

For Stuart and Lorae King. Te Aroha Fonterra dairy farmers supply number [REDACTED]

We are active dairy farmers of 34 years experience and are founding Fonterra members.

We noted that during the industry discussions for Fonterra's formation great importance was placed on the setting of a Fonterra farm gate milk price. We understood that setting if the milk price should provide an efficiency stretch incentive for Fonterra while not being set artificially high and unfairly killing off competition. We are concerned that while milk price is the most important parameter to both farm owners and sharemilkers that conflict between the desire to achieve profit and give a fair milk price can led to perverse outcomes and undermine accountability.

From a Fonterra farmers perspective we believe that unhelpful deficiencies in the way that milk price model is calculated have been revealed by events past two (2014 and 2015) Fonterra financial years.

-in the 2014 the Fonterra milk price was reviewed down from the model price of \$8.93 to \$8.40. This was stated by Fonterra as necessary because the companies product mix could not support the returns based on the model. While farmers noted the use of discretion in setting the milk price they were surprised that the use of discretion went to the extent of providing for sufficient profit to allow for a 10 cent dividend.

-in the 2015 Fonterra Annual Review earnings of \$729 million for reference products and \$614 million for non-reference products is given. This translates to gross margins for reference products of \$376 and \$980 per ton for non-reference products. We submit that the discretion used adjust the milk price in 2014 should be used to recognise the average \$500 per ton gross margin earned by the reference and non-reference products in comparison to the GDT based values.

We also submit that the substantial amount contributed by non-reference products needs to be included in the milk price model to avoid issues such as arose in both 2014 and 2015. Given that Fonterra's accounts show that the amounts earned on sales of ingredient products are substantially higher than those achieved on GDT we believe that this recognition of value should be considered when modelling the milk price.

We submit that Fonterra's initiative of offering supplying shareholders support via an interest free loan would have been better served through using discretion to increase the milk price particularly given the gross margins achieved on ingredient sales. Many sharemilkers supplying Fonterra have their contract income based on milk price and their need for support is in many cases greater than farm owners.

Thankyou for the opportunity to submit;
Stuart and Lorae King

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