

Fonterra & the New Zealand dairy industry: options going forward

A discussion document

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We address all the problems that are involved in growth: strategy, marketing, pricing, innovation, new product development, new markets, organisation, leadership, economic competitiveness.

We bring to our clients specialised industry and functional expertise. We invest significant resources in building knowledge. We see it as our mission to bring this knowledge to our clients and we publish much of it for the benefit of others.

A hallmark of our work is rigorous, fact-based analysis, grounded in proven methodologies. We rely on data because it provides clarity and aligns people.

However, we deliver results, not reports. To that end, we work side by side with our clients to create and implement practical solutions.

The Coriolis name

The coriolis force, named for French physicist Gaspard Coriolis (1792-1843), may be seen on a large scale in the movement of winds and ocean currents on the rotating earth. It dominates weather patterns, producing the counterclockwise flow observed around low-pressure zones in the Northern Hemisphere and the clockwise flow around such zones in the Southern Hemisphere. *To us it means understanding the big picture before you get into the details.*

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PROJECT SCOPE

This report was completed by Coriolis on a pro-bono basis to examine the growth options going forward for Fonterra and the New Zealand dairy industry

- The New Zealand dairy industry and Fonterra are hugely important to New Zealand. The dairy sector is a major contributor to New Zealand's exports and a historical driver of export growth and, as such, is crucial to the national economy. The total turnover of New Zealand-based dairy firms is approximately NZ\$18 billion. Dairy exports represent 27% of the total \$41 billion total merchandise export value in 2009.
- More than 90%+ of all New Zealand dairy product exports are made through Fonterra, a farmer-owned cooperative formed in 2001 through a government-sanctioned mega-merger of cooperatives. The New Zealand government allowed the formation of Fonterra, in part, to allow the formation of a national champion ("New Zealand's Nokia") which would drive economic growth. This expected growth has not materialised. Of late there has been considerable discussion in dairy industry circles, government and in the general media, around ownership structures and how to drive growth for Fonterra.
- Clearly, major structural and strategy decisions taken by the Fonterra Board can have substantial effects in the wider economy, well beyond the confines of the company. We decided to complete the project after being appalled at the generally low level of understanding surrounding the strategic options of the NZ dairy industry by a range of stakeholders, including farmers, government officials and the press. Following feedback from reviewers, the document has evolved from being a informative fact based situation overview into a much stronger strategic options report.
- We completed this work on a pro bono basis. However it is in many ways a continuation of a number of pieces of past work for government on the dairy industry (e.g. F&B Taskforce work).
- The primary audience for this document is government and it has been presented to all the key agencies with dairy industry involvement. In addition, we have presented it to the key dairy players and other interested parties.
- This document is not intended to make a definitive conclusion about the best strategy going forward; rather it is intended to arm the reader with the facts and analysis they require to be able to draw their own conclusions.

PROJECT LIMITATIONS

This report has a number of limitations

- The document is built using:
 - External publicly available data sources (FAO, Comtrade, various statistical agencies, etc.)
 - Without access to any confidential firm research, strategies or data
- Available data on the global dairy industry is, in places, limited and inconsistent.
- The numbers in this report come from multiple sources, using multiple methodologies. While we believe the data are directionally correct, we recognise the limitations in the available data. In many cases different data sources disagree (e.g. MAF vs. Statistics New Zealand vs. FAO vs. USDA vs. Comtrade). Many data sources incorporate estimates of industry experts.
- Financial results presented are from numerous countries with different financial years and accounting regulations; they are also in multiple currencies.
- As a result, all information presented in this document should be treated as directional.
- If you have any questions about the source or meaning of a number in this report, please contact the project leader, Tim Morris at Coriolis Research on (09) 623 1848.

EXECUTIVE SUMMARY - SITUATION

The global dairy industry continues to change and consolidate; as the sixth largest global dairy company, Fonterra must participate in this change or be marginalised

- Fonterra is currently the world's sixth largest dairy company and also the biggest cross-border trader in milk powder and other commodity dairy products. However, Fonterra's sales have grown at a modest 2% CAGR over the past seven years.
- Historically, New Zealand's greatest advantage in the market place was low production costs relative to competitors. While processing plants are high volume and high efficiency in comparison with peers, on-farm production costs have been rising at a faster rate than a number of pastoral-based competitors such as Argentina. Similarly, feedlot dairy continues to improve its performance. For example, California has been rapidly growing average herd size and key variables are growing at twice New Zealand's rates.
- The comparative advantage of lower cost of production which has been our country's catch-cry in the past can no longer be taken for granted.
- Continuing with the present cooperative structure will result in continued farmer control of the milk supply, totally in line with effectively all peer group countries. However the experience of global peers strongly suggests production will remain primarily relatively low value commodities, with resulting slower sales growth and lower profitability compared with corporate dairy companies. Where peer group dairy cooperatives appear to be achieving sales growth, this is almost always the result of mergers with other cooperatives rather than solid organic growth.
- Driving more robust sales and profit growth for Fonterra will be challenging and likely involve large acquisitions (as even a large number of small ones may not be sufficient). However, large acquisitions require access to large amounts of capital, something Fonterra currently lacks.
- The situation facing Fonterra is not unique; other large cooperative dairy players are also working through the issues surrounding access to capital (e.g. Arla the #3 global dairy cooperative).
- There are four broad models for restructuring cooperatives to bring in outside capital/investors; a cooperative with listed subsidiary, "The Irish Model," appears the most popular and sensible.
- Bringing in outside investors provides additional capital; whether this capital is used wisely is dependent on the quality of management and the strategy pursued. Of the eight identified peer group dairy cooperatives that have listed, 2 have been a strong success, 5 have been a success and 1 has been a failure.
- We propose and discuss five potential strategies (page over).

EXECUTIVE SUMMARY – POTENTIAL STRATEGIES

We propose and develop five strategies for discussion

Five potential strategic visions for Fonterra are developed:

1. Become the dominant force in commodity milk production in the Southern Hemisphere, and as a result, the clear leader in the global dairy trade through the development of a multi-country cooperative model. Do this by merging with Murray Goulburn, the leading dairy cooperative in Australia. This is a safe, low risk option (at least in the short-medium term), with a strong potential to increase market power.
 2. Become the leading global supplier of specialised dairy and related ingredients across North America and Europe. Create “**Fonterra Ingredients**”, strengthen existing dairy ingredients platform, expand into high growth markets and related ingredients adjacencies. Following the path of Kerry into a wider range of ingredients is a relatively clear strategy, but not without its challenges.
 3. Become the largest refrigerated consumer products sales and marketing organisation in Australasia. Create “**Fonterra Foods**”, consolidate consumer dairy market in Australasia and acquire complementary businesses to increase profitability. Floating the Australasian consumer dairy business would free up capital from what is a relatively mature business in a mature, low growth market.
 4. Become the largest consumer dairy products company in the Southern Hemisphere with a #1 position across all major markets. Create “**Fonterra Foods**”, consolidate consumer market in Australia and South America and invest in developing a strong, defensible portfolio. Fonterra is in the prime position to consolidate the South American dairy industry, however this is clearly a high risk / high reward strategy.
 5. An option to truly “add value” would be to become the largest supplier of infant formula in the world. List “**Fonterra Nutrition**” and acquire second tier players in infant nutrition then create an integrated supply chain to Asia. Fonterra could then acquire one or more major infant formula businesses as a way of adding value to existing milk powder exports, but this will likely be very expensive.
- It is recommended that the owners of Fonterra decide on a strategic direction and then use this to drive ownership structure, rather than the other way around.
 - Ultimately, the strategy pursued will suggest or determine the logical ownership structure for Fonterra (alternatively, if ownership structure is fixed, strategic options are limited).



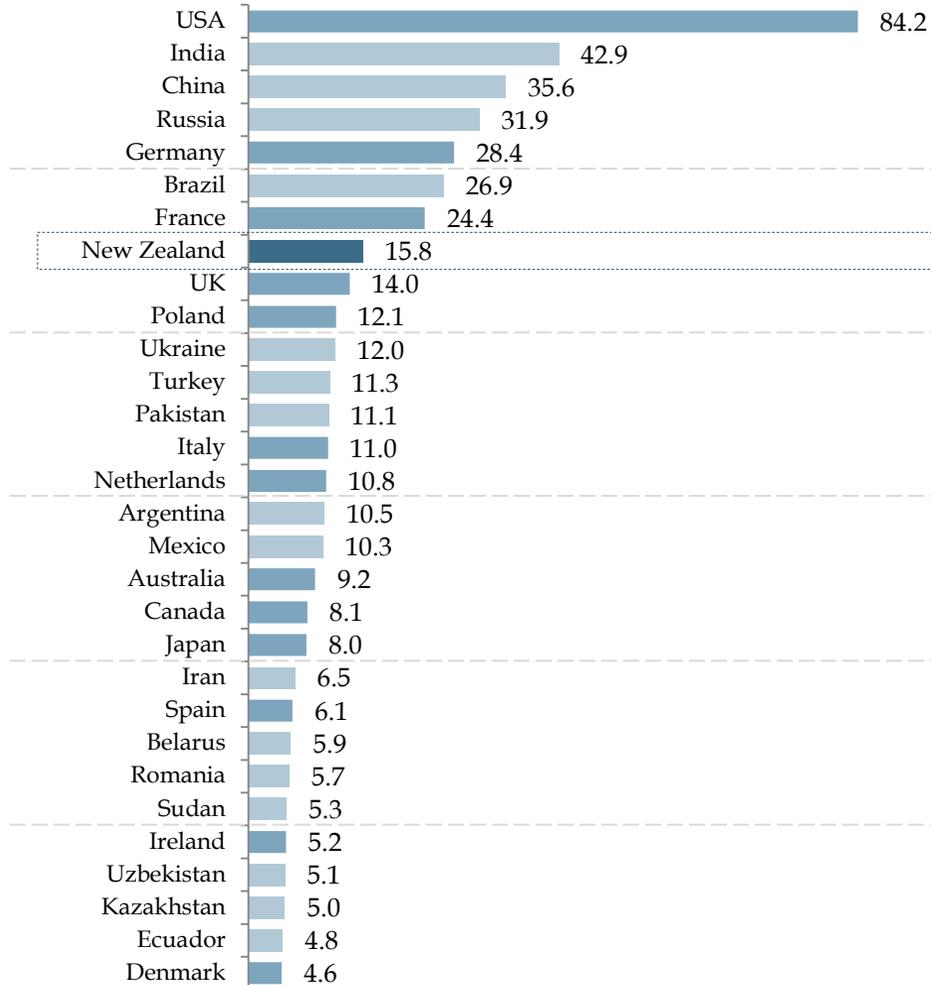
DOCUMENT STRUCTURE

- I. Overview of the New Zealand dairy industry
- II. Ownership options going forward
 - A. Remain being a co-op
 - B. Bring in outside investors
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 - B2. Full corporatisation
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- IV. Potential strategies going forward
 - i. Develop multi-country co-op
 - ii. Become global ingredients leader
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 - iv. Roll-up strategy in developed markets
 - v. Forward integrate into infant nutrition
- V. Appendices

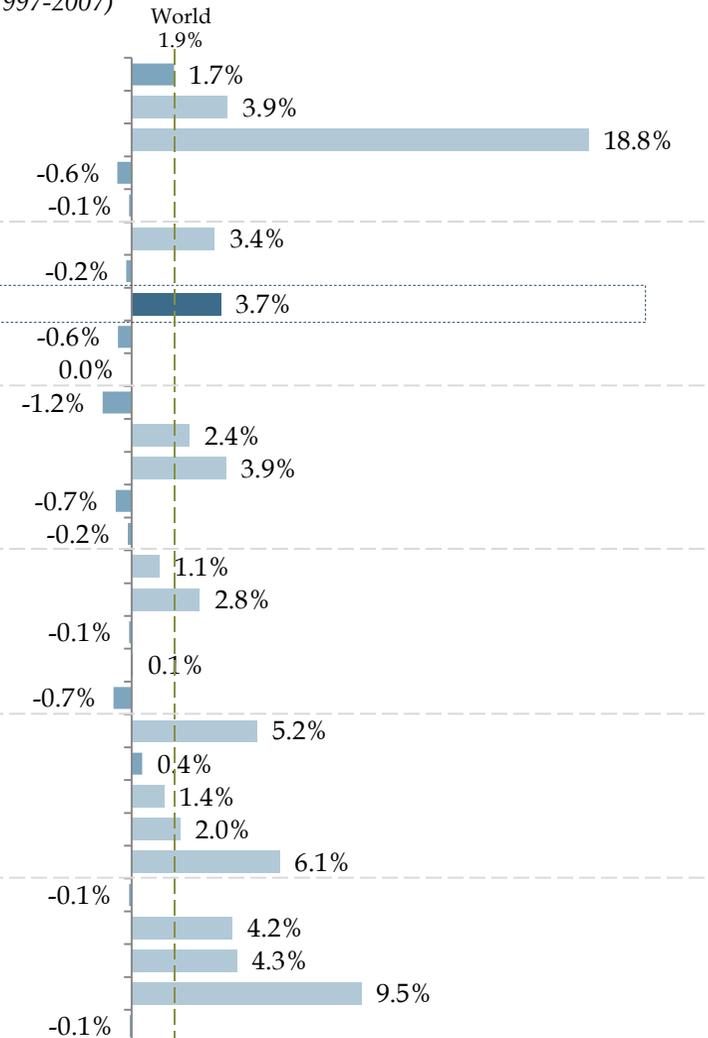
TOP 30 MILK PRODUCERS

New Zealand is the eighth largest milk producing country in the world; it is the only major developed country producer significantly increasing production

Top 30 producers of whole cows milk by country in tonnes
(t; m; 2007)



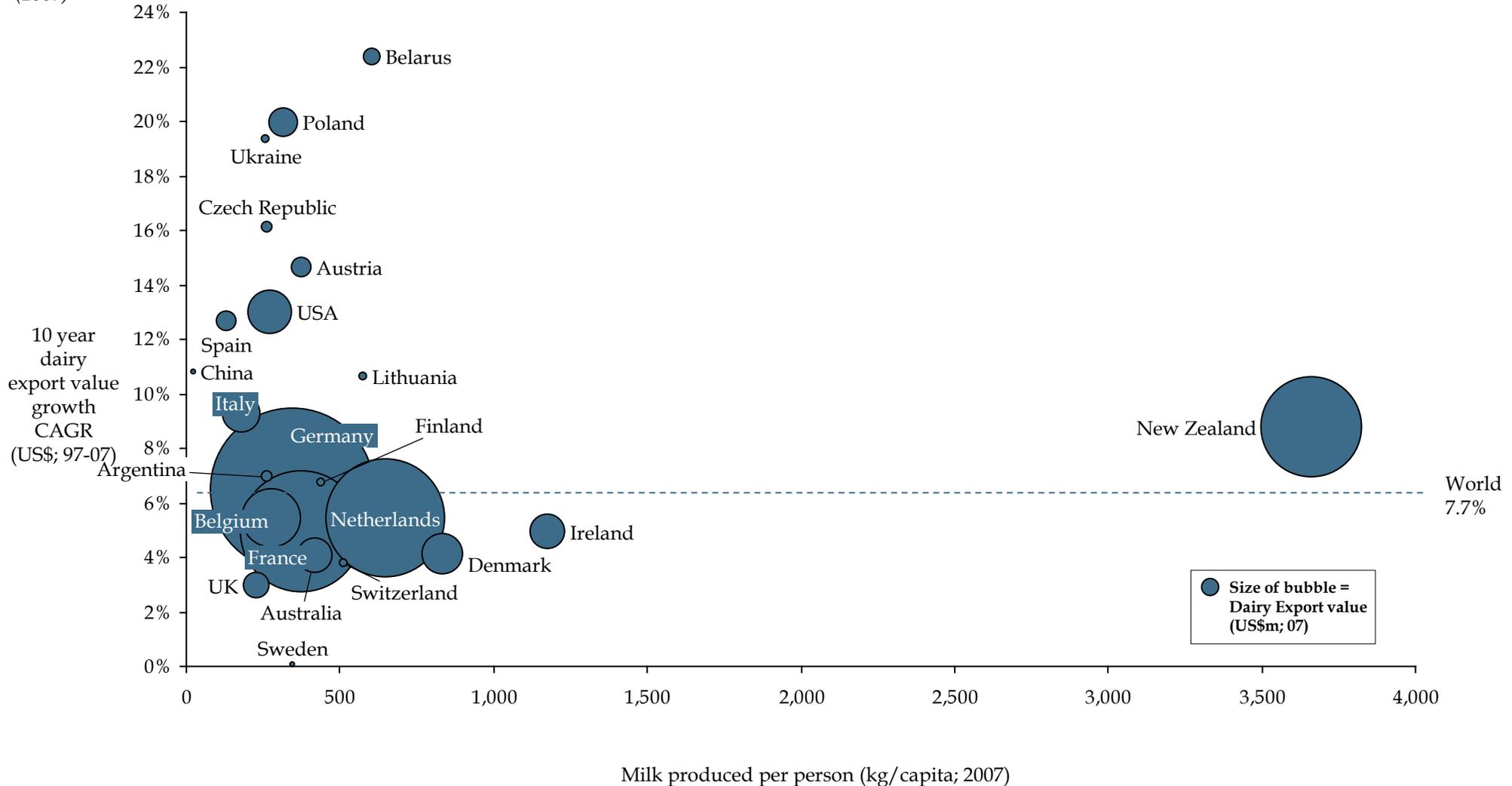
10 year production growth rate CAGR
(%; t; 1997-2007)



EXPORT DRIVERS MATRIX

New Zealand is a medium sized country, with a small population and a lot of cows; as it produces significantly more milk than it can consume, it is a major dairy exporter

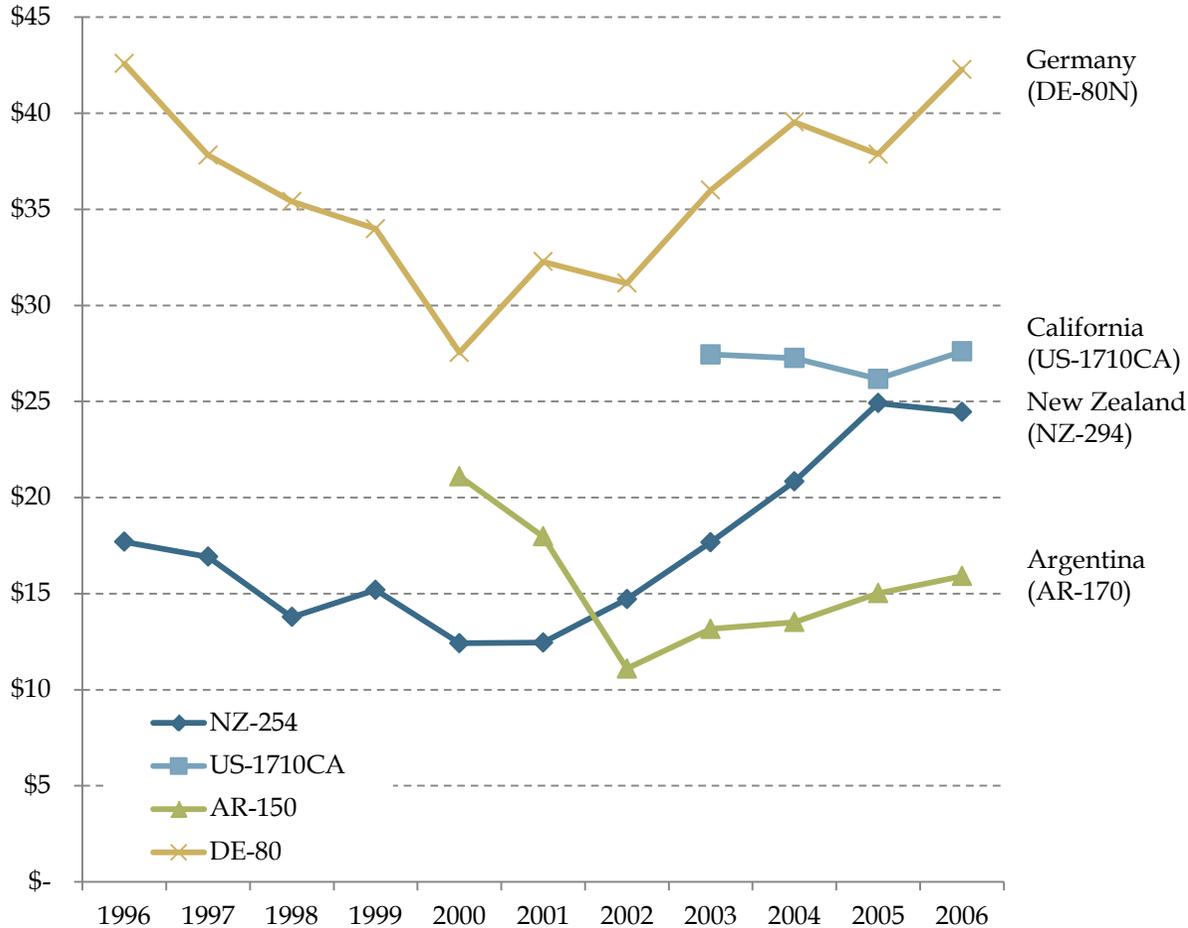
Export drivers matrix: milk production/capita vs. dairy export value growth vs. dairy export value (2007)



NO LONGER LOWEST COST

New Zealand is a low cost dairy producer; however it is not the lowest cost producer; costs have been increasing faster than peers

Cost of milk production: New Zealand vs. select competitors
(US\$ per 100kg milk ECM; 1996-2006)



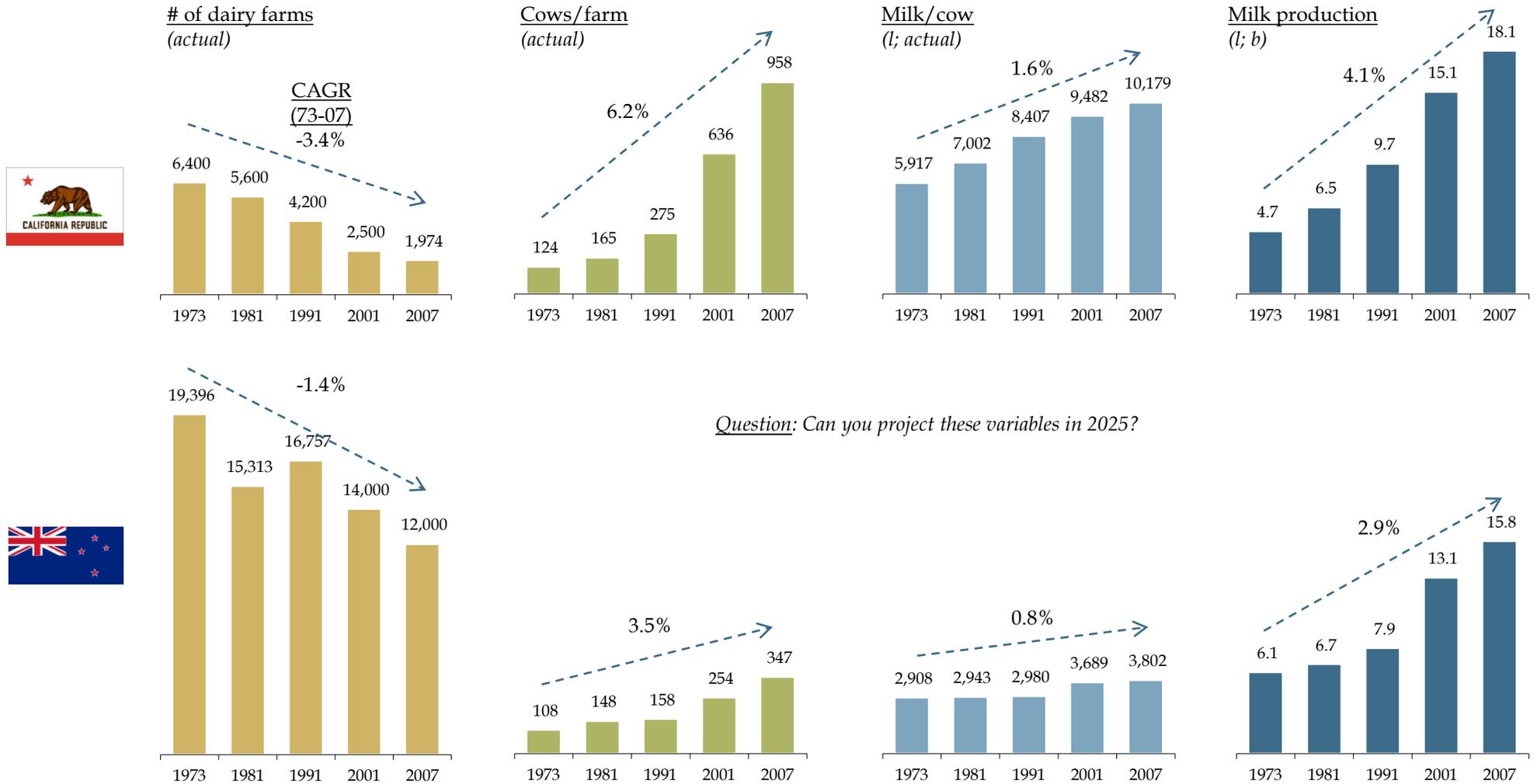
Comments/Notes

- Data is from IFCN database and represents 4 typical farm types for four select countries

COMPETITORS IMPROVING FASTER

New Zealand's key dairy competitors are not standing still; they continue to improve, often at a faster rate

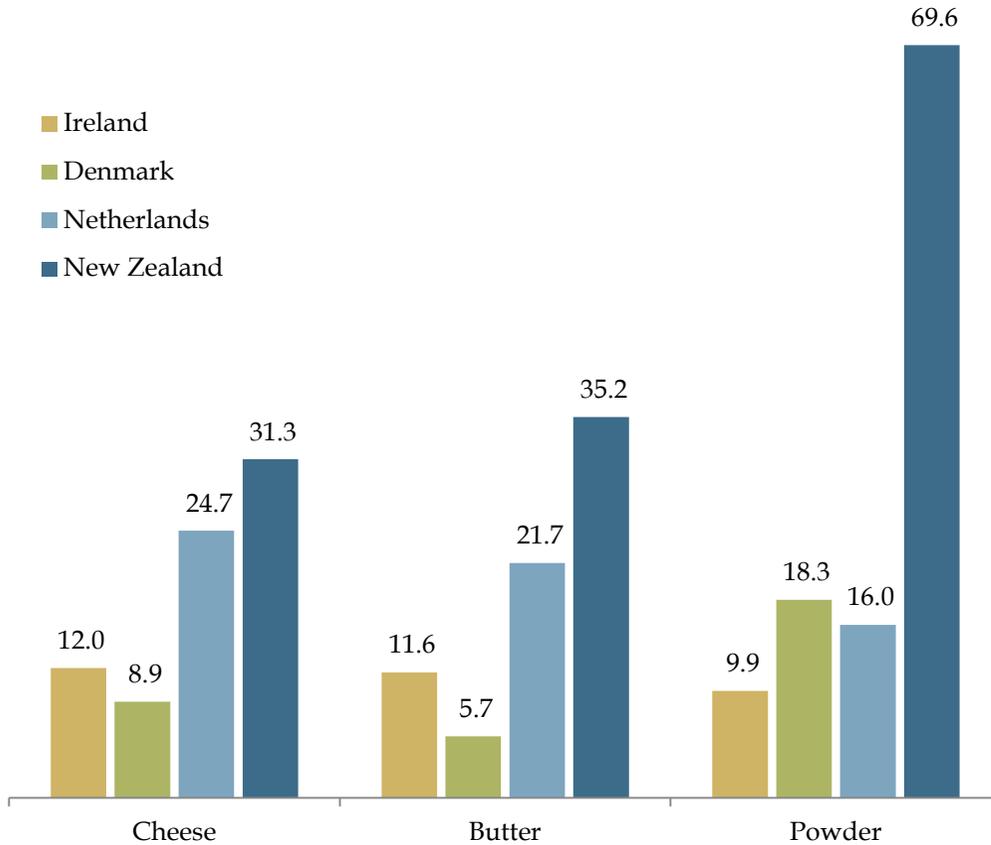
EXAMPLE: Changing variables in milk production: California vs. New Zealand (1973-2007)



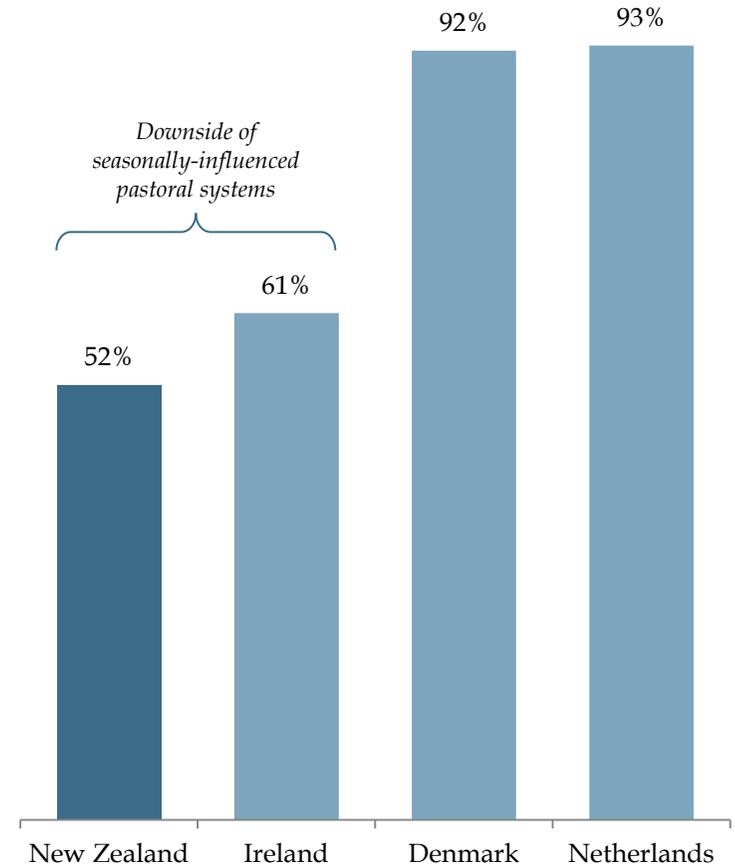
HIGH VOLUME PLANTS

New Zealand has high volume/high efficiency production plants relative to peers

Average annual production per plant: New Zealand vs. select peers
(t; 000; 2001)



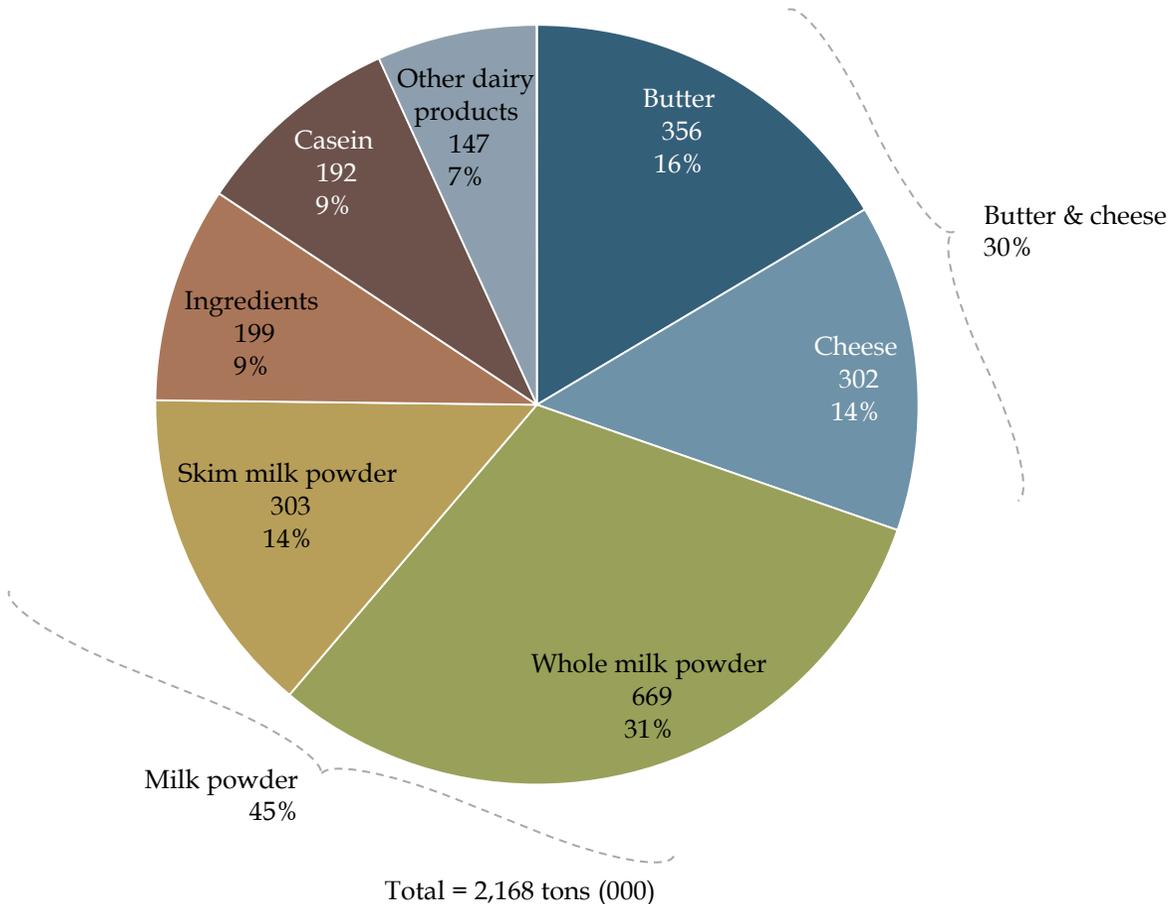
Capacity utilisation: New Zealand vs. select peers
(%; 2001)



NZ EXPORT VOLUME BY TYPE

New Zealand exports its surplus milk as a handful of dairy products: milk powder (45%), butter & cheese (30%) and casein/ingredients (18%)

New Zealand dairy export volume by form
(t; YE 3/09)



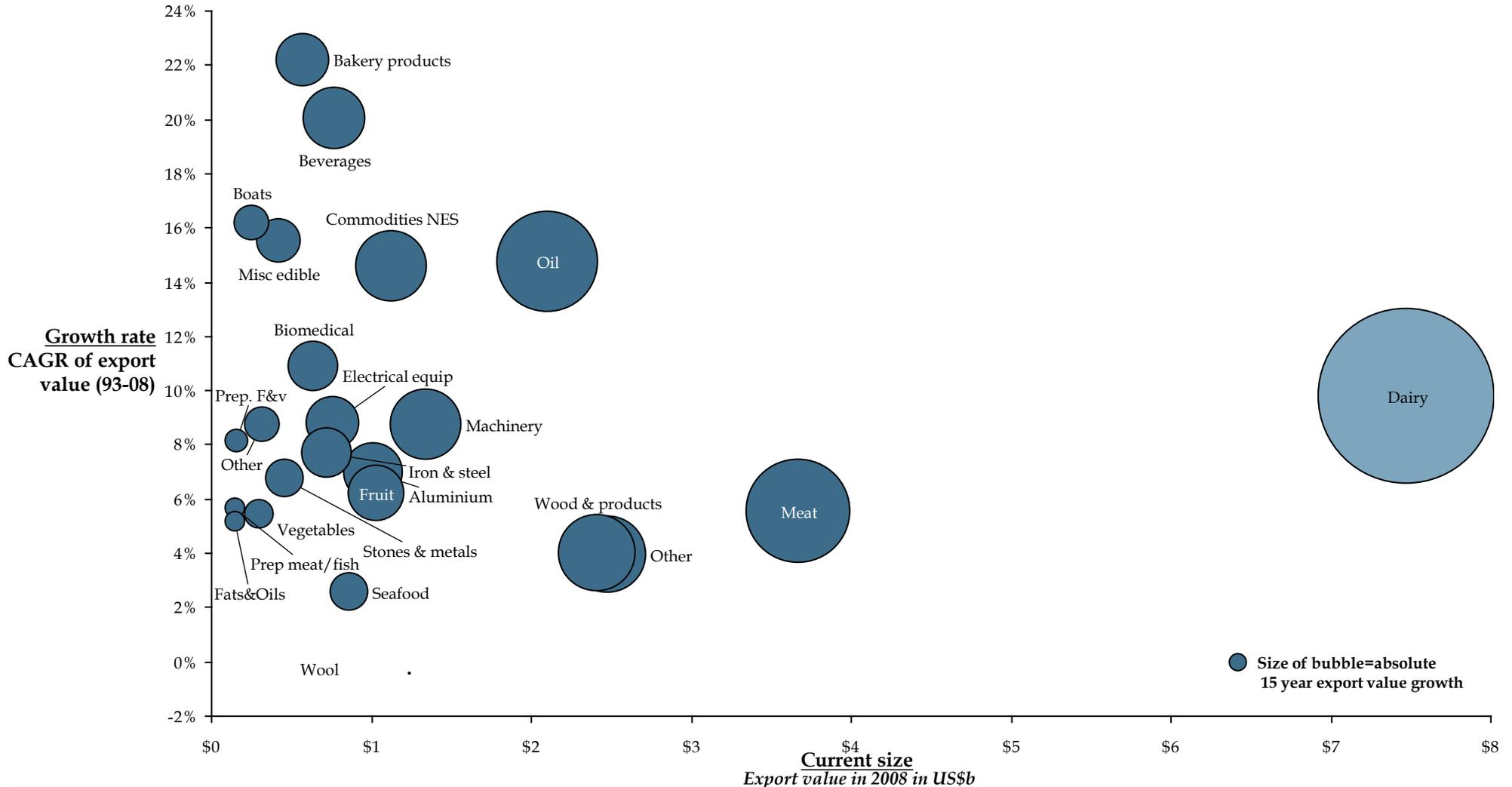
Comments/Notes

- For historical, primarily geographical, reasons, New Zealand's dairy exports are almost all shelf-stable
- There may be more opportunity to exploit New Zealand's well developed cool-chain capabilities

EXPORT ENGINE

The dairy sector is the engine driving New Zealand's export growth; the sector is hugely important to the wider economy

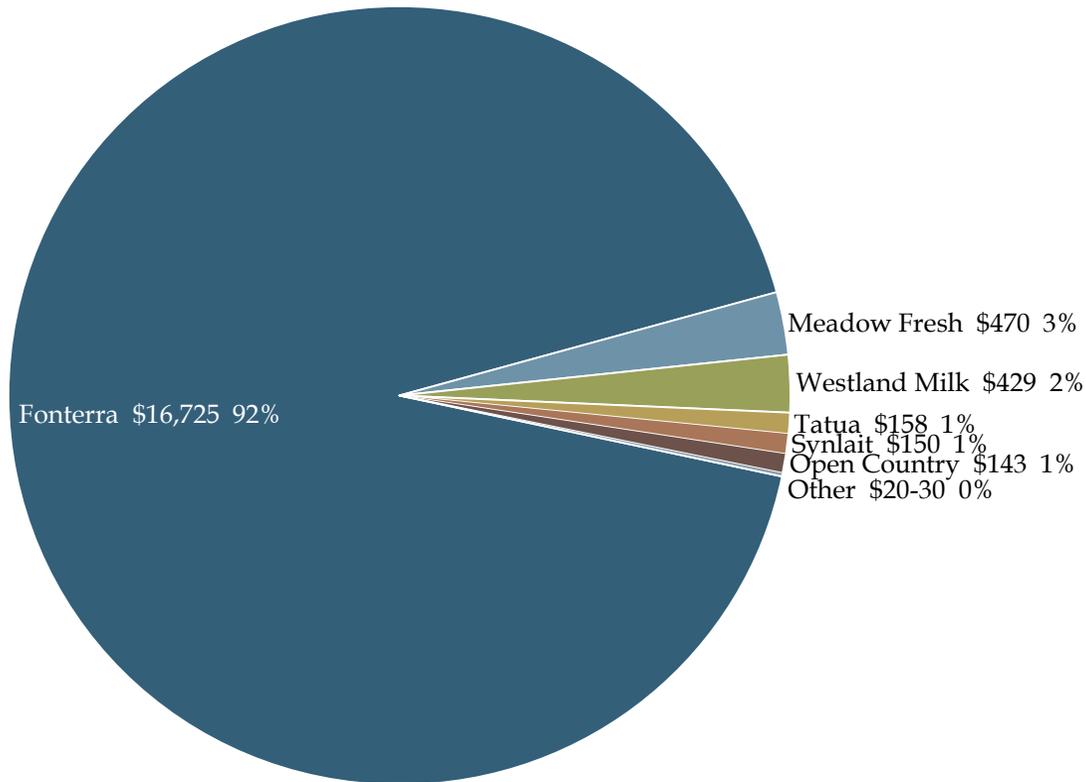
Export matrix for key products in 2008 vs. 15 year CAGR of export value vs. 15 year absolute growth in exports (US\$b; nominal; 1993v2008)



TOTAL TURNOVER - NZ-BASED FIRMS

New Zealand exports almost all of its milk through Fonterra, a farmer-owned cooperative formed in 2001 in a government sanctioned mega-merger of cooperatives

Total global turnover of New Zealand based dairy firms
(NZ\$m; FY08)



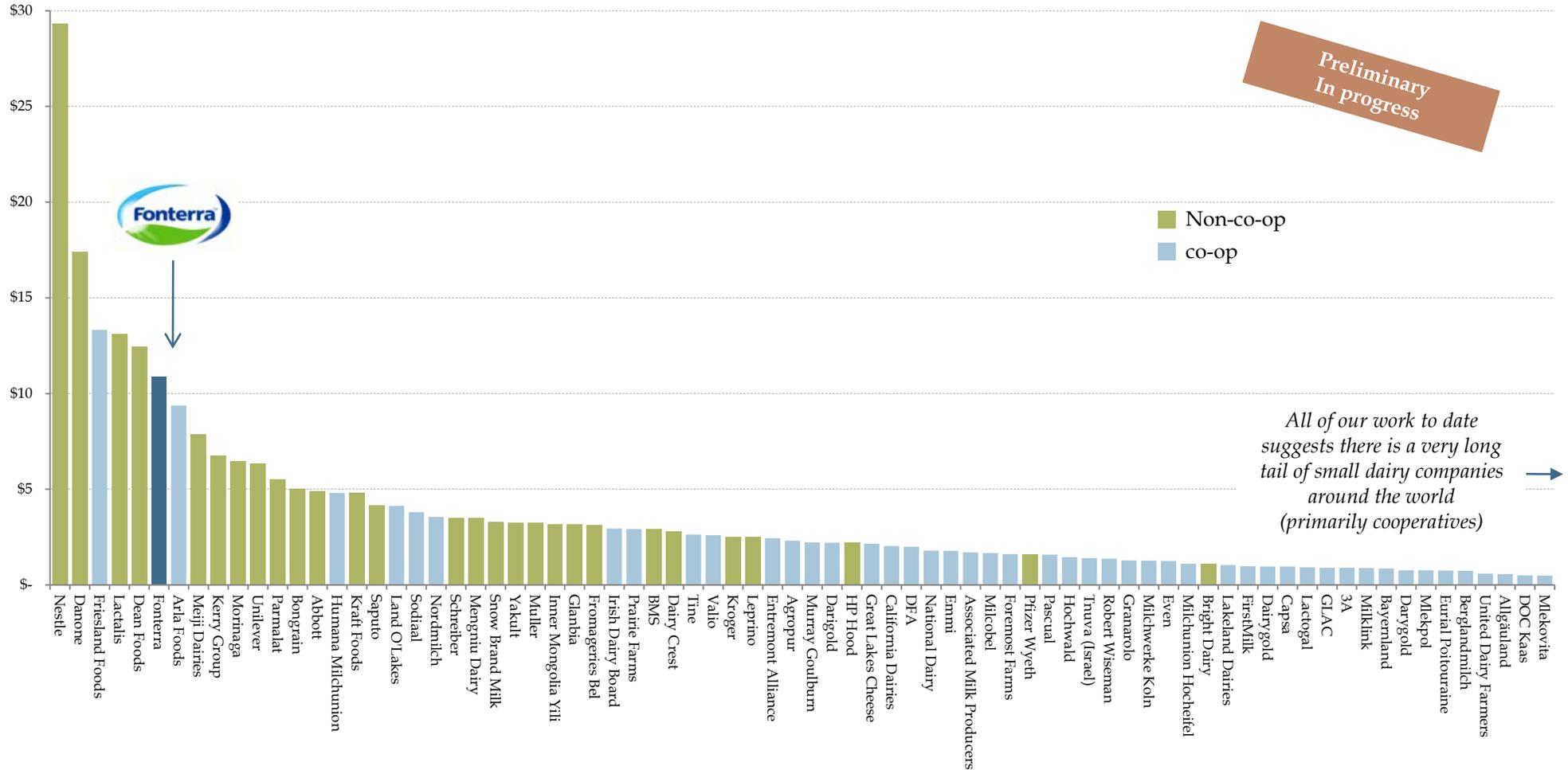
Comments/Notes

- Chart attempts to show the relative turnover of NZ-resident firms and NZ-produced dairy products
- 12 month turnover of Fonterra, Westland and Tatua estimated from 14mo value given in annual reports (as 12/14 of given value)
- Meadowfresh is a division of Goodman Fielder (formerly Mainland Products before Fonterra brand swap) and sales given here includes Huttons Kiwi meats business
- Other is a Coriolis estimate NZ turnover of the remainder of smaller, primarily specialty, dairy firms (e.g. Ballantyne NZ, Whitestone)
- Excludes domestic sales of non-NZ dairy products (e.g. National Foods; \$49.2m)

ALREADY VERY LARGE

Fonterra is a very large dairy company on global standards

Top 76 global dairy firms ranked by dairy products turnover (US\$; 2008 or most recent available)

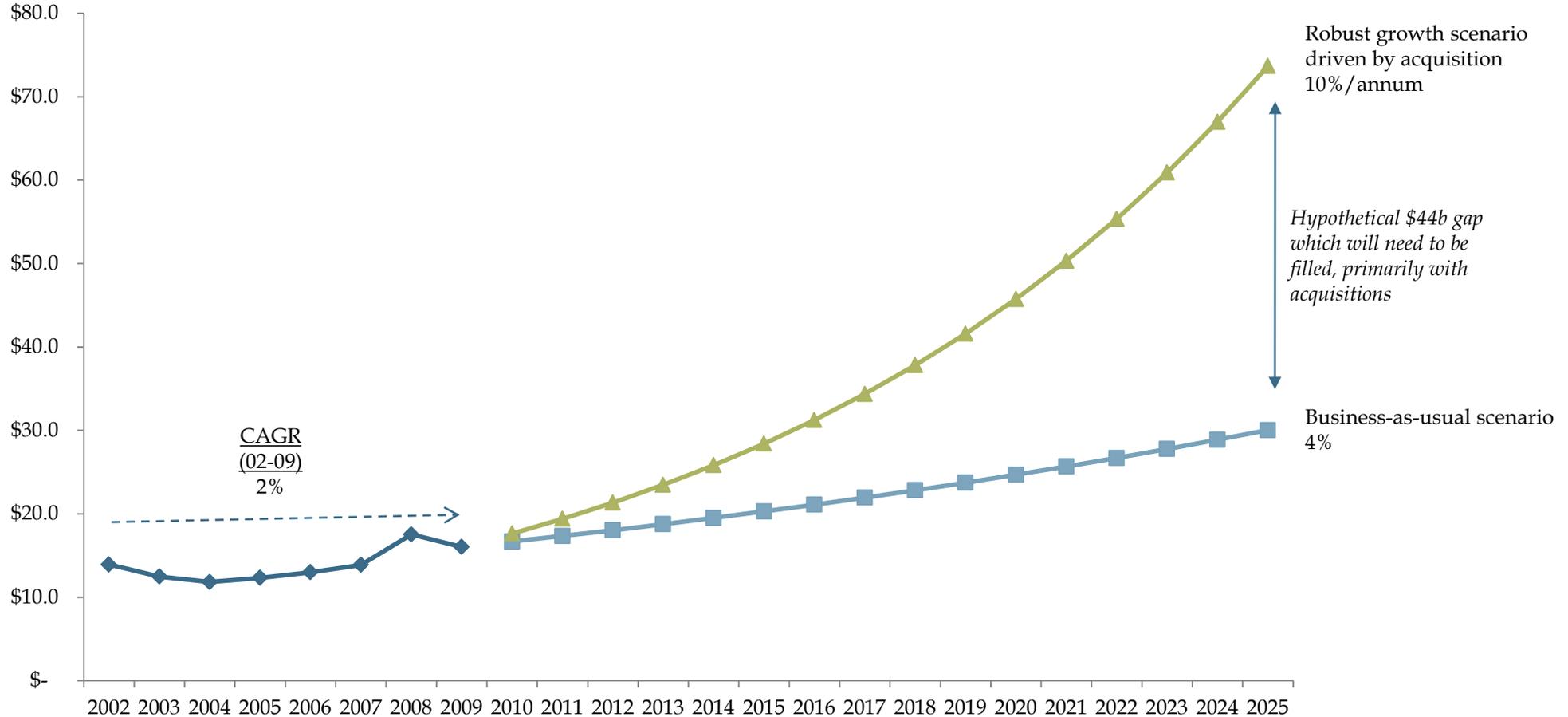


GROWTH CHALLENGING

Driving robust and profitable growth going forward will be challenging and will likely involve large acquisitions (*as a large number of small ones may not fill the gap*)

Fonterra sales growth: actual vs. two different growth scenarios

(NZ\$b; 2002-2009 actual; 2010-2025 projections)





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A. REMAIN BEING A CO-OP

Fonterra's first ownership option is to remain a farmer-owned dairy cooperative

"As a cooperative, MD Foods* has three main operational objectives:

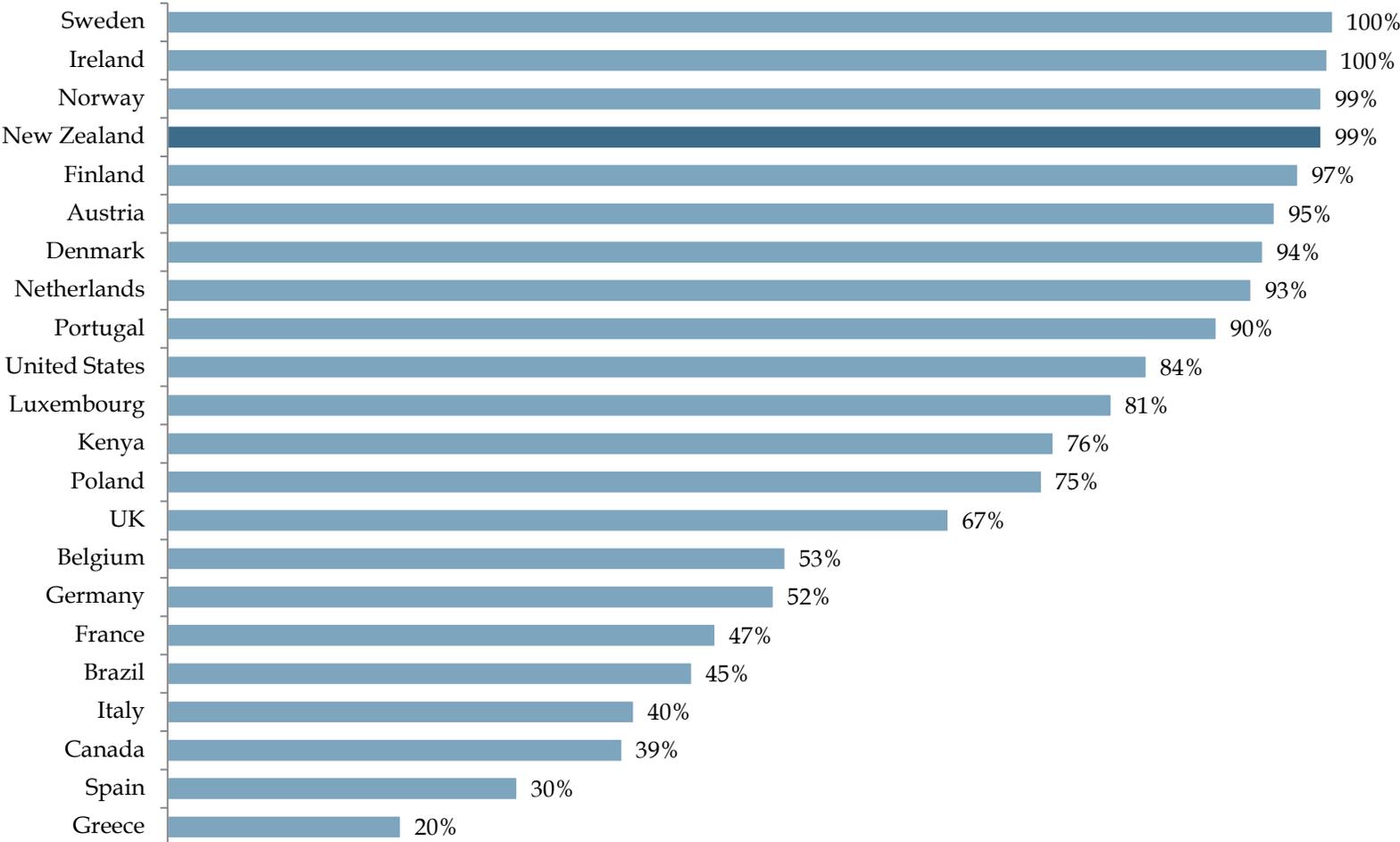
- (1) to maximize the milk price paid to farmer members;
- (2) to process and market the milk collected every day from member farms; and
- (3) to maintain farmer control."

F.A. Christiansen, Executive Director, MD Foods, 1994

CO-OP CONTROL MILK SUPPLY

Dairy cooperatives control the milk supply across much of the developed world

Cooperative intake share of total milk supply: New Zealand vs. select peer
(% of milk supply marketed; various dates 97-05)

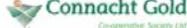


KEY DAIRY CO-OP BY COUNTRY

New Zealand is completely in line with effectively all global peers in having a dairy industry controlled by one or a handful of dairy cooperatives

Key dairy cooperatives by country: New Zealand vs. select peer group (2009)

See appendix 2 for more details

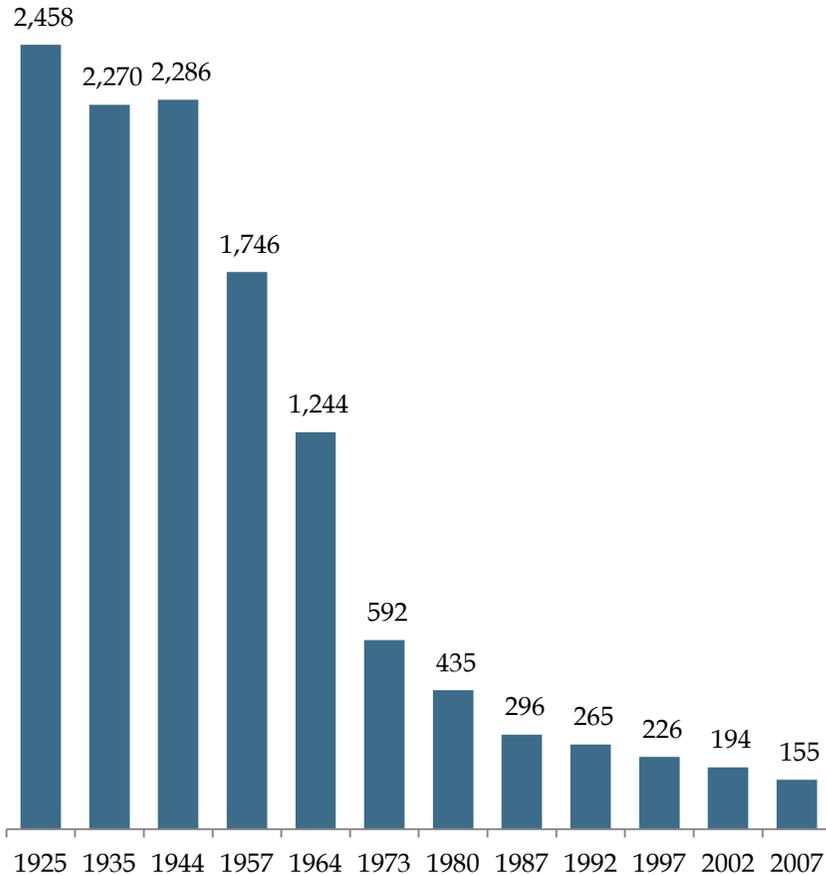
New Zealand	  	Netherlands	  
Australia	 	United Kingdom	  
Norway		Ireland	     
Finland	 	Austria	     
Denmark		Germany	     
Sweden	   		      
Belgium	 	France	      
Luxembourg		Canada	      
Switzerland	 	United States	      
Poland	 		      
Portugal			    
Spain	 		

INCREASING CONSOLIDATION & SHARE

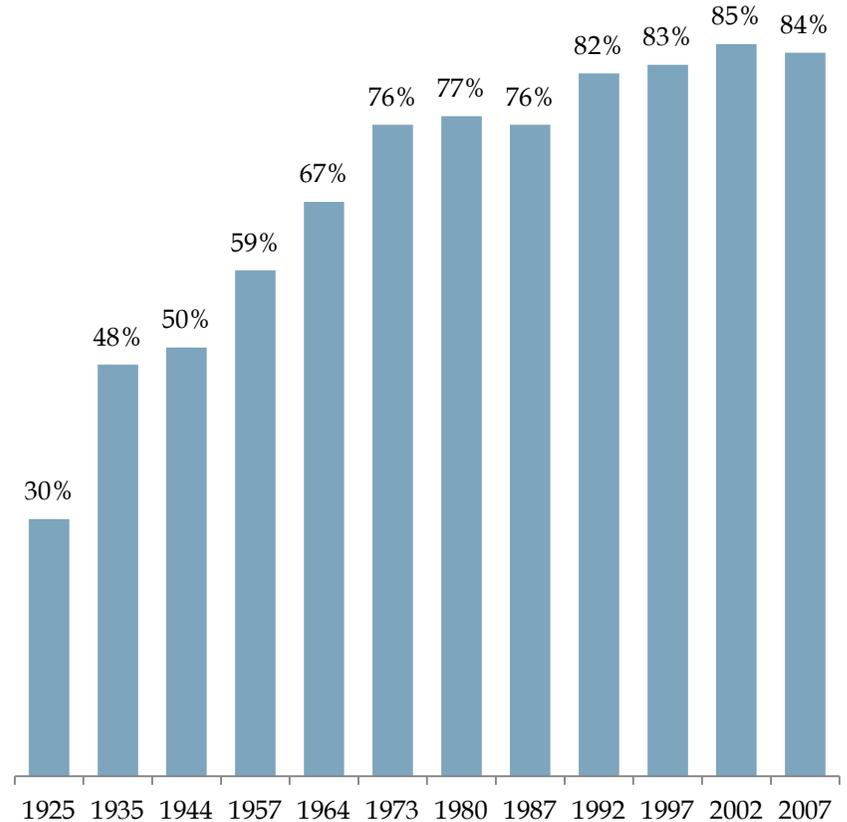
Rapid consolidation of the number of dairy cooperatives has gone hand-in-hand with an increased control of the milk supply

EXAMPLE: Consolidation of US dairy cooperatives and their increasing role in US milk supply (1925-2007)

Number of dairy cooperatives
(#; actual)



Dairy cooperatives share of total milk marketed
(% of raw milk marketed)

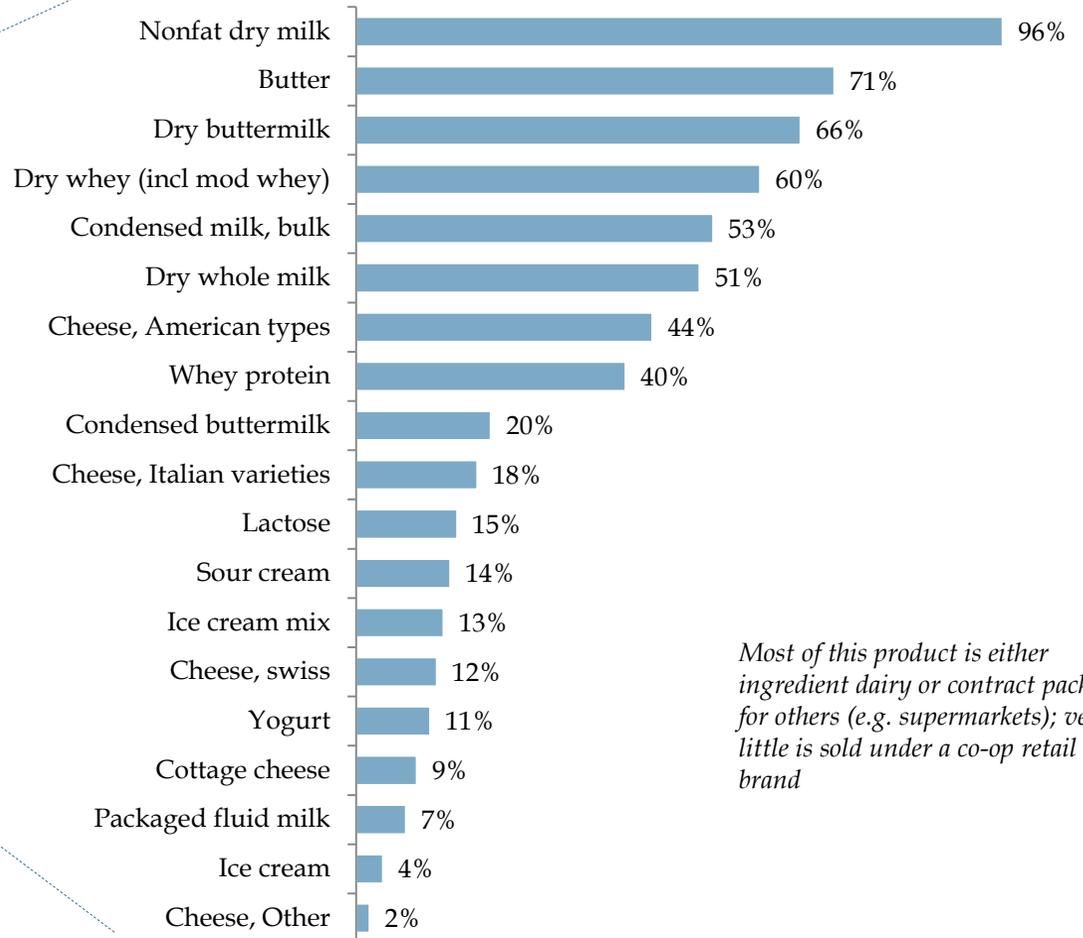
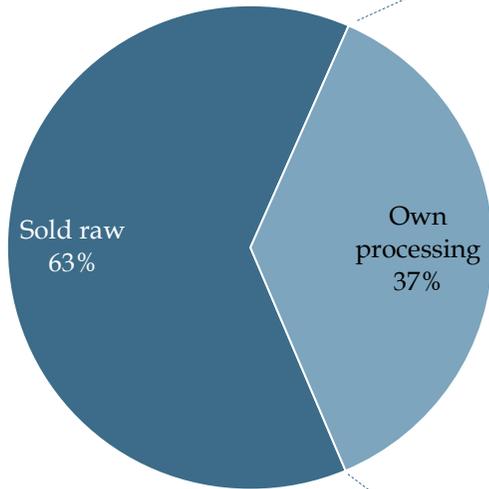


PRODUCE COMMODITIES

Dairy cooperatives either on-sell their members milk to manufacturers (corporate, private or other co-op) or process it themselves, typically into commodities

EXAMPLE: Dairy cooperatives production share of various U.S. dairy products by type
(% of total volume; 2007)

Typically sold to manufacturers or partially-owned joint-venture plants

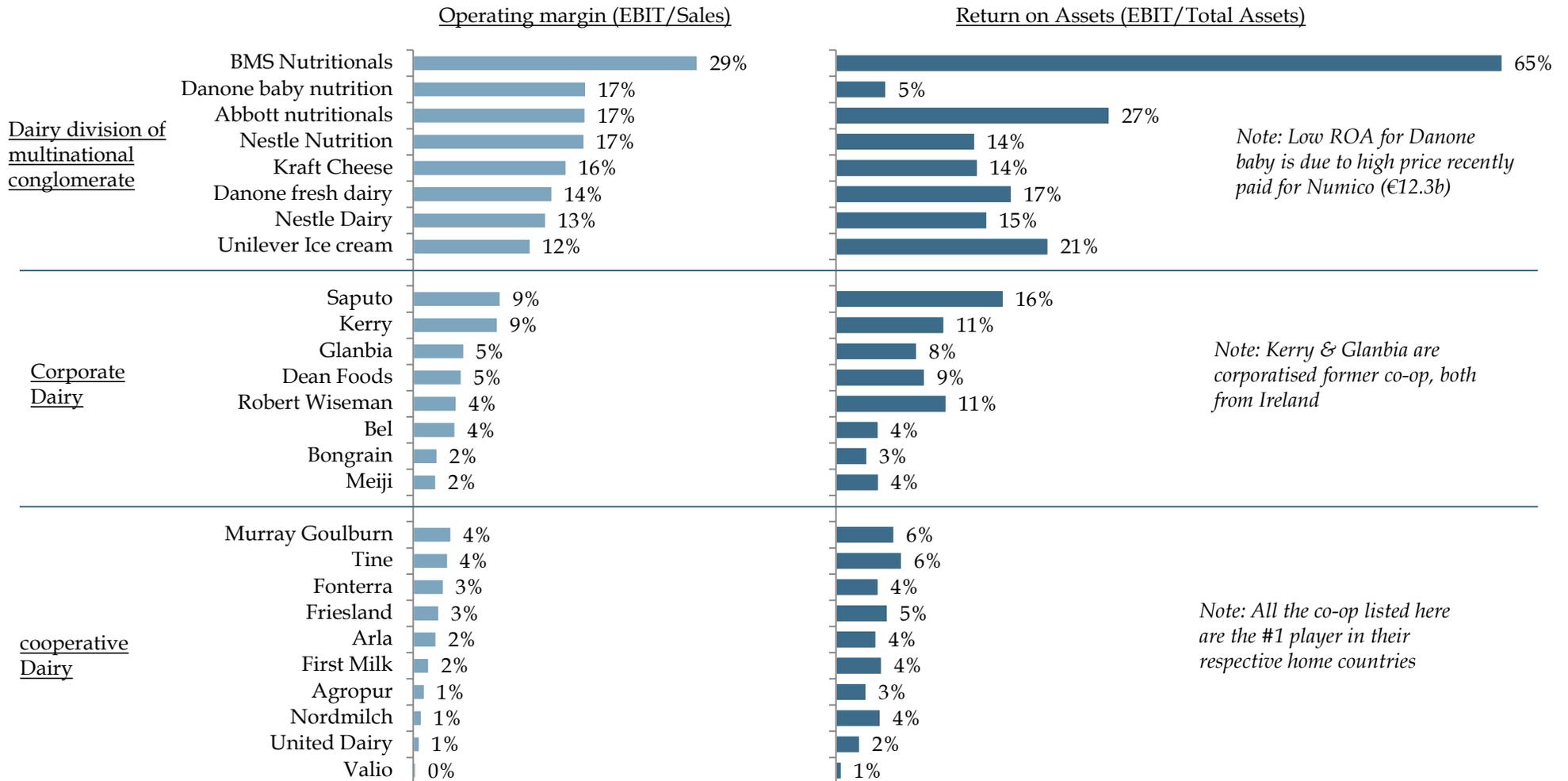


Most of this product is either ingredient dairy or contract packed for others (e.g. supermarkets); very little is sold under a co-op retail brand

COOPERATIVES ACHIEVE LOW RETURNS

As a result of primarily producing commodities, cooperatives achieve lower returns than either the dairy products divisions of major multinationals or corporate dairy focused firms

Comparison of operating margins and return on assets across select dairy operations by ownership structure
(%; 2008)



CONCLUSIONS - REMAIN BEING A CO-OP

If the owners of Fonterra choose to remain being a cooperative, we make the following conclusions from the experience of global peers

1. There is nothing “wrong” with remaining being a cooperative
 - a) New Zealand is completely in line with global peers
 - b) Dairy cooperatives control the milk supply across the developed world and their share of the milk supply is increasing
 - c) Commentary to the contrary appears uninformed

2. However, the experience of global peer group cooperative suggests the following:
 - a) The firm will remain focused on milk disposal
 - b) Production will remain primarily low value-added commodities
 - c) Achieving robust sales growth will be difficult
 - d) The profitability of the firm will remain low relative to corporate peers
 - This low firm profitability must be balanced with potentially higher payouts at the farmgate



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B. BRING IN OUTSIDE INVESTORS

There are four broad models for restructuring cooperatives to bring in outside capital/investors; the “The Irish Model” appears the most popular and sensible

Models for introduction of outside investors into a cooperative

Model	Details	Dairy cooperative examples	Non-dairy cooperative examples
1. cooperative with listed subsidiary <i>“The Irish Model”</i>	<ul style="list-style-type: none"> – co-op creates subsidiary which is publicly listed – co-op initially maintains controlling share – May involve multiple share classes (A & B) – Future option to sell down ownership – May ultimately lead to (4) full corporatisation 	<ul style="list-style-type: none"> – Kerry Group (Ireland) – Waterford (Ireland) – Avonmore (Ireland) – Dairygold/REOX (Ireland) – Emmi (Switzerland) – [Fonterra proposed 2007] 	<ul style="list-style-type: none"> – HK Ruokatalo (Finland) – Metsäliito (Finland)
2. Separate class of non-voting equity <i>“The Canadian Model”</i>	<ul style="list-style-type: none"> – Outside investors are allowed to buy shares in the cooperative but shares are non-voting – Typically preferred non-voting stock 	<ul style="list-style-type: none"> – Clover (South Africa) 	<ul style="list-style-type: none"> – Sask Wheat Pool (Canada) – Pro-Fac (Canada) – Agricore United (Canada) – CHS (USA) – Westfleisch (Germany)
3. Full corporatisation <i>“The ENZA model”</i>	<ul style="list-style-type: none"> – Full conversion of co-op into investor-owned firm – Not necessarily publicly listed, but likely to lead this way – May have requirements to be an investor (e.g. own an orchard) 	<ul style="list-style-type: none"> – Donegal (Ireland) – Golden Vale (Ireland) – [Dairy Crest (UK)]*??? 	<ul style="list-style-type: none"> – Calavo Growers (USA) – Diamond Growers (USA) – ENZA (New Zealand) – Gold Kist (USA) – IAWS (Ireland)
4. Sell share to private equity or other investor <i>“The European Model”</i>	<ul style="list-style-type: none"> – Generally as a result of poor management damaging balance sheet leading to capital injection requirement – Either parent or daughter entity receives additional capital from outside investor – Typically with expectation that ultimate exit path will be a public float 	<ul style="list-style-type: none"> – Sodiaal’s Yoplait sub (France) – NOM (Austria) – Mlekara Subotica (Serbia) – Granrolo (Italy) – Central Lechera Asturiana (Spain) – Tnuva (Israel) – SanCor (Argentina) 	<ul style="list-style-type: none"> – ?

Primary focus of this section

Profiled in appendix 3

LIMITED PEER GROUP

Our research to date has identified eight cooperatives that have listed some or all of their activities (generally consumer products)

Profiles of dairy cooperatives that have brought in outside investors
(1990-2007)

Parent	Floated company	Country	Year floated	Ownership structure relative to cooperative parent
		Ireland	1986	<ul style="list-style-type: none"> - Parent is Kerry cooperative Creameries - Uses A & B share structure; parent owns 100% of B representing 66% of total (as of 1988)
		Ireland	1988	<ul style="list-style-type: none"> - Parent is Avonmore Creameries Federation (co-op) - Uses A & B share structure; parent owns 100% of B and 14.7% of A (as of 1992)
		Ireland	1988	<ul style="list-style-type: none"> - Parent is Waterford cooperative Society - Parent owns 68.6% of ordinary shares plus 99% of convertible redeemable preference shares (as of 1991)
		Ireland	1989	<ul style="list-style-type: none"> - Converts from co-op to corporation; no parent; shares to farmers - Purchased by Kerry in 2001 for 10-1 Kerry shares or cash (most shareholders take shares)
		Ireland	1989	<ul style="list-style-type: none"> - Firm formed in 1970 in merger of three smaller co-op; lists in 1989 in conversion of co-op to corporation (no parent); shares to farmers
		Ireland	2006	<ul style="list-style-type: none"> - Parent is Dairygold cooperative Society - Uses A & B share structure; parent owns 100% of A equivalent to 25% of total (as of 2006) - A shares give right to appoint 4 directors; no other shareholder allowed to hold more than 5% - Parent maintained milk processing activities but floated "non-farm dependant" businesses (including consumer dairy) and distributed shares to farmers
		Switzerland	1993 2001	<ul style="list-style-type: none"> - Parent is Zentralschweizer Milchproduzenten [Central Switzerland Milk Producers (ZMP)] - Parent maintains 63.9% shareholding; another co-op owns 4.4%; remainder floated
National co-op Dairies		South Africa	2003	<ul style="list-style-type: none"> - Converts to investor owned in 2003; listed in 2004 - Uses two classes of shares to maintain farmer control

MIXED RESULTS

The results of listing have been mixed, with outcomes ranging from stunning to poor

Financial results of dairy cooperatives that have floated their business

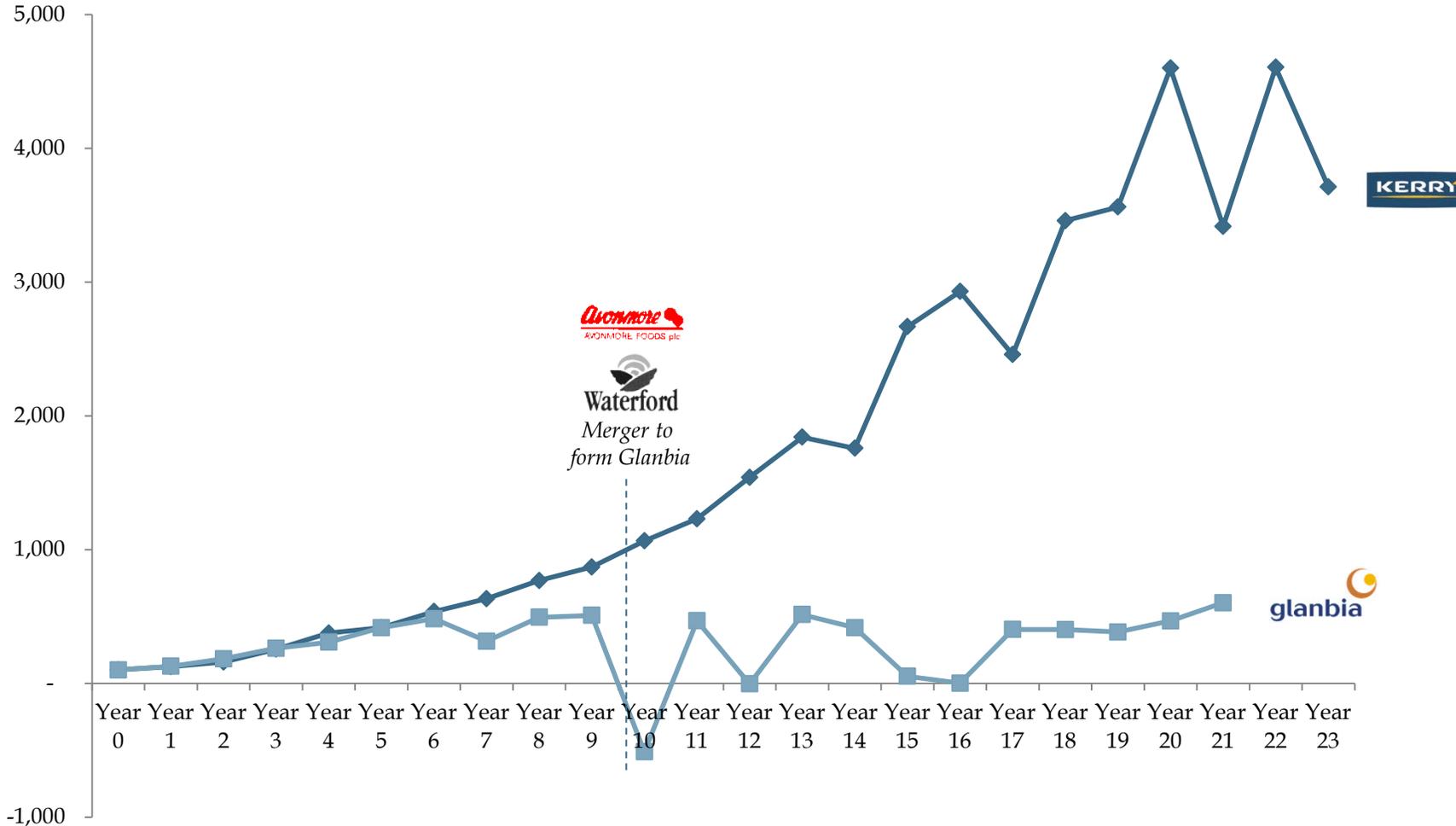
(various currencies; various years)

Floated company	Outcome summary	Sales growth			EBIT growth			Comments/outcome
		Year 1	Latest /last	CAGR	Year 1	Latest /last	CAGR	
	↑↑↑	€370m (87)	€4,791m (08)	13% (87-08)	€14m (87)	€318m (08)	16% (87-08)	<ul style="list-style-type: none"> Lists on stock exchange in 1987; 90m shares distributed to co-op members Kerry makes numerous acquisitions consolidating fragmented Irish dairy and global ingredients sectors
	↑↑	SFr1,879m (03)	SFr2,694m (08)	7% (03-08)	SFr49.5m (03)	SFr102.1m (08)	16% (03-08)	<ul style="list-style-type: none"> Parent ZMP lists consumer dairy after acquiring bankrupt major competitor (needs capital as result) Parent still controls firm
	↑↑	€245m (89)	€759m (00)	9% (89-00)	€14m (89)	€34m (00)	11% (89-00)	<ul style="list-style-type: none"> Lists in 1989; initially achieves little; later makes progress in domestic dairy industry Purchased by Kerry in 2001 for 10-1 Kerry shares or cash (90%+ shareholders take Kerry shares)
	↑↑	€678m (88)	€2,232m (08)	6% (88-08)	€27m (88)	€127m (08)	8% (88-08)	<ul style="list-style-type: none"> Waterford & Avonmore list in 1988; merge in 1998; new name 1999; further mergers/acquisitions; business loses its way and is still struggling to re-invent itself
	↑↑	€33m (89)	€130m (08)	7% (87-08)	€0.8m (87)	€3.1m (08)	8% (87-08)	<ul style="list-style-type: none"> Converts from co-op to corporation Golden Vale owned 10% at one point Still in existence
	↑	R3.6m (03)	R5.5b (08)	9% (03-08)	R0.2b (87)	R0.2b (08)	0% (03-08)	<ul style="list-style-type: none"> Converts from co-op to corp in 2003; acquires Mayo 08 Has JV with Fonterra and Danone
	↓↓	€353m (05)	€280m (08)	-74% (05-08)	€8.7m (05)	-€9.1m (08)	-115% (05-08)	<ul style="list-style-type: none"> Troubled parent spins off consumer dairy (and a raft of other bus.) into REOX; ex-Kerry Exec as CEO In March 2009 sells consumer dairy operations to Kerry Group; fires CEO

PROFIT GROWTH: KERRY VS. GLANBIA

A comparison of the profit growth of Kerry and Glanbia (Avonmore/Waterford) following listing has both succeeding initially, but results diverging following a poorly executed merger

Index of growth in earning before interest and tax (EBIT) by select listed operations of dairy cooperatives
(Index; year prior to listing = 100)



LIMITED PEER GROUP

In addition, Arla [*the third largest dairy cooperative in the world after Friesland and Fonterra*] is currently developing a plan to list part of its business

Examples of dairy cooperatives that have partially floated their consumer products business
(2009)

Parent	Floated company	Country	Year floated	Ownership structure relative to cooperative parent
		Denmark & Sweden	2010?	<ul style="list-style-type: none"> - Global number three dairy cooperative after Friesland and Fonterra - Planned; details in development currently

Planned

“During the autumn the Board of Directors announced the launch of a new five-year strategy. The next step is to solve the challenge of how to finance the strategy. Arla’s Board is discussing various options, such as establishing a limited liability company for its international operations. Whatever is decided, the new corporate structure will be implemented with respect for the cooperative.”

Arla annual report 2008

CONCLUSIONS - BRING IN OUTSIDE INVESTORS

If the owners of Fonterra choose to bring in outside investors, we make the following conclusions from the experience of global peers

1. Partially listing some or all of the business did not...
 - a) ...lead to any massive wealth transfer from farmers to bankers/investors
 - b) ...lead to any immediate acquisition or takeover
 - c) ...in itself inevitably lead to either business success or failure

2. It is possible to overrate the “magic of the market”
 - a) Poorly managed businesses with bad strategies remain so after listing [e.g. Dairygold/REOX listing]
 - b) Low growth, high cost milk producing countries remain so after listing [e.g. ZMP/Emmi in Switzerland]
 - c) Listed firms are quite capable of making poor business decisions [e.g. Avonmore/Waterford merger]

3. Success and ownership structure do not appear to be directly correlated:
 - a) Of the eight identified peer group dairy cooperatives that have listed, 2 have been a strong success, 5 have been a success and 1 has been a failure
 - b) A huge number of dairy cooperatives have failed historically and been acquired (often by other cooperatives) [see appendix for details]

4. The situation facing Fonterra is not unique; other large cooperative dairy players are also working through the issues surrounding access to capital (e.g. Arla the #3 global dairy cooperative)

5. Bring in outside investors provides additional capital; whether this capital is used wisely is dependant on the quality of management and the strategy pursued [see next two sections for discussions of potential strategies that could be pursued]



DOCUMENT STRUCTURE

- I. Overview of the New Zealand dairy industry
- II. Ownership options going forward
 - A. Remain being a co-op
 - B. Bring in outside investors
 - B1. Partial float
 - B2. Full corporatisation
- III. Background: Evolution of corporate dairy models
- IV. Potential strategies going forward
 - i. Develop multi-country co-op
 - ii. Become global ingredients leader
 - iii. Float consumer products business
 - iv. Roll-up strategy in developed markets
 - v. Forward integrate into infant nutrition
- V. Appendices

CORPORATE DAIRY EVOLUTION

Before looking at strategic options for Fonterra, it is important to understand the corporate dairy model and the common evolution of this model

Evolution of corporate dairy players business model
(model)

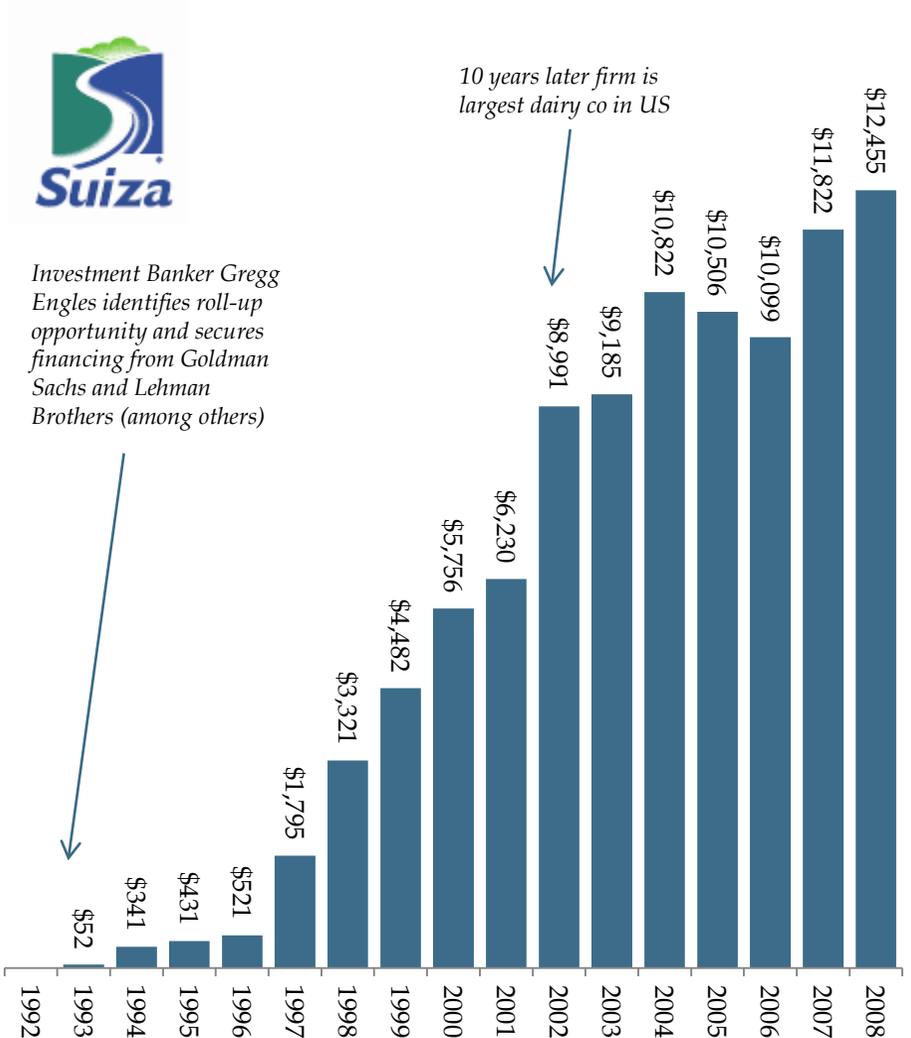
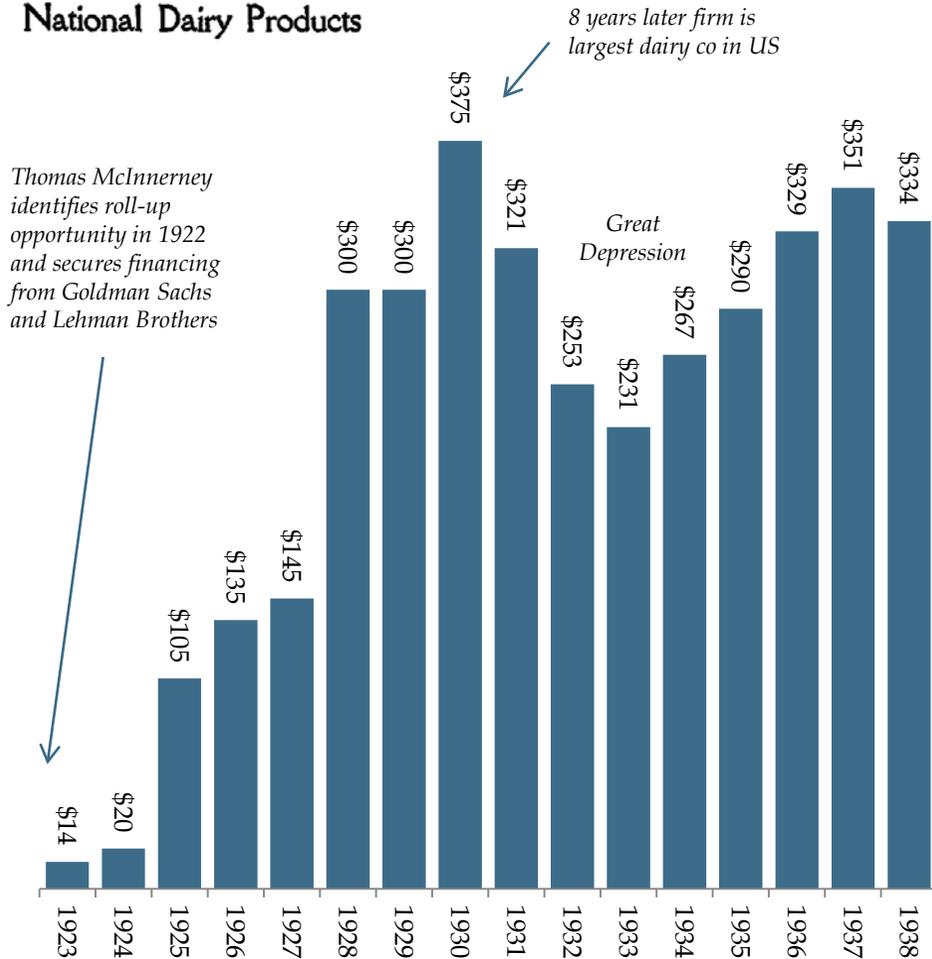
	Stage I Roll-up	Stage II Diversification	Stage III Rationalisation/Exit
Concept	<ul style="list-style-type: none"> Identify fragmented dairy market and sector Execute on roll-up driven acquisition strategy Acquire shares at non-earnings dilutive prices; acquiree buys into participating in growth story 	<ul style="list-style-type: none"> Leverage existing strengths into new categories (e.g. fluid milk refrigerated distribution into deli meats) Acquire upstream or downstream suppliers (e.g. packaging) Search for higher margins (e.g. dairy>casein>adhesives>chemicals) 	<ul style="list-style-type: none"> Decide to invest or exit segments Final terminal consolidation to remaining few category players
Key drivers	<ul style="list-style-type: none"> Technological change increasing scale Fragmented ownership Industry overcapacity 	<ul style="list-style-type: none"> Scale and scope Leveraging cash flow Portfolio management: cash cows seeking growth stars 	<ul style="list-style-type: none"> Decline in technological innovation and change in industry Capital efficiency (ROA) Threat of takeover by corporate raiders Sharemarket/analyst expectations
Required capabilities	<ul style="list-style-type: none"> Financial engineering Integration and rationalisation Deal-making to make non-dilutive acquisitions 	<ul style="list-style-type: none"> Leveragable skills or IP Acquisition/merger integration New product development 	<ul style="list-style-type: none"> Brand transition & rationalisation Rational, non-sentimental management Positioning a business for sale
Winners	<ul style="list-style-type: none"> Investment bankers Firms with superior technology/profitability 	<ul style="list-style-type: none"> Firms with cash cows and some form of leverage 	<ul style="list-style-type: none"> Those who exit low margin businesses at a high price ("the winners curse") Last man standing if category is defensive and does not commoditise
Examples	<ul style="list-style-type: none"> National Dairy (aka Kraft) 1923-1930 Bongrain (1970's-1990's) Suiza (1993-2000) Parmalat (1980's-1990's) 	<ul style="list-style-type: none"> Borden (then US #2 dairy) 1930-1970 Dart-Kraft merger (1980) Nestle 1940's to current 	<ul style="list-style-type: none"> ConAgra complete exit from dairy products (had acquired Borden) Kraft selling Chesdale to NZDB in 1995 Nestle exiting fluid milk operations in South America (to Fonterra JV) Nestle exiting yoghurt in AU to Fonterra

STAGE I - ROLL-UP

Major corporate dairy firms often begin life as acquisition-driven roll-up strategies, typically of fluid milk distribution

EXAMPLE: Executing on an acquisition-driven roll-up strategy: National Dairy (1923-1938) & Suiza (1993-2008)

National Dairy Products



NOTHING NEW UNDER THE SUN

Roll-up strategies are surprisingly similar

National Dairy (aka Kraft)

“Thomas McInerney of Chicago went to New York six years ago to interest capital in the formation of a large national dairy corporation. He found hard sledding. New York bankers were not interested. They could see no future in such an arrangement. He pleaded with them, argued with them and drew a rosy picture of the future. But to no avail.

One of the most powerful bankers in New York, a man well known nationally, refused to see Mr. McInerney upon the ground that such a business “lacked dignity.” He couldn’t connect cows with finance. Mr. McInerney finally received five minutes of this man’s time.

He went into the bankers office and put his watch on the desk, prepared to talk “cows” for just five minutes. The banker kept him talking an hour... At last he got a group of bankers* to go to the limit with him on the development of what has become National Dairy [later Kraft]”

Los Angeles Times, July 28, 1929

Result: One Chicago ice cream company to largest dairy company in United States in 8 years

Suiza (aka Dean Foods)

“Emerging from relative obscurity two years ago, Suiza Foods is putting on a growth performance that investors are finding delectable. Fed by an acquisition spree that's driving sales and earnings, Suiza's stock has turned into a highflyer since the dairy-products company went public in April 1996 at \$14 a share...

[Investment Banker] Gregg L. Engles, Suiza's 40-year-old chairman and CEO... and a partner saw opportunities in the mid-1990s to capitalize on consolidation in the highly fragmented dairy-products business, after getting a start in another fragmented sector, packaged ice.

Engles and friends* formed Suiza (Spanish for Swiss) Foods in 1995 as a holding company for three acquired food companies (Suiza-Puerto Rico, Velda Farms and Reddy Ice). Since then, Engles observes, the Dallas-based company has made about "20 significant acquisitions," along with a bucketful of smaller "tuck-in" purchases.”

Barron's Feb 1998

Result: One Puerto Rican dairy company to largest dairy company in United States in 10 years

LISTED DAIRY = FLUID MILK DISTRIBUTION

Most of the top 15 global dairy-focused listed companies are organised around fluid milk distribution which provides economies of scale and semi-protected duopoly position in many markets...

Dairy activities of top 15 global corporate dairy-focused companies
(2008)

Firm	Turnover	Ownership	Dairy activities	Details
 Dean. FOODS	US\$12.5b (2008)	Public (NYSE)	<ul style="list-style-type: none"> - Fresh milk - Other fluid dairy - Other dairy/soy 	<ul style="list-style-type: none"> - Formed in acquisition-driven roll-up strategy by investment banker Gregg Engles which took firm from single Puerto Rican dairy in 1993 to market leadership in the US in less than a decade
 meiji	US\$7.9b (2007)	Public (Tokyo)	<ul style="list-style-type: none"> - Fluid milk (60% of sales) - Yoghurt (15%) - Other dairy 	<ul style="list-style-type: none"> - Formed in 1917 to launch condensed milk into Japan - Numerous acquisitions to create leading Japanese fluid milk company
 parmalat	€9.3b (2008)	Public (BIT)	<ul style="list-style-type: none"> - UHT & fresh milk - Other dairy products - Other food 	<ul style="list-style-type: none"> - Formed in 1961 in Parma, Italy to produce UHT milk in Tetra-Pak - Launched UHT milk into Brazil and other developing countries - Went on acquisition binge ending in €14b bankruptcy in 2003
 morinaga	US\$4.1b	Public (Tokyo)	<ul style="list-style-type: none"> - Fluid milk - Other dairy products 	<ul style="list-style-type: none"> - Formed in 1899 to introduce candy to Japan; dairy operations formed in 1917 - Dairy operations spun-off in 1949; parent still owns share
 BONGRAIN	€3.6b (2008)	Public (Euronext)	<ul style="list-style-type: none"> - Cheese (66% of sales) - Other dairy products 	<ul style="list-style-type: none"> - Formed in 1920 as cheesemaker by Jean Bongrain; small until 1956 when son takes over and develops Caprice des Dieux (soft moulded oval cheese) - Expansion through organic growth and acquisition - Listed in 1980 but remains controlled by Bongrain family
 Saputo	C\$5.1b (2008)	Public (Toronto)	<ul style="list-style-type: none"> - Fluid milk - Cheese - Other dairy products 	<ul style="list-style-type: none"> - Formed in 1954 by Italian immigrant to make mozzarella cheese in Canada - Mixture of organic growth and acquisitions - Acquired Dairyworld from Agrifoods in 2001, taking firm into fluid milk
 MENGNIU	US\$3.5b (2008)	Public (CN/HK)	<ul style="list-style-type: none"> - Fluid milk - Yoghurt - Other dairy products 	<ul style="list-style-type: none"> - Formed in 1999 as Inner Mongolia Mengniu Dairy; listed in HK exchange 04 - Formed JV with Arla 2006 - 20 production sites; 1.5m t production capacity
 Yakult	US\$3.2b (2008)		<ul style="list-style-type: none"> - Yoghurt drinks (worldwide) - Milk and other dairy (Japan) 	<ul style="list-style-type: none"> - Formed in 1935 to market Lactobacillus containing yoghurt drink - Offers wide range of dairy products in Japan; global ops Yakult focused - Expands throughout Asia and world; diversifies into pharmaceuticals

LISTED DAIRY = FLUID MILK DISTRIBUTION

... continued

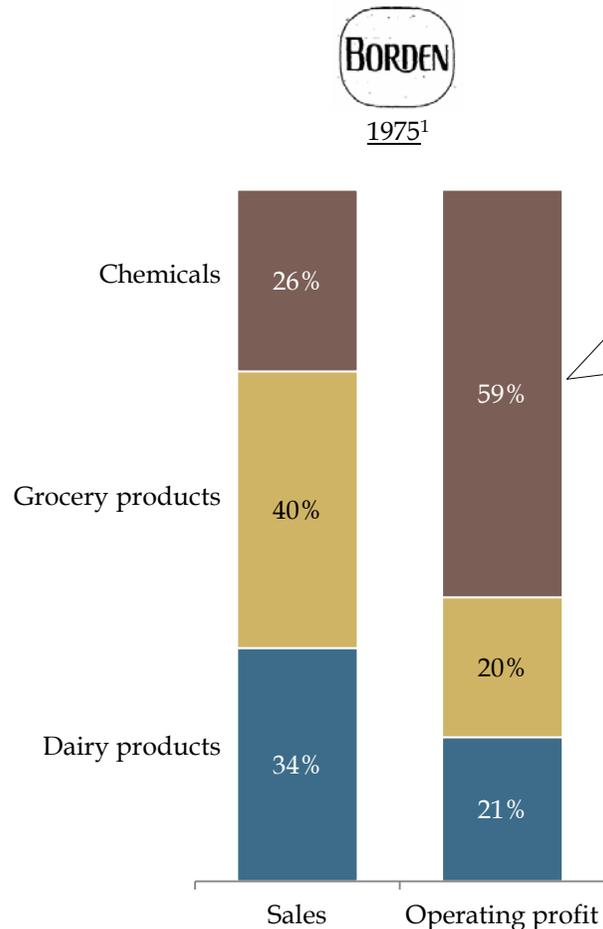
Dairy activities of top 15 global corporate dairy-focused companies
(2008)

Firm	Turnover	Ownership	Dairy activities	Details
	US\$3.2b (2008)	Public (Shanghai)	<ul style="list-style-type: none"> - Fluid milk - Yoghurt - Other dairy products 	<ul style="list-style-type: none"> - Formed in 1993 in privatisation of Municipal dairy factory - IPO of Inner Mongolia Yili Dairy in 1996
	€2.2b (2008)	Public (Euronext)	<ul style="list-style-type: none"> - Cheese - Other dairy products 	<ul style="list-style-type: none"> - Formed in 1865 by Leon Bel; registers laughing cow brand in 1921 - Expands through acquisition and organic growth; 60% owned by Bel family
	£1.6b (2008)	Public (LSE)	<ul style="list-style-type: none"> - Fluid milk (65% of sales) - Yoghurt (Yoplait JV) - Spreads - Other dairy products 	<ul style="list-style-type: none"> - British Government establishes Milk Marketing Board in 1933 - Dairy Crest created in 1981 as processing arm of board - Dairy Crest privatised in 96; listed on LSE - 28,000 dairy farmers offered shares or cash as part of sale; 90%+ took shares
	Group US\$76b Dairy \$2.5b (08)	Public (NYSE)	<ul style="list-style-type: none"> - Fluid milk - Ice cream - Other dairy products 	<ul style="list-style-type: none"> - Firm is supermarket retailer with own dairy operations - Started in 1883 as a grocery store opened by Barney Kroger - Historically backwards integrated into food manufacturing, incl. dairy - Kroger currently operates 15 dairies and 3 ice cream plants - Product sold under own private label brands and to other retailers
	£848m (2008)	Public (LSE)	<ul style="list-style-type: none"> - Fluid milk - Other dairy products 	<ul style="list-style-type: none"> - Founded in 1947 as milk delivery service in Scotland - Acquisition-driven roll-up strategy of fluid milk operations across UK
	US\$1.1b (2008)	Public (Shanghai)	<ul style="list-style-type: none"> - Fresh & UHT milk - Yoghurt - Other dairy products 	<ul style="list-style-type: none"> - Processed 500,000t; owns 52,000 hectares - Danone sold its 20% shareholding in 2008 (acquired in 2000) - Controlled by Bright Food Group (31%); itself partially state-controlled
	US\$1.0b (2008)	Public (NYSE)	<ul style="list-style-type: none"> - Fluid milk - Ice cream - Other dairy products 	<ul style="list-style-type: none"> - Firm is supermarket retailer with own dairy operations - Formed by Merrill Lynch in 1920's roll-up of West Coast supermarkets - Historically backwards integrated into food manufacturing, incl. dairy - Safeway currently operates 8 dairies and 4 ice cream plants - Product sold under own private label brands and to other retailers

STAGE II - INTEGRATION/DIVERSIFICATION

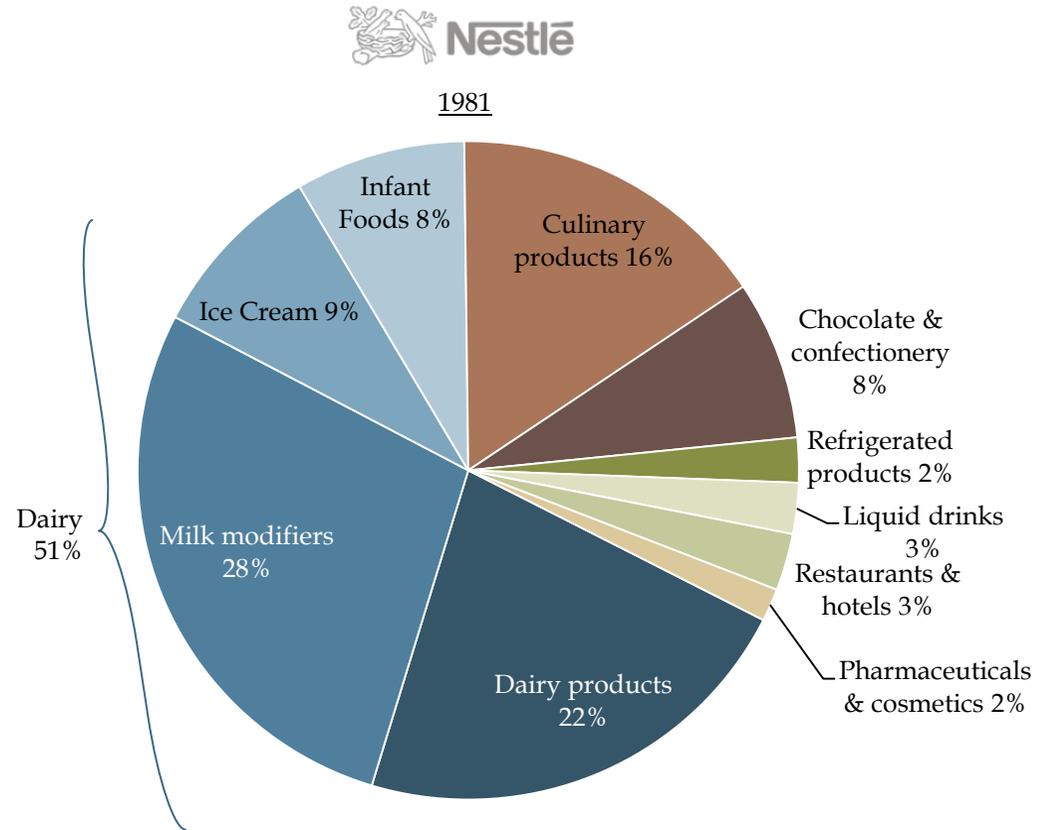
As they grow, corporate dairy firms then diversify into new areas in a search of ongoing sales and profit growth, as illustrated by the two firms that initially developed the global condensed milk market

EXAMPLE: Product diversification by two firms that began life producing condensed milk
(%; 1975/1981)



Entered chemicals via 1929 acquisition of Casein Company of America; expanded and diversified from there into adhesives, chemicals, etc.

Firm has origin in Gail Borden's 1856 invention of condensed milk

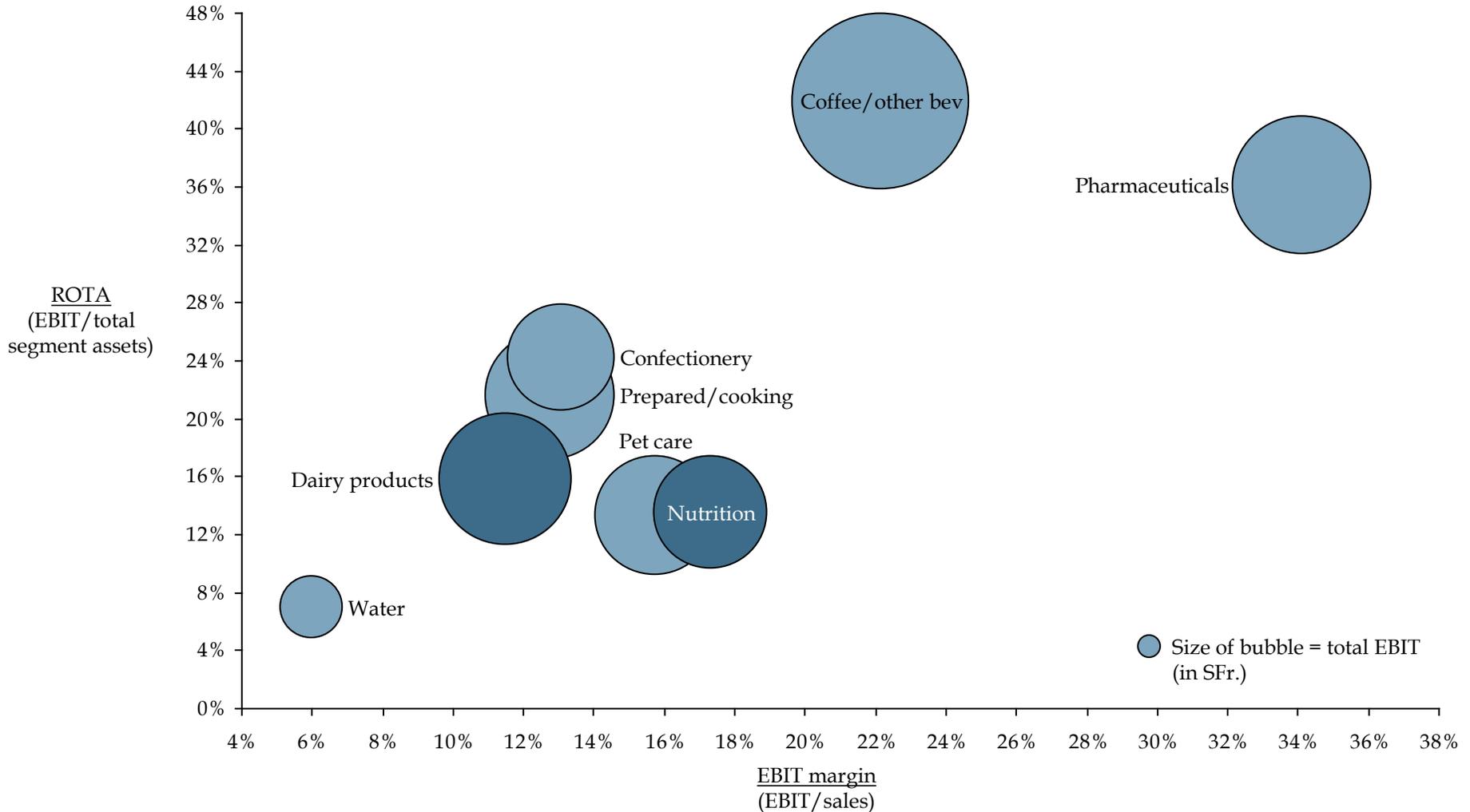


Firm has origin in 1866 licensing of European rights to Gail Borden's condensed milk invention by Anglo-Swiss Milk Company

DAIRY PART OF PORTFOLIO

As diversification progresses, dairy becomes just one part of the total business portfolio, often one of the least attractive parts

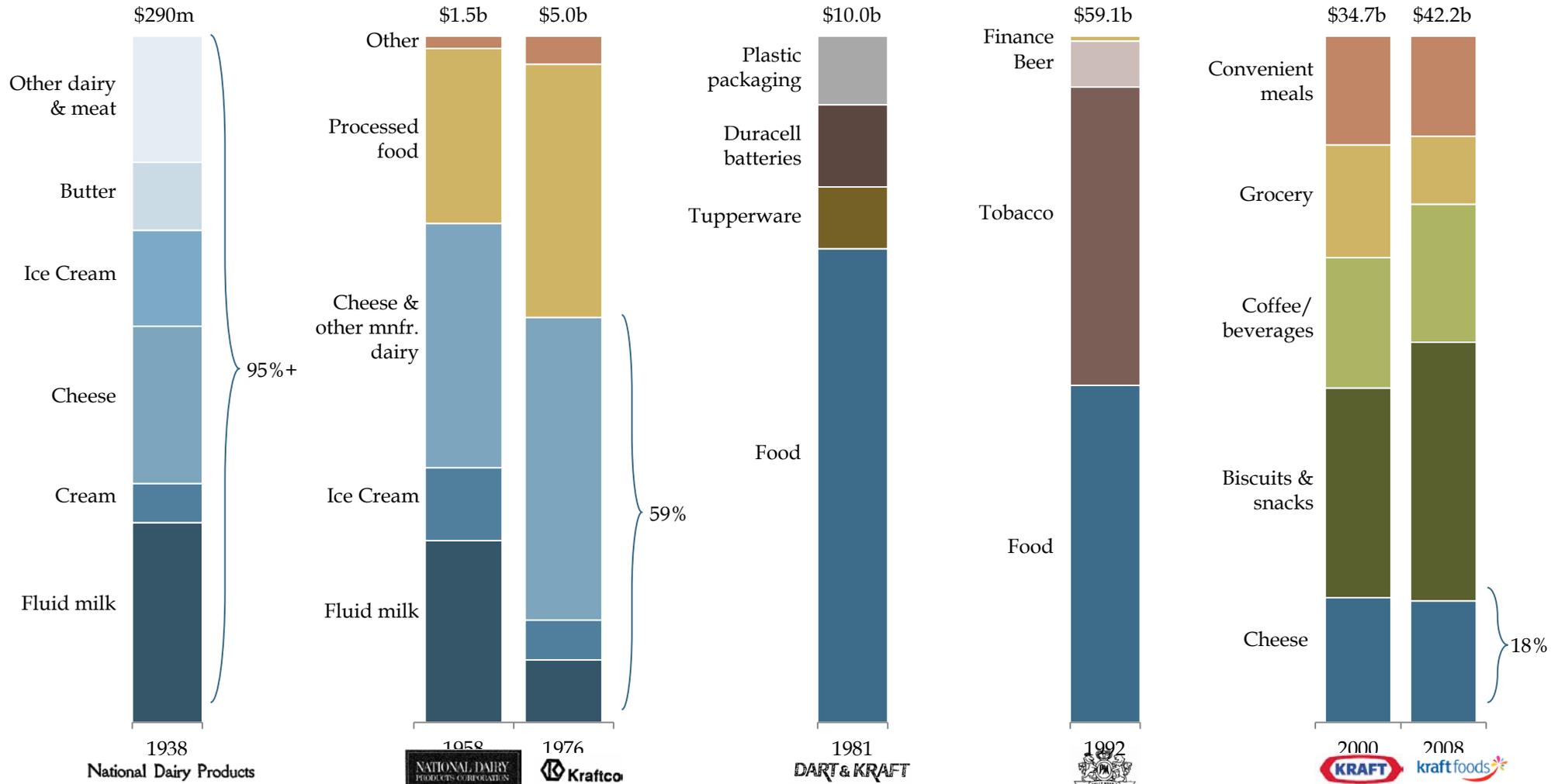
Nestle business matrix: comparison of profitability results by product group
(2008)



STAGE III - RATIONALISATION

In the long-term, diversification leads corporate players to rationalise and exit from high capital/low margin dairy activities, as the history of Kraft illustrates

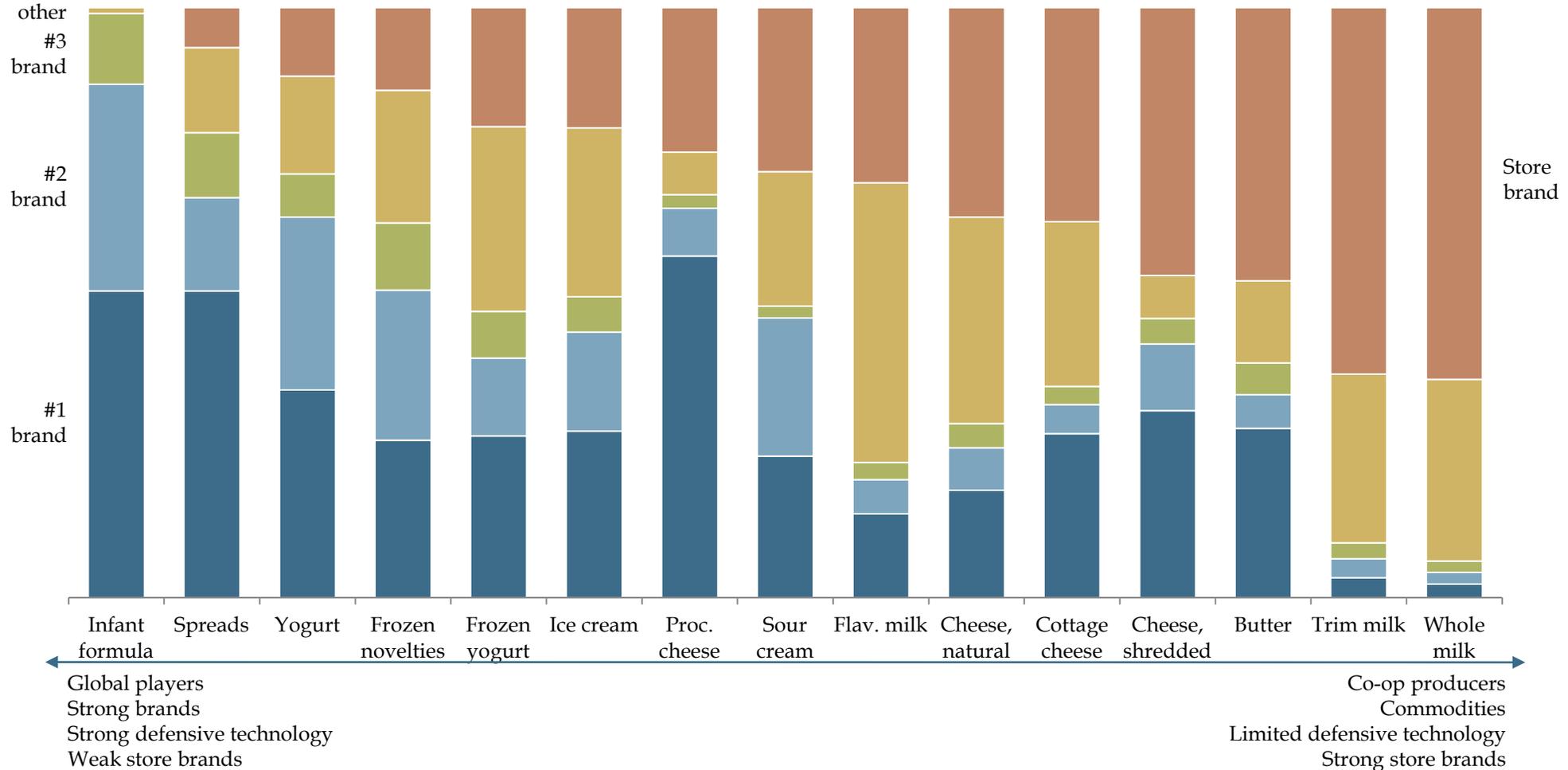
EXAMPLE: 70 year evolution of the type and role of dairy products in Kraft parent entity business portfolio
 (% of sales; US\$ non-inflation adjusted; 1938-2008)



CORPORATES STRONG IN DEFENSIBLE CATEGORIES

The remaining dairy activities of conglomerates are in defensive/differentiated categories; leaving cooperatives (and private firms) with commoditised store brand categories (and dairy ingredients)

EXAMPLE: Level of category consolidation by leading players and store brands in the US market
(% of sales; 2007)



LARGE MULTINATIONAL = FOCUS

Multinational conglomerates with dairy activities focus on narrow defensible segments with high margins; many have divested historically wider ranging dairy activities

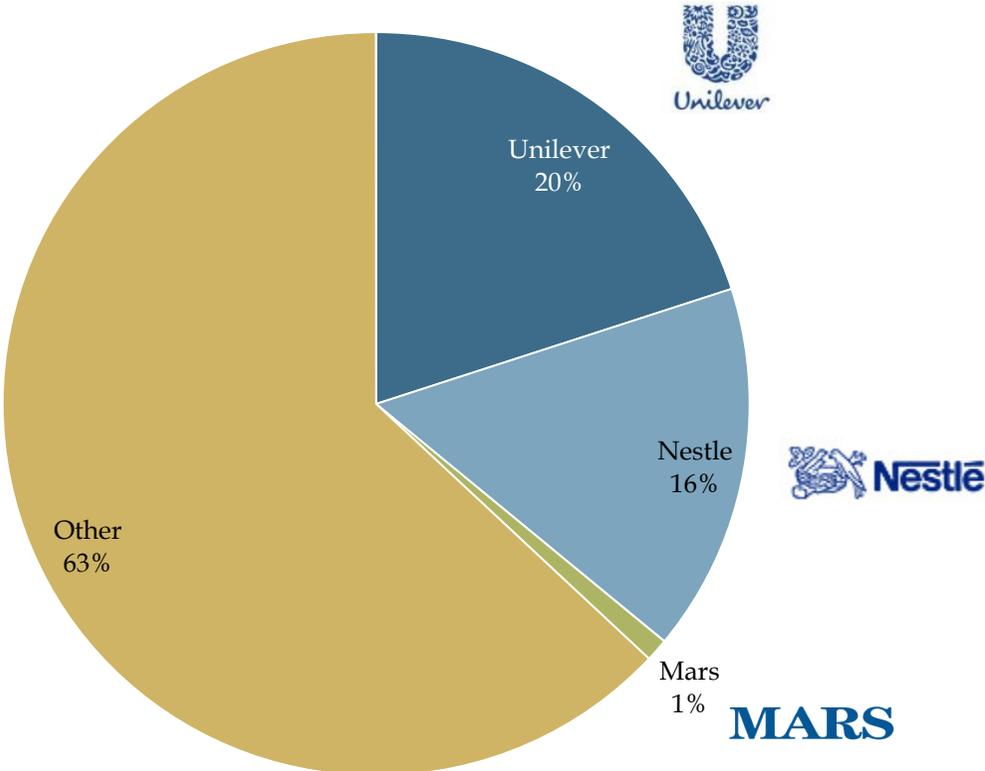
Dairy activities of major corporate dairy companies (2008)

Firm	Group turnover	Dairy turnover	Dairy % total	Dairy activities	Details
 Nestlé	SF109.9 €73b (2008)	SF30.9b €20.4b	28%	<ul style="list-style-type: none"> - Infant formula - Condensed milk - Milk modifiers (e.g. Milo) - Ice cream 	<ul style="list-style-type: none"> - Formed in 1905 Anglo-Swiss Milk and Farine Lactée Henri Nestlé merger - Anglo-Swiss founded in 1867 by 2 Americans using Gail Borden's technology (developed in 1856); Nestlé developed a milk-based baby food - Firm has exited fluid milk and most dairy products
 DANONE	€15.2b (2008)	€12.3b	80%	<ul style="list-style-type: none"> - Yoghurt (€8.7b) - Infant formula (€3.6b) 	<ul style="list-style-type: none"> - Founded in 1919 to produce yoghurt in Spain; expanded to France - Developed yoghurt with fruit on the bottom - Sold US operations in 1959; acquired back in 1981 (from Beatrice) - Acquired Royal Numico in 2007 for €12.3b
 kraft foods	US\$42.2b (2008)	US\$7.5b (2008)	18%	<ul style="list-style-type: none"> - Cheese, natural - Cheese, processed 	<ul style="list-style-type: none"> - Invented shelf-stable processed cheese; took product global in 1920's - Executed on acquisition-driven roll-up strategy of US dairy industry in 1920-30s; diversified into other foods - Firm has exited fluid milk and most dairy products due to low margins
 Unilever	€40.5b (2008)	€4.5b	11%	<ul style="list-style-type: none"> - Ice cream 	<ul style="list-style-type: none"> - Formed in 1872 to commercialise invention of margarine - Acquired U.S. ice cream maker Good Humor in 1961 - Acquisitions and organic growth to take global #2 position in ice cream
 Abbott	US\$29.5b (2008)	US\$4.9b	17%	<ul style="list-style-type: none"> - Infant formula 	<ul style="list-style-type: none"> - Formed in 1888 as pharmaceutical company; develops and markets a wide range of drugs and medicines (e.g. Humira) - Recently acquired nutritional supplements maker EAS
 Bristol-Myers Squibb Company	US\$20.0b (2008)	US\$2.9b	14%	<ul style="list-style-type: none"> - Infant formula 	<ul style="list-style-type: none"> - Founded in 1887 and pharmaceutical manufacturer; develops and markets a wide range of drugs and medicines (e.g.) - In 1967 acquired Mead Johnson, an early developer of infant formula (1912) - Partially listed in Feb 2009 with BMS holding 83.1% stock (97.5% of voting)
 Pfizer  Wyeth	US\$71.1b (2008)	US\$1.6b	2%	<ul style="list-style-type: none"> - Infant formula 	<ul style="list-style-type: none"> - Formed in 1849 to manufacturer drugs and chemicals - Recently acquired Wyeth for \$68b, which had infant formula business that it had acquired historically

GLOBAL LEVERAGE

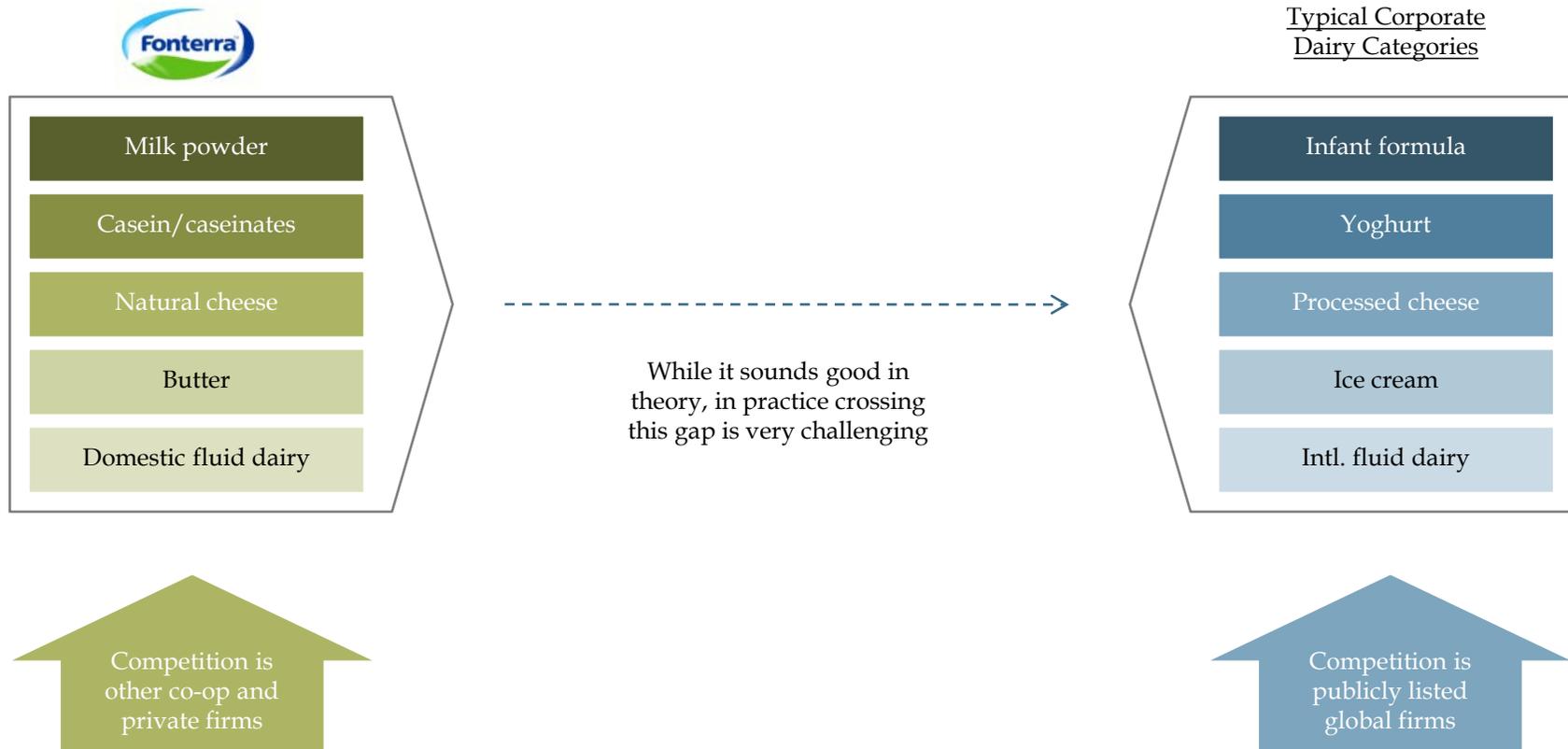
Dairy activities of multinational conglomerates tend to have global leadership due to their ability to leverage their defensive capabilities and IP

EXAMPLE: Global market share in Ice Cream
(% of global sales by company; 2004)



MISALIGNED PORTFOLIO

The current Fonterra product portfolio is misaligned with the high margin needs of a listed company





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FIVE STRATEGIES

We propose, for discussion, five potential strategies for Fonterra

	Outcome	Global business models					
i. Develop multi-country cooperative							
ii. Become global ingredients leader							
iii. Float consumer products business							
iv. Roll-up strategy in developing markets							
v. Forward integrate into infant nutrition							

OWNERSHIP DEPENDS ON STRATEGY

Ultimately, the strategy pursued will suggest or determine the logical ownership structure for Fonterra (alternatively, if ownership structure is fixed, strategic options are limited)

		Potential ownership structures		
		A. Remain being a cooperative	B. Bring in outside investors	
			B1. Partial Listing	B2. Full corporatisation
Potential strategies	i. Develop multi-country cooperative model	●	-	-
	ii. Become global ingredients leader	◐	◐	●
	iii. Float consumer products business	-	●	-
	iv. Roll-up strategy in developed markets	◑	◐	●
	v. Forward integrate into infant nutrition	◑	◐	●

- Strong match; in line with global models/peers
- ◐ Partial match; limitations on ultimate growth
- No or poor match



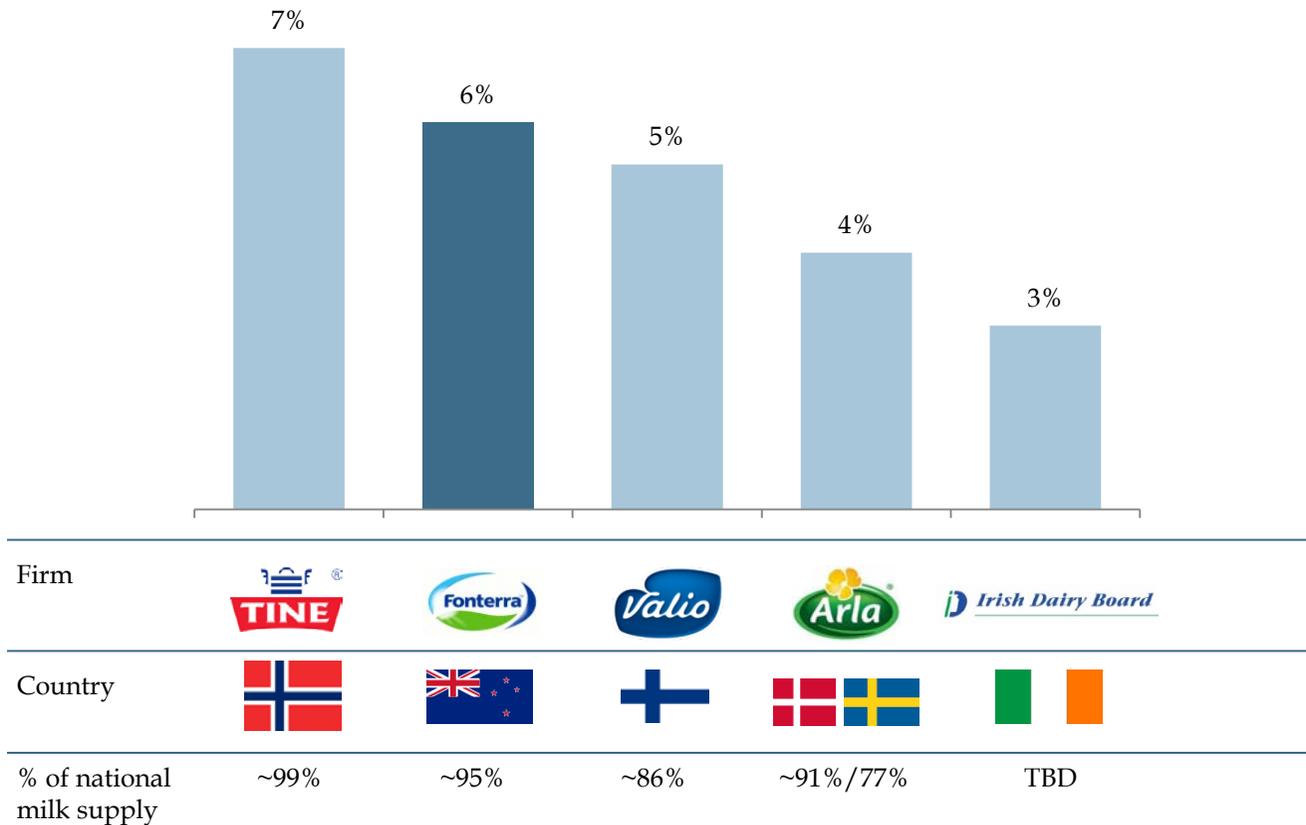
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SALES GROWTH DIFFICULT

Peers suggest being a single country dairy cooperative is a relatively low growth model

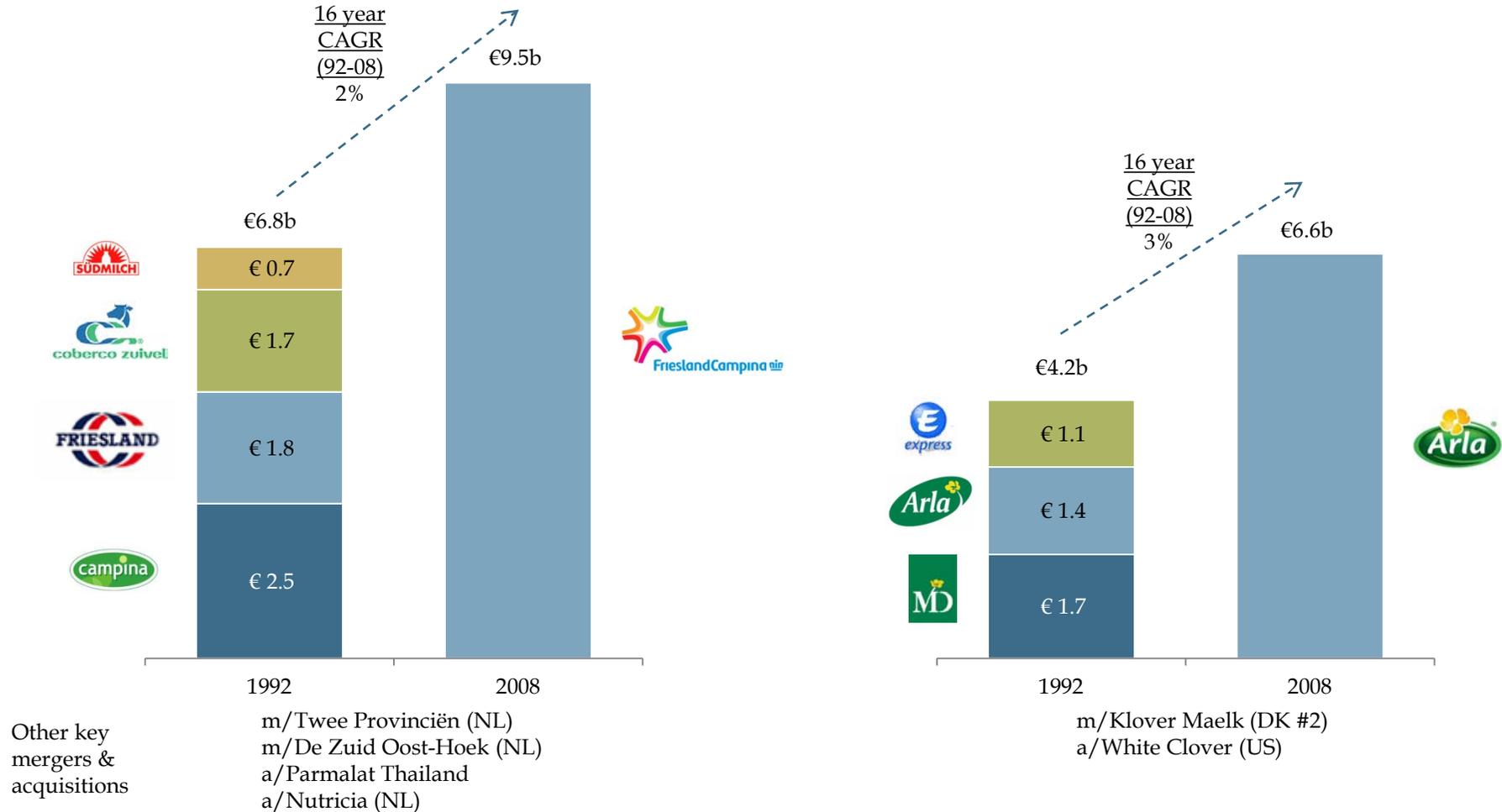
Five year compound annual growth rate of sales: Fonterra vs. select country national champion dairy cooperatives
 (% CAGR; local currency; non-inflation adjusted; 2003-2008)



GROWTH THROUGH MERGER

Where dairy cooperatives appear to be achieving sales growth, this is primarily through mergers and, to a lesser extent, acquisitions

EXAMPLE: Sixteen year absolute sales growth of two largest dairy cooperatives in Europe; FrieslandCampina and Arla
(€; b; non-inflation adjusted; 1992-2008)



MULTI-COUNTRY MODEL

Fonterra is the second largest co-op in the world; the experience of the largest (Friesland) and the third largest (Arla) suggest future growth could include a multi-country membership element

Top 3 global dairy cooperatives: details of multi-country ownership models
(2009)

Dairy cooperative	Global turnover	# of shareholders	Countries with shareholder members	Comments/notes
	€9.5b (2008)	16,000	Netherlands Germany Belgium	<ul style="list-style-type: none"> - Formed in 2008 with merger of Friesland and Campina - Friesland formed in 1997 in mega-merger of 4 Dutch co-op; further mergers follow - Campina formed in 1989 merger of Melkunie & DMV Campina; acquired Sudmilch Germany in 93; in 2001, Campina merged with the Milchwerke Köln/Wuppertal cooperative from Cologne, Germany and the De Verbroedering cooperative from the Antwerp region of Belgium - Parent company (Zuivelcoöperatie FrieslandCampina U.A.) has full member in three countries (all Euro zone) - Milk price paid to farmer contains two elements: <ul style="list-style-type: none"> - A base price which varies by each country - A premium based on group performance
	€7.8b (NZ\$16b)	11,000	New Zealand	<ul style="list-style-type: none"> - Formed in 2001 New Zealand mega-merger - Sources milk in Australia and other countries but currently only NZ shareholders
	€6.6b (2008)	7,996	Denmark (3,906) Sweden (4,090)	<ul style="list-style-type: none"> - Formed in 2000 merger of MD Foods (#1 Denmark) and Arla (#1 Sweden); both were result of in-country mega-mergers; a number of smaller co-op have joined since - Uses common milk pricing formula across both countries even though Denmark remains outside the Euro (3 years to organise) - Sources milk from farmers in the UK through Arla Foods Milk Partnership (JV with farmers); recently restructured this to “provide greater transparency” to UK farmers and ensure supply as supply was falling (farmers were going to UK co-ops) - Planning to expand “collaboration” with supplying Finnish milk producers (likely along UK lines) - Perennial rumour of Valio (Finland #1) joining - Explored and rejected merger with Campina prior to it joining Friesland

MERGE WITH MURRAY GOULBURN

The logical initial multi-country cooperative partner for Fonterra is Murray Goulburn, a marriage which would give Fonterra an even stronger position in the global dairy trade

Comparison of key business metrics: Fonterra vs. Murray Goulburn

(various; 2008)

			
# of supplier/shareholders	10,724 (2008)	2,500 (2008)	~13,225
Milk intake	13.86b litres (2008) (95%+ of NZ)	3.25b litres (2008) (36% of Australia)	~17.1b litres
Turnover	NZ\$16,035m (2009) #2 largest global dairy co-op	A\$2,635m (2008) (NZ\$3,186m) #14 largest global dairy co-op	~NZ\$19.2b (~€9.4b) #2 largest global dairy cooperative
Total assets	NZ\$14,117m (2009)	A\$1,790m (2008) (NZ\$2,163m)	~NZ\$18.2b
Major products (volume)	Milk powder (~659,000t)* Cheese (~302,000t)* Butter (~356,000t)* Casein/other ingredients	Milk powder (250,000t) Cheese (120,000 t) UHT Products (170,000t) Butter (77,000t)	Milk powder (~910,000t) = ~28% world trade Cheese (~420,000t) = ~10% world trade Butter (~430,000t) = ~28% world trade
# of countries	Over 140	Over 100	Over 140
Employees	15,900	2,300	18,200
Comments	- "More than a third of international dairy trade"	- "Accounts for 8% of world dairy trade" - 9 manufacturing sites	- Clearly the world's largest dairy exporter

*Shown is total New Zealand (effectively ~95%+ Fonterra)

PROPOSED STRATEGIC VISION

If Fonterra's owners choose to become a multi-country co-op, we propose the following strategic vision for discussion

Vision: Become the dominant force in commodity milk production in the Southern Hemisphere, and as a result, the clear leader in the global dairy trade through the development of a multi-country cooperative model

Merge with Murray Goulburn

- Develop multi-country cooperative model like Friesland and Arla
- Merge with Murray Goulburn to create entity with ~40% world dairy trade

Increase efficiency & leverage scale

- Consolidate sales and marketing functions
- Share best-of-breed processes and systems across businesses

Increase control of S. Hemisphere milk

- Explore potential for members from other low cost S.H. dairy producing countries
 - Argentina
 - Brazil
 - Chile
 - Uruguay
- Clear need for more complex wet/dry share model (*see Friesland Campina for model*)
- Alternatively create partially owned local JV with farmers (*see Arla's UK operations for model*)
- Merge with SanCor of Argentina?

Increase returns to farmers

- Manage world dairy trade (e.g. OPEC of dairy)
- Invest in technology to reduce costs on farm and in processing

SWOT ANALYSIS – REMAIN COOPERATIVE

Developing a multi-country cooperative model is a safe, low risk option (at least in the short-medium term), with a strong potential to increase market power

SWOT analysis for option 1: develop multi-country cooperative
(2009)

Strengths	Weaknesses
<ul style="list-style-type: none"> - Maintain total farmer control - Conservative, low risk strategy - Completely in-line with effectively all global peer group countries - Maintain focus on selling New Zealand dairy commodities to the world 	<ul style="list-style-type: none"> - Limited growth going forward (95% of NZ milk supply) <ul style="list-style-type: none"> - Only grow as fast as New Zealand production - Some ability to grow through minor international acquisitions through retained earnings - Co-ops are typically commodity producers who focus on milk disposal rather than value-added - Returns will remain low (relative to corporate dairy) and highly variable year-to-year
Opportunities	Threats
<ul style="list-style-type: none"> - Imitate multi-country co-op model of select European peers <ul style="list-style-type: none"> - Merge with Murray Goulburn - Merge with co-op in other countries - Form new co-op in emerging markets - Trade liberalisation improving access to high value markets increasing realised commodity prices 	<ul style="list-style-type: none"> - Dairy prices decline over medium/long term driven by growing production in low production cost emerging markets <ul style="list-style-type: none"> - Chinese milk production volume growing at 19% per year (97-07) - Can your children support themselves selling milk powder cheaper than Brazil, India, China, Russia, Ukraine and Poland? - Genetic modification improving competitiveness of feedlot dairy (vs. pasture systems) - Government breakup of Fonterra due to failure to deliver on “national champion” role (e.g. see British Government breakup of Milk Marque into three smaller co-op in 2000)



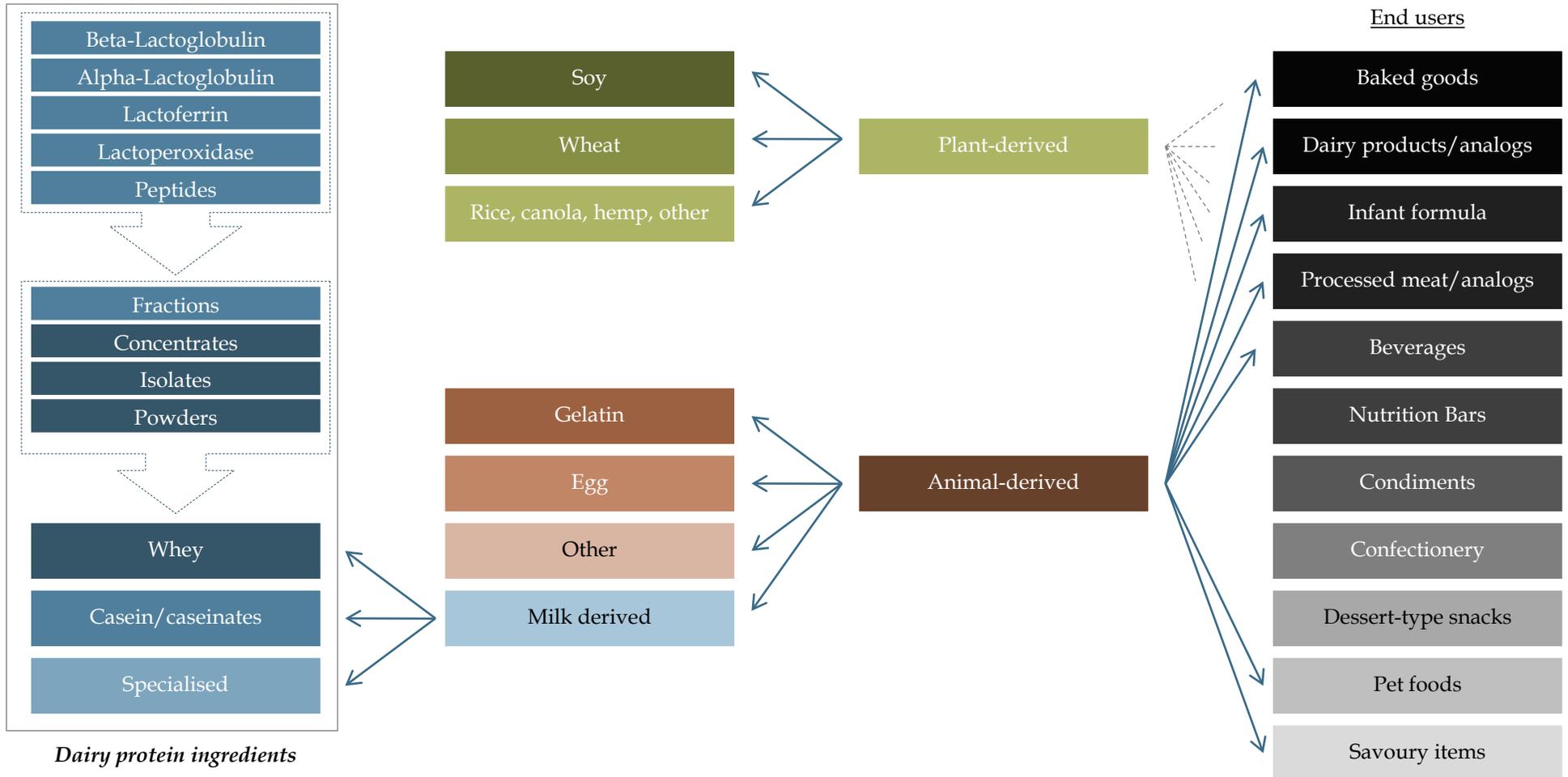
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PROTEIN INGREDIENTS

Fonterra could drive and expand its current dairy ingredients strategy

Simplified model of the global protein ingredients market
(model; 2009)



DAIRY INGREDIENTS

Dairy ingredients is a challenging sector, dominated by large dairy cooperatives and private firms; the strong co-op presence will limit sector profitability; however, there are obvious acquisition targets

Key players in global dairy ingredients
(various currencies; 2008)

Examples - not
complete list

Company	Ownership	Turnover
Agri-Mark	Dairy cooperative	US\$0.8b
American Casein Co.	Private	N/A
Arla Foods Amba	Dairy cooperative	€6.6b
Associated Milk Producers	Dairy cooperative	US\$1.7b
California Dairies	Dairy cooperative	US\$2.0b
Carberry	Dairy cooperative	€ 0.2b
Century Foods Intl.	Public (Hormel div (NYSE: HRL))	US\$6.8b
Chr. Hansen	Private equity (PAI France)	€ 0.5b
Dairy Farmers Of America	Dairy cooperative	US\$11.7b*
Dairygold	Dairy cooperative	US\$2.2b
Davisco Foods Intl.	Private	US\$1.0b
DMV International	Dairy cooperative (Friesland div)	€ 9.1b
Erie Foods International	Private	N/A
First District Assn.	Dairy cooperative	US\$0.5b
Fonterra	Dairy cooperative	NZ\$16b
Foremost Farms	Dairy cooperative	US\$1.6b
Glanbia	Dairy cooperative	€ 2.2b

Company	Ownership	Turnover
Gossner Foods	Private	US\$0.3b
Grande Custom Ingredients	Private	N/A
Hilmar Cheese	Dairy cooperative	US\$1.2b
Kerry Group	Dairy cooperative	€ 4.8b
Kraft Foods	Public (NYSE: KFT)	US\$42b
Leprino Foods Co.	Private	US\$2.5b
Milei	Private	€0.1b
Morinaga Milk	Public (Japan)	US\$4.1b
Murray Goulburn	Dairy cooperative	A\$2.6b
Nordmilch	Dairy cooperative	€ 2.5b
Tillamook Cheese	Dairy cooperative	US\$0.4b

FOOD INGREDIENTS

Moving out into the wider food ingredients is similarly challenging, with some of the largest firms in the world involved (*e.g. Cargill US\$117b*)

Key players in global ingredients
(various currencies; 2008)

Examples - not
complete list

Company	Ownership	Focus	Turnover
ADM	Public (NYSE: ADM)	Agribusiness	US\$69.2b
Ajinomoto	Public (Japan)	Ingredients	US\$12.2b
Asahi Kasei	Public (Japan)	Chem/Pharma	US\$17.3b
BASF	Public (Germany)	Chemicals	US\$87.8b
Bunge, Ltd.	Public (NYSE: BE)	Oilseeds/grains	US\$52.6b
Cargill, Inc.	Private	Agribusiness	US\$117b
Danisco	Public (OMX)	Ing/enzymes	DKK13b
DSM	Public		€ 9.1b
Firmenich	Private	Flavours	CHF2.6b
Gelita Ag	Private	25% world gelatine	US\$583m
Givaudan	Public (Swiss)	Flavours	CHF4.1b
IFF	Public (NYSE)	Flavours	US\$2.4b
J.M. Huber/CP Kelco	Private	Chemicals	US\$2b
Kyowa Hakko Kirin	Public (Japan)	Pharmaceuticals	US\$3.0b
Lonza	Public (Swiss)	Ingredients	CHF2.9b

Company	Ownership	Focus	Turnover
Manildra Group	Private	Grain-based	US\$0.4b
Meelunie B.V.	co-op (Avebe)	Starch/other	€ 717m
Michael Foods, Inc.	Private equity	Eggs (#1 global)	US\$1.5b
Nitta Gelatin	Public (Japan)	Gelatin/other	US\$0.4b
Novozymes	Public	Enzymes	DKK8.5b
Protient Corp.	Public (div ABF)	Various	£8.2b
Remy Industries	Co-op (Sudzucker)	Sugar/rice	€ 5.9b
Roquette Freres	Private	Sugar/starch	€ 2.5b
Rousselot	Co-op (VION)	Gelatin	€ 10b
Royal DSM N.V.	Public (Euronext)	Functional	€ 9.0b
The Solae Co.	Dupont/Bunge JV	Soy	US\$0.2b
Symrise	Public (Germany)	Flavours	US\$1.9b
Takasago	Public (Japan)	Ingredients	US\$1.4b
Tate & Lyle, Plc	Public (London)	Sugar	US\$5.3b
Tessenderlo Chemie	Public (Euronext)	Chemicals	€ 2.5b

PROPOSED STRATEGIC VISION - INGREDIENTS

If Fonterra's owners choose to drive and expand its ingredients business, we propose the following strategic vision for discussion

Vision: Become the leading global supplier of specialised dairy and related ingredients across North America and Europe

Create Fonterra Ingredients

- Put ingredients-related activities into business
- List on ASX/NZX
- Initially maintain 80% parent co-op ownership
- Keep proceeds of float for acquisitions (rather than use it to pay off debt)

Strengthen existing dairy ingredients platform

- Identify and acquire key holders of dairy ingredient-related technology and IP
 - e.g. Davisco Foods; Chr. Hansen
- Consider merging entity with Kerry Ingredients division (but not Irish consumer products); keep Kerry management in place

Organic expansion in high growth markets

- Ground up construction of ingredients plants in low cost locations inside large markets
 - Mexico in NAFTA
 - Poland in EU
- Build clear leadership position in dairy ingredients in Europe and USA

Extend into related ingredients adjacencies

- Leverage scale and scope provided by dairy leadership
- Buy companies who sell similar products to the same customers
 - e.g. flavourings, seasonings, coatings
- Offer customers integrated one-stop-shop ingredients range
- Ongoing heavy R&D investment to strengthen position

SWOT ANALYSIS - GLOBAL INGREDIENTS

Following the path of Kerry into a wider range of ingredients is a relatively clear strategy, but not without its challenges

SWOT analysis for becoming global leader in ingredients
(2009)

Strengths	Weaknesses
<ul style="list-style-type: none"> - Fonterra already a global leader in dairy ingredients - Strong existing R&D/development capabilities in dairy ingredients both inside Fonterra and in New Zealand research/universities - Leverages existing customer relationships 	<ul style="list-style-type: none"> - Limited pool of suitable acquisitions; best opportunities already taken by Kerry? - Primary competition is either other dairy cooperatives (likely soft sellers) or major agribusiness conglomerates (e.g. ADM) - Unclear leverage or capabilities/competencies beyond dairy (e.g. oilseed extraction) - Limited pool of high quality targets; many of the best are privately owned and may not sell - Strategy required deal making capabilities and access to significant capital (cf. Past Fonterra attempts to acquire Chr. Hansen)
Opportunities	Threats
<ul style="list-style-type: none"> - Aging baby boomers looking to repair years of excess through ongoing new product fads (e.g. Goji berries) - Growing processed food consumption globally leading to increased demand by manufacturers for new and novel functional ingredients 	<ul style="list-style-type: none"> - Other competitors who have been acquiring and integrating acquisitions in the sector longer doing it better - Rapidly changing technology and GMO-type innovations disrupting sector - Scientific research creating irrational food fears impacting dairy/ingredient sales



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KEY AUSTRALASIAN BRANDS

Fonterra has a range of consumer dairy brands across Australasia

Fonterra brand portfolio: key brands by product category by region
(2009)

	Fluid milk	Yoghurt	Cheese	Butter	Ice Cream
New Zealand	    	   	      		 <p><i>Perennial sale rumour</i></p> 
Australia	      	 	    	  	 <p>Sold to Nestle & Bulla 6/09</p>

KEY PLAYERS IN AUSTRALASIA

Fonterra is the largest dairy company in Australasia; opportunities for further growth through acquisition appear marginal and will likely face ACCC/NZCC challenge...

Australasian dairy industry – key players

(various; as available 06-09)

Company	Turnover	Ownership	Home Country	Dairy products	Key Dairy Brands	Comments
 Fonterra	NZ\$16,035m (2009)	Co-op (11,000 members)	New Zealand	Milk powder Butter Cheese	Anchor Anlene Mainland	Purchased Bonlac in stages Marketing for Bega
 Murray Goulburn Co-operative Co. Limited	A\$2,027m	Co-op (2,900 members)	Australia	Milk Powder Fluid Milk Cheese Butter	Devondale	Handles 36% of AU milk; exports 395,000MT to over 100 countries; 9 plants
 NATIONAL FOODS	A\$1,837m (2006)	Subsidiary of Kirin (Public: Tokyo)	Australia (Philippines)	Fluid Milk Yogurt Cheese Other	Pura (#1 milk) Yoplait (license) King Island Dairy Farmers Union Dairy Farmers Coon	Fonterra lost A\$1.9b bidding war for National Foods to San Miguel in 2005; acquired by Kirin 2007 Acquired Dairy Farmers in 2008 for A\$910m
 Nestlé	A\$2,342m (total business; 2006)	Subsidiary (Public: Euronext)	Switzerland	Infant formula Ice cream <i>Other non dairy</i>	Nestle Milo Nescafe	Dairy products only form part of turnover given here Licenses yoghurt to Fonterra Bought ice cream from Font.
 parmalat	A\$731m (2006)	Subsidiary (Public: Milan)	Italy	Fluid Milk Yogurt	Paul's Breaka	Italian parent struggled in 2003 in financial scandal; business was rumoured for sales at that time
 Bega TATURA	A\$570m+ (2006)	Co-op (100 members)	Australia	Cheese Infant Formula	Bega Tatura	Recently purchased 70% of Tatura for A\$39m Consumer brands marketed by Fonterra

SECONDARY PLAYERS IN AUSTRALASIA

... continued

Australasian dairy industry – secondary players

(various; 2006/2007)

Company	Turnover	Ownership	Home Country	Dairy products	Key Dairy Brands	Comments
 Kraft Foods	A\$676m	Subsidiary Public (NYSE)	USA	Cheese <i>Other non-dairy</i>	Kraft Philadelphia	Cheese only dairy Other foods in total (e.g. Vegemite)
 Meadow Fresh	NZ\$530m (2005)	Subsidiary of Goodman Fielder (Public: ASX)	NZ/AU	Fluid Milk Yogurt Cheese/ Spreads	Tararua Meadow Fresh Meadowlea	Formerly NZDF; brand swap with Font; Incl. Huttons Kiwi Nat Foods likely long-term owner
 Westland NEW ZEALAND	NZ\$501m (2008)	Co-op (380 members)	New Zealand	Milk powder Milk fats/proteins	Nutriprime Immuprime	
 WARRNAMBOOL EST'D 1888 CHEESE & BUTTER	A\$442m (2009)	Public (ASX: WCB)	Australia	Cheese Butter		Intake 900m litre of milk
 TATUA	NZ\$184m (2008)	Co-op (124 members)	New Zealand	Specialty ingredients	Tatua	
 Ballantyne	A\$158m (2006)	Private	Australia	Butter Cheese	Ballantyne	Also have canned Butter factory in New Zealand
 Bulla	n/a	Private	Australia	Yoghurt Ice cream	Bulla	Acquired Fonterra AU ice cream
 synlait™ making more from milk	NZ\$150m (2009e)	Public (unlisted)	New Zealand	Milk powder	Synlait	Based in Canterbury
 OPEN COUNTRY	NZ\$143m (2008)	Public (NZX)	New Zealand	Cheese Whey	-	52% owned by Dairy Trust
 BURRA FOODS AUSTRALIA	A\$90m (2007)	Private	Australia	Milk powder Other ingredients	Burra	
 SNOW BRAND	A\$57.2m (2006)	Subsidiary (Public: Tokyo)	Japan	Infant formula Cheese	Snow Brand Unicorn	

PROPOSED STRATEGIC VISION

If Fonterra's owners choose to float the Australasian consumer products business, we propose the following strategic vision for discussion

Vision: Become the largest refrigerated consumer products sales and marketing organisation in Australasia

Create Fonterra Foods

- Put Australasian branded consumer products activities into business
- List on ASX/NZX
- Initially maintain 80% parent co-op ownership
- Split proceeds of float; leave some in for acquisitions but use some for other parent co-op investment opportunities in high growth markets (e.g. Brazil)

Consolidate consumer dairy market in Australasia

- Buy one or more of the remaining major players:
 - National Foods
 - Nestle dairy
 - Parmalat
- Rationalise and increase efficiencies
- Resulting duopoly should hypothetically generate strong cash flow (see Kerry consumer products business in Ireland)

Acquire complementary businesses

- Leverage chilled distribution into new product segments
 - Deli meats/bacon
 - Refrigerated juice
 - Chilled meals
 - Soups, etc.

Increase profitability

- Increase efficiency per delivery
- Increase scale and scope of business
- Streamline supply chain to remove cost

SWOT ANALYSIS - FLOAT CONSUMER

Floating the Australasian consumer dairy business would free up capital from what is a relatively mature business in a mature, low growth market

SWOT analysis: float Australasian consumer products but keep control
(2009)

Strengths	Weaknesses
<ul style="list-style-type: none">- Float frees up capital from relatively mature, low growth Australasian business for use in high growth markets elsewhere (e.g. South America)- Existing business in strong leadership position; generally #1 or #2 on most categories	<ul style="list-style-type: none">- Only as good as management; no guarantee of success- Given no parent shareholder dilution under 51%, new capital is a one-time hit; need to be smart with the money, but what?- Could easily make a number of acquisitions (e.g. National Foods) that ultimately give you more of a low growth market (i.e. the Emmi in Switzerland story) rather than a profit generating growth engine (i.e. the Kerry story)- Exited Huttons Kiwi meats business historically; unclear competencies outside dairy
Opportunities	Threats
<ul style="list-style-type: none">- Sale of key Australian consumer dairy products businesses by current non-committed owners [e.g. Kirin and Parmalat]	<ul style="list-style-type: none">- Competitors with better execution or products



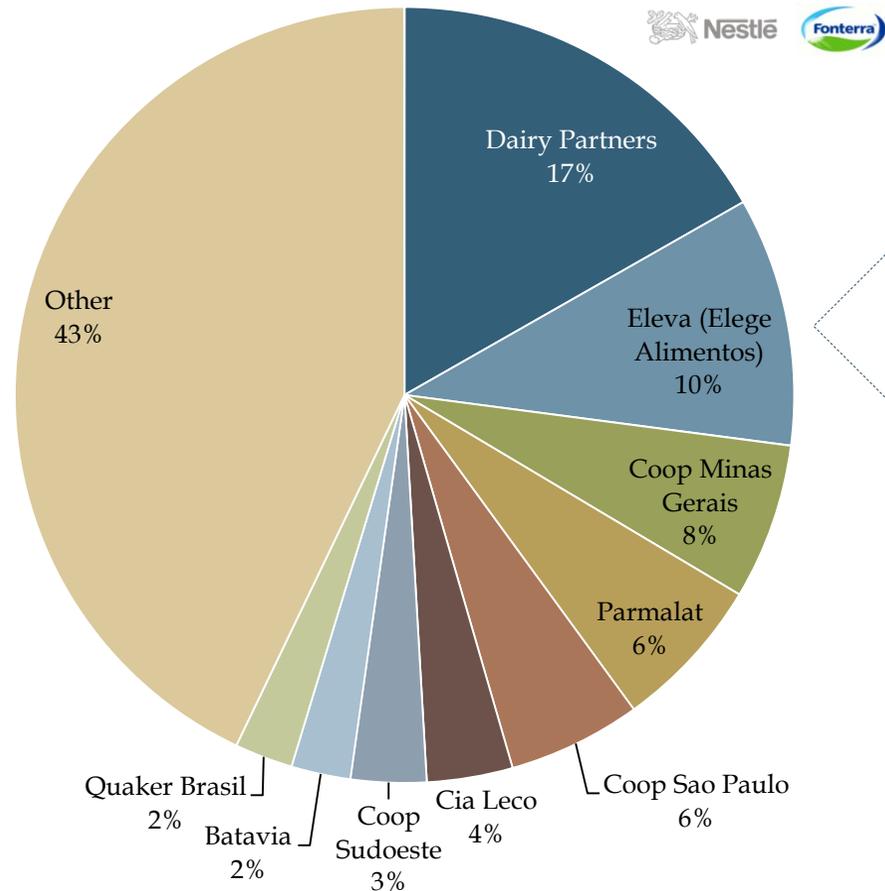
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ROLL-UP OPPORTUNITIES

A number of major developing markets appear ready for a classic acquisition-driven roll-up strategy in fluid milk distribution, as this example from Brazil shows

EXAMPLE: Fluid milk market share in Brazil
(% of retail sales; 2006)



May 2009 purchase/merger of Sadia (sales US\$4.6b) by Perdigao (sales US\$4.8b)(Eleva¹ parent) to create new company Brazil Foods, now major US\$9.4b meat company creates opportunity for disposal of dairy operations to pay for merger

PROPOSED STRATEGIC VISION

Developing a strong position in South America through an industry roll-up is a clear opportunity; if Fonterra doesn't do it, someone else will

Vision: Become the largest consumer dairy products company in the Southern Hemisphere with a #1 position across all major markets

Create Fonterra Foods

- Put global branded consumer products activities into business
- List on ASX/NZX
- Initially maintain 80% parent co-op ownership
- Keep proceeds of float for acquisitions (rather than use it to pay off debt)

Consolidate consumer dairy market in Australasia

- Buy one or more of the remaining major players:
 - National Foods
 - Nestle dairy
 - Parmalat
- Rationalise and increase efficiencies
- Resulting duopoly should hypothetically generate strong cash flow (see Kerry consumer products business in Ireland)

Consolidate consumer dairy market in South America

- Consolidate current position in Chilean market via acquisition
- Execute on roll-up strategy in Brazil leveraging existing business (may need to acquire Nestle share)
- Repeat model in other countries (e.g. Argentina)
- Explore acquiring Clover in South Africa; use as platform for African expansion
- Key large acquisitions will need to be financed through further capital raising, likely reducing co-op share under 51%

Invest in developing strong, defensible portfolio

- R&D into defensible dairy categories
 - Yoghurts
 - Spreads
 - Processed cheese
 - Infant formula
- Launch/roll-out products across business geographies
- Create defensible position against growth of private label (expect #1, #2, PL end game industry structure; be #1 in all cases)

SWOT ANALYSIS – ROLL-UP SOUTHERN HEMISPHERE

Fonterra is in the prime position to consolidate the South American dairy industry, however this is clearly a high risk / high reward strategy

SWOT analysis: consolidate South America
(2009)

Strengths	Weaknesses
<ul style="list-style-type: none"> – Fonterra is currently the #1 dairy player in South America with deep market experience and understanding – Fonterra is a co-op (currently); many of the key targets are co-ops – Fonterra is the logical player to execute on this strategy 	<ul style="list-style-type: none"> – Very limited Fonterra financial engineering capabilities or experience; this is typically a strategy driven by investment bankers – Strategy is highly dependant on management and board capabilities and execution, particularly in achieving non-dilutive acquisitions – Outside NZ, Fonterra has neither control of milk supply or leveragable brand/technology – Will clearly dilute co-op ownership under 51%
Opportunities	Threats
<ul style="list-style-type: none"> – Existing multinationals with dairy operations not committed to business due to low returns relative to rest of their portfolio creating acquisition opportunities – Many of these countries currently have strong dairy co-op presence with weak, regional consumer brands portfolios which could be purchased (e.g. Itambe /co-op Minas Gerais) – Dairy industry in key emerging markets currently highly fragmented and comparable to developed world circa 1920-1960's 	<ul style="list-style-type: none"> – All the various forms of crisis for which South America is known (such as economic meltdown, devaluation, social unrest, revolution, coup, drought, nationalisation and corruption) – Others with better experience doing it first/better (e.g. Dean Foods) and thus creating a strong competitor for Fonterra globally



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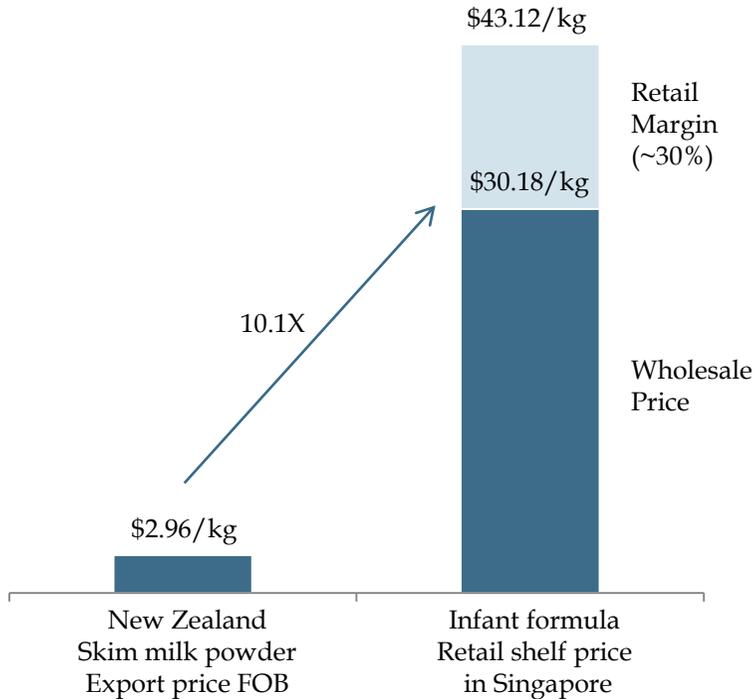
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HOW TO ADD VALUE

The phrase “adding value” is often discussed; a comparison of the FOB price New Zealand received for milk powder with the retail price of infant formula gives a real-world example of how this is done

New Zealand FOB price of SMP vs retail price of infant formula in Singapore

(NZ\$/kilogram; Aug/Sept 2009)



Ingredients: (in order of volume)

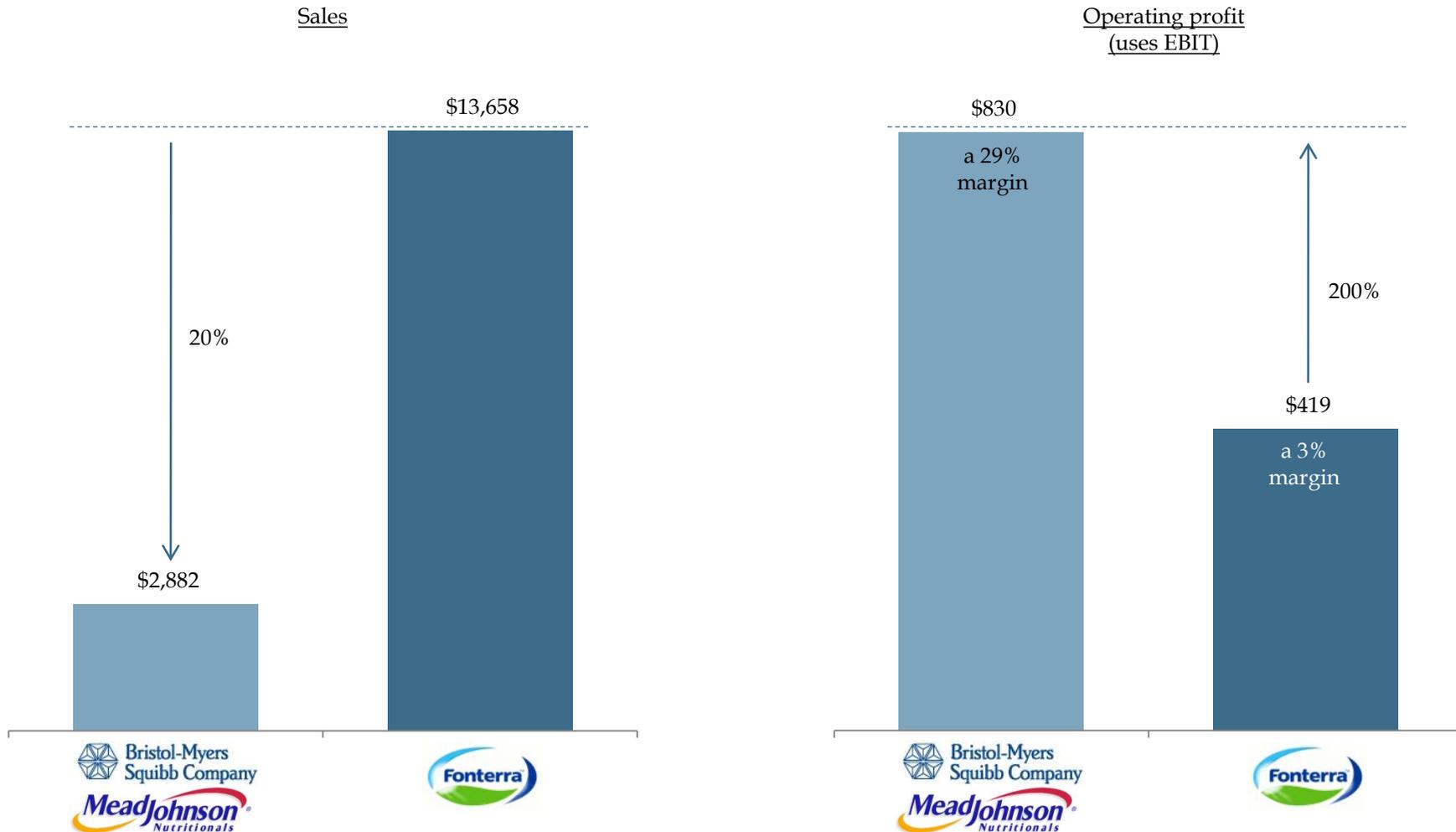
Nonfat Milk Powder, Lactose, High Oleic Safflower Oil, Soy Oil, Coconut Oil, Whey Protein Concentrate.

In addition, less than 2% of the following: Potassium Citrate, Calcium Carbonate, Ascorbic Acid, Potassium Chloride, Magnesium Chloride, Ferrous Sulfate, Choline Chloride, Choline Bitartrate, Ascorbyl Palmitate, Sodium Chloride, Taurine, m-Inositol, Zinc Sulfate, Mixed Tocopherols, Niacinamide, d-Alpha-Tocopheryl Acetate, Calcium Pantothenate, L-Carnitine, Cupric Sulfate, Vitamin A Palmitate, Thiamine Chloride Hydrochloride, Riboflavin, Pyridoxine Hydrochloride, Beta-Carotene, Folic Acid, Manganese Sulfate, Phylloquinone, Biotin, Sodium Selenate, Vitamin D₃, Cyanocobalamin, Calcium Phosphate, Potassium Phosphate, Potassium Hydroxide, and Nucleotides (Adenosine 5'-Monophosphate, Cytidine 5'-Monophosphate, Disodium Guanosine 5'-Monophosphate, Disodium Uridine 5'-Monophosphate)

FORWARD INTEGRATION

Mead Johnson makes twice as much profit as Fonterra on 20% of the sales

EXAMPLE: Sales and operating profit: Fonterra vs. Bristol Myers Squibb's Mead Johnson Infant Nutrition division
(US\$m; 2008)

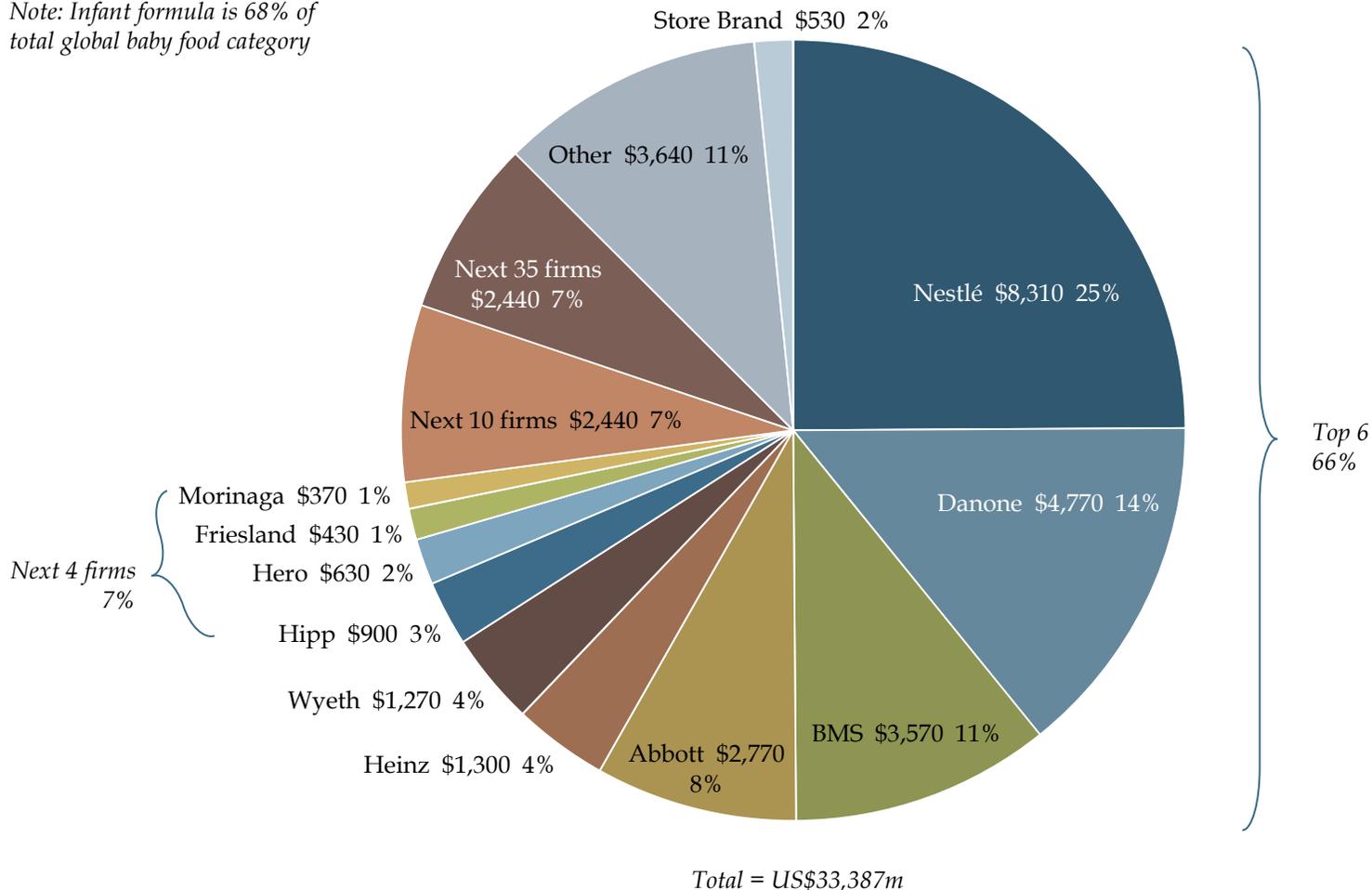


BABY FOOD/INFANT NUTRITION - GLOBAL MARKET SHARE

The industry is highly consolidated, with the top six firms accounting for 66% of global sales

Baby food/infant nutrition global sales and market share by firm
(US\$m; 2008)

Note: Infant formula is 68% of total global baby food category

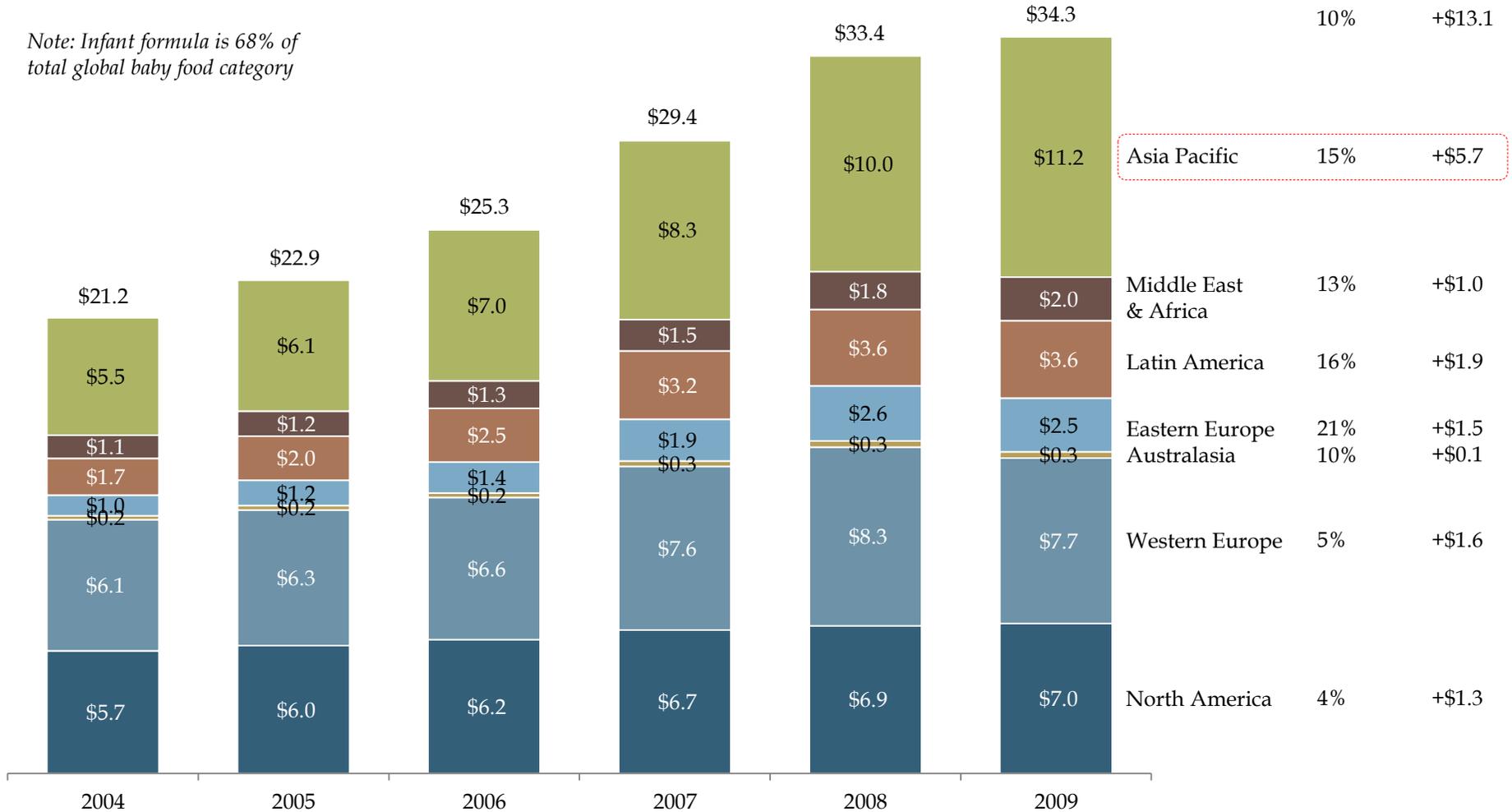


BABY FOOD/INFANT NUTRITION - GLOBAL MARKET GROWTH

The baby food/infant nutrition sector is achieving strong sales growth driven by increasing demand, particularly in the Asia Pacific region

Growth in baby food/infant nutrition sales by global region
(US\$b; 2004-2009)

Note: Infant formula is 68% of total global baby food category



BABY FOOD/INFANT NUTRITION - KEY PLAYERS

There are six key players globally in infant nutrition: three food conglomerates (Nestle, Danone & Heinz) and three pharmaceutical giants (BMS, Abbott & Pfizer/Wyeth)

Key global players in infant nutrition (various; 2008)

Company	Global Sales	Global Emp.	Infant Nutrition (IN) Division	Global IN Sales	Key IN brands	Notes/comments	
 Nestlé	US\$103.2b (CHF109.9b) (2008)	283,000	 Nestlé Nutrition	US\$8.0b (CHF8,434m)	Nestle Nestum NAN /NAN Pro Nido Gerber DHA	Cerelac Mucilon Alfare Alprem AL 110 Althera	Invented infant formula Invests US\$1b/year in infant nutrition research Acquired Gerber & N. Medical Nutrition from Novartis (07)
 Bristol-Myers Squibb Company	US\$20.0b (2008)	35,000	 MeadJohnson Nutritionals	US\$2.9b	Enfamil Enfagrow Enfa		MJ recently spun-off from BMS in Feb 2009; BMS retains 83.1%
 Abbott	US\$29.5b (2008)	72,000	 Abbott Nutrition	US\$4.9b	Similac Isomil Alimentun	PediaSure	Historically called Ross Products Recently acquired EAS sports nutrition
 DANONE	€15.2b (2008)	80,140	Royal Numico Cow and Gate EAC Dumex Milupa GmbH PT Sari Husada	€2.8b (baby) €0.8b (medical)	Bledina (FR) Cow&Gate (UK) Dumex Karicare	Mamil (MY) Milupa (DE) Nutricia (UK/others)	Acquired Numico (07) for €12.3b Danone Dumex (Malaysia) PT Sari Husada (Indonesia)
 Pfizer Wyeth	US\$71.1b (2008)	49,732	 Wyeth Nutrition	US\$1.6b	S-26 Promil Bonna Promise	Bonamil Bonakid SMA (UK)	Wyeth (US\$22.8b) in the process of being acquired by Pfizer (US\$48.3b)
 Heinz	US\$10.1b	32,500	Baby food/infant nutrition	US\$1.1b	Farley's (UK) Plasmon (IT) Heinz	Nurture Others	More baby food than IN Hindustan Foods (India) Heinz PMV (Czech/Slovak)

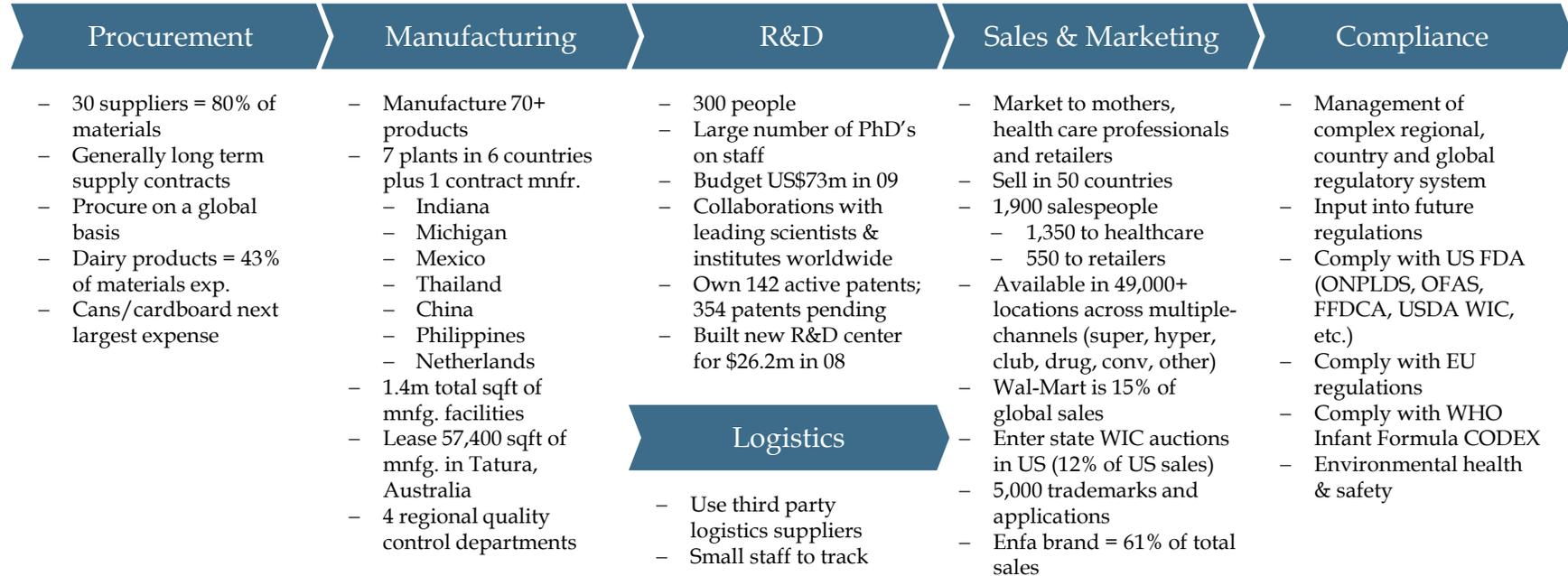
VALUE CHAIN - EXAMPLE - MEAD JOHNSON

While infant formula may sound simple, major players have complex value chains, as this Mead Johnson example shows

EXAMPLE: Mead Johnson infant nutrition value chain
(various; 2008)



Sales:	US\$2,882m	Cost of product sold:	37% of sales (materials + manufacturing)
EBIT:	US\$696m	Marketing, selling & Administrative:	22% of sales
Total assets:	US\$1,361m	Advertising and Promotions:	12% of sales
Employees:	5,300	Research & Development:	3% of sales
Founded:	1905	EBIT:	24% of sales



INFANT NUTRITION - SECONDARY PLAYERS - ASIA

There are a handful of major secondary players in infant nutrition...

Secondary global players in infant nutrition - Asia
(various; 2008)

Preliminary

Company	Global Sales	Global Emp.	Infant Nutrition Division	Global IN Sales	Key IN brands	Notes/comments
Asia						
	US\$4.1b	5,799	Infant Formula	US\$0.4b	Morinaga MA-1 BF-1/2; NL-33	
	US\$7.1b (¥707b)	7,054	Infant Products	US\$0.3b (¥28.1b)	Meiji Hohoemi Meiji Step	Mnfr. in Thailand (Siam Meiji)
	US\$0.7b (CN¥5b)	n/a	Infant food	US\$0.3b	Beingmate	Located in Hangzhou Runs retail stores; makes strollers, etc.
	US\$0.3b	3,400+	Total business	US\$0.3b	Shengyuan Synutra	US incorporated; makes infant formula in China
	US\$3.2b (2008)	TBD	Infant formula	US\$0.2b	Yili	Inner Mongolia Yili
	US\$0.6b (CN¥4b)	TBD	Infant formula	US\$0.2b	Yashily	Carlyle Group purchased 17% stake in 09/09
	w773b (US\$0.7b)	2,200	Infant formula	US\$0.2b	Namyang	Namyang Dairy
	w681.4b US\$0.5b	1,839	Infant formula	US\$0.2b	Maeil	Maeil Dairy
	US\$16.2b	3,800		US\$0.2b	Wakodo Lebens	Retort Club Wakodo acquired by Asahi (2006)
	US\$3.8b (IR38.8b)	64,200	PT Gizindo Primanusantara	n/a	Promina Sun	

INFANT NUTRITION - SECONDARY PLAYERS - EU & NORTH AMERICA

... continued

Secondary global players in infant nutrition – Europe & North America (various; 2008)

Preliminary

Company	Global Sales	Global Emp.	Infant Nutrition Division	Global IN Sales	Key IN brands	Notes/comments
Europe						
	US\$0.9b (2008)	1,000 (2006)	Total business	US\$0.9b (2008)	HiPP Bebivita	
	US\$1.4b (CHF1.45b)	4,500	Baby foods	US\$0.6b (2008)	Beech-Nut Semper Sunar Smafolk	Allomin Friso Organix Adapta Acquired Organix (UK) in FY08 Market leader in Spain & Turkey (Ulker JV est. 02)
	€9,454m (2008)	22,000	Infant & Toddler Nutrition Div.	US\$0.4b	Frisolac Friso Frisomel	Dutch Lady Dutch Baby Frisian Flag IN primarily in Russia and Asian markets; strong in Vietnam, Malaysia, Indonesia & Thailand
	US\$2.8b	18,485	Agousha	US\$0.3b	Agousha	Major dairy player in Russia/CIS
	€9.3b (2008)	16,500	Nutricia France	US\$0.2b	Nutricia Lactel	Acquired Nutricia France from Danone/Numico in 2008
	€3.4b (2008)	3,200+	 Aus Liebe zum Kind	US\$0.2b	Humana Lasana	Recently formed Nordcontor with Nordmilch
	€95m	320	Total business	€95m	Nutribio	Merger of Entremont/Cofranlait & Sodiaal/Sodiaal Industrie divisions (08)
North America						
	US\$200m	400+		~US\$180m	Bright Beginnings Store brands	Purchased Wyeth IN operation in US Producing PL infant formula
	US\$1.1b	2,986		US\$2b	Earth's Best	Heinz owns 20% of firm

EXAMPLE – SINGAPORE - CONSTRUCTION OF 2 INFANT FORMULA PLANTS

Wyeth built an infant formula plant in Singapore in 2002; this plant was expanded +50% in 2008; in 2009 Abbott completed an infant formula plant

Details of investment in infant formula plants in Singapore
(various; 2002-2009)

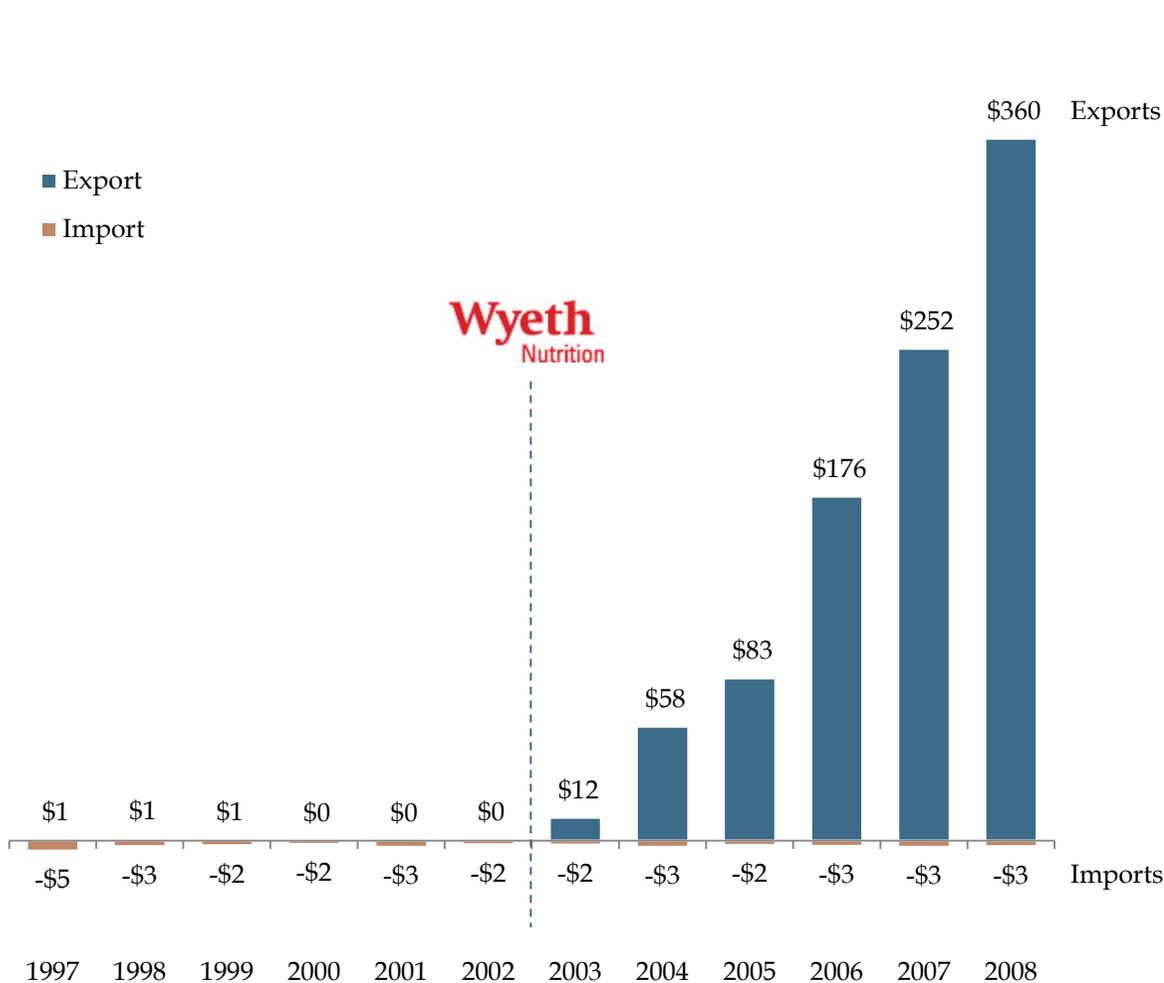
Date	Company	Investment	Activity	Details
April 2002	Wyeth	US\$300m S\$450m	Plant construction	<ul style="list-style-type: none"> – Construction of a state-of-the art two dryer infant nutritional manufacturing facility of 45,000m² – Produces the infant product, Promil, Progress, S-26, Promise and the gold product range. – The plants will employ 600 workers at full capacity.
April 2008	Wyeth	US\$96m S\$134m	Plant expansion	<ul style="list-style-type: none"> – 50% capacity expansion of existing state-of-the-art facility, utilising the strictest operational and quality standards, – Enabling the facility to increase its supply to the Singapore market, as well as manufacturing additional product for export to other key markets throughout the Asia Pacific region.
Feb 2009	Abbott	US\$300m S\$450m	Plant construction	<ul style="list-style-type: none"> – Construction of a fully integrated infant nutrition manufacturing plant for the production of powder nutritional products; key unit operations include wet processing, evaporation, spray drying, blending and packaging. – The plant employs approximately 300 people, 50 of whom are solely devoted to quality assurance. – Abbott's pediatric products sold in Asia, including infant formula, follow-on formula and growing-up milk, are now manufactured in this state-of-the-art facility. This facility offers world-class levels of safety, process control and cleanliness throughout the manufacturing and distribution process. – Importantly, the Singapore location allows for faster shipments to retail and health care establishments across countries in the region, including China, Hong Kong, Indonesia, Malaysia, Philippines, Singapore, Taiwan, Vietnam, as well as the Middle East.



GROWTH IN INFANT FORMULA EXPORTS

As a result of the opening of the Wyeth Nutrition infant formula plant in 2002, Singapore has become a major exporter of infant formula

Change in Singapore infant food trade value following opening of Wyeth plant
(US\$m; 1997-2008)



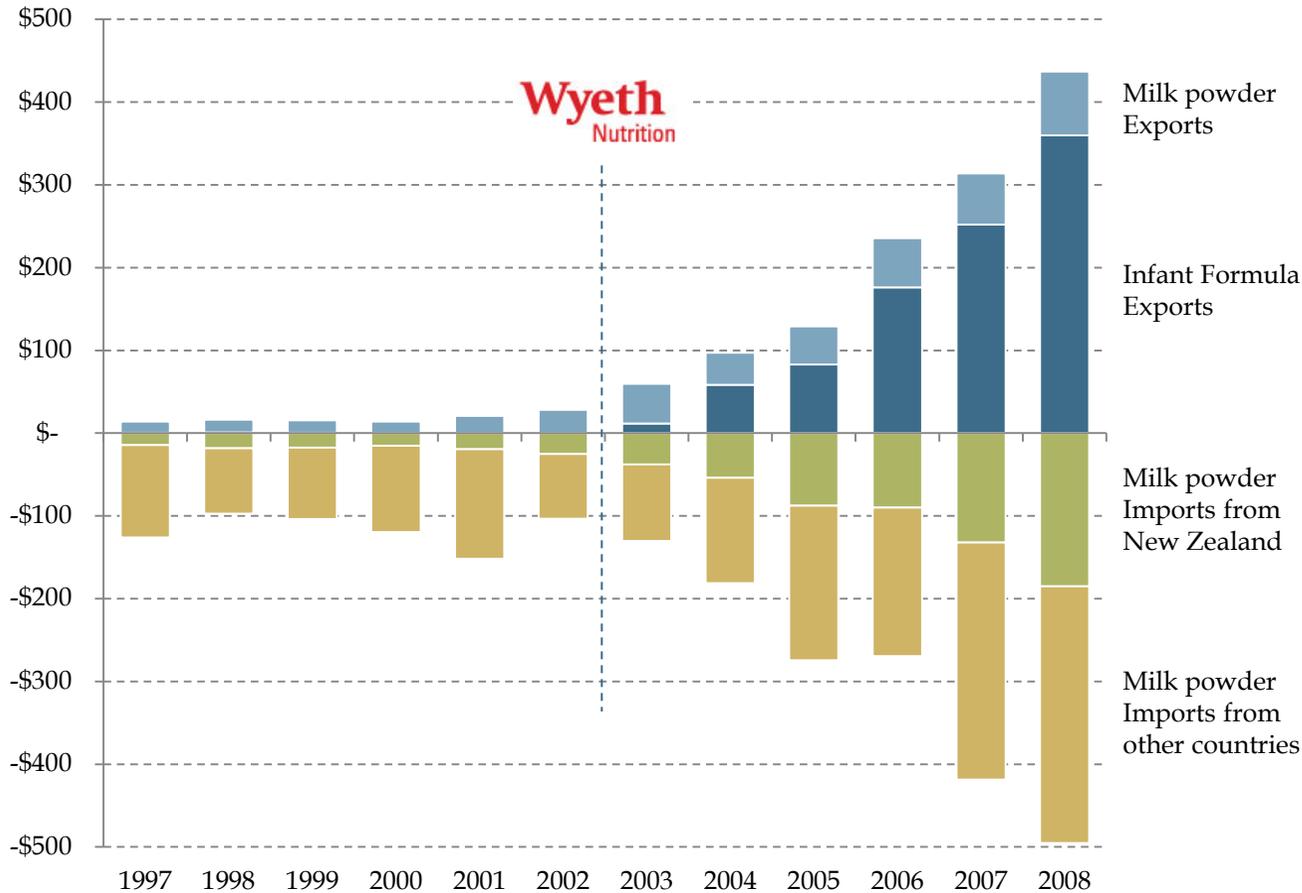
Comments/Notes

- Uses HS190110 only for reasons of data access and simplification of analysis
- Some infant formula is classified as various milk powder classifications

GROWTH IN MILK POWDER IMPORTS

As a result of the increase in infant formula exports, Singapore has increased milk powder imports, including from New Zealand

Change in Singapore milk powder and infant food trade value following opening of Wyeth plant
(US\$m; 1997-2008)



Comments/Notes

- Singapore has no cows
- Singapore has other uses for milk powder
- Milk powder uses HS 040210/040221/040229; some amount of infant formula falls under this classification
- Infant formula uses HS190110

PROPOSED STRATEGIC VISION

If Fonterra's owners choose to focus on infant nutrition, we propose the following strategic vision for discussion

Vision: Become the largest supplier of infant formula in the world

List Fonterra Nutrition

- Put milk powder and infant formula (Anmum)/nutrition related activities into business
- List on ASX/NZX
- Initially maintain 80% parent co-op ownership
- Keep proceeds of float for acquisitions (rather than using it to pay off debt)

Acquire second tier players in infant nutrition

- Acquire 3-5 regional infant nutrition companies, e.g.
 - Hero
 - Indofoods
 - Nutribio
 - Hipp
- Rationalise and consolidate acquisitions with existing Fonterra activities
- Identify technology/IP gaps and fill where possible with further small acquisitions

Acquire drug company infant nutrition "orphan"

- Pfizer/Wyeth merger makes infant nutrition minor and non-core to parent entity
- Alternatively BMS recent float of share in Mead-Johnson indicates business is non-core
- Scale of purchase will clearly require dilution of co-op share under 51%

Integrated supply chain to Asia

- Process New Zealand milk powder into consumer-ready infant formula
- Exploit large and growing demand in developing Asia, particularly India and China

SWOT ANALYSIS – FORWARD INTEGRATION

Fonterra could acquire one or more major infant formula businesses as a way of adding value to existing milk powder exports, but this will likely be very expensive

SWOT analysis: forward integrate into infant formula
(2009)

Strengths	Weaknesses
<ul style="list-style-type: none"> - Fonterra already has some capabilities in infant nutrition (Annum) and is a second-tier player in some Asian markets - Fonterra is already the largest single global supplier of ingredients to infant formula manufacturers - Synergies with existing dairy research and development capabilities while clearly requiring stretch growth in capabilities/competencies - Dramatic increase in profitability assuming solid execution 	<ul style="list-style-type: none"> - Overlap period where Fonterra is competing with some of its own customers - Limited channel experience (e.g. doctors, pharmacy, hospitals) - Strategy is highly dependant on management and board capabilities and execution - Potential misalignment of interests of farmers (milk price) and shareholders (NPV of future cash flow) - A major acquisition will likely require a large amount of capital (Danone paid €12.3b for Numico)
Opportunities	Threats
<ul style="list-style-type: none"> - Existing pharmaceutical companies with infant nutrition operations not committed to business due to low returns relative to rest of their portfolio creating acquisition opportunities - Rapid income growth in developing Asia dramatically increasing pool of customers 	<ul style="list-style-type: none"> - A wide range of global food players would be interested in pharma nutrition orphans (e.g. Heinz); likely “winners curse” if Fonterra wins bidding (ie pay too much) - Recent rapid emergence of private label infant formula in US & Canadian markets driven by sale of former Wyeth US operations to PBM - Commoditisation of infant formula through expiry of patents/IP - Emergent Chinese players moving into exports into Asia

OWNERSHIP DEPENDS ON STRATEGY

In conclusion, we recommend that the owners of Fonterra decide on a strategic direction and then use this to drive ownership structure

		Potential ownership structures		
		A. Remain being a cooperative	B. Bring in outside investors	
			B1. Partial Listing	B2. Full corporatisation
Potential strategies	i. Develop multi-country cooperative model	●	-	-
	ii. Become global ingredients leader	◐	◐	●
	iii. Float consumer products business	-	●	-
	iv. Roll-up strategy in developed markets	◑	◐	●
	v. Forward integrate into infant nutrition	◑	◐	●

- Strong match; in line with global models/peers
- ◐ Partial match; limitations on ultimate growth
- No or poor match



DOCUMENT STRUCTURE

- I. Overview of the New Zealand dairy industry
- II. Ownership options going forward
 - A. Remain being a co-op
 - B. Bring in outside investors
 - B1. Partial float
 - B2. Full corporatisation
- III. Background: Evolution of corporate dairy models
- IV. Potential strategies going forward
 - i. Develop multi-country co-op
 - ii. Become global ingredients leader
 - iii. Float consumer products business
 - iv. Roll-up strategy in developed markets
 - v. Forward integrate into infant nutrition
- V. Appendices

APPENDIX 1 - LIST OF PEER DAIRY COOPERATIVES

In the course of our research we identified and profiled a large dairy cooperative peer group of Fonterra; this information is presented here for reference

SIMILAR TO PEERS

Most peer group countries also have a dairy industry dominated by a single or a handful of cooperatives

Presence of dairy industry cooperatives in peer group countries
(2008)

Country	cooperative	Turnover	Volume share	Ownership	Comments/notes
Ireland	 Irish Dairy Board	£2,090m (2008)		Various Irish co-op (and former co-op)	<ul style="list-style-type: none"> - Established in 1961 as export marketing coordinator for milk powder - Owns Kerrygold brand
	 glanbia	£2,232m (2008)	5.3b l ~35% Ireland	54.7% by parent co-op; remain listed	<ul style="list-style-type: none"> - Waterford Co-op formed in 1964 in merger of 5 regional cooperatives; further co-op mergers; bus activities listed on ISX in 1988; - Avonmore Creameries Fed. formed in 1966 merger of 25 regional co-op; further co-op mergers; listed on ISX in 1988; remained famer controlled - 1997 mega-merger of Waterford and Avonmore; new name 1999; further mergers/acquisitions; remains 54.7% controlled by parent farmers co-op
	 Dairygold	~€688m (2008)		10,000+ farmer/ shareholders	<ul style="list-style-type: none"> - Formed in 1990 in merger of Ballyclough co-op and Mitchelstown co-op - Spun off consumer foods into listed REOX; maintains ~31% share
	 LAKELAND	€434m (2008)		1b l	<ul style="list-style-type: none"> - Formed in 1990 merger of Killeshandra (1896) and Lough Egish (1902) co-op; primarily milk powder
	 Connacht Gold <small>Co-operative Society Ltd</small>	~€311m (2008)		14,000 farmers	<ul style="list-style-type: none"> - Formed in 2000 merger of North Connacht co-op(NCF) and Kiltoghert co-op, themselves the results of numerous mergers over last century
	 CARBERY	~€200m (2008)			<ul style="list-style-type: none"> - Formed in 1965; produces cheese (30% IE total) and ingredients (particularly to infant formula mnfr.)
	 Arrabawn Co-op	€168m (2008)			<ul style="list-style-type: none"> - Formed in 2001 merger of Nenagh Co-op and Mid West Farmer's Co-op

Numerous additional smaller Irish dairy co-op exist

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Presence of dairy industry cooperatives in peer group countries
(2008)

Country	cooperative	Turnover	Volume share	Ownership	Comments/notes
Norway		€2,060m (2008)	99%	16,312 farmers	<ul style="list-style-type: none"> - Firm has roots in 1856; national dairy export co created in 1928 - Owns Jarlsberg cheese brand (60% of firm export value)
Finland		€1,844m (2008)	86%	22 dairy co-op (10,900 farmers)	<ul style="list-style-type: none"> - Established in 1905 as butter export co-op for 17 Finish dairies - Industry consolidates; Valio takes on all marketing for member dairies - Long rumoured to be looking at joining Arla
Denmark Sweden		€6,647m (2008)	91% DK 71% SWE	7,996 farmers (MD/Arla)	<ul style="list-style-type: none"> - Merger of Arla (Sweden) and MD Foods (Denmark) in 2000 - Aborted merger with Campina in 2004
Sweden		€289m (2008)	~11% Sw 363m kg	693 farmers	- Formed in 1932; deregulation catalyst for mergers
		€255m (2008)	~10% Sw 300m kg	900 farmers	<ul style="list-style-type: none"> - Formed in 2000 merger of NNP and Milko - Centered in Northern Sweden; dissolved JV with Skane
		€173m (2008)	~6% Sw 190m kg	1,000 farmers	- Centered in Northern Sweden
	<i>Falköpings MEJERI</i>	€72m (2008)	~% Sw		-
UK		£602m (2008)	18% UK 1.7b l	2,500 farmers	<ul style="list-style-type: none"> - Formed in 2000 as one of 3 successor co-op to Milk Marque - Merged with Scottish Milk; moved into processing - Proposed merger with Milklink called off 2008; owns 15% RW
		£547m (2008)	1.3b l capacity		<ul style="list-style-type: none"> - Formed in 2000 as one of 3 successor co-op to Milk Marque - Numerous acquisitions; sold fluid milk to R. Wiseman
		£366m (2008)	1b l	2,110 farmers	<ul style="list-style-type: none"> - Formed in 1995 from N. Ireland Milk Marketing Board to farmers - A number of acquisitions since then; acquired UHT ops from Express

SIMILAR TO PEERS

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Presence of dairy industry cooperatives in peer group countries
(2008)

Country	cooperative	Turnover	Volume share	Ownership	Comments/notes
Belgium France		€688m (2007)			– Result of 2004 merger of Belgomilk and BZU Melkaanover co-op
Netherlands Germany		€9,454m (2008)			– Roots in 1879; Friesland formed in 1997 in mega-merger of 4 Dutch co-ops – Merged in 2008 with Campina (another Dutch co-op formed in 1989 merger of Melkunie & DMV Campina; acquired Sudmilch DE in 93)
Netherlands		€405m (2007)			– Formed in 1895; merged with other in region in 1962 – Produces primarily cheese
		€160m (2007)	300m kg	500 farmers	– Founded in 1901 in Northern Holland – Produces primarily cheese
Luxemburg		€61m (2007)	118m kg	505 farmers	– Formed in 1894; sequence of mergers leading to single entity

SIMILAR TO PEERS

Most peer group countries also have a dairy industry dominated by a single or a handful of cooperatives

Presence of dairy industry cooperatives in peer group countries
(2008)

Country	cooperative	Turnover	Volume share	Ownership	Comments/notes	
France		€2,700m (2008)	~10% (2.3b l)	9,100 farmers	<ul style="list-style-type: none"> Formed in 1964 merger of 6 regional co-op; Yoplait as common brand Yoplait spun off into 50/50 JV with PAI private equity 	
		€1,736m (2008?)	~10% (2.2b l)	9,000 farmers	<ul style="list-style-type: none"> Formed in merger of dairy activities of Unicopa and Entremont Co-op Major producer of milk powder (660k tons) 	
		€1,150 (2008)			<ul style="list-style-type: none"> Formed in 1930 Owens Laita (€300m) with co-op Bretagne and Terrena) 	
		€823m (2008)	600m l	2,700 farmers	<ul style="list-style-type: none"> Formed in 1988 (Alliance Agro Alimentaire) 	
	<i>Numerous additional smaller French dairy co-op exist</i>		€526/1,951m (2007)			<ul style="list-style-type: none"> Formed in 1906; has diversified operations: dairy, hort, meat, feed, etc €526m in dairy turnover in 2007
			€500m (2008)	850m l	3,100 farms	<ul style="list-style-type: none"> Merger of marketing activities of three co-ops: Colarena Presqu'île, Poitouaine and UCAL in North West France
			€641m (2005)	120m l		<ul style="list-style-type: none"> Founded in 1893;
Spain		€683m (2006)	14% Spain		<ul style="list-style-type: none"> Formed in 1960; sequence of regional co-op mergers; partially listed Proposed merger w/Pascual; rejected takeover bid by Agrolimen in 2006 Partially owned by Bongrain and regional Spanish banks 	
		€1,123m (2007)	766m l	1,450 farmers	<ul style="list-style-type: none"> Formed in 1969; acquires/merges with a range of other dairies Now a major player in mineral water, juice and other foods 	
Italy		€908m (2006)	30% Italy	1,600 farmers (60,000 cows)	<ul style="list-style-type: none"> Formed In Bologna in 1957; ongoing regional mergers Granarolo sold 20% of shares to Intesa Bank to fund recent acquisition 	
Portugal		€1,070m (2008)	50% Port		<ul style="list-style-type: none"> Formed in 1996 merger of 3 co-op (Agros, Prolette & Lactico-op) Acquired Leche Celta in Spain in 1997; acquired Vigor 2001 	

SIMILAR TO PEERS

Most peer group countries also have a dairy industry dominated by a single or a handful of cooperatives

Presence of dairy industry cooperatives in peer group countries
(2008)

Country	cooperative	Turnover	Volume share	Ownership	Comments/notes
Germany	 NORDCONTOR <small>A DAIRY COOPERATIVE UNION MEMBERSHIP OF ALL GERMAN DAIRY COOPERATIVES</small>	~€5,900m (2008)	7.5b kg % DE	~13,700 farmers	<ul style="list-style-type: none"> - 2009 merger of activities of Nordmilch and Humana Milchunion co-op - Planned total merger in 2004 called off; future total merger likely
	 NORDMILCH	€2,500m (2008)	4.1b kg	8,000 farmers	<ul style="list-style-type: none"> - Formed in 1999 merger of 5 regional cooperatives in Germany
	 Humana Milchunion	€3,412m (2008)	3.4b kg	5,700 farmers	<ul style="list-style-type: none"> - Formed in 1998 merger of Milchwerke Westfalen & Westmilch; 6 other German co-op joined 99-01
	 hochwald	€1,251m (2008)	1.9b kg	5,100 farmers	<ul style="list-style-type: none"> - Founded 1932; regional mergers in 69-70; more regional mergers 86-91 - Acquired Nestle fluid milk 2003; more co-op mergers 03-05
	 Bayernland	€608m (2008)	0.8b kg	5,500 farmers	<ul style="list-style-type: none"> - Founded in 1930 merger of 16 dairies; merges w/ Barvarian competitor - Acquired Kraft soft cheese operations in 1984
	 MUM	€620m (2008)	1.1b kg		<ul style="list-style-type: none"> - Formed in 1966 merger of three regional dairies - 80% of sales are contract pack private label; largest UHT milk prod in EU
	 BWI <small>Bayernische Milchwerke</small>	€380m (2007)	0.9b kg		<ul style="list-style-type: none"> - Co-op has activities other than dairy
	 OMIRA MILCH	€467m (2008)	0.8b kg	4,000 farmers	<ul style="list-style-type: none"> - Founded in 1929; initially focused on butter
	 Allgäu	€403m (2008)	0.6b kg	2,986 farmers	<ul style="list-style-type: none"> - Formed in 1966 merger of three regional dairies
	 MOLKEREI AMMERLAND	€387m (2008)	0.9b kg	2,000 farmers	<ul style="list-style-type: none"> - Founded in 1885; - 43% of production is exported
Numerous additional smaller German dairy co-op exist	 GOLDSTEIG	€367m (2008)	0.6b kg	4,800 farmers	<ul style="list-style-type: none"> - Formed in 1992 merger of GKP and EMP - Merged with Ostbayrischen Milchwerken in 1998
	 Uelzена	€355m (2008)	0.4b kg		<ul style="list-style-type: none"> - Formed in 1952 by 31 dairies to convert excess milk into powder - Focused on ingredient milk powder

SIMILAR TO PEERS

Most peer group countries also have a dairy industry dominated by a single or a handful of cooperatives

Presence of dairy industry cooperatives in peer group countries
(2008)

Country	cooperative	Turnover	Volume share	Ownership	Comments/notes
Switzerland		n/a	285m kg	3,900 farmers	<ul style="list-style-type: none"> – Founded in 1907 in a merger of 62 cooperatives – Created collection and marketing separation by floated but still controls consumer products business (Emmi)
		€1,781m (2008)	880m kg		
Austria		€580m (2007)	837m kg ~30%	12,000 farmers	<ul style="list-style-type: none"> – Firm has roots in Central Austrian Butter co-op formed in 1900 – Formed in 1996 in merger of 6 regional Austrian dairies
		€190m (2008)	300m kg	3,600 farmers	<ul style="list-style-type: none"> – Formed in 1931 in Upper Austria
		€154m (2008)	223m kg	5,000 farmers	<ul style="list-style-type: none"> – Formed in 1904 in Tyrolia, Austria – Numerous mergers and acquisitions; 35% export (prim. Italy)
		€114m (2008)	156m kg		<ul style="list-style-type: none"> – Formed in 1993 in merger of two Salzburg region co-op
		€85m (2008)	126m kg		<ul style="list-style-type: none"> – Formed in 1929; outsources marketing to Berglandmilch in 1996; reassumes own marketing 2002; primarily prod cottage cheese
Poland		€540m (2008)	13% Pol	1b+ 1	<ul style="list-style-type: none"> – Formed in 1972 to process surplus into powder; mergers & acquisitions – 13% Polish milk supply; 35% of polish UHT milk
		€350m (2006)			
Lithuania		€m (2008)	0.5b l	farmers	<ul style="list-style-type: none"> – Formed in 1925 as Rokiškis cooperative dairy
Estonia		€34m (2003)	24%	260 members	<ul style="list-style-type: none"> – Formed in 1997 merger of Põltsamaa Meierei, Järva Jaani Piimandusühistu and Ühistu Haimre Piim co-ops
		€26m (2008)	14%		
					

SIMILAR TO PEERS

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Presence of dairy industry cooperatives in peer group countries
(2008)

Country	cooperative	Turnover	Volume share	Ownership	Comments/notes
USA	 LAND O'LAKES, INC.	US\$4,136m (2008)	12b lbs	1,300 co-op (7,000 farmers)	<ul style="list-style-type: none"> Formed in 1921 by 320 dairy co-op as butter marketing organisation Numerous acquisitions and mergers
	 DFA Dairy Farmers of America	US\$1,989m [ex milk JV] (2008)	60b lbs ~33% US	10,000 farmers	<ul style="list-style-type: none"> Formed in 1998 through mega-merger of Associated Milk Producers, Mid-America Dairymen, Milk Marketing, and Western Dairymen Co-op Recently sold fluid milk JV National Dairy to Grupo Lala (Mexico)
	 Prairie Farms	US\$2,924m (2008)		700+ farmers	<ul style="list-style-type: none"> Formed in 1932 in merger of Illinois dairy co-op
	 DARIGOLD	US\$2,200m (2008)	6.5b lbs		<ul style="list-style-type: none"> Founded in 1918 in merger of 5 regional co-op Acquired Consolidated Dairy in 1930; called WestFarm 1999-2007
	 California DAIRIES inc.	US\$2,039m (2008)	18b lbs ~40% California	620 farmers	<ul style="list-style-type: none"> Formed in 1999 in merger of 3 CA co-op: California Milk Producers, Danish Creamery and San Joaquin Valley Dairymen Produces and markets 2/3 of US milk powder via DairyAmerica
	 DairyAmerica	N/A	66%+ US milk powder	Co-op of 7 co-op	<ul style="list-style-type: none"> Markets 100% of member co-op's milk powder; Agri-Mark, California Dairies, Land O'Lakes, Maryland & Virginia Milk Producers, O-AT-KA Milk Producers, United Dairymen of Arizona, DFA and Lone Star Milk Fonterra sells its milk powder to Latin America, Mexico, Southeast Asia and the Middle East markets (254,000t for US\$1b in 2008)
	 amp	US\$1,700m (2008)	5.8b lbs		<ul style="list-style-type: none"> Formed in 1969 with three midwest regions centered around Illinois Sequence of expansion and acquisitions; Southern region joins DFA
	 Foremost FARMS-USA	US\$1,617m (2008)			<ul style="list-style-type: none"> Formed in 1890's merger of 38 regional co-op Acquired Morning Glory Farms region of AMP in 1995 Sold consumer fluid milk and sour cream in 2009 to Dean Foods
	 Dairylea Cooperative Inc.	US\$1,066m (2007)	5.5b lbs	2,300 farmers	<ul style="list-style-type: none"> Formed in 1907 as co-op of New York dairy farmers; 100k farms in 1920s Formed Dairy Marketing Services with DFA (9,500 farms/16.0b lbs) Sold commercial ops (incl. Dairylea brand) in 1988 to focus on raw milk

SIMILAR TO PEERS

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Presence of dairy industry cooperatives in peer group countries
(2008)

Country	cooperative	Turnover	Volume share	Ownership	Comments/notes
USA	 Agri-Mark	US\$881m (2008)	300m gal	1,300 farmers	<ul style="list-style-type: none"> Formed in 1916 as New England Milk Producers Assn. Merged with Cabot (Vermont) in 1992
	 UNITED DAIRYMEN OF ARIZONA	US\$741m (2008)	90% AZ	90 producers (1,200 cows/prod)	<ul style="list-style-type: none"> Formed in 1960 merger of 2 co-op 1 plant; processes 10m lbs milk/day
	 UPSTATE NIAGARA Cooperative, Inc.	US\$600m (2008)			<ul style="list-style-type: none"> Formed in 1965 in Western New York; acquired Bison Foods in 1983 Merged with Niagara Milk cooperative in 2006 Majority owned of O-AT-KA
	 Maryland & Virginia Milk Producers Cooperative Association, Inc.	US\$532m (2008)	3b lbs	1,500 farmers	<ul style="list-style-type: none"> Formed in 1920
	 Swiss Valley FARMS	US\$500m (2008)			
	 FDA FIRST DISTRICT ASSOCIATION	US\$495m (2008)			
	 Tillamook Cheese <i>"Tastes better because it's made better."</i>	US\$449m (2008)			<ul style="list-style-type: none"> Formed in 1909 in merger of 10 dairies; consolidated Oregon industry
	 ORGANIC VALLEY <i>Family of Farms</i>	US\$275m (2008)		1,326 farmers	<ul style="list-style-type: none"> Formed in 1988 as a co-op of 7 organic milk producers
	 MMPA <i>MICHIGAN MILK PRODUCERS ASSOCIATION</i>	US\$275m (2008)		2,300 farmers	<ul style="list-style-type: none"> Formed in 1916 in Michigan
	 DIETRICH'S MILK PRODUCTS	US\$162m (2008)		JV of 2 other co-op	<ul style="list-style-type: none"> Started as family owned fresh milk delivery; moved into powder Acquired by DFA & Dairylea in JV to "balance" NE US milk supply into powder

Numerous additional smaller US dairy co-op exist

SIMILAR TO PEERS

Most peer group countries also have a dairy industry dominated by a single or a handful of cooperatives

Presence of dairy industry cooperatives in peer group countries
(2008)

Country	cooperative	Turnover	Volume share	Ownership	Comments/notes
Canada	 agropur	C\$2,805m	~50%+ Quebec ~10% On	3,615 farmers	<ul style="list-style-type: none"> - Founded in 1938 in Quebec - Operations in Canada, US and Argentina
		C\$389m (2007)	~25% Ontario	1,200+ farmers	<ul style="list-style-type: none"> - Founded in Ontario in 1958 as United Dairy and Poultry cooperative
		C\$243m (2007)			<ul style="list-style-type: none"> - Formed in 1900; growth through acquisitions and mergers
		C\$186m (2007)		173 farmers	<ul style="list-style-type: none"> - Founded in Nova Scotia in 1961 as Farmers cooperative Dairy - Expanded through series of co-op mergers
		C\$173m (2006)		1,200 farmers (inc non-dairy)	<ul style="list-style-type: none"> - Founded in 1967 in regional co-op merger; other mergers follow - Merges with meat co-op to form Nutrinor in 1989 - Diversified activities: water, petroleum, pastries, propane (group \$267m)
		C\$171m (07) [inc non-dairy]		650 farmers	<ul style="list-style-type: none"> - Formed in 1966 merger of 2 co-op; additional acquisitions and diversifications into pork, chicken, grain and other foods - Also has farm machinery and building/hardware operations
		C\$125m (2007)	~2% Can 90m l	232 farmers	<ul style="list-style-type: none"> - Formed in 1953 mega-merger of 6 P.E.I. dairy co-op - Also sells farm machinery
		C\$77m (2007)		306 farmers	<ul style="list-style-type: none"> - Formed in 1927 in New Brunswick; growth through acquisition - Also has farm supplies stores
Australia		A\$2,635m (2008)	35%+	2,500+ farmers	<ul style="list-style-type: none"> - Formed in 1950 - Accounts for "9% of world dairy trade"
South Africa		R4.3b	30% SA		<ul style="list-style-type: none"> - Formed in 1898 as Natal cooperative Creamery - Effectively corporatised in 2003 via dual class shares

SIMILAR TO PEERS

Most peer group countries also have a dairy industry dominated by a single or a handful of cooperatives

Presence of dairy industry cooperatives in peer group countries
(2008)

Country	cooperative	Turnover	Volume share	Ownership	Comments/notes
India		US\$1,504m (2008)	3.1b l (2008)	2.8m members	<ul style="list-style-type: none"> Formed as Gujarat Co-op Milk Marketing Federation in 1946 Federation of 13 district co-op
Numerous additional smaller Indian dairy co-op exist		US\$650m (2008)	1.3b kgs	2.0m members	<ul style="list-style-type: none"> Formed in 1974 in Karnataka; formation funded by World Bank 13 milk unions in state; KMF is umbrella body
		US\$161m (2008)			<ul style="list-style-type: none"> Formed in 1981 in Tamil Nadu
		US\$162m (2008)		370,000 farmers	<ul style="list-style-type: none"> Formed in 1973; merged with P. D. Dev. Corp in 1983
Argentina			25% Arg 90% exp		<ul style="list-style-type: none"> Formed in 1938 merger of regional dairy co-op in SantaFe & Cordoba Controls 90% of Argentine dairy exports via export licenses Recently bailed out by Hugo Chavez (Venez.) due to loans to G. Soros
Brazil			1.2b l	8,000 farmers	<ul style="list-style-type: none"> Formed in 1944 privatisation of state milk board (AKA Co-op Minas Gerais) Group is composed of 27 associated dairy co-op
Numerous additional smaller Brazilian dairy co-op exist			241m l (05)	4,500 farmers	<ul style="list-style-type: none"> Formed in 1997 merger of seven dairy co-op
Uruguay		US\$397m (2006)			<ul style="list-style-type: none"> Formed in 1930's by gvnt. to stabilise Uruguayan dairy industry Became highly export driven; strong in UHT into Brazil Was potential takeover target after series of troubles Major McKinsey project to fix business; partnership with Bongrain
South Korea				4,000 farmers	<ul style="list-style-type: none"> Formed in 1937 as Seoul Milk Products

APPENDIX 2 - OTHER FINDINGS

We made a number of other findings in our research

PRIVATE = CHEESE

Large private dairy companies generally focus on a single product, typically cheese

Dairy activities of major corporate dairy companies (2008)

Firm	Turnover	Ownership	Dairy activities	Details
 GROUPE LACTALIS	€9.3b (2008)	Private	<ul style="list-style-type: none"> - Cheese - Fluid milk - Yoghurt 	<ul style="list-style-type: none"> - Founded in 1933 to make cheese by Andre Besnier - Created President brand in 1968; then started acquisition-driven roll-up strategy of French cheese and dairy industry (bringing in non-cheese)
 SCHREIBER	US\$3.5b (2008)	Private	<ul style="list-style-type: none"> - Cheese 	<ul style="list-style-type: none"> - Founded in 1945 to produce cheese; firm is employee owned - Mixture of organic growth and single plant acquisitions
 müller	€2.3b (2008)	Private	<ul style="list-style-type: none"> - Yoghurt 	<ul style="list-style-type: none"> - Theo Muller took over 4 employee family dairy company in 1971 - Growth through yoghurt product innovation - Milk subsidiary Sashsenmilch is publicly listed (w/Muller controlling share) - Operations in Germany and UK
 LFP LeprinoFoods	US\$2.5b (2008)	Private	<ul style="list-style-type: none"> - Cheese 	<ul style="list-style-type: none"> - Founded in 1950 by Italian immigrant; privately owned - World's largest manufacturer of mozzarella cheese
 Hilmar CHEESE COMPANY	US\$1.2b (2008)	Private	<ul style="list-style-type: none"> - Cheese - Whey protein 	<ul style="list-style-type: none"> - Founded 1984 by 12 "dairy families" to add value to their milk - 2 factories (CA & TX); processed 7.1m l milk/year - Produces cheese and whey protein
 Grassland	US\$1.1b (2008)	Private	<ul style="list-style-type: none"> - Butter 	<ul style="list-style-type: none"> - Established in 1904 in Wisconsin by John Wuethrich; still owned by family - Historically butter (retail, private label and foodservice) - Recently installed milk dryer
 Wells	US\$1.0b (2008)	Private	<ul style="list-style-type: none"> - Ice Cream 	<ul style="list-style-type: none"> - Founded in 1913 by Fred Wells as milk deliver; moved into ice cream in 1925 - Three plants (2 IA; 1 UT); ice cream sold in US Midwest
 DAVISCO FOODS INTERNATIONAL, INC.	US\$1.0b (2008)	Private	<ul style="list-style-type: none"> - Cheese (370m lbs) - Whey protein (10m lbs) 	<ul style="list-style-type: none"> - Founded in 1934 by Stanley Davis - Firm is contract packer to Kraft (#1 Kraft cheese supplier) - Claims "65% of whey protein isolates sold globally"
 SARGENTO	US\$0.9b (2008)	Private	<ul style="list-style-type: none"> - Cheese 	<ul style="list-style-type: none"> - Founded in 1948 by Leonard Gentine; still owned by family - First vacuum pack cheese; first pre-shredded cheese; brand & contract pack

SALE OF COOPERATIVES

While a range of peer group cooperatives have decided to (or needed to) sell their business, typically as a result of poor management, these situations should not be confused with listing on the sharemarket

Sale of dairy cooperatives in peer group countries (2008)

Note: 100's of examples exist of poorly managed dairy cooperatives being sold to a range of buyers, from corporates to other co-op

Firm	Country	Sold/ failed	Outcome	Details
	Australia	2005	<ul style="list-style-type: none"> - Acquired by Fonterra 	<ul style="list-style-type: none"> - Formed in 1888 as Cobden and District Pioneer Cheese and Butter Factory - 1,500 suppliers across Victoria and Tasmania - Financially troubled; discussed merger with Murray Goulburn - Merged consumer foods business to into Fonterra's Australian operations in 2002; kept 11% share - Supply co-op (#2 AU dairy exporter) acquired by Fonterra in 2005
	Australia	2008	<ul style="list-style-type: none"> - Vote by farmers to potentially list - Business sold to National Foods 	<ul style="list-style-type: none"> - Formed in 1900 as Dairy Farmers cooperative Milk Co supplying Sydney with milk - Creation of domestic milk marketing board in 1930's; board appoints DF as selling agent - Numerous mergers and acquisitions during 80-90's; Gvnt. deregulates industry in 2000 - Farmers vote to restructure and convert consumer products to "Irish model"; never listed - Business restructured and ultimately sold to National Foods in 2008
	United Kingdom	2009	<ul style="list-style-type: none"> - Poor management - Bad acquisition - Failed and sold in pieces 	<ul style="list-style-type: none"> - Formed in 2000 as one of 3 successor co-op to Milk Marque after the breakup of this co-op by government ; merged with The Milk Group - Spent £75m purchasing Associated cooperative Creameries - Was #3 UK milk processor; 1,800 farmers; 1.3b l; 10% UK milk - Into receivership; farmers lose £50,000; sold in pieces to competitors; members joined other co-op
	Canada		<ul style="list-style-type: none"> - Poor management - Forced to sell assets - Husk remains as milk transport op 	<ul style="list-style-type: none"> - Formed in 1992 in merger of three Alberta co-ops: the Central Alberta Dairy Pool, the Fraser Valley Milk Producers cooperative Association and the Northern Alberta Dairy Pool; later merged with Dairy Producers Sask. and Manco Manitoba co-ops; 1993 sales \$1.1b; 1b l milk - In 1993, created JV with Agropur to pool yoghurt and fresh cheese marketing activities (incl. Yoplait license) - Sold ice cream operations to Nestle in 1997 - Rapid growth was financially mismanaged; forced into liquidation - In 2000 sold Dairyworld Foods (C\$1.5b sales; 3,200 emp, 24 plants), its fluid milk and cheese operations to Saputo (for whom it has been very profitable)

COOPERATIVES - PRIVATE EQUITY

A number of dairy cooperatives have brought in external equity

Dairy cooperatives that brought in external equity in peer group countries

(various)

Firm	Country	Year	Outcome	Details
	Argentina	?	- Unclear at this point	- Formed in 1938 merger of regional dairy co-op in SantaFe & Cordoba - Controls 90% of Argentine dairy exports via export licenses - Recently bailed out by Hugo Chavez (Venez.) due to loans to G. Soros
	Brazil	?	- Unclear at this point	- Details are in Portuguese
	France	2002	- No decision made to date on partially listing Yoplait	- Sold 50% ownership of its daughter company Yoplait for a capital infusion of € 250m from Banque National Paribas Affaires Industrielles (PAI) - Proposed to list Yoplait within three to five years; no results to date
	Israel	2008	- Looking to clean up historic convoluted ownership - Controlling share sold to PE Funds	- Formed in 1920; 620 members (Kibbutzim/Moshavim); largest dairy mnfr. In Israel (~70% share) - Produces consumer dairy products and has meat/deli/egg and other division - Dairy farmer members wish to keep co-op; all other members want to sell; struggle/tensions - Auction held for non-dairy shareholders share; Apax Partners and Mivtach Shamir acquires 76.6% share in 2008 for NIS2.88b; remainder held by other shareholders (primarily dairy)
	Serbia	2003	- Upgraded plant - Brought in PE equity	- Formed in 1955 as Subotica cooperative Dairy; merged with Belgrade and Sarajevo co-op in 1963 - Upgraded to 1.3b l capacity EU compliant plant in 2003 - Salford Investment (UK) then buys majority control
	Spain	?	- Bongrain likely owner long run?	- 56.39% held by the cooperative Central Lechera Asturiana, S.A.T. - Other shareholders include the French Bongrain Group with 27% and a group of regional Spanish financial entities with 15.89%.
	Italy	2004	- Unclear at this point	- Offered 20% of shares to Intesa Bank to fund €72m acquisition of Yomo - Intention was to list to provide Intesa with exit
	Austria		- Austrian mega-merger at some point?	- Brought in Austrian Raiffeisen (cooperative) bank as shareholder; Parmalat also has share? - Regular rumours of Austrian dairy industry mega-merger

