmer who is 100 per cent shared up.

[2] 21 cents per share is attributable to Co-operative shareholders, after taking into account non-controlling interests.

[3] In the second half of the 2010 financial year, Fonterra adopted a monthly Milk Price for determining the cost of raw milk supplied in New Zealand for financial reporting purposes. In previous half years, Fonterra used a Milk Price in our interim financial statements that resulted in a nil profit attributable to shareholders, on the basis that the final Milk Price could only be confirmed at the end of the financial year.

However, with global prices for many ‘hard’ and ‘soft’ commodities, including dairy, approaching all-time highs, Sir Henry sounded a note of caution. “We must be mindful of the impact that dairy prices can have on demand in some markets, as well as on supply growth around the world. As prices continue to climb, the possibility of a downward correction can increase and farmers should always need to be prepared for a potential global price drop.”

Fonterra CEO Andrew Ferrier said the rising Milk Price is putting some pressure on Fonterra’s operating earnings, which are primarily driven by the ability to make and sell a range of dairy products at a margin above the cost of milk collected from farmers.

“This margin squeeze is particularly significant in our ingredients businesses where the cost of raw milk represents a substantial proportion of total operating costs. Thanks to our strategy of building leading brand positions in key categories, our consumer businesses are better placed to withstand price increases – but they are not immune.”

The tragic events of February and March in Christchurch and Japan will be reflected in the second half of the financial year. At this stage Fonterra is in the process of quantifying the impacts on its business, which will be primarily in the area of inventory losses. To some extent Fonterra expects these losses will be covered by insurance.

Half Year Financial Highlights

Revenue of $9.4 billion, 21 per cent higher than the corresponding period in FY 2010, primarily reflecting the impact of higher international dairy prices which were partly offset by a slight decline in sales volumes.

Net Profit After Tax of $293 million, of which 21 cents per share is attributable to shareholders. This is the first time Fonterra has reported a half year profit.

Interim Dividend of 8 cents per share will be paid to shareholders on 20 April 2011, out of a full year target dividend of 25-30 cents per share. The interim dividend in FY10 was also 8 cents per share.

Gearing ratio (economic debt to debt plus equity, which takes account of the carrying value of debt hedges) was 48.5 per cent at 31 January 2011, a substantial improvement from 54.3 per cent a year earlier. The key contributors to this were increased equity contributions from shareholders, increased retentions as a result of adoption of the Group’s dividend policy, and recording an interim profit for the first time. Although the gearing ratio at 31 July 2010 was lower at 44.9 per cent, the seasonal nature of Fonterra’s business means the more meaningful comparison is with the position at the previous half year.

Milksolids production in New Zealand for the season to 31 January 2011 was marginally ahead of the same period last season, reflecting difficult climatic conditions across much of the country. Assuming normal rainfall in the March-May period, overall production across the entire 2010/11 season is expected to be broadly in line with, or slightly ahead of, last season.

Commodities & Ingredients segment revenue for the half year was 24 per cent higher at $6.3 billion, with higher selling prices for dairy products, partly offset by a 2.6 per cent decrease in sales volumes. Normalised segment earnings before net finance costs and tax were $194 million. As in the previous year, a rising Milk Price placed pressure on Fonterra’s ability to make and sell a range of dairy products at a satisfactory margin above the cost of milk collected from farmers.

Australia/New Zealand revenue was up 18 per cent to $1.8 billion, mainly because higher commodity prices flowed through to consumer pricing and partly from the effect of a higher Australian dollar against the New Zealand dollar. Normalised segment earnings before net finance costs and tax were $153 million. ANZ’s businesses continued to perform well despite sustained competition across many categories.

Asia/Africa, Middle East revenue increased 13 per cent to $832 million. This was almost entirely due to price increases across all categories, with volumes year to date in line with the previous half year. Normalised segment earnings before net finance costs and tax were $93 million. Asia/AME's continued focus on higher value brands and a strong nutritional focus in South East Asia has given its brand portfolio greater resilience despite the impact of near-record milk prices.

Latin America revenue, which reflects our Soprole business in Chile, increased 14 per cent to $403 million. While more than half this increase was price related, overall volumes increased slightly due to growth in the yoghurts, desserts, milk, cheese and butter categories. Normalised segment earnings before net finance costs and tax, which includes Fonterra's share of its DPA joint venture earnings, were $64 million.

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For further information contact:
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Results Briefing
There will be a briefing on the interim results today at 2:00pm with Chairman Sir Henry van der Heyden, CEO Andrew Ferrier and CFO Jonathan Mason. Dial 083035 (no pin, you will be connected by an operator), if you are dialling from outside NZ please contact Nicky Heap on Nicky.Heap@fonterra.com for relevant international dial-in number.