



Dairy for life

# Fonterra Capital Structure Review

Owners Conversations - May 2021



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

Email [CS\\_feedback@fonterra.com](mailto:CS_feedback@fonterra.com)

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

# Have your say



## How to contribute:

- Director Roadshows
- Regional meetings
- Fonterra Cooperative Council
- [www.Fonterra.com/csfeedback](http://www.Fonterra.com/csfeedback)
- Email [CS\\_feedback@fonterra.com](mailto:CS_feedback@fonterra.com)
- Area Managers

We are here



Director Meetings



Further Regional Meetings



Review and address feedback



Refine options



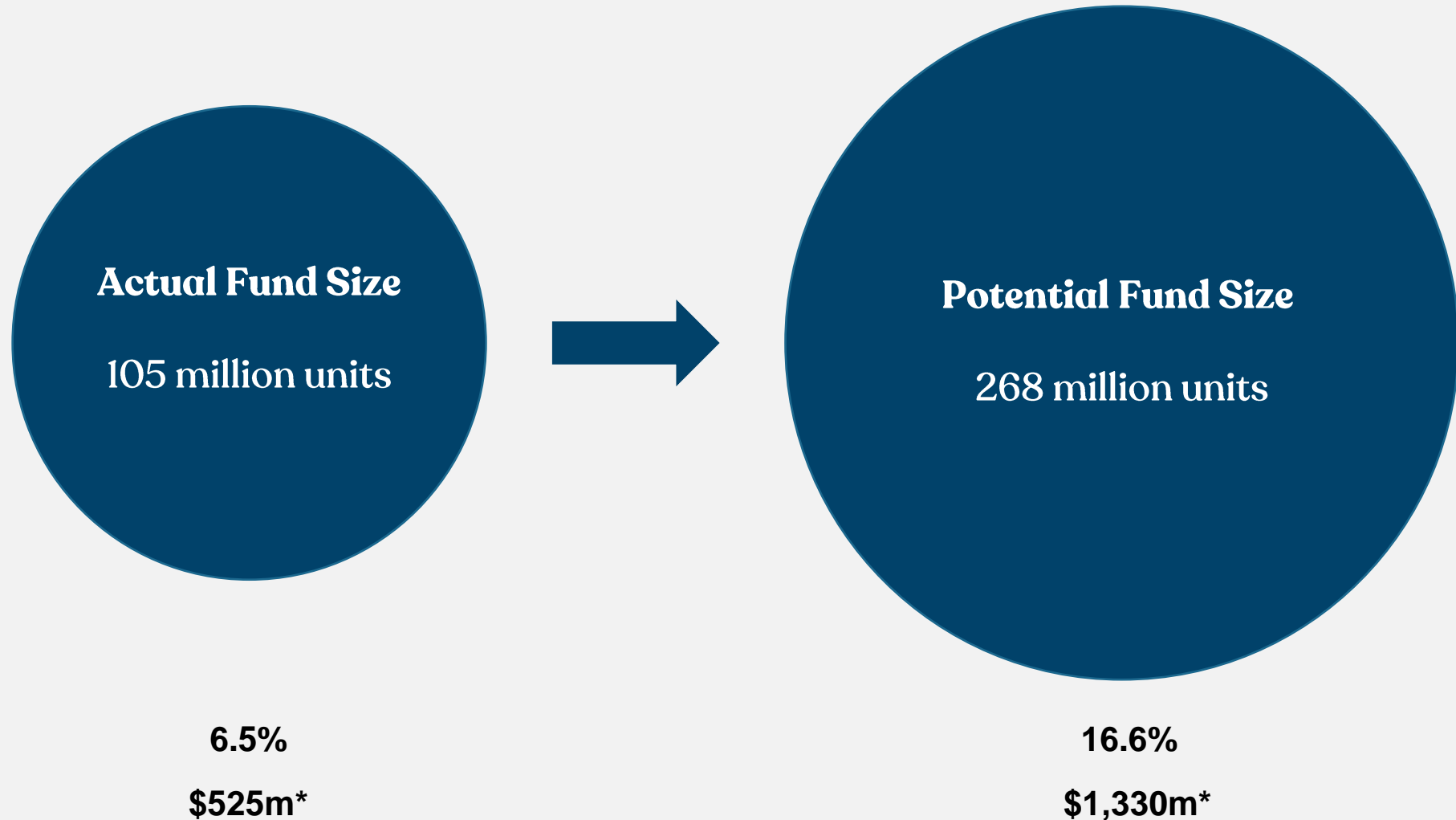
Further Consultation



Proceed with Preferred Option

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

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



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



# What we'll cover today



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

**2.**  
**Our Options**

**3.**  
**Alternate  
Capital  
Structures and  
Considerations**



**1.**  
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# Our Strategy



CONSUMER & MARKET TRENDS

SUSTAINABLE VALUE

CORE DAIRY

FOOD SERVICE

PAEDIATRICS

SPORTS & ACTIVE

MEDICAL & AGEING

Prioritising New Zealand milk



The Co-operative Difference

## Innovation

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

## Efficiency

Unlock greater value from our scale efficiency and focus on execution

## Sustainability

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

# Recap of changes made in 2019 strategy refresh



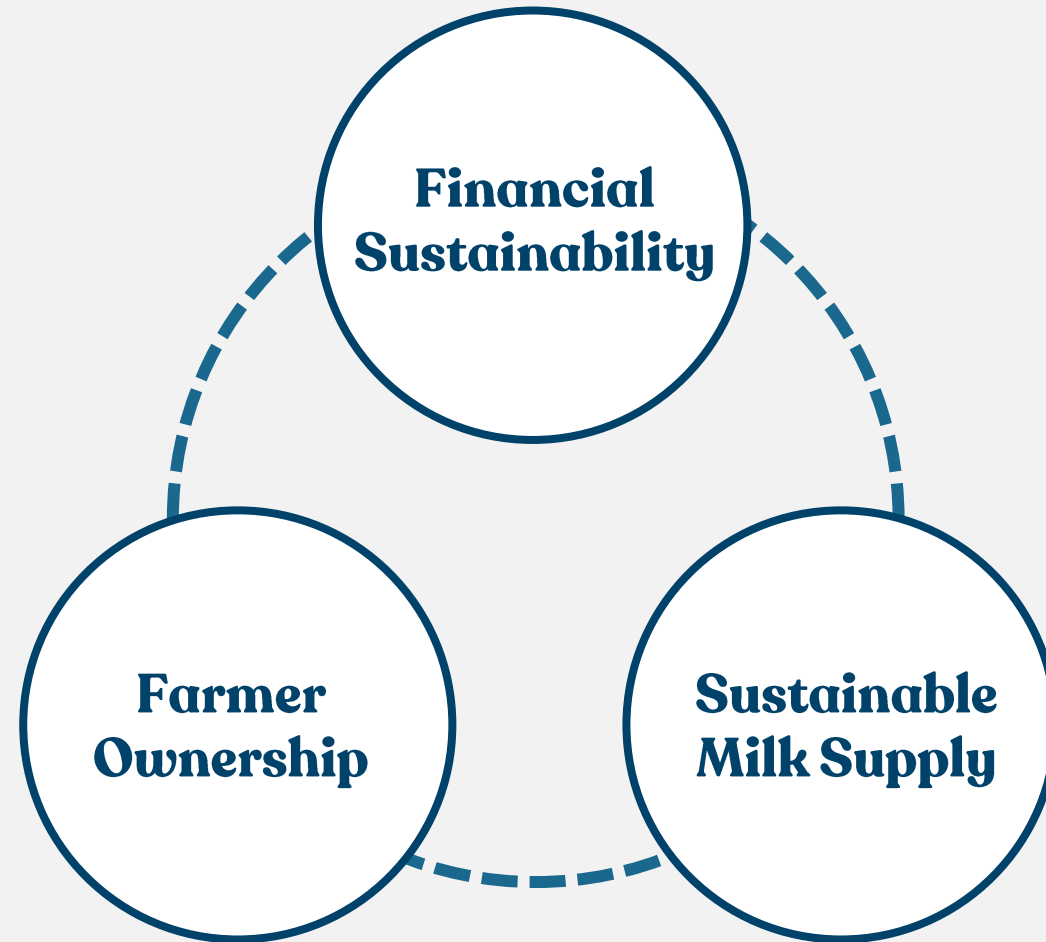
## From

## To

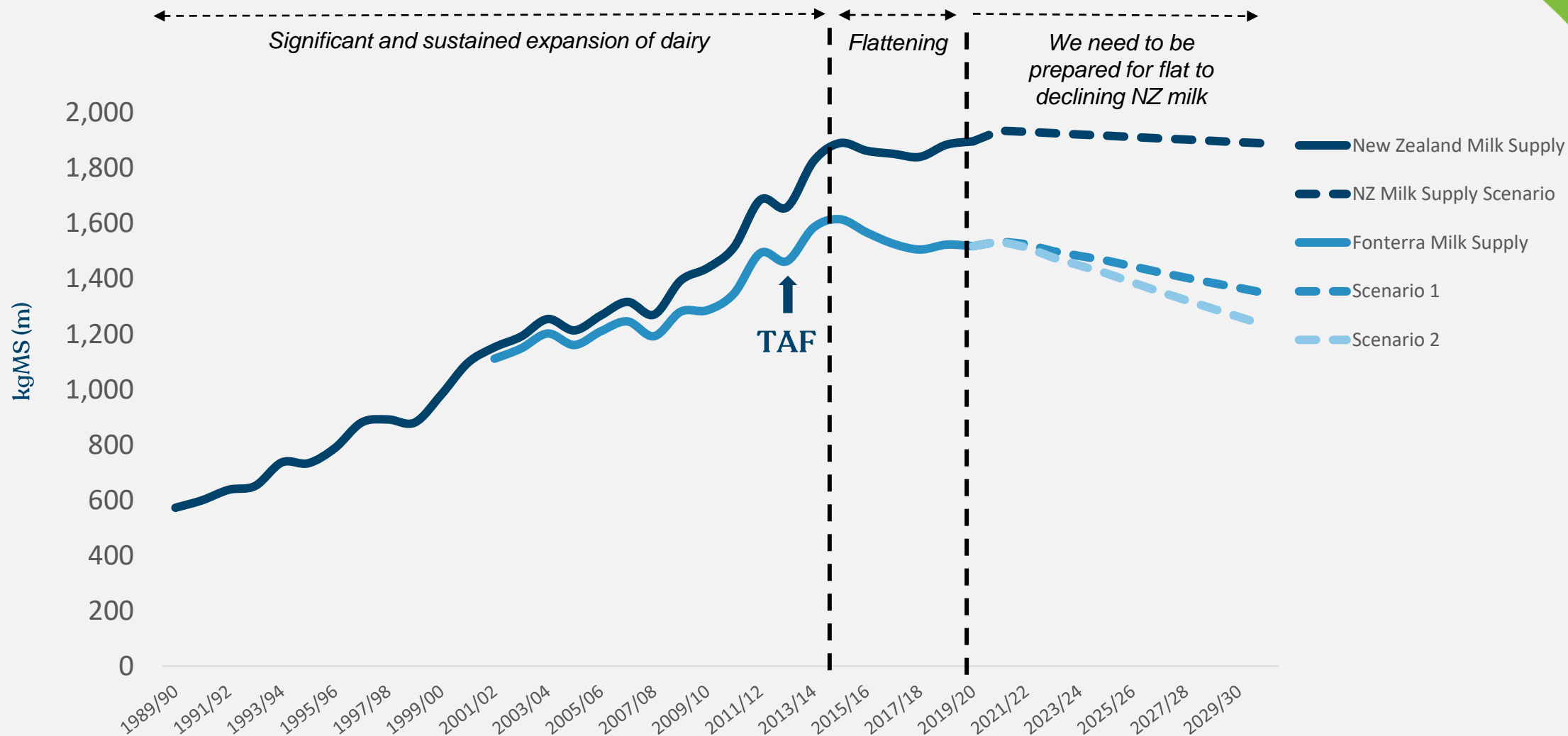
Volume	➡	Value
Global Milk Pools	➡	Prioritise New Zealand Milk + complementary components
Maximum volume into consumer	➡	Focus on key categories to deliver superior value
Dairy only	➡	Supplement with non-dairy where makes sense
Partner with cash investments	➡	Partner with IP and skills and lift R&D
Debt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



# These three factors are fundamental to our long-term success



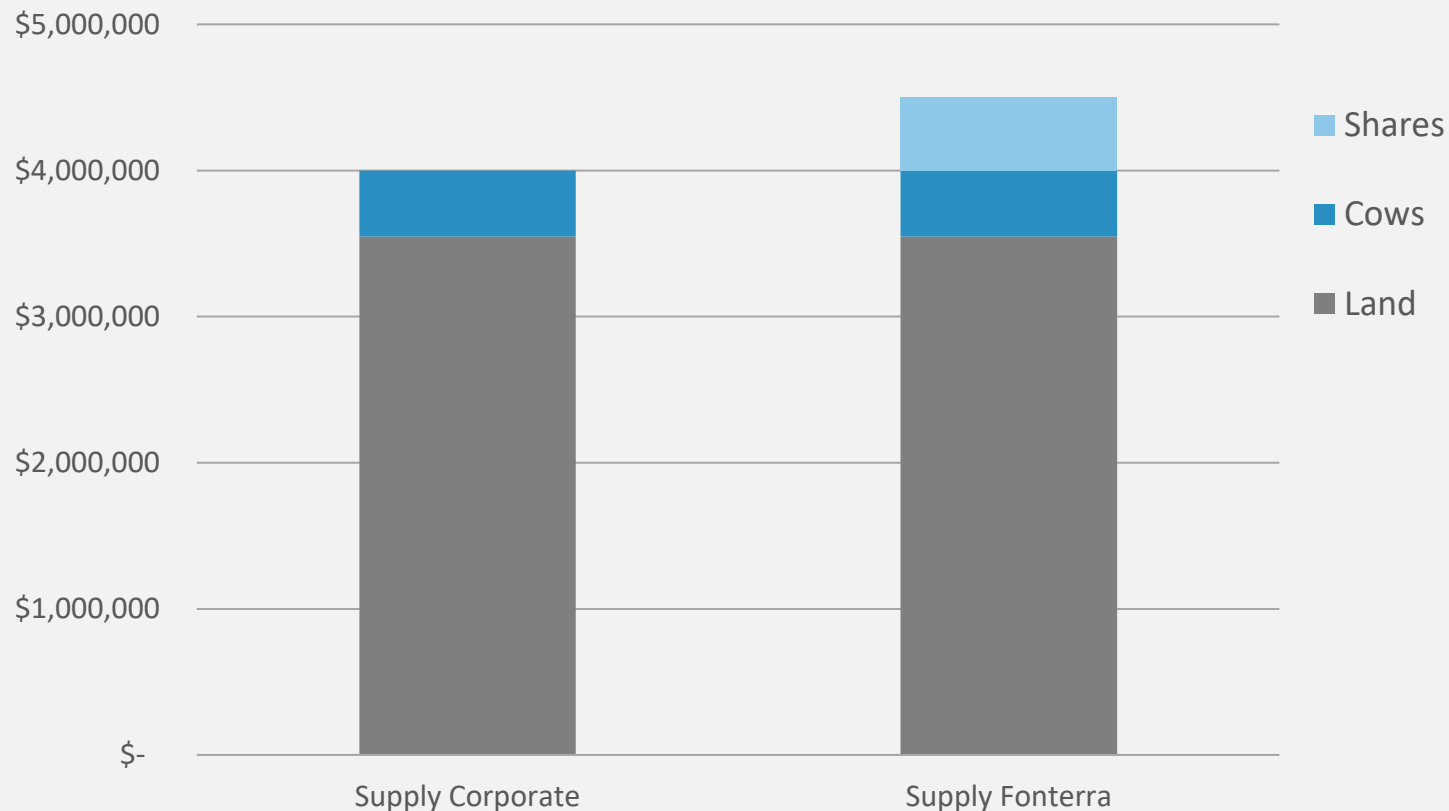
# We need to be prepared for flat to declining NZ milk



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



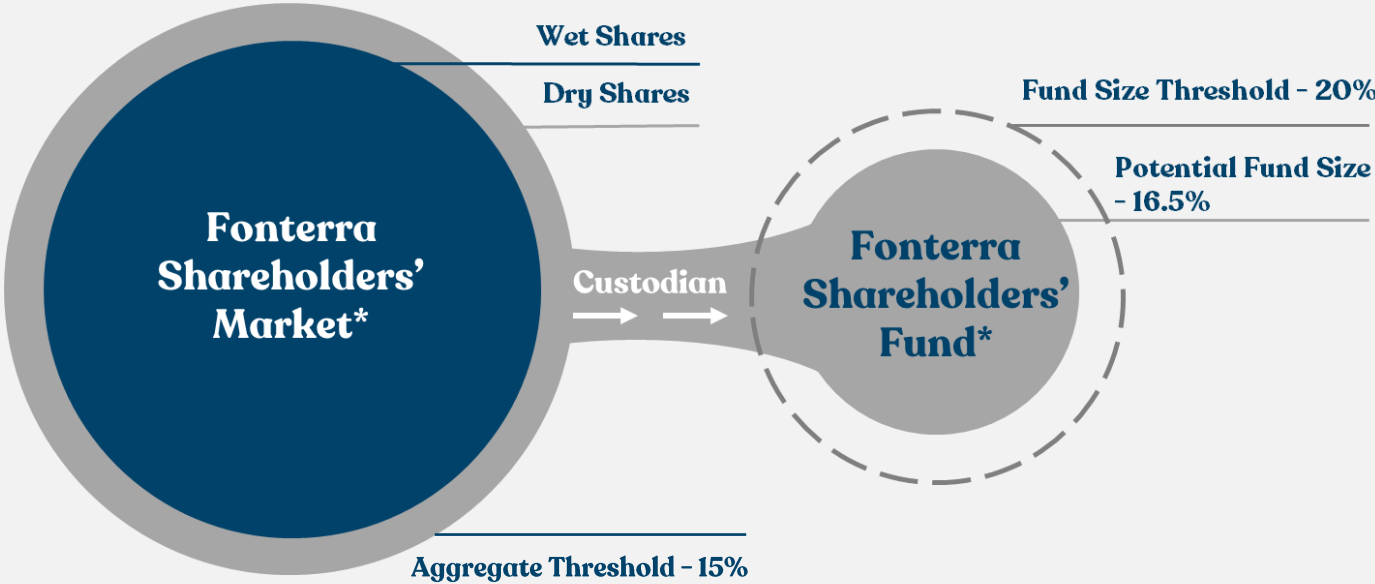
Amount Invested for a 100,000 kgMS Farmer





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

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

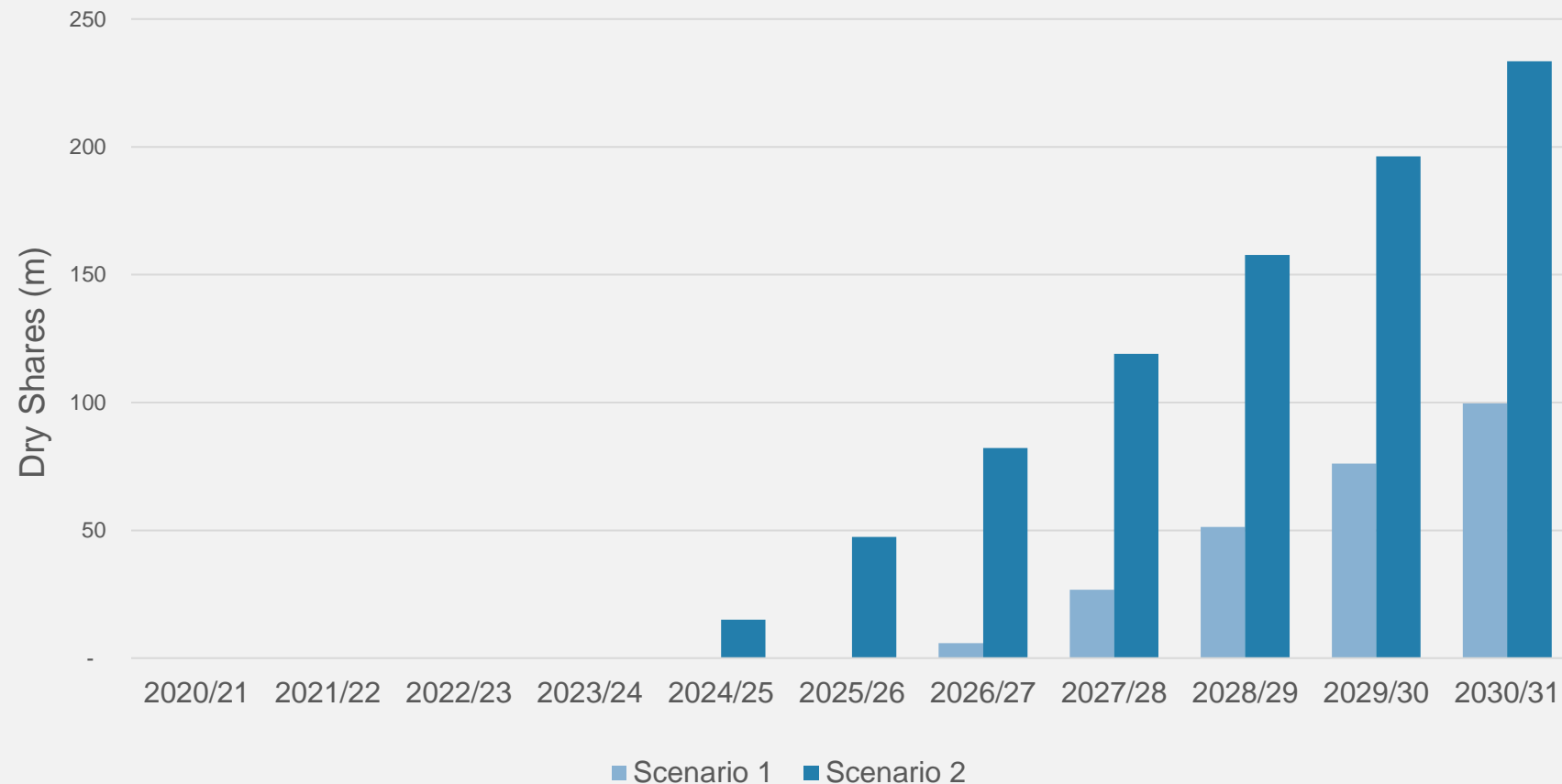


\*Not to scale

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



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





**1.**

**Our Context  
and Co-op  
Fundamentals**

**2.**

**Our Options**

**3.**

**Alternate  
Capital  
Structures and  
Considerations**

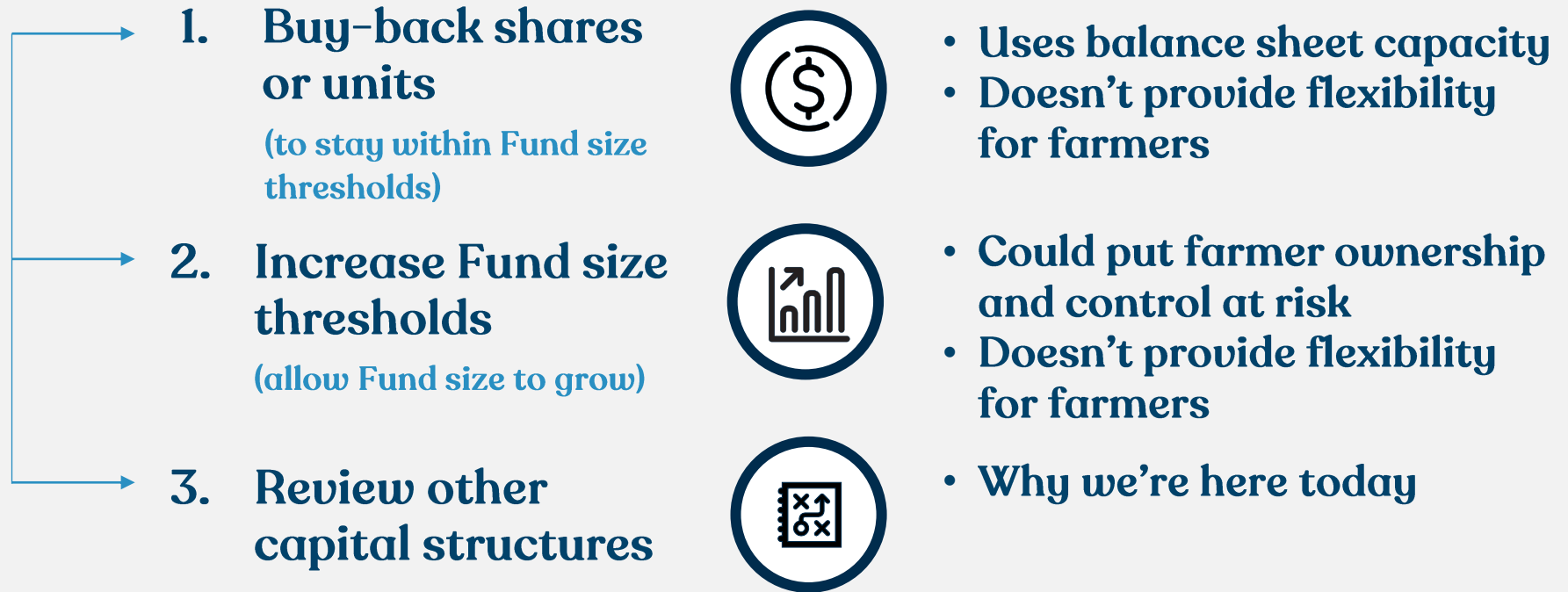


# We have three possible paths to address this

Milk declines



Fund exceeds thresholds for farmer ownership





1.

**Our Context  
and Co-op  
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2.

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3.

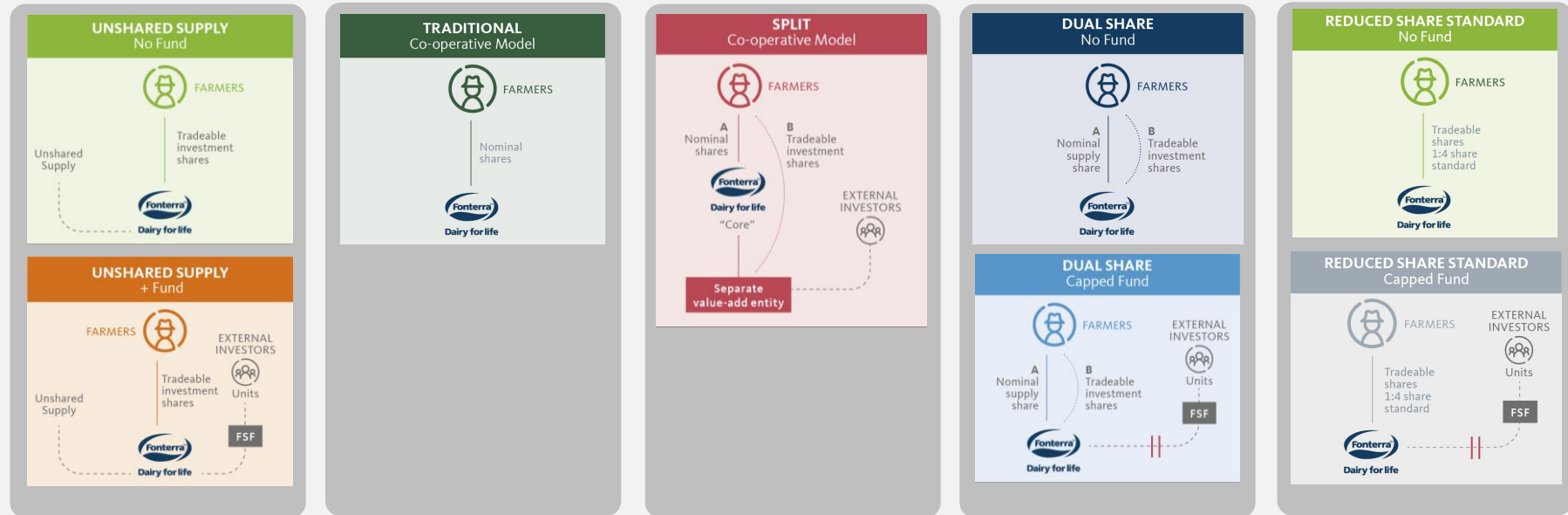
**Alternate  
Capital  
Structures and  
Considerations**

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



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

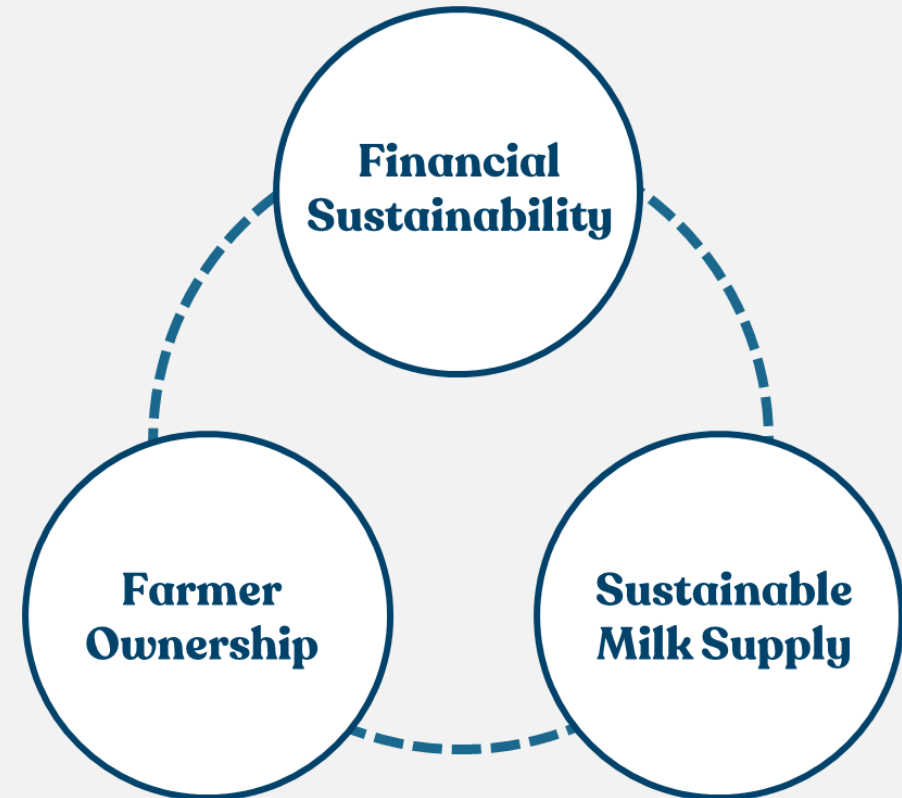
# We have reviewed many different capital structure options



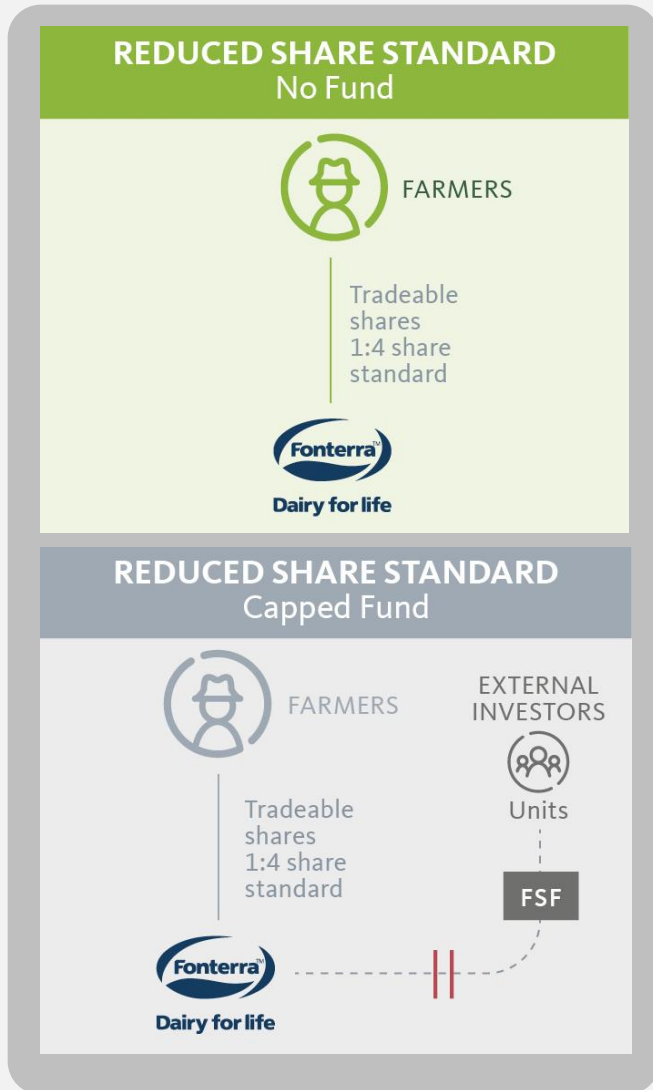
<b>Farmer Ownership</b>	✗	✓	✗	✓	✓
<b>Sustainable Milk Supply</b>	✓	✓	✓	✓	✓
<b>Financial Sustainability</b>	✗	✗	✓	✗	✓

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

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



# How it could work



## From

Limited flexibility

1:1 minimum share standard

Maximum share ownership 2x supply

Share/Unit exchangeability

Share price set in public and farmer markets

1 vote per 1000 kgMS supplied backed by shares

## To

Increased flexibility

1:4 minimum share standard

Maximum share ownership 4x supply

Capped Fund or No Fund

Share price set in farmer-only market

1 vote per 1000 kgMS supplied backed by shares



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

## Public Market

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

## Farmer-only Market

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

# Capped Fund versus No Fund



## Capped Fund

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Fund size is permanently capped

---

No offer is made to buy back the Fund

---

No unit holder vote required

---

No capital allocation required

---

FSF and FSM both operate but independently

---

Shares and units could trade at different prices

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## No Fund

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Fund is removed

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An offer is made to buy back the Fund

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

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Capital is allocated to buy back the Fund

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Only FSM operates

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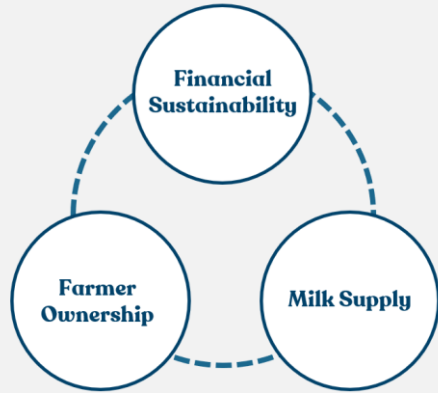
Share price only in the farmer-only market

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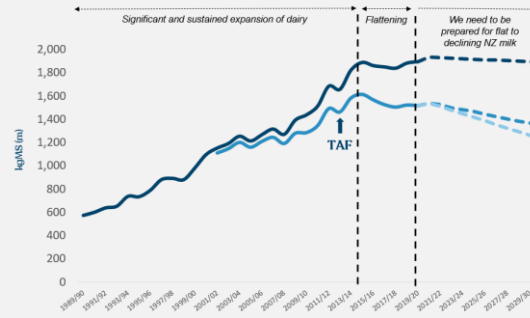
# Recap



## Our fundamentals



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



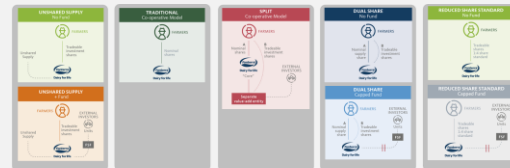
## We have choices to make

Milk declines

Fund exceeds thresholds for farmer ownership

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

## All options have trade offs



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

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



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

# Have your say



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# Discussion.



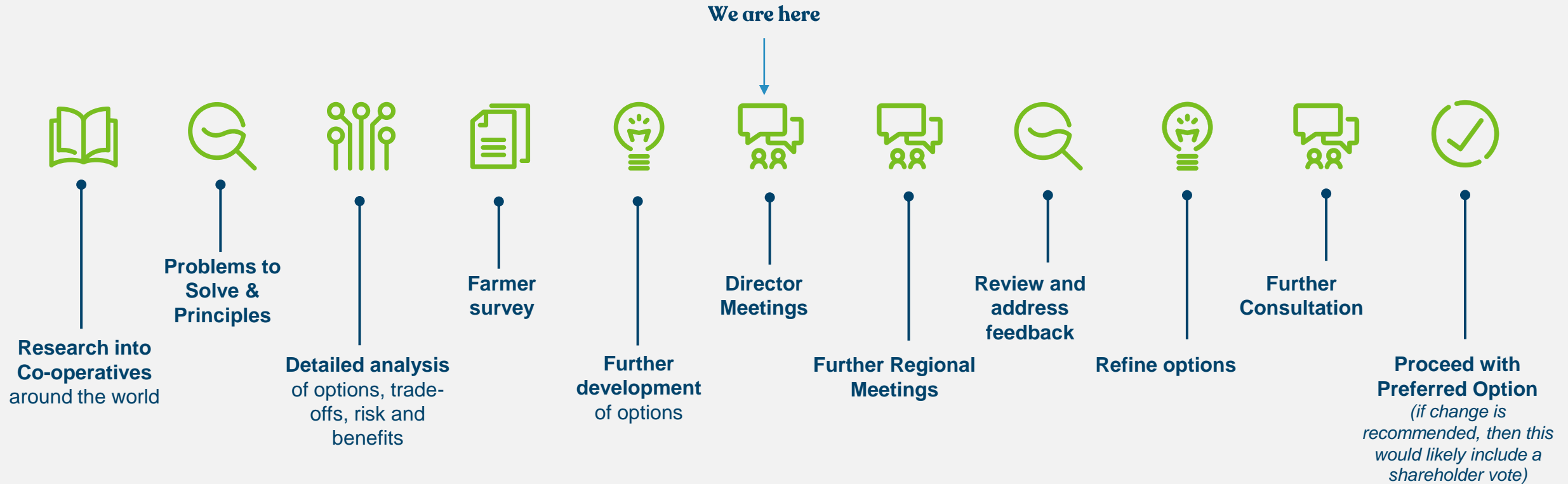


**Thank You.**

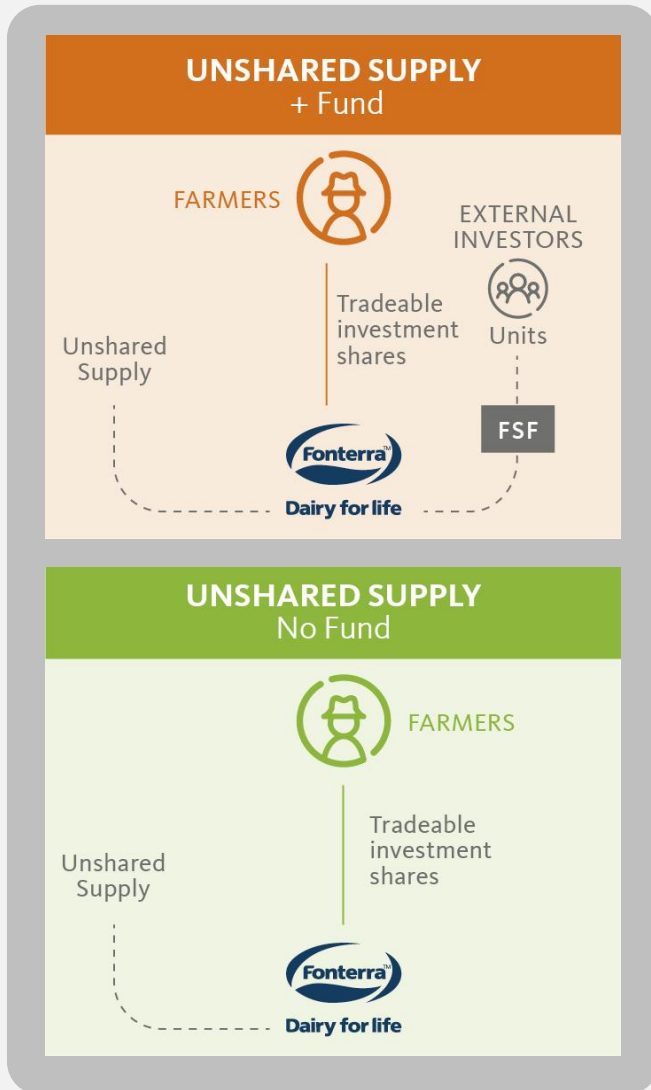
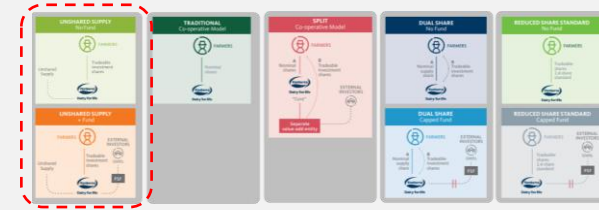


# Appendix

# The stages of the review



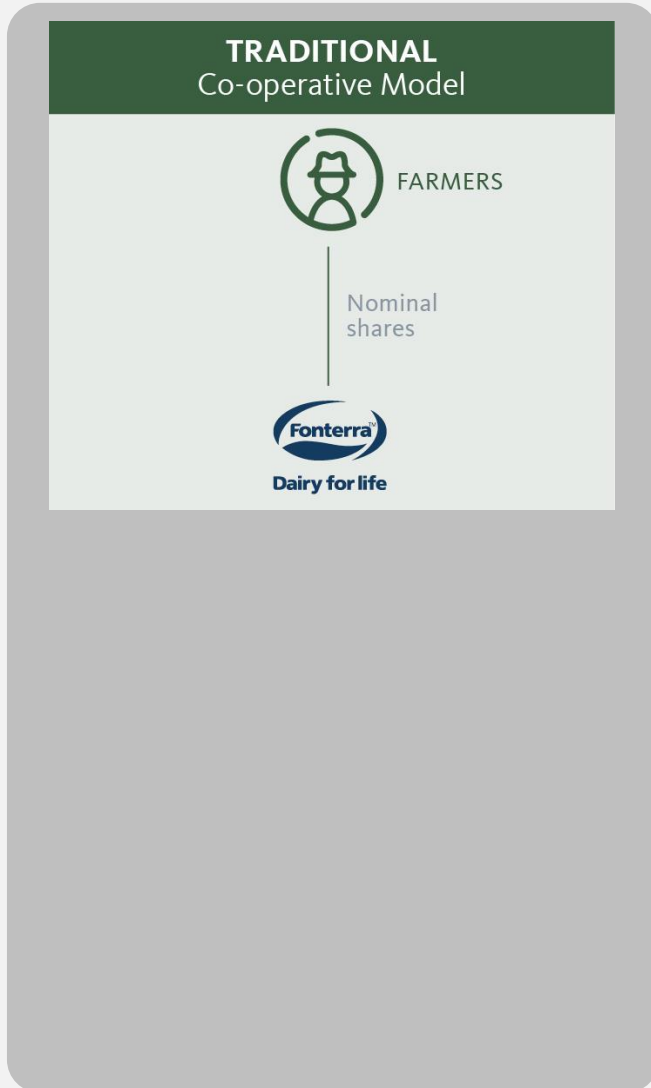
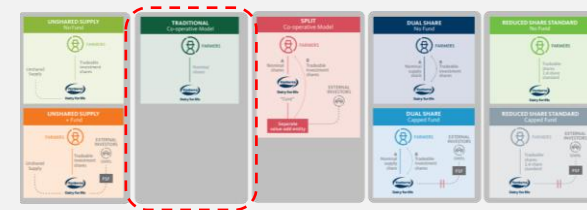
# Unshared Supply



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

<b>Farmer Ownership</b>	✗
<b>Sustainable Milk Supply</b>	✓
<b>Financial Sustainability</b>	✗

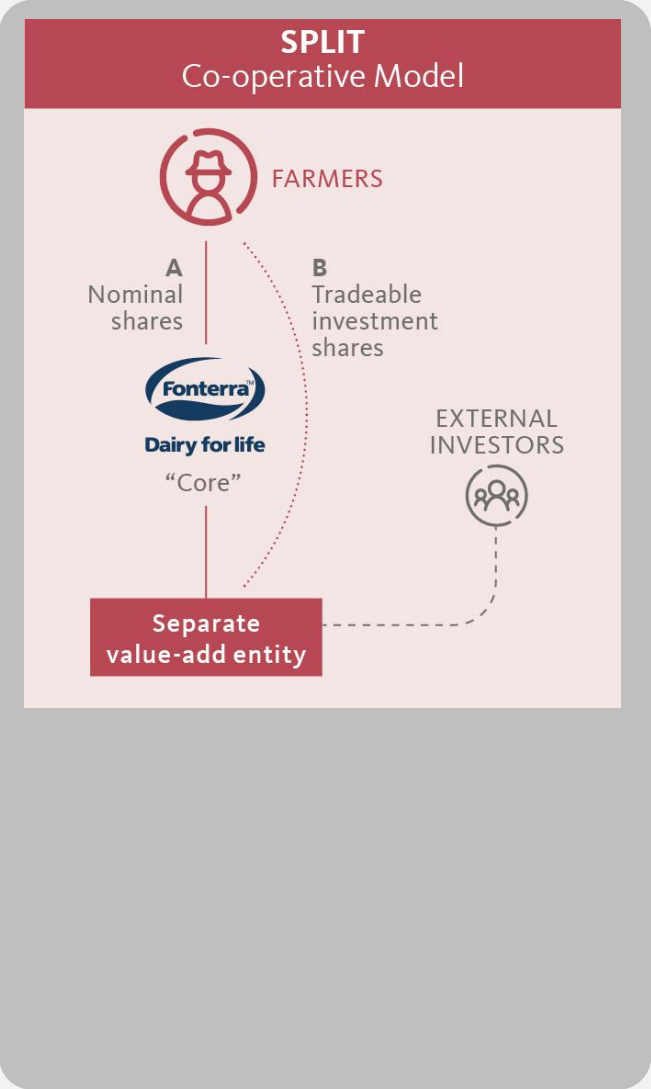
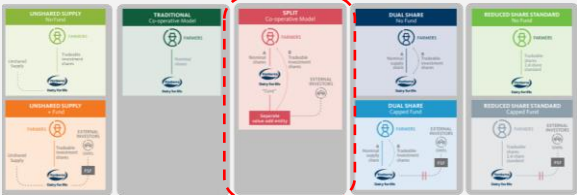
# Traditional Co-op



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

<b>Farmer Ownership</b>	✓
<b>Sustainable Milk Supply</b>	✓
<b>Financial Sustainability</b>	✗

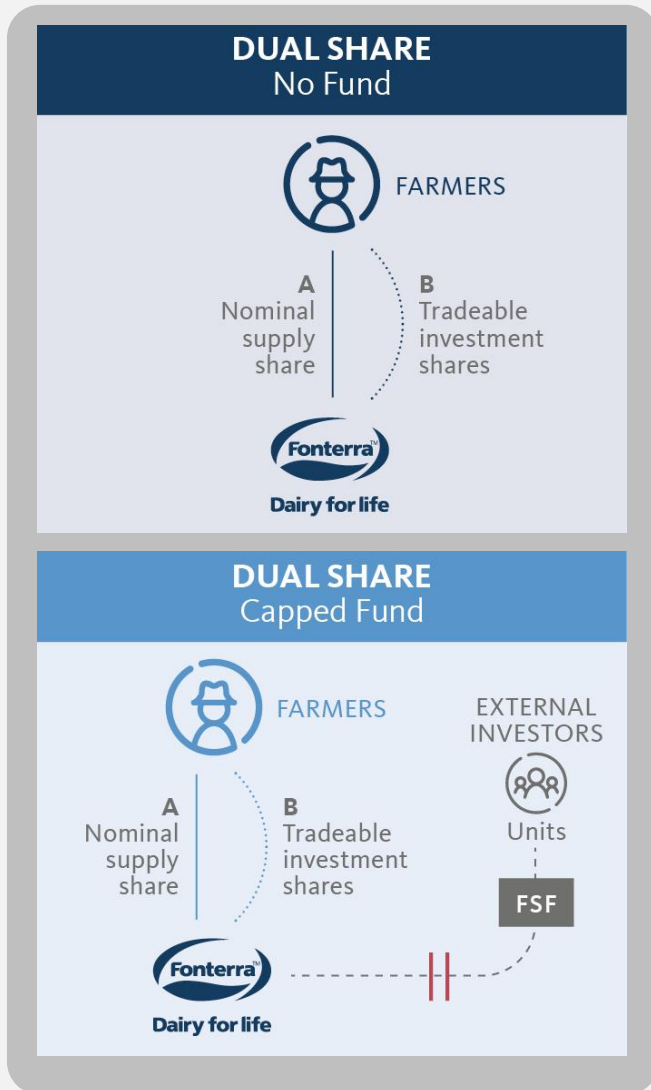
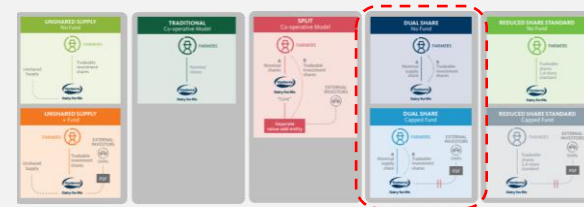
# Split Co-op



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

<b>Farmer Ownership</b>	✗
<b>Sustainable Milk Supply</b>	✓
<b>Financial Sustainability</b>	✓

# Dual Share

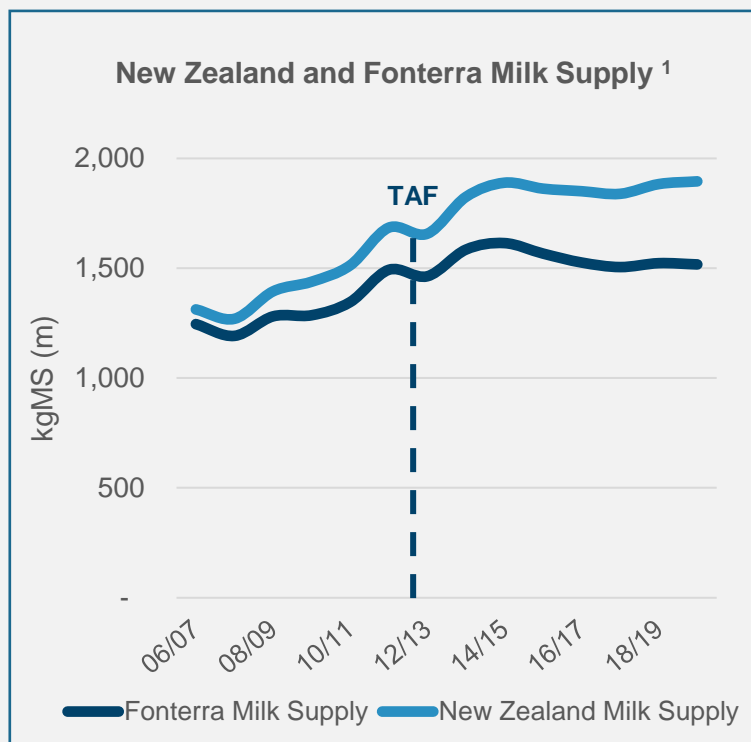


- Move to two classes of shares
- Nominal “A” supply share
- Optional “B” investment share
- Discretionary dividends paid on both A and B-shares. Dividend on supply shares capped at a level that reflects the risk on those supply shares. Any surplus dividend would be paid on the investment shares only.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

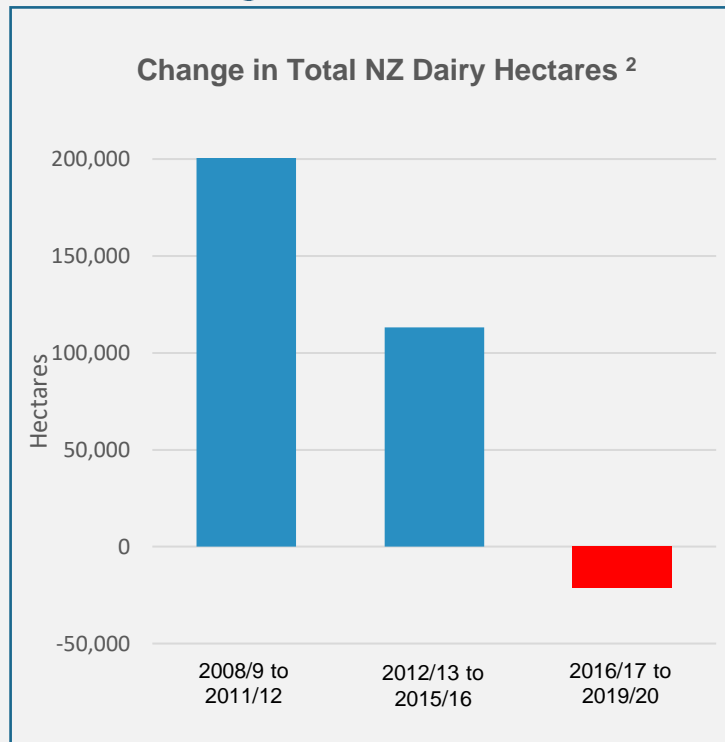
<b>Farmer Ownership</b>	✓
<b>Sustainable Milk Supply</b>	✓
<b>Financial Sustainability</b>	✗

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

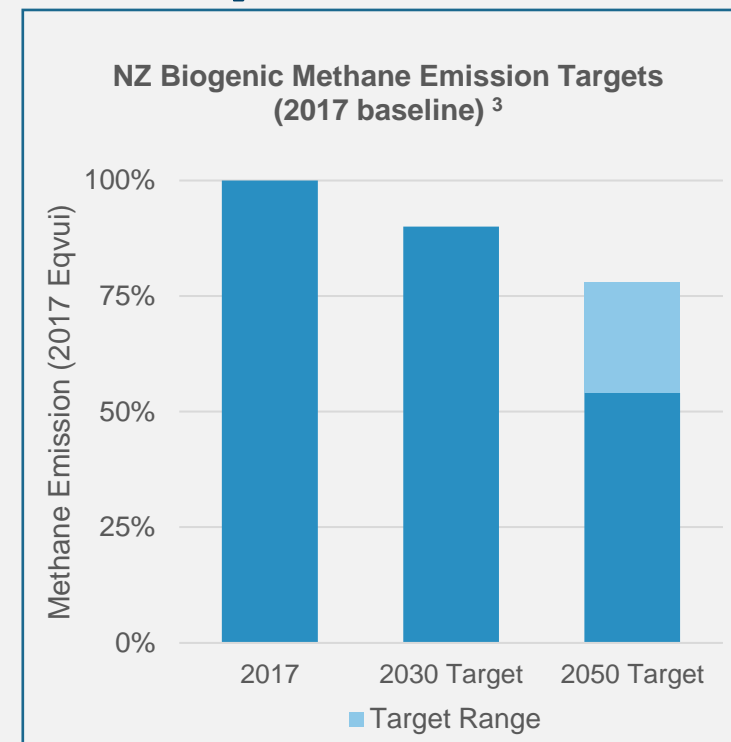
## New Zealand milk growth has flattened



## Fewer conversions and more land moving to alternative uses



## Environmental limits are likely impact milk volumes



Source: 1) Dairy NZ – New Zealand Dairy Statistics 2019-20, Summary of milk production statistics for the last 35 seasons

2) Dairy NZ – New Zealand Dairy Statistics 2019-20, Summary of herd statistics since 1975/76

3) Dairy NZ - DairyNZ's position on the Zero Carbon Bill

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

