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FONTERRA ANNOUNCES 2014 FINANCIAL RESULTS

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Highlights

- Cash Payout \$8.50, up 38% - Farmgate **Milk** Price \$8.40 per kgMS - Dividend of 10 cents per share - Revenue \$22.3 **billion**, up 19% - Normalised EBIT \$503 **million**, down 50% - Net profit after tax \$179 **million**, down 76% - Earnings per share 10c, down 77% - Total sales volumes stable at 4 **million** metric tonnes

Annual results

Fonterra Co-operative **Group** announced today a final Cash Payout of \$8.50 for the 2014 year for a 100 per cent share-backed farmer, comprising a Farmgate **Milk** Price of \$8.40 per kgMS and a dividend of 10 cents per share.

Chairman John Wilson said that the Cash Payout to the Co-operative's 10,500 farmer shareholders was the highest ever made since Fonterra's formation in 2001.

"The Farmgate **Milk** Price on its own represents an injection of more than \$13.3 **billion** to the New Zealand economy for the season.

"It is a strong result, reflecting the determination of our farmer shareholders to lift on-farm performance, matched within the **business** by a focus on driving revenue.

"Our farmers took advantage of good conditions to produce 1,584 **million** kgMS, eight per cent more than last season, to make the most of the good prevailing prices early in the season.

"North Island volumes were up nine per cent at 969 **million** kgMS, while the South Island delivered a seven per cent rise in volumes to 615 **million** kgMS.

"A very good spring saw our farmer shareholders achieve record **milk** production through an extended peak, stretching our production capacity for powders. This led to early impacts on stream returns from the less valuable products we were forced to make."

Fonterra CEO Theo Spierings said the Co-operative had come through a very demanding year.

"We have continued to stay on track with our strategy, focusing on securing the best returns to our farmer shareholders.

"We achieved record revenue of \$22.3 **billion** for the year, a direct result of the focus on achieving the highest possible revenue line that is good for the Farmgate **Milk** Price.

"Constrained margins in our foodservice and consumer businesses and on non-**milk** powder products were the knock-on effect, contributing to a 27 per cent rise to \$19.8 **billion** in the cost of goods **sold**. However, we maintained our focus on efficiency and achieved a two per cent reduction of \$46 **million** in our operating costs.

"Our higher cost of goods **sold**, along with higher interest and taxation, saw our net profit after tax decline by 76 per cent to \$179 **million**."

Strategy in action

Mr Spierings said 2014 was a tough but defining year and Fonterra had held to its strategy. High commodity prices, while good for farmers, had put margins under pressure in Fonterra's consumer and foodservice businesses.

"We focused on building volumes and value in our key markets, especially Asia and Latin America," Mr Spierings said. "In Asia, we saw volume growth of 12 per cent, primarily driven by excellent performance in **China**. In Latin America, our Soprole **business**' focus on new product development and innovation contributed to the region's three per cent volume growth.

"However, our New Zealand and Australian businesses had a challenging year due to much higher input costs and competitive pressure that constrained our ability to pass these on. These businesses are now on a firmer footing to lift their performance in the current financial year.

"Very strong **milk** flows and an extended peak season stretched our powders capacity and forced us to make lower-returning products. We fast-tracked investments to expand our New Zealand capacity and undertook immediate projects to maximise output from existing plant."

In addition to the \$235 **million** expansion at Pahiatua, the Fonterra **Board** in August approved \$555 **million** of investment in a new high-efficiency drier at Lichfield and three additional plants at Edendale.

At the same time, Fonterra is supporting the growth of its foodservice and consumer businesses by investing \$126 **million** in a UHT plant at Waitoa, \$72 **million** in expanding its mozzarella capacity at Clandeboye, and a \$32 **million** expansion at Eltham.

Mr Spierings said Fonterra had made positive steps forward this year in complementing New Zealand **milk** supply with **milk** pools offshore, protecting the Co-operative's scale in order to remain truly globally relevant.

"Our global partnership with leading infant food manufacturer Beingmate in **China** puts our high-quality **dairy** ingredients in a strong position to capitalise on the opportunity in **China**'s rapidly growing infant formula market with a respected local partner."

Good progress was being made in securing the necessary regulatory approvals and proceeding with the partial tender offer as part of the Beingmate transaction, Mr Spierings said.

Global outlook

The revised forecast Cash Payout for 2014/15 is \$5.55-\$5.65: - Forecast Farmgate **Milk** Price of \$5.30 per kgMS - Targeted dividend range of 25 to 35 cents per share.

While the fundamentals for **dairy** remained strong, the revised forecast reflected current high levels of volatility, said Mr Wilson.

"The forecast reflects an uncertain outlook for the global economic environment and an expectation of continued volatility for **dairy** prices driven by geopolitical events and the supply/demand imbalance.

"The **Board** will continue to keep farmers informed as we move through the year."

Consumer and foodservice margins are expected to recover from the second quarter of this financial year. Stream returns are currently making a positive earnings contribution but it is still very early in the financial year.

Forecast capital expenditure of \$1.6 **billion** for 2015 financial year, signalled in earlier announcements, remains unchanged.

A further update will be provided at Fonterra's Annual Meeting in November.

[Click here to view Annual Results presentation, the Annual Review and the Financial Statements & Statutory Information.](#)

NB: All dollars quoted are New Zealand dollars. - ENDS -

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About Fonterra Fonterra is a global leader in **dairy** nutrition - the preferred supplier of **dairy** ingredients to many of the world's leading food companies. Fonterra is also a market leader with our own consumer **dairy** brands in Australia/New Zealand, Asia/Africa, Middle East and Latin America.

The farmer-owned New Zealand co-operative is the largest processor of **milk** in the world, producing more than two **million** tonnes of **dairy** ingredients, value added **dairy** ingredients, specialty ingredients and consumer products every year. Drawing on generations of **dairy** expertise, Fonterra is one of the largest investors in **dairy** based research and innovation in the world. Our more than 16,000 staff work across the **dairy** spectrum from advising farmers on sustainable farming and **milk** production, to ensuring we live up to exacting quality standards and delivering every day on our customer promise in more than 100 markets around the world. **Business** units

Global Ingredients and Global Operations (formerly NZ **Milk** Products) Global Ingredients and Global Operations had a solid year, with a mild winter and spring ensuring that the season started well. The North Island faced dry conditions through summer but returned to more favourable conditions in autumn, leading to robust growth in New Zealand **dairy** production. **Milk** collection across New Zealand reached 1,584 **million** kgMS, 8% higher than last season. However, record **milk** volumes did not fully translate into increased sales volume, as the year began with low inventory levels as a result of the previous season's drought. Total sales volume was up 1% and revenue increased 30% from \$13.9 **billion** to \$18 **billion**.

The relative increase in the price of Reference Commodity Products (RCPs) compared to the increase in the price of Non-Reference Commodity Products (Non-RCPs), was significant for most of the year and this had a substantial impact on stream returns. The extent of these differences was unprecedented and our asset footprint limited our ability to fully respond by switching production to higher-returning **milk** powders. This was exacerbated by the fact that the relative stream returns strongly favoured RCPs during our peak **milk** collection period in October and November, when we have limited product mix flexibility. As a result, our ability to switch production from Non-RCPs to RCPs was substantially constrained.

This resulted in significant margin pressure for Non-RCP products, with **milk** input costs rising disproportionately against the sales price and selling prices being below the input cost in some product streams. In the second half of the year, the divergence in prices between RCPs and Non-RCPs decreased and then reversed. However, the timing of the decrease in commodity prices and the weighting of **milk** purchasing to the first half of the year, were insufficient to offset the impact on earnings.

In December last year, the **Board** decided to maintain the Forecast Farmgate **Milk** Price at \$8.30 per kgMS, \$0.70 per kgMS lower than that calculated under the Farmgate **Milk** Price Manual, due to asset inefficiency issues that created considerable margin pressure. In May 2014, the **Board** reduced that 70 cent gap by 17 cents to 53 cents, resulting in a Forecast Farmgate **Milk** Price of \$8.40 per kgMS. The **Milk** Price adjustment partially offset the impact of the significantly lower stream returns, and contributed to a Normalised EBIT of \$269 **million**, 46% lower than last year.

Oceania The integrated Australia and New Zealand **business** experienced another challenging year, with higher input costs that were difficult to recover in very competitive environments. Total sales volumes of 832,000 MT for Australia and New Zealand were 6% lower than last year, in part due to the **sale** of the Norco liquid distribution **business** in 2013, decreased nutritional volumes from the Australian ingredients **business** and reduced yoghurt volumes in Australia. The New Zealand **business** held volumes despite challenging market conditions. Oceania's Normalised EBIT declined 78% to \$31 **million** and revenue declined 4% to \$3.6 **billion**.

Significant progress has been made in the transformation of the Australian **business** through lowering operating costs and streamlining the brands portfolio. Normalised EBIT fell \$37 **million** in Australia and \$75 **million** in New Zealand as a result of a margin squeeze in the consumer brands **business**, with significantly higher input costs and competitive pressure that constrained the ability to pass these on.

Asia The focus in 2014 was to increase volume across our key leadership and strategic markets in Asia, given the earnings challenges presented by global **dairy** pricing dynamics. Volume growth of 12% was primarily driven by excellent performance in **China**. In Indonesia, volumes were up 20%, driven by growth in foodservice and the Anlene and Annum premium brands.

However, volumes were down 20% in Sri Lanka, partly due to the temporary suspension of our operations, which resulted in a large short-term decline in volumes and a temporary loss of the market leadership position. Market share has now returned to previous levels, and excluding Sri Lanka, volumes across Asia have increased by 18%.

Normalised EBIT dropped 56% to \$91 million, due to significantly higher input costs as a result of high dairy commodity prices and the challenging market conditions in Sri Lanka. Price increases were taken in line with individual market conditions, while ensuring that the Co-operative was positioned for future earnings growth. This allowed Fonterra to largely maintain or improve its strong market share position in all key markets.

The China business experienced continued growth in a number of strategically important areas. Normalised EBIT in China grew 38%, driven by our farming business and foodservice. Supply shortages in China benefited Fonterra's local farming operations, with increased volumes and higher price per litre.

Latin America Latin America grew volumes by 3% to 387,000MT, driven by the Soprole business in Chile. Consumer volumes were up 2% in Soprole driven by growth in liquid milk, mature cheese and powdered milk. Soprole continues to grow volume through new product development, particularly in cheese, and innovation in serving size and packaging, to expand beyond traditional products and help grow the category.

Normalised EBIT for Latin America decreased by 19% to \$111 million, driven by Soprole, where earnings fell 40% or 31% in constant currency terms. The priority this year was to grow market share and volumes to position the business for long-term success, which resulted in a lower margin, as increased input costs were not fully passed on to customers. Soprole has positioned the business for the more challenging economic environment ahead with the review and realignment of its structure.

Normalised EBIT in Dairy Partners Americas (DPA) increased for the DPA Venezuela liquid and chilled joint venture. This was partly due to some one-off actions, including a hyperinflationary accounting gain and a land sale. Although this remains a challenging market, underlying business performance was stronger than the previous year, driven by changes in product mix into more profitable categories.

i This comprises an interim dividend of \$0.05 and a final dividend of \$0.05. Record date of final dividend is 9 October 2014, with a final dividend payment date of 20 October 2014.

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