FUNDAMENTAL PRINCIPLE

THE FARM GATE MILK PRICE IS THE DEFAULT FOR THE MARKET PRICE FOR MILK

- Independent processors must pay their farm suppliers an annual milk price close to the annual farm gate milk price or risk losing them

- Fonterra uses the notional producer model, based on the DIRA, as a basis for determining the farm gate milk price.

- Only one known deviation known from this approach – being the 2013/14 season where a lower milk price was paid
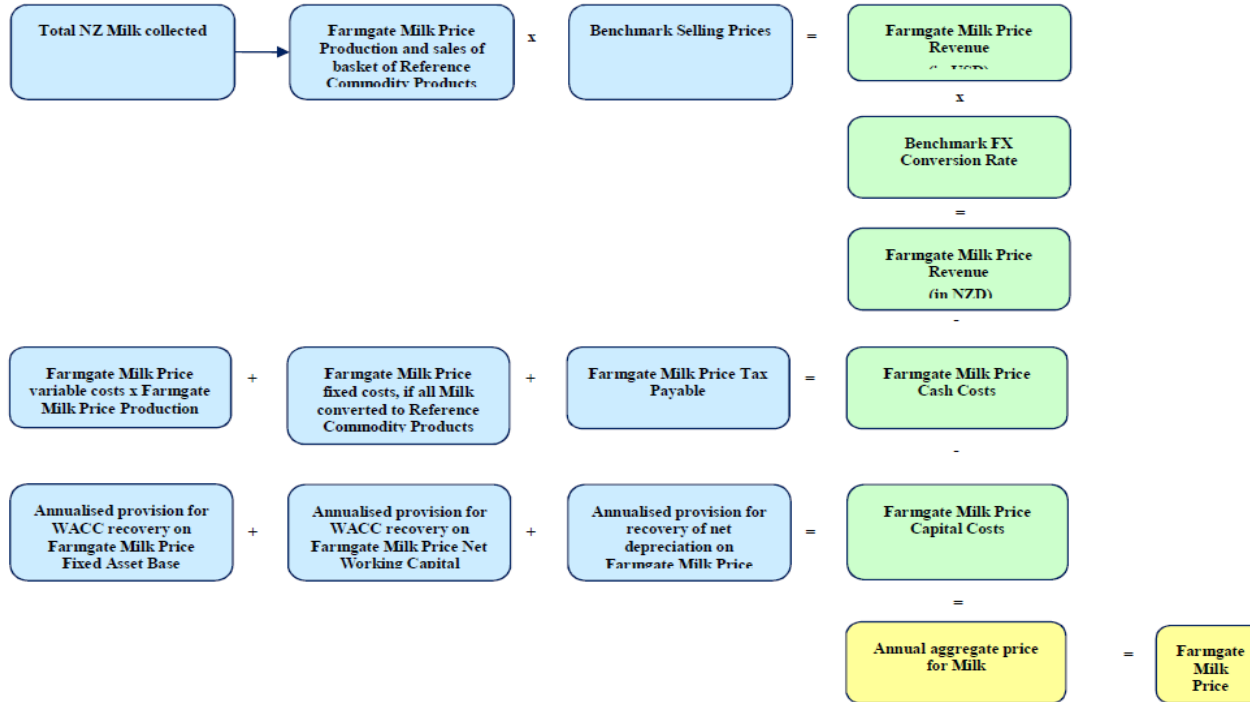
FORECASTING ANNUAL MILK PRICE CRITICAL

- As a listed company accurately forecasting full year result during the year accurately is essential

- The cost of milk represents approximately 70% of our cost of sales. Just a 10 cent milk price movement has an approximate $6.0m before tax impact on our results. This is only 1.5% of an annual $6.50 milk price or 2.2% of an annual $4.50 milk price

- Under NZX continuous disclosure rules the Board is required to notify the market if they believe that our annual forecast result will be 10% greater or less than market expectations. In FY16 a 10% variation was only $5.0m before tax

- Therefore we MUST have reasonable certainty of how the annual milk price mechanisms operate in the notional producer model to produce an effective annual forecast

SO HOW DO WE DO THIS??

- Independent processors have each developed their own version of the notional producer model applying the methodology outlined in the following slide

- Clearly there are many variables applied within the model which ultimately predicts the annual milk price

- Each year we review the annual Milk Price Statement (MPS) released by Fonterra with its Annual Result and identify changes in assumptions between our own model and that actually applied by Fonterra in the previous season

- We then update our model for the next season (already 4 months into the new year), together with any other Fonterra announced changes to be made to the NPM

FARMGATE MILK PRICE METHODOLOGY

| Total NZ Milk collected | → | Farmgate Milk Price Production and sales of basket of Reference Commodity Products | x | Benchmark Selling Prices | = | Farmgate Milk Price Revenue (in USD) |

x

Benchmark FX Conversion Rate

=

Farmgate Milk Price Revenue (in NZD)

-

| Farmgate Milk Price variable costs x Farmgate Milk Price Production | + | Farmgate Milk Price fixed costs, if all Milk converted to Reference Commodity Products | + | Farmgate Milk Price Tax Payable | = | Farmgate Milk Price Cash Costs |

-

| Annualised provision for WACC recovery on Farmgate Milk Price Fixed Asset Base | + | Annualised provision for WACC recovery on Farmgate Milk Price Net Working Capital | + | Annualised provision for recovery of net depreciation on Farmgate Milk Price | = | Farmgate Milk Price Capital Costs |

=

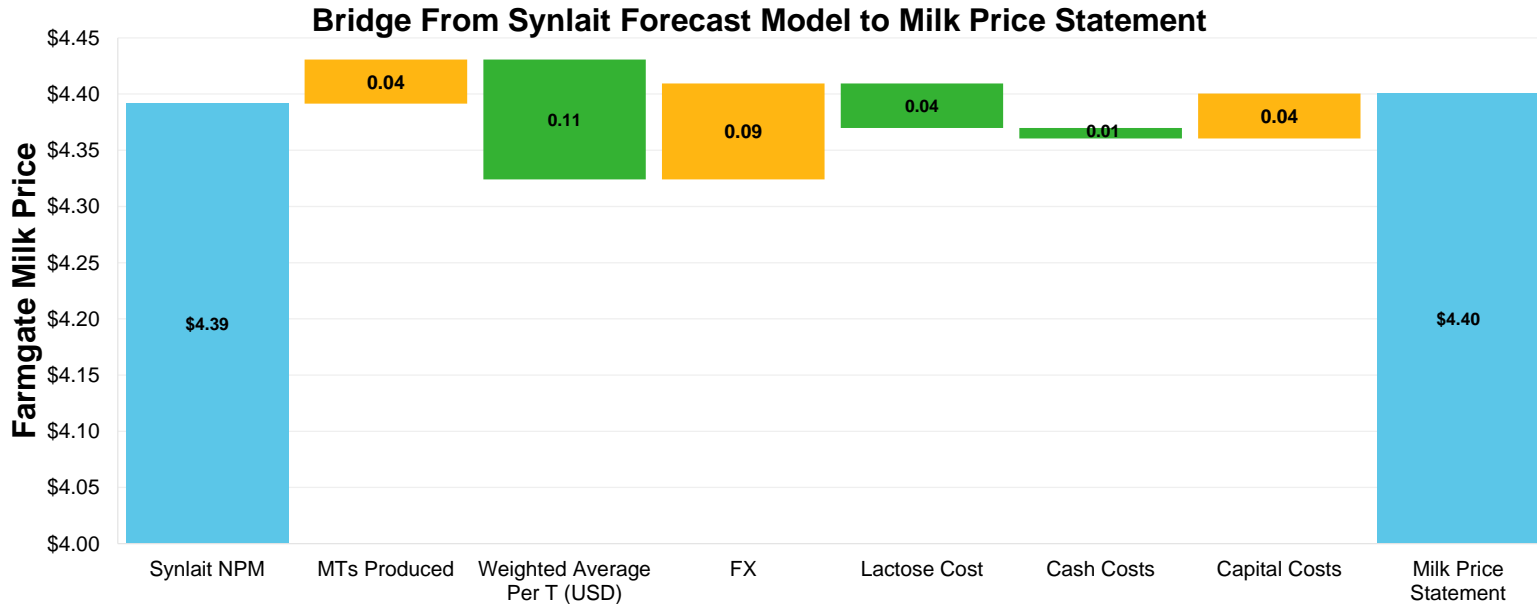Annual aggregate price for Milk   =   Farmgate Milk Price

EXAMPLE – 2014/15 SEASON

- What are the variables we particularly focus on when reconciling to the MPS –

1. Milk production curve
2. Production mix
3. Sales prices
4. Sales curve
5. FX
6. Raw material costs
7. Cash costs
8. Capital costs

HOW DID FGMP STATEMENT COMPARE TO THE NPM

There was a 1 Cent variance for the 2014/15 Milk Price Fonterra paid in comparison to our NPM. However, there were a number of large variations

Bridge From Synlait Forecast Model to Milk Price Statement

Waterfall chart — Farmgate Milk Price (y-axis $4.00 to $4.45):
- Synlait NPM: $4.39
- MTs Produced: 0.04
- Weighted Average Per T (USD): 0.11
- FX: 0.09
- Lactose Cost: 0.04
- Cash Costs: 0.01
- Capital Costs: 0.04
- Milk Price Statement: $4.40

FOCUS ON THREE KEY VARIABLES

- The three key variables that drive the annual FGMP are –
  - Sales Phasing
  - Product Mix
  - Foreign Exchange

- The impacts of differences in sales phasing and product mix are included within the "Weighted Average per MT (USD)" bridge item – 11 cent upside in 2014/15. Also included in this bridge item is the impact of calculating the weighted average USD sales price

- The foreign exchange difference between Synlait and the NPM resulted in a 9 cent downside

# SALES PHASING IMPACT

Sales Curves
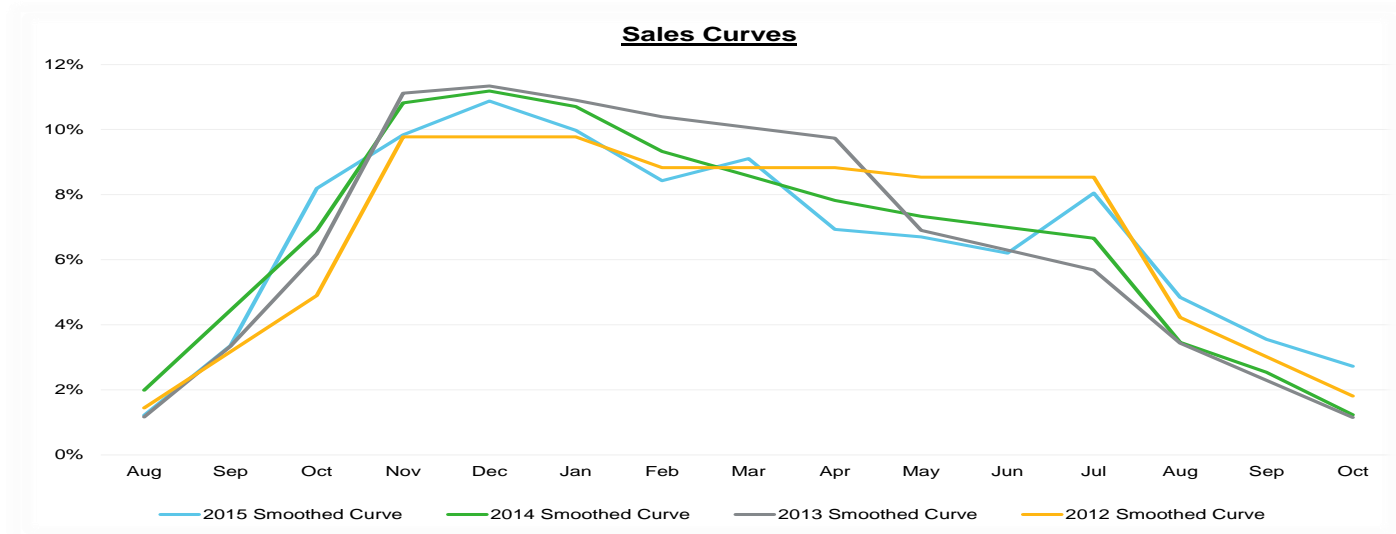
- The above graph reflects for the fours years ended 2015 a different sales phasing curve applied every year. This can lead to either positive or negative impacts on the IP's assumed sales phasing curve

- During the FY15 season there were multiple large fluctuations in forecasts of production and thus availability on the GDT platform. This has resulted in what can only be described as a bazaar sales curve.

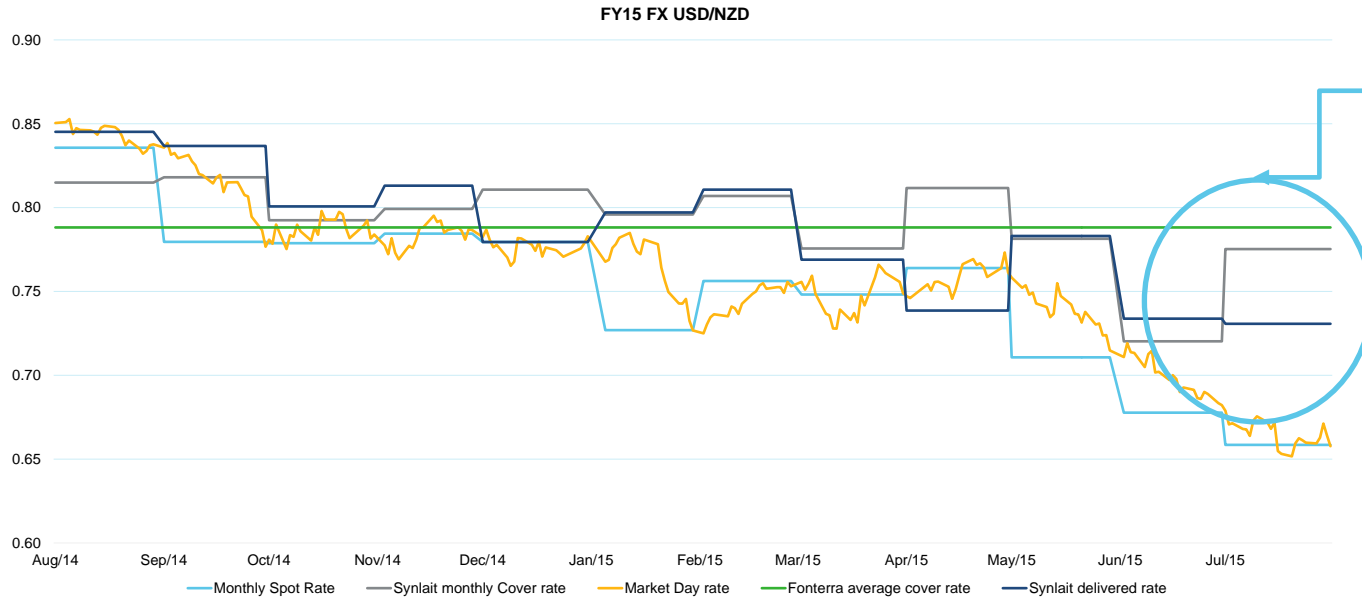## This created an approximate 18 cent upside in our model vs the NPM

(Milk Price manual)

PRODUCTION MIX IMPACT

The MPS declared a WMP mix of 65%. This was significantly higher than the previous five year range of between 57%-63%. Our model assumed the mid-point of this range being 61%. Model impact was a 7 cent downside

Production Mix

FX IMPACT

FY15 FX USD/NZD
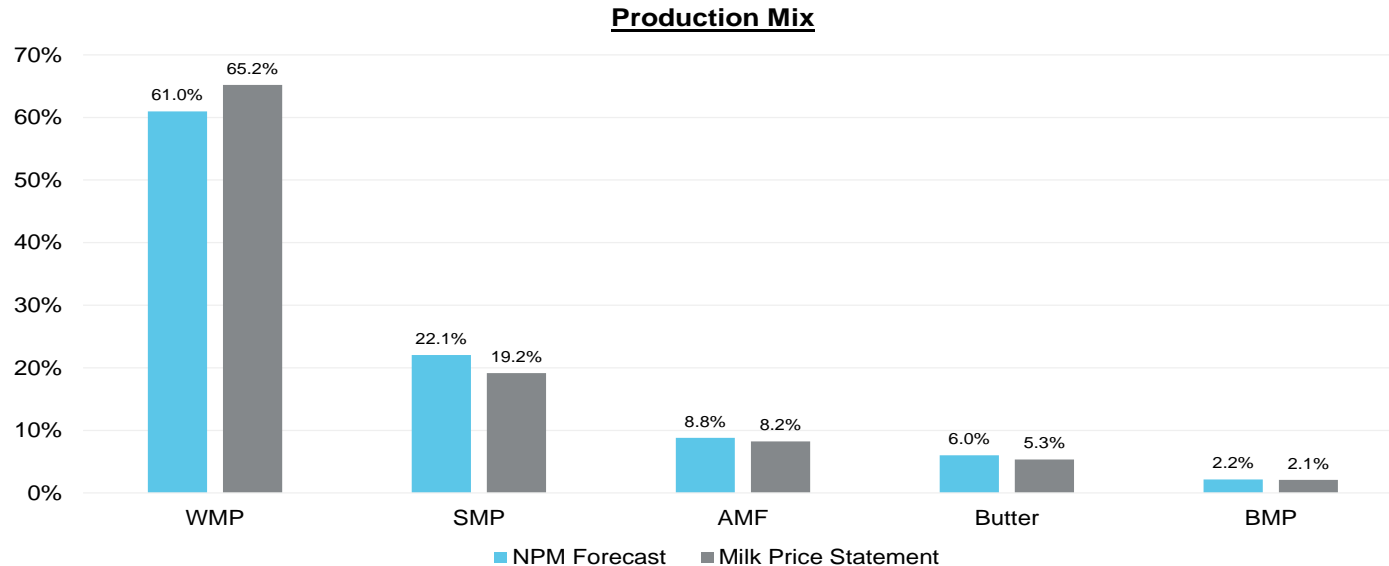
Fonterra actual FX rate of 0.7882 vs Synlait actual FX rate of 0.7985.
Difference of 1.03 cents impact = 9 cents

Legend: Monthly Spot Rate — Synlait monthly Cover rate — Market Day rate — Fonterra average cover rate — Synlait delivered rate

At no point during the year did we have any real insight as to where the Fonterra annual average FX rate would land

MORE TRANSPARENCY REQUIRED

- Transparency is not about whether or not certain attributes applied in the model are practical feasible or not – that is a separate argument

- Transparency is about providing more insight throughout each milk price season as to –
  - What are the assumptions being applied related to the key variables applied in the NPM
  - What changes are being applied in the model for that season, not previously advised

- Being transparent at the end of the season is only helpful to -
  - understand where we went wrong in our assumptions
  - What changes we need to make to our models for the next season

WHY NOT BE MORE TRANSPARENT

▪ So the key question to ask is why Fonterra has to date refused to be more transparent – even though the Commerce Commission has requested this?

▪ We do not see that this transparency is asking Fonterra to disclose commercially sensitive information as -

– It is ultimately disclosed at the end of the season

– It is not information that provides IP's with the ability to impact Fonterra's commercial operations

▪ Transparency is a reasonable expectation and should be implemented

EXPANDED DISCLOSURES

- Milk price model:
  - Monthly rather than quarterly data
  - Product compositions
  - Unbundling of line items (eg fixed and variable cost lines)
- Regular disclosure of selected items:
  - Forecast conversion rate used in the Fonterra milk price forecasts
  - Historical outcomes advised quarterly:
    - Sales phasing
    - Working capital (base for WACC charge)
- Delivering against previous disclosure commitments:
  - Expanded disclosures to identify impact of sales phasing on selling prices (GDT phasing vs NP phasing)
  - Disclosures to identify the impact of including off-GDT sales