

November 1st 2023



Fonterra Shareholders Fund (FSF)

The company will hold its Annual Shareholders Meeting at **10.00am Monday 13 November 2023.**

The location is **Fonterra's Auckland Offices 109 Fanshawe Street, Auckland.**

You can also join the meeting online [here](#).

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.

In essence an investor in the Fund 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 Fund to influence Fonterra for the benefit of Fonterra shareholders as compared with suppliers.

We note the previous Chair's comments in his report in the FY22 Annual Report (emphasis added):

*"The concerns of the Independent Directors of the Manager of the Fund over the impact of the capital restructuring on the Fund's unit price have been outlined in detail in market updates, and at the 2021 annual meeting. **It is the Independent Directors' view that Fonterra should have offered to buy back the Fund, the units in which were trading at \$4.60 when the restructuring plans were announced in May 2021.**"*

This position was completely supported by NZSA. We believe that the well-intended controls established at the time of establishment of the Fund (including reference price benchmarks and the ability for Commerce Commission review) have failed to curb the natural incentive for FCG to operate in farmer-suppliers' interests.

However, we also note that the capital structure changes last year that now allow farmer-suppliers to purchase up to three times the number of shares they were able to previously may have some consequence in better aligning farmer interests with those of unitholders in FSF.

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	G	See below.
Director unit ownership	A	See below.
Executive Remuneration	n/a	The Fund is externally managed.
Golden parachutes/handshakes	n/a	See above.
Director Independence	G	See below.
Board Composition	A	See below.
Director Tenure	G	See below.
ASM Format	G	Hybrid Meeting
Independent Advice for the Board and Risk Management	G	See below.

Directors Fees: We note these are paid by Fonterra (the Manager). They comprise \$80,000 for the Chair and \$43,000 for each independent Director.

Director Unit Ownership: There is no disclosure as to whether Directors are required to own units, however only two Directors hold units indicating there is no compulsion. While NZSA encourages unit ownership by independent Directors, it does not support compulsion as this reduces the pool of available Directors, may compromise independence, and removes the ‘market signal’ associated with unit purchases.

Director Independence: Three of the five Directors including the Chair, Mary-Jane Daly, are independent, with the remaining two appointed by the Manager Fonterra. We note that the role of Chair is not disclosed on nzx.com.

Board Composition: The Annual Report does not include a skills matrix that attributes skill sets to individual Directors to demonstrate how they contribute to the governance of the Fund.

The Fund does not participate in the IoD’s Future Director programme designed to develop and mentor the next generation of Directors. NZSA expect NZX50 companies to participate as part of a responsibility to develop and mentor the next generation of Directors.

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 also prefer a term maximum of 9-12 years, unless there are exceptional circumstances that may apply.

One Director was appointed in 2019, one in 2020 and three in 2022. Although not an issue in the short-term care will need to be given to rotation to ensure an orderly transition to prevent the loss of institutional knowledge.

Independent Advice for the Board & Risk Management: NZSA looks for evidence, through disclosures, that a Board has access to appropriate internal and external expertise to support board assurance activities. We also look for evidence that Boards are across their risk management responsibilities.

The Board Charter allows Directors to seek external independent advice but are expected to consult the Chair before seeking advice. There is no disclosure around Board access to internal assurance support. The Fund does not have an internal audit function.

There is good disclosure of business and operational risks associated with the Fund, together with risk management and governance processes.

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 Fund ensures the Lead Audit Partner is rotated at 5 years as required by the NZX Listing Rules, it does not disclose if the Audit Firm is rotated at 10 years. NZSA also expects disclosure of the appointment dates of the Lead Audit Partner and Audit Firm to improve transparency for investors.

Environmental Sustainability

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment
Approach	G
Sustainability Governance	G
Strategy and Impacts	G
Risk and Opportunity	A
Metrics and Targets	G
Assurance	G

Overall approach: The 2023 Annual Report for Fonterra’s Shareholders’ Fund focuses on statutory disclosures only. It directs readers to the separate Sustainability Report and Corporate Governance Statement for the Fonterra Co-operative – a reasonable approach given that the Fund only holds interests in this company.

Fonterra Co-operative Group has a good track record of Sustainability reporting, preparing disclosures since 2017 and seeking external assurance for each one. Unsurprisingly in this context, Fonterra Group performs well in our assessment.

Sustainability Governance: FCG does not disclose their Board Skills Matrix. However, they do dedicate resources to Sustainability issues via their Sustainability Advisory Panel, established in 2018.

Strategy and Impact: Fonterra discloses the environmental impacts on their business strategy and has outlined their approach to helping farmers understand their emissions, decarbonising their manufacturing operations and improving animal welfare. Principle 6 of their Corporate Governance Statement outlines the key risk areas (including environmental sustainability) they face.

Risk and Opportunity: Despite good disclosure in all other areas of environmental sustainability, Fonterra’s Sustainability Report does not provide a detailed description of their environmentally related risks and opportunities. The risks identified in their Corporate Governance Statement are ‘broad’ in nature and do not drill down into specific environmental risks or mitigation strategies.

Metrics and Targets: Fonterra provides tables and graphs of their GHG Emissions (including Scope 3) with comparative data from FY22 and against their 2018 baseline, which they appear to be making progress towards reducing. They also disclose a detailed table of other environmental metrics, their short and long-term targets and comparative data showing their progress.

Assurance: For NZX-listed companies, Fonterra is a market leader in providing external assurance. Since producing their first Sustainability Report in 2017, Fonterra has engaged Bureau Veritas to provide assurance that their reporting complies with GRI standards.

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	No donations were made.

Financial & Performance

Policy Theme	Assessment	Notes
Capital Management	G	Dividends received from Fonterra are paid in full to Unitholders.
Takeover or Scheme	n/a	<i>n/a if no takeover</i>

Fonterra shareholders fund’s share price fell from \$3.92 to \$3.05 (as of 18th October 2022) over the last 12 months – a 22% decline. This compares unfavourably with the NZX 50 which declined by 17% in the same period. The capitalisation of FSF is \$321m placing it 58th out of 130 companies on the NZX by size and makes it a mid-sized company.

Metric³	2020 (m)	2021 (m)	2022 (m)	2023 (m)	Change
Revenue	\$20,282	\$20,565	\$22,953	\$24,658	7%
Gross Profit	\$3,062	\$2,984	\$3,216	\$4,259	32%
NPAT	\$686	\$578	\$661m	\$1,241	88%
Gross Margin	15%	15%	14%	17%	23%
EPS ¹	\$0.426	\$0.358	\$0.362	\$0.98	171%

PE Ratio	10	10	8	3	
Current Ratio	1.43	1.29	1.34	1.31	-3%
Debt Equity	1.67	1.52	1.72	1.33	-22%
Operating CF	\$1,565	\$1,278	\$193m	\$3,182	1,549%
NTA Per Share ¹	\$2.77	\$2.87	\$2.94	\$3.82	30%
Dividend per Share ^{1,2}	\$0.05	\$0.20	\$0.20	\$0.50	150%

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

² Dividends relate to FSF

³ Metrics relate to the wider Fonterra Co-operative Group

Fonterra Shareholders Fund (FSF) is a fund that only 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 a total of 1,609 million FCG shares.

This raises an interesting dilemma and the *potential* for a conflict of interest 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. As noted earlier in this document, there are a series of controls in place to minimise the risk of that conflict occurring.

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

Revenues improved by 7% for FCG to \$24.7m and NPAT attributable to shareholders of the company was up 170% at \$1,577m. The gross profit margin increased 23% to 17% and EPS delivered to shareholders of the company was \$0.98, placing FSF on a very low PE of 3. (Assuming earnings flow through directly)

The company is in sound financial position with a current ratio above 1 and a debt equity ratio of 1.33. During the year the company retired a large amount of long-term debt with non-current interest bearing debt falling from \$4,900m to \$3,156m. Current borrowings did increase from \$356m to \$887m.

Inventory levels fell 16% to \$4.3b and this impacted the operating cashflow which rose to \$3,182m in FY 23.

In a comprehensive and interesting [71 page](#) results presentation, Fonterra forecast 2023/24 season Farmgate Milk Price range of \$6.00 - \$7.50, with a midpoint of \$6.75, that reflects ongoing volatility and reduced demand for powders. FY24 earnings guidance is in the range for continuing operations of 45 - 60 cents per share, reflecting lower ingredients margins.

The company paid \$0.50 cents in dividends for the year. Dividends are not imputed but FSF is a Foreign Investment Variable Rate PIE – therefore, the whole distribution is excluded income for NZ resident investors.

ACC are the largest unitholder with a 4.86% stake in the Fund.

Resolutions

1. To re-elect Mary-Jane Daly as an Independent Director.

Mary-Jane (“MJ”) Daly was appointed to the Board in November 2020 and Chair in November 2022. She is Chair of AIG Insurance New Zealand Limited, and an Independent Director of Kiwi Property Group Limited and Kiwibank Limited. She is also a member of the MBIE Risk and Advisory Committee. She has served on the boards of Auckland Transport, Toka Tu Ake EQC, Cigna Life Insurance, Airways Corporation of New Zealand, and the New Zealand Green Building Council. In her executive career MJ worked mainly in banking and insurance in a variety of roles both in New Zealand and the UK. Her last executive role was as Executive General Manager at State Insurance. Prior to this appointment she was Chief Financial Officer for IAG in New Zealand. MJ spent four years with Fonterra as Group Treasurer and Risk Manager. Her earlier career was spent with BNZ, National Australia Bank, and Toronto-Dominion Bank. MJ holds an MBA from City University in London, a BCom from Canterbury University and is a Distinguished Fellow of INFINZ, a Fellow of the Financial Services Institute of Australasia and a Chartered Fellow of the Institute of Directors New Zealand.

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 November 2023.**

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

The Team at NZSA