New Zealand Shareholders Association Inc.
NZSA
Many Investors, One Voice

30 November 2021

Fonterra Shareholders Fund (FSF)

The company will hold its Annual Shareholders Meeting at **10.00am Monday 13 December 2021.**

It will be a virtual meeting. You can join the meeting online

Company Overview

The Fund was established in 2012 to allow non-dairy farmers to trade the economic rights in Fonterra shares. The Fund is externally managed by FSF Management Company Ltd. It derives its income from the dividend paid by the Co-Operative on the shares held by the Fund.

The Co-Operative is holding a Special Meeting in December to consider a Capital Structure Review. One of the issues the Co-Operative has faced is that farmer suppliers are required to hold 1 share in the Co-Operative for every 1KG MS they supply. This can put financial pressure on farmers at different stages of their career and has been a factor in farmers leaving the Co-Operative.

The proposal includes a provision to have a flexible shareholding with a minimum of 1 share for every 3 KG MS to a standard shareholding of one for one and allowing up to 4 shares for every 1KG MS.

Current Strategy

To provide a platform to allow non-dairy farmers to trade the economic rights in Fonterra shares.

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Key

The following sections calculate an objective rating against criteria contained within NZSA policies.

Colour	**Meaning**
G	Strong adherence to NZSA policies
A	Part adherence or a lack of disclosure as to adherence with NZSA policies
R	A clear gap in expectations compared with NZSA policies
n/a	Not applicable for the company

Governance

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Directors Fees	n/a	See comment below.
Director unit ownership	A	See comment below.
Executive Remuneration	n/a	The Fund is externally managed.
Golden parachutes/handshakes	n/a	The Fund is externally managed.
Director Independence	G	See comment below.
Board Composition	A	See comment below.
Director Tenure	G	See comment below.
ASM Format	G	Virtual due to uncertainty around Covid restrictions.
Company Sec independence	G	Good disclosure.

Director's Fees: We note these are paid by Fonterra (the Manager). They comprise $80,000 for the Chair and $53,000 for each independent director.

Director Unit Ownership: Not disclosed if Directors are required to own units. NZSA policy is that this should left to individual Directors according to their personal circumstances.

Director Independence: Three of the five Directors are appointed by unit holders, with two appointed by Fonterra. Unusually, we note that the Chair of FSF is also the Chair of the Audit Committee.

We believe at this time, the role and profile of independent directors is critical for unitholders in FSF.

During 2021, Fonterra has proposed winding up the FSF (May) although it is now proposing a 'capped' fund (September) into which former farmer suppliers would not be able to exchange their shares. Since the May announcement, the FSF share price has tracked well above the corresponding price for Fonterra (FCG) shares. FCG shares can only be owned by supplier-farmers or associated parties.

Fonterra shareholders (**not** FSF unitholders) will vote on the proposal at a special meeting on December 9th – prior to the FSF unitholder meeting. This will see the introduction of a "flexible" shareholding for farmer-shareholders in FCG, allowing farmers to increase their holding beyond current supply-related allowances.

The proposal includes a cap on the size of the FSF at 10% of FCG (it currently holds 6.7%).

There is some validity to media commentary that suggests that the new structure will act to curb the ability of Fonterra to raise additional capital from external investors. While FCG may feel it currently has appropriate capital to meet current needs, this may act as a significant constraint in future.

It also further enshrines the inherent conflict of interest between payments to suppliers who are also the majority shareholders of the company.

Essentially, an investor in the FSF is a minority investor in a larger organisation that has some commercial incentive to work against the interests of minority investors. NZSA remains concerned about the ability of the FSF to influence Fonterra for the benefit of Fonterra shareholders as compared with suppliers.

Director Tenure: NZSA looks for evidence of ongoing succession or 'staggered' appointment dates that reduce the risks associated with effective knowledge transfer in the event of succession. We prefer directors to serve a term of no between 9-12 years as a means of maintaining innovation and managing institutional knowledge transfer.

Currently, all directors have served less than 9 years, although we note the proposed election of John Shewan for a further term and the accompanying comments in the Annual Report. NZSA believes this is appropriate in the circumstances, as a means of ensuring continuity in ensuring that the rights of unitholders are upheld within Fonterra's potential capital structure changes.

Board Composition: There is no skills matrix to demonstrate how the individual Directors skill sets contribute to the governance of the fund. The fund does not participate in the IoD's Future Director Programme; NZSA believes that NZX listed entities have a responsibility to mentor and develop the next generation of Directors.

ASM Format: Covid-19 restrictions have meant this is a virtual-only meeting, a decision supported by NZSA in this context. Normally, NZSA favours a hybrid meeting, to maximise shareholder attendance and engagement through both virtual and physical means.

Audit

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Audit independence	G	Good disclosure
Audit rotation	A	See below

Audit rotation: Whilst the company ensures the Lead Audit Partner is rotated at 5 years (an NZX Listing requirement), it does not disclose if the Audit Firm is rotated at 10 years. Its also does not disclose the appointment dates of the Lead Audit Partner or Audit Firm. Whilst this is common amongst NZX companies, NZSA prefers transparent disclosure of appointment dates.

Ethical and Social

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Whistleblowing	n/a	The Fund is externally managed
Political donations	G	There were no donations made.

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Financial & Performance

Policy Theme	Assessment	Notes
Dividends and Imputation	G	Good disclosure
Capital Raise process	n/a	There was no capital raising

Fonterra shareholders fund's share price fell from $4.42 to $3.66 (as of November 23rd) over the last 12 months – a 17% decline. This compares unfavourably with the NZX 50 which increased by 2% in the same period. The *Performance Factor* for FSF is -8.99.

The table below shows metrics applicable to the Fonterra Co-operative. FSF owns 6.6% of Fonterra.

Metric	2021 (m)	2020 (m)	Change
Revenue	$20,565	$20,282	1%
Gross Profit	$2,984	$3,062	-3%
NPAT	$578	$686	-16%
Gross Profit Margin	15%	15%	n/c
EPS[1]	$0.358	$0.426	-16%
PE Ratio	10	10	
Current Ratio	1.29	1.43	-10%
Debt Equity	1.52	1.67	-9%
Operating CF	$1,278	$1,565	-18%
NTA Per Share[1]	$2.87	$2.77	4%
Dividend Per Share[1,2]	$0.20	$0.05	300%

[1] *per share figures based off actual shares at balance date (not weighted average)*

[2] *Dividends relate to FSF*

Fonterra Shareholders Fund (FSF) is basically a holding company that owns shares in Fonterra Co-operative Group Limited (FCG). How much influence, if any, the directors of FSF have on FCG is debateable. This structure was established to allow non-supplying investors to invest in Fonterra. There are 107.4 million units of FSF and there are a total of 1,613 million FCG shares.

This raises an interesting dilemma and a conflict of interests between suppliers and shareholders. Suppliers would rather receive a higher price for their commodity, but a higher price means a higher cost of sales and subsequently a lower profit and thus earnings for shareholders.

The above metrics in the table relate to the Co-operative or FCG, as this is where FSF derive their income and there is a direct correlation between the performance of FSF and FCG.

Revenues improved slightly for FCG to $20,565m and *NPAT* attributable to shareholders of the company was down 16% at $578m. The gross profit margin remained steady at 15% and EPS delivered to shareholders of the company was $0.358, placing FSF on a PE of 10.

The company is in reasonably sound financial position with a *current ratio* above 1 and a debt equity ratio of 1.52. This is still relatively high but is manageable and the company retired $1b of *long-term* debt during the year, although short term liabilities did increase by $0.4b.

The company paid $0.20 cents in *dividends* for the year. Dividends are not imputed.

Resolutions

1. To re-elect John Shewan as an Independent Director.

John Shewan was appointed Chairman when the Fund was established in November 2012. He also chairs the board of Munich Reinsurance Australasia and is a Director of China Construction Bank (New Zealand) Limited. He is an Adjunct Professor in the Business School at Victoria University of Wellington.

We note that if he is re-elected, he will have served 12 years at the end of that term. NZSA policy is that unless there are exceptional circumstances a Director should only serve 9 years. In addition, it is internationally recognised that a Director ceases to be considered independent after they have served 12 years.

We note the following statement in the Chairman's Letter to Unitholders in the Notice of Meeting.

"I was originally appointed to the Board of the Manager by Fonterra when the Fund was established in 2012. Having served three terms, it was my intention to retire from the Board at this year's Annual Meeting. However, Fonterra's Capital Structure Review, and the potential implications for unit holders, have caused me to conclude that this is not an appropriate time for the Chair to step down from the Board. There is currently uncertainty over the outcome of Fonterra's Capital Structure Review. The role the Capital Structure Review Subcommittee of independent Directors of the Manager performs in representing unit holders' interests is important. I believe there are benefits in continuity of independent directors during this period."

We will vote undirected proxies **IN FAVOUR** of this resolution.

Proxies

You can vote online or appoint a proxy at https://www.investorvote.com.au/

Instructions are on the Proxy/voting paper sent to you.

Voting and proxy appointments close **10.00am Saturday 11 December 2021.**

Please note you can appoint the Association as your proxy. We will have a representative attending the meeting.

STANDING PROXIES - AUTOMATICALLY APPOINT NZSA AS YOUR PROXY

MAKE YOUR VOTE COUNT!

Details on the NZSA website.

https://www.nzshareholders.co.nz/your-proxy-counts/

The Team at NZSA