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Champions Trophy
Case Competition 2013

Case 4: Fonterra Co-operative Group Limited

2 February 2013

Case prepared by Samantha Hewlett and Matthew Sung under the supervision of Mr Sunny Gu.
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Fonterra™
Dairy for life

Benjamin Banker

From: Benjamin Banker
Sent: 2 February 2013
To: Fonterra Project Team
CC: Michelle Money; David Dollar; Peter Partner; Warren Wallstreet; John Jobs
Subject: Fonterra Strategy Presentation

Good morning all,

Today's client, Fonterra Co-operative Group Limited, is a dairy co-operative and New Zealand's largest company. Fonterra is a leading producer of dairy nutrition, comprising one third of global dairy trade, and supplies products to more than 100 markets.

Fonterra's vision is to be the natural source of dairy nutrition for everybody, everywhere, every day. As part of this, Fonterra has 16,800 staff globally, with strong bases in its key markets. Current focuses for Fonterra internationally include emerging markets; the co-operative currently has strong presences in Latin America and China as part of this.

Fonterra does not currently have a presence in India, the largest dairy market in the world. The Indian market shows great promise; the growing Indian middle class is creating an increased demand for quality dairy nutrition and the domestic market does not have the capability to keep up, which creates an opportunity for overseas dairy companies to meet this supply gap.

However, the nature of the Indian market creates challenges for overseas companies. The Indian government aims for self-sufficiency in food production, including dairy, and as a result of this the tariffs on imported products are high (30% to 60% for dairy products). Quality and logistics issues in the Indian supply chain also mean that overseas companies seeking to meet the demand for quality dairy products would not be able to source locally. Operations in India may therefore require significant investment into the country prior to commencing trade.

Fonterra has come to us today to determine whether the risks of entering the Indian market outweigh the costs, and what strategy should be adopted to address this issue over the next few years.

The members of the executive team are looking forward to your presentation of the issues facing Fonterra's entrance into the Indian market and the strategies that you propose.

You will have ten minutes to present to Fonterra, which will be followed by a ten-minute question and answer session to clarify any issues. Our research team has compiled some relevant information, which I have attached to this email.

Regards,
Mary Milkmaid and Matt Milkman
SYG Consulting Group

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Fonterra in India

Fonterra
Dairy for life

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Fonterra Co-operative Group Limited

Fonterra is the world's largest diversified milk processing company and one of the world's top producers of dairy nutrition for export, including milk powders, cheese and butter. Revenues in the 2012 financial year were NZD 19.8 billion (see Appendix 1 for detailed financial information).

The company has substantial interests in consumer branded businesses across Asia, Latin America, Australia, and the home market of New Zealand. With around 900 unique dairy ingredient products, Fonterra is the preferred supplier to many of the world's leading food companies, specialist infant formula producers and quick service restaurants. Ingredients produced by Fonterra, through joint venture DMV-Fonterra Excipients, are also used by the top 100 pharmaceutical companies in the world. Fonterra's products are manufactured to globally accepted standards. In addition, selected products are produced to Halal, Kosher, and Organics certification requirements.

Fonterra has built strong partnerships with other leading global dairy companies through supply chain integration and innovation. Fonterra products are sold globally in more than 100 countries with sales and marketing being managed through principal hubs in Auckland, Singapore, Tokyo, Santiago, Shanghai, Melbourne, Dubai, Mexico City, Chicago and Amsterdam.

All operations are aligned either with the processing of dairy nutrition or sales of branded products to consumers.

Vision

Fonterra has a vision to be "the natural source of dairy nutrition for everybody, everywhere, every day". Emerging markets are a key part of achieving this vision for Fonterra. Looking forward to 2020, Fonterra estimates that the expected growth in milk supply will be greater than the growth in demand in mature markets such as Europe, North America and Australasia, leading to a supply surplus. The reverse is expected for emerging markets, however, as illustrated in Figure 1, making these attractive opportunities for Fonterra.

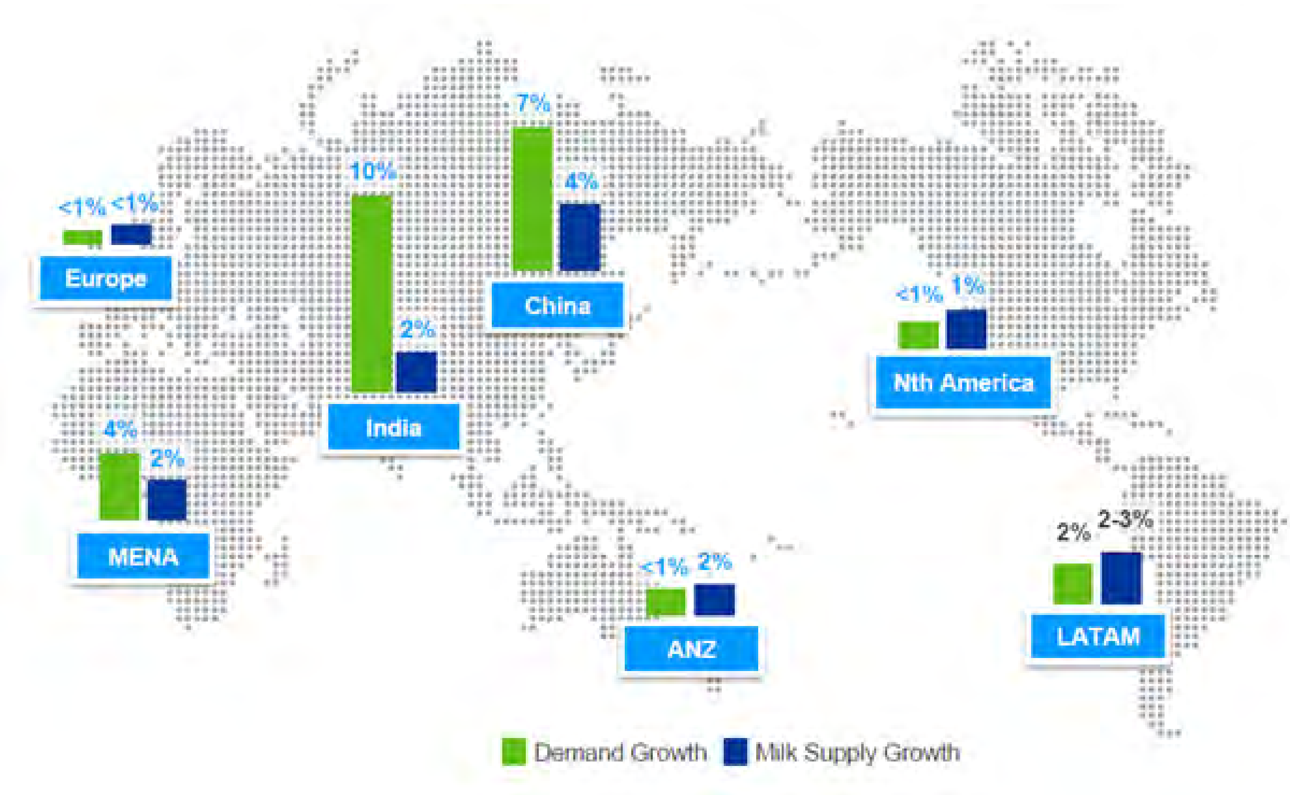


Figure 1: Estimated 2020 Supply/Demand

The New Zealand dairy industry

History

The early years (1800s-1930s):

New Zealand's dairy industry dates back to 1814, when missionary Samuel Marsden brought a bull and two heifers into the country. The industry grew steadily, aided by New Zealand's temperate climate.

The first co-operative cheese company was formed in 1871 on the Otago Peninsula. A co-operative is a firm that is owned, controlled and operated by a group of users for their own benefit, with each member contributing equity capital and sharing in the control of the firm. Like other co-operatives, the first cheese co-operative was established to benefit from the power of pooled resources. By the start of the twentieth century, the majority of dairy factories in New Zealand were owned by co-operatives. Numbers rose to more than 400 by the 1930s.

Meanwhile, dairy co-operatives started selling their products overseas. It was difficult for the hundreds of small New Zealand dairy companies to service foreign markets, so in 1923 the Government established the Dairy Export Produce Control Board to control all dairy exports.

Growth and consolidation (1930s-1960s):

The Dairy Board gave farmers power to access new markets and earn better returns for their products. As a result the industry grew and prospered.

Industry maturity brought consolidation. Co-operatives began joining forces to become more efficient, aided by improved technologies in transport and refrigeration. These included wholemilk collection by tanker from 1951, and cooling of milk on-farm, introduced in 1955. By the 1960s, 400 co-operatives had become 168.

Diversification of markets (1960s-1990s):

During the 1960s, the industry began to diversify both its markets and product ranges. The Dairy Board started seeking new markets when Britain (New Zealand's largest export market) joined the European Economic Community, leading to a severe limitation of the amount of product Britain imported from New Zealand.

By the 1980s the Dairy Board had 19 overseas subsidiaries and associated companies, rising to 80 by 1995. At this time the New Zealand Dairy Board was the world's largest dedicated dairy marketing network.

However, inefficiencies remained in production. In order to overcome these and increase competitiveness in foreign markets, the industry consolidated further and by 1996 there were only 12 dairy companies.

Diversification of products (1960s-1990s):

In conjunction with foreign market expansion, product development and diversification resulted in increased return to farmers. The industry developed a consumer marketing infrastructure and created new brands. Co-operatives shifted their capabilities from butter and cheese - the mainstay of UK exports - to milk powders. New products included the world's first spreadable butter, developed by New Zealand technologists in 1991.

Industry collaboration (1990s-2000):

By the end of 2000 more than 95% of the industry was represented by two major companies: New Zealand Dairy Group and Kiwi Co-operative Dairies (two smaller co-operatives held the remaining five per cent).

In July 2001 84% of New Zealand farmers voted in favour of a merger of the two largest co-operatives, New Zealand Dairy Group and Kiwi Co-operative Dairies (together with the New Zealand Dairy Board, which had been the marketing and export agent for all the co-operatives). This single integrated company put an end to the competition between New Zealand's leading dairy co-operatives, as well as providing the advantages of economies of scale. The two smaller co-operatives, Tatua and Westland, did not join the merger, preferring to remain independent.

The merger was consummated in October 2001 and a new company, Fonterra Co-operative Group Limited, was created. To resolve potential internal conflicts, Fonterra was set up as a new company that bought the assets of both co-operatives and the Dairy Board. Fonterra is co-operatively owned by New Zealand dairy farmers, representing about 96% of all dairy farmers in the country.

As part of this restructure of the dairy industry, the Dairy Industry Restructuring Act (DIRA) was introduced. DIRA included provisions to ensure that Fonterra's market dominance did not eliminate a competitive domestic dairy market. As a result, Fonterra has a number of unique legal obligations, including obligations to:

- Collect all milk that farmers wish to supply to them.
- Allow farmers to withdraw their supply at any time.
- Supply up to 5% of each season's milk collection to other milk processors at a specified price.

Present State

Although small in global terms, with production of around 16.5 billion litres of milk each year (less than 3% of the world's milk production), New Zealand is nonetheless a significant player in the global markets as more than 90% of all production is exported[1].

Farmer-owned co-operatives collect more than 90% of New Zealand's milk production. Aside from Fonterra, the other farmer-owned collectives in New Zealand are Westland and Tatua. These co-operatives are also export-focused. Profits are returned to the farmer shareholders proportional to the volume of milk each supplies. Multinational processors such Goodman Fielder are also active in the market, as are a number of other small domestic companies. See Figure 2 for an illustration of milk supply in New Zealand (all numbers in the diagram are millions of litres)[2].

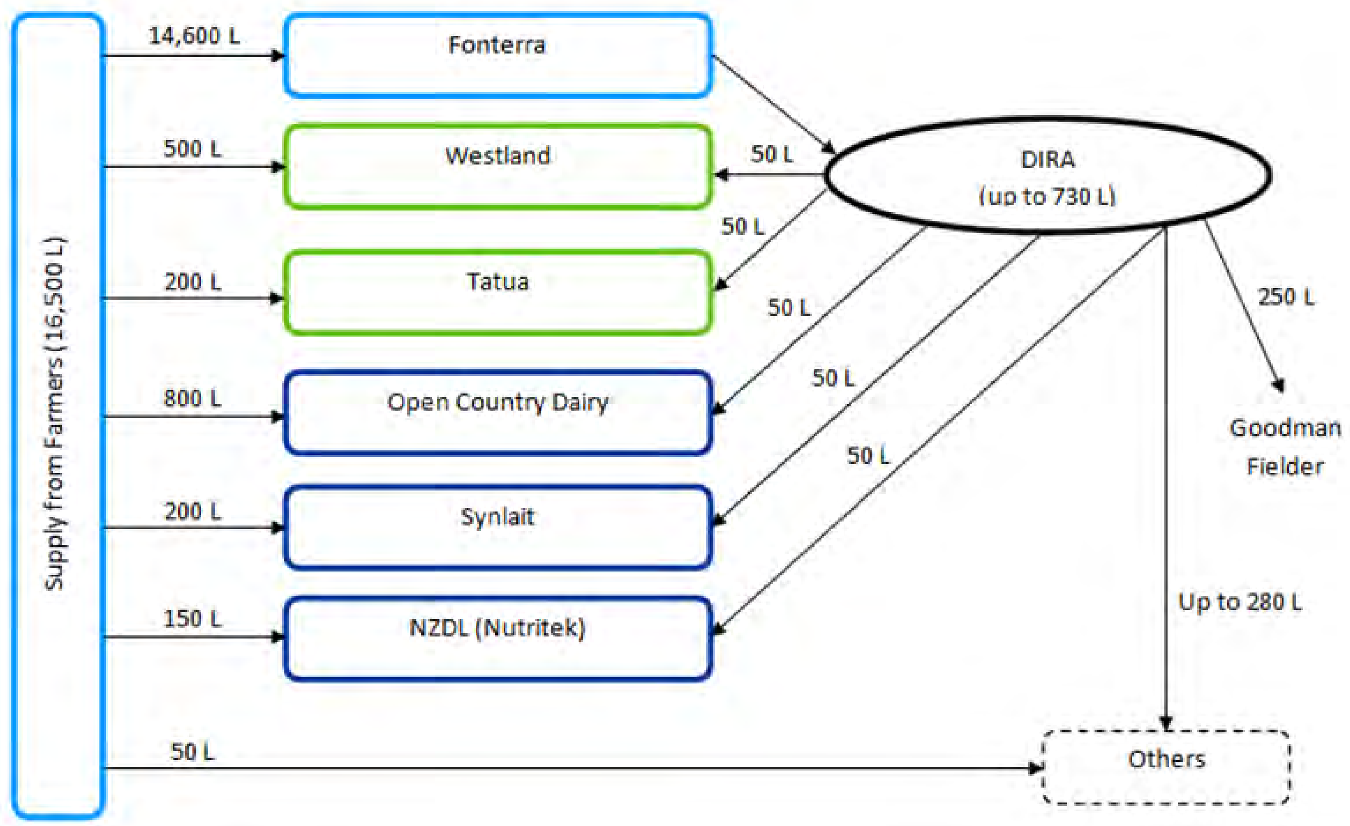


Figure 2: New Zealand Milk Supply

[1] New Zealand Trade and Enterprise, 2012

[2] Rabobank Food and Agribusiness Research and Advisory, 2010

New Zealand dairy exports

New Zealand's dairy industry exports to more than 140 countries. Diversification is high and no one destination accounts for more than 20% of exports. Major markets include China (18%), the Philippines (4%), Algeria (4%), Australia (4%), and Saudi Arabia (4%). Although individual destinations do not significantly impact returns, the importance of exporting to China has been steadily increasing over recent years as the Chinese dairy market experiences high rates of growth.

Exports include a broad range of dairy products. Milk powders account for 58% of exports; in recent years their proportions have been increasing as proportions of butter, cheese and casein have been decreasing. Butter exports are currently at 21% and cheese at 11%. See Appendix 3 for information about the applications of dairy products.

Future of dairy in New Zealand

Milk production in New Zealand has been on the increase for the last 20 years, driven by factors such as the increased profitability of dairy farming, advances in farming technology, and better genetics leading to a greater production of milk per cow. There has been an increase in production of approximately 77% over the last 20 years. Growth is expected to continue at 2% to 4% per year, lower than over the previous two decades as production increases become incremental rather than being due to large structural changes.

[3] New Zealand Trade and Enterprise, 2012

[4] Statistics New Zealand, 2011

[5] New Zealand Trade and Enterprise, 2012

[6] New Zealand Ministry for Primary Industries, 2012

The Indian dairy industry

According to the most recent livestock census undertaken in 2003, India's 185 million cattle and 98 million buffaloes account for 19% of the world's bovine population. India holds the world's second largest cattle population and is the world's largest milk-producing country, with production of approximately 110 billion litres of milk. 42% of this was cow milk, with the remaining 58% composed largely of buffalo milk. However, the productivity of these animals is low in comparison to the rest of the world.

Dairy is a vital part of Indian life. It is part of the daily diet of Indians, and forms a vital source of protein for the large vegetarian population of the country. Milk products contribute around two thirds of total livestock sector value, and milk is the single largest agricultural commodity by value. Milk is an important source of income for many families, particularly in rural areas. For most, dairy is a source of secondary income rather than an exclusive focus; small producers with one or two cows or buffaloes are the most common, and many dairy farmers do not have land or have only a very small amount of land on which to raise cattle.

The Indian government aims for self-sufficiency in food production. This includes dairy; there are government initiatives aiming to build processing capacity, increase processing capability, and to increase the milk yields of cows and buffaloes. The National Dairy Development Board (NDDB) in India seeks to ensure that local farmers choose to produce dairy and helps them to produce it more efficiently. It aims to support farmers through methods such as education and funding research on improving genetics to help with yield improvements. However, until now the NDDB has had limited success in developing real improvements in the Indian dairy market. This limited success is in part due to the fact that while NDDB has ideals of developing India's dairy industry, it has few long-term plans in place to take this idea into the future.

Only 20% of milk currently enters the organised market in India. The organised market is composed of co-operatives and private dairies, in contrast to the unorganised market, in which loose milk is sold to directly to consumers or to indigenous sweet-making shops. The shares of various parties are shown in Figure 3 below.

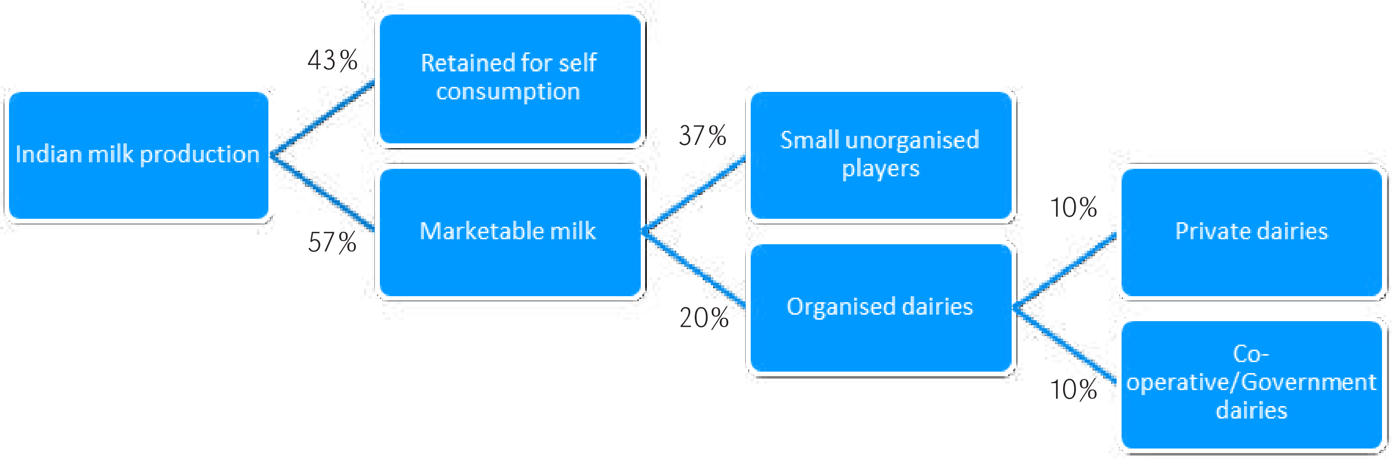


Figure 3: Indian Milk Supply[9]

[7] Central Statistical Organization, Government of India, 2012

[8] D Shah, "Export Potential of India in Livestock Sector", 2008

[9] Rabobank Food and Agribusiness Research and Advisory, 2010

The organised sector is expected to grow 15-20% per anum over the next few years as a result of consumer shifts towards organised players due to the higher quality of their products. Within the organised sector, there is considerable variation in what is produced. Co-operatives mostly produce milk, ghee, indigenous sweets and fresh milk products such as buttermilk and chaas (a buttermilk drink). Conversely, private dairies focus on high value-added products such as sweetened condensed milk and yoghurt. The operating models of these two forms differ greatly, as described in Table 1.

Table 1: Comparison of Indian operating models[10]

	Co-operative	Private
Support to producers (cattle feed, artificial insemination, veterinary drugs, etc.)	Extensive support	Limited support
Infrastructure (bulk coolers, chilling centres, milking machines, etc.)	Investment in infrastructure for the benefit of producers	Hardly any investment undertaken by private companies
Credit available to producers for improving/increasing milk production	Relationship with financial institutions for easy access to credit	Lack of relationships with financial institutions
Credit facility to retailers	No credit given	7-10 days credit facility provided to retailers
Range of products	Entire range of milk products	Mostly value added milk products

The current strengths and weaknesses of the Indian market can be summarised as follows:

- Production
  - Strengths: largest cattle population in the world, and largest milk producer in the world (first in buffalo milk production and second in cow milk production).
  - Weaknesses: low level of farmer education, small herd sizes, low milk yielding cattle, poor quality breed, poor quality feed
- Procurement
  - Weaknesses: milk procured from small and marginal farmers, lack of information at grass-root level, fragmented base leading to high transport costs, significant presence of unorganised channel agents, lack of quality checks
- Processing
  - Weaknesses: quality of milk received at dairy plant significantly degraded, no cool chain
- Sales/Consumption
  - Strengths: milk and milk products consumed on a daily basis in India, farm gate milk price paid to producers for raw product increasing 20% per anum due to gap supply gap (particularly in summer when milk supply dries up).
  - Weaknesses: huge unorganised market with cheaper alternatives means very low margins for organised players.

[10] Rabobank Food and Agribusiness Research and Advisory, 2010

Future of dairy in India

Currently, the Indian government avoids importing dairy from outside of the domestic market as much as possible as part of its aim of self-sufficiency in food production. There are high tariffs, ranging from 30% to 60%, in place for overseas companies that wish to import into India, often making it financially unsustainable. Where there are supply issues, the NDDB does import dairy products from overseas and distributes these among Indian co-operatives. When the NDDB imports, the tariffs are dropped, but for all private players the tariffs remain.

With increasing incomes driving more Indians into the middle class, domestic demand for quality dairy products has been on the increase. The Indian middle class is currently estimated to contain 300 million people[11]. Currently, demand is greater than domestic supply, and accordingly the price of dairy has been trending upwards. These shortages have led to occasions when India has been forced to import. This is further compounded by the fact that dairy is being seen less and less as a good career option by this growing middle class, who are moving away from the rural sector, reducing the dairy supply available to meet the increasing demand. It is estimated that India's demand for dairy products will increase to approximately 200 billion litres by 2022, of which India will be able to supply 160 billion litres itself, leaving a 40 billion litre shortfall[12].

The future of Indian dairy can take one of three paths:

1. Increased domestic milk production to sufficiently meet demand.
2. Importing from overseas markets to add to supply produced domestically.
3. Demand rationing through lifting domestic milk prices to balance the market.

The ability of Indian supply to adequately meet the increased demand for quality dairy products over the next few years is unlikely, even with the government initiatives that are currently in place. It is therefore likely that the other two options, importing or demand rationing, will need to be considered.

Fonterra in India

New Zealand is currently in the process of negotiating a free trade agreement with India. This would have a number of effects for both New Zealand and India. For New Zealand it would mean the opening of a new market that is a natural dairy consumer, where the benefits of dairy do not need to be sold to consumers as has been needed in other markets. Indeed, with the Western world moving away from saturated fats but the Indian market still heavy consumers of ghee (a cooking fat used in Indian households), the Indian market could be an even more natural dairy consumer than the West in the future. For India it would mean that imports could be used to meet supply shortfalls and to encourage demand growth in the domestic market, which would be beneficial for domestic producers as well as New Zealand producers. Depending on the level of involvement, the Indian market could also benefit from the knowledge and technology that New Zealand possesses, which would further assist in the development of the Indian domestic market.

While a free trade agreement would be the ideal scenario, even with the current tariffs in place there is the potential for profitable exporting to India. There may be opportunities to work with private players who can brand New Zealand-made products and sell these at a premium. It is also possible that even if the tariffs are not eliminated they may be reduced, which would further increase the profitability of working with private players to sell premium products.

Fonterra previously had a presence in the Indian market under the form of a joint venture with Indian company Britannia Industries, launched in 2002. The aim of this joint venture was to combine the robust base of Britannia with the technical knowledge of Fonterra. However, in 2009 it was deemed that the joint venture did not fit Fonterra's strategic priorities at that point in time. Mark Wilson, Fonterra's Managing Director for Asia and Middle East, released a statement at the time:

[11] Deutsche Bank, 2010

[12] National Dairy Development Board, 2012

"We are casting a critical eye over our investments on an ongoing basis to ensure they reflect our key strategic priorities. While we are seeing a lot of growth in India, the local milk supply is fragmented and requires significant development and investment in order to deliver an efficient supply chain for high quality fresh milk. Investing in India's consumer dairy market is not a core priority for Fonterra at this time."

However, the question has been raised in the years since then of whether India should once again become one of Fonterra's strategic priorities, in light of recent movements towards a free trade agreement and the notable unmet demand forecasted in the Indian domestic market over the coming years.

While Fonterra does not view a free trade agreement as likely to happen quickly, the organisation nonetheless maintains an active interest in the Indian market and seeks to be ready for changing market conditions. Fonterra is currently building relationships in the Indian market, and maintains an office in India. Even without a free trade agreement, the Indian office can help with understanding the market and developing relationships with the private players who may make India profitable despite the high tariffs.

The option of co-owning dairy farms has also been investigated by the co-operative. Fonterra has been in talks with the Indian Farmers Fertiliser Co-operative (IFFCO), which included the signing of a Memorandum of Understanding with the aim of conducting a feasibility study on co-owning a pilot dairy farm in India as a first step towards establishing larger-scale operations in the country. Through a co-owned Indian farm, Fonterra would be working with local farms and providing education to local farmers in order to secure a supply of high-quality, safe milk. This would assist Fonterra by developing a presence on the ground and creating a positive perception in the local market of being willing to work with locals and support the Indian government, which would be an important factor in a successful entry in the future.

As part of the strategy refresh and restructure that has taken place under new CEO Theo Spierings, an Indo-China director has been appointed and a focus on an integrated play in selected markets has been explicitly stated. The question now is whether India should be one of those selected markets.

Learnings from other markets

India would not be the first emerging market that Fonterra develops a presence in. Fonterra currently has a strong presence in Latin America and China in order to take advantage of the strong growth that has been seen in these markets and is expected to continue.

In Latin America, Fonterra operates under DPA (Dairy Partners Americas), a joint venture with Nestlé. Fonterra also owns the Chilean consumer brands business Soprole, and has a large stake in Prolesur, Soprole's manufacturing subsidiary. With Fonterra offices in these regions that have control of everything from manufacturing to the marketing of consumer goods and customer support in this region, Fonterra owns all parts of the value chain except for the procurement stage, i.e. milk supply.

Lack of control over the milk supply, however, has been an issue for Fonterra in the past. The company made headlines in a negative way in 2008 when China's third-largest dairy processer, Sanlu, was caught up in a milk contamination scandal. It was revealed that melamine had been added to milk to cause it to appear to have a higher milk protein content. As a result, an estimated 300,000 people were reported to have fallen ill, with six infants dying and a further 860 hospitalised. Fonterra owned a 43% stake in Sanlu at the time, and while the company notified the New Zealand Government and pushed for a full recall in China, the negative publicity that followed was inevitable.

Particularly since the Sanlu incident, Fonterra has taken the approach of full ownership of milk supply in China. Milk is supplied from Fonterra owned and operated farms in China in order to ensure a high-quality, sustainable fresh local milk supply. There are currently two Fonterra farms in operation in China, with another farm under construction based on their success as well as a further two farms planned. This model is also being trialled in Latin America, with one pilot farm currently in operation in Brazil.

The Indian question

Fonterra is now at a point where it needs to decide how to approach the Indian market. If the co-operative wants to enter the Indian market, it would seek to do so by placing itself in such a way that it will be the first overseas dairy company to mobilise in the market.

Entrance would not be without challenges, and doing business in India represents a unique set of challenges for multinational companies. One of the biggest challenges is working with the Indian government. State laws and incentives are structured to attract investments, which are seen as critical to driving growth. However, neighbouring states may have vastly different laws, which can make operating in India extremely difficult. And as in many emerging markets, corruption also presents a challenge. While the government is taking definite action to tackle corruption, it is still a widespread issue in India, with politicians, bureaucrats, and businesspeople involved in corrupt practices.

Fonterra would need to commit to India; in most market entrances, investment follows trade, but the Indian government is looking for overseas companies who will make an investment and commit resources before full-scale trade commences. Even aside from government requirements, Fonterra would need to commit resources to an Indian entry as it would not be able to source locally due to quality issues (high quality dairy products are sought by the middle class consumers, but milk procured domestically often lacks quality control) and logistical issues (the fragmented base of small farmers would create high milk collection costs). Fonterra would need to be able source their own products through such avenues as importing or setting up its own farms in India.

India is not the only investment option for Fonterra, but the co-operative does not have the capacity to service all of its options. While milk supply in New Zealand is growing, New Zealand milk production still makes up a small absolute percentage of the world's milk production. With a limited milk supply and growing world markets, New Zealand does not have the capability to supply all markets. A partial solution to this is setting up farms globally, such as the farms that have been set up in China, but even with this Fonterra is a long way away from being capable of supplying to everyone. With this in mind, Fonterra must carefully weigh up its global options when looking at investing in new markets. A summary of key global dairy markets, their characteristics and their competitive environments is provides in Appendices 4 and 5.

Fonterra must decide whether the potential benefits of entrance to the Indian market are worth the costs in relation to the other opportunities Fonterra could pursue.

If so, what is the best strategy for making a successful entrance? Should imports be the focus, or would the Indian market value local milk of guaranteed high quality in the same way that the Chinese market does? Should Fonterra operate a commodity business in India, or would there be more value unlocked through an integrated play with brands aimed at providing a higher margin? Overall, how should Fonterra's Indian presence look in one, five, and ten years?

Selected press releases

Trade, with extra spice

Published: Tuesday, 20 September 2011

With a population of more than 1.2 billion, India is one of the world's largest economies. It is also undergoing a period of significant social change and extremely rapid growth. Even during recession, its economic expansion has been plotted at more than 5%. And those tracking these things project the country will speedily return to the 9-10% it has experienced over most of the last decade.

However, food prices in India are on the increase was well – they lifted by 8.4% in June alone – as demand outstrips supply and the nation struggles to feed its population.

The country currently ranks at 67 out of 84 countries on the International Food Policy Research Institute's global hunger index, created to assess levels of child malnutrition, child mortality and the proportion of population who do not get enough to eat.

In fact the Indian government is poised to introduce a new law making access to food a basic right of every Indian citizen. Driving this policy is the idea of subsidising food for 70% of the population.

It is onto this stage that New Zealand has been advancing since early last year in an attempt to encourage India to abolish trade tariffs on our exports and reduce other non-tariff barriers.

This is a path we have trodden before.

There have been a number of bilateral treaties in place between New Zealand and India, across a range of market sectors, since 1963. More recently, the two countries have been in talks regarding a bilateral free trade agreement (FTA).

This follows the respective trade ministers confirming in 2009 that a feasibility study had found that "the two economies are largely complementary, and an FTA would deliver an outcome of genuine mutual benefit".

New Zealand Trade Minister Tim Groser talked up the opportunities: "A free trade agreement with India offers great promise for New Zealand businesses. India is already one of our fastest growing markets, with New Zealand exports having tripled over the last decade." The fourth round of FTA negotiations took place in New Delhi in March 2011. Then, in the same month, Prime Minister John Key headed a delegation back to New Delhi for the fifth stage in the process. The next meeting will take place in Wellington in mid-to late-August and it is expected that a deal will be clinched early next year.

The March/June trip this year was modelled on the new New Zealand Inc India Strategy.

It was the first of a series of all-of-government initiatives to set priorities and coordinate relations with key offshore partners. The strategy incorporates a clear vision that India should be a core trade, economic and political partner for New Zealand. Among its five goals, it aims to treble exports from mid-2010 levels to $2 billion per year by 2015.

So what do New Zealand producers stand to gain in all this? Two-way trade between New Zealand and India is currently valued at more than $1.25 billion, with our exports worth $917 million for the year ending March 2011. That's nearly double their value two years ago and now makes India this country's 7th largest export market. The majority of those goods are primary commodities, including dairy products, fruit, log exports and wood pulp, and hides and skins.

The sociologist Ashis Nandy once noted that "in India the choice could never be between chaos and stability, but between manageable and unmanageable chaos".

Given dairy's near super-star status in our economy, it was no surprise that representation from the New Zealand dairy industry was encouraged on the June trip, with a trade strategist from Fonterra joining the party.

What was surprising, however, was the sheer size and scale of India's own industry.

"India is the single largest dairy producer in the world and, unlike other parts of Asia, it already has a high level of domestic dairy consumption. Precedent suggests that that's only going to grow as consumers become wealthier," says Simon Tucker, executive director of the Dairy Companies Association of NZ (DCANZ), of which Fonterra is a member. "Much of the country's domestic herd is buffalo. They supply the ghee that is the common cooking fat in Indian households, the milk that gets added to teacups and the ever-prevalent yoghurt."

Until relatively recently, the sub-continent was self-sufficient in regards to dairy, but demand today is rapidly outstripping supply. This is leading to a new situation where India is much more open to the idea of dairy imports, says Tucker. However, it currently charges a high tariff on many dairy imports so in addition to the chance to address these through FTA negotiations, the New Zealand sector is examining other opportunities as well.

"Fonterra is looking particularly at partnering with Indian farming interests to produce milk in India," Tucker observes, "and if we do get into producing milk over there, it could also make sense to work with Indian partners to look at supply chain and R&D issues as well. With the remarkable projections for dairy consumption in India – and its export market – it would make great sense for us to be part of that. It's essential that we take a long-term strategic view of this very important country."

Another traveller on the official trip to the sub-continent was Don Braid, group managing director of transport and logistics powerhouse Mainfreight. As a key player in New Zealand's export activities and someone with an eye for offshore opportunities, Braid was keen to take a look at the state of India's freight and distribution capabilities.

"India has been on our radar for some time. We have known for a while that there would be significant opportunities in that market. What we were after was clarity; some way to judge the size of that opportunity," he explains.

"Unlike China, India is a country that places a strong focus on domestic consumption, and food producers simply can't keep up with the demand. However, from a transport point of view, what logistics framework there is, is disparate and disorganised, particularly when it comes to cool chain. This currently means that up to 40% of their domestic crop perishes post-harvest, simply because of the delay and the poor standard of handling before it gets to market. It's a tremendous waste."

That said, he is quick to observe that New Zealand firms like his need to be very careful not to over-commit, should they look to enter the Indian market.

"There are two points to make here: we're not on our own internationally in approaching this massive market and the chances it offers; and each individual company will do best out of adopting a specialised approach, rather than trying to be all things to all people. This means that Kiwi businesses need to be tightly niched in their approach in order to reap the greatest successes."

For Braid, the trip was very much a fact-finding mission, and he was impressed at how the Ministry of Foreign Affairs and Trade (MFAT) and New Zealand Trade and Enterprise (NZTE) paved the way.

"First and foremost, the government and the businesses that attended approached the Indian market as NZ Inc. rather than as a bunch of individual players. That went down exceedingly well on both sides. NZTE also put a lot of time and effort into researching who we needed to talk to in order to get the answers we wanted. We were fully briefed, right down to how to behave and how to do business in India," he says.

"Then we were given the opportunity to meet a number of international players and our next step is to determine which one we will be best to partner with. We will definitely be back up there in the next three months and we hope to have a deal up and running in the next six months." And milk and logistics are just the tip of the iceberg. According to Credit Suisse, the total wealth of India has tripled in a decade to $3.5 trillion and is expected to double again in the next five years.

This is driving a change in demographics resulting in a growing cohort of increasingly discerning middle class foodies with more disposable income than ever before at their fingertips. All going well, Kiwi producers are going to be a part of that new Indian future.

Fonterra moves to “higher gear”

Published: Monday, 2 April 2012

Fonterra is moving to a higher gear, seeking more volume, value and velocity, according to the chief executive Theo Spierings.

His “Group Strategy Refresh” announced last week contained elements to grow milk volumes, target high value areas in nutritional need and execute these plans at speed.

He said the strategy refresh was built on an in-depth look at the cooperative’s strengths, social and economic trends as well as underlying projections for a marked increase in global demand for milk. Global demand has been forecast by the Food and Agriculture Organisation to grow by 100 billion litres by 2020, of which New Zealand could contribute only five billion.

Demand growth would be greatest in the emerging markets of India, China, the Middle East and Africa.

Spierings said there were significant opportunities to grow non-NZ milk, using the 100-year experience of producing safe, high quality and relatively low-cost milk.

He suggested that another four billion litres annually by 2020 could be generated.

But he made no mention of doing that in India, only China, Australia and Latin America.

Fonterra currently produces 22 billion litres, 17 billion in NZ and five elsewhere. With both NZ and non-NZ growth, that total could grow to 30 billion, Spierings said.

“According to our models, we remain relevant in world trade with that sort of total.”

Spierings said the full strategy refresh contained more than 100 projects, many underway.

He pointed out five: A strong push on the rapidly growing emerging markets where Fonterra already has a strong presence, optimising the NZ milk business to drive cash and improve the return on capital, building integrated milk pools offshore (as in China where Fonterra is developing three pilot farms), growing volumes of higher-value, consumer-branded and out-of-home nutrition, and meeting the advanced nutrition needs of mothers and babies and the aging population.

Fonterra would also continue to move higher up the value

chain, and grow its food service business, which had enormous potential.

“A big part of this strategy refresh has been about making choices - we can’t do it all.”

“We want to make fewer bets and really focus our resources where we know we can win,” said Spierings.

“In the area of advanced nutrition, we will focus on the nutritional needs of mothers and babies and healthy ageing.” Spreading both Anmum and Anlene further around Asian markets is a priority.

Paediatric nutrition was the fastest-growing dairy category in the world and Fonterra already had a substantial business manufacturing high standard ingredients for multinational infant nutrition companies.

“With rapidly ageing populations in the west and in China, Anlene is a true power brand for us with the scope to stand for total mobility, not just bone health.”

Spierings said the strategy refresh underlined the need to introduce Fonterra’s new farmer-only share trading market, Trading Among Farmers.

“We simply can’t deliver on this strategy unless we have access to secure, permanent capital.

“The world is moving fast, which demands speed of execution - and that is why velocity is so important. Fonterra is a strong co-op with great people - but it is velocity that will move us forward.”

Federated Farmers dairy chair Willy Leferink said reliably growing milk volumes underpins Fonterra’s strategy refresh.

“This is about getting into growing markets on the ground floor and In that respect, we’re in the right part of the world at the right time.

“Federated Farmers believes Fonterra has the capital means to take advantage of new markets and opportunities.

“This is by using retentions and a gearing ratio now at 47%.

“Last financial year, for instance, Fonterra retained 35c and that translated into about $470 million.

“It needs to be remembered Federated Farmers pushed Fonterra hard to develop a retentions policy; it’s only a recent evolution.

“We’re excited to see Fonterra plan to grow milk supply outside the country, so long as the parent Fonterra brand is firewalled.”

“Our farmers would be nervous if our reputation was based on what farm workers did or didn’t do overseas,” Leferink said.

Fonterra to invest in two new farms in China

Published: Thursday, 12 April 2012

Fonterra today unveiled the next step in its strategy to build a high-quality, sustainable fresh local milk supply in China, announcing plans to develop two new large-scale dairy farms in Hebei province.

Chief Executive Theo Spierings made the announcement at the official opening of Fonterra's second farm in China - called Yutian Farm One.

Speaking at the ceremony, Mr Spierings said China is a significant priority in Fonterra's refreshed global strategy.

"We have a long history in China and we are committed to the further development of the local Chinese dairy industry. We want to establish an integrated milk business in China that processes high quality milk from Chinese farms into dairy nutrition for Chinese customers and consumers," he said.

With consumption in China expected to double by 2020, the country will be consuming more than 70 billion litres of milk every year by 2020.

"It is clear that much of this growth in demand for dairy nutrition will be met from local production.

"An integrated business all starts with a safe, high quality local milk supply. Our intention is to develop separate farming hubs across China, with the ultimate goal of producing up to 1 billion litres of high quality milk every year by 2020."

Fonterra has already committed investment to five farms in the Hebei Province, in the north east of China.

"Our first farm in Tangshan opened in 2007 and today we are celebrating the official opening of our second farm in the area. Yutian Farm One is currently milking around 2200 cows and producing around 11 million litres a year. At full capacity it will reach 30 million litres of high quality milk a year.

"Construction of our third farm, also at Yutian County, is underway and today we are also announcing that we will be investing NZ$100 million (RMB557 million) in a further two farms in the same Province.

"This will mean we will have a hub with five farms within the area. Combined, they will have a herd size of around 15,000 milking cows producing 150 million litres a year and all nearby a large market like Beijing.

"We will be using local suppliers, partners and contractors to build our two new farms and when all five farms are up and running we will be employing around 500 local staff to operate them. This investment will flow right through the local economy."

Mr Spierings said the success of Fonterra's farming operations in China, and their future growth would not be possible without the support of local Government.

"The Government of Yutian County of China has played an integral role in the development of our farms in the region. These partnerships will continue to be vital as we expand our presence in China over the long term and work with local players to further develop the local industry."

Fu Zhenbo, Magistrate of Yutian County said: "Fonterra's investment in dairy farms in the region is helping to further build Yutian's reputation as a key national agriculture demonstration zone. The farm is positive for the future development of Yutian as a dairy farming region.

"Today's announcement of further investment will play a significant role in continuing to develop the security, quality and sustainability of our locally produced milk."

Bringing our dairy management expertise to India

Published: Monday, 24 September 2012

The International Farming Ventures team has welcomed a new member to their team in India.

Newly-appointed Farm Extension Manager Denise Burrell says she has always been attracted to the dairy industry. "I like working with farmers."

Denise's career in dairy spans 20 years and has taken her across the globe, including Pakistan, Indonesia, Nepal and Australia, where she trained local dairy farmers and young people in best practice farm management.

"A key focus of my work offshore has been to build bridges between farming communities and governments to encourage sustainable and profitable dairy production," she said.

IFV's General Manager of Operations, Tony Eyres, said India is a very important dairy market to watch given its size and enormous growth potential, and Fonterra is working with India Farmers Fertiliser Co-operative (IFFCO) to look at specific opportunities for milk production.

"Today most of the milk in India is produced on one or two-cow farms but longer term, it has the potential to develop into a significant local milk pool to meet growing domestic demand for high-quality, traceable milk," said Tony.

"Denise, along with our International Farming Ventures team, will play an integral role in exploring the opportunities for our business in India and other growth markets in the wider Asia region," he said.

Denise's initial focus will be to ascertain the needs of farming communities, and work with farmers to improve their on-farm management skills, productivity, milk quality and profitability.

"I have a firm belief that training and education empowers local communities and helps them to become more affluent – both economically as well as building capability. So I'm certainly excited about the opportunity to work in India," said Denise.

Appendices

Appendix 1: Financial Information for FY12 (August 2011 – July 2012)

Fonterra Co-operative Group Limited is a co-operative company incorporated and domiciled in New Zealand. Fonterra is registered under the Companies Act 1993 and the Co-operative Companies Act 1996, and is an issuer for the purposes of the Financial Reporting Act 1993. Fonterra is also required to comply with the Dairy Industry Restructuring Act 2001. The parent entity owns the co-operative shares, buys milk from famer shareholders, and contains the group corporate functions. The group financial statements are for the parent entity, its subsidiaries and the group's interests in its equity accounted investees.

Summary of FY12:

REVENUE **$19.8b**	NET PROFIT AFTER TAX **$624m**	NORMALISED EARNINGS BEFORE INTEREST AND TAX **$1.03b**
GEARING **39.1%**	DIVIDEND **32c**	SALES VOLUMES **3.94m MT**

Profit before tax was up 9% on the prior year and net profit after tax was $624 million, down 19%, largely due to tax credits of $202 million in the prior year not repeated in the current year. Excluding those credits, Fonterra's net profit after tax improved by 10%.

Results highlights compared to the prior year include:

- Record New Zealand milk flows, up 11% in the current season.
- 11% increase in export volumes to 2.32 million tonnes of final product.
- Sales volumes increased 2% to 3.94 million tonnes of final product.
- Flat revenues of $19.8 billion.
- Higher operating cash flows of $1.4 billion, up $206 million.
- Balance sheet strengthened with economic gearing ratio improving from 41.8% to 39.1%.

INCOME STATEMENT
FOR THE YEAR ENDED 31 JULY 2012

	NOTES	GROUP $ MILLION 31 JULY 2012	GROUP $ MILLION 31 JULY 2011	PARENT $ MILLION 31 JULY 2012	PARENT $ MILLION 31 JULY 2011
Revenue from sale of goods		19,769	19,871	9,050	10,257
Dividends received		–	–	114	495
Total revenue		19,769	19,871	9,164	10,752
Cost of goods sold	1	(16,721)	(16,861)	(9,050)	(10,257)
Gross profit		3,048	3,010	114	495
Other operating income		132	165	56	53
Selling and marketing expenses		(568)	(596)	(10)	(12)
Distribution expenses		(501)	(487)	–	–
Administrative expenses		(784)	(700)	(241)	(218)
Other operating expenses		(385)	(336)	(73)	(66)
Net foreign exchange losses	3	(7)	(91)	–	–
Operating profit/(loss)	2	935	965	(154)	252
Finance income	4	30	32	263	375
Finance costs	4	(340)	(438)	(287)	(372)
Net finance (costs)/income		(310)	(406)	(24)	3
Share of profit of equity accounted investees		52	63	–	–
Profit/(loss) before tax		677	622	(178)	255
Tax (expense)/credit	5	(53)	149	226	183
Profit for the year		624	771	48	438
Profit for the year is attributable to:					
Shareholders of the Parent		609	754	48	438
Non-controlling interests		15	17	–	–
Profit for the year		624	771	48	438

		GROUP $ 31 JULY 2012	GROUP $ 31 JULY 2011
Earnings per share:			
Basic and diluted earnings per share	25	0.42	0.55

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 JULY 2012

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Profit for the year	624	771	48	438
Cash flow hedges:				
– Net fair value (losses)/gains	(229)	1,384	(3)	(36)
– Transferred and reported in revenue from sale of goods	(400)	(863)	–	–
– Tax credit/(expense) on cash flow hedges	176	(146)	–	10
Net investment hedges:				
– Net fair value (losses)/gains on hedging instruments	(33)	49	–	–
– Tax credit/(expense) on net investment hedges	9	(14)	–	–
Foreign currency translation gains/(losses) attributable to Shareholders	37	(164)	–	–
Foreign currency translation reserve transferred to income statement	(7)	(15)	–	–
Foreign currency translation attributable to non-controlling interests	1	(4)	–	–
Share of equity accounted investees' movements in reserves	1	7	–	–
Other comprehensive (expense)/income recognised directly in equity	(445)	234	(3)	(26)
Total comprehensive income for the year	179	1,005	45	412
Attributable to:				
Shareholders of the Parent	163	992	45	412
Non-controlling interests	16	13	–	–
Total comprehensive income for the year	179	1,005	45	412

STATEMENT OF FINANCIAL POSITION

AS AT 31 JULY 2012

		GROUP $ MILLION		PARENT $ MILLION	
	NOTES	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
ASSETS					
Current assets					
Cash and cash equivalents		1,033	785	793	570
Trade and other receivables	8	2,302	2,279	9,125	9,423
Inventories	9	2,981	3,277	–	–
Tax receivable		18	29	–	–
Derivative financial instruments	19(g)	275	1,100	270	1,088
Other current assets		83	90	–	–
Total current assets		6,692	7,560	10,188	11,081
Non-current assets					
Property, plant and equipment	10	4,569	4,326	210	222
Investment in subsidiaries		–	–	6,895	6,895
Equity accounted investments	11	439	429	–	–
Intangible assets	12	2,882	2,748	77	66
Deferred tax asset	16	99	116	385	403
Derivative financial instruments	19(g)	198	154	198	154
Other non-current assets		238	197	9	10
Total non-current assets		8,425	7,970	7,774	7,750
Total assets		15,117	15,530	17,962	18,831
LIABILITIES					
Current liabilities					
Bank overdraft		42	23	–	–
Borrowings	15	1,204	444	999	53
Trade and other payables	13	1,386	1,350	7,053	7,343
Owing to suppliers		1,083	1,679	1,134	1,729
Tax payable		28	19	–	–
Derivative financial instruments	19(g)	255	58	247	41
Provisions	14	83	67	20	29
Other current liabilities		44	6	–	–
Total current liabilities		4,125	3,646	9,453	9,195
Non-current liabilities					
Borrowings	15	3,745	4,206	3,015	3,799
Derivative financial instruments	19(g)	413	718	413	718
Provisions	14	81	106	42	79
Deferred tax liability	16	85	295	–	–
Other non-current liabilities		13	18	–	–
Total non-current liabilities		4,337	5,343	3,470	4,596
Total liabilities		8,462	8,989	12,923	13,791
Net assets		6,655	6,541	5,039	5,040
EQUITY					
Co-operative shares		5,690	5,261	5,690	5,261
Retained earnings		1,078	943	(584)	(157)
Foreign currency translation reserve		(211)	(217)	–	–
Cash flow hedge reserve		63	516	(67)	(64)
Total equity attributable to Shareholders of the Parent		6,620	6,503	5,039	5,040
Non-controlling interests		35	38	–	–
Total equity		6,655	6,541	5,039	5,040

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 JULY 2012

GROUP $ MILLION	ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT						
	CO-OPERATIVE SHARES	RETAINED EARNINGS	FOREIGN CURRENCY TRANSLATION RESERVE	CASH FLOW HEDGE RESERVE	TOTAL	NON-CONTROLLING INTERESTS	TOTAL EQUITY
As at 1 August 2010	5,016	547	(73)	141	5,631	36	5,667
Profit for the year	–	754	–	–	754	17	771
Other comprehensive income/(expense) for the year	–	7	(144)	375	238	(4)	234
Total comprehensive income/(expense) for the year	–	761	(144)	375	992	13	1,005
Transactions with Shareholders in their capacity as Shareholders:							
Dividends paid to Shareholders of the Parent	–	(365)	–	–	(365)	–	(365)
Co-operative shares issued	404	–	–	–	404	–	404
Co-operative shares surrendered	(159)	–	–	–	(159)	–	(159)
Dividends paid to non-controlling interests	–	–	–	–	–	(11)	(11)
As at 31 July 2011	5,261	943	(217)	516	6,503	38	6,541
As at 1 August 2011	5,261	943	(217)	516	6,503	38	6,541
Profit for the year	–	609	–	–	609	15	624
Other comprehensive income/(expense) for the year	–	1	6	(453)	(446)	1	(445)
Total comprehensive income/(expense) for the year	–	610	6	(453)	163	16	179
Transactions with Shareholders in their capacity as Shareholders:							
Dividends paid to Shareholders of the Parent	–	(475)	–	–	(475)	–	(475)
Co-operative shares issued	584	–	–	–	584	–	584
Co-operative shares surrendered	(155)	–	–	–	(155)	–	(155)
Dividends paid to non-controlling interests	–	–	–	–	–	(19)	(19)
As at 31 July 2012	5,690	1,078	(211)	63	6,620	35	6,655

PARENT $ MILLION	CO-OPERATIVE SHARES	RETAINED EARNINGS	CASH FLOW HEDGE RESERVE	TOTAL EQUITY
As at 1 August 2010	5,016	(230)	(38)	4,748
Profit for the year	–	438	–	438
Other comprehensive expense for the year	–	–	(26)	(26)
Total comprehensive income/(expense) for the year	–	438	(26)	412
Transactions with Shareholders in their capacity as Shareholders:				
Dividends paid to Shareholders	–	(365)	–	(365)
Co-operative shares issued	404	–	–	404
Co-operative shares surrendered	(159)	–	–	(159)
As at 31 July 2011	5,261	(157)	(64)	5,040
As at 1 August 2011	5,261	(157)	(64)	5,040
Profit for the year	–	48	–	48
Other comprehensive expense for the year	–	–	(3)	(3)
Total comprehensive income/(expense) for the year	–	48	(3)	45
Transactions with Shareholders in their capacity as Shareholders:				
Dividends paid to Shareholders of the Parent	–	(475)	–	(475)
Co-operative shares issued	584	–	–	584
Co-operative shares surrendered	(155)	–	–	(155)
As at 31 July 2012	5,690	(584)	(67)	5,039

CASH FLOW STATEMENT

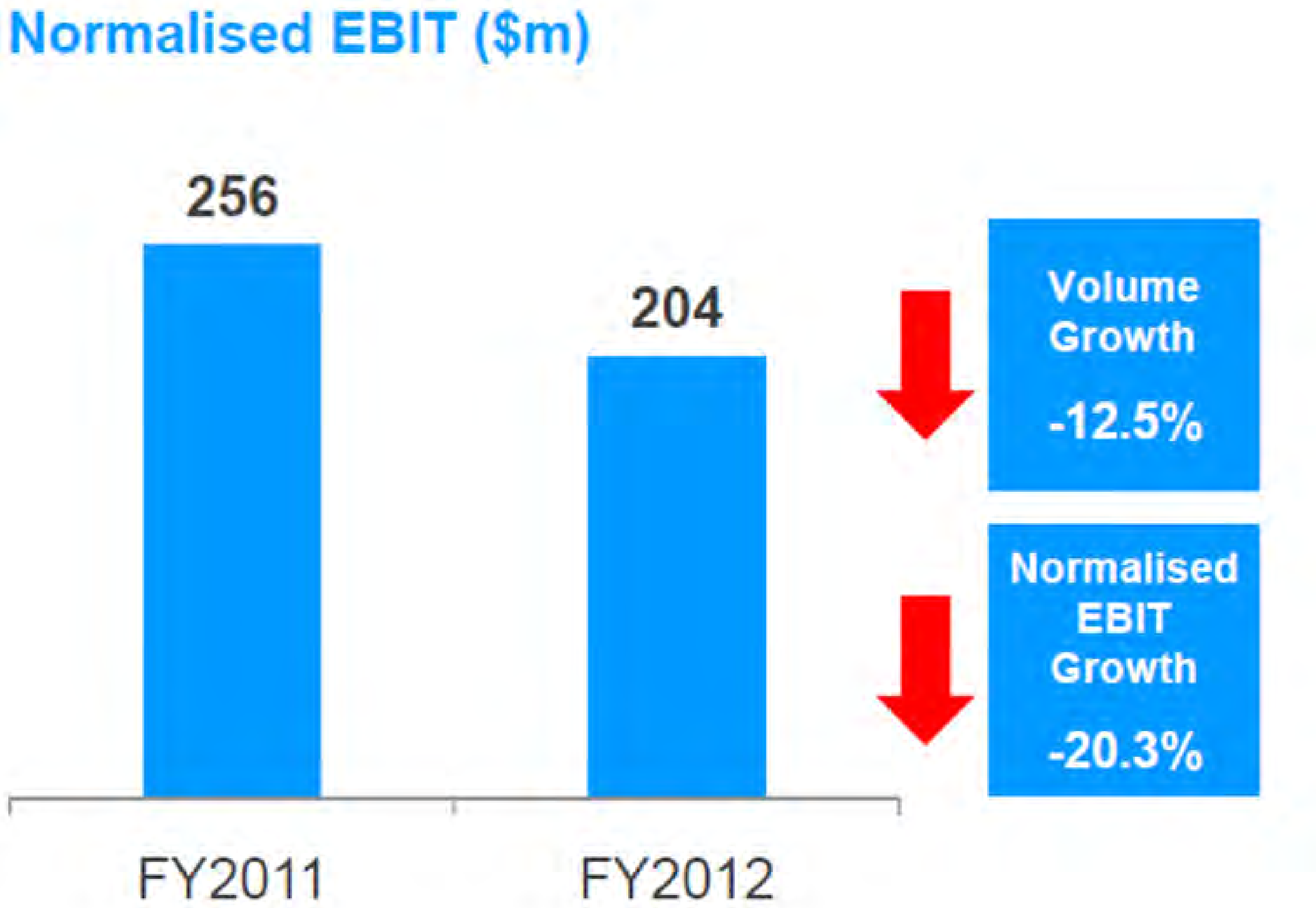
FOR THE YEAR ENDED 31 JULY 2012

		GROUP $ MILLION		PARENT $ MILLION	
	NOTES	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Cash flows from operating activities					
Cash was provided from:					
– Receipts from customers		20,045	19,490	9,104	10,311
– Dividends received		37	63	–	–
– Tax received		11	5	–	–
Cash was applied to:					
– Payments to creditors and employees		(7,905)	(7,528)	(299)	(280)
– Payments for milk purchased		(10,721)	(10,780)	(9,593)	(9,632)
– Tax paid		(77)	(66)	–	–
Net cash flows from operating activities	17	1,390	1,184	(788)	399
Cash flows from investing activities					
Cash was provided from:					
– Proceeds from disposal of property, plant and equipment		11	9	–	–
– Proceeds from settlement of net investment hedges		26	20	–	–
– Proceeds from sale of Group entities and other business operations		–	184	–	–
– Net loans from Group entities		–	–	1,435	507
Cash was applied to:					
– Acquisition of property, plant and equipment		(673)	(488)	(19)	(25)
– Acquisition of intangible assets		(184)	(135)	(25)	(27)
– Outflows on settlement of net investment hedges		(2)	(23)	–	–
– Acquisition of Group entities and other business operations		–	(55)	–	–
– Advances made to equity accounted investees		(4)	–	–	–
Net cash flows from investing activities		(826)	(488)	1,391	455
Cash flows from financing activities					
Cash was provided from:					
– Proceeds from borrowings		2,215	3,648	1,706	1,535
– Proceeds from issue of Co-operative shares		505	368	505	368
– Proceeds for Co-operative shares not yet issued		44	25	44	25
– Proceeds from settlement of borrowing derivatives		13	21	–	–
– Interest received		31	32	18	20
Cash was applied to:					
– Interest paid		(406)	(397)	(309)	(353)
– Repayment of borrowings		(2,097)	(3,548)	(1,214)	(1,699)
– Outflows on settlement of borrowing derivatives		(5)	(46)	–	–
– Surrender of Co-operative shares		(155)	(160)	(155)	(160)
– Dividends paid to non-controlling interests		(19)	(11)	–	–
– Dividends paid to Shareholders of the Parent		(475)	(365)	(475)	(365)
Net cash flows from financing activities		(349)	(433)	(380)	(629)
Net increase in cash and cash equivalents		215	263	223	225
Cash and cash equivalents at the beginning of the year		762	534	570	345
Effect of exchange rate changes on cash balances		14	(35)	–	–
Cash and cash equivalents at the end of the year		991	762	793	570
Reconciliation of closing cash balances to the statement of financial position:					
Cash and cash equivalents		1,033	785	793	570
Bank overdraft		(42)	(23)	–	–
Closing cash balances		991	762	793	570

Parent undertakes financing activities for the Group. As a result receipts and payments from and to subsidiaries for operating and financing activities (including dividends) are settled on a net basis and presented in investing activities as net loans from Group entities.

Performance of key regions:

ANZ[13]

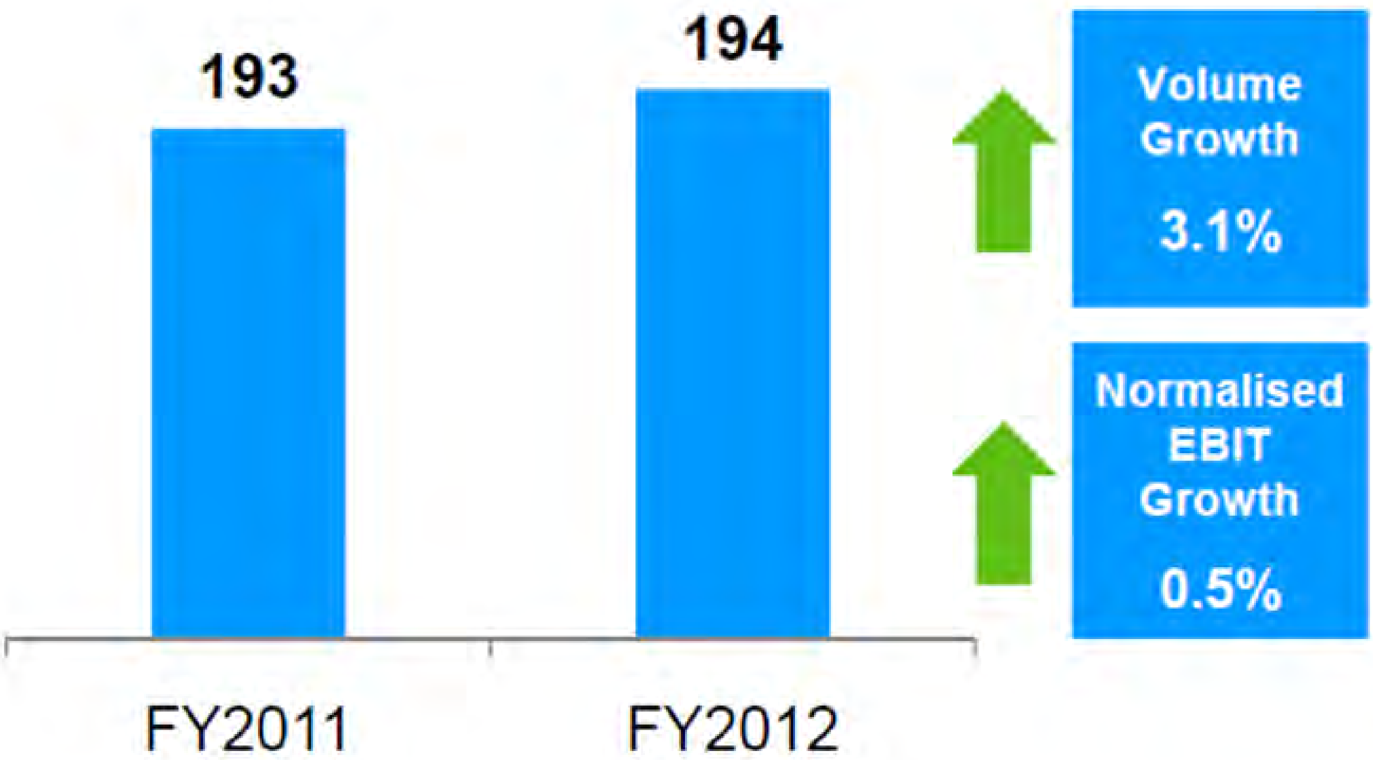


- Lower result reflects challenging trading conditions.
- Higher trade and promotional spend to maintain market share.
- Good performance from foodservice[14] .
- Stable performance in New Zealand and in ingredients.

[13] The Australia and New Zealand consumer brands business unit.

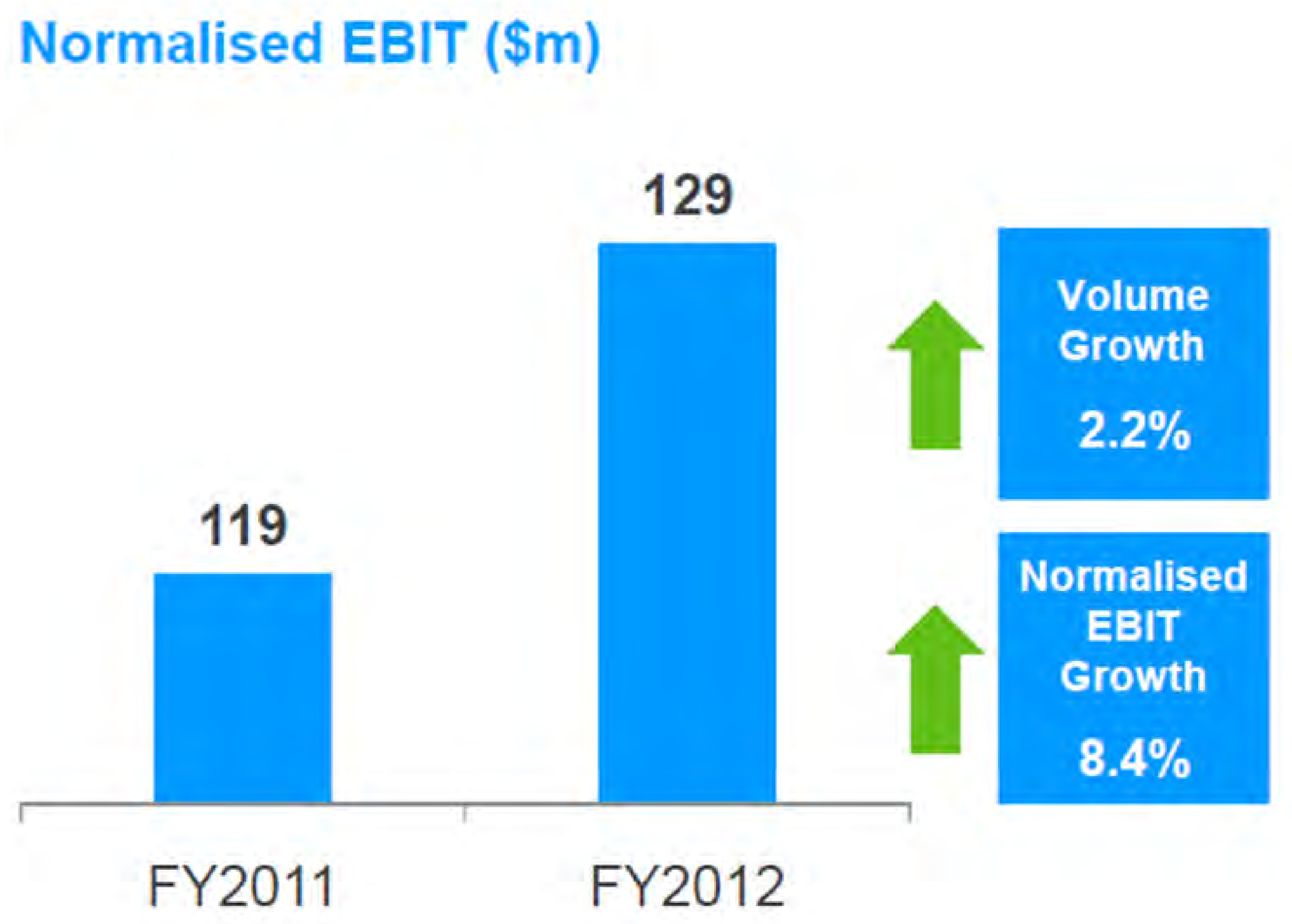
[14] Products supplied for meals prepared outside the home, including fast food, restaurants, school/ hospital cafeterias, and catering.

Asia, Africa and Middle East



- Strong demand.
- Strong New Zealand dollar had a negative impact on EBIT.
- EBIT growth of 8% (constant currency).
- Anlene and Anmum brands performed well in Vietnam, Hong Kong, the Philippines and Malaysia.
- Strong volume growth by Anlene and Anmum brands in China.
- Strong performance in Sri Lanka across all categories.

Latin America



- Soprole[15] had normalised EBIT up 6% to $83 million.
- Latin America had normalised EBIT growth of 16% (constant currency).
- Product innovation had positive impact on EBIT.
- Dairy Partners Americas[16] related income was up 12% to $46 million.

[15] Majority owned by Fonterra.

[16] Joint venture with Nestlé across Latin America.

Capital expenditure in key regions:

$m	FY2010 *Actual*	FY2011 *Actual*	FY2012 *Actual*
NZ Milk Products	378	470	645
Australia and New Zealand	74	135	181
Asia, Africa and Middle East	13	17	19
Latam	27	22	43
Total capital expenditure	492	644	888

Appendix 2: Fonterra Brands

Fonterra's Consumer Brands businesses include Fonterra Australia/New Zealand, Fonterra Asia/Africa, Middle East and Fonterra Latin America. As well as trusted consumer brands, these businesses also sell foodservice solutions in conjunction with Fonterra's global foodservice business.

In both Australia and New Zealand Fonterra holds the number one or two leadership positions in cheese, spreads, yoghurt and dairy desserts. In New Zealand this is also the case for milk, flavoured milk and ice cream.

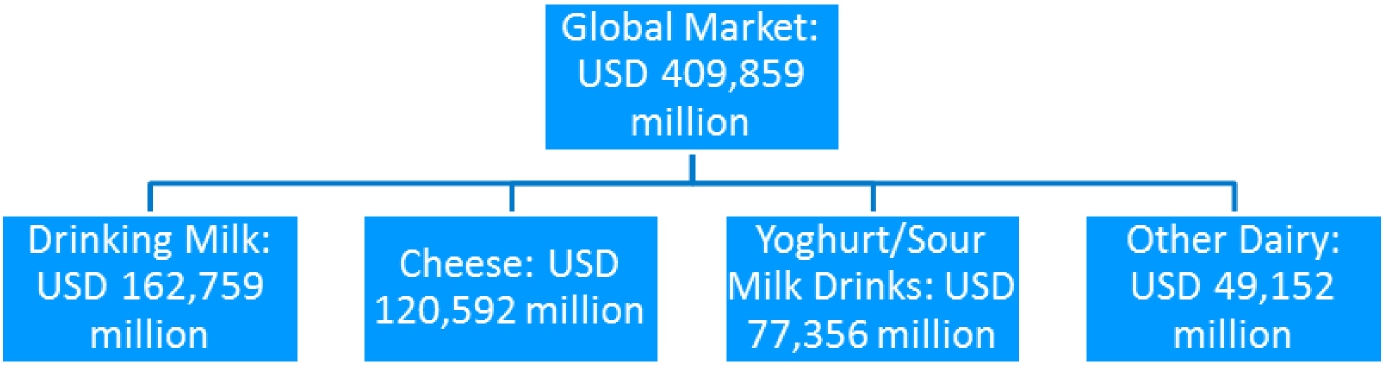
The Anmum Materna™ product is the leading milk for pregnant women across five markets in Asia, and the Anlene™ beverage is the clear leader in the bone health milk segment across Asia and the Middle East.

Consumer products produced by Fonterra's Soprole business hold around a quarter of the total dairy market in Chile, while Fonterra's consumer business in other Latin American countries operate through the Dairy Partners Americas (DPA) joint venture in Brazil, Venezuela, Ecuador and Argentina.

Appendix 3: Application of dairy products

Product	Application
Milk powder	Recombination of milk
	Bread making
	Pastry dough
	Egg substitute in baking
	Chocolate
	Sausages
	Ingredient in nutritional products
	Ice cream
Butter	Butter spreads
	Cooking/baking ingredient
Cheese	Standard cheese
	Specialty cheese
	Shredded cheese
	Processed cheese
Casein	Ingredient in nutritional products
	Coffee creamer
	Processed cheese
	Imitation cheese
	Bakery glazes
	Infant formula
	Coating for paper/cardboard
	Adhesive for wood
	Synthetic fibres
	Leather tanning
	Paints
	Plastics
Whey powder	Desserts
	Soups/sauces
	Clinical foods
	Baby food
	Sports supplements
	Chocolate
	Bakery products
	Ice cream
Milk protein concentrate	Nutritional drinks
	Cheese
	Cultured foods/yoghurt

Appendix 4: Key global dairy markets

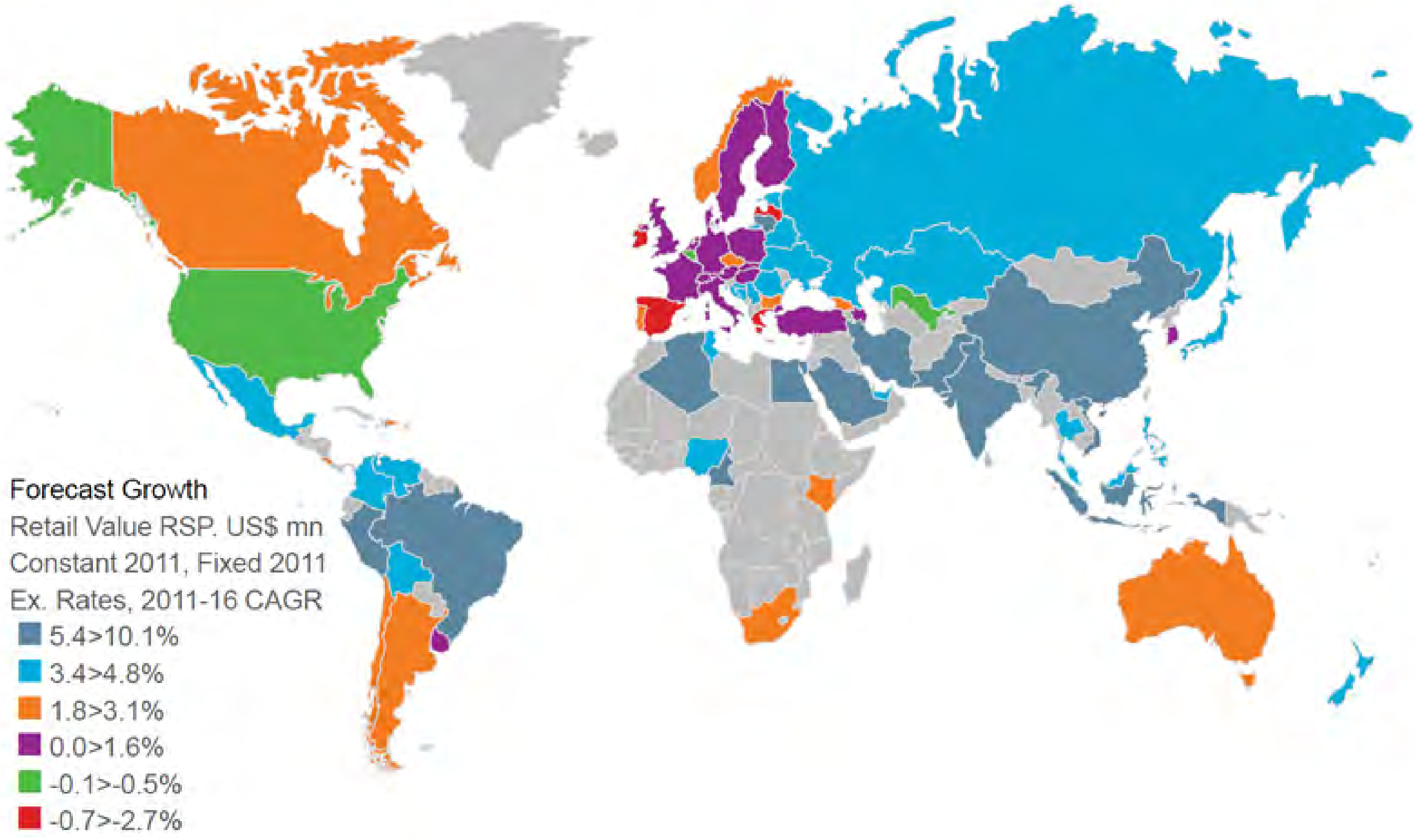


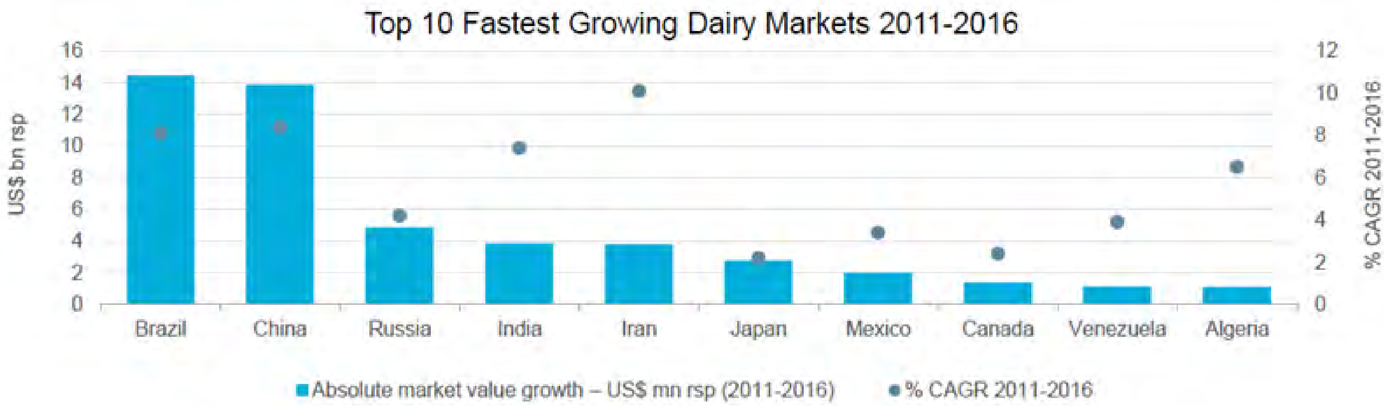
Euromonitor 2012 Data

Key trends:

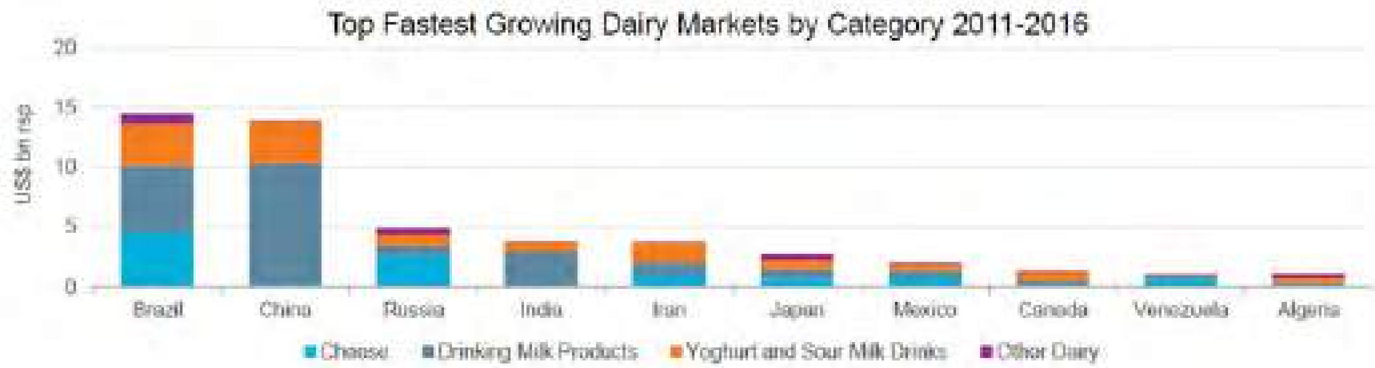
- The global dairy market is expected to have a cumulative average growth rate of 3% through to 2016 to a value of USD 480 billion[17].
- Emerging markets are expected to contribute 95% of growth out to 2016.
- By 2016, regional contribution to global dairy sales is expected to have shifted; North American and Western European shares will decline while Asia Pacific, Latin American and Middle Eastern shares will increase.
- With CAGRs of 8%, Brazil and China are expected to be the largest contributors to this regional shift. Other key growth markets are expected to be India, Russia and Iran.
- Large populations (88% of the global population are expected to live in emerging markets by 2016), high growth in GDP and disposable incomes, and currently low consumption will be the drivers of high growth rates.
- Key challenges in emerging markets will be underdeveloped infrastructure and supply chains, fragmented retail networks and rapid market consolidation as a result of heavy investment in expansion by multinational and leading local players.
- Growth in North America and Western Europe will be driven by trends of health, convenience, on-the-go consumption and value for money in difficult economic times.

[17] Exchange rate used: 1 New Zealand dollar = 0.7989 US dollars





Drinking milk products are expected to be the key driver of emerging market dairy growth. In China in particular, drinking milk products are predicted to account for 73% of total dairy market value expansion through to 2016.

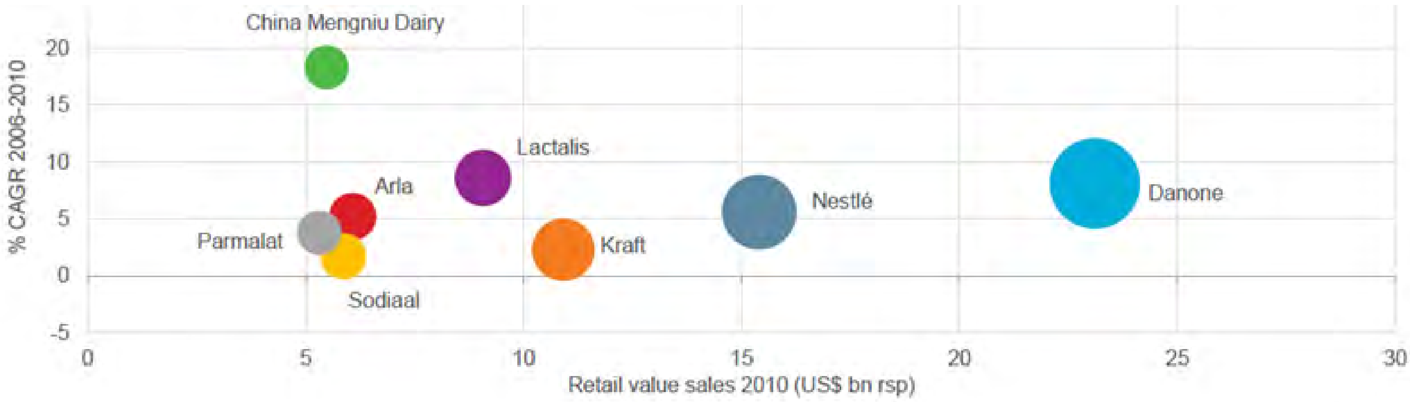


	Current % of Global Consumption	Market Type	Opportunities for Fonterra	Constraints for Fonterra	Fonterra Presence
EU	19%	Mature	High dairy consumption, high incomes	Economic uncertainty, saturated, predicted supply surplus, strong trade protectionism	5 sales offices, strong presence in pharmaceutical applications
North America	13%	Mature	High dairy consumption, high incomes	Saturated, trade quotas for dairy, free trade agreement in place among North American countries	2 sales offices, joint venture with Dairy Farmers of America, 1 technical centre
Southern Cone (Argentina, Brazil, Chile, Paraguay, Uruguay, Venezuela)	7%	Emerging	Growing incomes, traditional consumers of dairy	Free trade agreement in place among South American countries	4 sales offices, majority share in dairy manufacturer Soprole (including 1 manufacturing site in Brazil), joint venture with Nestlé across Latin America
Middle East/ North Africa	7%	Emerging	Growing incomes, growing awareness of health benefits of dairy	Tariffs in place	8 sales offices, 1 processing site (in Saudi Arabia), strong consumer brands retail presence
India	17%	Emerging	Growing incomes, traditional consumers of dairy	High tariffs in place, aiming for self-sufficiency	Small office maintained
China	6%	Emerging	Growing incomes, growing awareness of health benefits of dairy	Tariffs in place	4 sales offices, Fonterra-owned farms
Southeast Asia	7%	Emerging	Growing incomes, growing awareness of health benefits of dairy	Tariffs in place	10 sales offices, 4 manufacturing sites (in Sri Lanka and Malaysia), strong consumer brands retail presence
Russia	5%	Emerging	Growing incomes, traditional consumers of dairy	Tariffs in place	None

Appendix 4: key global dairy markets

Fonterra ranked fourth in Rabobank's 2012 Global Dairy Top 20 report, with a turnover of USD 15.7 billion. The top three companies were Nestlé at USD 25.9 billion, Danone at USD 19.5 billion, and Lactalis at USD 18.8 billion.

Fonterra's key competitors have all experienced growth over the past few years:



Key trends:

- Players who have strong presences in emerging markets showed the strongest growth.
- Danone's growth in retail sales have been driving by the acquisition of Unimilk, a large Russian dairy company.
- China Mengniu, the highest growing major player, had strong performance based on its rapid expansion in its domestic Chinese market.
- The companies showing the lowest growth rates all generate less than 15% of their sales in emerging markets.

	EU	North America	Latin America	Middle East/ North Africa	India	China	South-east Asia	Russia
Arla	✓	✓	✓	✓	✗	✓	✗	✓
Danone	✓	✓	✓	✓	✓	✓	✓	✓
Fonterra	✓	✓	✓	✓	✗	✓	✓	✗
Kraft	✓	✓	✓	✓	✓	✓	✓	✓
Lactalis	✓	✓	✓	✓	✗	✗	✗	✓
Mengniu	✗	✗	✗	✗	✗	✓	✗	✗
Nestlé	✓	✓	✓	✓	✓	✓	✓	✓
Parmalat	✓	✓	✓	✗	✗	✓	✗	✓
Sodiaal	✓	✓	✓	✗	✗	✓	✗	✗

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