FONTERRA
DAIRY FOR LIFE

ANNUAL REVIEW 2016
FONTERRA CO-OPERATIVE GROUP LIMITED

CONTENTS

Fonterra uses several non-GAAP measures when discussing financial performance. Fonterra refers to normalised segment earnings, normalised EBIT, EBIT, EBITDA, constant currency variances, normalisation adjustments and payout when discussing financial performance. These are non-GAAP financial measures and are not prepared in accordance with 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. Please refer to page 98 for the reconciliation of the NZ IFRS measures to the non-GAAP measures and page 99 for definitions of the non-GAAP measures used by Fonterra.

OUR CO-OPERATIVE

Our Co-operative's strength comes from our common goal. Our job is to produce the best milk and secure the best returns, while maintaining our commitment to sustainability and our communities.

FONTERRA FARM SOURCE™ REWARDS AND BENEFITS

$30M

FARMERS THAT CHECK THEIR MILK PICK-UPS DAILY WITH THE ON-FARM APP

63%

$3.90 ↓

2015/16 SEASON FARMGATE MILK PRICE

1,566M KGMS ↓

NEW ZEALAND MILK COLLECTION FOR THE 2015/16 SEASON

40CPS ↑

FINANCIAL YEAR 2016 TOTAL DIVIDEND PER SHARE

OUR POTENTIAL

We are continuing to grow value by converting more of our farmers' milk into higher-value products for customers around the world.

ADDITIONAL MILK CONVERTED INTO CONSUMER AND FOODSERVICE PRODUCTS

380M LME

VOLUME INTO CONSUMER AND FOODSERVICE BY 2025

10 B LME

OUR PERFORMANCE

A strong result reflects both increased earnings from the execution of our strategy and strong financial discipline.

GROUP VOLUME

23.7B LME

GROUP REVENUE

$17.2B

We create value by delivering innovative ingredient solutions to meet our customer needs.

$1,358M

GROUP NORMALISED EBIT (NZD)

Anchor™ is becoming more global in our consumer business and through Anchor Food Professionals in foodservice.

12.4%

RETURN ON CAPITAL

Our research and development is ensuring our products offer the highest quality nutrition.

$834M

NET PROFIT AFTER TAX (NZD)

LETTER FROM **THE CHAIRMAN**

The 2015/16 season has been incredibly difficult for our farmers, their families and our rural communities. Global dairy prices remained at unsustainably low levels and the New Zealand dollar stayed high.

40 CPS

DIVIDEND
The full-year dividend of 40 cents per share is 15 cents higher than last year.

OUR CO-OPERATIVE HAS RESPONDED.

WE CONTINUED WITH THE SIGNIFICANT AND NECESSARY CHANGES WE BEGAN IN THE BUSINESS OVER THREE YEARS AGO TO SUPPORT OUR STRATEGY AND PRIORITIES.

The final phases of this were completed this year to ensure a strong Co-operative that can deliver every cent possible to our farmers, while supporting our younger farmers and sharemilkers through Farm Source™ supplies and service.

Our Farmgate Milk Price of $3.90 per kilogram of milk solids (kgMS) is a result of the low prices for milk that farmers globally have faced this year. The full-year dividend of 40 cents per share, 60 per cent higher than last year, delivers a final Cash Payout of $4.30 per kgMS to a 100 per cent shared up farmer. Total earnings per share are 51 cents, and the 40 cent dividend meets Board policy of 65–75 per cent of adjusted net profit after tax over time. This dividend has been paid while lowering debt by $1.6 billion, delivering a year-end gearing ratio of 44.3 per cent.

The priority has been moving higher volumes of milk into higher-returning consumer and foodservice products while securing sustainable ingredients margins over the GlobalDairyTrade benchmarks, especially through speciality ingredient solutions and service offerings.

Expenses are down as we work to be more responsive to customer and consumer demand and build more flexibility into the business to respond to rapidly changing market requirements and opportunities.

All this has been tough on our people, but we are now seeing the benefits not only in financial performance but in the feedback from the business and our customers.

Normalised earnings before interest and tax were up by 39 per cent to $1.4 billion and net profit after tax was up 65 per cent to $834 million, a record result.

Higher earnings and financial discipline supported a lift in our return on capital on a like-for-like basis from 8.9 per cent to 12.4 per cent. Our total return on capital, including equity-accounted investments, goodwill and brands has risen from 6.9 per cent last year to 9.2 per cent.

SUPPORTING OUR FARMERS

We have done what we can to support our farmers through a demanding season.

After an extraordinary fall in global dairy prices at the start of our financial year, we reacted with the decidedly co-operative step of providing our Fonterra Co-operative Support loan of 50 cents per kgMS for milk produced up to December 2015. This loan is interest-free until May 31, 2017 and repayable when the Farmgate Milk Price is over $6.00 per kgMS. The loan was taken up by 76 per cent of our shareholders and as at April 2016 the total amount advanced was $383 million.

We brought forward the percentage paid in advance rate payments for milk, to support cash flows at the periods of highest financial demand on farms. We also brought forward dividend payments to support winter cash flows. Our farmer shareholders and unitholders received 20 cents per share paid after the interim result in April and two payments of 10 cents per share paid in June and September. These early dividend payments saw surplus cash generated by efficient working capital management, passed quickly through to farmers.

LETTER FROM **THE CHAIRMAN**

LEANER BUSINESS
Our farmers have reduced costs and improved efficiencies and we have done the same.

Through our Farm Source™ stores we used our collective strength to lower the cost of farm supplies and to provide attractive trading terms. This provided a significant benefit to all farmers, in particular our younger farmers and sharemilkers. This has been supported by our change to a regional leadership model enabling our management to be more responsive to our farmers' needs.

Over the past two years there has been a significant adjustment in farm operating systems to reduce costs. From 2010 to 2015 we saw increased stocking rates, higher feed inputs and increased cost structures as farmers responded to higher milk prices. Farmers invested in improving farm assets, particularly in sustainability initiatives.

With prices falling, the 2015/16 season has seen lower stocking rates, and farmers optimising their pasture-based systems. DairyNZ calculates that average farm working expenses in 2016/17 have dropped to $3.55 per kgMS, the lowest since 2009/10. The break-even payout is $5.05 per kgMS for the average farmer in 2016/17 compared to $5.25 per kgMS for 2015/16 and $5.77 in 2014/15.

Together with Fonterra ensuring we have the most efficient manufacturing and logistics to get milk from farm to consumer, it is critical that our farmers maintain their low-cost, high-efficiency pastoral-based systems and that our Co-operative and our farmers are better at the basics than our global competitors. We have a real opportunity with many of our consumers increasingly favouring food which is produced as naturally and sustainably as possible.

Milk from predominantly pasture-fed cows has nutritional advantages over milk from grain-fed herds, typically being richer in Omega-3 fatty acids. Our farmers' herds graze freely outdoors, compared to their barn-housed counterparts in other parts of the world. Anchor™-branded products have been exported for more than 100 years, supported by images of well-fed cows grazing on lush pastures under clear skies.

The milk our farmers' herds produce and the products made with it have many positive qualities, some that we have known for years as well as those recently uncovered. Our farmers have invested in highly sustainable systems and our Co-operative's extraordinary innovation and efficiency in our manufacturing, food assurance and traceability systems, provides trusted dairy products to our consumers. We are unique in the world with this vertically integrated supply chain from outstanding pasture-based systems. We share this story confidently with customers and consumers.

FONTERRA MILK FOR SCHOOLS

Provides children with a 200ml carton of Anchor™ UHT milk, available at 1,455 schools every day.

HIGH QUALITY AND SAFE MILK

We have worked with farmers on raising environmental standards, as well as maintaining the standards which ensure high quality and safe milk.

#431AM

We have started sharing this story at home with our #431AM campaign. Showing our farmers on their farms is a quiet reminder that while Fonterra might be significant globally, we are a predominantly family business. This family of more than 10,500 farmer shareholders – whose days start well before dawn and who care about people, their communities and their land and herds – is supported in our local communities by our 11,400 New Zealand employees and their families and further afield by our 9,900 employees located in other parts of the world.

PRODUCTION

New Zealand milk collection reached 1,566 million kgMS, three per cent lower than the previous season. This decrease was due to a change in farming systems, partially offset by an unusually wet summer across most dairying regions. North Island milk collection was 954 million kgMS and South Island 613 million kgMS.

OPEN TRADE SUPPORTS GROWTH

The long-term fundamentals for dairy remain strong. World population growth, emerging market demand and renewed recognition of the nutritious qualities of dairy across all markets are increasing demand. An open trade environment is now more important than ever. Yet our access to markets is significantly constrained, with 87 per cent of global consumers living in markets where we meet tariffs of greater than 10 per cent on our products.

It is vital that the New Zealand Government brings renewed energy and commitment to its trade agenda. We must continue to develop New Zealand's trade strategy capability in our current markets, as well as combating non-tariff barriers, develop new cross-border rules for e-commerce, and open up new markets such as Africa. The current rhetoric and actions towards protectionism by some of our trading partners is of significant concern, and has the potential to slow global growth.

We strongly support every effort made by our Government to advance the trade agenda and we openly encourage more to be done, especially given the contribution of agriculture and dairy to our economy and to the health of rural communities here and globally.

#431AM SHARING OUR STORY

Our 10,500 farmers produce trusted, natural dairy for New Zealanders and for the world. They're proud of the Co-operative they own and their contribution to our country.

78%

OF NEW ZEALANDERS

are aware of the #431AM campaign.[1]

IT'S A GREAT STORY THAT WE SEE EVERY DAY, BUT THE REST OF NEW ZEALAND DOESN'T ALWAYS GET TO SEE IT OR HEAR ABOUT THE GOOD WORK THAT HAPPENS ON-FARM.

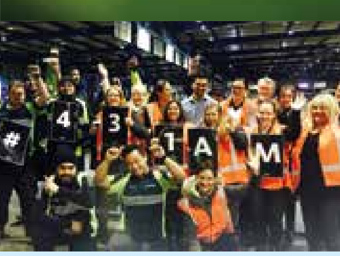
While New Zealand sleeps, some people are already at work – including our farmers. 4:31AM is a time our farmers know well, the start of the day for many of them as they rise for the first milking. #431AM is their voice, and the voice of other early risers, sharing their stories with New Zealand.

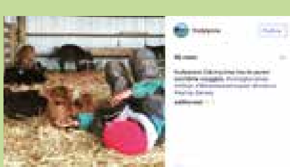
1 *Based on a Colmar Brunton poll.*

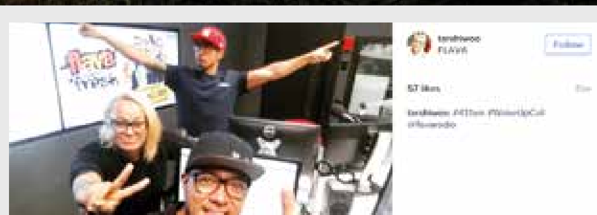
GIVING FARMERS A VOICE TO SHARE THEIR STORY

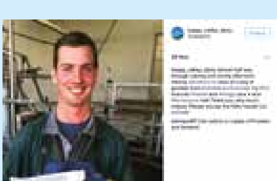
#431AM is all about our farmers and our brand ambassador, Richie McCaw, having an important conversation with New Zealanders about our farmers' contribution to the country and their care for the land and waterways. It recognises our world-leading innovation, support for communities and the hard work of our farming families and our people sharing New Zealand's dairy with the world.

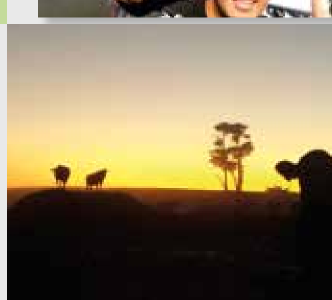
Following the campaign's launch in May 2016, we've continued to encourage our farmers and people to share their stories using #431AM and they're responding in droves. But it isn't just our farmers and people who are on board, it's bakers, nurses, transport operators, TV and radio hosts, Anchor™ franchisees, supermarket employees – anyone up in the early hours of the morning doing their bit for New Zealand, or wishing to support those of us who are up before the rest of the country wakes.



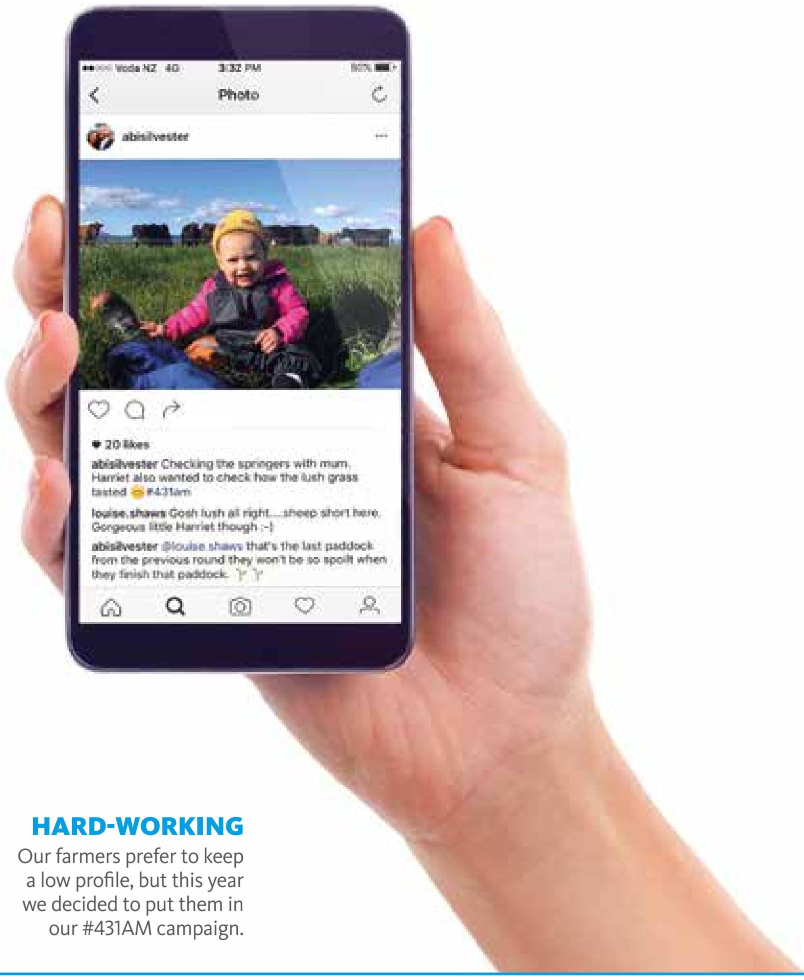








LETTER FROM **THE CHAIRMAN**



HARD-WORKING

Our farmers prefer to keep a low profile, but this year we decided to put them in our #431AM campaign.

GOVERNANCE AND REPRESENTATION REVIEW

Over the past 12 months, our Governance and Representation Review Committee has been working to evolve and improve our Co-operative's unique Governance and Representation model.

Constantly improving Governance and Representation is critical to our success. We have ensured all shareholders have had an opportunity to have their say, with more than 500 meetings across New Zealand.

The key outcome of the review is a recommendation that is designed to consistently attract and then deliver the best-quality candidates for our Board and Council. Shareholders must be confident in their access to people with the attributes and diversity of skills and experience needed to lead an organisation of Fonterra's scale.

Two Independent Expert Panels which reviewed the Governance and Representation recommendations endorsed them to our shareholders.

Ultimately, the mandate for change must come from our farmer shareholders. They will make a decision on the future of our Co-operative at a Special Meeting in October 2016.

BOARD CHANGES

Post balance date, we announced the retirement of Independent Director, John Waller ONZM, who has been a valued member of the Board since 2009.

John chaired our Fair Value Share Review Committee, the Trading Among Farmers Due Diligence Committee and the Milk Price Panel, and was a member of the Audit and Finance Committee and the Risk Committee.

In each of those roles, and as a Director, he was outstanding, making an invaluable contribution by combining his strong personal values, drive and leadership with commercial common-sense. He has been a great friend to Fonterra, to the Board and to me as Chairman, providing wise counsel, careful analysis and energy. We will always be grateful to John for his contribution.

In November, Clinton Dines took up his appointment as an Independent Director. He brings international business and governance credentials to the Board, and a deep understanding of China where he lived and worked for more than three decades as a senior executive with BHP Billiton.

SOLID PERFORMANCE
We have become a stronger Co-operative – operationally, financially and in our mindset.

Ashley Waugh was welcomed to the Board in November when he was voted on as a Farmer Director. He joined with a strong track record in the dairy industry through 10 years of senior roles in the New Zealand Dairy Board and eight with National Foods, including four years as CEO.

We thank Blue Read who was elected to the Board in 2012 and who previously served as Chairman of the Shareholders' Council from 2007 to 2010. Blue's service to the Co-operative as a Councillor and then Director is much appreciated. His firm belief in the importance of a co-operative to farmers was always apparent.

A STRONGER CO-OPERATIVE

Our performance and our ability to support farmers this year, while significantly strengthening our balance sheet, is due to strict financial discipline in the business and a determined effort to shift more volumes of milk into higher-returning products. Our management team and all of our people deserve recognition for this, and their determination to see positive changes made quickly so that the benefits could be realised at pace for our farmers.

After a three year period of deliberate and disciplined attention to the business, we have become a stronger Co-operative, operationally, financially and in our mindset with a clear sense of direction and a structure which will support real momentum in our strategy going forward. Pleasingly we are coming into a new financial year where prices are improving as the market rebalances, however we must and will continue with the same determination and discipline we have shown this year so that we keep delivering value for our farmers, our shareholders, and our communities.

John Wilson
Chairman

LETTER FROM THE **CHIEF EXECUTIVE**

This year, we've seen the strength of our Co-operative showing through. That strength comes from the work and direction since we set our strategy and secured our capital structure. We are starting to see that effort pay off.

12.4%

RETURN ON CAPITAL
Increased return on capital through higher earnings and good financial discipline.

WE KNEW WE WOULD FACE THE UPS AND DOWNS OF A VOLATILE MARKET THIS YEAR, JUST AS WE DID LAST YEAR.

WE KNEW FARMERS WOULD FACE A LOW MILK PRICE, SO WE KEPT THAT FRONT OF MIND, AND PUSHED HARDER ON STRATEGY SO WE WOULD COME OUT STRONGER.

Looking at our performance this year against our promises, we've done what we said we would do and, where we could, we have done more. It has been a team effort and it's been hard going sometimes. We've put pressure on ourselves, setting ambitious goals for cost efficiencies and challenging all of our people to adapt how we work to better manage the shifts in the global market. I am proud of how the team has responded, because we have a Co-operative set up for more growth, more progress on strategy and better returns for our farmers.

USEFUL FACT
More volumes of milk sold at higher value is at the heart of our strategy.

This is another low payout year because of weak dairy prices globally, so we owed our best efforts to our farmers. Our Farmgate Milk Price of $3.90 per kgMS and our 40 cent dividend combine to return $4.30 per kgMS to a fully shared up farmer as Cash Payout. In most cases, that's below their breakeven point, so it was important for us to show how our Co-operative is behind them every day of the year and that we are keeping our promises.

INCREASED VALUE FROM THE MILK WE PRODUCE

More volumes of milk sold at higher value is at the heart of our strategy. For our farmers, the promise is that we will make the most of their milk. We're keeping that promise.

Every year, we convert more and more of our farmers' milk into higher-returning products, through our ingredients solutions and consumer and foodservice business. The value of this strategy is measured not only in the Cash Payout, but also in growing the value of every dollar of capital our farmers have invested in us.

This starts in our ingredients business. Because of the money our farmers have invested in stainless steel we are in a stronger position to achieve higher yields through our optimised plants. We have more choices in what we do with their milk, and to generate the most value from it, we aim to shift as much volume as possible into higher-margin ingredients solutions. Our increased ingredients earnings this year show how we have matched production to the highest value customer demand while taking advantage of our reduced costs, especially at the peak of the season when we get the most milk.

Given low global prices, making the right choices was more important than ever. As much as possible, we switched production away from the powders and related product streams of butter and anhydrous milk fat (AMF) that make up the Farmgate Milk Price while margins for these products were lower. This allowed us to take advantage of a 24 per cent higher gross margin per tonne for the other products we make, offsetting the impact of an 18 per cent fall in margins on powders, butter and AMF. What this means is an overall lift in our ingredients gross margin of $300 million.

In consumer and foodservice, we converted an additional 380 million liquid milk equivalents (LME) into higher-returning products, increasing our total volumes in this business from 4.5 billion LME to 4.9 billion LME.

Our aim is to have 10 billion LME in consumer and foodservice products by 2025. We are half-way there, building on the great work of the past two years where we converted an extra billion litres of milk into higher-returning products. Increasing our consumer and foodservice volumes, and especially our foodservice growth, meant we increased our normalised earnings before interest and tax in this business by 42 per cent to $580 million.

LETTER FROM THE **CHIEF EXECUTIVE**

CREATING VALUE
We are creating value with local supply in other markets which is used to meet the needs of our customers.

Our results show how each part of the Co-operative is pulling together for our farmers this year. We were single-minded about transforming our business to get the best results we could, especially on the measure of how much value we create for our farmers. We've achieved our best-ever results by running the business well, improving all the fundamentals and thinking more like our farmer owners when it comes to cash. We cut our operating expenses, increased our free cash flow, reduced our working capital days, drove debt and gearing down, and reduced capital expenditure.

All of this effort, combined with higher earnings and margins, meant our overall return on capital increased from 8.9 per cent to 12.4 per cent.

Our ingredients return on capital was 13.4 per cent compared with last year's 9.3 per cent. Our consumer and foodservice return on capital was 41.7 per cent. As farmers buy shares to match their milk production, the returns they get on those shares are important to them. This year, we achieved a dividend yield of 7.3 per cent. If farmers have borrowed to fund share purchases, these returns should more than cover the costs of that borrowing.

Our results show how our strategy is creating value for our farmer shareholders and unitholders. We are delivering on volume and value and driving for results more quickly.

THE FUTURE FOR DAIRY

The future for dairy remains positive because of forecast population growth, and demand growth in emerging markets. We are well-placed thanks to everyone's hard work from the farm right through to our sales team.

We have access to high-quality milk in New Zealand and all the new milk coming off farms is going directly into higher-returning products. We are creating value with local supply in other markets which is used to meet the needs of our customers. We have a world-class ingredients business. We are converting more volumes to higher-value products in our consumer and foodservice business. We have an integrated business in China, our biggest market, and we have a secure milk source through our increasingly efficient farms there.

We have turned around our Australian business, as we said we would do, and we have in place all the building blocks to build on our strengths in cheese, whey and nutritionals and our market-leading brands in the butter and cheese categories.

CHALLENGE BOUNDARIES

Disrupt is about tapping into the great ideas and energy of our people to stay two steps ahead.

TRANSFORMING THE WAY WE WORK AS TEAMS

To make a difference in the lives of two billion people by 2025 we need to be alert to what they want and be first to market with the answer.

Increasingly, we operate in markets where things change constantly and how you respond can either blow you off course or carry you into the future. This reminds us of the need to go forward at pace. We know fast-moving markets need fast-moving thinkers who can spot consumer trends before they happen, so we are ready to go to market with clever products well before our competitors.

We have become our own disruptors, asking how consumers will interact with our products in two, five and 10 years and what their expectations will be. The next step is to find the best ideas and put them through an acceleration programme.

We tapped into the ideas of around 700 of our people across Australia, China and New Zealand as the first step in creating truly innovative dairy products and ventures.

This is about creating a compelling combination of innovative ideas and the right environment so we connect with consumers through fresh thinking and products that make the most of the goodness of dairy and our New Zealand origins, to generate more value for our farmers.

It is about keeping two steps ahead with e-commerce and business models that are changing how customers and consumers buy from us, and continuing to rapidly advance and evolve. We are using people across multiple functions and markets, making the most of our Co-operative value of challenging boundaries. This is about generating value faster through rapid innovation in dairy nutrition.

We are comfortable challenging boundaries in innovation because we have successfully done the same across the Co-operative over the past year as we have transformed the business. We have reduced working capital and debt, found ways to generate cash faster and generated more value for our farmer shareholders and unitholders. The results are a total Co-operative effort, with our people across the business collaborating on challenging and changing the way we work. This takes commitment and discipline, but we have shown we can develop and implement transforming ideas at speed, and create more value through delivering our strategy.

LETTER FROM THE **CHIEF EXECUTIVE**

FOOD SAFETY AND QUALITY
Throughout our supply chain, we record ingredients and packaging information used in manufacture, enabling us to obtain history, location and status of specific batches.

OUR STORY
Our strength lies in the fact we are a business owned and controlled by our farmers.

SHARING OUR STORY

Our strategy sets out how we will make a difference in the lives of two billion people by 2025. Since developing it we have had our heads down putting everything in place so we can make it a reality.

The Co-operative that started out in 2001 is not the Co-operative we have today in terms of revenue, assets, results and attitude. We've changed for the better and we keep changing as market expectations increase. Our farmers have made real and measurable progress in making their farms more sustainable through fencing, protecting waterways, effluent and nutrient management, and paying even more attention to animal welfare and milk quality. We take the same care across all of our sites, using resources like water and energy responsibly and looking after our employees in our health and safety programmes.

Our strong food safety and quality framework is now even stronger as we work towards world-class standards in traceability. We have invested in new plant, in innovation and in our people. We've kept our promise to share great dairy nutrition with our communities through Fonterra Milk for Schools, and through our Fonterra Grass Roots Fund and our Living Water partnership, we are looking after local communities and the environment.

As a large New Zealand company, it's important we share our story. In the long run, when communities understand that we're doing what's right, that we have the same concerns as they do about the environment, that we can be trusted to produce great products responsibly, and that our success contributes to New Zealand's success, we will all be better off.

We know trust is earned. When I look back at all the effort we've made over the past five years or so I think we can say we're earning it. We're not perfect and would never claim that, but we're very proud of what we do, who we are and our values, as well as the fact that we keep trying to be better every day.

OUR GREAT TEAM

We've come to the end of a demanding, but rewarding year. Our leadership team has been a real source of strength to me and set a great example for all of our people. They've encouraged the performance we achieved.

We have made the team stronger with changes to better support our goals of value creation and strong performance. The most significant leadership changes were the newly created Global Consumer and Foodservice business unit led by Jacqueline Chow, Judith Swales' appointment to Chief Operating Officer Velocity and Innovation and Miles Hurrell heading up Farm Source, formerly Co-operative Affairs.

These changes mirror others made to the business structure so we can make even faster progress on our strategy.

I want to thank all of our people. We've asked a great deal from them this year and, in many cases, reorganisation of the business meant considerable change. Change is never easy, so I very much appreciated the fact that all of our people put our shareholders first and ensured we kept our promises on performance.

I want to also thank our farmer shareholders. Everything we do starts with your milk and the care you take.

We have hard-working, efficient and innovative farmers and it is not surprising that other processors would like their supply. We're proud that our shareholders continue to put their trust in us and I can promise that we are all determined to live up to that.

OUTLOOK

We announced in August a forecast Farmgate Milk Price of $4.75 per kgMS and a forecast total payout available to farmers in the 2016/17 season of $5.25 to $5.35 before retentions. This includes our forecast earnings per share range of 50 to 60 cents.

Our higher forecast earnings per share range reflects the performance improvements we intend to keep making across the business, building on last year's hard work and results.

Throughout the dairy pricing downturn, we have made every effort to generate the best returns for our shareholders that we can, both at the farm gate and through the dividend. There are good signs of a recovery and our forecast reflects that, but we have no intention of relaxing our focus on producing quality results from a high-quality product and sharing our dairy's trusted goodness with the world. We will continue to make improvements.
Our commitment is always to seek feedback, to listen and to get better at what we do. We have big ambitions and we're determined to achieve them, generating increased value on our shareholders' investment in us.

Theo Spierings
Chief Executive

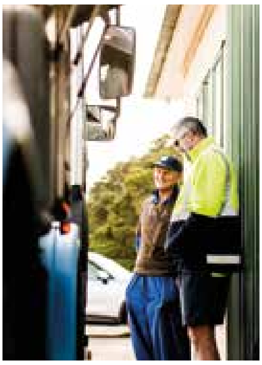
SHARING OUR DAIRY'S **TRUSTED GOODNESS WITH THE WORLD**

Over many years, Fonterra has played a big part in building the image of New Zealand. Our Fonterra brand and our nutritious and delicious consumer and customer brands are already closely associated with New Zealand's great, pure image.

OUR FARMERS MAKE THE MOST OF NEW ZEALAND'S ENVIRONMENT.

THEY'RE ACKNOWLEDGED AS AMONG THE BEST IN THE WORLD AND LEAD WITH INNOVATION AND BEST PRACTICE.

Their hard work over generations in practising good environmental stewardship, upholding high standards of animal welfare and commitment to the strictest standards of milk quality, means we can turn our natural advantages and farmer efforts into solid returns by getting a premium for our higher-value products.



PURE NEW ZEALAND **DAIRY**

More and more, global consumers want to know where their food comes from and who produces it. They want to know that their food has been produced in a socially and environmentally responsible way, and that it is high quality, safe, healthy and from a trusted source.

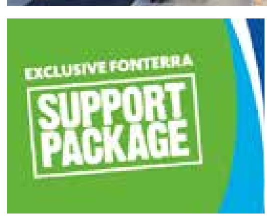
Our farmers and our people have an incredible story to share with customers and consumers wherever they are in the world. One that talks about their commitment to our pasture-based system, animal welfare, sustainable farming practices, caring for the environment, and world-class food safety and quality systems.

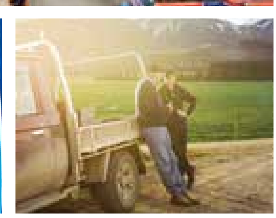
STRENGTH IN NUMBERS

Our Co-operative's strength lies in the fact we are a business owned and controlled by our farmers, with a common goal to produce the best milk and secure the best returns in our global markets.

OUR PRIORITY IS TO TAKE CARE OF OUR FARMER OWNERS AND THIS YEAR WE'VE SUPPORTED THEM IN MANAGING THE DROP IN INCOME THAT HAS FOLLOWED SUSTAINED LOW DAIRY PRICES.

Our Farm Source™ Support Package, our Fonterra Co-operative Support loan and advancing dividend payments to help over the winter months when cashflow is tight, are good examples of how we are working alongside our farmers during this time.





Farm Source™ works to help bring costs down for our farmers, using our collective strength to secure competitive pricing from vendors and to pass discounts on for core farming needs. We add to these savings with our Farm Source™ Rewards Dollars, with FS$10.5 million earned last year.

FARM SOURCE™ FARMER SUPPORT PACKAGE

In May, Farm Source™ rolled out a support package offering a mixture of discounts of up to 30 per cent off and bonus Rewards Dollar offers on products that our farmers need the most. It included six months interest-free deferred terms.

WELL-CONNECTED
CO-OPERATIVE

Our regional network is coming into its own, giving farmers regular contact in their local region. This season, for example, our area managers had more than 22,000 points of contact with shareholders.

In addition, we stay close to farmers through our regional sustainable dairying and food safety and quality teams.

ALL TOGETHER, **STRONGER**

Co-operatives are about collective strength. From day one, we have used our size and scale to create an efficient end-to-end dairy manufacturing and supply chain to capture returns from the global market for our farmers.

COMMITMENT
In the communities where we live, work and farm, we have a responsibility to nourish, care and protect.

OUR OPERATIONS BEYOND THE FARM GATE ARE AN EXTENSION OF OUR FARMERS' BUSINESS, COLLECTING AND PROCESSING THEIR MILK AS EFFECTIVELY AS POSSIBLE AND GETTING IT TO MARKET, WHILE AT THE SAME TIME MOVING MORE OF THEIR MILK INTO HIGHER-RETURNING PRODUCTS.

We have pioneered transparency in global dairy pricing to give our farmers signals on prices, as well as our dividend forecast, so they can make the most informed budget and production decisions.

We're on track with our strategy and, as our results show, it's creating value.

We will stay on course to maintain our position and that will require continued discipline and capable management. We will be able to take advantage of the turn in global pricing because of the hard work that has been done over the years, and especially since 2012.

However, we do not operate in isolation. We're part of a wider community, which not only includes our farmers and their families but also New Zealanders and the people from the countries in which we operate.

Our commitment is to take care for both today's and for future generations. We are committed to responsible dairying, including the use of all the resources we rely on, and we aim for dairy excellence every day. We are making sure that our food is safe and of high-quality. That's our Co-operative way.

On pages 50 to 63 of this report, we provide full details on our sustainability and social responsibility activities, but here are some highlights.

DAIRY BENEFITS
Our Fonterra Milk for Schools programme delivers free nutritious milk to primary school students every school day.

NURTURING NUTRITION

Fonterra Milk for Schools benefits

Our Fonterra Milk for Schools programme is our way of sharing dairy's benefits with young New Zealanders.

In July 2013, we set up a study with the University of Auckland's National Institute of Health Innovation to assess the impact of Fonterra Milk for Schools on dairy consumption, general health indicators, and attitudes to nutrition from participating children. After two years, the conclusions are positive:

- There was a significant increase in the proportion of children achieving the dietary guidelines for dairy consumption every day.
- 93 per cent of children achieved the dietary guidelines on weekdays.
- 96 per cent of the children liked the taste of the milk.
- 72 per cent of parents surveyed considered the programme to have a positive impact on their children's health.

CARE IN OUR CO-OPERATIVE

Regenerating waterways

Each year, we make progress on excluding stock from waterways. By the end of May 2016, 97.4 per cent of defined waterways on mapped Fonterra farms were stock-excluded. To get there has taken 24,410 kilometres of fencing. Excluding stock from waterways is important, but add riparian planting and you have a greater contribution to water quality.

CLEAN WATERWAYS
Stock exclusions and riparian planting by our farmers helps to improve water quality.

Planting more than 24,000 kilometres of banks is no small job, so it pays to have a plan. Our Sustainable Dairying Advisors help farmers using software and GPS mapping of farm waterways to plan and track planting, and other activities. We're working towards all farmers having a riparian management plan by 2020.

OUR **CO-OPERATIVE**

BIODIESEL
We're switching our 500 tankers to Z Biodiesel for greater efficiency and sustainability.

Results can be a real incentive. Near Te Waihora, in Canterbury, for example, we have shareholders who have put 15 years into protecting native vegetation, fencing off waterways and forming their own native wetland on-farm. It's now a thriving sanctuary for native fish, birds and plants, and a research ground for the University of Canterbury's Freshwater Ecology Research Group, CAREX.

Our nitrogen-recording programme also underlines the benefit of a plan. Nitrogen is essential for plant growth. Without it, we'd have poor pastures, slow crop growth and below-par nutrition for animals. Nitrogen behaviour is also complex, but must be understood so farmers can manage nitrogen for maximum profitability and minimum environmental impact. Our farmers are working towards nitrogen loss commitments under the Sustainable Dairying: Water Accord, and making good progress.

This year, 86 per cent of farmers submitted their nitrogen data pages so we could prepare reports to measure their nitrogen efficiency use. This enables farmers to benchmark their use against other farms in the region and then prioritise what they can do on-farm to make improvements.

New PKE standard

We have listened to community concerns around the role of palm products, including palm kernel expeller (PKE), and have adopted a new sourcing standard, developed in consultation with key supply partners and following discussions with Greenpeace.

The standard commits Fonterra to purchasing only segregated palm oil, and for our suppliers to have plans in place for full traceability to plantation for palm oil and palm kernel extract by 2018.

Award-winning tanker safety

Our 500 tankers collect milk from our farms and deliver to our 31 manufacturing sites around New Zealand.

Keeping our tanker operators safe is always a priority and driver fatigue is a threat to that safety. We've introduced a Fatigue Risk Assessment Tool to identify driver fatigue exposure across our milk collection depots and drivers.

Fatigue-proofing strategies, such as restricted runs and self-selected breaks are in place and at-risk individuals are supported. This initiative has won a national health and safety award. We are proud of this award but we are still working hard to improve our approach. This includes trialling auto-sensing technology that identifies drivers by facial recognition, monitors their shift and will shake their seat and sound an alarm if they close their eyes for more than 1.5 seconds.

FONTERRA GRASS ROOTS FUND

The Fonterra Grass Roots Fund supports initiatives that enrich people's lives and make a real impact in the community.

SAFE PRODUCTS

We have introduced covert anti-counterfeiting technology across much of our consumer-ready packaging.

Global food defence

We continue to build our food traceability capabilities, including an automated system to help us track the batch history of all ingredients and packaging efficiently and accurately across our supply chain.

At our Canpac site, we're developing a new world-leading approach to product authentication which will allow customers across the world to access product confirmation and origin details at the point of sale, using their mobile phone. This capability will be launched next year.

To defend against criminal activity, we have introduced covert anti-counterfeiting technology across much of our consumer-ready packaging and we will continue to extend this.

CARE IN THE COMMUNITY

Living Water

Living Water is our 10 year, $20 million partnership with the Department of Conservation. Together with our farmers, we work with iwi, hapū, community groups and key stakeholders to improve the abundance and variety of native wildlife and water quality.

We're focused on five sensitive catchments where dairy farming exists: the Waikato Peat Lakes catchment, Kaipara Harbour's Hikurangi catchment, Tīkapa Moana (Firth of Thames) Pūkorokoro/Miranda catchment, Te Waihora (Lake Ellesmere) in Canterbury focusing on the Ararira/LII catchment, and Awarua-Waituna in Southland focusing on the Waituna catchment.

From little things, big things grow

Great pasture is the basis of our business and we know how important it is to feed the roots to achieve the growth that keeps our cows well-fed and productive.

We take a similar approach in our communities with our Fonterra Grass Roots Fund. Sometimes all a local initiative needs is a sprinkling of 'fertiliser' by way of funding to grow into a safer community, a healthier environment or a better-connected district.

We help community groups in New Zealand, Australia and Sri Lanka by providing grants to support local initiatives. While these may be simple, such as calf club days, or vital, such as equipment for volunteer fire brigades, we're making a difference by bringing communities together in a good cause.

OUR **GLOBAL BRAND FAMILY**

We have a portfolio of well-known global brands from Anchor™ to Anmum™ and Anlene™, together with NZMP™ and Farm Source™. These brands draw on our trusted processes and quality, and build a connection and understanding of Fonterra as the natural source of goodness.

ANCHOR™ AUSTRALIA

In an Australian first, microfiltration technology prolongs shelf-life of our milk.

Anchor™ Since 1886

Our most widely known and loved brand, Anchor™'s taste and goodness is born out of New Zealand's green pastures. Anchor™ is renowned for its high-quality, innovative range of products, which meet the needs and tastes of consumers around the world.

Highlights this year include:

- **In Australia,** since launching, Anchor™ milk has continued to build strong momentum in both volume and market share.
- **In Ethiopia** we launched Anchor™ Fortified Milk Drink, with Anchor™ now the number two powder brand in Ethiopia, which has a population of close to 100 million people.
- **In Sri Lanka** we launched Anchor™ Liquid Milk, growing our range by offering family-sized UHT milk. Anchor™ Newdale Yoghurt continues to set new sales records and Anchor™ Newdale kids flavoured milk delivered strong volume growth.

Anlene™

Anlene™ is designed for healthy ageing and offers consumers the benefit of bone strength and improved movement. This is driven by the growing ageing population who want to live longer, healthier and active lives, as well as the declining relevance of bone health as a single benefit.

Highlights this year include:

- **In Malaysia** we launched our new Anlene™ with MoveMax™, a fortified milk drink that contains a bundle of important nutrients to support bones, joints and muscles for optimal movement.
- Anlene™ with MoveMax™ will be launched in Hong Kong, Indonesia and Vietnam later this year.

ANMUM™ **LAUNCHES IN NEW ZEALAND**

Our internationally established maternal and paediatric nutrition brand, Anmum™, draws on Fonterra and its legacy companies' 50-plus years of experience in dairy research and in producing paediatric formulas for third parties.

Anmum™ is available across Asia, including China, Indonesia and Malaysia, offering products for pregnancy, lactation and infancy through to toddlerhood.

For Anmum™ to be strong globally, it must be strong at home so now we're proudly making Anmum™ for our little New Zealanders, providing paediatric nutrition for key life stages. Our Anmum™ PediaPro toddler milk has no added sugars – only lactose, the sugar naturally present in milk.

Five months after its launch in New Zealand, Anmum™ had driven more than 81 per cent brand awareness.

OUR
POTENTIAL

Every morning, our farmers walk their cows to the milking sheds in the dawn, the lights go on and thousands of litres of pure New Zealand milk are pumped into stainless steel vats across the country. This is the lifeblood of our Co-operative.

INCREASED DEMAND

There is a consistent pattern of population and GDP growth supporting growth in dairy.

OUR JOB IS STRAIGHT FORWARD, TO GENERATE THE MOST VALUE FROM THIS MILK.

WE COLLECT, PROCESS, PACKAGE, DISTRIBUTE AND SELL IT AROUND THE WORLD. EVERY DAY, WE SET OUT TO GROW FARMERS' WEALTH THROUGH OUR RETURNS ON THEIR MILK, THE DIVIDEND ON THEIR SHARES AND THE VALUE OF THEIR INVESTMENT IN OUR CO-OPERATIVE.

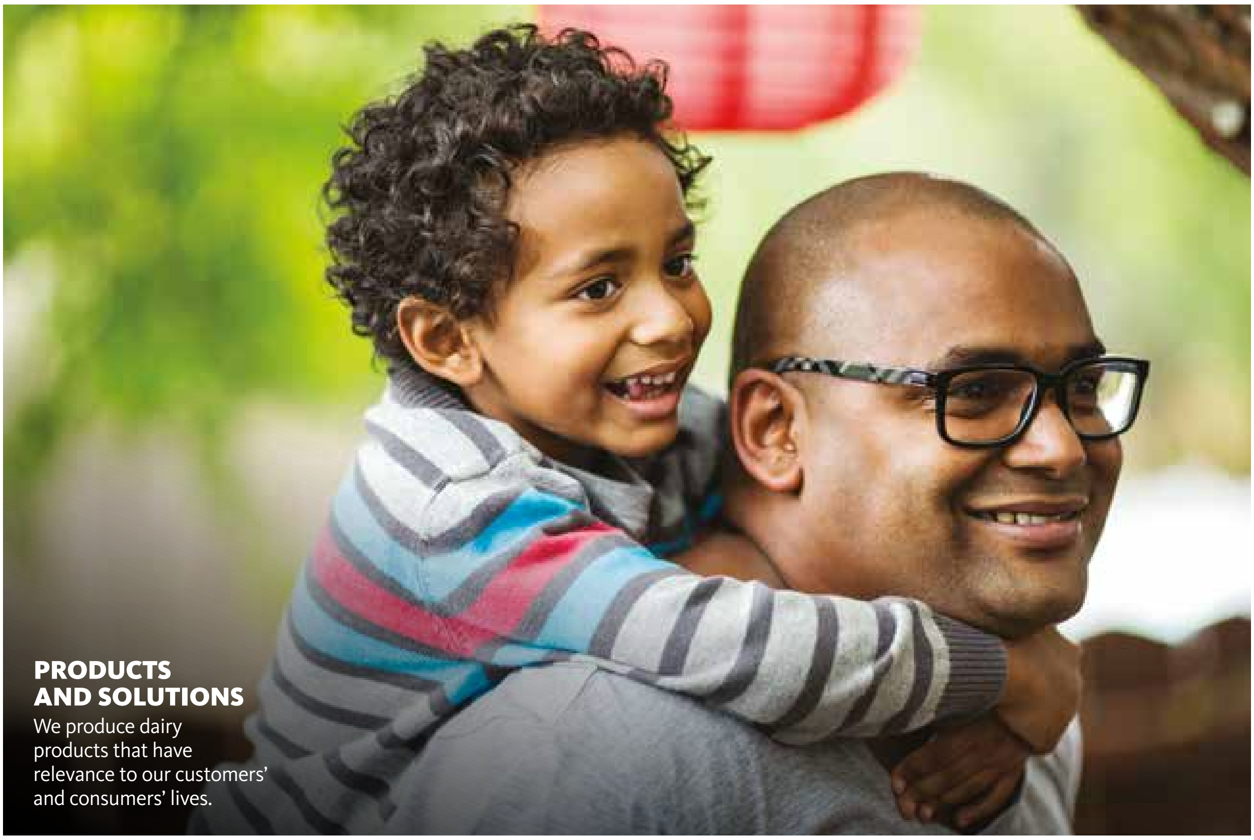
CAPTURING MORE DEMAND

Growing populations and their need for healthy, nutritious and good-tasting dairy foods are fuelling demand for our milk. We are making sure we are capturing more of this demand for our farmers by turning more of their milk into higher-returning products, and doing it quickly. We currently convert almost five billion LME of our milk to higher-returning consumer and foodservice products and we aim to double that to 10 billion LME by 2025.

Our ingredients return on capital was 13.4 per cent compared with last year's 9.3 per cent. Our consumer and foodservice return on capital was 41.7 per cent, a big increase on last year's return on capital of 25.5 per cent.

SEIZING THE OPPORTUNITIES

To capture more of the growing demand for nutritious dairy food, we must provide the products and solutions that consumers and customers want. We must also meet demand for volume. With all new milk production in New Zealand going into higher-returning products, we are supplementing our New Zealand milk with internationally sourced milk when it makes financial and strategic sense to do this and generates value for our shareholders.



PRODUCTS AND SOLUTIONS

We produce dairy products that have relevance to our customers' and consumers' lives.

We are growing our milk supply from 25 billion litres to 30 billion litres, and our ambition is to be the number one ingredients supplier in the world. We are aiming to have leading positions in key categories in our eight strategic consumer and foodservice markets of New Zealand, Australia, Sri Lanka, Malaysia, Chile, China, Indonesia and Brazil.

By achieving this, we aim to be a $35 billion business making a positive difference to the lives of two billion people by 2025.

We have built a strong Co-operative as the foundation, so we know we can reach our targets.

HOW'S PROGRESS?

We're succeeding because we're all pulling in one direction to make our goals real. We're making the best products to the best of our abilities. We're working as effectively and efficiently as possible, and we set and meet high standards in everything we do. This is how we're getting ahead of the competition and it will ensure we stay ahead.

Our ingredients business is delivering the products and solutions our customers want. That includes everything from the basics, like skim milk powder, to the customised ingredients solutions our customers use to set their products apart. This is how we will be number one in ingredients.

We had another strong year in ingredients, with growth of 24 per cent in normalised earnings before interest and tax.

Our consumer and foodservice business looks after two quite different groups of people.

Our consumer brands meet the growing demand for dairy products for all ages and stages of life, from infancy through to old age.

In consumer, we've already secured leadership positions in key dairy categories in New Zealand, Australia, Malaysia, Sri Lanka and Chile. We are on track to do the same in China, Brazil and Indonesia.

Our foodservice products capitalise on the fact that people are eating out more and there's an entire sector serving their needs, from the quick service restaurants to hotels, airports and cafés. We've always believed in the potential of the foodservice sector and our faith is being rewarded. The growth we've achieved makes us confident we will grow it into a $5 billion business by 2023.

OUR **POTENTIAL**

19%

INGREDIENTS

Our total ingredients gross margin rose 19 per cent to $1,862 million.

MORE CHEESE

This year, we made more higher-value products, like cheese and casein.

NUMBER ONE IN INGREDIENTS

We talk a lot about making the most of our farmers' milk. We achieve this by making the products most in demand and selling them for prices above the benchmarks achieved on GlobalDairyTrade (GDT) events.

KEY INVESTMENT

Since 2012, we've invested $1.5 billion in increasing our manufacturing capacity in New Zealand.

It sounds simple, but it takes a highly efficient and flexible ingredients producer to do this at scale. We've achieved that position. Since 2012, we've invested $1.5 billion in increasing our manufacturing capacity in New Zealand. This means we have more flexibility around the products we make and we can switch production to those making the best returns. New plants have contributed to gains in efficiency, better yields and improved quality performance. Our higher ingredients' earnings this year show how we are matching production to the highest value customer demand and how we are creating value through ingredients solutions for those customers.

This year, for example, we made nine per cent more higher-value products like cheese and casein and had lower volumes of products like milk powders – down seven per cent. Our gross margin per tonne on these higher-value products rose 24 per cent to $1,348 per tonne as a result.

In the ideal world, we would only make the highest-returning products. But we don't live in an ideal world and we still need to make a full range of ingredients from the milk we collect, especially when farms are in peak production. That range includes the powders and related products like butter and anhydrous milk fat that form the basis of the Farmgate Milk Price paid to our farmers.

To ensure we still get the best returns, our global sales team knows they have to sell products for more than the GDT benchmarks. This year, around 20 per cent of our total 23.7 billion LME was sold on the GDT platform. Our total ingredients gross margin rose 19 per cent to $1,862 million.

RIGHT PRODUCTS

We want our children to be energetic and active and, as we get older, we want to stay mobile and well, so we look for products that support our lifestyle.

GIVING CONSUMERS WHAT THEY WANT

We all buy by brand and there are various influences on why we choose one product over another. Trust is a big factor, because as consumers we want a product that does what it says it will do. When it comes to dairy products, many of those expectations relate to health.

THINKING AHEAD

We are thinking ahead, bringing new products to market today while anticipating future consumer trends and how we can meet them through more innovation.

We're meeting those needs and doing it with our three global brands, as well as our regional favourites. We have years of experience and knowledge to draw on, such as unlocking and validating the different nutritional benefits of milk. This enables us to develop products aligned to specific consumer needs, including the basics, such as good energy levels and nutrition for growth and development, through to healthy ageing.

We're using our expertise to set our brands apart, using our intellectual property, including the work of the Fonterra Research and Development Centre, to bring new products to market. This year, we moved 380 million LME into higher-value consumer and foodservice products in Greater China, Oceania, Asia and Latin America. That is an eight per cent increase in volumes.

Our Anmum™ brand regained its leading position in Hong Kong and, through our partnership with Beingmate, appeared on the shelves in 170 cities in China compared with 60 last year. We're also now proudly making Anmum™ for our little New Zealanders, providing paediatric nutrition for all key life stages. In Sri Lanka, where we lead the market, we achieved volume and value growth across all categories including, Anchor™ milk powder and Anchor™ UHT.

OUR **POTENTIAL**

BACKING FOODSERVICE

Our confidence comes from the way we do business, because that's just as important as the products we make.

DELIVER ON FOODSERVICE POTENTIAL

We've always backed foodservice as a winner. Each year, we are proven to be right.

This confidence comes from the way we do business, because that's just as important as the products we make. We don't just sell products. We sell our foodservice customers the prospects of a more profitable business using our products, solutions and often our recipes. We show them how to make the most of dairy and how they can make more money, especially in Asian markets less familiar with products like cream cheese. We have developed three key channels to market: Asian bakery, Italian kitchen and Western quick service restaurants (QSR).

ADDING VALUE

We sell our foodservice customers the prospects of a more profitable business using our products, solutions and often our recipes.

To each, we bring on-the-ground chef support, clear value propositions that use our products to make our customers more profitable, and insights into consumer trends and how we can help our customers benefit from them.

We formulate especially for commercial kitchens under Anchor Food Professionals. This includes Anchor™ UHT cream, which eliminates the splitting that causes waste and reduces margins, and our Anchor™ UHT whipping cream, which maintains its texture and appearance 24 hours after being applied to cakes or desserts.

In the quick service restaurant channel, our expansion in Eltham, in the North Island of New Zealand, means we can now produce 3.5 tonnes of cheese every hour, enough for more than three billion burgers per year.

And because customers have unique needs, we produce more than 350 different cheese specifications in Eltham, meeting precise specifications from different quick service restaurant customers.

Consumer and foodservice highlights this year include volume growth of 48 per cent in Greater China, five per cent in Oceania and Asia, and three per cent in Latin America.

465B LITRES

GLOBAL INCREASE

By 2020, global dairy consumption is expected to reach 465 billion litres.

MORE MILK = MORE OPPORTUNITIES

New Zealand farmers are efficient and competitive, and produce a high-quality product that is in demand in global markets. Our strategy sees us making the most of every drop of milk.

But when we look at the globally traded market for milk, we see more opportunities to grow returns for our farmers and these do not depend on them increasing production on their farms.

The fact is that the globally traded market for milk is growing faster than New Zealand's entire dairy industry. By 2020, we expect the world to be utilising up to 91 billion litres of milk, while we can produce around 25 billion litres in New Zealand. If we look at the entire global dairy market, which includes consumption within countries, demand will be some 465 billion litres by 2020.

Rather than limit our growth, and therefore our returns, to the 25 billion litres of milk produced in New Zealand, we're sourcing milk internationally where it makes financial and strategic sense to do so and where we know we can create additional value for our shareholders. This also frees us up to ensure all growth milk in New Zealand goes into higher-returning products in ingredients solutions and consumer and foodservice.

Australia is a good example of using local milk to generate value. The milk we collect there enables our Australian business to compete in the butter, cheese and fresh milk markets. The milk we source for cheese production links into our nutritionals business by providing whey and whey protein, while the nutritionals business provides fats to our spreads business.

GLOBAL SOURCING

We're sourcing milk internationally where it makes financial and strategic sense to do so.

It's a similar story in Chile, where we buy milk locally for our Soprole consumer business. Soprole has 30 per cent of the Chilean consumer dairy market. It has number one or two positions in all key dairy categories. It's a long-established, widely recognised and highly regarded brand in Chile. Soprole has performed well this year contributing to our returns and it's due to that locally sourced milk.

GROUP **OVERVIEW**

The strong performance by the Co-operative is demonstrated by an increase in our return on capital to 12.4 per cent, up from 8.9 per cent the previous year. This reflects increased earnings from our strategy to drive more volume into higher-value products and strong financial discipline.

$1,358M **NORMALISED EBIT** Up 39 per cent compared to last year.

HIGHLIGHTS

- Significant increase in return on capital to 12.4 per cent, up from 8.9 per cent
- Normalised EBIT up 39 per cent to $1.4 billion with increased profitability across both the ingredients and consumer and foodservice businesses
- Volume growth of one billion LME including an additional 380 million LME in our consumer and foodservice business
- Strong sales performance and supply chain efficiencies resulting in ingredients inventories down 25 per cent
- Ongoing financial discipline strengthened the Co-operative with the gearing ratio reduced to within the target 40–45 per cent range

Total sales volume increased to 23.7 billion liquid milk equivalent (LME) for the year, up four per cent on the previous year. Our ingredients sales teams achieved four per cent growth despite lower milk collections and challenging global market conditions. The growth came through our strong presence in key markets and a concentrated focus on meeting customer needs through product and service innovations. These efforts, alongside supply chain efficiencies resulted in lower inventory levels.

In our consumer and foodservice business, the continued focus on executing our strategy resulted in a further 380 million LME being sold through these channels, an increase of eight per cent over the previous year. Our China farms operations grew volumes too, as our second hub was completed, delivering 229 million LME this financial year.

We delivered significantly higher normalised EBIT of $1,358 million, an increase of 39 per cent compared with last year.

Ingredients continued its earnings momentum and had another very strong year, with normalised EBIT growth of 24 per cent. Our increased earnings reflect better optimisation of our production to match customer demand enabled by increased optionality and improved efficiency in our plants. Ingredient's return on capital increased to 13.4 per cent, up from 9.3 per cent the previous year.

23.7B LME

SALES VOLUME

Volume grew four per cent to 23.7 billion LME, despite challenging conditions.

NZD MILLION	YEAR ENDED 31 JULY 2016	YEAR ENDED 31 JULY 2015	CHANGE
Volume (LME, billion)	**23.7**	22.8	4%
Volume ('000 MT)	**4,526**	4,303	5%
Sales revenue	**17,199**	18,845	(9%)
Gross margin	**3,632**	3,278	11%
Gross margin percentage	**21.1%**	17.4%	–
Operating expenses	**(2,528)**	(2,760)	(8%)
Reported EBIT	**1,431**	942	52%
Normalised EBIT	**1,358**	974	39%
Net finance costs	**(499)**	(518)	(4%)
Tax (expense) / credit	**(98)**	82	–
Net profit after tax	**834**	506	65%
Earnings per share (cents)	**51**	29	76%
Adjusted earnings per share[1] (cents)	**54**	39	38%
Dividend per share (cents)	**40**	25	60%
Adjusted debt to EBITDA[2] (ratio)	**2.8**	4.7	–
Gearing ratio[3]	**44.3%**	49.7%	–
Return on capital[4]	**12.4%**	8.9%	–
Free cash flow	**2,184**	(1,372)	–
Capital expenditure	**944**	1,531	(38%)

1 *Adjusted earnings per share excludes certain non-cash items.*

2 *Ratio is economic net interest bearing debt divided by earnings before interest, tax, depreciation and amortisation (EBITDA). Both debt and EBITDA are adjusted for the impact of operating leases.*

3 *Gearing ratio is economic net interest bearing debt divided by economic net interest bearing debt, plus equity, excluding cash flow hedge reserve.*

4 *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. Capital employed excludes brands, goodwill and equity-accounted investments. Return on capital, including brands, goodwill and equity-accounted investments was 9.2 per cent (2015: 6.9 per cent).*

GROUP **OVERVIEW**

42%

INCREASE IN NORMALISED EBIT

Consumer and foodservice normalised EBIT increased to $580 million.

Our consumer and foodservice business performed well and delivered normalised EBIT of $580 million, up 42 per cent. Globally, our consumer businesses grew five per cent by volume and our foodservice strategy continued to deliver, with sales volumes up 15 per cent. Combined, this delivered a sales volume increase of eight per cent, reflecting our strategy of increasing volume in higher-value products.

USEFUL FACT

Liquid Milk Equivalent (LME) is a standard measure of the quantity of milk used in dairy products, based on the amount of fat and protein in the product.

Within our consumer and foodservice business, Greater China provided the largest growth in both sales volume and earnings, with normalised EBIT of $131 million, up 191 per cent on the previous year. This was predominantly as the result of strong growth in our foodservice business.

The higher earnings resulted in a return on capital for Fonterra's consumer and foodservice business of 41.7 per cent, up from 25.5 per cent the previous year.

Providing access to high-quality fresh milk, our China farms are an important component of our integrated strategy in China. We have completed construction of our second hub and commenced building the first farm on our third hub (a joint venture with Abbott). Throughout the year we reduced on-farm cash costs significantly by taking out RMB0.81 per litre produced to better manage in a low milk price environment.

Our business-wide transformation programme has been a key driver of the Co-operative's overall performance. This programme has helped to shift mind-sets to doing things faster and more cost effectively without compromising quality, as well as achieving cost savings and prioritising expenditure in the right areas. Total operating expenses were down eight per cent on last year.

Good progress was made on returning our Australian operations to profitability, reflecting an on-going commitment to fixing an under-performing business. Consistent with our plan, we have taken out costs, reduced working capital, and divested non-core assets, including the loss-making yoghurt and dairy desserts business, and shares in Bega Cheese Limited and Dairy Technology Services (DTS). This enabled the business to focus on its core ingredient strengths in cheese, whey and nutritionals, which are complementary to our consumer and foodservice brands including Anchor™, Western Star™, Perfect Italiano™, Bega™ and Mainland™.

GEARING RATIO

Significant improvement in the gearing ratio to 44.3 per cent, from 49.7per cent.

44.3%

STRONGER PERFORMANCE

Enabled us to support our shareholders through an increased and early payment of the dividend.

Sales of nutritional powders are growing from our Darnum factory, with new long-term customers including Bellamy's Organic, signing this year. In addition, the realignment of the Australian milk price to a realistic level that reflects global dairy prices provides a more sustainable basis for the Australian ingredients business. The Australian turnaround has put the right foundations in place for sustainable returns.

Tax expense is higher than last year due to higher pre-tax profit and a tax charge of $45 million for capital gains triggered by the sale of DairiConcepts. Partially offsetting this, the 15 cents per share higher dividend created a $63 million higher tax credit than last year.

STRONG CO-OPERATIVE

On-going financial discipline complemented the strong operating result. In accordance with our plan, we have reduced our debt levels this year following the investment in increased capacity over the previous two years. As at 31 July 2016, our economic net interest-bearing debt was $5.5 billion, a reduction of $1.6 billion from the previous year. This lower debt level, combined with higher retained earnings from improved performance, resulted in a significant improvement in the gearing ratio to 44.3 per cent, down from 49.7 per cent the previous year.

Free cash flow for the year ended 31 July 2016 was $3.6 billion higher than the previous year, reflecting significant improvements in both operating and investing cash flows. Operating cash was up $2.6 billion due to higher earnings, significant working capital improvements and supplier payables moving towards our standard policy. Working capital throughout the year was driven lower by our focus across all areas, including strong sales and supply chain efficiency, which reduced the amount of inventory we carry throughout the year.

USEFUL FACT

As at 31 July 2016, our economic net interest-bearing debt was $5.5 billion, a reduction of $1.6 billion from the previous year.

The combination of a strong operating performance and on-going financial discipline resulted in a declared dividend of 40 cents per share for the year ended 31 July 2016, an increase of 15 cents per share over the previous year. This is in line with Fonterra's dividend policy to pay out 65–75 per cent of adjusted net profit after tax over time.

The performance enabled us in a period of low milk prices to also offer assistance to our shareholders through the Fonterra Co-operative Support loan and an early payment of the dividend. Both of these initiatives were possible because of our improved working capital and stronger financial position.

INGREDIENTS

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

$1,204M

NORMALISED EBIT

Ingredients normalised EBIT of $1,204 million was up 24 per cent.

INVENTORY DOWN

Year-end inventory was 25 per cent down on last year.

HIGHLIGHTS

- Return on capital increased to 13.4 per cent from 9.3 per cent last year
- Normalised EBIT of $1,204 million up 24 per cent
- Higher sales volumes despite challenging global market conditions
- Optimising product returns on relative pricing, markets and customer mix
- Sales focus and supply chain efficiencies delivered significantly lower inventory
- Prior investments in capacity led to improved optionality and higher yields, and ensured no peak costs
- Australia ingredients earnings improved

VOLUME

Milk collection across New Zealand for the 2015/16 season was 1,566 million kgMS, down three per cent compared with the previous season. Lower milk collections were largely a result of the low milk price environment, with farmers reducing stocking rates and supplementary feeding in order to help reduce costs. In Australia, milk collection for the 2015/16 season was 121 million kgMS, four per cent lower than the previous season.

New Zealand milk production varied across the country with the North Island down five per cent and the South Island up one per cent. In general, lower production levels as a result of changes in farming systems were mitigated by favourable growing conditions across most dairying regions.

Despite lower milk collections and the tough global market environment, sales volume grew by four per cent to 22.4 billion LME. In December 2015, over 300,000 MT was shipped from New Zealand to global markets, the first time we have achieved that volume in a single month. Year-end inventory volume was 25 per cent down on last year through managing to optimal levels across our supply-chain and successfully matching production to the sales forecasts of our direct-to-customer ingredients sales teams. This means we have lower inventories, but made up of the right level of the products that our customers need.

GLOBAL PRESENCE
Our global presence allows us to allocate sales to the markets where demand is strongest.

NZD MILLION	YEAR ENDED 31 JULY 2016	YEAR ENDED 31 JULY 2015	CHANGE
Volume (LME, billion)	**22.4**	21.5	4%
Volume ('000 MT)	**3,074**	2,982	3%
Sales revenue	**13,005**	14,341	(9%)
Total gross margin	**1,862**	1,562	19%
– New Zealand product mix	**1,605**	1,465[3]	10%
New Zealand reference products	**634**	782[3]	(19%)
New Zealand non-reference products	**971**	683[3]	42%
– Australia ingredients	**58**	(27)	–
– Other gross margin	**199**	124[3]	60%
Normalised EBIT[1]	**1,204**	973	24%
Gross margin per MT			
Reference products ($ per MT)	**330**	403[3]	(18%)
Non-reference products ($ per MT)	**1,348**	1,090[3]	24%
Return on capital[2]	**13.4%**	9.3%	–

1 *Normalised EBIT for Ingredients excludes unallocated costs.*

2 *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. Capital employed excludes brands, goodwill and equity-accounted investments.*

3 *From 1 August 2015 there was a change in the management accountabilities of the Commodity Risk and Trading function within the Ingredients business. Comparatives have been restated to reflect this change.*

INGREDIENTS

NEW ZEALAND INGREDIENTS REVENUE AND VOLUME	YEAR ENDED 31 JULY 2016	YEAR ENDED 31 JULY 2015	CHANGE
Sales volume ('000 MT)			
Reference products	**1,920**	1,939	(1%)
Non-reference products[1]	**720**	626	15%
Production volume ('000 MT)			
Reference products	**1,873**	2,009	(7%)
Non-reference products	**746**	682	9%
Revenue per MT NZD			
Reference products	**3,276**	3,826	(14%)
Non-reference products[1]	**4,972**	5,831	(15%)

1. Sales volume and revenue excludes bulk liquid milk. The bulk liquid milk volume for the year ended 31 July 2016 was 77,000 MT (year ended 31 July 2015 was 67,000MT).

Our global sales mix by market reflected a recovery in the China market with dairy imports up 27 per cent this year to July 2016 with our sales volume for the financial year up 20 per cent. In addition, there was increased demand in North America for fat-based products, and good growth in protein and cheese across the markets.

USEFUL FACT

Our investments in plant capacity and operational efficiencies have resulted in no peak costs.

Low dairy prices created opportunities in affordable nutrition and opened up opportunities in the Middle East, Africa and Latin America. These opportunities partially offset the negative impact of challenging geopolitical and economic conditions in oil-dependent economies. Our Australian ingredients volumes were up nine per cent this year with the domestic business driven by strong demand for cheese.

VALUE

Ingredients delivered another strong performance, delivering $1,204 million normalised EBIT, up 24 per cent on last year. This was supported by the increase in volumes sold, improved product mix and the value proposition of our products and services under the NZMP ingredients brand. Continued strength in our New Zealand ingredients business was complemented by an improved position in Australia.

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. The relative difference between reference product and non-reference product prices can impact our gross margin. In this financial year, we sold more non-reference products as gross margins for these were superior compared with reference products. Gross margin per metric tonne for non-reference products increased 24 per cent, compared with an 18 per cent decrease in reference products margins.

Our investments in plant capacity in New Zealand in recent years have improved our ability to respond to price volatility and channel milk to the highest-returning products over periods of peak milk collection and throughout the season. We have been able to better match our production mix to customer demands and global price signals, delivering higher price premiums above GDT and avoiding any additional peak costs.

NON-REFERENCE PRODUCTS

Gross margin for non-reference products favoured production over reference products.

During the season, we used this flexibility to move processing away from reference products (down seven per cent) such as whole milk powder (WMP) and skim milk powder (SMP), towards non-reference products (up nine per cent) like cheese and casein to take advantage of the change in relative contribution. The result of these strategic decisions was an overall increase in New Zealand ingredients gross margin of $140 million to $1,605 million.

In Australia, we delivered on our plans to return the business to profitability. Earnings improved due to a strong domestic cheese business, a focus on increasing sales of nutritionals and divestment of non-core assets. Our cheese business was supported by New Zealand volumes this year, and will be strengthened when our state-of-the-art Stanhope cheese plant, which will produce 45,000 MT of cheese per year, is commissioned in financial year 2017. In nutritionals, we secured new long-term strategic customers for our nutritionals plant in Darnum, including Bellamy's Organics, and we are awaiting final regulatory approval for our joint venture agreement with Beingmate.

Alongside the improvements in the supply chain, operating performance was lifted by further gains in operational and capital efficiency at our sites. We reduced input costs, improved yields and lifted product quality. Within our capital investment programme the focus was on simplification, reliability and quality performance.

We constructed a new large-scale WMP plant at Lichfield, made multiple investments at Whareroa (one of our largest sites) and also closed smaller end-of-economic-life plants to improve our overall efficiency. We commissioned a new spray drier at Pahiatua and a low-volume, high-value lactoferrin plant at Hautapu for our ingredients business.

Prior year investments such as the mozzarella plant at Clandeboye, AMF and MPC plants at Edendale and in slice-on-slice cheese at Eltham are now fully operational and performing well.

Our customers have responded positively to our hard work during the year and we achieved a best-in-class result on our customer value measure. This reflected the continued strength of our product and service performance relative to competitors, with customers highlighting our better service, product quality and reliability.

An example of this was the opening of the offshore ingredients hub in Singapore, our second after Dubai. Through this facility, we are able to shorten our supply chain, reduce our costs and more quickly meet customer orders.

CONSUMER AND **FOODSERVICE**

This platform comprises the consumer brands and foodservice businesses in Asia, Greater China, Latin America and Oceania.

380 M LME

HIGHER VALUE

An additional 380 million LME moved into higher-value consumer and foodservice products.

HIGHLIGHTS

- Return on capital increased to 41.7 per cent from 25.5 per cent last year
- An additional 380 million LME moved into higher-value products
- Normalised EBIT growth of 42 per cent to $580 million
- Investments in innovation and distribution channels supporting growth
- Foodservice volume growth of 15 per cent with expanded gross margins

VOLUME

In line with our strategy to move more volume into higher-value consumer and foodservice products, we achieved volume growth of eight per cent to 4.9 billion LME. We added another 0.2 billion LME in both consumer and foodservice sales, representing growth of five per cent and 15 per cent respectively. Greater China was the main growth driver by region:

- **Greater China:** 48 per cent volume growth, largely due to the continued expansion of our foodservice business in Mainland China, Hong Kong and Taiwan
- **Oceania:** strong volume growth of five per cent in the mature markets of Australia and New Zealand, as a result of increased demand for fresh white milk and butter, and UHT sales both for domestic supply and export
- **Asia:** strong growth of five per cent in consumer and domestic foodservice with Sri Lanka up 22 per cent, but the overall volume was down one per cent due to reclassification of North Asia foodservice sales to ingredients
- **Latin America:** three per cent volume growth due to strong performance from Soprole in liquid milk and mature cheese, increased sales of spreadable cheese, fermented milk and desserts in Brazil, offset by lower production due to the plan to reduce use of imported materials in Venezuela.

FOODSERVICE ROLLOUT

We continued the roll-out of our foodservice business in Mainland China and Taiwan.

NZD MILLION	YEAR ENDED 31 JULY 2016	YEAR ENDED 31 JULY 2015	CHANGE
Volume (LME, billion)	**4.9**	4.5	8%
Consumer	**3.1**	2.9	5%
Foodservice	**1.8**	1.6	15%
Volume ('000 MT)	**1,800**	1,685	7%
Sales revenue	**6,296**	6,701	(6%)
Gross margin	**1,808**	1,723	5%
Gross margin (percentage)	**29%**	26%	–
Consumer	**29%**	27%	–
Foodservice	**27%**	22%	–
Normalised EBIT	**580**	408	42%
Return on capital	**41.7%**	25.5%	–

NORMALISED EBIT: KEY PERFORMANCE DRIVERS NZD MILLION	YEAR ENDED 31 JULY 2016	YEAR ENDED 31 JULY 2015
Normalised EBIT prior year	**408**	**129**
Volume	120	41
Price	(210)	(67)
Cost of goods sold	251	284
Operating expenses	(3)	43
Other	14	(22)
Normalised EBIT	**580**	**408**

CONSUMER AND **FOODSERVICE**

CONSUMER AND FOODSERVICE PERFORMANCE

	LME (BILLION)			NORMALISED EBIT ($M)		
	YEAR ENDED 31 JULY 2016	YEAR ENDED 31 JULY 2015	CHANGE	YEAR ENDED 31 JULY 2016	YEAR ENDED 31 JULY 2015	CHANGE
Consumer and foodservice	**4.9**	**4.5**	**8%**	**580**	**408**	**42%**
Greater China	0.9	0.6	48%	131	45	191%
Oceania	1.8	1.7	5%	97	51	90%
Asia	1.6	1.6	(1%)	244	202	21%
Latin America	0.6	0.6	3%	108	110	(2%)

VALUE

Our consumer and foodservice businesses delivered a strong improvement in return on capital, up to 41.7 per cent from 25.5 per cent the year before. This was a combination of increasing normalised EBIT by $172 million to $580 million and a reduced capital base through divestments and lower working capital:

- **Greater China:** normalised EBIT growth to $131 million as a result of significant volume growth through our on-going investments in brands and distribution
- **Oceania:** an additional $46 million in normalised EBIT, reflecting the sale of the loss-making yoghurt and dairy desserts business in Australia and continued good performance in New Zealand
- **Asia:** normalised EBIT growth of $42 million to $244 million, driven by an improvement in gross margins
- **Latin America:** solid result of $108 million reflected robust growth out of Chile, but was offset by Venezuela's lower contribution this year due to rebasing of the exchange rate and the planned volume reductions.

REGIONAL UPDATE

Greater China

Greater China continues to deliver strong results with volume growth of 48 per cent and normalised EBIT up $86 million to $131 million. We held operational expenditure to a 1.5 per cent increase against this significant increase in volume.

USEFUL FACT

We announced a partnership with leading online retailer JD.com to increase distribution of our consumer products to lower tier cities.

China foodservice grew significantly as we broadened our operations, supported the growth of our existing customers and secured new business. Our successful channel strategy focusing on Asian bakery, Italian kitchen and quick service restaurants continues to deliver both volume and value growth, particularly in Mainland China. We have well-performing foodservice businesses in Hong Kong and Taiwan that have enjoyed continued growth in volume and value.

Strong Anchor™ brand awareness as a leading imported milk brand with clear perception of our New Zealand origin, together with an increased e-commerce presence has strengthened our brands in China.

INNOVATION
In New Zealand we launched a number of successful products.

In specialty powders, our partnership with Beingmate enabled our Anmum™ range to expand coverage from about 60 to 170 cities. Our Anlene™ brand focused on increasing awareness, regaining number-one market position in Hong Kong on the back of our 'Freedom to Move' campaign successfully expanding our consumer base.

Oceania

Our consumer and foodservice businesses in Australia and New Zealand (including the Pacific Islands) delivered a significant gain on last year's performance, with normalised EBIT increasing $46 million to $97 million. New Zealand continued its strong performance, while in Australia, our focus on divesting non-core assets, winning brands and strong customer relationships accelerated the turnaround and delivered an improved result.

During the year, we sold our shares in Bega Cheese Limited and the loss-making Australian yoghurt and dairy desserts business. This included manufacturing sites at Tamar Valley and Echuca as well as the associated brands. The benefits of this sale are shown in the second half of our result, as we were still operating these businesses through the first half.

Innovation supported our volume growth of five per cent. In Australia, our Anchor™ branded milk launched in the premium category utilising microfiltration technology, an Australian first in milk.

USEFUL FACT

Anchor Food Professionals in New Zealand developed a tailored smoothie solution for the café segment.

In New Zealand, we had a number of successful new products in Fresh 'n Fruity™ pouches, Top Notch™ ice cream, and Kapiti™ sorbets. We also saw the New Zealand launch of the Anmum™ range of infant formula and maternal nutritional powders.

Our domestic foodservice businesses in both markets delivered good results with volume and revenue growth and improved gross margins. We launched Anchor Food Professionals and have continued our strong track-record of developing new products to match consumer trends.

CONSUMER AND **FOODSERVICE**

ASIA
Foodservice delivered significant volume growth across most of our markets.

Asia

We continued our earnings momentum in Asia and increased normalised EBIT by $42 million to deliver another strong result of $244 million. This came despite some challenging economic and geopolitical conditions, particularly throughout the Central Asia, Middle East and Africa regions.

USEFUL FACT

In Ethiopia, we successfully launched Anchor™ milk powder with focus on affordability, availability, and awareness.

Growth in our underlying consumer and foodservice businesses was five per cent by volume, but the reclassification of North Asia foodservice sales to the ingredients business resulted in volumes being down one per cent.

Overall, Asia delivered an improved gross margin as a result of favourable costs of goods sold, driven by lower commodity prices, price management and moving more volume into higher-value foodservice products. We implemented the right pricing strategies to counter intense competition within the consumer business and launched new Anlene MoveMax™, and Anmum™ Maternal and Paediatric formulation with Nuelipid™. Our foodservice business model differentiates us from the competition and contributed to the improved gross margin.

The consumer business across the region performed well. In Sri Lanka, where we hold the number-one market position, we grew 22 per cent in volume and 18 per cent in value. Anchor™ and Ratthi™ full-cream milk powder grew faster than the category as a result of successful marketing activities and competitive pricing, combined with the launch of Anchor™ Newdale liquid milk and yoghurt.

In the domestic foodservice businesses, we achieved significant volume growth across most of our markets, including Sri Lanka, Indonesia, the Philippines, Vietnam and Thailand, with a strong focus on chef-led solutions driving good growth in cheese, butter and UHT cream.

FOCUSED CATEGORIES
Soprole growth was driven by innovation in our focus categories of UHT milk, cheese, yoghurts and desserts.

Latin America

Our Latin America business delivered normalised EBIT of $108 million, slightly behind last year's performance of $110 million. Sustained growth in Chile, the success of our Caribbean business and the positive results of our Brazil transformation plan were offset by one-time implementation costs in Brazil and the impacts of inflation and our plan to reduce reliance on imported products in our Venezuela business.

USEFUL FACT

We added 20,000 new points of sale for Dairy Partners Americas products.

Soprole, our consumer business in Chile, delivered an outstanding result this year. This was driven by sustainable growth through a robust innovation agenda in our focus categories of UHT milk, cheese, yoghurts and desserts. We also saw the benefits of our new distribution centre running extremely well and our 'Simplicity' programme reducing the number of stores we deliver to directly enabling lower costs without compromising on volume.

In Brazil, we completed our transition of the business following the restructuring of our joint venture with Nestlé. The first half of the year carried significant one-time costs associated with implementing the transition plan. Operating performance improved in the second half, but gains were largely offset by increases in the domestic milk price (now up 47 per cent over last year), a continued decline in the overall dairy category and the challenging economic environment.

We delivered volume growth and increased market share in volume and value despite a shrinking overall market. This came through a strong innovation agenda, investing in marketing and the continuous improvement of our new go-to-market model.

In Venezuela, we incurred additional costs early in the year as access to US dollars in market became more limited and more expensive. Our strategy to reduce the risk from our exposure to US dollar expenses in Venezuela has been successful.

Our Caribbean businesses remain a success story – delivering sustained earnings through operating a lean, low-cost trading business. We have strong distributor networks and good brand recognition and this helped performance in a year where low European milk prices saw increased imports into the region.

FINDING PERFORMANCE IN THE BUSINESS OF FOOD

As Anchor Food Professionals, we work alongside our customers to deliver business, menu and product solutions that drive performance in all aspects of their operations and to help grow their business.

EXTRA STRETCH MOZZARELLA

Pre-grated mozzarella saves valuable time and reduces wastage. Individually quick frozen to capture the fresh quality and authentic taste, making the perfect pizza.

WE ARE UNIQUELY POSITIONED TO DELIVER ON OUR GROWTH ASPIRATIONS:

1. Fit-for-purpose products designed for food professionals, by food professionals.
2. Fonterra's world-leading technology platforms in mozzarella, butter and cream.
3. The uniquely New Zealand dairy taste and texture profile resulting from our pasture-fed system.
4. A network of foodservice specialist, chefs, bakers and application kitchens across Asia Pacific to deliver chef-led solutions for customers.
5. The full dairy range and heritage of our Anchor Food Professionals brand.

Our strategy is focussed on chef-led solutions for three specific types of foodservice businesses where dairy provides the 'wow' factor:

ASIAN BAKERY

The largest foodservice segment and a unique style of bakery throughout Asia and China, where the focus is on pastries, cakes, desserts and buns.

ITALIAN KITCHEN

Pizza/pasta restaurants are the largest foodservice segment globally. Pizza is the world's most popular food and pasta dishes are increasingly cream-based.

QUICK SERVICE RESTAURANTS (QSR)

Global brands dominate the QSR segment of the foodservice market. We are the preferred supplier in Asia Pacific for cheese solutions to many of these customers today.

WE HAVE CLEAR **ASPIRATIONS:**

By 2023, we aim to be a $5 billion business, supplying over one million MT (five billion LME) of dairy products to customers around the world each year.

By this time, we will be using over 20 per cent of the New Zealand milk pool.

Foodservice is all about food and beverages that are consumed out of the home, including a wide range of eating occasions and outlets:

CHINA **FARMS**

This platform comprises the farming operations in China, producing high-quality fresh milk as part of our integrated China strategy.

229 M LME

MILK VOLUME

Sales volume for the year increased by 40 per cent.

HIGHLIGHTS

- Completion of Ying (Hub Two)
- Significant reduction in operating costs
- Part of an integrated dairy business in China

VOLUME

Our farming operations in China comprise two completed hubs producing high-quality fresh milk. Yutian is our most established hub and is fully housed with livestock. It consists of three single farms and one double farm with 16,200 milking cows in total.

Our second hub, Ying became fully operational during the year, with development now complete. Ying consists of one single farm and two double farms, with 14,200 milking cows and we will see further growth as the herd matures.

USEFUL FACT

A typical hub consists of three to five farms in one region with approximately 16,000 milking cows. A single farm can accommodate up to 3,200 milking cows, while a double farm has capacity of up to twice that number.

Sales volume of raw milk increased by 40 per cent compared with last year. This increase in volume was largely due to the additional farms at the Ying hub coming on stream and the scaling up from single to double farms. Volume will continue to build at Ying and when at full capacity, expected in financial year 2020, our farms will be able to produce a combined volume of around 380-400 million LME.

COST REDUCTIONS
Cost reductions were achieved through reduced feed and labour costs, and enhanced plant processes.

We are continuing to progress 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 farm has begun and a second farm will be completed in 2017. We have a rolling plan for further development.

VALUE

Our strategy for China farms is still to deliver value through integrating them into our ingredients, consumer and foodservice businesses in Greater China. We are reducing our costs through operational efficiencies driven by a combination of higher milk volume and increased on-farm efficiencies. Cost reductions were achieved this year through reduced feed and on-farm costs, and production efficiencies.

Despite the operational efficiencies and milk volume growth, the low Chinese milk price did not allow us to deliver to full earnings potential. At RMB3.35, the average milk price in the year was down RMB0.51 on last year. Although this was partly offset by our efficiency improvements, the low absolute level of prices still resulted in a normalised EBIT loss of $59 million.

In China, purchasers place a premium on having long-term contracts for high-quality milk such as that produced at our farms. At our established hub in Yutian, we were able to sell the majority of our milk under contract.

NZD MILLION	YEAR ENDED 31 JULY 2016	YEAR ENDED 31 JULY 2015	CHANGE
Volume (LME, billion)	**0.2**	0.2	40%
Volume ('000 MT)	**229**	164	40%
Sales revenue	**183**	141	30%
Normalised EBIT	**(59)**	(44)	–

Our new hub at Ying is still in the process of securing contracts for its milk as production ramps up. This resulted in a higher proportion of milk sold on the spot market, at lower prices.

Livestock valuations are required by accounting practices and reflect the milk price and herd assumptions at the time. These assumptions were in line with last year, and for the full year there was a net loss of $7 million.

Capital expenditure for the year was significantly reduced as development finished at Ying. Other investments were made in livestock purchases and an effluent treatment system upgrade at the Yutian and Ying hubs. With both hubs now fully operational, capital expenditure will be at long-run average levels sufficient to cover on-going maintenance and farm performance. We are now well placed through our China farms to meet growing demand for high-quality, fresh dairy products.

SUSTAINABILITY AND **SOCIAL RESPONSIBILITY**

At Fonterra operating responsibly means we listen to the perspectives of our stakeholders, take ownership for the impacts of our decisions on society and the environment, and contribute to sustainable development within our communities.

BUILDING ON STRONG VALUES

WE ARE IMPROVING OUR SUSTAINABILITY PERFORMANCE GLOBALLY.

WE ARE BUILDING ON GREAT WORK ALREADY UNDERTAKEN BY OUR PEOPLE, FROM BEHIND THE FARM GATE, THROUGHOUT OUR INTEGRATED SUPPLY CHAIN AND REACHING TO OUR CUSTOMERS, CONSUMERS AND COMMUNITIES. WE HAVE MADE PROGRESS, BUT THERE IS ALWAYS MORE THAT WE CAN DO.

EMBEDDING A PRIORITISED APPROACH

We gather and analyse information on what's important to our farmers, employees, customers, consumers, national and regional government bodies and industry organisations.

As a result, we have prioritised the range of topics that matter most to both our stakeholders and the Co-operative's success: employment and development, food safety, health and nutrition, community development, water, climate and energy.

OUR VALUES

Developed collaboratively, our values of Co-operative Spirit, Do What's Right, Challenge Boundaries and Make It Happen guide our actions and underpin our approach.

OUR PEOPLE

People are core to what we do: our farming families caring for the animals and resources that produce milk; our global staff making, selling and delivering our products; and our customers and consumers who enjoy the high-quality nutrition we provide.

Our values help create an environment where people with diverse experiences and ways of thinking are encouraged and enabled. We do not tolerate discrimination or harassment and we provide an independently operated confidential hotline so employees can anonymously report any concerns they may have.

LOWEST INJURY RATE

Employee injury rate down to 6.4 total injuries per million hours worked, down 65 per cent since 2010.

Our agreement with the International Union of Food and the New Zealand Dairy Workers Union recognises our commitment to meet the fundamental labour standards as set by the International Labour Organisation, for all Fonterra employees. This year, our Centre of Expertise for Employee Relations has launched a training video for employees to help ensure we meet these obligations.

Health, safety and wellbeing

Right across the globe we want all of our people to be healthy, to live a balanced life and to go home from work safely every day.

Our Safe Home System is helping our people leaders become even more safety aware and to involve their teams regularly in shaping safer workplaces. In Latin America, this was extended further, with staff family members involved in our 'Life Savers'[1] campaign to emphasise the importance of going home safely every day.

Our Safe Home System standards are aligned as a minimum with AS/NZS 4801:2001 (Occupational Health and Safety Management Systems), and this year, in addition to 72 self-assessment audits, we completed comprehensive audits on 10 of our sites, and they show improved resilience.

Sadly, a member of the public lost their life on one of our China farms[2]. However, our serious harm injuries[3] decreased to 21, our lowest level ever recorded. For all fatalities and serious-harm injuries, we conduct investigations to identify root causes and we implement corrective actions and share learning across the business.

We achieved a 21 per cent reduction in employee injury rates, which were down to 6.4 total injuries per million hours worked. Again, this is our lowest recorded level, and a total reduction of 65 per cent since 2010. While this is pleasing, 291 of our employees still required medical treatment, restricted work duties or time away from work as a result of an injury so we remain committed to further reduction.

At the New Zealand Workplace Health and Safety Awards this year, we received three awards including 'Supreme Award for Best Overall Contribution to Improving Workplace Health and Safety'.

Our wellbeing challenge for the year was 'Eat, Move, Sleep'. For six weeks, staff competing in teams were encouraged to eat five servings of fruit and vegetables, move for more than 30 minutes and sleep for at least seven hours daily. Globally, nearly 20 per cent of employees took part and for most it led to healthy changes that they intended to maintain.

We also care about safety in the community so we partnered with Southland District Council to use smartphone technology in our milk tankers to automatically gather road-quality information. The data from the daily work helps the Council ensure safer journeys for Southland's road users, a project that won the Council an award for infrastructure management at the 2016 Local Government Excellence Awards.

1 *Life Savers are six simple behaviours introduced as a way of making our staff aware of our most significant risks.*

2 *There were also eight on-road fatalities (including members of the public) that were found to be beyond Fonterra's control.*

3 *Serious harm injuries are injuries that cause temporary or permanent loss of body function and includes both employees and contractors.*

SUSTAINABILITY AND **SOCIAL RESPONSIBILITY**

CAREER DEVELOPMENT

Wang Xiangru has progressed from translator to Production Manager responsible for more than 150 staff.

BUYING POWER

Fonterra Farm Source™ offers significant discounts on the core products that farmers need for the new season.

Training and development

We have globally expanded our He Tangata: It is People leadership programme and since February 2015, more than 2,000 managers have completed the 'Coaching to Lead' module and 700 staff have completed e-learning modules.

This year, 71 staff completed our Dairy Apprenticeship and Skills Recognition programme, which offers existing dairy factory workers a path to a recognised[4] qualification.

We have also partnered with local iwi at our Lichfield and Hautapu sites so that young Māori employed into our engineering apprenticeship scheme also have support and pastoral care from their community to help ensure their long-term success.

Case Study – Career Development in China

Developing capability is essential to our success and employee engagement. Wang Xiangru, affectionately known as Shrerk, is a case in point. Shrerk was a fresh graduate when he joined the Co-operative as a translator during the building of our first farm in China in 2008. After six months he became a Fonterra full-time Vet Assistant. Then, just two months later he became a Technical Assistant to the Operations Manager. In 2011, Shrerk decided working with the cows was his preference, becoming a Milk Parlour Supervisor and leading a team in the Yutian 1 Farm. In September 2012, Shrerk became the Production Manager for Yutian 2 Farm and since 2015, he has been managing two farms at the hub, responsible for more than 150 staff.

Livelihoods and income creation

We are committed to generating sustainable employment, skills development and wealth creation opportunities for our communities. During this period of sustained low international dairy prices, we have sought creative ways to reduce the financial impact on our farmer shareholders, sharemilkers, farm managers and hence the wider communities.

In addition to interest-free deferred terms already helping about 8,000 farms, our Farm Source™ retail stores launched a much larger package in May, offering significant discounts on the core products farmers need going into a new season. The discounts are available to all Fonterra shareholders, sharemilkers, contract milkers and herd managers.

Through this difficult year, our farmers and staff living in rural areas have found many different ways to provide additional support, organising rural events on topics such as personal resilience and reducing operating costs, or simply holding 'pie Fridays' as an opportunity to meet and chat.

In Australia, where supplying farmers have also been impacted by the dairy downturn, we provided access to low-interest support loans to assist with cash flow and further measures to support autumn calvers.

4 Recognised by the New Zealand Qualifications Agency at level 4.

SRI LANKA
Our team of Supplier Relationship Officers provide on-farm training to local farmers.

DAIRY DEVELOPMENT

Dairy Development is our contribution to improving livelihoods and creating thriving communities by generating sustainable employment, skills development and wealth creation opportunities in other markets.

USEFUL FACT

Our new milk collection centre at Doluwa in Sri Lanka uses rapid chilling technology to reduce milk temperature from 35 to 4 degrees Celsius in seconds.

Sri Lanka

This year, we opened a demonstration and training farm at Pannala, the first major private-sector training facility in Sri Lanka. The facility employs local people in managerial, animal care and farmhand roles, and will train around 2,500 farmers each year. To support this activity, three Fonterra shareholders from New Zealand volunteered their time and spent a month each in Sri Lanka to provide practical hands-on advice.

Providing on-going farming training, our network of Supplier Relationship Officers has grown to 21, and we now have our own seven milk collection centres, providing milk for use in our Anchor™ products.

Indonesia

Working with the Indonesian Government, our Fonterra Dairy Scholarship is now in its fourth year. This 12-month programme helps dairy farmers through classroom and practical training sessions in Indonesia and New Zealand. For all but one of this year's cohort of 12 students, their month in New Zealand was their first international travel experience. Practical work on farms in the Waikato is different, but it gives first-hand experience of the underlying topics that lead to good management practice, such as animal welfare, pasture management and hygiene.

An active alumni support programme and other short training courses are also offered throughout the year in Indonesia.

China

Encouraging the development of young Chinese talent in agriculture is important to us. On our farms in China, more than 75 per cent of staff are locally recruited and trained and we source about 85 per cent of feed locally, providing income and development opportunities for the wider industry.

We also support a farmer training programme with the Chinese Ministry of Agriculture, Dairy Association of China and the National Dairy Industry Technology System that has developed the skills of 3,400 local farmers since 2012. In association with the Ministry of Industry and Information Technology, we also support manufacturing training with about 20 dairy practitioners invited to New Zealand each year.

SUSTAINABILITY AND **SOCIAL RESPONSIBILITY**

QUALITY FIRST

Our Te Awamutu site was first in the world to be awarded the newly created combined food safety and quality system certification FSSC22000-Q.

GLOBAL FOOD DEFENCE

We are taking a four-pronged approach to further protect our consumers through innovative technology.


BATCH HISTORY


ANTI COUNTERFEIT


PRODUCT AUTHENTICATION


TAMPER EVIDENT SEALS

TRUST IN SOURCE

We challenge ourselves to see the world through our customers' and consumers' eyes, producing the safest, high-quality dairy products and innovating to create better dairy nutrition choices for tomorrow.

Last year we started a process to surpass standard compliance and have our manufacturing plants audited against the latest globally recognised benchmark standards. All our New Zealand sites have now achieved FSSC22000 Food Safety System Certification and our Te Awamutu site was the first in the world to be awarded the newly created combined food safety and quality system certification FSSC22000-Q.

Thinking and living food safety and quality

To reach these benchmarks, our comprehensive food safety and quality standards require a proactive approach where our staff think and live quality at every step.

We have built on the success of our Supply Chain Experience road shows last year to ensure our staff understand our expectations regarding food safety and quality, using a mix of interactive activities and real-life examples from the past year to propagate that thinking.

Global food defence – a four-pronged approach

We continue to build our food traceability capabilities and are progressively deploying an automated system to help us track the batch history of all ingredients and packaging efficiently and accurately across our supply chain.

At our Canpac site, we are developing a new world-leading approach to product authentication which, from next year, will allow customers across the world to access product confirmation and origin details instantly at the point of sale, using their mobile phone.

To defend against criminal activity, we have introduced covert anti-counterfeiting technology across much of our consumer-ready packaging and we will continue to extend this.

To further protect our consumers we have also extended our use of tamper-evident seals on packaging to all Anmum™ products in New Zealand and Indonesia, giving consumers a visible indication of product tampering that could occur post-packing.

Our customers

For our business-to-business customers we use an annual satisfaction survey to assess our performance and identify areas for improvement. This year, we achieved an overall value performance score of 8.0, our highest score ever.

Based on feedback we received last year, handling complaints was identified as an area for improvement, so this year we rationalised our approach. Our goal was to shorten the value chain, reducing the time to resolve any complaint raised and building a closer connection between the specific expert for any given case and the customer. This focus has reduced total resolution time by eight days and increased the quality of response, raising our overall complaints experience score from 7.7 to 8.0. Any score of 8.0 or above is considered a best-in-class result.

REDUCED SUGAR

Anchor Uno™ the lowest sugar yoghurt brand for kids in New Zealand.

HEALTHY RESULTS

Fonterra Milk for Schools is having a positive impact with an increase in the proportion of children achieving the dietary guidelines.

HEALTH AND NUTRITION

Fonterra is committed to delivering superior dairy nutrition based on sound science and championing dairy nutrition understanding, awareness and accessibility.

We are continuously moving our product portfolio towards using minimum quantities of added sugars without compromising quality, taste, texture and safety. Over recent years, we have been reviewing products, prioritising those everyday products that deliver the goodness of dairy targeted at children.

Anchor Uno™ was launched as a smooth, probiotic yoghurt aimed at kids, with an added bundle of vitamins and minerals tailored specifically to support healthy immune systems. It also has no artificial colours, flavours or sweeteners.

Although this product had contained similar levels of added sugar to our competitors, we used an innovative solution, developed by our own research team, to reduce sugar by 40 per cent without compromising on taste. It makes Anchor Uno™ the lowest-sugar yoghurt brand for kids in New Zealand[5].

In March, we launched Anmum™ in New Zealand with PediaPro3, our toddler milk with no added sugars. Anmum™, our maternal and paediatric brand, has been delivering value-add products to Asia since 1994.

Further afield, this year we also launched our first Anchor™ branded product into Ethiopia. Under-nutrition and micronutrient deficiency is a real problem in Ethiopia, so we worked with the Food and Nutrition Society of Ethiopia to create a fit-for-purpose fortified milk-based drink that provides children with access to affordable, smaller portions of dairy along with eight essential nutrients they may be missing from their daily diets.

In-school programmes

Fonterra Milk for Schools

Through Fonterra Milk for Schools we want to make a difference to the health of future generations of Kiwi kids by making a free serving of cold milk available to all primary-aged school children every school day.

Three years since the national rollout started, 1,455 schools are involved, with more than 140,000 children drinking and about 68 million individual packs.

In July 2013, we set up a study with The University of Auckland's National Institute of Health Innovation to assess the impact of Fonterra Milk for Schools on dairy consumption, general health indicators and attitudes to nutrition from participating children. After two years, the conclusions are very positive:

- There was a significant increase in the proportion of children achieving the dietary guidelines for dairy consumption every day.
- 93 per cent of children were achieving the dietary guidelines on weekdays.
- 96 per cent of the children liked the taste of the milk.
- 72 per cent of parents surveyed considered the programme to have a positive impact on their child's health.

5 Based on the average sugar content of the top five kid's yoghurt brands according to Nielson data as at 26 June 2016.

SUSTAINABILITY AND **SOCIAL RESPONSIBILITY**

125,000 **KICKSTART BREAKFASTS** served every week, through 879 breakfast clubs.

EMERGENCY SERVICES
Grants from the Fonterra Grass Roots Fund have helped a variety of ambulance, rural fire and search and rescue teams across the regions.

KickStart Breakfast

Targeted at those New Zealand children arriving at school hungry, our KickStart Breakfast programme is now in its seventh year.

USEFUL FACT

KickStart Breakfast started in 2009 with Sanitarium and was expanded from two to five days a week when the Government joined as a partner in 2013.

With more than 125,000 breakfasts served every week to more than 28,000 children and young people, we know these students are getting a great start to their school day. KickStart Breakfast enables New Zealand children in need to learn, helping them achieve their potential. It is a great example of how the community, the private sector and the Government can work together to create a positive change in the lives of those in need.

COMMUNITY DEVELOPMENT

The Fonterra Grass Roots Fund

The Fonterra Grass Roots Fund provides financial support for initiatives that help to strengthen our dairy communities, making them safer and more vibrant places to be. It was launched in 2007 in New Zealand and Sri Lanka in 2014, and we aim to gradually expand its coverage.

New Zealand

In New Zealand, community groups are invited to apply for grants with decision-making on who receives them made regionally involving staff, our farmers and, the community. More than 2,000 grants have been provided in total and, this year, approximately $600,000 was given to more than 300 community organisations, with a few highlighted here.

Love Soup is an organisation providing meals to those who need them around the country. We originally helped to get Love Soup started with a community garden in Tokoroa. This year, our contribution helped them buy eye-catching t-shirts for their volunteers as they expand their services to the Hibiscus Coast.

Several search and rescue teams around the country received grants, including Motueka who purchased new wet weather gear. The St John Ambulance Central Region team purchased Etonox regulators to provide fast-acting pain relief in difficult-to-reach situations and we also helped rural fire services in Opunake, Manawatu and Kawhia.

UPGRADING INFRASTRUCTURE

In Sri Lanka this year, we upgraded nine early childhood centres and constructed a new classroom for children from our dairying community.

Sri Lanka

Our Sri Lankan Fund works with trusted partners such as the Sarvodaya Shramadana Movement and the Kansarmen Foundation, responding to specific community needs, especially those of children. Since its launch, we have contributed over Rs30 million (NZD280,000 approx), completing 40 projects and reaching an estimated 25,000 people in rural areas where we source milk. Projects this year included infrastructure development, water and sanitation facilities and teacher training.

Greater China

In Greater China, our care for our communities focuses on health and nutrition in the rural villages where we have farming operations and on vulnerable groups in the cities.

This year, through our partnership with the China Soong Ching Ling Foundation, we donated more ambulances, two to Yutian County and two to Ying County. We also provided free health checks to over 200 villagers near Yutian and funding to help Hangu Middle School renovate its dormitory. For World Milk Day, we donated nutritional dairy products to students at Guang'ai School in Beijing, Shanghai Baby's Home and Gaojiazhuang Primary School in Yutian.

With our new business partner, Beingmate, we have also launched a new programme where consumers can help us to donate Anmum™, Anchor™ and Anlene™ products to people in need, with RMB3 million (over NZD600,000) of donations already generated by the programme.

Latin America

For 15 years, Soprole has been supporting school sports in Chile. With an estimated one and a half million people impacted through the activities of different clubs and organisations across seven different disciplines, this is a great opportunity to encourage healthy outdoor exercise and to instil important values such as hard work, perseverance and solidarity. Every year we also grant scholarships to the best participant in each discipline, to cover tuition fees for the following year if the student graduates from high school.

This year, we continued our partnership with the Universidad Católica de Chile to bring theatre performances to 12 of Chile's main cities, providing free entertainment to more than 5,000 spectators. This is proving a great way to bring families and communities together and to convey cultural values in an engaging and amusing way.

Australia

Our community goal in Australia is to make a valued difference to the social wellbeing, nutritional health and sustainability of the communities that support our business. Throughout the year, we contributed over AUD60,000 to more than 30 community organisations where our sites operate. This included helping to build school vegetable gardens, supporting sports, community and surf lifesaving clubs, and providing funds to help purchase essential equipment for emergency response services.

SUSTAINABILITY AND **SOCIAL RESPONSIBILITY**

STOCK EXCLUDED
In addition to the 24,410 kilometres, our farmers have also fenced more than 10,000 kilometres of intermittent streams to further protect the environment.

SUPPLY FONTERRA
Through Supply Fonterra we are helping our farmers build on their good practices.

Food banks

In New Zealand this year, we were awarded a 'Valued Partner' trophy by The Salvation Army in recognition of our five year partnership, one of only eight such trophies ever presented. In addition to donating short-dated product, our staff help with the Christmas food bank drive and we've even provided compost from our recycle lab to the community gardens where The Salvation Army grow vegetables for their food parcels. In the Auckland region, we also support five other food banks including the Auckland City Mission.

We also contribute to Foodbank, Australia's largest food relief organisation and we are a partner of the Fresh Milk Collaborative Supply Programme which supplies fresh milk to disadvantaged Australians.

SUSTAINABLE FARMING

New Zealand

Our farmers consider themselves stewards of the land and, even when times are tough, they continue to demonstrate their commitment to building an industry that's sustainable and resilient.

Supply Fonterra

Through Supply Fonterra in New Zealand, we are helping our farmers build on their existing good practices. Each year, every farm is assessed by a third party against defined environmental, food safety and animal welfare criteria. Results continue to demonstrate the real progress and investment made by our farmers. Over the 2015/16 season, less than four per cent of assessments resulted in a referral to our Sustainable Dairy Advisors for anything greater than minor support.

In New Zealand we are also signatories to the Sustainable Dairying: Water Accord, an industry-wide commitment to improve environmental performance on dairy farms with respect to water.

Waterway Management

Our farmers are committed to having all stock excluded from all defined waterways by 31 May 2017. At the end of May 2016, 97.4 per cent (24,410 kilometres) of defined waterways on mapped farms were stock-excluded[6], and 99.5 per cent of regular water crossings have a bridge or culvert. The total distance excluded is up and, although the percentage is down by 0.7 per cent due to farm changes, our farmers have effectively delivered on this target and we are transitioning to an annual verification process.

6 This includes approximately 161km of waterways and 19 stock crossing points with dispensations, primarily due to a management plan achieving stock exclusion through a temporary or natural barrier. Taranaki farms are excluded from these statistics as they are covered by the Regional Council programme. 99 per cent of all other farms have been mapped.

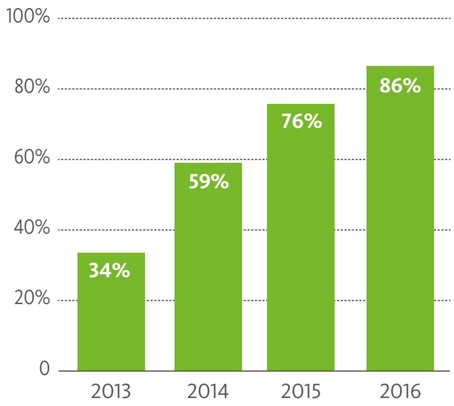
7 Waterways that are not present all year, or are too small to be included under the target.

8 Management of the strip of land adjacent to the waterways including suitable planting to reduce erosion, capture nutrients and provide shade.

9 OVERSEER® is owned by the Ministry for Primary Industries, the Fertiliser Association and AgResearch.

GPS MAPPING

New software helps our farmers plan and track progress on riparian management.



NITROGEN MANAGEMENT PARTICIPATION

86 per cent of our farmers completed an assessment.

In addition to the 24,410 kilometres, our farmers have also fenced more than 10, 000 kilometres of intermittent streams[7] to further protect the environment.

We are now working towards a target of all farmers having a documented riparian management[8] plan by 2020, and in October 2015, we launched a service to help our farmers achieve this. Using newly created software, our Sustainable Dairying Advisors work with farmers to plan and track progress on riparian management, using GPS mapping. Over time the progress made can be recorded and updated.

Water-use management

Our farmers rely on water to ensure good hygiene in the farm dairy, to provide drinking water for the animals and for growing pasture. To manage water-use responsibly it is important that farmers know how much they are using. Our target is for 85 per cent of farmers to have water meters on their farms by 2020 and 50 per cent have achieved this already.

Nitrogen management

Our farmers are working to reduce the risk of nitrogen leaching into waterways via surface and ground water, through nutrient management. In the past year, we have continued to see growing participation from our farmers, taking the time to record and provide detailed information about their farming operations during the year. We then produce individual farm reports using the Overseer® tool[9] to detail leaching risk, conversion efficiency, and to let farmers compare their performance with other farms in their region.

With this information potential improvements can be identified and analysed for use in the coming season, to reduce the impact on the environment and lower on-farm costs.

This year, 86 per cent of our farmers completed an assessment, up from 76 per cent in the 2014/15 season and, while some farmers are yet to do this, it demonstrates a continued commitment even in tough times.

Carbon footprint of New Zealand milk

The 2014/15 estimate of greenhouse gas emissions for New Zealand milk for the full lifecycle to the farm gate stage was 0.89 kilograms of carbon dioxide equivalent per kilogram of fat-and-protein-corrected milk (kg CO_2-e/kg FPCM), or 11.6 kilograms of carbon dioxide equivalent per kilogram of milk solids (kg CO_2-e/kg MS). This is a four per cent decrease from our 2009/10 season, with the reduction primarily associated with improved productivity per cow.

Australia

We are a member of the Australian Dairy Industry Council (ADIC) and actively support the ADIC Sustainability Framework. Through Fonterra's SupportCrew™ in Australia we make a team of specialists available to our farmers to help them identify and implement improvements that increase farm profitability and reduce environmental impacts.

Since launching in 2013, SupportCrew™ has implemented over 320 sustainability projects, primarily improving nutrient management, soil health and efficiency projects for water or energy.

SUSTAINABILITY AND **SOCIAL RESPONSIBILITY**

SILT TRAPS

Silt traps allow sediment to fall from water before entering lakes.

12,000km

Godwits fly about 12,000km from New Zealand to Alaska via China.

To deliver these projects, farmers' investments have been supported by a number of agencies. NRM North and Melbourne Water are helping with projects to improve water quality, and the Australian Government's Carbon Farming Futures programme helps with emissions reductions.

Living Water – partnerships in action

Living Water is our 10-year partnership with the Department of Conservation (DOC), working with dairy farmers, iwi, hapū, conservation and other community groups to demonstrate how dairy farming can operate as part of healthy ecosystems. Established in 2013, Living Water focuses on five sensitive water catchments where dairy farming exists. Proven solutions from the work become exemplars to help enhance performance on farms in other catchments across the country. Projects are occurring in all five catchments, with the following examples of activities this year.

We have completed 20 detailed biodiversity assessments on dairy farms across the five catchments. These assessments identify key habitats where our farmers can prioritise activities to enhance biodiversity. We are now supporting farmers to progress improvements.

An agreement was signed between DOC and the State Forestry Administration of China to protect, manage and restore wetlands where migratory birds feed. The coastal wetland at Pūkorokoro/Miranda provides a seasonal home for many shorebirds. Among these are red knots and bar-tailed godwits, which fly around 12,000 kilometres to their breeding grounds landing in China to refuel on the way. Through Living Water, our farmers are helping to protect the habitat for these birds in New Zealand.

USEFUL FACT

Through Living Water alone, more than 72,000 native shrubs and trees have been planted this year.

Peat lakes are globally rare ecosystems and this year we have created silt traps on two of the lakes in the Waikato. Placed where major drains enter the lakes, the silt traps slow water flow allowing sediment to fall naturally from the water rather than entering and building up on the lake floor.

HEALTHY COWS
Healthy, well-cared-for animals are vital to producing safe, high-quality milk and we are committed to continuously improving animal health and welfare outcomes.

Protecting biodiversity

Fonterra is committed to working collaboratively with communities and farmers to protect biodiversity and to contribute to natural habitat restoration.

In consultation with key supply partners and Greenpeace, we have developed a new standard for sourcing palm products to further reduce the risk of deforestation. The standard commits Fonterra to purchasing only segregated palm oil, and for our suppliers to have plans in place for full traceability to plantation for palm oil and palm kernel extract by 2018.

Work has started under the new partnership with the NEXT Foundation, formed in 2015 together with four other dairy companies, to support the goal of Zero Invasive Predators in New Zealand. Pests such as rats, possums and stoats prey on native species and kill an estimated 25 million native birds each year. The investment of $3 million over two years by the dairy industry is targeted at accelerating the development of new technologies and methods of pest control.

In July this year, the Government added further strength to this work by formally adopting a target to eradicate all pest predators that threaten New Zealand's native birds by 2050.

Animal health and welfare

Fonterra is committed to managing animals responsibly, partnering with our farmers to support the adoption of good management practices on farm that continuously improve animal health and welfare outcomes and eliminate practices that contravene the internationally recognised 'Five Freedoms'[10].

In New Zealand, ensuring good animal health and welfare on our farms is achieved through a combination of regulatory, industry bodies and Fonterra-specific activities. Nationally, we have animal welfare regulations which have been internationally recognised by World Animal Protection as A-rated but, aligned with our support of the Dairy Sustainability Framework, our focus in New Zealand is very much one of continuous improvement.

10 Freedom from hunger or thirst; freedom from discomfort by providing an appropriate environment; freedom from pain, injury or disease by ensuring rapid diagnosis and treatment; freedom to express normal behaviour by providing sufficient space, proper facilities and the company of the animal's own kind; freedom from fear and distress by ensuring conditions and treatment which avoid physical and mental suffering.

SUSTAINABILITY AND **SOCIAL RESPONSIBILITY**

THE DELOITTE ENERGY EXCELLENCE AWARDS WINNER 2016

ENERGY AWARDS

Our Energy Manager Linda Thompson won Young Energy Professional of the Year.

ENERGY RECOVERY

At Pahiatua, equipment on our new gas fired boiler recovered enough heat to bring 15 Olympic-size swimming pools of water to the boil.

SUSTAINABLE MANUFACTURING

Fonterra's largest manufacturing footprint is in New Zealand, with Australia our second largest asset base. Together, this represents more than 95 per cent of our raw milk supply.

At the Deloitte Energy Excellence Awards, our 'Project InteGreat' was a finalist in the Large Energy User of the Year category.

Climate and energy

We are committed to reducing the intensity[11] of energy use and greenhouse gas emissions across our business operations and moving towards cleaner technologies and energy sources.

Project InteGreat successfully delivered four new processing plants at our Edendale site without needing to install an additional coal boiler. This was achieved by implementing numerous energy recovery projects within the existing plants and designing highly-efficient new plants.

This project contributes to energy efficiency and avoids an estimated 23,500 tonnes of carbon dioxide equivalent (tCO_2-e) greenhouse gas emissions per annum.

During the Pahiatua expansion, we installed a condensing economiser on the new gas-fired boiler to enhance heat recovery from the stack gases. In its first season this has recovered 12,187 gigajoules (GJ) of heat energy – enough to bring 15 Olympic-size swimming pools of water to the boil.

Since we began our energy efficiency programme in 2003, we have achieved a reduction in energy intensity of more than 16 per cent for our New Zealand operations, against our target reduction of 20 per cent by 2020[12].

Energy use per tonne of production in New Zealand and Australia decreased 1.7 per cent to 8.22 GJ/tonne. Energy efficiency continues to be our main focus for greenhouse gas reduction but we are also committed to transitioning to lower-emission energy sources.

In 2015/16, the greenhouse gas emission intensity from our manufacturing activities reduced 3.1 per cent from 0.608 tonnes of carbon dioxide equivalent per tonne of production (tCO2-e/tonne) in 2014/15 to 0.592 tCO2-e/tonne. This reflects improved energy intensity, an improving fuel mix and an even lower emissions factor for New Zealand electricity due to increased renewables.

11 'Intensity' is the amount of energy used or greenhouse gas emissions produced per tonne of production.

12 Improvement is from a 2003 baseline and applies to New Zealand.

USING RAIL
Our use of rail saved an estimated 25,000 tonnes of CO_2 equivalent this year.

We are also a foundation partner with Z Energy, helping them to introduce a new biodiesel fuel into New Zealand. By committing to use ZBioD in our large fleet of milk collection tankers, we not only reduce our emissions, but also help make this fuel available to other New Zealanders to use in their vehicles.

Water

Water-use in manufacturing in New Zealand and Australia this year increased 1.7 per cent to 14.7 cubic metres of water per tonne of production. While there were significant water-use reductions at sites such as Pahiatua, Cobden and Wynyard, lower milk volumes led to slightly less efficient water-use.

As Fonterra builds new capacity we invest in resource-efficient plants. At Pahiatua this year we increased production by 85 per cent while using less water. This has been achieved primarily by capturing and cleaning the water evaporated from drying the milk so it can be reused.

After using water, we also need to dispose of it, minimising the impact of the wastewater when we discharge it into the environment.

SUSTAINABLE DISTRIBUTION

We have shipped product quickly after production this year, reducing demand for storage. This has allowed us to increase the use of our primary storage and distribution network, including continuing to increase our use of rail, which reduces our carbon footprint as well as road congestion. We increased the proportion of freight by rail by more than 10 per cent compared to last year. The total volume moved by rail this year was equivalent to 184,730 truck movements on road, saving an estimated 25,000 tonnes of carbon dioxide equivalent (tCO_2-e) compared to road transport.

USEFUL FACT

This year at Edendale, in line with our new environmental guidelines, we upgraded our treatment facilities to turn waste nutrients into a fertiliser for farmers.

CORPORATE **GOVERNANCE**

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CORPORATE **GOVERNANCE**

The Board and management of Fonterra consider that strong governance plays a critical role in the success of our Co-operative and are committed to achieving the highest standard of corporate governance and leadership.

To support this our Board has developed governance systems that reflect Fonterra's unique characteristics and requirements as a significant New Zealand based co-operative competing in the global dairy market.

Fonterra continuously reviews its Governance and Representation to ensure they reflect best practice for our Co-operative. A recommendation to enhance Governance and Representation has been put to farmer shareholders for consideration at a Special Meeting scheduled for 12 October 2016. Corporate Governance described in this section reflects Fonterra's current Governance and Representation structure and practices.

CHANGES TO THE FONTERRA BOARD

There were several changes to the Fonterra Board during the financial year ending 31 July 2016. In November 2015, Sir Ralph Norris, an Independent Director, retired and was replaced by Mr Clinton Dines. Mr Blue Read was not re-elected to the Fonterra Board following the November 2015 Director Elections and Mr Ashley Waugh was elected as a Farmer Director. Mr John Waller, an Independent Director, subsequently advised that he would be retiring with effect from 31 August 2016.

COMPLIANCE WITH BEST PRACTICE GOVERNANCE STANDARDS

The Fonterra Board's governance framework takes into consideration contemporary standards in New Zealand and Australia. It incorporates the Corporate Governance in New Zealand Principles and Guidelines issued by the Financial Markets Authority in December 2014 and the Corporate Governance Best Practice Code issued by NZX Limited (NZX) for the Fonterra Shareholders' Market (FSM). These are guidelines designed to maximise company performance and accountability in the interests of farmer shareholders, unitholders and the broader community.

Fonterra complies with the Fonterra Shareholders' Market Corporate Governance Best Practice Code.

We focus on governance in a way that promotes:

- the interests of our farmer shareholders, unitholders and other key stakeholders
- Fonterra's Co-operative philosophy, which is largely expressed through our Co-operative principles
- transparency, giving our farmer shareholders, unitholders and other stakeholders the information they need to assess our performance
- effective risk management and compliance to ensure that Fonterra meets its business objectives and all legal and reporting requirements
- an appropriate balance between the roles and responsibilities of the Board and management
- communication with important stakeholder groups, including farmer shareholders, employees, customers, unitholders, debt investors, governments and the communities Fonterra works in.

CORPORATE GOVERNANCE

Principle 1: Ethical Standards

Ethics framework

Fonterra expects its Directors, officers and employees to maintain high ethical standards. The Board is committed to maintaining high ethical standards in all aspects of the business in all parts of the world. The Group Ethical Behaviour Policy and the Board Charter set out these standards. These documents are reviewed and approved annually.

Fonterra's Code of Business Conduct – The Way We Work – provides practical guidelines on how to apply Fonterra's values in everyday work situations and when interacting with customers, farmer shareholders, unitholders, suppliers and the wider community.

The Group Ethical Behaviour Policy, The Way We Work and the Board Charter include clear expectations for Directors and employees in matters relating to ethical behaviour which include acting honestly and all of the matters recommended in Principle 1 of the FMA Corporate Governance in New Zealand Principles and Guidelines.

The Group Ethical Behaviour Policy is published in English, Sinhala, Spanish, Chinese and Portuguese. The Way We Work is published in English, Spanish, Chinese and Portuguese, to facilitate its accessibility to Fonterra's global employee base. The document has been written in simple, straightforward language and is available to all employees on both Fonterra's internal website and www.fonterra.com.

An independently run telephone, e-mail and web-based Hotline provides individuals with a confidential channel to raise ethical issues. In the 2016 financial year, 20 calls were raised globally with the Hotline.

All were fully investigated by the Human Resources and Internal Audit teams and appropriate action taken, including managing issues through other HR processes.

Employee training is provided annually on both the Group Ethical Behaviour Policy and The Way We Work. Individuals are assessed to ensure understanding of group policies and an annual compliance certification process promotes compliance.

Principle 2: Board Composition and Performance

Our Board

Fonterra's Constitution provides for not more than 13 directors and sets out how they are appointed.

In accordance with the Constitution, not more than nine Directors are elected by farmer shareholders from the shareholder base, and not more than four Directors are appointed by the Board. The People, Culture and Safety Committee oversees the process for identifying and recommending potential Appointed Directors, and makes appropriate recommendations to the Board. The Board of the Fonterra Shareholders' Fund is also consulted in relation to the appointment of Appointed Directors.

Appointed Directors are selected to enable the Board to access a full complement of skills and competencies needed to lead an enterprise of Fonterra's size, sophistication and complexity. They bring to the Board perspectives, experience and skills to augment the direct industry knowledge and other expertise provided by Farmer Directors.

The Board considers it important that there is a good balance of experience on the Board. To help achieve this, the Board has developed, and regularly reviews, a Skills Matrix which is used when appointing Independent Directors and is provided to potential candidates as part of the Farmer Director election process. There is also a non-mandatory formal assessment panel for candidates in the Farmer Director elections. The panel assesses the capability of candidates and then shares the outcome with farmer shareholders prior to voting.

Farmer Directors must be qualified as farmer shareholders under section 12.3 of the Constitution and are therefore not considered Independent Directors.

The Chief Executive Officer does not serve on the Fonterra Board.

Director independence

The rules of the Fonterra Shareholders' Market require Fonterra to have a minimum of two Independent Directors or if there are eight or more Directors, three or one-third of the total number of Directors of Fonterra, whichever is greater. With Fonterra's current Board of thirteen Directors, four must be Independent Directors.

Fonterra has been granted a waiver from Fonterra Shareholders' Market Rule 3.2.1(c) until the earlier of 30 November 2016 or the appointment of a new Independent Director. Under the terms of the waiver the Fonterra Board will have no less than three Independent Directors until the appointment of a new Independent Director to replace Mr John Waller.

In order to be an Independent Director, a director must not be an executive officer of Fonterra, or have a 'disqualifying relationship'.

A Director has a disqualifying relationship where he or she has a direct or indirect interest or relationship that could reasonably influence, in a material way, the Director's decisions in relation to Fonterra. The FSM Rules contain specific examples of what may give rise to a disqualifying relationship. Appointed Directors cannot be shareholders and are expected to maintain independence for the length of their term.

At 31 July 2016, Clinton Dines, Simon Israel, David Jackson, and John Waller each did not have (and continue not to have) any disqualifying relationship in relation to Fonterra and were therefore Independent Directors.

The Board has determined that Clinton Dines, Simon Israel, David Jackson and John Waller (being the Directors appointed by the Board in accordance with Fonterra's Constitution) are Independent Directors under the FSM Rules as at 31 July 2016. John Waller has subsequently resigned from the Fonterra Board with effect from 31 August 2016.

John Wilson, who is a Farmer Director, is the Board-elected Chairperson. Under Fonterra's Constitution, the Board Chairperson must be a Farmer Director. Following good governance, the Chairperson and Chief Executive roles at Fonterra are not exercised by the same individual.

Board Charter

The Board Charter, which sets out the responsibilities, roles and obligations of the Board and Directors is reviewed annually and was last approved by the Board in August 2015. The Board Charter and the Charters of the Board Committees are available on www.fonterra.com.

The Board Charter contains principles in relation to the Board composition, tenure of Directors, the Chairman's election and role, the Board's interaction with management and Incident Management engagement protocols. In addition, the Board Charter contains details of the delegation of authority to management, the Board's procedures, the training provided to Directors and the process for assessing the Board's performance.

Board meetings

The Board meets formally at least seven times a year and has regular and ad hoc teleconferences to ensure the Board is kept informed, and to deal with specific issues as they arise. Between full Board meetings, the Board uses committees to advance its work programme and to enhance the efficiency and effectiveness of its decision making.

Information for the Board

It is important that all members of the Board are appropriately informed of the Group's activities.

Directors are supplied with detailed monthly performance reports and analysis in advance of all Board meetings, together with papers on any significant commercial initiatives, and information on the Group's competitive position, industry updates and general economic indicators.

The Directors also make a point of meeting away from head office on a semi-regular basis so that they can broaden their understanding of the business through direct contact with managers and customers. Directors regularly visit key markets to gain a better understanding of the global dairy market.

Director Training

Following appointment to the Board, Directors undertake an induction programme to familiarise themselves with the Group. Areas covered include:

- business strategy and planning
- an overview of key financial metrics to monitor business performance
- an overview of material areas of the Fonterra business, including through meetings with key executives
- the Fonterra Constitution and other governance systems.

Directors are expected to keep themselves abreast of changes and trends in the business and in Fonterra's environment and markets, and trends in the economic, political, social and legal climate generally. As a group the Board holds several workshops on relevant subjects each year, and Directors are also expected to keep up to date with governance issues.

Nomination Committee

The People, Culture and Safety Committee oversees the process for appointments to the Board. To the extent the Board is responsible for appointing Directors, the People, Culture and Safety Committee satisfies the role of a nomination committee.

Performance assessment

Directors formally assess the performance of the Board as a whole each year. A regular programme of peer review of individual Directors also occurs. The Shareholders' Council reviews the Board's Statement of Intentions against the performance and operation of the Fonterra Group and reports on this to farmer shareholders annually. The Board is responsible for reviewing the Chief Executive's performance.

Independent professional advice

Any Director of the Board is entitled to seek independent professional advice relating to the affairs of Fonterra or to his or her other responsibilities as a Director. Fonterra will pay the reasonable cost of independent professional advice.

Diversity and Inclusion Policy

Fonterra has a Board approved People Management Policy that encompasses the Group's policy on diversity and inclusion. Fonterra is committed to creating and maintaining an environment where people with diverse experiences and ways of thinking are encouraged and enabled. Fonterra recognises that diversity is not solely a matter of compliance; it means respecting differences and making those differences count. The People Management Policy requires that all policies, standards and guidelines support the intent of diversity and inclusion. Fonterra proactively identifies and maximises local talent pools to improve participation. This includes increasing gender ratios in leadership, and access for people with disabilities, and those representing different cultures and ethnicities. Every manager and employee , through Fonterra's culture value and people frameworks, will be supported and expected to make decisions every day that align with Fonterra's intent relating to diversity and inclusion.

As at 31 July 2016, the gender composition of the Board comprised 11 male directors and two female Directors (2015: 2 of 13). The nine Farmer Directors on the Fonterra Board are elected by postal ballot of the farmer shareholders conducted by the Shareholders' Council, and the four Appointed Directors are appointed by the Board and ratified by farmer shareholders. Of eight officers who reported directly to the Chief Executive at 31 July 2016, three were female (2015: 4 of 16).

CORPORATE GOVERNANCE

Principle 3: Board Committees

Fonterra has a number of permanent Board Committees, as detailed in the table below. Additional Board Committees will be formed when it is efficient or necessary to facilitate effective decision-making by providing for a sub-group of Directors to focus on particular areas or issues and to develop recommendations to the full Board.

The Fonterra Board Committees have a standard Terms of Reference and each committee has a charter, which defines the scope and responsibilities of that committee and is approved by the Board annually. The minutes for each of the Board committees' meetings are supplied to the Board for review.

COMMITTEE OR GROUP	MEMBERSHIP AS AT 31 JULY 2016		PURPOSE
Audit and Finance Committee	David Jackson (Chair) Ian Farrelly Leonie Guiney	Michael Spaans John Waller Ashley Waugh	To assist the Board in fulfilling its governance responsibilities in relation to Fonterra's financial reporting, audit activities, treasury matters, financial risk management and internal control frameworks.
People, Culture and Safety Committee	John Wilson (Chair) Ian Farrelly John Monaghan	Simon Israel Clinton Dines David Jackson (observer)	To assist the Board in fulfilling its governance responsibilities in relation to the recruitment, retention, remuneration and development of directors, executives and other employees, and to promote a safe and healthy working environment.
Co-operative Relations Committee	John Monaghan (Chair) Malcolm Bailey David MacLeod	Leonie Guiney Ashley Waugh Michael Spaans	To assist the Board in fulfilling its governance responsibilities in relation to the supply of milk from Fonterra suppliers, and to seek to resolve supplier complaints before reference to the Milk Commissioner.
Risk Committee	Nicola Shadbolt (Chair) Malcolm Bailey David Jackson	David MacLeod John Waller	To assist the Board in fulfilling its corporate governance responsibilities relating to Fonterra's management of key enterprise wide risks. This includes strategic and operational risks, through Fonterra's risk management framework, the behaviours required of its people and its guidelines, policies and processes for monitoring and mitigating enterprise-wide risks.

Board and Committee attendance

	BOARD	AFC	PCS	CRC	RC
John Wilson	19/19	–	5/5	–	–
Malcolm Bailey	17/19	–	–	5/6	4/4
Clinton Dines	10/13	–	3/3	–	–
Ian Farrelly	19/19	6/6	5/5	–	3/3
Simon Israel	17/19	–	5/5	–	–
Leonie Guiney	19/19	6/6	–	3/3	3/3
David Jackson	17/19	6/6	5/5	–	4/4
David MacLeod	18/19	–	–	6/6	1/1
John Monaghan	19/19	–	5/5	6/6	–
Sir Ralph Norris	3/6	–	1/2	–	–
Blue Read	6/6	–	–	2/2	1/2
Nicola Shadbolt	18/19	2/3	–	–	1/1
Michael Spaans	19/19	4/6	–	6/6	–
John Waller	16/16	6/6	–	–	3/3
Ashley Waugh	13/13	3/3	–	3/3	–
TOTAL MEETINGS	**19**	**6**	**5**	**6**	**4**

Directors' attendances may reflect serving on committees for only part of the year.
Directors' attendances are noted for those Board meetings held during their tenure.

Audit and Finance Committee

There is an established Audit and Finance Committee as described on the previous page.

The Audit and Finance Committee comprises two Appointed Directors and four Farmer Directors. The committee is chaired by David Jackson, who is an Independent Director and a Fellow of the New Zealand Institute of Chartered Accountants.

Principle 4: Reporting and Disclosure

Fonterra is committed to high standards of reporting and disclosure. The Board has overall responsibility for the financial statements and the Audit and Finance Committee, as described above, plays an important role in overseeing the financial reporting processes used by management.

Financial Reporting

The Audit and Finance Committee reviews the financial statements and recommends approval of the financial statements to the Board. The Committee considers whether the financial statements are complete, whether they reflect appropriate accounting policies, any major judgement areas, any legal matters that may significantly impact the financial statements and any complex transactions.

The CEO and CFO provide the Board with management representations that the Fonterra financial statements give a true and fair view, in all material respects, of Fonterra's financial position and financial performance for each financial reporting period.

The Audit and Finance Committee oversees the Internal Assurance function and reviews the annual Internal Audit work plan. Internal audits provide assurance to the Board and management that the internal control framework is operating effectively.

Milk Price Panel

The Board has created the Milk Price Panel for the purpose of providing assurances as to the governance of the Farmgate Milk Price and the proper application of the Farmgate Milk Price Manual and the Milk Price Principles.

The Panel does not determine the Farmgate Milk Price, as this is a decision for the Board.

The Dairy Industry Restructuring Act 2001 (New Zealand) requires that the Chair and a majority of the members of the Panel (including the Chair) are independent. The Panel consists of two Appointed Directors, one Farmer Director and two appropriately qualified persons nominated by the Shareholders' Council, at least one of whom must be independent. The Chair must be one of the Appointed Director members. The Panel is currently chaired by David Jackson. Other Board members are Clinton Dines and Michael Spaans. The Shareholders' Council appointees are Patrick Boyle and Bill Donaldson. It has been announced that Andrew Wallace will replace Patrick Boyle as a Shareholders' Council appointee on the Panel from 1 November 2016. The Board confirmed that at 31 July 2016, John Waller, David Jackson and Patrick Boyle were considered to be Independent Members of this Panel. The Board has also confirmed that as at 31 July 2016 Andrew Wallace is an Independent appointee to the Panel and that Clinton Dines is an Independent Member as at 1 September 2016.

Continuous Disclosure Regime

Fonterra is committed to promoting a well-informed and efficient market in its shares, units issued by the Fonterra Shareholders' Fund and debt securities. The Board has approved a Group Disclosure Policy to ensure compliance with the NZX and ASX listing rules regarding disclosure. The Group Disclosure Policy governs Fonterra's communications with investors and market participants, and the disclosure of information relevant to Fonterra.

Fonterra has a Disclosure Committee that holds regular monthly, and ad hoc meetings required to oversee Fonterra's continuous disclosure obligations. The members of the Disclosure Committee are the CEO, CFO, Managing Director Corporate Affairs, Director Capital Markets and the Company Secretary. The Disclosure Committee has a Charter and has responsibility for overseeing Fonterra's continuous disclosure obligations, reviewing, monitoring and implementing the Group Disclosure Policy. The Committee maintains a register of Continuous Disclosure matters and also ensures a consistent and high standard of communication with farmer shareholders, investors and market participants on a timely basis.

The Chairman of the Board and the Chairman of the Audit and Finance Committee attend the Committee's meetings to review and approve the materials for release of the Interim and Annual Reports.

Fonterra and the Manager of the Fonterra Shareholders' Fund have entered into an arrangement to co-operate with each other and take all steps reasonably required to ensure that information to be disclosed by either of them under the listing rules of the FSM, the NZSX or the ASX (as the case may be) is disclosed simultaneously to the Fonterra Shareholders' Market, the NZX Main Board and ASX. It is intended that where NZX, as market operator of the Fonterra Shareholders' Market, receives information provided by Fonterra for release under the Fonterra Shareholders' Market, NZX will simultaneously release the information under the code relating to the Fund. This process is intended to be automatic. Fonterra simultaneously discloses relevant information on ASX.

Securities Trading Policy

Fonterra has adopted a Securities Trading Policy that details the rules for trading in units, shares, bonds and milk price futures. The policy applies to Directors, officers, employees and contractors of Fonterra and members of the Shareholders' Council and Milk Price Panel, and is additional to legal prohibitions on insider trading in New Zealand and Australia. All Directors comply with the legislative requirements for disclosing interests and with the Securities Trading Policy, which regulates both Directors and management in their personal dealings with Fonterra securities and those of related companies.

The Securities Trading Policy is available, along with other key Group Policies on www.fonterra.com.

CORPORATE GOVERNANCE

Principle 5: Remuneration

Remuneration of Directors

Fonterra's remuneration framework is designed to attract, retain and motivate high quality Directors and senior management.

The Constitution modifies the discretion of the Board to set remuneration of Directors. In accordance with the Constitution, farmer shareholders elect an independent committee of six farmer shareholders to consider and make recommendations to the Annual Meeting on Farmer Director remuneration.

The members of the Directors' Remuneration Committee as at 31 July 2016 were David Gasquoine (Chair), Murray Holdaway, Scott Montgomerie, Stephen Silcock, Philip Wilson and Gerard Wolvers.

The Board has full discretion over the remuneration of Appointed Directors. The details of the Directors' remuneration are contained on page 45 of the Annual Financial Results for the year ended 31 July 2016.

The Remuneration framework for management is outlined on page 49 of the Annual Financial Results for the year ended 31 July 2016.

Principle 6: Risk Management

Risk management

There is an established Risk Committee as described previously. The Audit and Finance Committee oversee financial risk management and the Risk Committee covers all other aspects of risk including ensuring a strong risk management culture in Fonterra.

The Risk Committee comprises two Appointed Directors and three Farmer Directors. The Committee is chaired by Professor Nicola Shadbolt, who is a Farmer Director. It is a requirement that the Chairman of the Audit and Finance Committee is also a member of the Risk Committee.

Fonterra has a global Risk Management Policy, the purpose of which is to embed a risk management capability within Fonterra to provide a consistent method for the identification, assessment, control, monitoring and reporting of risks faced by the organisation. The policy recognises that risk represents both opportunity and threat and that risk is an integral part of business.

Fonterra's tolerance for risk is defined in the Risk Management Framework which requires the reporting of material risks as appropriate to the Fonterra Management Team, the Risk Committee and the Board.

Fonterra's Risk Management Policy is aligned with the ISO31000 Risk Management Standard. The Policy is supported by a detailed Group Risk Management Standard and Guidelines that define the mandatory requirements relating to risk management for businesses. The Risk Management Policy provides a consistent methodology and approach for the execution of these mandatory requirements by specifying processes for:

- identifying existing and potential risks that may impact upon business objectives
- assessing the consequence and likelihood of risks identified
- identifying key controls in place to address risks
- evaluating the design and operating effectiveness of controls in mitigating risks to an acceptable level
- generating action plans to improve controls where required
- regularly monitoring risks and tracking progress against action plans

Risk reporting to the Board for review occurs on a regular basis. The Board materials include risk reporting on Health and Safety and Food Safety and Quality risks at every meeting. The regular schedule of Board reporting includes Fonterra's top risks, and changes in risks which also encompasses emerging risk areas. This process is supported by a formal evaluation of the top risks along with a quarterly review and update of this risk assessment material. A summary of the results of this assessment is reported to the Risk Committee.

Fonterra's Internal Audit function is accountable for formally reviewing the effectiveness of the Group's risk management processes, including using the outputs of risk assessments to compile its audit plan and performing independent validation of the internal control environment.

Principle 7: Auditors

The Audit and Finance Committee is responsible for making recommendations to the Board regarding the appointment of the external auditor. The auditor is appointed by the shareholders at the Annual Meeting.

The Audit and Finance Committee reviews the independence of the auditor and reviews the external audit fees, the terms of engagement and annual audit plan.

Fonterra encourages the rotation of the lead external audit partner in the relationship in accordance with best practice. Fonterra has a Group Audit Independence Policy, for certain activities the auditor may undertake for the Group. This policy is prescriptive as to the types of activities that the auditor may undertake, those the auditor may only undertake with the approval of the Audit and Finance Committee, and the types of activities that are not permitted. The Audit and Finance Committee will not approve the auditor performing any tasks that have the potential to create a conflict except in exceptional circumstances and then only if appropriate safeguards are in place.

The Audit and Finance Committee Chairman communicates regularly with the external auditor and the Audit and Finance Committee meet with the external auditor without management at least annually.

The fees paid to Fonterra's auditor, PricewaterhouseCoopers are detailed in Note 4 to the financial statements contained in the Annual Report.

Principle 8: Shareholder Relations

Shareholders' Council

One of the Board's most important relationships is with the Shareholders' Council. The Council, Fonterra's representative body, which is established under the Fonterra Constitution, is independent of the Board and comprises 35 farmer shareholders elected as councillors, representing 35 wards across New Zealand. The Shareholders' Council was created to be the guardian of the Co-operative Principles which apply to the cornerstone activities of the Co-operative. The functions of the Council are set out in the Constitution. The Council reviews the Board's statement of intentions for the performance and operations of the Group and publishes an annual report, commenting on these matters.

The Council, Board and management have a working interface document which sets out the principles to facilitate the working partnership between the Board and the Council and the way operational issues will be dealt with by the Board and the Council.

The working interface document is available on the Farm Source website.

The Council and the Board meet regularly, as do the Chairs of the Board and the Council and the Chairs of their respective Committees.

Farmer communications

Fonterra is committed to maintaining and improving dialogue with our farmer shareholder base to ensure that the objectives of both the Group and farmer shareholders are understood. An extensive farmer shareholder and supplier relations programme is managed by the Chief Operating Officer, Farm Source. Channels for electronic communication are provided through the fonterra.com and Fonterra Farm Source websites and the My Co-op phone application.

Fonterra's communications with farmer shareholders include regular face-to-face meetings, Sky Broadcasts, a regular monthly Global Dairy Update, Farm Source publication and a regular Chairman's email. As described above, Fonterra releases all material information to the relevant stock exchanges and complies with the Fonterra Shareholders' Market, NZX and ASX Listing Rules with respect to shareholder communications.

Farmer meetings

A schedule of regular meetings with farmer shareholders, sharemilkers and farm workers is held across the country at least twice each year. Often these are run in conjunction with the Shareholders' Council, Area Managers and the Fonterra Farmer Network.

Directors also regularly attend other farmer meetings during the year on specific topics.

In addition, the Board consults with farmer shareholders on specific issues as they arise.

Fonterra.com and Farm Source

Presentations on the development of the business are available on the fonterra.com website. The Group also uses digital media, email alerts, including regular updates from the Chairman and regular farmer shareholder updates.

The Farm Source website enables Fonterra shareholders, their employees and business partners to transact online with Fonterra and access information and tools on milk production and quality, online statements and up-to-the-minute news and weather. This site is also used to provide information on the business to farmer shareholders.

Annual Meeting

The Board views the Annual Meeting of farmer shareholders, which is held at a different venue around New Zealand each year, as an opportunity to communicate directly with farmer shareholders and ensures that adequate time is provided at these meetings for farmer shareholders to raise issues or ask questions from the floor.

Notices of meetings are sent to farmer shareholders at least 10 working days before the meeting.

The Fonterra Constitution describes the process whereby a farmer shareholder can raise a proposal for discussion or resolution at the next meeting of farmer shareholders at which the farmer shareholder is entitled to vote.

Annual Report

The Group's Annual Report including financial statements and an annual review, together with the half-year reports and other material announcements, are designed to present a balanced and clear view of Fonterra's activities and prospects and are available on fonterra.com.

Other Disclosures

Information on the Group's performance, annual and half-year financial results, director changes, and other significant matters, is advised to the market through the NZX and ASX in accordance with the Disclosure Policy. Farmer shareholders and other stakeholders receive regular updates on these and other issues relevant to them and all media and market releases are available on fonterra.com.

Principle 9: Stakeholder Interests

The Board has policies in place for the governance and management of Fonterra's relationships with key stakeholders. The Co-operative Relations Committee of the Board specifically provides governance oversight of the management of Fonterra's relationships with key external stakeholders in New Zealand and all other key markets, including, but not limited to, its government, non-government and community relationships. This includes oversight of Fonterra's community initiatives in support of its social responsibility and identity objectives. Examples of this activity are detailed in the social responsibility reporting section of this report. Of particular significance are the approaches to relationships with the Shareholder's Council, farmer shareholders and farmer suppliers. These approaches are detailed at Principle Eight.

FSM Waivers

On 31 August 2016 NZX Regulation granted a waiver to Fonterra Co-operative Group Limited from the Fonterra Shareholders' Market Rule 3.2.1(c) until the earlier of 30 November 2016 or the appointment of a new Independent Director. Under the terms of the waiver the Fonterra Co-operative Group Limited Board will have no less than three Independent Directors until the appointment of a new Independent Director to replace John Waller.

BOARD OF **DIRECTORS**

1. **JOHN WILSON**
2. **MALCOLM BAILEY**
3. **CLINTON DINES**
4. **IAN FARRELLY**
5. **LEONIE GUINEY**
6. **SIMON ISRAEL**
7. **DAVID JACKSON**
8. **DAVID MACLEOD**
9. **JOHN MONAGHAN**
10. **NICOLA SHADBOLT**
11. **MICHAEL SPAANS**
12. **JOHN WALLER** ONZM
13. **ASHLEY WAUGH**

1. JOHN WILSON

BOARD RESPONSIBILITIES *Chairman, and Chair of the People, Culture and Safety Committee*

TERM OF OFFICE *Elected 2003, last re-elected 2015*

John Wilson was elected to the Fonterra Board in 2003 and became Chairman in 2012. Previously he served as the inaugural Chairman of the Fonterra Shareholders' Council. John is a director of Turners & Growers Limited and he serves on the Executive Board of the New Zealand China Council. He is a chartered member of the Institute of Directors in New Zealand. John lives on his dairy farm near Te Awamutu and jointly owns a dairy farming business based near Geraldine, South Canterbury.

B.Agr.Sc

2. MALCOLM BAILEY

BOARD RESPONSIBILITIES *Farmer-elected Director, Chair of the Risk Committee until May 2016 and Member of the Co-operative Relations Committee*

TERM OF OFFICE *Elected 2004, last re-elected 2013*

Malcolm Bailey was elected to the Fonterra Board in 2004. Malcolm represents Fonterra on the Dairy Companies Association of New Zealand. He is a director of Westpac New Zealand Limited, Hopkins Farming Group Limited and Gleneig Holdings Limited. He is also the Independent Chair of the Red Meat Profit Partnership and New Zealand International Business Forum. Malcolm's dairy farming interests are as a shareholder in Hopkins Farming Group Limited.

B.Agr.Econ

3. CLINTON DINES

BOARD RESPONSIBILITIES *Appointed Director, Member of the People, Culture and Safety Committee and Milk Price Panel*

TERM OF OFFICE *Appointed 2015*

Clinton was appointed to the Fonterra Board in 2015. Clinton lived and worked in China for 36 years, 21 of which were as President of BHP Billiton's China business. He has extensive experience as an executive in China and Asia businesses and has had an active career as a non-executive director, currently serving on the Boards of Aurecon, North Queensland Airports and Zanaga Iron Ore. Clinton was Executive Chairman of Caledonia Asia from 2010 to 2013, a venture investment group in Asia, and is a Partner in Moreton Bay Partners, a strategic advisory firm based in Brisbane. He is an Adjunct Professor at Griffith University's Asia Institute and is a Member of the Griffith University Council.

BA (Modern Asian Studies, Griffith), CIM, INSEAD

4. IAN FARRELLY

BOARD RESPONSIBILITIES *Farmer-elected Director, Member of the Audit and Finance Committee and the People, Culture and Safety Committee*

TERM OF OFFICE *Elected 2007, last re-elected 2013*

Ian Farrelly was elected to the Fonterra Board in 2007. Ian had a 20-year career in the banking industry including 15 years as head of ASB's Rural Division. Ian serves on the Board of the Manager of the Fonterra Shareholders' Fund and is also a director of First Mortgage Managers Limited, Spectrum Dairies Limited, Fortuna Group Limited and Waikato Stud. He owns and runs a 500-hectare 10,000 animal calf-rearing farm in Te Awamutu and has ownership interests in dairy farms in Canterbury and the Waikato.

B.Agr

5. LEONIE GUINEY

BOARD RESPONSIBILITIES *Farmer-elected Director, Member of the Audit and Finance Committee and the Co-operative Relations Committee*

TERM OF OFFICE *Elected 2014*

Leonie Guiney was elected to the Fonterra Board in 2014. Leonie has worked in the agriculture sector for 25 years in a number of positions including as a lecturer of Dairy Production at Lincoln University and consultant on the BNZ Growth Programme for farmers. She has also held roles with Golden Vale Dairy Co-operative in Ireland, LIC and FarmRight South Island. Leonie was the 2014 winner of the low input NZ Dairy Business of the Year and the 2006 Canterbury Sharemilker of the Year titles. Leonie began farming in Canterbury in 2002 and she is now a director and shareholder of five Canterbury farms and Bobby Square Limited.

B.Agr.Sc

6. SIMON ISRAEL

BOARD RESPONSIBILITIES *Appointed Director, Member of the People, Culture and Safety Committee*

TERM OF OFFICE *Appointed 2013*

Simon Israel was appointed to the Fonterra Board in 2013. Simon currently chairs Singapore Telecommunications Limited and Singapore Post Limited and is a Director of CapitaLand, one of Asia's largest real estate companies. He was an Executive Director of Temasek Holdings for six years and President from 2010 to 2011. Simon was a director of Fraser & Neave, Neptune Orient Lines, Asia Pacific Breweries, Griffin Foods and Frucor Beverage Group. He had 10 years' experience in the dairy industry with Danone as a Senior Vice President and member of the Group Executive Committee. He was conferred Knight in the Legion of Honour by the French Government in 2007.

Diploma of Business Studies

7. DAVID JACKSON

BOARD RESPONSIBILITIES *Appointed Director, Chair of the Audit and Finance Committee, Member of the Risk Committee and Chair of the Milk Price Panel, Observer of the People, Culture and Safety Committee*

TERM OF OFFICE *Appointed 2007*

David Jackson was appointed to the Fonterra Board in 2007. David also serves on the boards of Nuplex Industries Limited, Mitre 10 (New Zealand) Limited and Tegel Group Holdings Limited and was previously Chairman of The New Zealand Refining Company Limited. David spent more than 30 years with accounting firm Ernst & Young in a variety of roles, and served as Chairman of the board of management for the firm in New Zealand from 1999 to 2002.

M.Com(Hons), FCA, FInstD

8. DAVID MACLEOD

BOARD RESPONSIBILITIES *Farmer-elected Director, Member of the Co-operative Relations Committee and the Risk Committee*

TERM OF OFFICE *Elected 2011, last re-elected 2014*

David MacLeod was elected to the Fonterra Board in 2011. David also serves on the boards of Port Taranaki Limited and A.J. Greaves Electrical Limited. He is Chairman of the Taranaki Regional Council. David lives near Hawera in South Taranaki and is a director of P.K.W. Farms GP Limited, one of Fonterra's largest shareholders, and is a shareholder of Far South Farms Limited, which owns a dairy farm in Southland.

9. JOHN MONAGHAN

BOARD RESPONSIBILITIES *Farmer-elected Director, Chair of the Co-operative Relations Committee and Member of the People, Culture and Safety Committee*

TERM OF OFFICE *Elected 2008, last re-elected 2014*

John Monaghan was elected to the Fonterra Board in 2008. Prior to joining the Fonterra Board John was Chairman of the Fonterra Shareholders' Council for a three-year period. He is also a director of Centre Port Limited and Centre Port Properties Limited, and is a trustee of the Wairarapa Irrigation Trust. John has dairy farming interests in the Wairarapa and Otago regions.

10. NICOLA SHADBOLT

BOARD RESPONSIBILITIES *Farmer-elected Director, Chair of the Risk Committee*

TERM OF OFFICE *Elected 2009, last re-elected 2015*

Nicola Shadbolt was elected to the Fonterra Board in 2009. Nicola is a Professor of Farm and Agribusiness Management at Massey University, serves on the Board of the Manager of the Fonterra Shareholders' Fund and represents New Zealand in the International Farm Comparison Network in Dairying. Nicola and her husband live in the Pohangina Valley in the Manawatu, which is the base for the five farming and forestry equity partnerships they run, which include two dairy farms.

B.Sc(Hons), M.AgrSc(Hons), DipBusStud (Accountancy), FNZIPIM (Reg), FAICD

11. MICHAEL SPAANS

BOARD RESPONSIBILITIES *Farmer-elected Director, Member of the Audit and Finance Committee and the Milk Price Panel*

TERM OF OFFICE *Elected 2013*

Michael Spaans was elected to the Fonterra Board in 2013. He was a member of the Fonterra Shareholders' Council since its formation in 2001 until 2008. Michael is Chairman of Dairy NZ. He serves on the board of ASB Bank Limited and is a director of Shoof International Limited. Michael's family farm is in the Waikato near Te Aroha where he milks a 500-cow herd.

Graduate Diploma Finance

12. JOHN WALLER ONZM

BOARD RESPONSIBILITIES *Appointed Director, Chair of the Milk Price Panel, Member of the Audit and Finance Committee and the Risk Committee*

TERM OF OFFICE *Appointed 2009, retired August 2016*

John Waller was appointed to the Fonterra Board in 2009. He served as Chairman of the Bank of New Zealand and as a director of National Australia Bank Limited for eight years. John serves on the boards of Haydn & Rollett Limited, Sky Network Television Limited, Property For Industry Limited and Donaghys Limited. He is Chairman of the GS Group Limited. John was a partner at PricewaterhouseCoopers for more than 20 years. He was also a member of their board and led their advisory practice for many years. Mr Waller was made an Officer of the New Zealand Order of Merit for services to business and the community in 2016.

BCom, FCA

13. ASHLEY WAUGH

BOARD RESPONSIBILITIES *Farmer-elected Director, Member of the Audit and Finance Committee and the Co-operative Relations Committee*

TERM OF OFFICE *Elected 2015*

Ashley Waugh was elected in 2015. Ashley spent ten years with The New Zealand Dairy Board followed by eight years with National Foods in Australia including the last four years as Chief Executive Officer. Ashley serves on the Board of Seeka Kiwifruit Industries Limited, Moa Brewing Company Limited and the Colonial Motor Company Limited. Ashley has shareholding interests in Puke Roha Limited in Pokuru.

BBS

FONTERRA **MANAGEMENT TEAM**

1. **THEO SPIERINGS**
2. **LUKAS PARAVICINI**
3. **JACQUELINE CHOW**
4. **MILES HURRELL**
5. **ROBERT SPURWAY**
6. **JUDITH SWALES**
7. **KELVIN WICKHAM**

1. THEO SPIERINGS

Chief Executive Officer

Theo Spierings sets Fonterra's overall direction and leads the Fonterra Management team. He is focused on building on Fonterra's strengths and securing future growth for the Co-operative. Theo joined Fonterra in 2011, bringing with him extensive experience from across the dairy industry, particularly in Asia, Latin America, Africa, the Middle East and Europe. Theo has over 30 years' experience in the global dairy industry in a variety of roles including general management, operations and supply chain, and sales and marketing positions. He was previously the acting CEO of Royal Friesland Foods, a Dutch dairy co-operative which, in 2008, he led through a merger with Campina. Before taking up his leadership role at Fonterra, Theo ran his own company in the Netherlands focusing on corporate strategy, and mergers and acquisitions, in fast-moving consumer goods (FMCG). Theo holds a Bachelor of Arts in Food Technology/Biotechnology and a Master of Business Administration.

2. LUKAS PARAVICINI

Chief Financial Officer

Lukas Paravicini joined Fonterra as CFO in 2013 after 22 years with Nestlé where he was General Manager for Nestlé Professional Europe. Before this, Lukas held a number of senior positions including CFO of Nestlé Brazil, Nestlé's fourth largest market, Vice President of Global Business Services and CFO of Nestlé Professional and Nestlé's globally managed Out-of-Home business. He has an in-depth understanding of dairy and has lived and worked in some of Fonterra's most strategically important markets. Lukas holds a business and administration degree from the University of Zurich, Switzerland, and speaks five languages.

3. JACQUELINE CHOW

Chief Operating Officer, Global Consumer and Foodservice

Jacqueline heads Fonterra's Global Consumer and Foodservice business unit. Previously, as Chief Operating Officer Velocity, she led our business transformation to accelerate the delivery of strategy and drive a step-change in performance. Prior to this, Jacqueline was Managing Director Fonterra Global Brands and Nutrition, responsible for the group-wide consumer brand strategies in marketing, innovation, technology and food quality. Before joining Fonterra in 2013, Jacqueline was Australia and New Zealand General Manager for Arnott's. She has also held executive marketing and innovation roles at Campbell's and the Kellogg Company. Jacqueline has extensive FMCG and marketing experience garnered from a 20-year career in global blue-chip multinationals. Jacqueline holds a Bachelor of Science (First Class Honors) and an MBA in International Business Strategy and Finance. She is also a graduate of the Australian Institute of Company Directors.

4. MILES HURRELL

Chief Operating Officer, Farm Source

Miles Hurrell heads Fonterra's global Co-operative farming strategy which includes farmer services and engagement, milk sourcing and the chain of 71 Farm Source™ rural retail stores throughout New Zealand. Miles' 16 years' experience in the dairy industry has spanned four continents. In his previous role as General Manager Middle East, Africa and CIS he lead a period of sustained growth during a time of political unrest across the region. He reset the African sales strategy and was a director of Fonterra's joint venture with Africa's largest dairy company, Clover Industries Limited. From 2006-2008 Miles oversaw the streamlining of the Co-operative's European operations before moving to the United States to establish new offshore partnerships. Miles has completed management programmes at INSEAD (International Executive Development), London Business School (Finance) and Kellogg's North Western University (Global Sales).

5. ROBERT SPURWAY

Chief Operating Officer, Global Operations

Robert Spurway joined Fonterra in 2011. As Chief Operating Officer, Global Operations, Robert leads Fonterra's global operations business and is responsible for the Co-operative's manufacturing and supply chain operations in New Zealand and around the world. In his previous role he was responsible for overseeing milk collection, manufacturing and logistics for the Co-operative's New Zealand milk supply. Prior to that, he was Fonterra's South Island Regional Operations Manager. In this role, he oversaw the greenfield development of the Co-operative's Darfield site. Robert has more than 20 years' experience in the food and dairy industries. After managing the Northland Dairy Company's Dargaville site, he moved to Australia in 1999, where he held various roles in Goodman Fielder Australia. From 2008 to 2011, Robert led two Australian food companies before returning to New Zealand. Robert holds a Bachelor of Engineering (Chemical and Materials).

6. JUDITH SWALES

Chief Operating Officer, Velocity and Innovation

Judith Swales has been with Fonterra since 2013 and was appointed Chief Operating Officer Velocity and Innovation in June 2016. She is responsible for driving efficiency across the Co-operative, bringing increased commercial focus to Fonterra's research, development and technology, and taking a strategic view on developing game changing business models. Prior to this appointment, Judith was the Managing Director of Fonterra Oceania, leading the successful turnaround of the Australian business and overseeing Fonterra Brands New Zealand.

She has extensive experience in senior management and business turnarounds, and prior to joining Fonterra, Judith was the Managing Director of Heinz Australia and CEO and Managing Director of Goodyear Dunlop, Australia and New Zealand. Before coming to Australia in 2001, Judith worked for a number of UK retailers which culminated in her move to Australia as the Managing Director of Angus and Robertson. She has served as a Non-Executive Director on the DuluxGroup Board since April 2011 and has a degree in microbiology and virology.

7. KELVIN WICKHAM

Chief Operating Officer, NZMP

Kelvin Wickham leads the sales and marketing of all Fonterra ingredients globally, delivering solutions to our global customers, ensuring optimisation of supply and demand, commodity price risk management, and championing the NZMP™ brand. Kelvin has more than 27 years' experience in the dairy industry and has played a key role in building markets, customer relationships and partnerships. His previous role of President Greater China and India focused on directing the development of Fonterra's business in these expanding markets, during which he oversaw a period of rapid growth. Prior to that, Kelvin led Fonterra's Supplier and External Relations team, and was Managing Director of Fonterra's Global Trade overseeing the launch of GlobalDairyTrade. From 2005 to 2007 he was the Director of Sales and Operations Planning. Kelvin holds a chemical and materials engineering degree, a Master of Management and a Diploma of Dairy Science and Technology.

SUMMARY **FINANCIAL STATEMENTS**

For the year ended 31 July 2016

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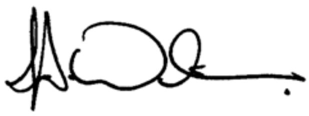
DIRECTORS' STATEMENT

FOR THE YEAR ENDED 31 JULY 2016

The Directors hereby approve and authorise for issue the summary financial statements for the year ended 31 July 2016 presented on pages 78 to 93. For and on behalf of the Board:



JOHN WILSON
CHAIRMAN
20 September 2016

DAVID JACKSON
DIRECTOR
20 September 2016

Fonterra Co-operative Group Limited (Fonterra 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 summary financial statements comprise Fonterra and its subsidiaries (together referred to as the Group) and include the Group's interest in its equity accounted investees after adjustments to align to the accounting policies of the Group. They have been prepared in accordance with Financial Reporting Standard No. 43: Summary Financial Statements and have been extracted from the Group's full financial statements. The Group's full financial statements comply with International Financial Reporting Standards. They also comply with New Zealand Equivalents to International Financial Reporting Standards and have been prepared in accordance with New Zealand Generally Accepted Accounting Practice.

The Board has elected to present summary financial statements for the year ended 31 July 2016 as part of the Annual Review sent to Shareholders. These summary financial statements include notes setting out key information.

These summary financial statements are presented for the year ended 31 July 2016. The comparative information is for the year ended 31 July 2015. These summary financial statements of the Group have been prepared using the same accounting policies and measurement basis as the Group's full financial statements for the year ended 31 July 2016.

The full financial statements for the year ended 31 July 2016, approved and authorised for issue by the Board on 20 September 2016, have been audited by PricewaterhouseCoopers and given an unqualified opinion.

The Group is primarily involved in the collection, manufacture and sale of milk and milk-derived products and is a profit-oriented entity. These summary financial statements are presented in New Zealand Dollars ($ or NZD), which is Fonterra's functional and presentation currency, and rounded to the nearest million, except where otherwise stated.

The summary financial statements cannot be expected to provide as complete an understanding of the financial affairs of the Group as the full financial statements, which are available from Fonterra's registered office at 109 Fanshawe Street, Auckland, New Zealand or on Fonterra's website, www.fonterra.com.

INCOME STATEMENT

FOR THE YEAR ENDED 31 JULY 2016

		GROUP $ MILLION	
	NOTES	31 JULY 2016	31 JULY 2015
Revenue from sale of goods		**17,199**	18,845
Cost of goods sold	2	**(13,567)**	(15,567)
Gross profit		**3,632**	3,278
Other operating income		**266**	288
Selling and marketing expenses		**(703)**	(693)
Distribution expenses		**(585)**	(700)
Administrative expenses		**(844)**	(874)
Other operating expenses		**(396)**	(493)
Net foreign exchange gains		**7**	70
Share of profit of equity accounted investees		**54**	66
Profit before net finance costs and tax		**1,431**	942
Finance income		**18**	39
Finance costs		**(517)**	(557)
Net finance costs		**(499)**	(518)
Profit before tax		**932**	424
Tax (expense)/credit	10	**(98)**	82
Profit after tax		**834**	506
Profit after tax is attributable to:			
Equity holders of the Co-operative		**810**	466
Non-controlling interests		**24**	40
Profit after tax		**834**	506

	GROUP $	
	31 JULY 2016	31 JULY 2015
Earnings per share:		
Basic and diluted earnings per share	**0.51**	0.29

The accompanying notes form part of these summary financial statements.

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 JULY 2016

	GROUP $ MILLION	
	31 JULY 2016	31 JULY 2015
Profit after tax	**834**	506
Items that may be reclassified subsequently to profit or loss:		
Cash flow hedges:		
– Net fair value gains/(losses)	**439**	(1,361)
– Transferred and reported in revenue from sale of goods	**396**	501
– Tax (expense)/credit on cash flow hedges	**(234)**	241
Net investment hedges:		
– Net fair value gains/(losses) on hedging instruments	**93**	(164)
– Transferred and reported in other operating income	**8**	–
– Tax (expense)/credit on net investment hedges	**(28)**	46
Available-for-sale investments:		
– Net fair value gains/(losses) on available-for-sale investments	**5**	(2)
Foreign currency translation (losses)/gains attributable to equity holders	**(376)**	385
Foreign currency translation reserve (gains)/losses transferred to income statement	**(15)**	78
Hyperinflation (losses)/gains attributable to equity holders	**(16)**	20
Share of equity accounted investees' movements in reserves	**5**	4
Total items that may be reclassified subsequently to profit or loss	**277**	(252)
Items that will not be reclassified subsequently to profit or loss:		
Foreign currency translation losses attributable to non-controlling interests	**(84)**	(6)
Hyperinflation movements attributable to non-controlling interests	**(10)**	13
Total items that will not be reclassified subsequently to profit or loss	**(94)**	7
Total other comprehensive income/(expense) recognised directly in equity	**183**	(245)
Total comprehensive income	**1,017**	261
Total comprehensive income is attributable to:		
Equity holders of the Co-operative	**1,087**	214
Non-controlling interests	**(70)**	47
Total comprehensive income	**1,017**	261

The accompanying notes form part of these summary financial statements.

STATEMENT OF FINANCIAL POSITION

AS AT 31 JULY 2016

	NOTES	GROUP $ MILLION 31 JULY 2016	GROUP $ MILLION 31 JULY 2015
ASSETS			
Current assets			
Cash and cash equivalents		**369**	342
Trade and other receivables		**1,625**	2,322
Inventories		**2,401**	3,025
Tax receivable		**13**	22
Derivative financial instruments		**451**	44
Assets held for sale		**87**	90
Other current assets		**145**	232
Total current assets		**5,091**	6,077
Non-current assets			
Property, plant and equipment		**6,172**	6,159
Equity accounted investments		**960**	1,185
Livestock		**342**	331
Intangible assets		**3,142**	3,273
Deferred tax assets		**410**	732
Derivative financial instruments		**417**	373
Other non-current assets		**584**	185
Total non-current assets		**12,027**	12,238
Total assets		**17,118**	18,315
LIABILITIES			
Current liabilities			
Bank overdraft		**12**	39
Borrowings	5	**955**	1,681
Trade and other payables		**2,169**	1,984
Owing to suppliers	6	**719**	159
Tax payable		**18**	39
Derivative financial instruments		**43**	993
Provisions		**47**	77
Other current liabilities		**35**	59
Total current liabilities		**3,998**	5,031
Non-current liabilities			
Borrowings	5	**5,397**	5,879
Derivative financial instruments		**569**	415
Provisions		**152**	186
Deferred tax liabilities		**44**	109
Other non-current liabilities		**11**	36
Total non-current liabilities		**6,173**	6,625
Total liabilities		**10,171**	11,656
Net assets		**6,947**	6,659
EQUITY			
Subscribed equity		**5,833**	5,814
Retained earnings		**1,384**	1,289
Foreign currency translation reserve		**(428)**	(110)
Cash flow hedge reserve		**64**	(537)
Other reserves		**6**	17
Total equity attributable to equity holders of the Co-operative		**6,859**	6,473
Non-controlling interests		**88**	186
Total equity		**6,947**	6,659

The accompanying notes form part of these summary financial statements.

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 JULY 2016

GROUP $ MILLION	SUBSCRIBED EQUITY	RETAINED EARNINGS	FOREIGN CURRENCY TRANSLATION RESERVE	CASH FLOW HEDGE RESERVE	OTHER RESERVES	TOTAL	NON-CONTROLLING INTERESTS	TOTAL EQUITY
	ATTRIBUTABLE TO EQUITY HOLDERS OF THE CO-OPERATIVE							
As at 1 August 2015	**5,814**	**1,289**	**(110)**	**(537)**	**17**	**6,473**	**186**	**6,659**
Profit after tax	–	810	–	–	–	810	24	834
Other comprehensive income/(expense)	–	5	(318)	601	(11)	277	(94)	183
Total comprehensive income/(expense)	–	815	(318)	601	(11)	1,087	(70)	1,017
Transactions with equity holders in their capacity as equity holders:								
Dividend paid to equity holders of the Co-operative	–	(720)	–	–	–	(720)	–	(720)
Equity instruments issued	19	–	–	–	–	19	–	19
Dividend paid to non-controlling interests	–	–	–	–	–	–	(28)	(28)
As at 31 July 2016	**5,833**	**1,384**	**(428)**	**64**	**6**	**6,859**	**88**	**6,947**
As at 1 August 2014	5,807	1,059	(455)	82	(1)	6,492	42	6,534
Profit after tax	–	466	–	–	–	466	40	506
Other comprehensive income/(expense)	–	4	345	(619)	18	(252)	7	(245)
Total comprehensive income/(expense)	–	470	345	(619)	18	214	47	261
Transactions with equity holders in their capacity as equity holders:								
Dividend paid to equity holders of the Co-operative	–	(240)	–	–	–	(240)	–	(240)
Acquisition of subsidiaries	–	–	–	–	–	–	120	120
Equity instruments issued	7	–	–	–	–	7	–	7
Dividend paid to non-controlling interests	–	–	–	–	–	–	(23)	(23)
As at 31 July 2015	5,814	1,289	(110)	(537)	17	6,473	186	6,659

The accompanying notes form part of these summary financial statements.

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 JULY 2016

	GROUP $ MILLION	
	31 JULY 2016	31 JULY 2015
Cash flows from operating activities		
Profit before net finance costs and tax	**1,431**	942
Adjustments for:		
Foreign exchange gains	**(365)**	(70)
Depreciation and amortisation	**570**	561
Other	**(44)**	(60)
	161	431
Decrease/(increase) in working capital:		
Inventories	**597**	713
Trade and other receivables	**485**	186
Amounts owing to suppliers	**560**	(1,612)
Payables and accruals	**171**	35
Other movements	**(42)**	28
Total	**1,771**	(650)
Cash generated from operations	**3,363**	723
Net taxes paid	**(85)**	(55)
Net cash flows from operating activities	**3,278**	668
Cash flows from investing activities		
Cash was provided from:		
– Proceeds from sale of business operations	**230**	62
– Proceeds from disposal of property, plant and equipment	**26**	20
– Proceeds from sale of livestock	**35**	30
– Proceeds from sale of available-for-sale assets	**78**	–
– Other cash inflows	**26**	36
Cash was applied to:		
– Acquisition of business operations	**–**	(771)
– Acquisition of property, plant and equipment	**(859)**	(1,189)
– Acquisition of livestock	**(95)**	(121)
– Acquisition of intangible assets	**(85)**	(104)
– Co-operative support loans	**(383)**	–
– Advances to and investments in equity accounted investees	**(41)**	–
– Other cash outflows	**(26)**	(3)
Net cash flows from investing activities	**(1,094)**	(2,040)
Cash flows from financing activities		
Cash was provided from:		
– Proceeds from borrowings	**4,909**	7,470
– Interest received	**7**	8
– Other cash inflows	**–**	28
Cash was applied to:		
– Interest paid	**(415)**	(455)
– Repayment of borrowings	**(5,815)**	(5,443)
– Dividends paid to non-controlling interests	**(28)**	(23)
– Dividends paid to equity holders of the Co-operative	**(701)**	(233)
– Other cash outflows	**(7)**	–
Net cash flows from financing activities	**(2,050)**	1,352
Net increase/(decrease) in cash and cash equivalents	**134**	(20)
Cash and cash equivalents at the beginning of the year	**303**	319
Effect of exchange rate changes on cash balances	**(80)**	4
Cash and cash equivalents at the end of the year	**357**	303
Reconciliation of closing cash balances to the statement of financial position:		
Cash and cash equivalents	**369**	342
Bank overdraft	**(12)**	(39)
Closing cash balances	**357**	303

The accompanying notes form part of these summary financial statements.

NOTES TO THE SUMMARY FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 JULY 2016

PERFORMANCE

1 SEGMENT REPORTING

a) Operating segments

The Group has five reportable segments that reflect the Group's management and reporting structure as viewed by the Fonterra Management Team. Transactions between segments are based on estimated market prices.

REPORTABLE SEGMENT	DESCRIPTION
Global Ingredients and Operations	Represents the collection, processing and distribution of New Zealand milk, global sales and marketing of New Zealand and non-New Zealand milk products (including the Quick Service Restaurant businesses in Asia and Greater China), Global Brands and Nutrition, Co-operative Affairs, Fonterra Farm Source™ stores and Group Services.
Oceania	Represents fast-moving consumer goods (FMCG) businesses in New Zealand (including export to the Pacific Islands) and all FMCG and ingredients businesses in Australia (including Milk Supply and Manufacturing). It includes foodservice sales in Australia and New Zealand.
Asia	Represents FMCG and foodservice businesses (excluding the Quick Service Restaurant business) in Asia (excluding Greater China), Africa and the Middle East.
Greater China	Represents FMCG, foodservice (excluding the Quick Service Restaurant business) and farming businesses in Greater China.
Latin America	Represents FMCG and ingredients businesses in South America and the Caribbean.

From 1 August 2015, Fonterra's organisational structure was realigned and as a result the Fonterra Farm Source™ stores have moved out of Oceania into Global Ingredients and Operations. Comparatives have been restated to reflect these changes.

NOTES TO THE SUMMARY FINANCIAL STATEMENTS CONTINUED

FOR THE YEAR ENDED 31 JULY 2016

1 SEGMENT REPORTING CONTINUED

a) Operating segments continued

	GROUP $ MILLION						
	GLOBAL INGREDIENTS AND OPERATIONS	OCEANIA	ASIA	GREATER CHINA	LATIN AMERICA	ELIMINATIONS	TOTAL GROUP
Segment income statement							
Year ended 31 July 2016							
External revenue	10,636	2,425	1,630	1,008	1,500	–	17,199
Inter-segment revenue	1,505	439	171	13	5	(2,133)	–
Revenue from sale of goods	12,141	2,864	1,801	1,021	1,505	(2,133)	17,199
Cost of goods sold	(10,343)	(2,362)	(1,213)	(742)	(1,042)	2,135	(13,567)
Segment gross profit	1,798	502	588	279	463	2	3,632
Selling and marketing expenses	(168)	(99)	(187)	(132)	(117)	–	(703)
Distribution expenses	(222)	(160)	(38)	(10)	(155)	–	(585)
Administrative and other operating expenses	(778)	(205)	(128)	(85)	(74)	30	(1,240)
Segment operating expenses	(1,168)	(464)	(353)	(227)	(346)	30	(2,528)
Net other operating income	145	97	3	27	20	(26)	266
Net foreign exchange gains/(losses)	30	1	(3)	(5)	(16)	–	7
Share of profit of equity accounted investees	59	1	–	(10)	4	–	54
Segment earnings before net finance costs and tax	864	137	235	64	125	6	1,431
Normalisation adjustments	(96)	23	–	–	–	–	(73)
Normalised segment earnings before net finance costs and tax	768	160	235	64	125	6	1,358
Normalisation adjustments							73
Finance income							18
Finance costs							(517)
Profit before tax							932
Profit before tax includes the following amounts:							
Depreciation	(337)	(48)	(13)	(30)	(37)	–	(465)
Amortisation	(72)	(27)	(4)	(1)	(1)	–	(105)
Normalisation adjustments consist of the following amounts:							
Gain on sale of DairiConcepts investment[1]	68	–	–	–	–	–	68
Disposal and impairment of the Australian yoghurt and dairy desserts business[2]	–	(23)	–	–	–	–	(23)
Time value of options[3]	28	–	–	–	–	–	28
Total normalisation adjustments	96	(23)	–	–	–	–	73
Segment asset information:							
As at and for the year ended 31 July 2016							
Equity accounted investments	188	–	–	763	9	–	960
Capital expenditure[4]	632	114	21	131	46	–	944

1 The $68 million normalisation adjustment relates to other operating income.

2 Of the total $23 million, $4 million relates to cost of goods sold and $19 million to other operating expenses.

3 The $28 million normalisation adjustment relates to net foreign exchange gains.

4 Capital expenditure comprises purchases of property, plant and equipment and intangible assets, and net purchases of livestock.

a) Operating segments continued

	GROUP $ MILLION						
	GLOBAL INGREDIENTS AND OPERATIONS	OCEANIA	ASIA	GREATER CHINA	LATIN AMERICA	ELIMINATIONS	TOTAL GROUP
Segment income statement							
Year ended 31 July 2015							
External revenue	11,861	2,438	1,551	807	2,188	–	18,845
Inter-segment revenue	1,570	480	181	–	2	(2,233)	–
Revenue from sale of goods	13,431	2,918	1,732	807	2,190	(2,233)	18,845
Cost of goods sold	(11,866)	(2,577)	(1,224)	(599)	(1,516)	2,215	(15,567)
Segment gross profit	1,565	341	508	208	674	(18)	3,278
Selling and marketing expenses	(147)	(103)	(176)	(135)	(132)	–	(693)
Distribution expenses	(221)	(160)	(33)	(10)	(276)	–	(700)
Administrative and other operating expenses	(805)	(264)	(105)	(81)	(162)	50	(1,367)
Segment operating expenses	(1,173)	(527)	(314)	(226)	(570)	50	(2,760)
Net other operating income	131	29	2	18	158	(50)	288
Net foreign exchange gains/(losses)	83	(1)	(4)	–	(8)	–	70
Share of profit of equity accounted investees	67	2	–	(5)	2	–	66
Segment earnings before net finance costs and tax	673	(156)	192	(5)	256	(18)	942
Normalisation adjustments	38	118	3	1	(128)	–	32
Normalised segment earnings before net finance costs and tax	711	(38)	195	(4)	128	(18)	974
Normalisation adjustments							(32)
Finance income							39
Finance costs							(557)
Profit before tax							424
Profit before tax includes the following amounts:							
Depreciation	(326)	(61)	(10)	(19)	(37)	–	(453)
Amortisation	(79)	(23)	(3)	(1)	(2)	–	(108)
Normalisation adjustments consist of the following amounts:							
Net gain on Latin America strategic realignment[1]	–	–	–	–	129	–	129
Impairment of the Australian yoghurt and dairy desserts business[2]	–	(108)	–	–	–	–	(108)
Restructuring and redundancy provisions[3]	(18)	(10)	(3)	(1)	(1)	–	(33)
Time value of options[4]	(20)	–	–	–	–	–	(20)
Total normalisation adjustments	(38)	(118)	(3)	(1)	128	–	(32)
Segment asset information:							
As at and for the year ended 31 July 2015							
Equity accounted investments	311	7	–	858	9	–	1,185
Capital expenditure[5]	939	84	36	382	90	–	1,531

1 Of the $129 million normalisation adjustment, $141 million relates to other operating income, $4 million to cost of goods sold and $8 million to other operating expenses.

2 Of the $108 million normalisation adjustment, $58 million relates to other operating expenses and $50 million to cost of goods sold.

3 The $33 million normalisation adjustment relates to administrative and other operating expenses.

4 The $20 million normalisation adjustment relates to net foreign exchange losses.

5 Capital expenditure comprises purchases of property, plant and equipment and intangible assets, and net purchases of livestock.

NOTES TO THE SUMMARY FINANCIAL STATEMENTS CONTINUED

FOR THE YEAR ENDED 31 JULY 2016

1 SEGMENT REPORTING CONTINUED

b) Strategic platforms

The Group also presents financial information that reflects Fonterra's strategic platforms. These strategic platforms are organised on a different basis than the Group's operating segments presented in section a) of this note. The basis of presentation is explained in the table below.

Fonterra considers this information to be useful as it provides more clarity on the financial performance of the ingredients, consumer and foodservice, and China Farms businesses.

PLATFORM	DESCRIPTION
Ingredients	Represents the Global Ingredients and Operations reportable segment, the ingredients businesses in Australia and South America, and excludes the Quick Service Restaurant businesses in Asia and Greater China and unallocated costs.
Consumer and foodservice	
– Oceania	Represents the Oceania reportable segment, excluding the ingredients business in Australia.
– Asia	Represents the Asia reportable segment and the Asia Quick Service Restaurant business reported in Global Ingredients and Operations.
– Greater China	Represents the Greater China reportable segment, excluding China Farms and including the Quick Service Restaurant business in Greater China reported in Global Ingredients and Operations.
– Latin America	Represents the Latin America reportable segment, excluding the ingredients businesses in South America.
China Farms	Represents farming operations in China.

	GROUP 31 JULY 2016								
	INGREDIENTS	CONSUMER AND FOODSERVICE					CHINA FARMS	UNALLOCATED COSTS AND ELIMINATIONS	TOTAL
		OCEANIA	ASIA	GREATER CHINA	LATIN AMERICA	TOTAL			
Volume[1] (liquid milk equivalents, billion)	22.4	1.8	1.6	0.9	0.6	4.9	0.2	(3.8)	23.7
Volume[1] (metric tonnes, thousand)	3,074	698	292	167	643	1,800	229	(577)	4,526
Sales revenue[1] ($ million)	13,005	2,051	1,944	916	1,385	6,296	183	(2,285)	17,199
Normalised EBIT ($ million)	1,204	97	244	131	108	580	(59)	(367)	1,358
Capital employed[2] ($ million)	7,724	489	127	22	284	922	873	(127)	9,392
Return on capital[3]	13.4%	10.9%	133.4%	429.9%	23.6%	41.7%	(6.5)%		12.4%

For the year ended 31 July 2016 the Group's return on capital including intangible assets, goodwill and equity accounted investments, was 9.2 per cent.

	GROUP 31 JULY 2015								
	INGREDIENTS	CONSUMER AND FOODSERVICE					CHINA FARMS	UNALLOCATED COSTS AND ELIMINATIONS	TOTAL
		OCEANIA	ASIA	GREATER CHINA	LATIN AMERICA	TOTAL			
Volume[1] (liquid milk equivalents, billion)	21.5	1.7	1.6	0.6	0.6	4.5	0.2	(3.4)	22.8
Volume[1] (metric tonnes, thousand)	2,982	619	284	122	660	1,685	164	(528)	4,303
Sales revenue[1] ($ million)	14,341	2,021	1,918	729	2,033	6,701	141	(2,338)	18,845
Normalised EBIT ($ million)	973	51	202	45	110	408	(44)	(363)	974
Capital employed[2] ($ million)	8,592	465	145	45	403	1,058	594	(757)	9,487
Return on capital[3]	9.3%	5.0%	96.2%	71.5%	18.6%	25.5%	(7.3)%		8.9%

For the year ended 31 July 2015 the Group's return on capital including intangible assets, goodwill and equity accounted investments, was 6.9 per cent.

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

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

3 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.

c) Geographical revenue

	GROUP $ MILLION								
	CHINA	REST OF ASIA	AUSTRALIA	NEW ZEALAND	UNITED STATES	EUROPE	LATIN AMERICA	REST OF WORLD	TOTAL
Geographical segment external revenue:									
Year ended 31 July 2016	**2,394**	**4,829**	**1,471**	**1,939**	**1,305**	**745**	**2,053**	**2,463**	**17,199**
Year ended 31 July 2015	2,111	5,222	1,560	1,882	1,198	725	3,113	3,034	18,845

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

d) 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 reportable non-current assets:								
As at 31 July 2016	**5,459**	**301**	**1,292**	**740**	**779**	**1,648**	**981**	**11,200**
As at 31 July 2015	4,783	464	1,394	814	822	1,751	1,105	11,133

	GROUP $ MILLION	
	AS AT 31 JULY 2016	AS AT 31 JULY 2015
Reconciliation of geographical segment's non-current assets to total non-current assets:		
Geographical segment non-current assets	**11,200**	11,133
Deferred tax assets	**410**	732
Derivative financial instruments	**417**	373
Total non-current assets	**12,027**	12,238

2 COST OF GOODS SOLD

	GROUP $ MILLION	
	31 JULY 2016	31 JULY 2015
Opening inventory	**3,025**	3,701
Cost of Milk:		
– New Zealand sourced	**6,205**	7,121
– Non-New Zealand sourced	**944**	1,151
Other purchases	**5,794**	6,619
Closing inventory	**(2,401)**	(3,025)
Total cost of goods sold	**13,567**	15,567

NOTES TO THE SUMMARY FINANCIAL STATEMENTS CONTINUED

FOR THE YEAR ENDED 31 JULY 2016

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 2015	**1,599,094**
Shares issued[2]	3,609
Shares surrendered	–
Balance at 31 July 2016	**1,602,703**
Balance at 1 August 2014	1,597,834
Shares issued	1,260
Shares surrendered	–
Balance at 31 July 2015	**1,599,094**

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

2 3,609,118 shares (31 July 2015: 1,260,116 shares) with a total value of $19 million (31 July 2015: $7 million) were issued under the Dividend Reinvestment Plan during the year ended 31 July 2016.

The rights attaching to Co-operative shares are set out in Fonterra's Constitution, available in the 'About/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 Fonterra Shareholders' Fund (the Fund) on trust for the benefit of the Fund. At 31 July 2016, 111,991,937 Co-operative shares (31 July 2015: 105,480,366) were legally owned by the Custodian, on trust for the benefit of the Fund.

	UNITS (THOUSANDS)
Balance at 1 August 2015	**105,480**
Units issued	**27,137**
Units surrendered	**(20,625)**
Balance at 31 July 2016	**111,992**
Balance at 1 August 2014	109,778
Units issued	21,906
Units surrendered	(26,204)
Balance at 31 July 2015	105,480

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

Capital management and structure

The Board's objective is to maximise equity holder returns over time by maintaining an optimal capital structure. Trading Among Farmers (TAF) allows shares in Fonterra to be traded between shareholders, on the Fonterra Shareholders' Market (a private market operated by NZX Limited). The Fund supports this by allowing investors, including farmers, to trade in units backed by Economic Rights in Fonterra. The Fund also allows farmers to acquire units and exchange them for shares in Fonterra, and to exchange shares for units and dispose of those units on the NZX or ASX.

The Group provides returns to farmer shareholders through a milk price, and to equity holders through dividends and changes in the Company's share price.

The Fund is subject to the issue and redemption of units at the discretion of Fonterra and Fonterra's farmer shareholders. Fonterra has an interest in ensuring the stability of the Fund and has established a Fund Size Risk Management Policy, which requires that the number of units on issue remain within specified limits and that within these limits, the number of units is managed appropriately. Fonterra may use a range of measures to ensure the Fund size remains within the specified limits, including introducing or cancelling a dividend reinvestment plan, operating a unit and/or share repurchase programme and issuing new shares.

4 DIVIDENDS PAID

DIVIDENDS	$ MILLION YEAR ENDED 31 JULY 2016	$ MILLION YEAR ENDED 31 JULY 2015
2016 Interim dividend – 10 cents per share[1]	160	–
2016 Interim dividend – 20 cents per share[2]	320	–
2015 Final dividend – 15 cents per share[3]	240	–
2015 Interim dividend – 10 cents per share[4]	–	160
2014 Final dividend – 5 cents per share[5]	–	80

1 Declared on 16 May 2016 and paid on 7 June 2016 to all Co-operative shares on issue at 30 May 2016. The Dividend Reinvestment Plan applied to this interim dividend.
2 Declared on 22 March 2016 and paid on 20 April 2016 to all Co-operative shares on issue at 8 April 2016. The Dividend Reinvestment Plan applied to this interim dividend.
3 Declared on 23 September 2015 and paid on 20 October 2015 to all Co-operative shares on issue at 8 October 2015. The Dividend Reinvestment Plan applied to this dividend.
4 Declared on 24 March 2015 and paid on 20 April 2015 to all Co-operative shares on issue at 10 April 2015. The Dividend Reinvestment Plan applied to this interim dividend.
5 Declared on 23 September 2014 and paid on 20 October 2014 to all Co-operative shares on issue at 9 October 2014.

Dividends declared after balance date

On 18 August 2016, the Board declared a dividend of 10 cents per share. This dividend totalling $160 million was paid on 9 September 2016 to all Co-operative shares on issue at 1 September 2016.

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 did apply to this dividend. Full details of the Dividend Reinvestment Plan are available in the 'Our Financials' 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 JULY 2016	GROUP $ MILLION AS AT 31 JULY 2015
Net interest-bearing debt position		
Total borrowings	6,352	7,560
Cash and cash equivalents	(369)	(342)
Interest-bearing advances included in other non-current assets	(464)	(65)
Bank overdraft	12	39
Net interest-bearing debt	5,531	7,192
Value of derivatives used to manage changes in hedged risks	(58)	(72)
Economic net interest-bearing debt	5,473	7,120

Total borrowings in the table above are represented by:

	GROUP $ MILLION AS AT 31 JULY 2016	GROUP $ MILLION AS AT 31 JULY 2015
Commercial paper	454	473
Bank loans	879	1,717
Finance leases	143	169
Capital notes	35	35
NZX-listed bonds	499	500
Medium-term notes	4,342	4,666
Total borrowings	6,352	7,560
Included within the statement of financial position as follows:		
Total current borrowings	955	1,681
Total non-current borrowings	5,397	5,879
Total borrowings	6,352	7,560

NOTES TO THE SUMMARY FINANCIAL STATEMENTS CONTINUED

FOR THE YEAR ENDED 31 JULY 2016

5 BORROWINGS CONTINUED

Leverage ratios

The Board closely monitors the Group's leverage ratios, which include the gearing ratio and debt coverage ratios (debt payback and interest coverage ratios). The primary debt payback ratios comprise funds from operations divided by economic net interest-bearing debt, and economic net interest-bearing debt divided by EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation). Debt payback ratios are adjusted for the impact of operating leases. The gearing ratio is calculated as economic net interest-bearing debt divided by total capital. Economic net interest-bearing debt is calculated in the table above. Total capital is calculated as equity, as presented in the statement of financial position (excluding the cash flow hedge reserve), plus economic net interest-bearing debt. The gearing ratio as at 31 July 2016 was 44.3 per cent (31 July 2015: 49.7 per cent). The Group is not subject to externally imposed capital requirements.

Liquidity risk

The Group manages its liquidity by retaining cash and marketable securities, the availability of funding from an adequate amount of committed credit facilities and the ability to close out market positions. Fonterra's funding facilities are reviewed at least annually, which is one of the key financial risk management activities undertaken by the Group to ensure an appropriate maturity profile given the nature of the Group's business. At balance date the Group had undrawn lines of credit totalling $3,723 million (31 July 2015: $2,520 million).

WORKING CAPITAL

6 OWING TO SUPPLIERS

The Board uses its discretion in establishing the rate at which Fonterra will pay suppliers for the milk supplied over the season. This is referred to as the advance rate. The following table provides a breakdown of the advance payments made to suppliers:

	AS AT 31 JULY 2016	AS AT 31 JULY 2015
Owing to suppliers ($ million)	**719**	159
Final milk price for the season	**$3.90**	$4.40
Of this amount:		
– Total advance payments made during the year	**$3.48**	$4.33
– Total owing as at 31 July	**$0.42**	$0.07
Amount advanced during the year as a percentage of the milk price for the season ended 31 May	**89%**	98%

INVESTMENTS

7 ASSETS HELD FOR SALE

Darnum manufacturing plant – Australia

On 16 March 2015, Fonterra acquired an 18.8 per cent shareholding in Beingmate Baby & Child Food Co., Ltd. (Beingmate). In conjunction with this investment, Fonterra and Beingmate confirmed their intention to establish a partnership to purchase the Darnum manufacturing plant in Australia. Fonterra remains committed to this transaction, which is expected to complete during the financial year ending 31 July 2017 following receipt of the required regulatory approvals. The final regulatory approval was received on 18 September 2016.

The carrying value of these assets as at 31 July 2016 is $87 million (31 July 2015: $90 million).

8 EQUITY ACCOUNTED INVESTMENTS

The Group's significant equity accounted investments are listed below. The ownership interest in these entities is 50 per cent or less and the Group is not considered to exercise a controlling interest.

		OWNERSHIP INTERESTS (%)	
EQUITY ACCOUNTED INVESTEE NAME	COUNTRY OF INCORPORATION AND PRINCIPAL PLACE OF BUSINESS	AS AT 31 JULY 2016	AS AT 31 JULY 2015
DMV Fonterra Excipients GmbH & Co KG	Germany	**50**	50
DairiConcepts, L.P.[1]	United States	–	50
DairiConcepts Management, L.L.C.[1]	United States	–	50
Beingmate Baby & Child Food Co., Ltd	China	**18.8**	18.8

All investees have balance dates of 31 December.

1 On 31 December 2015 the Group sold its 50 per cent interest in DairiConcepts, L.P. and DairiConcepts Management, L.L.C.

FINANCIAL RISK MANAGEMENT

9 FINANCIAL RISK MANAGEMENT

Overview

Global financial and commodity markets remain volatile. The nature of Fonterra's business is such that managing risks in the foreign exchange, interest rate, commodity, credit and liquidity markets is critical to minimising the volatility in returns to equity holders.

The Board has overall responsibility for the establishment and oversight of the Group's financial risk management framework. The Board:

- has established financial risk management policies and procedures to identify, analyse and, where appropriate, manage the financial risks faced by the Group;
- has approved a Treasury Policy that covers appropriate financial risk limits and controls (including, but not limited to, delegated authority levels and authorised use of various financial instruments); and
- monitors financial risks and adherence to approved limits.

The Group's overall financial risk management programme focuses primarily on maintaining a prudent financial risk profile that provides flexibility to implement the Group's strategies, while ensuring the optimisation of the return on assets. Financial risk management is centralised, which supports compliance with the financial risk management policies and procedures set by the Board.

Key financial risk management activities

Capital structure

The Board's objective is to maximise equity holder returns over time by maintaining an optimal capital structure. For further detail refer to Note 3.

Bank facility renewal

Fonterra's banking facilities are reviewed at least annually, which is one of the key financial risk management activities undertaken by the Group to ensure an appropriate maturity profile. For further detail refer to Note 5.

Leverage ratios

The Board closely monitors the Group's leverage ratios, which include the gearing ratio and debt coverage ratios (debt payback and interest coverage ratios). For further detail refer to Note 5.

OTHER

10 TAXATION

Taxation – income statement

The total taxation expense/(credit) in the income statement is summarised as follows:

	GROUP $ MILLION	
	31 JULY 2016	31 JULY 2015
Current tax expense	**108**	97
Prior period adjustments to current tax	**5**	–
Deferred tax movements:		
– Origination and reversal of temporary differences	**(15)**	(179)
Tax expense/(credit)	**98**	(82)

NOTES TO THE SUMMARY FINANCIAL STATEMENTS CONTINUED

FOR THE YEAR ENDED 31 JULY 2016

10 TAXATION CONTINUED

The taxation charge that would arise at the standard rate of corporation tax in New Zealand is reconciled to the tax expense/(credit) as follows:

	GROUP $ MILLION	
	31 JULY 2016	31 JULY 2015
Profit before tax	**932**	424
Prima facie tax expense at 28%	**261**	119
Add/(deduct) tax effect of:		
– Effect of tax rates in foreign jurisdictions	**(24)**	(31)
– Non-deductible expenses/additional assessable income	**90**	44
– Non-assessable income/additional deductible expenses	**(66)**	(71)
– Prior year under provision	**5**	–
Tax expense before distributions and deferred tax	**266**	61
Effective tax rate before distributions and deferred tax[1]	**28.5%**	14.4%
Tax effect of distributions to farmer shareholders	**(170)**	(107)
Tax expense/(credit) before deferred tax	**96**	(46)
Effective tax rate before deferred tax[1]	**10.3%**	(10.8)%
Add/(deduct) tax effect of:		
– Origination and reversal of other temporary differences	**(1)**	2
– Losses of overseas Group entities not recognised/(recognised)	**3**	(38)
Tax expense/(credit)	**98**	(82)
Effective tax rate[1]	**10.5%**	(19.3)%
Imputation credits		
Imputation credits available for use in subsequent reporting periods	**20**	20
Tax losses		
Gross tax losses available for which no deferred tax asset has been recognised	**48**	55

1 The effective tax rate is the tax charge on the face of the income statement expressed as a percentage of the profit before tax.

11 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. An initial hearing of the arbitration took place in February 2016 and a final hearing of the arbitration took place in June 2016. A decision of the arbitration panel is expected to be issued by the end of 2016.

Based on current information available and the claims made to date in both proceedings, Fonterra will vigorously defend its position in these proceedings. Uncertainty exists regarding the outcome of the proceedings. Fonterra has provided $11 million (31 July 2015: $11 million) in respect of the Danone claims, which represents the maximum contractual liability to Danone.

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

The Group has no other contingent liabilities as at 31 July 2016 (31 July 2015: nil).

12 NET TANGIBLE ASSETS PER SECURITY

	GROUP	
	AS AT 31 JULY 2016	AS AT 31 JULY 2015
Net tangible assets per security[1]		
$ per listed debt security on issue	**6.32**	5.62
$ per equity instrument on issue	**2.37**	2.12
Listed debt securities on issue (million)	**603**	603
Equity instruments on issue (million)	**1,603**	1,599

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

INDEPENDENT AUDITORS' REPORT

FOR THE YEAR ENDED 31 JULY 2016

TO THE SHAREHOLDERS OF FONTERRA CO-OPERATIVE GROUP LIMITED

REPORT ON THE SUMMARY FINANCIAL STATEMENTS

We have audited the accompanying Group summary financial statements of Fonterra Co-operative Group Limited ("the Company"), on pages 78 to 93 which comprise the statement of financial position as at 31 July 2016, the income statement, the statement of comprehensive income and the statement of changes in equity and the cash flow statement for the year then ended, and notes to the financial statements. The Group summary financial statements are derived from the audited financial statements of the Group for the year ended 31 July 2016. The Group comprises the Company and the entities it controlled at 31 July 2016 or from time to time during the financial year.

The summary financial statements do not contain all the disclosures required for full financial statements under New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards. Reading the Group summary financial statements, therefore, is not a substitute for reading the audited Group financial statements of Fonterra Co-operative Group Limited.

DIRECTORS' RESPONSIBILITY FOR THE SUMMARY FINANCIAL STATEMENTS

The Directors are responsible on behalf of the Company for the preparation of the summary financial statements in accordance with FRS-43: Summary Financial Statements (FRS 43).

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with International Standard on Auditing (New Zealand) 810: Engagements to Report on Summary Financial Statements.

Our firm carries out other assignments for the Group in relation to other advisory, other assurance and attestation services. Partners and employees of our firm may deal with the Group on normal terms within the ordinary course of trading activities of the Group. These matters have not impaired our independence as auditors of the Group.

OPINION ON THE GROUP'S FINANCIAL STATEMENTS

Our audit of the financial statements for the year ended 31 July 2016 was completed on 20 September 2016 and our unmodified opinion was issued on that date.

OPINION ON THE SUMMARY FINANCIAL STATEMENTS

In our opinion, the Group summary financial statements have been correctly derived from the audited Group financial statements of Fonterra Co-operative Group Limited for the year ended 31 July 2016 and are consistent, in all material respects, with those financial statements, in accordance with FRS-43.

RESTRICTION ON DISTRIBUTION OR USE

This report is made solely to the Company's shareholders, as a body and has been prepared for inclusion in the Fonterra Annual Review report. Our work has been undertaken so that we might state those matters we are required to state to them in a report from the auditor and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company's shareholders, as a body, for this report, or for the opinions we have formed. In addition, we take no responsibility for, nor do we report on, any part of the annual report not specifically mentioned in our report.

PricewaterhouseCoopers

Chartered Accountants
Auckland
20 September 2016

STATUTORY INFORMATION

FOR THE YEAR ENDED 31 JULY 2016

CURRENT CREDIT RATING STATUS

Standard & Poor's long-term rating for Fonterra is A- with a rating outlook of stable. Fitch's long and short-term default rating is A with a rating outlook of stable. Retail Bonds have been rated the same as the Company's long-term rating by both Standard & Poor's and Fitch. Capital Notes which are subordinate to other Fonterra debt issued are rated BBB+ by Standard & Poor's and A- by Fitch.

EXCHANGE RULINGS AND WAIVERS

NZX Limited (NZX) has ruled that Capital Notes do not constitute 'equity securities' under the NZX Main Board/Debt Market Listing Rules ('Rules'). This means that where Capital Notes are quoted on NZX's Debt Market ('NZDX'), the Company is not required to comply with certain Rules which apply to an issuer of quoted equity securities.

The Company was issued with a waiver of Rule 11.1.1 to enable it to decline to accept or register transfers of Capital Notes (NZDX listed debt securities FCGHA) if such transfer would result in the transferor holding or continuing to hold Capital Notes with a face value or principal amount of less than $5,000 or if such transfer is for an amount of less than $1,000 or not a multiple thereof. The effect of this waiver is that the minimum holding amount in respect of the Capital Notes will at all times be $5,000 in aggregate and can only be transferred in multiples of $1,000.

The Company was issued with a waiver of Rule 5.2.3 by NZX on 10 April 2015 (for a period of one year from 21 April 2015) in respect of the Company's issuance of $350 million of unsecured, unsubordinated, fixed rate bonds maturing on 20 October 2021 ('FCG030 Bonds'), to the extent that that rule would otherwise require the FCG030 Bonds to be held by at least 500 members of the public holding at least 25% of the FCG030 Bonds.

The Company was also issued with a waiver of Rule 5.2.3, as modified by NZX's ruling on Rule 5.2.3, by NZX on 18 February 2016 (for a period of six months from 8 March 2016) in respect of the Company's issuance of $150 million of unsecured, unsubordinated, fixed rate bonds maturing on 7 March 2023 ('FCG040 Bonds'), to the extent that the rule (as modified) would otherwise require the FCG040 Bonds to be held by at least 100 members of the public holding at least 25% of the FCG040 Bonds.

The effect of these waivers from Rule 5.2.3 is that the FCG030 Bonds and the FCG040 Bonds may not be widely held and there may be reduced liquidity in those bonds.

The Company was issued with a waiver of Rule 7.11.1 by NZX on 18 February 2016 in respect of the Company's issuance of the FCG040 Bonds, to the extent that the rule would have otherwise required the Company to allot the FCG040 Bonds within five business days after the latest date on which applications for the FCG040 Bonds closed.

NZX TRADING HALTS

No trading halts were placed on Fonterra securities by NZX Regulation in the financial year ended 31 July 2016.

FIVE YEAR SUMMARY

FOR THE YEAR ENDED 31 JULY 2016

	JULY 2016	JULY 2015	JULY 2014	JULY 2013	JULY 2012
SHAREHOLDER SUPPLIER RETURNS					
Payout					
Farmgate Milk Price (per kgMS)[1]	**3.90**	4.40	8.40	5.84	6.08
Dividend (per share)	**0.40**	0.25	0.10	0.32	0.32
Cash payout[2]	**4.30**	4.65	8.50	6.16	6.40
Retentions (per share)[3]	**0.11**	0.04	–	0.14	0.10
OPERATING PERFORMANCE					
Average commodity prices (US$ per MT FOB)					
Whole Milk Powder[4]	**2,111**	2,639	4,824	3,394	3,359
Skim Milk Powder[4]	**1,803**	2,552	4,504	3,625	3,285
Butter[4]	**2,830**	3,027	3,920	3,550	3,546
Cheese[5]	**2,766**	3,477	4,706	4,124	3,498
Average NZD/USD spot exchange rate applying throughout the year[6]	**0.67**	0.76	0.84	0.82	0.80
Fonterra's average NZD/USD conversion rate[7]	**0.71**	0.79	0.81	0.80	0.77
Revenue ($ million)					
Ingredients and other revenue	**10,903**	12,144	17,748	13,926	14,824
Consumer revenue	**6,296**	6,701	4,527	4,717	4,945
Total revenue	**17,199**	18,845	22,275	18,643	19,769
Dairy ingredients manufactured in New Zealand (000s MT)	**2,466**	2,753	2,519	2,312	2,353
Total ingredients sales volume (000s MT)[8]	**3,074**	2,982	3,052	2,765	2,660
Segment earnings ($ million)[9]					
Global Ingredients and Operations	**864**	673	280	480	477
Oceania	**137**	(156)	31	93	218
Asia	**235**	192	50	207	182
Greater China	**64**	(5)	30	–	–
Latin America	**125**	256	111	137	124
Eliminations	**6**	(18)	1	20	(14)
Segment earnings	**1,431**	942	503	937	987
Normalisation adjustments	**(73)**	32	–	65	41
Normalised segment earnings	**1,358**	974	503	1,002	1,028
Profit after tax attributable to shareholders ($ million)	**810**	466	157	718	609
Earnings per share[10]	**0.51**	0.29	0.10	0.44	0.41

1 From the beginning of the 2009 season the Farmgate Milk Price has been determined by the Board. In making that determination, the Board takes into account the Farmgate Milk Price calculated in accordance with the principles set out in the Farmgate Milk Price Manual which is independently audited.

2 Average Payout for a 100 per cent share-backed supplier.

3 Retentions are calculated as net profit after tax attributable to Co-operative shareholders at 31 July divided by the number of shares at 31 May, less dividend per share.

4 Source: Fonterra Farmgate Milk Price Statement representing the weighted-average United States Dollar (USD) contract prices of Reference Commodity Products.

5 Source: Oceania Export Series, Agricultural Marketing Service, US Department of Agriculture.

6 Average spot exchange rate is the average of the daily spot rates for the financial period.

7 Fonterra's average conversion rate is the rate that Fonterra has converted net United States Dollar receipts into New Zealand Dollars based on the hedge cover in place.

8 For the year ended 31 July 2014 the total ingredients sales volume has been restated to reflect Fonterra's strategic platforms. Figures for the years ended 31 July 2013 and earlier have not been restated.

9 Represents segment earnings before unallocated finance income, finance costs and tax. For the years ended 31 July 2016, 2015 and 2014, Greater China has been disclosed separately in alignment with the disclosures in the segment note. For the years ended 31 July 2013 and earlier, Greater China was part of Asia. The year ended 31 July 2015 has been restated to reflect changes to the organisation of business units that occurred in the year ended 31 July 2016. The year ended 31 July 2014 has been restated to reflect changes to the organisation of business units that occurred in the year ended 31 July 2015. The year ended 31 July 2012 has been restated to reflect changes to the organisation of business units within reported segments which occurred in the year ended 31 July 2013.

10 On 27 February 2013, Fonterra announced a non-cash bonus issue of one share for every 40 shares held. The bonus issue increased the number of shares on issue by 40.4 million. The record date for the bonus issue was 12 April 2013 and the issue date was 24 April 2013. Earnings per share for the year ended 31 July 2012 have been restated as if the bonus issue was effective at the beginning of the periods presented.

	JULY 2016	JULY 2015	JULY 2014	JULY 2013	JULY 2012
KEY CAPITAL MEASURES ($ million)					
Equity excluding cash flow hedge reserve	**6,883**	7,196	6,452	6,830	6,592
Economic net-interest bearing debt[11]	**5,473**	7,120	4,732	4,467	4,229
Economic debt to debt plus equity ratio[12]	**44.3%**	49.7%	42.3%	39.6%	39.1%
Capital employed[13]	**9,392**	9,487	8,493	8,249	8,004
Return on capital[14]	**12.4%**	8.9%	4.7%	10.5%	11.1%
STAFF EMPLOYED					
Total staff employed (000s, permanent full time equivalents)	**21.3**	22.0	18.2	17.5	17.3
New Zealand	**11.4**	11.9	11.4	11.2	11.0
Overseas	**9.9**	10.1	6.8	6.3	6.3
SEASON STATISTICS[15]					
Total NZ milk collected (million litres)	**17,585**	18,143	17,932	16,673	16,951
Highest daily volume collected (million litres)	**86.9**	89.7	87.1	84.8	81.2
NZ shareholder supply milk solids collected (million kgMS)	**1,453**	1,520	1,533	1,424	1,463
NZ contract supply milk solids collected (million kgMS)	**113**	94	51	39	30
NZ milk solids collected (million kgMS)	**1,566**	1,614	1,584	1,463	1,493
Total number of shareholders at 31 May	**10,579**	10,753	10,721	10,668	10,578
Total number of sharemilkers at 31 May	**3,098**	3,379	3,398	3,449	3,595
Total number of shares at 31 May (million)	**1,602**	1,599	1,598	1,598	1,433

11 Economic net interest-bearing debt reflects total borrowings less cash and cash equivalents and non-current interest-bearing advances adjusted for derivatives used to manage changes in hedged risks.

12 Economic debt to debt plus equity ratio is calculated as economic net interest-bearing debt divided by economic net interest-bearing debt plus equity excluding cash flow hedge reserves.

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

14 Return on capital is calculated as normalised EBIT, less equity accounted investees' earnings, less a notional tax charge, divided by capital employed.

15 All season statistics are based on the 12 month milk season of 1 June–31 May.

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 99. These are non-GAAP measures and are not prepared in accordance with NZ 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 NZ IFRS.

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

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

	GROUP $ MILLION	
	31 JULY 2016	31 JULY 2015
Profit for the period	**834**	506
Add: Depreciation	**465**	453
Add: Amortisation	**105**	108
Add: Net finance costs	**499**	518
Add/(Less): Taxation expense/(credit)	**98**	(82)
Total EBITDA	**2,001**	1,503
Add: Disposal and impairment of the Australian yoghurt and dairy desserts business	**23**	108
Add: Restructuring and redundancy provisions	**–**	33
(Less)/Add: Time value of options	**(28)**	20
Less: Gain on DairiConcepts sale	**(68)**	–
Less: Gain on Latin America realignment	**–**	(129)
Total normalisation adjustments	**(73)**	32
Normalised EBITDA	**1,928**	1,535

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

	GROUP $ MILLION	
	31 JULY 2016	31 JULY 2015
Profit for the period	**834**	506
Add: Net finance costs	**499**	518
Add/(Less): Taxation expense/(credit)	**98**	(82)
Total EBIT	**1,431**	942
(Less)/Add: Normalisation adjustments (as detailed above)	**(73)**	32
Total normalised EBIT	**1,358**	974

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

	GROUP $ MILLION	
	31 JULY 2016	31 JULY 2015
Profit for the period	**834**	506
(Less)/Add: Normalisation adjustments (as detailed above)	**(73)**	32
Add/(Less): Tax on normalisation adjustments	**52**	(42)
Total normalised earnings	**813**	496
Less: Share attributable to non-controlling interests	**(24)**	(40)
Net normalised earnings attributable to equity holders of the Parent	**789**	456
Weighted average number of shares (thousands of shares)	**1,600,825**	1,598,464
Normalised earnings per share ($)	**0.49**	0.29

GLOSSARY

NON-GAAP MEASURES

Fonterra refers to non-GAAP financial measures throughout the Annual Review, 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 Annual Review.

Constant currency	means a measure that eliminates the effect of exchange rate movements. Constant currency variances are calculated by taking the current period financial measure in local currency less the prior period financial measure in local currency and dividing this by prior period financial measure in local currency using the prior period local currency to the New Zealand Dollar exchange rate.
Contribution margin	is calculated as segmental gross profit less distribution, selling and marketing expenses.
EBIT	means earnings before interest and tax and is calculated as profit for the period before net finance costs and tax.
EBIT margin %	is calculated as profit for the period before net finance costs and tax and divided by revenue.
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 debt to debt plus equity ratio	is calculated as net interest-bearing debt divided by net interest-bearing debt plus equity. Net interest-bearing debt includes the effect of debt hedging, and equity excludes the cash flow hedge reserve.
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.
Net tangible assets	means total assets less total liabilities less intangible assets.
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 a specific event or set of circumstances that are outside the control of the business, or relate to the major acquisitions or disposals of an asset/group of assets or business. It may also include certain fair value movements created by required accounting treatments, in particular if they are non-cash movements, and will have no impact on profit over time. Unusual transactions by size are those that are unusually large in a particular accounting period. Unusually large is defined as greater than $30 million.
Normalised EBIT	means profit for the period before net finance costs, tax and after normalisation adjustments.
Normalised EBIT margin %	means profit for the period before net finance costs, tax and after normalisation adjustments divided by revenue.
Normalised EBITDA	means profit for the period before net finance costs, tax, depreciation, amortisation and after normalisation adjustments.
Normalised segment earnings	means segmental profit for the period before depreciation, amortisation, net finance costs, taxation expense, and after normalisation adjustments.
Payout	means the total cash payment to farmer shareholders. It is the sum of the Farmgate Milk Price (kgMS) 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.
Segment earnings	means segmental profit for the period before net finance costs, tax and normalisation adjustments.

DIRECTORY

FONTERRA BOARD OF DIRECTORS

John Wilson

Malcolm Bailey

Clinton Dines

Ian Farrelly

Leonie Guiney

Simon Israel

David Jackson

David MacLeod

John Monaghan

Nicola Shadbolt

Michael Spaans

John Waller

Ashley Waugh

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Theo Spierings

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WE ARE FONTERRA
WE ARE OF THE LAND

We were born from a heritage of staunchly independent farmers who knew we had to stand together as one Co-operative for us all to be successful. We honour the legacy of past dairy men and women who went out and created markets in far flung places for our New Zealand milk.

We will be fiercely loyal to our roots and always remember that we exist to secure the prosperity of future generations of New Zealand farmers by bringing the goodness of dairy to the world.

From those seeds we now source milk from around the world and create new products and services. We can do this because we know milk better than anyone else and can unlock its natural goodness in ways that add real value to customers and consumers throughout their lives.

We will succeed through the generations because we are committed to sustainable dairying and to the communities where we live and work. This starts with our own people. Their richness of difference – countries, cultures, experiences – and the shared passion they bring, make us successful.

We listen to our customers and partners, speak forthrightly and do what we say we'll do. We stand for naturalness, health and uncompromising standards of quality, safety and integrity.

We aim high, always work to deliver exceptional results and find ways to make it happen, even when the going gets tough. We will do things tomorrow that we can only dream of today.

WE ARE FONTERRA
WE ARE DAIRY FOR LIFE