INTERIM
REPORT 2018

INTERIM REPORT 2018
FONTERRA CO-OPERATIVE GROUP LIMITED

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Fonterra uses several non-GAAP measures when discussing financial performance. These measures include normalised segment earnings, normalised EBIT, EBIT, normalisation adjustments, normalised earnings per share, normalised NPAT and payout. These are non-GAAP financial measures and are not defined by NZ IFRS. Management believes that these measures provide useful information as they provide valuable insight on the underlying performance of the business. They are used internally to evaluate the underlying performance of business units and to analyse trends. These measures are not uniformly defined or utilised by all companies. Accordingly, these measures may not be comparable with similarly titled measures used by other companies. Non-GAAP financial measures should not be viewed in isolation nor considered as a substitute for measures reported in accordance with NZ IFRS. These non-GAAP measures are not subject to audit. Please refer to page 48 for the reconciliation of the NZ IFRS measures to the non-GAAP measures and page 49 for definitions of the non-GAAP measures used by Fonterra.

OUR CO-OPERATIVE

We have a unique strength coming from being a vertically integrated supply chain of scale – connecting high quality milk from pasture fed cows to customers around the world.

FARM SOURCE™ REWARDS DOLLARS EARNED THIS YEAR

FS$7M

NUMBER OF FARMERS WHO HAVE EARNED FARM SOURCE™ REWARDS DOLLARS THIS YEAR

8,200

$6.55 **FORECAST FARMGATE MILK PRICE**

10CPS **INTERIM DIVIDEND PER SHARE**

1,480M KGMS **2017/2018 NEW ZEALAND MILK COLLECTION FORECAST**

OUR POTENTIAL

We focused on shifting more of our farmers' milk into higher value products. We remain on-track to deliver an additional 400 million LME to our Consumer and Foodservice business this year.

OUR PERFORMANCE

We delivered a strong Ingredients performance and continued to make progress in moving milk up the value chain, with volume growth across a number of Consumer and Foodservice markets.

GOAL FOR LITRES OF MILK PROCESSED BY 2025

30B

EXPECTED INCREASE IN DEMAND FOR FOOD BY 2050

50%

INGREDIENTS NORMALISED EBIT

$558M

CONSUMER AND FOODSERVICE NORMALISED EBIT

$193M

We've introduced new financial tools to help our farmers become fully shared up.

$458M

GROUP NORMALISED EBIT (NZD)

Our Global Foodservice business topped $2 billion in revenue last year, making it the sixth biggest exporter.

$248M

NORMALISED NPAT (NZD)

We've set up a new medical nutrition and 'healthy ageing' division and launched a fast-acting milk protein.

($348M)

NET LOSS AFTER TAX (NZD)

CHAIRMAN AND CHIEF EXECUTIVE OFFICER'S LETTER

In what has been a challenging year to date for conditions on-farm, it's pleasing to be able to increase our forecast Farmgate Milk Price for the 2017/18 season to $6.55 per kgMS and announce an interim dividend of 10 cents.

FARMERS WILL WELCOME WHAT IS THE THIRD HIGHEST FORECAST AVAILABLE FOR PAYOUT IN THE LAST DECADE, BUT THE CO-OPERATIVE IS ACUTELY AWARE OF THE CHALLENGES MANY OF OUR FARMERS HAVE FACED THIS SEASON WITH DIFFICULT WEATHER CONDITIONS IMPACTING MILK PRODUCTION AND THEREFORE FARM REVENUE.

The Board will decide how the Beingmate impairment and the Danone payment will be treated for final dividend purposes after the end of the financial year when it will have the full picture of its operating performance. Given the possible impact of these decisions, the Board is providing a forecast dividend range for the full-year of 25–35 cents per share.

Based on our dividend policy, this forecast dividend range would allow for the full impact of the Danone payment, at the low end, through to an adjustment for both the Beingmate impairment and the Danone payment as one-off events at the higher end.

In the circumstances, we have taken a prudent approach in determining the 10 cent interim dividend.

We continue to offer a dividend reinvestment plan at a discount of 2.5 per cent to the strike price. Eligible shareholders who wish to participate in the plan for the interim dividend need to submit a notice of participation by 6 April 2018.

As indicated in December, the decision in our arbitration with Danone resulted in a downward revision of our earnings guidance of 10 cents to 35-45 cents per share.

We remain disappointed that the arbitration tribunal did not fully recognise the terms of our supply agreement with Danone, including the agreed limitations of liability, which was the basis on which we had agreed to do business.

In this period, we have reported $232 million related to the Danone arbitration, which represent the recall costs awarded to Danone and interest, and other costs associated with the arbitration. This brings the arbitration proceedings to a close.

The Co-operative has also re-assessed the value of our Beingmate investment so that it reflects a fair value at this point in time.

We have assessed the carrying value of Beingmate at $244 million which is the fair value of the investment, less the costs to sell the asset.

Shareholders will be rightfully frustrated with this outcome.

While Fonterra appreciates the substantial opportunity to build a significant business in China, Beingmate's continued poor performance is unacceptable. The urgent recovery of the investment is a key priority for the senior management team and the Board.

The opportunity in the Chinese infant formula market remains – as does the potential for our Beingmate partnership – but an immediate business transformation is needed in order for Beingmate to benefit from the market opportunities.

THE GLOBAL SUPPLY AND DEMAND PICTURE REMAINS IN BALANCE

Our farmers have endured tough farming conditions across much of the country. A cold, wet spring followed by low rainfall in early summer and then unusually high summer temperatures resulted in milk collection across New Zealand declining. Our full-year forecast New Zealand milk collection has been revised to 1,480 million kgMS, down three per cent compared to last season's actual total collection of 1,526 million kgMS.

USEFUL FACT

Global demand for dairy nutrition remains strong, and we're seeing positive growth in China, Asia and Latin America.

Continuing strong global demand for dairy is being led by China – where imports are up 13 per cent over the last 12 months – and is strongly supported by growth in Asia and Latin America. However, we are mindful of the potential impact of strong spring production in Europe on market sentiment.

Fundamentally, the market is balanced and we would expect prices to stay at current levels.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER'S LETTER

ANCHOR™ IN SRI LANKA

Our farmer shareholders Ross and Shayney Wallis visited Sri Lanka where 1.3 billion glasses of Anchor™ milk are consumed each year.

FINANCIAL PERFORMANCE

While the overall improvement in the Farmgate Milk Price compared to last year is good news for farmers, it does increase the pressure on our margins across the business.

Our low starting inventory levels, which were then followed by reduced New Zealand milk collections due to the difficult weather conditions, impacted our overall sales volume in the first half.

In the context of these two key challenges, our half-year operating performance is in line with expectations.

Ongoing financial discipline has enabled the Co-operative to maintain a strong balance sheet and manage the impact of the Danone arbitration decision and Beingmate impairment.

Our debt and gearing levels are both traditionally higher at the end of the first six months of the year, reflecting the seasonal profile of our business. As at 31 January 2018, debt was $7.1 billion – better than expected but $945 million higher than the comparable period last year. This is due in part to lower earnings, the impact of the Danone arbitration, and the timing of capital expenditure – particularly the expansion of Clandeboye with a new mozzarella plant, and a new cream cheese plant build at our Darfield site.

As a result, our gearing ratio at the half-year has increased to 51.6 per cent. We remain committed to our end of year gearing range target of 40 - 45 per cent.

Normalised operating costs were up three per cent for the six months to 31 January 2018, after two years of declining costs. This is a result of increased research and development spending to support new product development, digital platforms and technology opportunities.

INGREDIENTS BUSINESS

Our Ingredients business delivered a strong result, with revenue up $678 million, or nine per cent, and normalised EBIT also up nine per cent at $558 million.

The increase in normalised EBIT is reflective of higher margins, improvements in optimisation of our overall product mix and increased demand in our business in Australia.

The result benefited from higher stream returns in the first half compared to the same period last year. This enabled the overall New Zealand Ingredients gross margin, including both reference and non-reference products, to increase by 14 per cent to $734 million.

While revenue and gross margin per metric tonne for reference and non-reference products both increased, the relative increase in the milk price cost was greater for reference products, such as butter, due to the significant increase in fat prices. Stream returns on non-reference products were $90 million, $50 million ahead of the same period last year.

MOZZARELLA

Mozzarella is one of Fonterra's most profitable products.

CONSUMER AND FOODSERVICE

Our strategy emphasises making the most of our farmers' milk by shifting more volume into higher value products at velocity. Our high-value Consumer and Foodservice business delivered revenue of $3.5 billion for the six months to 31 January 2018, an increase of seven per cent.

Overall, normalised EBIT decreased 38 per cent to $193 million due to pressure on our margins in this business. It's important to note that this result is compared to an exceptional $313 million last year when the first half-year input costs were considerably lower.

Higher input costs over the first half of this year meant margins were reduced by 15 per cent. Strong competition in the Co-operative's strategic markets, especially in Foodservice, limited our options to pass through the higher input costs.

Consumer and Foodservice volumes were two per cent lower. Our sales volumes in the key markets of Asia, Latin America, and Greater China improved but this was offset by lower volumes in Oceania.

Oceania volumes were primarily affected by operational start up challenges at our new distribution centre in New Zealand which have now been resolved.

CREATING VALUE IN CHINA

While our Beingmate investment has underperformed, which we are very concerned about, our integrated business in China is delivering positive results for our Co-operative. We expect this high growth in China to continue.

In our first half, China volumes accounted for 2.2 billion LME of our total 9.8 billion LME in Ingredients, with around 80 per cent of this milk sourced in New Zealand.

In our Consumer and Foodservice business, China volumes accounted for 600 million LME of the total 2.7 billion LME over the first half, with Consumer and Foodservice in Greater China achieving normalised EBIT of $92 million on volume growth of three per cent.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER'S LETTER

INFANT MILK FORMULA

The China Infant Milk Formula market is growing at five per cent, with total value sales projected to grow from RMB84 billion to RMB100 billion (NZD18 billion to NZD22 billion) by 2020.

BEINGMATE

As a result of Beingmate's continued poor performance, its share price has deteriorated to a level where it is necessary for the Co-operative to reassess the value of its investment.

We have determined a fair value of $244 million using an estimate of what someone would pay for a similar long-term equity stake in Beingmate today. In this instance, we have used Beingmate's base share price. We have therefore taken an impairment of $405 million.

Clearly this outcome is unacceptable to our shareholders. The recovery of the value of this investment is the number one immediate priority for the Chief Executive and the senior management team.

As an 18.8 per cent shareholder, we do not have direct control over the company but we are working to influence its direction and continue to call for an urgent business transformation through our relationship with Beingmate's founder and majority shareholder.

The Board has a working group – that includes Independent Directors Simon Israel and Clinton Dines, who both have significant China experience and expertise – to provide guidance and oversight to management as they work to recover the investment.

CHINA FARMS

China Farms continued to lift efficiencies as our milk production increases. Operating costs per litre of milk are down six per cent over the reporting period. Our normalised EBIT has improved to a $12 million loss, compared to a $24 million loss in the same period last year.

Our China Farms result is buoyed by an internal raw milk price between China Farms and our Ingredients business which is currently higher than the unsustainably low domestic milk price.

The future of our investment in these farms is promising. Chinese demand for high-quality local fresh milk continues to grow and our recent partnerships with Alibaba and Starbucks in China have us well placed to maximise this opportunity.

In February this year, we launched a new 'Daily Fresh' milk range through Alibaba's Hema Fresh stores in Shanghai and Suzhou and volumes are growing rapidly. Sourced directly from the Co-operative's farm hub in Hebei province, the bottles of fresh milk capitalise on the continued shift in China's consumer market to premium products.

FONTERRA MILK FOR SCHOOLS
Fonterra Milk for Schools celebrated its fifth anniversary this year.

FONTERRA AUSTRALIA

In Australia, we continue to grow our market share, with milk supply increasing by 400 million litres to two billion litres since last season. We are now Australia's leading dairy processor in a competitive market and are taking advantage of good demand growth prospects especially in cheese, whey and nutritionals.

To meet growing consumer demand, we are focusing our annual capital expenditure on key sites in Victoria and Tasmania – most notably an expansion of Fonterra Australia's flagship Stanhope cheese facility in northern Victoria, almost doubling the size of the cheese plant.

Long term, we expect competition for milk volumes to increase. In preparation, our Australian business is working to improve our connection to local suppliers, beyond just the local milk price. This includes the recent launch of a tailored version of our Farm Source™ services and rewards programme, and continued discussions on the potential for developing an ownership model in Australia.

OUTLOOK

We expect our earnings to be weighted toward the second half of the year and that is reflected in our forecast earnings per share, which is in our target dividend range of 25 to 35 cents, giving a total forecast available for payout to our farmers of $6.80 to $6.90.

Despite more favourable weather conditions recently, we still expect our New Zealand milk volumes to be down for the year and will be managing our inventory and product mix carefully for the remainder of the season to ensure we maximise the overall value of our farmers' milk.

A strong commitment to our strategy of shifting more volume into higher value products at velocity is critical to the business achieving its forecast. We will continue to put as much milk as possible into higher value products, particularly into our Advanced Ingredients business, and Consumer and Foodservice business where we are still targeting an additional 400 million LME of volume this year.

Our management team is working hard to recover the impact of the Danone and Beingmate events, the latter being the primary focus for the senior management team and the Board.

Our Co-operative remains focused on providing high quality dairy nutrition to customers around the world and delivering sustainable value for our farmers – that's a sustainable Farmgate Milk Price, dividend, and return on their investment in the Co-op.

John Wilson
Chairman

Theo Spierings
Chief Executive Officer

A STRONG CO-OP **DOING WHAT'S RIGHT**

With weather extremes affecting production this season, it was as important as ever that we used the collective strength of our Co-operative to support our farmers, giving them services and advice.

$17.8M

FARM SOURCE™ REWARDS

In the last financial year, our farmers earned $17.8 million worth of Farm Source™ Rewards Dollars.

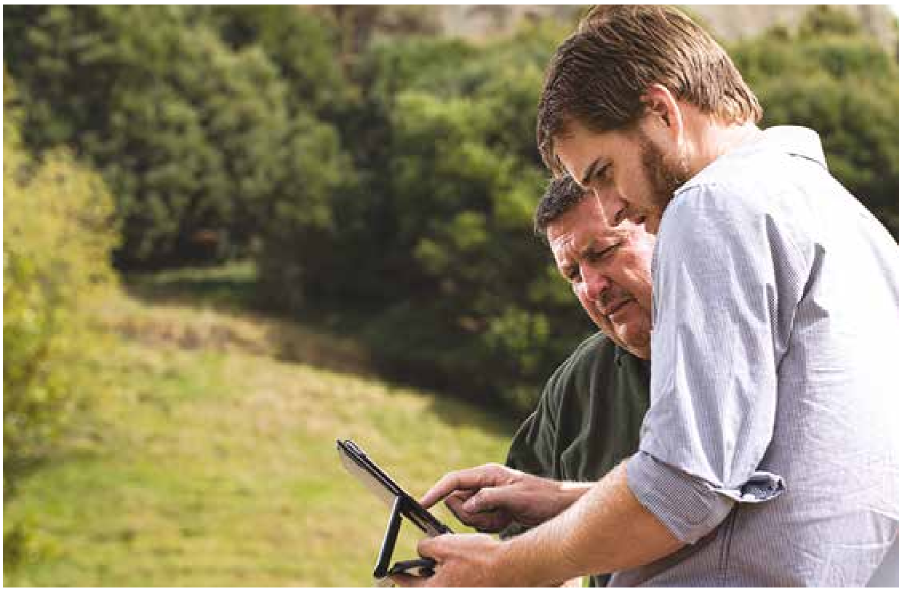
WE DEVELOPED NEW FLEXIBLE FINANCIAL TOOLS, INTRODUCED MY CONNECT WEBINARS TO UPDATE FARMERS ON IMPORTANT ISSUES, MAINTAINED OUR COMPETITIVE FARM SOURCE™ OFFERING FOR FARM SUPPLIES AND LOOKED AT NEW WAYS FOR OUR CO-OPERATIVE TO BUILD DEEPER CONNECTIONS WITH THE FARMERS WHO SUPPLY US IN AUSTRALIA AND LATIN AMERICA.

With the environment high on the national agenda, we demonstrated the significant progress our farmers and their Co-operative have already made, as well as making further sustainability commitments relating to water quality, emissions and on-farm best practice. We published our first stand-alone sustainability report, an independently audited report looking at our commitments and progress right across the global supply chain.

FARMING WITH FARM SOURCE™

Across a challenging half year for conditions on-farm, we have supported farmers by using our collective buying power for farm supplies through our Farm Source™ stores and by offering competitive terms.

We know that if farmers buy their supplies exclusively from us, we can make a real difference, with the average sized Fonterra farm saving approximately 10 cents per kgMS. As well as lowering the cost of farm supplies, we continue to reward farmers with Farm Source™ Rewards Dollars. In the year to date, 8,200 farmers have collectively earned almost seven million Farm Source™ Rewards Dollars, bringing the total number of Farm Source™ Rewards Dollars earned by farmers since inception to more than 40 million.



TIAKI SUSTAINABLE DAIRYING

This programme supports farmers in staying ahead of regulatory requirements and satisfying evolving consumer and market expectations.

FLEXIBLE TOOLS TO HELP FARMERS SHARE UP

In the last financial year, our shareholders earned $17.8 million worth of Farm Source™ Rewards Dollars. As well as redeeming these in store, farmers will have the option of using them to help meet their share requirements. The *Farm Source™ Rewards Dollars for Shares* scheme will allow farmers to use their Rewards Dollars to purchase shares during the offer window, before the share compliance date of December 1 each year.

Also new is the *Contract Fee for Units* programme where we can now redirect the contract fee from *Share-Up Over Time* contracts into a trust that will purchase units on the farmer's behalf. These units can then be used at a later date to acquire shares.

We have further simplified sharing up with the introduction of a *Strike Price Contract.* This is designed to help farmers who want to grow their businesses by providing greater flexibility for sharing up over time.

Under this programme, farmers buy a minimum shareholding in the first year - equal to 20 per cent of their production quantity. In subsequent years they will be required to buy additional shares only when the Farmgate Milk Price goes over the published Strike Price. This is set at $5.25 for the 2018/19 season.

MY CONNECT – BUILDING KNOWLEDGE AND CONNECTION TO OUR CO-OP

The Shareholders' Council, supported by our Farm Source team, has led My Connect, a replacement for the Fonterra Networkers programme, designed to help farmers better connect with one another, share knowledge, and engage more with experts from within our business.

Our new My Connect Conference in May will be an opportunity for all Fonterra farmers to come together, share what's happening on-farm, hear updates and get insights from our strategic markets, and set the My Connect agenda for the coming season.

We've put farmers in charge of My Connect webinar content, asking them to vote for the topics which most interest them, such as understanding the Farmgate Milk Price or the strategy behind our global milk pools.

FARM SOURCE™ EXPANDS INTO AUSTRALIA

In February, Farm Source™ was launched in Australia where Fonterra, as the country's leading processor, now collects two billion litres of milk from 1,300 farmers in Victoria and Tasmania.

The Australian offering has been tailored to local farmers who supply Fonterra through supply arrangements. It combines a range of farm services which have already been available to them with better, faster and easier-to-use tools and services that will support our suppliers' growth and profitability.

A STRONG CO-OP **DOING WHAT'S RIGHT**

NUTRIENT MANAGEMENT
95 per cent of supplying farms in New Zealand are participating in nutrient management reporting and benchmarking.

This initiative is part of a wider programme underway in Australia to secure our share of supply as our Co-operative works to expand our near-full production capacity across our key Australian sites. We are in the process of adding 500 million litres of processing capacity to meet growing demand for our Ingredients, Consumer and Foodservice products – particularly cheese from our Stanhope site.

We know our co-operative principles appeal to Australian farmers, along with the sense of certainty an ownership model provides. Therefore we are looking at how that might be achieved in Australia to provide a connection deeper than just the milk price.

We have provided similar opportunities in Latin America where farmer suppliers were offered the opportunity to acquire shares in Prolesur, our Chilean Ingredients business that supplies our Soprole™ operations with milk. These initiatives can provide closer connection with overseas farmers, without affecting our New Zealand shareholders' ownership and control of their Co-operative.

OPENING OUR GATES TO ALL OF NEW ZEALAND

The Co-operative's commitments and achievements in sustainability were acknowledged this year with the release of a sustainability report compiled using the internationally recognised Global Reporting Initiative (GRI) framework and independently assured.

The report gives an objective view of Fonterra's environmental footprint and our contribution to the United Nations' Sustainability Development Goals.

Highlights in the report include:

- New Zealand has among the lowest greenhouse gas emissions per litre of milk collected in the world (0.85 per kgCO2/kgFPCM).
- More than 140,000 Kiwi kids get a free 200ml serving of milk each school day from our Fonterra Milk for Schools programme, which celebrates its fifth anniversary this year.
- New specialised milk product was launched in Malaysia this year to help combat high rates of cholesterol and diabetes in this market.
- 95 per cent of supplying farms in NZ are participating in nutrient management reporting and benchmarking.
- 98.4 per cent of waterways on supplying farms in NZ are fenced to keep cows out of waterways and collection of milk was suspended at 78 farms in the past season due to non-completion of fencing.

In addition to reporting on our progress, 40 of our farmers invited Kiwis to see it for themselves in December. The Open Gates initiative received positive feedback from people who appreciated the chance to see on-farm initiatives like fencing of waterways and riparian planting.

OPEN GATES
We opened our gates to the New Zealand public to see for themselves the good work our farmers are doing.

COMMITTING TO WATER QUALITY

In November we announced six commitments to help improve water quality in farming regions. Each is underpinned by a set of clear actions.

These include supporting regional councils to set environmental limits for water use, investing $250 million to drive a 20 per cent reduction in water use across our 26 manufacturing sites and almost doubling the Co-operative's network of Sustainable Dairying Advisors.

These commitments complement existing programmes including our Living Water partnership with the Department of Conservation, work with local communities and our promise to help restore 50 key freshwater catchments.

The commitments announced in November are:

1. Farm within regional environmental limits.
2. Encourage strong environmental farming practices.
3. Reduce water use and improve wastewater quality at manufacturing plants.
4. Build partnerships to improve waterway health.
5. Invest in science and innovation to find new solutions.
6. Make the products people value most.

CREATING SUSTAINABLE VALUE FOR ALL OF OUR FARMERS

Environmental sustainability is critical to our future. It's important to customers and they look to us to demonstrate it on-farm.

We have a good story to tell, firstly because our Co-operative's farmers recognised the need for change back in 2003 with initiatives such as the Clean Streams Accord, and secondly, because farmers have all invested time, money and passion into making far-reaching changes to their farm management systems.

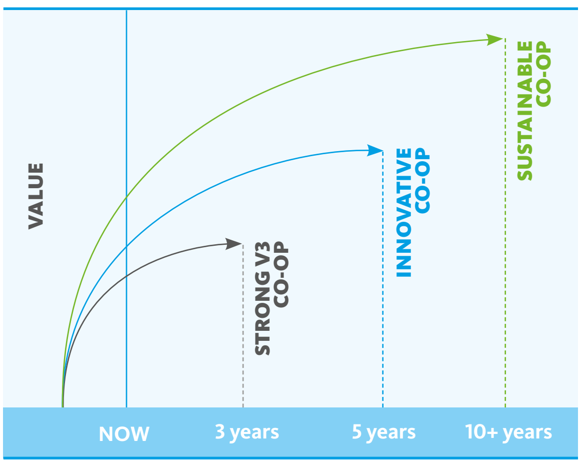
Farmers have made these improvements because it's the right thing to do for the communities in which we live and operate. There's an added benefit in that customers globally are increasingly seeking out nutrition that can be verified as produced using ethical and sustainable practices.

Fonterra's global Trusted Goodness™ programme earns our farmers greater value due to the grass-fed, Non-GMO and animal welfare standards behind their milk. The programme, which is represented by a global quality seal, is being progressively rolled out across parts of our NZMP brand and in the first half of the financial year has already delivered incremental price achievement of $6.9 million over and above the equivalent standard products.

OUR **POTENTIAL**

We have a goal to be processing 30 billion litres of milk a year by 2025 across five to six countries. The growth required to achieve this goal is ambitious but our team is united in how we're making it happen.

BUILDING THE FOUNDATIONS FOR OUR FUTURE SUCCESS.



STRONG V3 CO-OP

Demand-led optimisation of New Zealand milk, supported by milk pools.

INNOVATIVE CO-OP

Investment in technology and people for the future.

SUSTAINABLE CO-OP

Creation of sustainable value for all stakeholders.

It requires us to keep one eye on today and the other on the future, and sees us focusing on three horizons – creating a Strong V3 Co-op which will set the foundations for the future, an Innovative Co-op which will enable us to lead the future and a Sustainable Co-op which will ensure the future.

We're working on all three, creating sustainable value for our shareholders – that's a sustainable Farmgate Milk Price, dividend and investment in the Co-op. At the same time, we will be making a difference in the lives of two billion people and helping feed the world's growing population, which by 2050 is expected to drive a 50 per cent increase in the demand for food.

A STRONG V3 CO-OP

A Strong V3 (Volume, Value, Velocity) Co-op is about converting more milk into higher returning products at speed.

At the heart of this strategy we continue to put more milk into the products that create the most value – that's Consumer and Foodservice products and Advanced Ingredients like NZMP's pharmaceutical lactose used in asthma inhalers .

We have been adding about 400 million additional LME to our Consumer and Foodservice business each year and we expect this to continue.

$21.75M

DOUBLE 11 SALES

Anchor,™ Anlene™ and Anmum™ sales during the Double 11 sales period increased by about 65 per cent compared to last year.

The Ingredients engine

Our Ingredients business represents two-thirds of Fonterra's earnings. Customers want to buy high volume, quality ingredients from a trusted source. We create value in these ingredients through our scale, having a lean supply chain that's focused on our customers' needs and prioritising demand for higher value ingredients.

Our manufacturing sites can process multiple products, giving us flexibility to respond to market changes and ensuring we are getting the most out of every drop of milk. That's why we have invested in sites like Clandeboye, where we can produce mozzarella, whey protein concentrate and edible lactose.

We have also taken our dairy manufacturing, food quality and sales expertise and applied it around the world. This means we can supplement our New Zealand milk source and create more opportunities to produce higher value products to meet growing global demand.

A good example of this from the first half of this year is our work with US whey protein concentrate and lactose manufacturer Columbia River Technologies – a joint venture between dairy co-op Tillamook and Threemile Canyon Farms. Each party brings something different to the table. Threemile Canyon Farms supply the milk, Tillamook makes the cheese, and using our intellectual property, we commercialise the whey and lactose by-products of the cheese making process. Whey protein is a key ingredient in infant formula and sports nutrition products, and demand is growing for these products, especially in the US, European and Asian markets.

The launch of our dedicated medical nutrition division this year further strengthens our focus on selling advanced ingredient solutions to help people suffering from malnutrition and other diseases, as well as help people age in good health. The global medical nutrition industry is valued at $17.5 billion today and is expected to grow to almost $24 billion by 2020.

Growing our Consumer and Foodservice business

Growth in demand from Consumer and Foodservice markets is also set to be significant. Key trends driving this are population growth, urbanisation and a growing middle class with an increasing enthusiasm for Western-style foods and greater awareness around healthy diets and lifestyles.

Our global brands – Anchor,™ Anlene™ and Anmum™ – and regional brands – like Western Star™ and Soprole™ – are trusted and well positioned to meet the needs of customers. Our strong sales over the Chinese Double 11 sales period, especially for our Anchor™ UHT milk which was the most popular product in the imported UHT milk category, are evidence of this.

We have expanded the Anlene™ proposition to make it relevant to the lives of more adults in Asia and are aiming for 18 per cent growth this year. We are building on Anlene's scientific roots in helping bone health and preventing osteoporosis and tapping into a global trend for healthy ageing – a market segment with an estimated value of $8.5 billion per annum by 2026.

OUR **POTENTIAL**

DISRUPT
Disrupt helped us win the Diversity and Inclusion Award at the 2017 Deloitte Top 200 Awards.

Anchor Food Professionals™ is in high demand from chefs across the globe. Our targeted product range and innovative chef-led strategy gives us a competitive edge in the Asian Bakery, Italian Kitchen and Quick Serve Restaurants channels. In December Anchor Food Professionals™ became New Zealand's sixth biggest export business, having generated $2 billion in annual revenue.

The growth in tea and coffee consumption creates a new opportunity to further grow our Foodservice business. People are moving away from the traditional straight brew to more indulgent drinks, which increasingly means more dairy. That's why we are now carving out a new channel called Beverage House and selling cream, cream cheese and milk to the likes of Starbucks.

INNOVATIVE CO-OP

As we move further through the Innovative Co-op horizon, we prepare ourselves to lead in the face of fast-moving trends, sudden changes in customer behaviour and unprecedented changes in technology.

It requires us to innovate throughout our value chain and use technology to create more value. We've already started, stimulating teams to think differently, be fast and agile, and identify and deliver technology gains.

Disrupt

Our Disrupt programme encourages and fosters diverse ideas for new business models from our people around the world. In just two years, the initiative has involved some 1,300 individuals, spanning at least eight languages, 27 nationalities, and included thinking from people aged between 21 and 60.

We have already implemented four Disrupt ideas. Some are highly digital – such as using technology to extend the reach of our Foodservice business to cities where we don't have a sales team on the ground – and some require us to just think differently about old challenges. For example, our 'Reach the Unreached' venture in Sri Lanka is an innovative new business model that gets affordable dairy nutrition to rural people who wouldn't normally have access to it.

Velocity and Velocity^{NXT}

Velocity is our way of working. It's both a mindset of accountability and action, and a set of tools for uncovering and delivering significant value in our business. Over the last two-and-a-half years more than 4,260 initiatives have been completed by employees and delivered improvements in working capital, earnings and Farmgate Milk Price. Of these, 675 have been completed this year.

Many of these initiatives are incremental improvements but we are also challenging ourselves to be bold and harness emerging technologies that will streamline our business, improve process and capture value in new ways.

Velocity^{NXT} supports our people to implement both sustainable and disruptive initiatives that are more complex to develop as they typically require new technology, tools, capabilities and greater cross-functional collaboration – such as advanced analytics, machine learning, the Internet of Things, and robotics and software automation.



SUSTAINABLE CO-OP

Strong healthy local environments and communities are the foundation for sustainable and profitable dairy farming. That's why the Sustainable Co-op horizon is important. It requires us to look at how we create value for our farmers, customers and local communities. We are looking at the future challenges facing global food producers and making sure we are considering the long-term implications of the actions and plans today.

We have organised our Sustainable Co-op priorities into three main areas that will make the biggest difference to people's lives:

- **Nutrition:** improving health and wellbeing through products and services we deliver.
- **Environment:** achieving a healthy environment for farming and society.
- **Community:** delivering prosperity for our farmers and wider communities.

In December 2017 we published our first Sustainability Report. It highlights our commitment to an open discussion on how we're taking our responsibilities seriously and where we are making real progress.

Making changes today that will ensure the future

We have created new global Food and Nutrition Guidelines, endorsed by the New Zealand Nutrition Foundation. The guidelines help ensure we're continuously moving our product portfolio towards reduced use of added sugars, salt and other additives.

Our farmers continue to make a significant contribution to improving water quality in New Zealand's waterways. We're investing to improve our waste water treatment at sites like Brightwater and we've improved our storm water management systems at our sites in Takaka and Tirau in the first half of the year.

Our energy efficiency gains from last season meant we saved enough energy to power all the households in Hamilton city for nearly four years, and we're continuing to focus on reducing energy use across our sites.

We have made good progress on our roadmap with the Ministry for the Environment for a low emission future. In particular, we have completed a feasibility study to assess how we could transition to renewable energy sources and we continue to look for ways to demonstrate what's possible. This year we approved investment to convert the boiler at our Brightwater site to co-fire with wood biomass. This will reduce carbon emissions at the site by 25 per cent.

Details of how we are delivering our third priority are covered in depth in this report's 'Our Co-op' and 'Our Performance' sections.

GROUP **OVERVIEW**

We delivered strong Ingredients performance and continued to make progress in moving milk up the value chain, with volume growth across a number of Consumer and Foodservice markets.

$9.8B

SALES REVENUE
Up six per cent compared with the same period last year.

HIGHLIGHTS

- Operating performance in line with expectations, normalised EBIT of $458 million.
- Results impacted by Danone arbitration decision and Beingmate impairment.
- Volume in LME down 11 per cent, due to record low opening inventory and reduced milk collection.
- A strong Ingredients performance, generating normalised EBIT of $558 million, up nine per cent.
- In our Consumer and Foodservice businesses we increased prices but not enough to recover the higher input costs, resulting in a 38% decline in normalised EBIT.
- Higher gearing mainly due to lower earnings, including abnormal items.

Sales revenue for the six months to 31 January 2018 rose six per cent to $9.8 billion, reflecting improved global prices for dairy.

USEFUL FACT

Starbucks in Mainland China uses Fonterra milk from New Zealand and China. By 2020, we have plans to be a major supplier to all Starbucks stores in China. Milk products will be supplied from our China Farms and New Zealand.

Revenue increased despite a decline in total sales volume of 1.3 billion LME, as we started the year with record low opening inventory followed by a second year of lower milk collections. Milk collections this season were heavily impacted by the difficult weather conditions experienced across New Zealand. As a result, sales volumes in our Ingredients business were down 11 per cent compared to the same time last year. In Consumer and Foodservice, we moved 2.7 billion LME into higher value products over the six months ended 31 January 2018. This included volume growth in Greater China, Latin America and Asia, but was offset by declines in Oceania as our New Zealand business exited some private label contracts and experienced operational challenges at our new distribution centre.

CONSUMER AND FOODSERVICE

Our new Foodservice channel, Beverage House, will sell cream, cream cheese and milk to the likes of Starbucks.

NZD MILLION	SIX MONTHS ENDED 31 JANUARY 2018	SIX MONTHS ENDED 31 JANUARY 2017	CHANGE
Volume (LME, billion)	**10.5**	11.7	(11%)
Volume ('000 MT)	**2,003**	2,131[1]	(6%)
Sales revenue	**9,839**	9,241	6%
Gross margin	**1,662**	1,761	(6%)
Gross margin percentage	**17%**	19%	
Reported operating expenses	**(1,864)**	(1,232)	51%
Normalised operating expenses	**(1,263)**	(1,232)	3%
Reported EBIT	**(176)**	644	(127%)
Normalised EBIT	**458**	607	(25%)
Net finance costs	**(201)**	(157)	28%
Tax credit/(expense)	**29**	(69)	(142%)
Net (loss)/profit after tax	**(348)**	418	(183%)
Earnings per share (cents)	**(22)**	26	(185%)
Dividend per share (cents)	**10**	20	(50%)
Gearing ratio[2]	**51.6%**	46.6%	
Free cash flow	**(690)**	(417)	(65%)
Capital expenditure	**346**	244	42%

1. *China Farms volumes for the 2017 half year have been restated to aid comparability between segments. Previously China Farms volumes were converted to metric tonnes based on the litres of raw milk sold. These volumes are now converted based on weight of milk solids (i.e. fat and protein content) in line with the Ingredients methodology, where 1 litre of milk converts to approximately 0.07 kg.*
2. *Gearing ratio is economic net interest bearing debt divided by economic net interest bearing debt, plus equity, excluding hedge reserves.*

GROUP **OVERVIEW**

$458M

NORMALISED EBIT

Operating performance in line with expectations.

GROWING DEMAND

In the USA, more than 50 per cent of all food and beverage spend is now out of home, and the China foodservice dairy market has grown by 30 per cent between 2013 and 2017.

Group normalised EBIT of $458 million was down 25 per cent compared to the same period last year. Our Ingredients business delivered a strong result, with normalised EBIT of $558 million, up nine per cent on last year, driven by a solid performance from New Zealand and an improved performance in Australia. We made good progress on our five "must win battles" in Consumer and Foodservice. However, these could not fully recover the impact of higher commodity prices which compressed margins. As a result, normalised EBIT for Consumer and Foodservice declined 38 per cent to $193 million.

Growth in Greater China was driven by a strong performance from our Consumer business, which delivered double-digit volume growth for the first six months of the year. We continued to make progress in our Foodservice business. However, margins have declined compared to the same period last year when margins were higher due to the lower dairy commodity price environment. The benefits of our turnaround in the Australia Consumer and Foodservice business have continued to improve the Oceania result. However, higher dairy commodity prices and operational challenges in New Zealand have impacted overall earnings. Our Soprole™ business in Latin America continues to perform well. The decline in the Brazilian economy has been challenging. However, we have made further market share gains in the chilled dairy category this year.

Our China Farms' result has improved compared to last year due to the efficiencies generated from the farms being fully stocked with livestock and further on-farm cost control. We are well positioned to benefit from the shift in demand from ambient products towards fresh milk in the Greater China market.

USEFUL FACT

This year we celebrated the tenth birthday of our Hangu Farm, east of Beijing, which was our first farm in Greater China.

Normalised operating costs were up three per cent for the six months to 31 January 2018, after two years of declines. The increased spend this half has been targeted at new product innovation, digital platforms and technology opportunities. We will continue to focus our spend in these key areas where we see long-term benefits to our business.

Our reported EBIT has decreased 127 per cent to a loss of $176 million for the six months to 31 January 2018 reflecting the $196 million relating to the Danone arbitration decision, and the impairment and share of operating losses from our investment in Beingmate of $433 million.

STRONG CO-OPERATIVE

Ongoing financial discipline has enabled the Co-operative to maintain a strong balance sheet and absorb the impact of abnormal items incurred over this period. This included the recall costs awarded to Danone and the impact of the impairment of our investment in Beingmate.

Economic net interest-bearing debt and gearing are both typically higher for the Co-operative at the end of the first six months of the year, reflecting the seasonal profile of our business. As at 31 January 2018, economic net interest-bearing debt was $7.1 billion and better than expected due to higher cash collections following strong Ingredients sales in the second quarter. Relative to the previous comparable period, economic net interest-bearing debt was $945 million higher as additional funding was required over the period. This is due to lower earnings, including the Danone arbitration decision, the timing of capital expenditure, the impact of the translation of overseas debt due to a lower New Zealand Dollar, and the final dividend being part-paid early in the prior year. Consistent with the higher seasonal debt level and the impact of the Beingmate impairment on retained earnings, the gearing ratio at half year has increased to 51.6 per cent. We continue to be committed to our target end of year gearing range of 40-45 per cent.

Efficient working capital management continues to be a key focus of our financial discipline. The investment required in working capital has increased due to the higher milk price, and increased inventory volumes, including an increased portion of higher value products. Increased inventory volumes this period reflect the record low closing volumes in the prior period in our Ingredients business returning to more normal levels, and growth in milk collection in our Australian business.

During the period, expenditure on capital investments was in line with expectations but higher than the previous comparable period due to timing differences. Spend is also typically proportionally lower in the first six months of the year as scheduled maintenance occurs at our sites during winter when volumes are lower.

The interim dividend of 10 cents per share reflects the lower earnings this year as well as our commitment to financial discipline and maintaining a strong balance sheet. This is in line with Fonterra's dividend policy to pay out 65–75 per cent of adjusted net profit after tax over time.

INGREDIENTS

This includes global sales from our Ingredients businesses in New Zealand, Australia, Latin America and China. It also includes the Fonterra Farm Source™ rural supplies retail chain in New Zealand.

$558M

NORMALISED EBIT

Ingredients Normalised EBIT was up nine percent.

EXPORT

During peak season, one container of product is loaded every three minutes for export.

HIGHLIGHTS

- Normalised EBIT of $558 million, up nine per cent.
- Lower sales volumes due to record low opening inventories and a two percent decrease in New Zealand milk collections for the season to date.
- Sales revenue increased nine per cent due to higher dairy commodity prices.
- Australian Ingredients gross margin up $23 million, or 86 per cent.

VOLUME

Fonterra's milk collection across New Zealand was down two per cent to 1,036 million kgMS for the 2017/18 season to 31 January 2018. Lower collections were primarily due to the difficult weather conditions experienced this season, with a very wet spring followed by a hot, dry summer, which affected soil and pasture quality across the country. Although the rain in early January helped in some regions, collections for the season to date have declined, with the North Island down three per cent, and the South Island flat compared to last season.

In Australia, milk collection for the 2017/18 season to 31 January 2018 was 100 million kgMS, 27 per cent up on the same period last season. This volume includes milk collected directly and through third parties. The Australian business has benefited from an improvement in product mix and has attracted new suppliers to Fonterra over the course of the year. The increase in volumes collected represents a significant gain in market share of around four per cent for Fonterra.

Total sales volumes in Ingredients were 9.8 billion LME, a decrease of 11 per cent compared to the same period last year. This decline reflects our record low opening inventory volumes and the unusual profile of New Zealand milk collection this season. Opening inventory at the start of the period was approximately 63,000 metric tonnes lower than the previous period, a decline of 15 per cent, as we continued our efforts to drive lower inventory levels. Our total Ingredients' sales include 132 million LME from our China Farms as we continue to progress our strategy of a vertically integrated milk pool in China.

INHALABLE LACTOSE

The pharmaceutical lactose made at Kapuni is used in asthma inhalers all around the world.

11%

LOWER VOLUMES

Sales volumes for Ingredients were 9.8B LME, down from 11B LME for the same period last year.

NZD MILLION	SIX MONTHS ENDED 31 JANUARY 2018	SIX MONTHS ENDED 31 JANUARY 2017	CHANGE
Volume (LME, billion)	**9.8**	11.0	(11%)
Volume ('000 MT)	**1,441**	1,543[1]	(7%)
Sales revenue	**7,906**	7,228	9%
Total gross margin	**874**	801	9%
– New Zealand product mix	**734**	644	14%
New Zealand Reference products	**372**	246	51%
New Zealand Non-reference products	**362**	398	(9%)
– Australia Ingredients	**50**	27	86%
– China raw milk[2]	**(9)**	(9)	-
– Other gross margin[3]	**99**	139	(29%)
Normalised EBIT[4]	**558**	510	9%
Gross margin ($ per MT)			
– Reference products ($ per MT)	**413**	253	63%
– Non-reference products ($ per MT)	**1,309**	1,178	11%

1 *China Farms volumes for the 2017 half year have been restated to aid comparability between segments. Previously China Farms volumes were converted to metric tonnes based on the litres of raw milk sold. These volumes are now converted based on weight of milk solids (i.e. fat and protein content) in line with the Ingredients methodology, where 1 litre of milk converts to approximately 0.07 kg.*

2 *China raw milk gross margin represents the net benefit/(loss) from the external sale of milk produced by China Farms and sold to the Ingredients business in China at an internal raw milk price.*

3 *Other gross margin for the six months ended 31 January 2017 has been restated to reflect the China raw milk gross margin that was presented for the first time in the 2017 annual review.*

4 *Normalised EBIT for Ingredients excludes unallocated costs.*

INGREDIENTS

NEW ZEALAND INGREDIENTS – REVENUE AND VOLUME[1]	SIX MONTHS ENDED 31 JANUARY 2018	SIX MONTHS ENDED 31 JANUARY 2017	CHANGE
Production Volume ('000 MT)			
Reference products	**1,266**	1,292	(2%)
Non-reference products	**483**	457	6%
Sales Volume ('000 MT)			
Reference products	**900**	973	(8%)
Non-reference products	**277**	338	(18%)
Revenue Per MT (NZD)			
Reference products	**4,783**	3,873	23%
Non-reference products	**5,726**	5,201	10%

1 *Figures exclude bulk liquid milk. The bulk liquid milk volume for the six months ended 31 January 2018 was 34,000 MT (six months ended 31 January 2017 was 37,000 MT).*

VALUE

The Ingredients business delivered a strong result, particularly given the significant reduction in opening inventories and the variability in milk collections this season. Revenue was up $678 million, or nine per cent, and normalised EBIT was $558 million, also an increase of nine per cent. The increase in normalised EBIT is reflective of higher margins, improvements in our overall product mix and stronger operational performance from our business in Australia.

USEFUL FACT

NZMP SureStart™ Lipid 100, our breakthrough milk lipid ingredient, was selected as a finalist in the 'Ingredient of the Year – Infant Nutrition' at the NutraIngredients Awards 2017.

Our New Zealand Ingredients business manufactures five commodity products that inform the Farmgate Milk Price. These are referred to as reference products, while all other products are referred to as non-reference products.

Revenue for both reference and non-reference products has increased, up 23 per cent and 10 per cent respectively even with the lower volumes due to higher prices for the period to 31 January 2018.

The overall New Zealand Ingredients' gross margin, including both reference and non-reference products, increased by 14 per cent to $734 million. Gross margins for reference products increased 51 per cent or $126 million for the six-month period. Last year, with rapidly increasing dairy commodity prices, we made lower margins on these products due to the natural pricing lag inherent in our sales contracts. This year as prices stabilised, albeit at a higher level, margins for our reference product portfolio improved. For non-reference products, gross margin was $362 million, a decline of nine per cent compared to the same period last year, largely driven by lower volumes.

Product stream returns result from the relative difference between reference product and non-reference product prices and costs. For the six months to 31 January 2018, non-reference product stream returns were $90 million, $50 million ahead of the comparable period last year. These additional stream returns were predominantly due to the improved margins for non-reference products this period.

NEW STANHOPE PLANT

The expansion of Stanhope in Australia will almost double the size of our new cheese plant.

$734M

NEW ZEALAND INGREDIENTS GROSS MARGIN

The overall New Zealand Ingredients gross margin increased by 14 per cent to $734 million.

Our Australian Ingredients business delivered another stronger performance for the six months to 31 January 2018, compared to the same period last year with a gross margin of $50 million, up $23 million or 86 per cent. This was driven by strong demand for butter and cream and greater efficiencies at our factories.

Our Ingredients' gross margin included a $9 million loss for the six-month period, representing the difference between the domestic milk price and the internal raw milk price paid to China Farms.

USEFUL FACT

In Australia we produced 27 per cent more milk in the first six months compared to the same period last year.

Our New Zealand operations faced some challenges over the course of the first half, as difficult weather conditions impacted the country. Previous investments in capacity and lower milk collections this season have ensured there were no peak costs for the six months to 31 January 2018.

Our Global Operations team tightly managed capital expenditure through the year by focusing on value added products, efficiency gains and sustainability improvements. This year we invested in our mozzarella plant at Clandeboye and in a new cream cheese plant at our site in Darfield. In addition to this, our Ingredients business in Australia will benefit from further investments at key sites in Victoria and Tasmania to increase capacity and meet growing demand for our products, particularly mozzarella. The majority of this spend will be at our Stanhope site, where we are almost doubling the size of our plant. This will increase cheese production by a further 35,000 metric tonnes for a range of cheeses, including cheddar, mozzarella and parmesan.

CONSUMER AND **FOODSERVICE**

This comprises our Consumer and Foodservice businesses in Greater China, Latin America, Asia and Oceania.

$3,473M

SALES REVENUE

Consumer and Foodservice sales revenue increased seven per cent.

HIGHLIGHTS

- Sales revenue up seven per cent.
- Increased volumes in Greater China, Latin America and Asia.
- We increased prices but these were not sufficient to recover the impact of higher commodity prices, resulting in a decrease of 38 per cent in normalised EBIT.
- Strong Consumer growth in Greater China.
- Consistent earnings in Greater China and Latin America in a higher dairy commodity price environment.

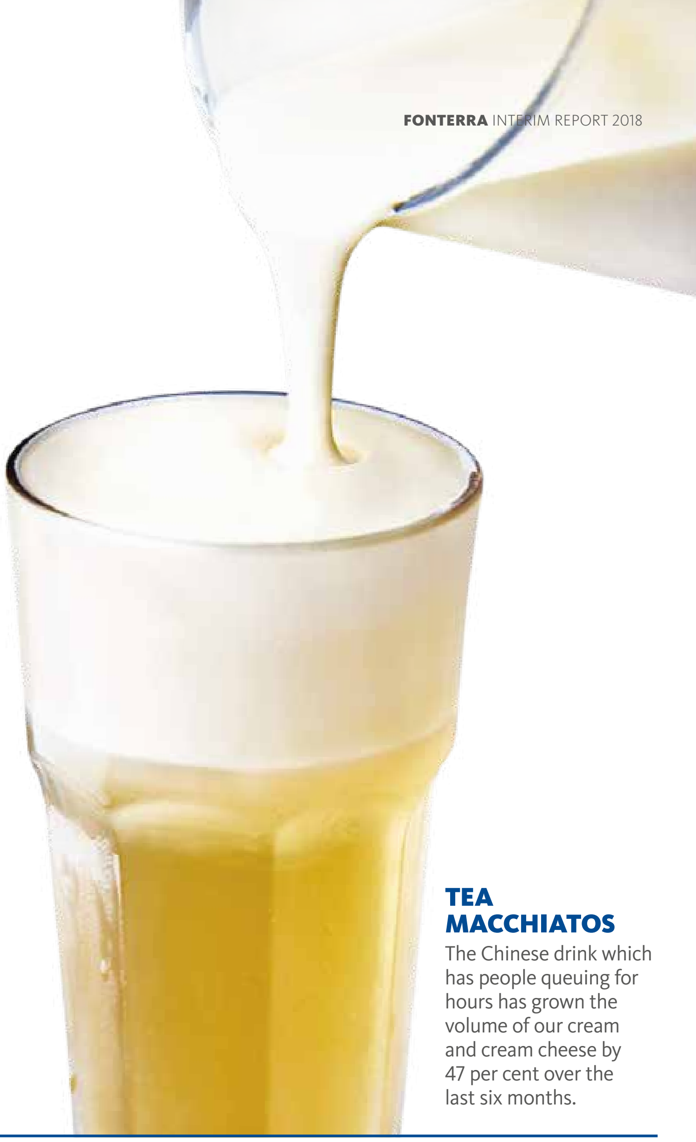
VOLUME

We achieved volume growth in Greater China, Asia and Latin America, but this was offset by the decline in volumes in Oceania. As a result, overall volumes in our Consumer and Foodservice business declined two per cent. Given the significant increase in prices for butter, which has a high LME factor, our product mix shifted away from butter, towards UHT cream, which has a relatively lower LME factor. As a result, total LMEs in Foodservice were flat compared to the same period last year.

- **Greater China:** additional 16 million LME, largely due to strong growth in our Consumer business, as well as further expansion in our Foodservice business in Mainland China.
- **Oceania:** good demand in Australia, however overall volumes down due to higher fat prices in our butter portfolio, operational challenges in New Zealand and our exit from parts of our private label portfolio.
- **Asia:** growth of two per cent due to strong demand in Malaysia, Thailand and Vietnam.
- **Latin America:** three per cent volume growth, reflecting growth in Soprole™ but partially offset by challenging economic environments in Brazil and Venezuela.

VALUE

Our Consumer and Foodservice business delivered revenue of $3.5 billion for the six months to 31 January 2018, an increase of seven per cent. Our normalised EBIT of $193 million decreased 38 per cent, as the increased prices were not sufficient to recover the impact of higher commodity prices, which compressed margins.



TEA MACCHIATOS

The Chinese drink which has people queuing for hours has grown the volume of our cream and cream cheese by 47 per cent over the last six months.

WESTERN STAR CREAM

Our Cobden site in Australia has a state of the art bottling facility where we produce Western Star™ cream.

NZD MILLION	SIX MONTHS ENDED 31 JANUARY 2018	SIX MONTHS ENDED 31 JANUARY 2017	CHANGE
Volume (LME, billion)	**2.7**	2.7	(2%)
Consumer	**1.6**	1.6	(3%)
Foodservice	**1.1**	1.1	0%
Volume ('000 MT)	**893**	908	(2%)
Sales revenue	**3,473**	3,239	7%
Gross margin	**821**	963	(15%)
Gross margin (%)	**24%**	30%	
Consumer	**27%**	31%	
Foodservice	**17%**	27%	
Normalised EBIT	**193**	313	(38%)

NORMALISED EBIT: KEY PERFORMANCE DRIVERS NZD MILLION	SIX MONTHS ENDED 31 JANUARY 2018	SIX MONTHS ENDED 31 JANUARY 2017
Normalised EBIT prior year	**313**	241
Volume	**(20)**	102
Price	**301**	(38)
Cost of goods sold	**(420)**	21
Operating expenses	**4**	32
Other	**15**	(45)
Normalised EBIT	**193**	313

CONSUMER AND **FOODSERVICE**

CONSUMER AND FOODSERVICE PERFORMANCE

	LME (BILLION)			NORMALISED EBIT ($M)		
SIX MONTHS ENDED	31 JANUARY 2018	31 JANUARY 2017	CHANGE	31 JANUARY 2018	31 JANUARY 2017	CHANGE
Consumer and Foodservice	**2.7**	2.7	(2%)	**193**	313	(38%)
Greater China	**0.6**	0.6	3%	**92**	96	(4%)
Latin America	**0.4**	0.4	3%	**30**	35	(14%)
Asia	**0.9**	0.9	2%	**56**	124	(55%)
Oceania	**0.8**	0.9	(10%)	**15**	58	(74%)

The key performance drivers table shows increased prices contributed an additional $301 million to earnings for the six months to 31 January 2018. Although we had improvements in performance at our key sites, higher input prices resulted in an increase in cost of goods sold of $420 million. This year the average commodity prices for our key Foodservice products, such as butter and cream, increased by 80 per cent and 18 per cent respectively.

Our strategy for Consumer and Foodservice is focussed on five 'must win battles' which will help us drive a greater value proposition for the business. These are innovation, strategic pricing, route to market, cost leadership and digital. We track these initiatives through our Velocity programme which enables us to measure performance and act in an agile manner. For the six months to 31 January 2018 we delivered around $90 million from our key 'must win battle' initiatives, which partially offset the increase in cost of goods sold this year.

For the six months to 31 January 2018 our Greater China and Latin American businesses produced solid earnings in a higher dairy commodity price environment:

- **Greater China:** largest contributor to earnings with normalised EBIT of $92 million, but slightly down on last year due to increased input costs.
- **Latin America:** consistant performance by Soprole,™ earnings impacted by challenging markets in Brazil and Venezuela.
- **Asia:** normalised EBIT of $56 million, a 55 per cent decline, driven by the lag in pricing on our periodic contracts in a rising commodity price environment.
- **Oceania:** strong performance in Australia, more than offset by margin compression and operational challenges in New Zealand.

REGIONAL UPDATE

Greater China

Our Greater China business continues to grow volume with an additional 16 million LME, as we progress our strategy of moving more volume into higher value products. On a metric tonne basis volume in Greater China has increased 15 per cent. However, the shift in our product mix away from butter, with its relatively higher LME factor, towards UHT cream has impacted growth on an LME basis. We have made progress in driving growth in our online presence, with sales via TMall and JD.com growing 81 per cent and 73 per cent respectively.

Normalised EBIT has declined four per cent to $92 million in an environment where average input costs have increased by more than 55 per cent. Our Consumer business delivered double-digit volume growth along with a positive EBIT contribution, E-Commerce channel growth, price structure optimisation and portfolio expansion. The Foodservice business continued to perform well, reflecting the success of our Anchor Food Professional™ model, particularly in mainland China, where sales of our UHT whipping cream have performed strongly, up 62 per cent. Foodservice margins have declined compared to the same period last year when margins were higher due to the lower dairy commodity price environment, particularly for butter.

The Greater China result has been normalised to exclude the $433 million impact of losses relating to and the impairment on our 18.8 per cent investment in Beingmate.

Latin America

Sales volumes in Latin America were up three per cent. The ongoing solid performance of Soprole™ in Chile was partially offset by challenging conditions in Venezuela and Brazil. This resulted in normalised EBIT being down $5 million to $30 million for the period.

Our Soprole™ business continues to perform well with strong demand in the mature cheese and butter categories. This resulted in increased volumes and improved margins despite the higher input costs this year. We achieved strong growth in our higher value yoghurt and dairy desserts categories.

The economy in Brazil continues to provide challenges, with further retraction seen in the chilled dairy category this year. However, focus on product innovation and sales execution has enabled us to gain market share and improve margins in a competitive environment.

Asia

Our business in Asia continued to deliver volume growth with 874 million LME, up two per cent on the same time last year. However, normalised EBIT declined by 55 per cent to $56 million, as the sharp increase in input costs could not be fully recovered through pricing. This was further impacted by price controls in some of our markets.

Indonesia had good volume growth in Foodservice. In Consumer, Anlene™ has performed well on the back of the launch of our Anlene™ Actifit range and our new "Total Anlene" campaign as we continue to expand our offering to customers. Our Malaysian business achieved strong volume growth due to the launch of Fernleaf™ UHT and our Anlene™ Gold formulation, which better supports joint mobility.

Oceania

The solid performance in our Australian business was impacted by a disappointing result from our Consumer business in New Zealand. This is reflected by the 74 per cent decline in normalised EBIT for Oceania, down to $15 million this year from $58 million in the previous comparable period.

Our Australian business is performing well, with normalised EBIT stable despite significantly higher input costs and lower overall sales volumes. The business has continued to focus on key product categories such as cheese and butter, where demand is growing and where we have strong brands and market share.

The New Zealand business has faced some challenges this year, with increased dairy commodity prices and lower category growth. Although we had strong ice cream demand this summer, record high fat prices impacted overall performance. In addition, our exit from some of our private label portfolio and operational start up challenges at our new distribution centre have impacted the overall Oceania result.

CHINA **FARMS**

This comprises our farming operations in China, which produce high quality fresh milk as part of our integrated China strategy.

6% ↓

OPERATING COSTS

We delivered a six per cent reduction in operating costs on our China Farms.

HEMA FRESH

The milk bottles have unique labels for each day of the week, emphasising freshness.

HIGHLIGHTS

- Continued focus on efficiencies and cost control to offset low milk prices.
- Fresh milk sales introduced into retail formats.
- Sales volumes down 15 per cent as the comparable period included milk powder sales.

VOLUME

Our farming operations in China comprise seven farms across two hubs, with around 34,000 milking cows. We finished this farm development programme in 2016 and all of our farms are fully operational and stocked with productive livestock.

Sales volumes decreased by 15 per cent to 132 million LME for the six months to 31 January 2018, as the comparable period last year included sales of milk powder.

USEFUL FACT

This year we launched our Daily Fresh milk range into Alibaba's new premium food stores, Hema Fresh, using milk sourced directly from our farms in the Hebei province.

We are progressing with our third hub, a joint venture between Fonterra and Abbott, which leverages our expertise in dairy nutrition and farming, and Abbott's continued commitment to business development in China. Construction of the first two farms is complete and further development will follow over the coming years.

CHINA

China is our largest and most strategically important market.

NZD MILLION	SIX MONTHS ENDED 31 JANUARY 2018	SIX MONTHS ENDED 31 JANUARY 2017	CHANGE
Volume (LME, billion)	**0.1**	0.2	(15%)
Volume ('000 MT)	**10**	13[1]	(19%)
Sales revenue	**123**	122	1%
Normalised EBIT	**(12)**	(24)	49%

1 China Farms volumes for the 2017 half year have been restated to aid comparability between segments. Previously China Farms volumes were converted to metric tonnes based on the litres of raw milk sold. These volumes are now converted based on weight of milk solids (i.e. fat and protein content) in line with the Ingredients methodology, where 1 litre of milk converts to approximately 0.07 kg.

VALUE

Operating performance for China Farms has improved from a normalised EBIT $24 million loss in the previous comparable period to a $12 million loss, largely due to ongoing cost control and scale efficiencies on-farm as our production volumes increase. For the six months to 31 January, we delivered a 0.20 RMB per litre or six per cent reduction in operating costs, due to more efficient operations as well as improved fixed cost and overhead recoveries. The China Farms' result also benefited from the internal raw milk price between China Farms and Ingredients. This reflects the long-term milk price forecast for high quality milk in China, and the fact that the responsibility for driving the greatest value from the raw milk produced in China now resides with the Ingredients team.

USEFUL FACT

Last year China Farms was the only dairy business in China to obtain Safety Quality Food (SQF) certification. This year we were recertified with an "excellent" grade for all seven farms.

INTERIM **FINANCIAL RESULTS**

For the six months ended
31 January 2018

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DIRECTORS' STATEMENT

FOR THE SIX MONTHS ENDED 31 JANUARY 2018

The Directors of Fonterra Co-operative Group Limited (Fonterra) present to Shareholders the financial statements for Fonterra and its subsidiaries (together the Group) and the Group's interest in its equity accounted investments for the six months ended 31 January 2018.

The Directors present financial statements for the six months, which fairly present the financial position of the Group and its financial performance and cash flows for that period.

The Directors consider the financial statements of the Group have been prepared using accounting policies which have been consistently applied and supported by reasonable judgements and estimates, and that all relevant financial reporting and accounting standards have been followed.

The Directors believe that proper accounting records have been kept which enable, with reasonable accuracy, the determination of the financial position of the Group and facilitate compliance of the financial statements with the NZX Listing Rules.

The Directors consider that they have taken adequate steps to safeguard the assets of the Group, and to prevent and detect fraud and other irregularities.

The Directors hereby approve and authorise for issue the financial statements for the six months ended 31 January 2018.

For and on behalf of the Board:

JOHN WILSON
CHAIRMAN
20 March 2018

BRUCE HASSALL
DIRECTOR
20 March 2018

INCOME STATEMENT

FOR THE SIX MONTHS ENDED 31 JANUARY 2018

		GROUP $ MILLION		
		SIX MONTHS ENDED		YEAR ENDED
	NOTES	**31 JAN 2018 UNAUDITED**	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
Revenue from sale of goods		**9,839**	9,241	19,232
Cost of goods sold	2	**(8,177)**	(7,480)	(15,968)
Gross profit		**1,662**	1,761	3,264
Other operating income		**52**	90	190
Selling and marketing expenses		**(346)**	(329)	(641)
Distribution expenses		**(278)**	(283)	(550)
Administrative expenses		**(461)**	(440)	(810)
Other operating expenses		**(178)**	(180)	(334)
WPC80 recall costs		**(196)**	–	–
Impairment of equity accounted investees		**(405)**	–	(35)
Net foreign exchange (losses)/gains		**(29)**	30	29
Share of profit/(loss) of equity accounted investees		**3**	(5)	7
(Loss)/profit before net finance costs and tax		**(176)**	644	1,120
Finance income		**11**	17	34
Finance costs		**(212)**	(174)	(389)
Net finance costs		**(201)**	(157)	(355)
(Loss)/profit before tax		**(377)**	487	765
Tax credit/(expense)		**29**	(69)	(20)
(Loss)/profit after tax		**(348)**	418	745
(Loss)/profit after tax is attributable to:				
Equity holders of the Co-operative		**(354)**	413	734
Non-controlling interests		**6**	5	11
(Loss)/profit after tax		**(348)**	418	745

	GROUP $		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2018 UNAUDITED	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
Earnings per share:			
Basic and diluted earnings per share	**(0.22)**	0.26	0.46

STATEMENT OF COMPREHENSIVE INCOME

FOR THE SIX MONTHS ENDED 31 JANUARY 2018

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2018 UNAUDITED	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
(Loss)/profit after tax	**(348)**	418	745
Items that may be reclassified subsequently to profit or loss:			
Cash flow hedges and other costs of hedging, net of tax	**(128)**	56	128
Net investment hedges and translation of foreign operations, net of tax	**209**	(127)	(124)
Hyperinflation (loss)/gain attributable to equity holders	**(1)**	4	(1)
Share of equity accounted investees' movements in reserves	**(1)**	1	–
Other reserve movements	**1**	(2)	(2)
Total items that may be reclassified subsequently to profit or loss	**80**	(68)	1
Items that will not be reclassified subsequently to profit or loss:			
Net fair value gains on investments in shares	**4**	2	2
Foreign currency translation gain/(loss) attributable to non-controlling interests	**12**	1	(3)
Hyperinflation movements attributable to non-controlling interests	**–**	3	–
Non-controlling interests other movements	**–**	(2)	(2)
Total items that will not be reclassified subsequently to profit or loss	**16**	4	(3)
Total other comprehensive income/(expense) recognised directly in equity	**96**	(64)	(2)
Total comprehensive (expense)/income	**(252)**	354	743
Total comprehensive (expense)/income is attributable to:			
Equity holders of the Co-operative	**(270)**	347	737
Non-controlling interests	**18**	7	6
Total comprehensive (expense)/income	**(252)**	354	743

STATEMENT OF FINANCIAL POSITION

AS AT 31 JANUARY 2018

		GROUP $ MILLION		
		SIX MONTHS ENDED		YEAR ENDED
	NOTES	**31 JAN 2018 UNAUDITED**	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
ASSETS				
Current assets				
Cash and cash equivalents		**359**	348	393
Trade and other receivables		**2,328**	2,210	2,303
Inventories		**5,017**	4,566	2,593
Tax receivable		**41**	23	32
Derivative financial instruments		**395**	454	580
Other current assets		**332**	140	181
Total current assets		**8,472**	7,741	6,082
Non-current assets				
Property, plant and equipment		**6,555**	6,112	6,391
Equity accounted investments		**609**	916	887
Livestock		**298**	317	319
Intangible assets		**3,200**	3,071	3,115
Deferred tax assets		**507**	328	363
Derivative financial instruments		**196**	242	239
Other non-current assets		**324**	617	446
Total non-current assets		**11,689**	11,603	11,760
Total assets		**20,161**	19,344	17,842
LIABILITIES				
Current liabilities				
Bank overdraft		**7**	9	11
Borrowings	5	**1,383**	983	1,112
Trade and other payables		**2,242**	2,176	2,117
Owing to suppliers		**2,737**	2,359	1,330
Tax payable		**39**	31	34
Derivative financial instruments		**91**	49	43
Provisions		**79**	47	40
Other current liabilities		**41**	38	44
Total current liabilities		**6,619**	5,692	4,731
Non-current liabilities				
Borrowings	5	**6,229**	5,768	5,151
Derivative financial instruments		**466**	567	547
Provisions		**142**	158	148
Deferred tax liabilities		**9**	26	9
Other non-current liabilities		**8**	8	8
Total non-current liabilities		**6,854**	6,527	5,863
Total liabilities		**13,473**	12,219	10,594
Net assets		**6,688**	7,125	7,248
EQUITY				
Subscribed equity		**5,877**	5,841	5,858
Retained earnings		**961**	1,638	1,637
Foreign currency translation reserve		**(343)**	(555)	(552)
Hedge reserves		**64**	120	192
Other reserves		**9**	10	5
Total equity attributable to equity holders of the Co-operative		**6,568**	7,054	7,140
Non-controlling interests		**120**	71	108
Total equity		**6,688**	7,125	7,248

STATEMENT OF CHANGES IN EQUITY

FOR THE SIX MONTHS ENDED 31 JANUARY 2018

	ATTRIBUTABLE TO EQUITY HOLDERS OF THE CO-OPERATIVE							
GROUP $ MILLION	SUBSCRIBED EQUITY	RETAINED EARNINGS	FOREIGN CURRENCY TRANSLATION RESERVE	HEDGE RESERVES	OTHER RESERVES	TOTAL	NON-CONTROLLING INTERESTS	TOTAL EQUITY
As at 1 August 2017	**5,858**	**1,637**	**(552)**	**192**	**5**	**7,140**	**108**	**7,248**
(Loss)/profit after tax	**–**	**(354)**	**–**	**–**	**–**	**(354)**	**6**	**(348)**
Other comprehensive (expense)/income	**–**	**(1)**	**209**	**(128)**	**4**	**84**	**12**	**96**
Total comprehensive (expense)/income	**–**	**(355)**	**209**	**(128)**	**4**	**(270)**	**18**	**(252)**
Transactions with equity holders in their capacity as equity holders:								
Dividend paid to equity holders of the Co-operative	**–**	**(321)**	**–**	**–**	**–**	**(321)**	**–**	**(321)**
Equity instruments issued	**19**	**–**	**–**	**–**	**–**	**19**	**15**	**34**
Dividend paid to non-controlling interests	**–**	**–**	**–**	**–**	**–**	**–**	**(21)**	**(21)**
As at 31 January 2018 (unaudited)	**5,877**	**961**	**(343)**	**64**	**9**	**6,568**	**120**	**6,688**
As at 1 August 2016	5,833	1,384	(428)	64	6	6,859	88	6,947
Profit after tax	–	413	–	–	–	413	5	418
Other comprehensive income/(expense)	–	1	(127)	56	4	(66)	2	(64)
Total comprehensive income/(expense)	–	414	(127)	56	4	347	7	354
Transactions with equity holders in their capacity as equity holders:								
Dividend paid to equity holders of the Co-operative	–	(160)	–	–	–	(160)	–	(160)
Equity instruments issued	8	–	–	–	–	8	–	8
Dividend paid to non-controlling interests	–	–	–	–	–	–	(24)	(24)
As at 31 January 2017 (unaudited)	5,841	1,638	(555)	120	10	7,054	71	7,125
As at 1 August 2016	5,833	1,384	(428)	64	6	6,859	88	6,947
Profit after tax	–	734	–	–	–	734	11	745
Other comprehensive income/(expense)	–	–	(124)	128	(1)	3	(5)	(2)
Total comprehensive income/(expense)	–	734	(124)	128	(1)	737	6	743
Transactions with equity holders in their capacity as equity holders:								
Dividend paid to equity holders of the Co-operative	–	(481)	–	–	–	(481)	–	(481)
Equity instruments issued	25	–	–	–	–	25	42	67
Dividend paid to non-controlling interests	–	–	–	–	–	–	(28)	(28)
As at 31 July 2017 (audited)	5,858	1,637	(552)	192	5	7,140	108	7,248

CASH FLOW STATEMENT

FOR THE SIX MONTHS ENDED 31 JANUARY 2018

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2018 UNAUDITED	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
Cash flows from operating activities			
(Loss)/profit before net finance costs and tax	**(176)**	644	1,120
Adjustments for:			
Foreign exchange losses/(gains)	**127**	(38)	(1)
Depreciation and amortisation	**275**	289	526
Other	**431**	(12)	15
	833	239	540
(Increase)/decrease in working capital:			
Inventories	**(2,419)**	(2,161)	(177)
Trade and other receivables	**3**	(561)	(634)
Amounts owing to suppliers	**1,273**	1,641	745
Payables and accruals	**227**	78	(100)
Other movements	**8**	(6)	(48)
Total	**(908)**	(1,009)	(214)
Cash flows from operations	**(251)**	(126)	1,446
Net taxes paid	**(41)**	(41)	(70)
Net cash flows from operating activities	**(292)**	(167)	1,376
Cash flows from investing activities			
Cash was provided from:			
– Proceeds from disposal of property, plant and equipment	**4**	97	105
– Proceeds from sale of livestock	**58**	41	62
– Proceeds from sale of investments	**6**	–	–
– Co-operative support loans	**138**	4	41
– Other cash inflows	**1**	3	10
Cash was applied to:			
– Acquisition of property, plant and equipment	**(400)**	(277)	(690)
– Acquisition of livestock	**(24)**	(53)	(89)
– Acquisition of intangible assets	**(74)**	(29)	(103)
– Advances to and investments in equity accounted investees	**(92)**	(36)	(42)
– Other cash outflows	**(15)**	–	–
Net cash flows from investing activities	**(398)**	(250)	(706)
Cash flows from financing activities			
Cash was provided from:			
– Proceeds from borrowings	**2,811**	2,788	4,174
– Interest received	**9**	6	13
– Other cash inflows	**–**	36	38
Cash was applied to:			
– Interest paid	**(199)**	(186)	(393)
– Repayment of borrowings	**(1,589)**	(2,058)	(3,968)
– Dividends paid to non-controlling interests	**(21)**	(24)	(28)
– Dividends paid to equity holders of the Co-operative	**(302)**	(152)	(456)
– Other cash outflows	**(58)**	–	(2)
Net cash flows from financing activities	**651**	410	(622)
Net (decrease)/increase in cash and cash equivalents	**(39)**	(7)	48
Cash and cash equivalents at the beginning of the year	**382**	357	357
Effect of exchange rate changes on cash balances	**9**	(11)	(23)
Cash and cash equivalents at the end of the period	**352**	339	382
Reconciliation of closing cash balances to the statement of financial position:			
Cash and cash equivalents	**359**	348	393
Bank overdraft	**(7)**	(9)	(11)
Closing cash balances	**352**	339	382

BASIS OF PREPARATION

FOR THE SIX MONTHS ENDED 31 JANUARY 2018

A) GENERAL INFORMATION

Fonterra Co-operative Group Limited (Fonterra, the Company or the Co-operative) 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 FMC Reporting Entity under the Financial Markets Conduct Act 2013. Fonterra is also required to comply with the Dairy Industry Restructuring Act 2001.

These interim financial statements, as at and for the six months ended 31 January 2018, comprise Fonterra and its subsidiaries (together referred to as the Group) and the Group's interest in its equity accounted investees after adjustments to align to the accounting policies of the Group.

The Group operates predominantly in the international dairy industry. The Group is primarily involved in the collection, manufacture and sale of milk and milk-derived products and in fast-moving consumer goods and foodservice businesses.

B) BASIS OF PREPARATION

These interim financial statements have been prepared in accordance with International Accounting Standard 34: Interim Financial Reporting and New Zealand Equivalent to International Accounting Standard 34: Interim Financial Reporting. They have also been prepared in accordance with Generally Accepted Accounting Practice (GAAP) applicable to for-profit entities. They should be read in conjunction with the financial statements for the year ended 31 July 2017.

These interim financial statements are presented in New Zealand dollars ($ or NZD), which is Fonterra's functional currency, and rounded to the nearest million, except where otherwise stated.

The preparation of interim financial statements requires management to make judgements, estimates, and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates. In preparing these interim financial statements, the significant judgements made by management in applying the Group's accounting policies and key sources of estimation uncertainty were the same as those applied to the financial statements for the year ended 31 July 2017.

Investment in Beingmate Baby & Child Food Co., Ltd.

Throughout the period Beingmate's share price has traded significantly below the share price at the time Fonterra acquired its investment and the base share price used in the valuation assessment at 31 July 2017. As a result the carrying value of the investment has been assessed for impairment. To assess the recoverable amount of the investment a fair value less costs to sell methodology has been applied. This methodology continues to be appropriate as the uncertainty in forecasting future cash flows following changes in regulations in the market remains.

The fair value of the investment has been determined using an estimate of what a market participant would pay for a similar long-term strategic equity stake in Beingmate under current market conditions. The key assumptions used in determining the fair value are the base share price and the net premium above the base share price (acquisition premium) that would be paid for a long-term strategic investment of a similar size.

The value of the investment has reduced since 31 July 2017 as a result of the following:

- Reduction in the base share price, reflecting the decrease in the traded price of Beingmate shares from 31 July 2017, and
- Reduction in the net premium. The premium reflects that Beingmate is an established local participant in a growth market and has a number of brands registered under the new regulations effective 1 January 2018. The significant reduction in the net premium from 31 July 2017 reflects the poor financial performance, reduction in market share, and the operational and governance challenges experienced by Beingmate.

The value of the investment on a fair value basis supports a carrying value of $244 million, therefore an impairment loss of $405 million has been recognised in the period (after share of losses of $28 million and favourable foreign currency translation movements of $60 million).

The assumptions underlying the calculation of the Fair Value of the 18.8% strategic investment in Beingmate are:

	AS AT	
RMB PER SHARE	31 JAN 2018 (UNAUDITED)	31 JULY 2017 (AUDITED)
Weighted average share price period	**15 trading days from 22 January 2018**	30 trading days pre-trading halt date up to 10 July 2017
Weighted average base price	**5.36**	13.66
Net premium (including cost to sell)	**0.52**	2.45
Implied value per share	**5.88**	16.11

For the year ended 31 July 2017, Beingmate shares were on a trading halt from 12 July 2017 to 4 September 2017, therefore in the absence of an active market, the period immediately before the trading halt (26 May to 10 July 2017) was considered the most appropriate period to determine the base price given during this period the shares traded at a relatively stable range.

For the six months ended 31 January 2018, to remove the impact of market volatility, a 15 trading day period immediately after the forecast earnings downgrade announced by Beingmate on the 21 January 2018 was used (22 January 2018 to 9 February 2018). It was appropriate to use information from immediately after the reporting date as the Beingmate share price continued to decline despite no new information being provided to the market. We considered this the most appropriate period as the market had fully reflected the earnings downgrade impact.

C) ACCOUNTING POLICIES

The same accounting policies are followed in these interim financial statements as were applied in the Group's financial statements for the year ended 31 July 2017.

Accounting Standards issued but not yet effective

The two accounting standards issued but not yet effective that could be expected to have a material impact on the Group's financial statements are:

NZ IFRS 15 Revenue from Contracts with Customers

There has been no change to Fonterra's preliminary assessment that the application of NZ IFRS 15 will not have a material impact on its financial position and performance.

NZ IFRS 16 Leases

During the six months to 31 January 2018 Fonterra has continued to assess the impact of NZ IFRS 16 and evaluate the policy choices. The impact of adoption on Fonterra's financial position and performance has not yet been fully assessed. Fonterra has evaluated the transition options and plans to utilise the modified retrospective approach. This means that the cumulative effect of adopting NZ IFRS 16 will be recognised as an adjustment to the opening balance of retained earnings on 1 August 2019 with no restatement of comparative information.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED 31 JANUARY 2018

PERFORMANCE

1 SEGMENT REPORTING

The financial information reviewed by the Fonterra Management Team has evolved over the past two years to reflect the changes in the management structure to support the operations of the Group. From 1 August 2017 the financial information reviewed by the Fonterra Management Team is solely based on the previously identified 'strategic platforms'.

a) Operating segments

Operating segments reflect the way financial information is regularly reviewed by the Fonterra Management Team (FMT). The measure of profit or loss used by the FMT to evaluate the underlying performance of operating segments is normalised segment earnings before net finance costs and tax. To enable underlying segment performance to be compared between reporting periods a normalised segment income statement has been presented. Comparative segment income statements have been re-presented on a normalised basis.

Transactions between segments are based on estimated market prices, with the exception of the sale of milk from China Farms to Ingredients. The transfer price used for these transactions is an amount reflective of long-term milk price trends in China.

Unallocated costs represent corporate costs including Co-operative Affairs and group services.

REPORTABLE SEGMENT	DESCRIPTION
Ingredients	Represents the collection, processing and distribution of the ingredients business in New Zealand, global sales and marketing of New Zealand and non-New Zealand ingredients products, Fonterra Farm Source™ stores, the ingredients business in Australia (including Milk Supply and Manufacturing) and the ingredients business South America.
Consumer and foodservice	
– Oceania	Represents the fast-moving consumer goods (FMCG) and foodservice businesses in New Zealand and Australia (including export to the Pacific Islands).
– Asia	Represents FMCG and foodservice businesses in Asia (excluding Greater China), Africa and the Middle East.
– Greater China	Represents FMCG and foodservice businesses in Greater China.
– Latin America	Represents FMCG and foodservice businesses in South America and the Caribbean.
China Farms	Represents farming operations in China.

a) Operating segments continued

GROUP $ MILLION

31 JANUARY 2018 (UNAUDITED)

	INGREDIENTS	CONSUMER AND FOODSERVICE					CHINA FARMS	UNALLOCATED COSTS AND ELIMINATIONS	TOTAL
		OCEANIA	ASIA	GREATER CHINA	LATIN AMERICA	TOTAL			
Normalised segment income statement									
External revenue[1]	6,448	1,002	905	731	750	3,388	–	–	9,836
Inter-segment revenue	1,455	85	–	–	–	85	123	(1,663)	–
Revenue from sale of goods	7,903	1,087	905	731	750	3,473	123	(1,663)	9,836
Cost of goods sold	(7,032)	(879)	(694)	(549)	(530)	(2,652)	(131)	1,638	(8,177)
Segment gross profit	871	208	211	182	220	821	(8)	(25)	1,659
Operating expenses	(391)	(192)	(154)	(98)	(196)	(640)	(14)	(218)	(1,263)
Net other operating income	32	1	2	7	3	13	8	(1)	52
Net foreign exchange gains/(losses)	15	(2)	(3)	1	1	(3)	4	(37)	(21)
Share of profit/(loss) of equity accounted investees	31	–	–	–	2	2	(2)	–	31
Normalised segment earnings before net finance costs and tax	558	15	56	92	30	193	(12)	(281)	458
Normalisation adjustments:									
Reduction in the carrying value of investment in Beingmate[2]	–	–	–	(433)	–	(433)	–	–	(433)
WPC80 recall costs[3]	(196)	–	–	–	–	–	–	–	(196)
Time value of options[4]	(5)	–	–	–	–	–	–	–	(5)
Segment earnings before net finance costs and tax	357	15	56	(341)	30	(240)	(12)	(281)	(176)
Finance income									11
Finance costs									(212)
Loss before tax									(377)
Other segment information:									
Volume[5] (liquid milk equivalents, billion)	9.78	0.82	0.87	0.60	0.37	2.66	0.13	(2.12)	10.45
Volume[5] (metric tonnes, thousand)	1,441	309	161	129	294	893	10	(341)	2,003
Depreciation and amortisation ($ million)	(198)	(15)	(7)	(1)	(14)	(37)	(14)	(26)	(275)

1 Total Group revenue from the sale of goods is $9,839 million, the difference of $3 million relates to the normalisation of time value of options.

2 Of the $433 million normalisation adjustment, $405 million relates to the impairment of equity accounted investees and $28 million to the share of losses of Beingmate.

3 The $196 million normalisation adjustment relates to operating expenses.

4 Of the $5 million normalisation adjustment, $3 million relates to revenue offset by $8 million of net foreign exchange losses.

5 Includes sales to other strategic platforms. Total column represents total external sales.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE SIX MONTHS ENDED 31 JANUARY 2018

a) Operating segments continued

	GROUP $ MILLION								
	31 JANUARY 2017 (UNAUDITED)								
	INGREDIENTS	CONSUMER AND FOODSERVICE					CHINA FARMS	UNALLOCATED COSTS AND ELIMINATIONS	TOTAL
		OCEANIA	ASIA	GREATER CHINA	LATIN AMERICA	TOTAL			
Normalised segment income statement									
External revenue[1]	6,159	920	835	567	751	3,073	–	–	9,232
Inter-segment revenue	1,060	68	98	–	–	166	122	(1,348)	–
Revenue from sale of goods	7,219	988	933	567	751	3,239	122	(1,348)	9,232
Cost of goods sold	(6,427)	(745)	(645)	(369)	(517)	(2,276)	(128)	1,351	(7,480)
Segment gross profit	792	243	288	198	234	963	(6)	3	1,752
Operating expenses	(367)	(186)	(165)	(83)	(204)	(638)	(20)	(207)	(1,232)
Net other operating income	23	2	3	5	3	13	12	–	48
Net foreign exchange gains/(losses)	37	(1)	(2)	–	–	(3)	(2)	12	44
Share of profit/(loss) of equity accounted investees	25	–	–	(24)	2	(22)	(8)	–	(5)
Normalised segment earnings before net finance costs and tax	510	58	124	96	35	313	(24)	(192)	607
Normalisation adjustments:									
Gain on sale of Darnum manufacturing plant[2]	42	–	–	–	–	–	–	–	42
Time value of options[3]	(5)	–	–	–	–	–	–	–	(5)
Segment earnings before net finance costs and tax	547	58	124	96	35	313	(24)	(192)	644
Finance income									17
Finance costs									(174)
Profit before tax									487
Other segment information:									
Volume[4] (liquid milk equivalents, billion)	10.98	0.91	0.86	0.58	0.36	2.71	0.16	(2.14)	11.71
Volume[4,5] (metric tonnes, thousand)	1,543	335	156	112	305	908	13	(333)	2,131
Depreciation and amortisation ($ million)	(208)	(15)	(8)	(1)	(17)	(41)	(13)	(27)	(289)

1 Total Group revenue from the sale of goods is $9,241 million, the difference of $9 million relates to the normalisation of time value of options.

2 The $42 million normalisation adjustment relates to other operating income.

3 Of the $5 million normalisation adjustment, $9 million relates to revenue offset by $14 million of net foreign exchange losses.

4 Includes sales to other strategic platforms. Total column represents total external sales.

5 China Farms volumes for the six months ended 31 January 2017 (metric tonnes, thousand) have been restated to align to the same product volume to weight conversion methodology as used by the Ingredients business to aid comparability between segments. Previously China Farms volumes were converted to metric tonnes based on the litres of raw milk sold.

a) Operating segments continued

	GROUP $ MILLION								
	31 JULY 2017 (AUDITED)								
	INGREDIENTS	CONSUMER AND FOODSERVICE					CHINA FARMS	UNALLOCATED COSTS AND ELIMINATIONS	TOTAL
		OCEANIA	ASIA	GREATER CHINA	LATIN AMERICA	TOTAL			
Normalised segment income statement									
External revenue[1]	12,986	1,810	1,668	1,272	1,478	6,228	–	–	19,214
Inter-segment revenue	2,280	142	142	5	–	289	269	(2,838)	–
Revenue from sale of goods	15,266	1,952	1,810	1,277	1,478	6,517	269	(2,838)	19,214
Cost of goods sold	(13,793)	(1,514)	(1,309)	(918)	(1,032)	(4,773)	(246)	2,844	(15,968)
Segment gross profit	1,473	438	501	359	446	1,744	23	6	3,246
Operating expenses	(725)	(339)	(298)	(156)	(357)	(1,150)	(31)	(429)	(2,335)
Net other operating income	106	2	3	6	7	18	14	10	148
Net foreign exchange gains/(losses)	42	–	(5)	–	3	(2)	(1)	9	48
Share of profit/(loss) of equity accounted investees	47	–	–	–	4	4	(4)	1	48
Normalised segment earnings before net finance costs and tax	943	101	201	209	103	614	1	(403)	1,155
Normalisation adjustments:									
Gain on sale of Darnum manufacturing plant[2]	42	–	–	–	–	–	–	–	42
Reduction in the carrying value of investment in Beingmate[3]	–	–	–	(76)	–	(76)	–	–	(76)
Time value of options[4]	(1)	–	–	–	–	–	–	–	(1)
Segment earnings before net finance costs and tax	984	101	201	133	103	538	1	(403)	1,120
Finance income									34
Finance costs									(389)
Profit before tax									765
Other segment information:									
Volume[5] (liquid milk equivalents, billion)	21.30	1.74	1.70	1.28	0.74	5.46	0.34	(4.16)	22.94
Volume[5] (metric tonnes, thousand)	3,019	636	310	237	600	1,783	26	(648)	4,180
Depreciation and amortisation ($ million)	(367)	(31)	(15)	(2)	(33)	(81)	(26)	(52)	(526)
Capital employed[6] ($ million)	7,950	463	117	22	270	872	789	(518)	9,093
Return on capital[7]	10.3%	13.5%	118.4%	680.5%	23.3%	47.2%	NA		11.1%

For the year ended 31 July 2017 the Group's return on capital including intangible assets, goodwill and equity accounted investments, was 8.3 per cent.

1 Total Group revenue from the sale of goods is $19,232 million, the difference of $18 million relates to the normalisation of time value of options.

2 The $42 million normalisation adjustment relates to other operating income.

3 Of the $76 million normalisation adjustment, $35 million relates to impairment of equity accounted investees and $41 million relates to the share of losses of Beingmate.

4 Of the $1 million normalisation adjustment, $18 million relates to revenue offset by $19 million of net foreign exchange losses.

5 Includes sales to other strategic platforms. Total column represents total external sales.

6 Capital employed excludes brands, goodwill and equity accounted investments.

7 Return on capital is calculated as normalised EBIT, less equity accounted investees' earnings, less a notional royalty charge for use of the Group's brands, less a notional tax charge, divided by capital employed.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE SIX MONTHS ENDED 31 JANUARY 2018

b) Geographical revenue

	GROUP $ MILLION								
	CHINA	REST OF ASIA	AUSTRALIA	NEW ZEALAND	UNITED STATES	EUROPE	LATIN AMERICA	REST OF WORLD	TOTAL
Geographical segment external revenue:									
Six months ended 31 January 2018 (unaudited)	**2,094**	**2,650**	**860**	**1,021**	**321**	**337**	**1,095**	**1,461**	**9,839**
Six months ended 31 January 2017 (unaudited)	1,565	2,404	785	977	650	430	1,065	1,365	9,241
Year ended 31 July 2017 (audited)	3,383	5,165	1,592	2,056	1,254	838	2,162	2,782	19,232

Revenue is allocated to geographical segments on the basis of the destination of the goods sold.

c) Non-current assets

	GROUP $ MILLION							
	GLOBAL INGREDIENTS AND OPERATIONS		OCEANIA		ASIA	GREATER CHINA	LATIN AMERICA	TOTAL GROUP
	NEW ZEALAND	REST OF WORLD	NEW ZEALAND	AUSTRALIA				
Geographical segment non-current assets:								
As at 31 January 2018 (unaudited)	**5,409**	**424**	**1,300**	**868**	**774**	**1,167**	**1,044**	**10,986**
As at 31 January 2017 (unaudited)	5,376	301	1,294	797	723	1,540	1,002	11,033
As at 31 July 2017 (audited)	5,479	347	1,285	840	738	1,481	988	11,158

	GROUP $ MILLION		
	AS AT		
	31 JAN 2018 UNAUDITED	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
Reconciliation of geographical segment's non-current assets to total non-current assets:			
Geographical segment non-current assets	**10,986**	11,033	11,158
Deferred tax assets	**507**	328	363
Derivative financial instruments	**196**	242	239
Total non-current assets	**11,689**	11,603	11,760

2 COST OF GOODS SOLD

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2018 UNAUDITED	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
Opening inventory	**2,593**	2,401	2,401
Cost of milk:			
– New Zealand sourced	**6,580**	6,078	9,471
– Non-New Zealand sourced	**737**	521	932
Other costs	**3,284**	3,046	5,757
Closing inventory	**(5,017)**	(4,566)	(2,593)
Total cost of goods sold	**8,177**	7,480	15,968

DEBT AND EQUITY

3 SUBSCRIBED EQUITY INSTRUMENTS

Co-operative shares, including shares held within the Group

Co-operative shares may only be held by a shareholder supplying milk to the Company (farmer shareholder), by former farmer shareholders for up to three seasons after cessation of milk supply, or by Fonterra Farmer Custodian Limited (the Custodian). Voting rights in the Company are dependent on milk supply supported by Co-operative shares.[1]

	CO-OPERATIVE SHARES (THOUSANDS)
Balance at 1 August 2017	**1,606,933**
Shares issued under the dividend reinvestment plan[2]	**3,309**
Balance at 31 January 2018 (unaudited)	**1,610,242**
Balance at 1 August 2016	1,602,703
Shares issued under the dividend reinvestment plan[2]	1,369
Balance at 31 January 2017 (unaudited)	1,604,072
Balance at 1 August 2016	1,602,703
Shares issued under the dividend reinvestment plan[2]	4,230
Balance at 31 July 2017 (audited)	1,606,933

1 These rights are also attached to vouchers when backed by milk supply (subject to limits).

2 Total value of $19 million (31 January 2017: $8 million; 31 July 2017: $25 million).

The rights attaching to Co-operative shares are set out in Fonterra's Constitution, available in the 'About Us/Our Governance' section of Fonterra's website.

Units in the Fonterra Shareholders' Fund

The Custodian holds legal title of Co-operative shares of which the Economic Rights have been sold to the Fund on trust for the benefit of the Fund. At 31 January 2018, 137,366,342 Co-operative shares (31 January 2017: 123,422,471; 31 July 2017: 126,047,304) were legally owned by the Custodian, on trust for the benefit of the Fund.

	UNITS (THOUSANDS)
Balance at 1 August 2017	**126,047**
Units issued	**19,504**
Units surrendered	**(8,185)**
Balance at 31 January 2018 (unaudited)	**137,366**
Balance at 1 August 2016	111,992
Units issued	22,222
Units surrendered	(10,792)
Balance at 31 January 2017 (unaudited)	123,422
Balance at 1 August 2016	111,992
Units issued	29,933
Units surrendered	(15,878)
Balance at 31 July 2017 (audited)	126,047

The rights attaching to units are set out in the Trust Deed constituting the Fonterra Shareholders' Fund, available in the 'Investors/Fonterra Shareholder's Fund' section of Fonterra's website.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE SIX MONTHS ENDED 31 JANUARY 2018

4 DIVIDENDS PAID

The Dividend Reinvestment Plan applied to all dividends in the table below.

	$ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
DIVIDENDS	**31 JAN 2018 UNAUDITED**	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
2017 Final dividend – 20 cents per share[1]	**321**	–	–
2017 Interim dividend – 20 cents per share[2]	**–**	–	321
2016 Final dividend – 10 cents per share[3]	**–**	160	160

1 Declared on 23 September 2017 and paid on 20 October 2017 to all Co-operative shares on issue at 9 October 2017.

2 Declared on 21 March 2017 and paid on 20 April 2017 to all Co-operative shares on issue at 5 April 2017.

3 Declared on 18 August 2016 and paid on 9 September 2016 to all Co-operative shares on issue at 1 September 2016.

Dividend declared after balance date

On 20 March 2018, the Board declared an interim dividend of 10 cents per share, to be paid 20 April 2018 to all Co-operative shares on issue as at 6 April 2018.

Fonterra has a Dividend Reinvestment Plan, where eligible shareholders can choose to reinvest all or part of their dividend in additional Co-operative shares. The Dividend Reinvestment Plan does apply to this dividend. Participation in the Dividend Reinvestment Plan requires shareholders to submit an election notice for participation by 6 April 2018. Full details of the Dividend Reinvestment Plan are available in the 'Investors/Dividends' section of Fonterra's website.

5 BORROWINGS

Economic net interest-bearing debt

Economic net interest-bearing debt reflects the effect of debt hedging in place at balance date.

	GROUP $ MILLION		
	AS AT		
	31 JAN 2018 UNAUDITED	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
Net interest-bearing debt position			
Total borrowings	**7,612**	6,751	6,263
Cash and cash equivalents	**(359)**	(348)	(393)
Interest-bearing advances	**(323)**	(481)	(435)
Bank overdraft	**7**	9	11
Net interest-bearing debt	**6,937**	5,931	5,446
Value of derivatives used to manage changes in hedged risks on debt instruments	**123**	184	155
Economic net interest-bearing debt	**7,060**	6,115	5,601

Total borrowings in the table above are represented by:

	GROUP $ MILLION		
	AS AT		
	31 JAN 2018 UNAUDITED	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
Commercial paper	**239**	313	164
Bank loans	**1,763**	1,226	854
Finance leases	**134**	139	137
Capital notes	**35**	35	35
NZX-listed bonds	**500**	499	500
Medium-term notes	**4,941**	4,539	4,573
Total borrowings	**7,612**	6,751	6,263
Included within the statement of financial position as follows:			
Total current borrowings	**1,383**	983	1,112
Total non-current borrowings	**6,229**	5,768	5,151
Total borrowings	**7,612**	6,751	6,263

LONG-TERM ASSETS

6 PROPERTY, PLANT AND EQUIPMENT

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2018 UNAUDITED	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
Additions	**310**	205	754
Disposals	**(7)**	(20)	(48)
Capital commitments	**236**	159	235

INVESTMENTS

7 EQUITY ACCOUNTED INVESTMENTS

The Group's significant equity accounted investments are listed below. The ownership interest in these entities is 51 per cent or less and the Group is not considered to exercise a controlling interest.

		OWNERSHIP INTERESTS (%)		
		AS AT		
EQUITY ACCOUNTED INVESTEE NAME	COUNTRY OF INCORPORATION AND PRINCIPAL PLACE OF BUSINESS	**31 JAN 2018 UNAUDITED**	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
DMV Fonterra Excipients GmbH & Co KG	Germany	**50**	50	50
Beingmate Baby & Child Food Co., Ltd[1]	China	**18.8**	18.8	18.8
Falcon Dairy Holdings Limited	Hong Kong	**51**	51	51

All investees have balance dates of 31 December.

1 For further information on the carrying value of the investment in Beingmate please refer to the 'Basis of Preparation' section of these financial statements.

OTHER

8 CONTINGENT LIABILITIES, PROVISIONS AND COMMITMENTS

Contingent liabilities

In the normal course of business, Fonterra, its subsidiaries and equity accounted investees, are exposed to claims and legal proceedings that may in some cases result in costs to the Group.

In early August 2013, Fonterra publicly announced a potential food safety issue with three batches of Whey Protein Concentrate (WPC80) produced at the Hautapu manufacturing site and initiated a precautionary product recall.

In late August 2013, the New Zealand Government confirmed that the *Clostridium* samples found in WPC80 were not *Clostridium botulinum* and were not toxigenic, meaning the consumers of products containing the relevant batches of WPC80 were never in danger from *Clostridium botulinum*.

In January 2014, Danone formally initiated legal proceedings against Fonterra in the High Court of New Zealand and separate Singapore arbitration proceedings against Fonterra in relation to the WPC80 precautionary recall. The New Zealand High Court proceedings have been stayed pending completion of the Singapore arbitration.

On 1 December 2017, the Singapore arbitration panel issued its award (judgement), finding in favour of Danone and ordered Fonterra to pay EUR105 million ($183 million) in recall costs to Danone. Following a comprehensive review of the award, Fonterra has accepted the outcome. Fonterra paid the award in December 2017.

In addition to the recall costs, Fonterra has agreed to pay Danone EUR29 million ($49 million) representing interest on the award amount and Danone's costs in connection with the arbitration proceedings.

It is unclear whether Danone will continue to pursue the New Zealand High Court proceedings that were stayed pending the decision in the Singapore arbitration. Due to the uncertainty regarding whether Danone will seek to re-initiate these proceedings, and the nature and scope of these potential proceedings in light of the arbitration findings and award, no amount has been recognised in relation to these proceedings.

The Directors believe that these proceedings have been adequately disclosed by the Group and that there are no additional claims or legal proceedings in respect of this matter that are pending at the date of these financial statements that require provision or disclosure.

The Group has no other contingent liabilities as at 31 January 2018 (31 January 2017: nil; 31 July 2017: nil).

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE SIX MONTHS ENDED 31 JANUARY 2018

9 FAIR VALUE

Fair value hierarchy

The fair value hierarchy described below is used to provide an indication of the level of estimation or judgement required in determining fair value:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: Inputs for the assets or liabilities that are not based on observable market data (unobservable inputs).

The following table shows the fair value hierarchy for assets and liabilities measured at fair value on the statement of financial position:

	GROUP $ MILLION								
	LEVEL 1			LEVEL 2			LEVEL 3		
	AS AT			AS AT			AS AT		
	31 JAN 2018 UNAUDITED	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED	**31 JAN 2018 UNAUDITED**	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED	**31 JAN 2018 UNAUDITED**	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
Derivative assets									
– Commodity derivatives	**21**	22	30	**5**	1	1	**–**	–	–
– Foreign exchange derivatives	**–**	–	–	**390**	453	595	**–**	–	–
– Interest rate derivatives[1]	**–**	–	–	**175**	220	193	**–**	–	–
Derivative liabilities									
– Commodity derivatives	**(4)**	(26)	(7)	**–**	(1)	(2)	**–**	–	–
– Foreign exchange derivatives	**–**	–	–	**(77)**	(23)	(24)	**–**	–	–
– Interest rate derivatives[1]	**–**	–	–	**(476)**	(566)	(557)	**–**	–	–
Investments in shares	**12**	8	10	**15**	–	–	**7**	–	9
Investment in Beingmate[2]	**–**	–	–	**–**	–	–	**244**	–	617
Livestock	**–**	–	–	**–**	–	–	**298**	317	319
Fair value	**29**	4	33	**32**	84	206	**549**	317	945

1 Includes cross-currency interest rate swaps.

2 The key assumptions used in determining the fair value of the investment in Beingmate are the base share price and the premium above base share price that would be paid for a long term strategic investment of a similar size.

The following table shows the fair value hierarchy for each class of financial asset and liability where the carrying value in the statement of financial position differs from the fair value:

	GROUP $ MILLION								
	CARRYING VALUE			LEVEL 1			LEVEL 2		
	AS AT			AS AT			AS AT		
	31 JAN 2018 UNAUDITED	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED	**31 JAN 2018 UNAUDITED**	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED	**31 JAN 2018 UNAUDITED**	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
Financial assets									
Long-term advances	**138**	481	300	**–**	–	–	**133**	489	289
Financial liabilities									
Borrowings									
– NZX-listed bonds	**(500)**	(499)	(500)	**(512)**	(490)	(510)	**–**	–	–
– Capital notes	**(35)**	(35)	(35)	**(34)**	(33)	(33)	**–**	–	–
– Medium-term notes	**(4,941)**	(4,539)	(4,573)	**–**	–	–	**(5,223)**	(4,780)	(4,829)
– Finance leases	**(134)**	(139)	(137)	**–**	–	–	**(149)**	(158)	(155)

10 NET TANGIBLE ASSETS PER SECURITY

	GROUP		
	AS AT		
	31 JAN 2018 UNAUDITED	31 JAN 2017 UNAUDITED	31 JUL 2017 AUDITED
Net tangible assets per security[1]			
$ per listed debt security on issue	**5.79**	6.73	6.86
$ per equity instrument on issue	**2.17**	2.53	2.57
Listed debt securities on issue (million)	**603**	603	603
Equity instruments on issue (million)	**1,610**	1,604	1,607

1 Net tangible assets represents total assets less total liabilities less intangible assets.

NON-GAAP MEASURES

Fonterra uses several non-GAAP measures when discussing financial performance. For further details and definitions of non-GAAP measures used by Fonterra, refer to the glossary on page 49. These are non-GAAP measures and are not prepared in accordance with IFRS.

Management believes that these measures provide useful information as they provide valuable insight on the underlying performance of the business. They may be used internally to evaluate the underlying performance of business units and to analyse trends. These measures are not uniformly defined or utilised by all companies. Accordingly, these measures may not be comparable with similarly titled measures used by other companies. Non-GAAP financial measures should not be viewed in isolation nor considered as a substitute for measures reported in accordance with IFRS.

Reconciliations for the IFRS measures to certain non-GAAP measures referred to by Fonterra are detailed below.

Reconciliation from the IFRS measure of profit for the period to Fonterra's normalised EBITDA

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2018	31 JAN 2017	31 JUL 2017
(Loss)/profit for the period	**(348)**	418	745
Add: Depreciation	**229**	240	435
Add: Amortisation	**46**	49	91
Add: Net finance costs	**201**	157	355
(Less)/Add: Taxation (credit)/expense	**(29)**	69	20
Total EBITDA	**99**	933	1,646
Add: WPC80 recall costs	**196**	–	–
Add: Reduction in the carrying value of investment in Beingmate	**433**	–	76
Add: Time value of options	**5**	5	1
Less: Gain on sale of Darnum manufacturing plant	**–**	(42)	(42)
Total normalisation adjustments	**634**	(37)	35
Normalised EBITDA	**733**	896	1,681

Reconciliation from the NZ IFRS measure of profit for the period to Fonterra's normalised EBIT

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2018	31 JAN 2017	31 JUL 2017
(Loss)/profit for the period	**(348)**	418	745
Add: Net finance costs	**201**	157	355
(Less)/Add: Taxation (credit)/expense	**(29)**	69	20
Total EBIT	**(176)**	644	1,120
Add/(Less): Normalisation adjustments (as detailed above)	**634**	(37)	35
Total normalised EBIT	**458**	607	1,155

Reconciliation from the NZ IFRS measure of profit for the period to Fonterra's normalised earnings per share

	GROUP $ MILLION		
	SIX MONTHS ENDED		YEAR ENDED
	31 JAN 2018	31 JAN 2017	31 JUL 2017
(Loss)/profit for the period	**(348)**	418	745
Add/(Less): Normalisation adjustments (as detailed above)	**634**	(37)	35
Add: Normalisation adjustment to net finance costs	**26**	–	–
(Less)/Add: Tax on normalisation adjustments	**(64)**	8	12
Total normalised earnings	**248**	389	792
Less: Share attributable to non-controlling interests	**(6)**	(5)	(11)
Net normalised earnings attributable to equity holders of the Parent	**242**	384	781
Weighted average number of shares (thousands of shares)	**1,608,821**	1,603,698	1,604,744
Normalised earnings per share ($)	**0.15**	0.24	0.49

GLOSSARY

NON-GAAP MEASURES

Fonterra refers to non-GAAP financial measures throughout the Interim Report, and these measures are not prepared in accordance with NZ IFRS. The definitions below explain how Fonterra calculates the non-GAAP measures referred to throughout the Interim Report.

EBIT	means earnings before interest and tax and is calculated as profit for the period before net finance costs and tax.
EBITDA	means earnings before interest, tax, depreciation and amortisation and is calculated as profit for the period before net finance costs, tax, depreciation and amortisation.
Economic net interest-bearing debt	means net interest-bearing debt including the effect of debt hedging.
Farmgate Milk Price	means the base price that Fonterra pays for milk supplied to it in New Zealand for a season. The season refers to the 12-month milk season of 1 June to 31 May.
Gearing ratio	is calculated as economic net interest-bearing debt divided by total capital. Total capital is equity excluding the hedge reserves, plus economic net interest-bearing debt.
Normalisation adjustments	means transactions that are unusual by nature and size. Excluding these transactions can assist users with forming a view of the underlying performance of the business. Unusual transactions by nature are the result of specific events or circumstances that are outside the control of the business, or relate to major acquisitions, disposals or divestments, or are not expected to occur frequently. It also includes fair value movements if they are non-cash and have no impact on profit over time. Unusual transactions by size are those that are unusually large in a particular accounting period.
Normalised EBIT	means profit for the period before net finance costs and tax, and after normalisation adjustments.
Normalised earnings per share (EPS)	means normalised profit after tax attributable to equity holders divided by the weighted average number of shares for the period.
Normalised profit after tax	means net profit after tax after normalisation adjustments, and the interest and tax impact of those normalisation adjustments.
Normalised segment earnings	means segmental profit for the period before net finance costs and tax, and after normalisation adjustments.
Payout	means the total cash payment to farmer shareholders. It is the sum of the Farmgate Milk Price (kg/MS) and the dividend per share. Both of these components have established policies and procedures in place on how they are determined.
Retentions	means net profit after tax attributable to farmer shareholders divided by the number of shares at 31 May, less dividend per share.
Return on capital	is calculated as normalised EBIT less equity accounted investees' earnings divided by capital employed. Capital employed is calculated as the average for the period of: net assets excluding net interest-bearing debt, deferred tax balances and brands, goodwill and equity accounted investments.
Segment earnings	means segmental profit for the period before net finance costs and tax.
Working capital	is calculated as current trade receivables plus inventories, less current trade payables and accruals. It excludes amounts owing to suppliers and employee entitlements.
Working capital days	is calculated as average period to date working capital divided by external revenue, multiplied by the number of days in the period.

SHAREHOLDER INFORMATION

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John Wilson

Clinton Dines

Brent Goldsack

Bruce Hassall

Simon Israel

Andrew Macfarlane

John Monaghan

Nicola Shadbolt

Donna Smit

Scott St John

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