ALL OF US TOGETHER...

FONTERRA ANNUAL REPORT 2012
FONTERRA CO-OPERATIVE GROUP LIMITED

Fonterra shareholders, Martin O'Neill and Tania Connor with son Cody O'Neill. The couple farm at Opotiki.

ONE PLACE ONE PEOPLE ONE AMBITION

Fonterra is one to the power of many – the thousands of shareholders and our people who work together as one seamless unit to bring the best of dairy nutrition to the world. That's the co-operative way, all of us working to one purpose for the benefit of all.

CONTENTS:

CHAIRMAN'S REVIEW

The past twelve months have been intense, but worth it. I can pass on the Chairman's baton knowing our Co-operative is in good hands and in good heart.

Good hands because we have a leadership team led by a Chief Executive whose commitment to the Co-operative is as big as his ambition for us. We have a Chairman-elect whose belief in the co-operative model comes from his heart as a farmer and his head as an astute director. Behind them both are good, loyal shareholders and staff.

Good heart because, even though it's been a year of intense and sometimes divisive debate, we are unanimous on the value of our co-operative model and farmer control and ownership of it. We've all worked hard in the co-operative's best interests all year. We've also got on with the job, with record milk flows, production and export volumes showing our integrated co-operative model working at its best.

The effort has paid off. Twelve months ago we were still wrestling with the redemption risk which has been hanging over Fonterra since our formation in 2001.

Today, we have in Trading Among Farmers (TAF) a solution which takes care of redemption risk and retains 100 per cent farmer control and ownership.

The 66.45 per cent vote in June which gave TAF the go-ahead was a massive milestone on a six-year road. I am tremendously proud that shareholders turned out in record numbers, representing over 85 per cent of milksolids – the best turnout I have seen in 20 years of co-operative governance. I am also tremendously proud of their tenacity. It's been a long and exhaustive effort by the entire Co-operative, but it has been worth it. There is more work to be done, but the back of the work is broken.

TAF will solve a challenge which has been with us since day one. Our capital structure was always a weakness because of redemption risk. We made the decision to live with it in return for the bigger prize of getting Fonterra under way.

Now, TAF will ensure a stable, permanent capital base for the Co-operative, secures our future and will support progress with our strategy to grow volumes and value. We broke new ground with the formation of Fonterra. We are doing it again with a robust solution which is unique to us and we are close to implementation.

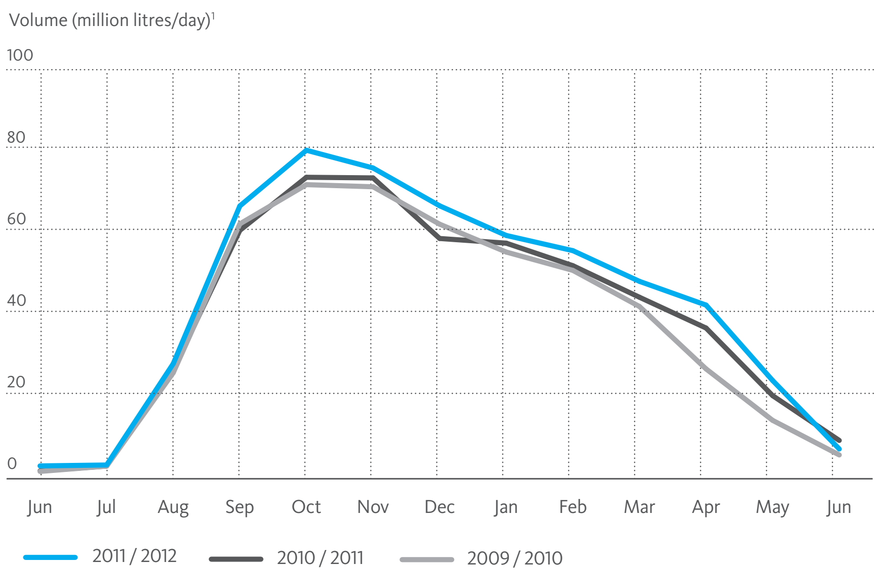
We have always had vigorous debate before making the game-changing decisions. Debate is healthy and necessary.

It crystallises what's important, and that's a co-operative controlled and owned by farmers. We also recognised the value we have in our integrated business model and the competitive advantage this gives us.

We are now a single-minded, customer-led and focused business, with an unbroken supply chain right back to the farmgate. Our integrated business model, which puts us in control of quality, food safety and product mix, is a real competitive strength. We will be driving it for all it's worth through our refreshed strategy which takes this strength and focuses our efforts where we know we can win.

Strength also comes from our game-changing GlobalDairyTrade™ (GDT). Launching the world's first online trading platform for dairy commodities in 2008 enabled three transformations of the market. It made pricing transparent, it established a traceable global index for dairy commodities and it laid the

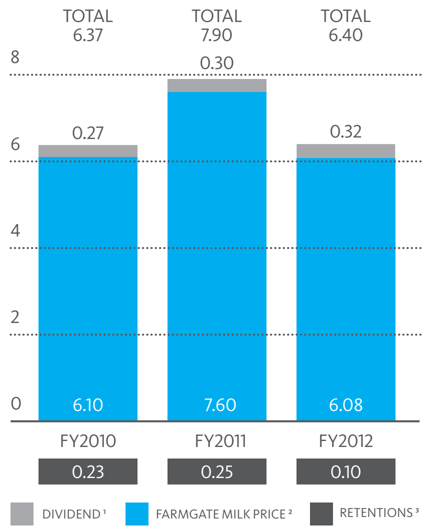
RECORD MILK COLLECTION



Source: Fonterra

1 Volumes represent a six-day moving average of daily production

PAYOUT



1 Cents per share

2 $ per kgMS

3 Retentions are calculated as net profit after tax attributable to Co-operative Shareholders divided by number of shares at 31 May, less dividend per share

groundwork for some of the most important performance goals we set and strive for in the Co-operative. Now we are firmly focused on outperforming the GDT™ commodity price and raising our returns to shareholders.

We saw our integrated co-operative model come into its own this year. It will go on the record books as an extraordinary one for dairy with near-perfect conditions through much of the year in dairy-producing countries and a record-breaking performance here at home.

Shareholders will receive a final payout of $6.40 per share for a fully shared up farmer after retentions of 10 cents per share, comprising a Farmgate Milk Price of $6.08 kgMS and a dividend of 32 cents per share.

Farmers will always measure our performance by the Fonterra Farmgate Milk Price. Today we have a structure, processes, strategy and performance measures all aligned to achieve the best Farmgate Milk Price and the best profit in each season and we are clear on how both are achieved. As well as delivering the best Farmgate Milk Price, our strategy is designed to increase returns above it, increasing shareholder wealth through dividends.

We have come a long way in 11 years, and we're going to go a lot further. Every step of progress has been made because our people in the business and our shareholders have shared the common goal of turning a national champion into a global one.

All of us together make Fonterra what it is today. It has meant making some big calls, but most have paid off and the Co-operative is stronger.

We've gained a lot and lost little. Dairy is still an industry where families can start out small, as my parents did, make a good go of it and hand over to the next generation. It's also an industry which can accommodate big visions and operations. Our co-operative model provides the framework for both to succeed.

We've made the most of our inheritance. Fonterra left the blocks with a head start because generations of farmers had built up a global reputation for the milk made here. That reputation continues to open customers' doors and consumers' fridges around the world.

I am proud of our progress, honoured to be part of it and full of enthusiasm for what's next. I am grateful for the support I've had from shareholders, directors, my family and the wider Fonterra family during my time as Chairman. It has been a privilege and I look forward to contributing to the future success of our united Co-operative. Thanks.

HENRY VAN DER HEYDEN
CHAIRMAN

ONE PLACE. THAT IS OUR INSPIRATION.

NEW ZEALAND.

“FONTERRA IS A CITIZEN OF THE WORLD, BUT THERE IS ONLY ONE PLACE WE CALL HOME, NEW ZEALAND.”

Great growing conditions during the season meant record volumes produced on farms like this one in Taranaki.

IT STARTS HERE.

FROM THIS ONE PLACE, NEW ZEALAND, WE'VE CREATED A GLOBAL MARKET FOR OUR PRODUCTS AND WE'RE BRINGING THE RETURNS BACK HOME.

THEO SPIERINGS

CHIEF EXECUTIVE

One place underpins our scale with the high-volumes of quality milk produced in New Zealand flowing from our shareholders' farms, through our factories and out into the world. We're one tight team from grass to glass.

From one place, we've set our sights on satisfying global dairy demand. We're playing to our strengths – our seamless supply chain, years of dairy knowledge and great people working as one to take dairy to the world and bring home the returns.

Our know-how, can-do attitude, means our growth and ambition will never be defined by the geographic boundaries of home. Our strong roots here in New Zealand support our growth in the markets where we see opportunities, while our skills enable us to seize these chances quickly to grow volumes and value.

As the sign on our shareholders' gates says, "It starts here."

NEW ZEALAND IS OUR HOME GROUND

We created a competitive advantage when we formed Fonterra.

It's all about scale, with around 89 per cent of all the milk produced in New Zealand flowing from farms owned by our shareholders, through our factories and out into the world.

Our Co-operative comprises 10,578 Fonterra farmers and 17,300 Fonterra people, working as one tight team.

This team is the world's largest dairy processor and the world's largest operator in the globally traded market for dairy.

Collectively we processed 17 billion litres of milk in New Zealand this season. These record milk flows led to record export volumes.

10,578 Farmer shareholders

17,300 People

17 BILLION

LITRES OF MILK PROCESSED IN NEW ZEALAND THIS YEAR

ONE PLACE – STRONG ROOTS SUPPORT OUR GROWTH

As the year's results have shown, one place powers our performance, with our integrated business model collecting, processing and exporting record volumes to deliver the best Farmgate Milk Price and dividend to our shareholders.

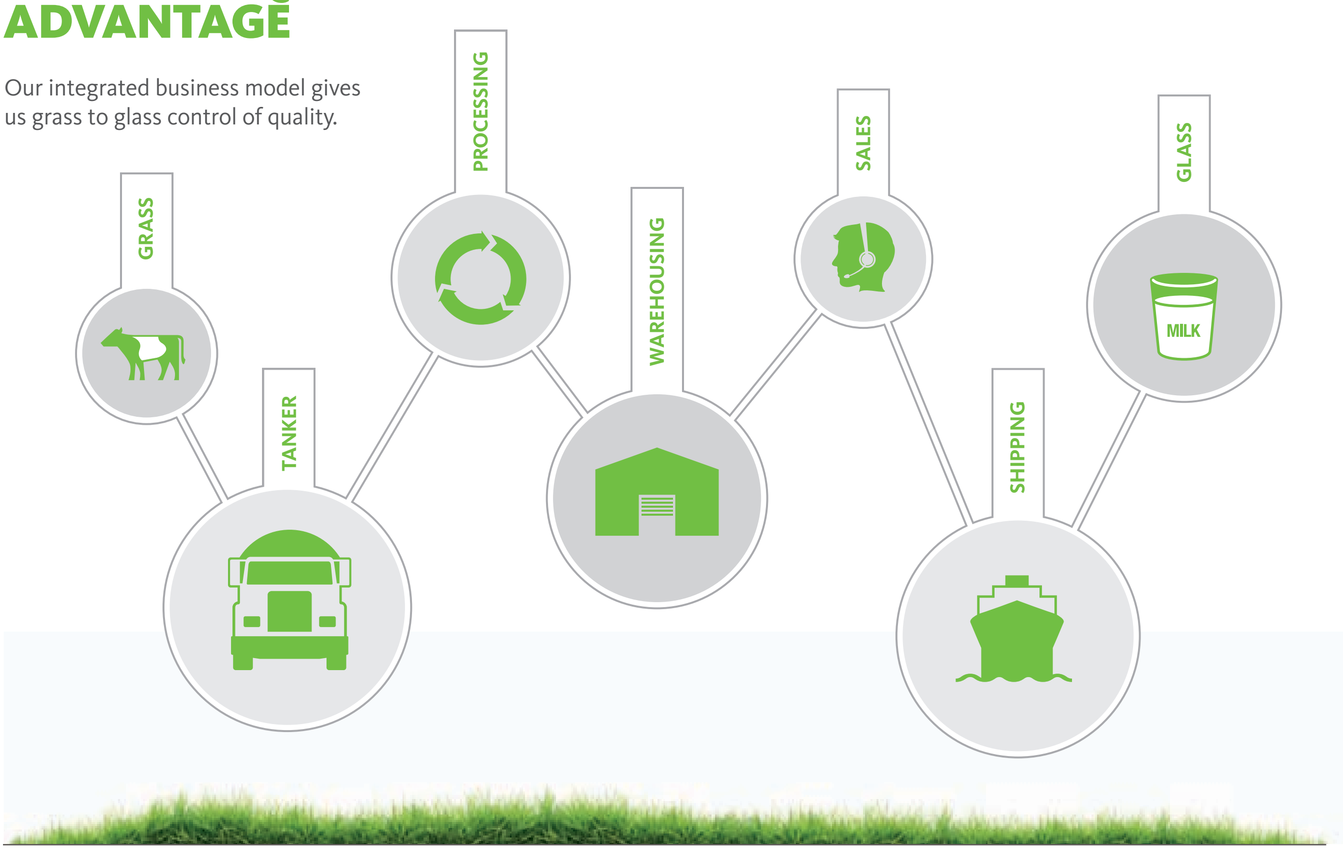
But our know-how means opportunities for growth don't stop at the New Zealand coastline.

Global demand for quality dairy nutrition means demand for milk is expected to grow by at least 100 billion litres by 2020. On current forecasts, it's expected we can grow milk volumes from New Zealand by another five billion litres by 2020.

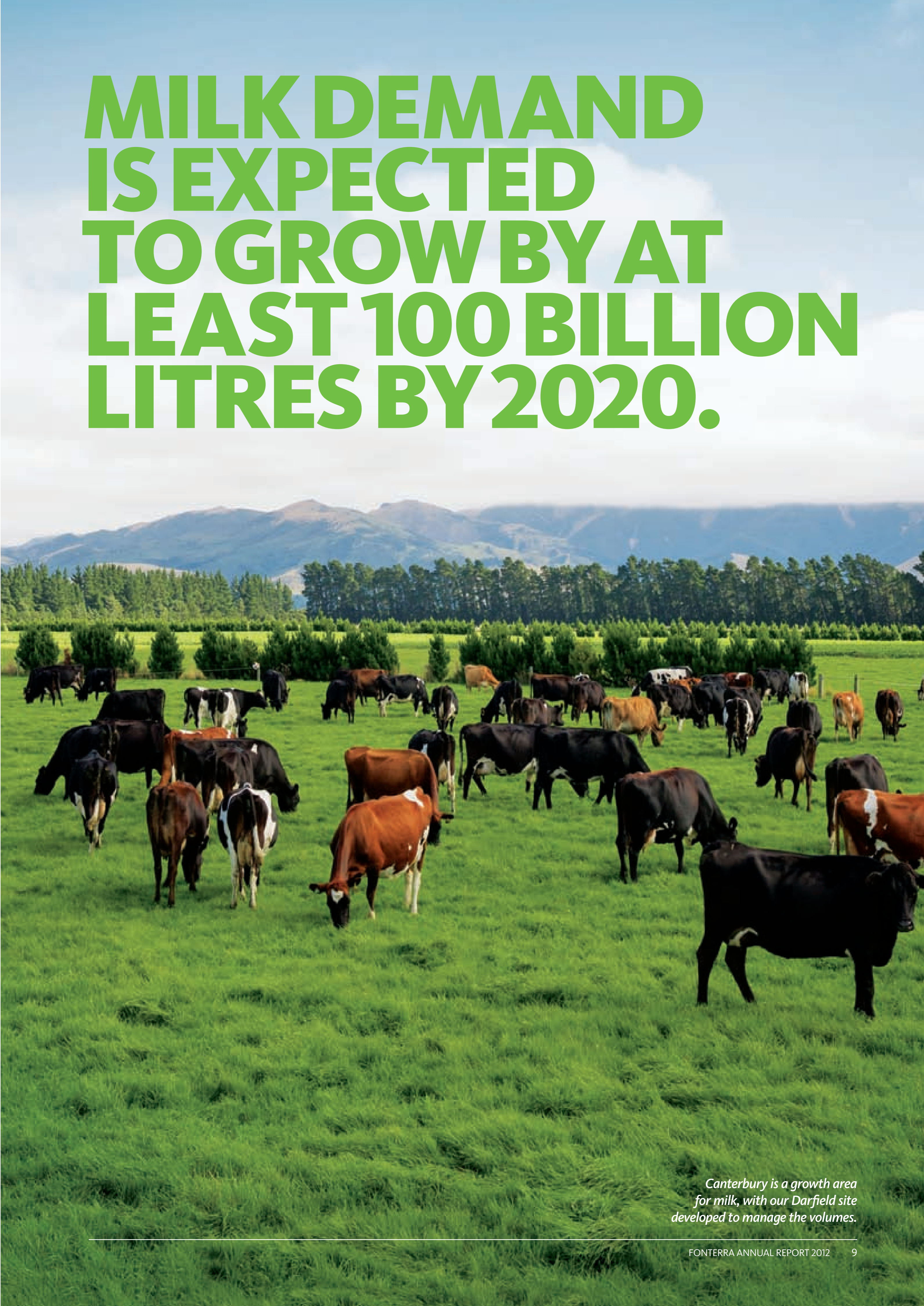
Using our strong knowledge base here in New Zealand, we're moving to selectively invest in milk pools which can satisfy the demand we cannot meet from here. That protects the integrity of our integrated business model, keeping control in our hands as we expand.

GRASS TO GLASS IS OUR UNIQUE ADVANTAGE

Our integrated business model gives us grass to glass control of quality.



MILK DEMAND IS EXPECTED TO GROW BY AT LEAST 100 BILLION LITRES BY 2020.



Canterbury is a growth area for milk, with our Darfield site developed to manage the volumes.

ONE PEOPLE. WORKING TO ONE PRINCIPLE.

ENRICHING LIVES.

"THE WORLD IS A BETTER PLACE WITH DAIRY. WE ENRICH LIVES THROUGH BETTER NUTRITION AND WE ENRICH COMMUNITIES BY HONOURING WHAT'S IMPORTANT TO THEM."

In partnership with the Taranaki community, Fonterra has transformed Nowell's Lakes from retired dairy land into an award winning community asset. Doug Hutchinson (right) and Trevor Redmond, Supervisor Operator, Whareroa Environmental, admire the results.

GUARDING GOODNESS.

ENRICHING LIVES IS ABOUT KNOWING THE ROLE WE PLAY IN THE AREAS WHERE WE OPERATE.

Milk is pure and simple, so is our approach.

What do people want?

That's simple, too. Healthy productive lives, supported by trusted nutrition at every age and stage in life. We're listening, using our dairy knowledge to make products which enrich people's lives around the world.

We're also listening to our communities. After all, we're part of them. Communities, like co-operatives, are enriched when we all come together and work on what's important.

FONTERRA MILK FOR SCHOOLS: SHARING THE BENEFITS

We produce some of the best milk in the world. It's only right we share.

More than 120 Northland primary schools have participated in the pilot of Fonterra Milk For Schools, providing a free serving of chilled Anchor™ Lite UHT milk every school day.

The pilot launched on 19 March 2012 with the support of Northland schools, communities and health organisations. The pilot will see over a million packs of milk delivered to Northland children in 2012. Reports from participating schools are that a daily dose of dairy nutrition is already helping children's ability to learn and concentrate.

FONTERRA RURAL MATERNITY AND INFANT HEALTH-CARE COMMUNITY PROGRAMME

Fonterra and China's Soon Ching Ling Foundation have been improving access to medical services for women and children in rural areas of China.

The five-year programme, funded by a USD 5 million donation from Fonterra, has helped Guizhou, Hubei and Gansu provinces improve the overall health of women and children.

A review of the third year of the programme in Guizhou showed:

11,633

Medical healthcare workers trained to improve their medical skills as they work to reduce the risks associated with pregnancy in rural areas and to improve the overall health of women and children.

117

117 sets of donated medical equipment used to provide treatment for over 96,000 individuals improving local medical facilities and their capabilities.

2,250

15 donated ambulances have helped transport more than 2,250 women and patients in critical conditions, covering a total of 155,000 miles. Emergency transport is challenging in Guizhou province because of geographic conditions, so these ambulances play an important role in providing access to care.

33 per cent

Over 33 per cent reduction in maternal mortality and over 9 per cent reduction in infant mortality.

L-R: Brent Spencer (Regional Food Safety Manager, Fonterra) Geoff Spark (Fonterra Supplier in Canterbury) Roger Kilpatrick (Regional Manager, Fonterra)

SUPPORTING BETTER ENVIRONMENTAL PERFORMANCE.

We're working with our shareholders, regional councils, iwi and local communities to make a difference in water quality in dairying regions in New Zealand.

It's a work in progress, but we have made a good start. We continue to make good progress with our Effluent Management Programme. Since inception on 1 August 2010 to 31 July 2012, we have closed almost 2,400 cases, enabling farmer shareholders to bring their effluent systems up to required standards. Regional councils are reporting improved compliance performance, acknowledging farmers' and our work as a contributor.

But there's more to be done. We have taken action by making stock exclusion from waterways a condition of supply. Shareholders are now required to exclude stock from all waterways that permanently contain water, are wider than one metre and deeper than 30cm at any point. The Supply Fonterra Waterway Management Programme is actively working to ensure that shareholders meet this requirement by December 2013.

These initiatives are part of our Supply Fonterra Programme. It covers all aspects of milk quality and environmental management to help shareholders meet the regulatory and market requirements that are now part of everyday dairying life.

Supply Fonterra includes the Nitrogen Management Programme which will collect and analyse nitrogen on each shareholder's farm. It will be used to provide each Fonterra farmer with reliable annual information about their farm's nitrogen conversion efficiency and modelled nitrogen loss, enabling them to take steps to limit the losses which influence water quality.

GOOD PEOPLE MAKING GOOD PRODUCTS.

Good people come with strong values. We share in our belief in Fonterra's values: Co-operative Spirit; Do What's Right; Challenge Boundaries; and Make It Happen.

With 17,300 staff globally, Fonterra has one of the most diverse workforces of any New Zealand-based company in terms of skills, cultures and geographies. 36 per cent of our team live and work overseas. With their New Zealand-based colleagues, our people bring experience, knowledge and passion to our Co-operative.

We want our people to succeed in their professional and personal lives. Our people strategy fosters high performance, personal development and makes Fonterra a great place to work. We aim for world-class health and safety, highly engaged teams, building meaningful careers for all our staff and growing our next generation of leaders.

ONE AMBITION.
THE NATURAL SOURCE OF DAIRY NUTRITION.
FOR EVERYBODY, EVERYWHERE, EVERY DAY.

"OUR STRATEGY PLAYS TO OUR STRENGTHS AND TAKES ITS LEAD FROM WHAT THE WORLD WANTS."

In vibrant Shanghai we're developing dairy products and premium ingredients, to meet the needs of Chinese customers and consumers.

BETTER HEALTH GROWS WEALTH.

OUR GOAL IS SIMPLE, GROW RETURNS.

We're focusing on our strengths, where we can win and the biggest opportunities for growth. We've got a lot to work with; quality milk, an integrated business, a strong product portfolio, great customers and passionate people. We take our lead from what the world wants; the growing demand for dairy nutrition in emerging markets and meeting the nutritional needs of the young, the ageing and foodservice customers.

So the goal is more volume and more value.

Volume growth to stay relevant in the global market and maintain our leadership position; and producing more high value products the world wants.

Ambition to action – we're making it happen in these priority areas.

EVERYDAY

1 **OPTIMISING NZ MILK PRODUCTS**

2 **BUILDING AND GROWING BEYOND OUR CURRENT CONSUMER POSITIONS**

OUT-OF-HOME

3 **DELIVERING ON OUR FOODSERVICE POTENTIAL**

ADVANCED

4 **GROWING OUR POSITION IN AIDING MOBILITY AND BONE HEALTH**

5 **DEVELOPING SELECTED LEADING POSITIONS IN PAEDIATRICS AND MATERNAL**

ENABLERS

6 **SELECTIVELY INVESTING IN SECURE MILK POOLS**

7 **ALIGNING BUSINESS STRUCTURE WITH ORGANISATIONAL STRATEGY**

① OPTIMISING NZ MILK PRODUCTS

NZ Milk Products is the heart of our business that collects, processes, sells and ships milk from our New Zealand farmers around the world. It includes our exports to all markets including our biggest, China.

We already have projects underway to improve the way we use our manufacturing plants in New Zealand, drive efficiencies and achieve further gains in quality. We are adding value for customers by better tailoring our services and product offerings so we can beat base commodity prices.

Our processing capacity was boosted this year with construction of our first drier at Darfield. It is capable of processing 2.2 million litres a day. Stage Two will be ready by spring 2013.

As we become more and more customer-led, our Value Stream Optimisation (VSO) programme is putting in place the systems and processes to rapidly turn market signals into successful sales.

In the past year, the VSO programme has delivered over $18 million in savings and is making good progress towards its goal – to create one integrated plan from customer demand through manufacturing, logistics and back to the customer, ultimately delivering more value to shareholders.

The benefits have come through improved processes – creating less rework, increased production schedule attainment and more accurate master data. It also means we are getting better at matching what we plan to sell into actual sales.

In the coming year VSO will continue to improve decisions around what we make and sell to ensure we get the best value out of every litre of milk.

② BUILDING AND GROWING BEYOND OUR CURRENT CONSUMER POSITIONS

Our strategy identifies opportunities to grow both volume and value through everyday nutrition, especially in emerging markets, and through growing the market shares of our well-known, higher-value consumer brands.

Everyday nutrition grows volumes by enabling cost-conscious consumers in emerging markets to benefit from dairy delivered in affordable formats, including UHT and powdered milks. This builds on already established positions in this category in markets like Sri Lanka where pack sizes for Anchor™ full cream milk powder start at just 75 grams, rising to one kilogram, and where we are the undisputed market leader in family milk powders.

At the same time, our established higher-margin consumer brands, particularly Anlene™ in mobility and Anmum™ in maternal and paediatric nutrition, present opportunities for growth through new markets and through innovation.

During the year, good volume growth was achieved in Sri Lanka across all categories and especially in milk powder, while Hong Kong, Vietnam and China confirmed our view that our consumer product portfolio offers opportunities for growth.

Shareholders will always earn more from a tonne of high-value Anlene™ than a tonne of standard whole milk powder, so growing volumes also grows value in line with our strategy.

With dairy demand forecast to increase substantially in Indonesia over the next eight years, our strategy demands that we're ready to capitalise on this growth, building on our 40-year reputation in this market.

In April, we announced plans to invest in a blending and packing plant in Indonesia to help support the growing demand for high-quality dairy nutrition in this country. This investment will support the local expansion of Fonterra's consumer brands Anlene™, Anmum™ and Anchor Boneeto™ throughout Indonesia and the plant is expected to be operational next year. Indonesia is one of the fastest growing markets. This investment in our local packing and blending capabilities will not only help meet local demand, but also the Association of Southeast Asian Nations (ASEAN) region's growing appetite for dairy nutrition.

Anchor™ is delivering everyday nutrition through fresh, powdered and UHT milk formats, yoghurts, cheese and dairy spreads. It is sold in around 70 countries through our consumer and foodservice channels.

It is not only our leading brand by global reach, but also by heritage, having first appeared on Waikato-made butter back in 1886. The Anchor™ branded butter went on to win first prize at the Melbourne Exhibition of 1888 – surely a sign of good things to come.

Anchor™ has a strong presence in New Zealand, Sri Lanka, Asia, the Middle East and the Pacific.

It is backed by the Anchor Institute which funds nutritional research by established scientific and medical experts, ensuring consumers get the best from the dairy in their diet.

BRAND ESTABLISHED

1886

COUNTRIES SELLING ANCHOR™

70

③ DELIVERING ON OUR FOODSERVICE POTENTIAL

Fonterra's Foodservice business operates in around 50 countries with our portfolio of cheese, cream, butter, yoghurt, pastries and beverages designed to meet the needs of chefs and commercial kitchens.

Our Group Strategy Refresh identified growth potential in emerging markets – China, ASEAN, the Middle East, North Africa and Latin America (Latam). We are generating growth in higher-margin products such as our Anchor™ specialty cooking creams. Alongside selling our established everyday dairy nutrition, such as butter and the cheese portfolio, we've created new, branded foodservice solutions which meet the specific needs of chefs.

This responds to trends in these emerging markets, especially the growing propensity of consumers to dine out.

By putting our own chefs in the kitchen, especially in ASEAN and China, we're talking directly to the chefs interested in using our products and showing them how these can be used in profitable additions to their menus.

In Singapore for example, our work with the 35-store outlet Polar Puff and Cakes chain saw us develop a completely new bakery item for the customer called Hokkaido Cake. Concept to launch took less than three months delivering incremental revenue to the customer and growth in UHT cream sales to Fonterra.

We are the only dairy company in Asia Pacific with this sustained focus – turning chefs' needs into profitable solutions.

We have invested to accelerate our Foodservice potential, opening an upgraded innovation centre in Shanghai in May. It is allowing us to work more closely with major customers and the foodservice industry, especially in product development to meet consumer needs. It is a high potential area with demand for dairy products like cheese and cream from bakeries alone growing by over 50 per cent every year in some second tier cities such as Harbin, Chongqing and Xiamen. Demand in tier one cities such as Shanghai, Beijing and Guangzhou is growing by 20 to 30 per cent per year.

In addition, the new centre is developing innovative dairy nutrition products for Chinese customers and consumers. China is a significant priority in Fonterra's global strategy and our ability to develop unique products and formats that suit the needs of the local population will be important to capturing growth there.

④ GROWING OUR POSITION IN AIDING MOBILITY AND BONE HEALTH

Anlene™ is our clinically proven milk that provides all the important nutrients for bone health and calcium absorption. Bone health has a natural connection to mobility. We're leveraging our expertise to extend Anlene™ in the mobility category for nutrition.

Anlene™ has a loyal consumer following and now has market leadership in the Gulf Co-operation Council in the Middle East, Sri Lanka, Thailand, Singapore, Malaysia, Indonesia, Vietnam, Hong Kong and the Philippines. We are supporting its market penetration in China with advertising and promotional spending and post re-launch in 2009 the brand became market leader in Shanghai and Guangzhou.

The brand recorded constant currency growth of 10 per cent in Asia/AME during the year and is one of our big three, contributing around 20 per cent of segment revenue.

Our Fonterra Research Centre has a team focused purely on bone health and developing new products to extend the Anlene™ offer, including Anlene Total™ to promote joint health using a form of glucosamine.

To support our total mobility offering, research will expand into muscle health and the prevention of muscle wastage in the elderly. Results will be used to expand Fonterra's own consumer brands and bring science-led solutions to our NZ Milk Products customers.

We are also exploring dairy's benefits in managing gout which also influences mobility.

A study supported by Fonterra and published in the British Medical Journal's Annals of the Rheumatic Diseases during the year showed that a daily dose of skimmed milk, enriched with two value-add ingredients naturally found in dairy products, may reduce the frequency and intensity of gout flares.

This is the first clinical trial to study dietary intervention in gout, and was conducted by Dr Nicola Dalbeth from the University of Auckland's Bone and Joint Research Group in conjunction with scientists from the Fonterra Research Centre and the University's Department of Medicine. Fonterra has patented the use of the two ingredients in relation to gout and is currently investigating opportunities to bring this new solution to gout sufferers globally.

SHAPING OUR FUTURE WITH OUR PRODUCTS.

WE'RE TUNING INTO BAKERS' NEEDS , UNLOCKING DEMAND GROWTH FOR DAIRY IN FOODSERVICE.

⑤ DEVELOPING SELECTED LEADING POSITIONS IN PAEDIATRICS AND MATERNAL

Our Anmum™ nutritional portfolio for mothers and children is an established leader in meeting their nutritional needs, achieving constant currency growth of 16 per cent in Asia/AME this year.

We have continued to grow the brand and our market share, with Anmum™ the leading maternal milk brand in seven countries across the region.

In Malaysia, the brand has performed strongly in the infant formula follow-on milk category. This was achieved on the back of a significant effort to provide medical professionals with the results of third-party research into the benefits of key nutrients such as probiotics and gangliosides.

In Vietnam, Anmum Materna™ performed well, supported by a new marketing campaign.

⑥ SELECTIVELY INVESTING IN SECURE MILK POOLS

New Zealand has earned a reputation for safe, high-quality milk. As demand in global markets far exceeds what we can produce here in New Zealand, we're using all our years of experience to produce quality milk in selected markets, notably China and Latam.

These investments complement our New Zealand-origin product sales and enable us to participate in the new demand of at least 100 billion litres forecast for dairy by 2020.

It's a win-win for our shareholders who earn money on this milk, even if they don't produce it, as the value of the milk brings back higher returns for them.

Growing volumes enables us to stay relevant as a global supplier, especially with large customers who need us to have the scale to provide the volumes they need. It also protects some of our established positions. China is a good example. We are committed to farm developments there and to supporting its local industry. This helps maintain access for our New Zealand milk exports to China, currently our largest export market.

The year saw continued progress in building a sustainable, high-quality fresh milk supply in China which we are using to provide dairy nutrition for local consumers. In April we officially opened our second China farm, Yutian Farm One, and announced plans to develop three new large-scale dairy farms in the Hubei province.

Their development means over time we will have a hub with five farms within the area. Combined, they will have a herd size of around 15,000 milking cows producing 150 million litres a year and all in close proximity to the large market of Beijing.

The hub follows our first farm in Hangu which opened in 2007 and Yutian Farm One, opened in April 2012.

⑦ ALIGNING BUSINESS STRUCTURE TO ORGANISATIONAL STRATEGY

Fonterra has great people, with the energy and drive to make things happen. Having identified our strategic priorities, we moved quickly to align our structure to ensure we can deliver.

The new structure is aligned to our focus on markets with the best growth opportunities and categories where we can win. It puts more resources in key emerging markets while right-sizing resources in Europe and North America.

Having determined the consumer categories which offer most potential, based on what consumers are looking for, we have also strengthened our resources with a new nutrition division to drive growth.

Our new structure, effective from 1 August 2012, is closely aligned to our volume and value priorities. It will see us focus our capital, our energy, our innovation and our brand portfolio on achieving the best results.

FONTERRA

PREVIOUS BUSINESS UNIT / REPORTABLE SEGMENT	NZ MILK PRODUCTS[1]	AUSTRALIA NEW ZEALAND (ANZ)	ASIA/AME		LATAM
NEW BUSINESS UNIT BY GEOGRAPHY[2]	NZ Milk Products	ANZ	ASEAN/MENA	Greater China/ India	Latam
MILK SOURCING ARRANGEMENTS	• Farmer Shareholders	• In-market (Australia) • NZ Milk Products	• Predominantly from NZ Milk Products	• NZ Milk Products • In-market milk sourcing being developed	• In-market • NZ Milk Products
KEY OPERATIONS	• Collection and processing of milk, marketing and distribution of NZ Milk Products	• Branded consumer and Foodservice business in NZ • Integrated consumer dairy and milk processing business in Australia • International distribution from Australia and New Zealand • RD1	• Branded consumer and Foodservice business	• Branded consumer and Foodservice business	• Soprole – integrated consumer dairy and milk processing business • Dairy Partners Americas (DPA) – integrated consumer dairy and milk processing business
KEY BRANDS[3]	• NZMP™	• Anchor™, Bega®, Mainland™, Fresh'n'Fruity™, Tip Top™, Nestlé® Ski®, Kapiti™ and Western Star™	• Anlene™, Anmum™, Anchor™ and Fernleaf™	• Anlene™, Anmum™ and Anchor™	• Soprole™, Huesitos™, California™, Ninho Soleil™, Dos™, Alamos™, Next™, Activ™, Chamyto™, and Chandelle™

GROUP-WIDE FUNCTIONS							
	Fonterra Nutrition	People, Culture and Services	Office of the CFO	Group Strategy	Mergers and Acquisitions	Group Optimisation and Supply Chain	Co-operative Affairs

1 Formerly known as Standard & Premium Ingredients.
2 Business unit names are only a broad guide to regions in which Fonterra operates. For example, there are some countries that fall within the ASEAN/MENA business unit that are located outside the ASEAN/MENA region such as Sri Lanka and Mauritius.
3 Key brands are owned by the Fonterra Group or used under licence.

CONTENTS:

ONE YEAR. BUSINESS REVIEW AND FINANCIAL PERFORMANCE.

FOR THE YEAR ENDED 31 JULY 2012.

BY THE NUMBERS

What an extraordinary year for dairy. Record milk flows in New Zealand were matched by exceptional growth globally, with markets hard-pressed to absorb the volume. We took the challenge head–on, growing exports by 11 per cent while managing price volatility.

We delivered strong growth in profit before tax, driven by good performances from our NZ Milk Products and Latam businesses, offset by a significantly higher tax expense for the year.

Returns to our farmer Shareholders were $6.40 per share for a 100 per cent share-backed supplier after retentions of 10 cents per share, comprising a Farmgate Milk Price of $6.08 per kilogram of milksolids (kgMS) and a dividend of 32 cents per share.

Payout was down 19 per cent on the prior year, with the Farmgate Milk Price lower as a result of lower global dairy prices and the strength of the New Zealand dollar. However, overall Shareholder earnings were supported by the significantly higher volumes produced by farmers, which helped ease the impact of that lower Farmgate Milk Price.

Our Co-operative performed well, growing both volumes and value, even with declining prices. We handled the price volatility by managing our product mix effectively and adding value for customers to secure sales prices above GlobalDairyTrade™ (GDT™) benchmarks.

Our regional businesses achieved mixed performances, with Latam and Asia/AME showing strong constant currency performance, while ANZ earnings declined in the face of a very tough trading environment in Australia.

As this year has shown, vast volumes of milk alone don't deliver the best returns to farmers. Volume has to go hand in hand with value. Our Group Strategy Refresh, developed and delivered in the first half of the calendar year and now underway, is designed to achieve this.

Speed matters in a volatile world. Having developed our strategy and secured the full support of the Board, we have moved quickly on execution. The planned implementation of Trading Among Farmers (TAF) will further support this.

Both our strategic priorities and TAF set the stage to drive us forward as a united Co-operative. All of our energies can be devoted to maximising the performance of our integrated business. An absolute priority is to deliver the best Farmgate Milk Price, as well as the profits which will further fund growth and back dividends.

Our Shareholders and our people are united in our belief in co-operative principles, in the collective strength of our Co-operative and in our confidence that we are making the right moves to grow our place in the global market. All of us together make one Fonterra.

THEO
CHIEF EXECUTIVE OFFICER

ONE YEAR HIGHLIGHTS

REVENUE (NZD)

$19.77B

NET PROFIT AFTER TAX (NZD)

$624m

PAYOUT (NZD)

$6.40

FARMGATE MILK PRICE (NZD)

$6.08

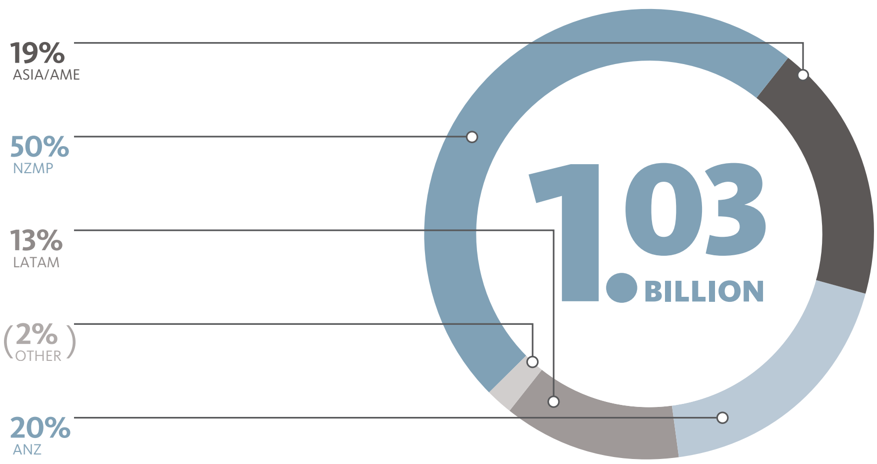
DIVIDEND PER SHARE (NZD)

32c

EARNINGS PER SHARE (NZD)

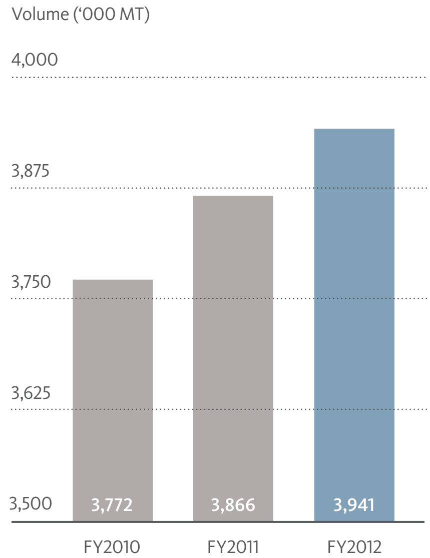
42c

NORMALISED EBIT (NZD)[1]



1 Earnings before interest, tax and non-recurring items.

VOLUMES



SEGMENT EARNINGS[1]

IN NZD MILLIONS FOR THE 2012 YEAR

1 Earnings before interest, tax and non-recurring items.

KEY DRIVERS OF EARNINGS FOR 2012

Fonterra is the world's largest milk processor handling around 22 billion litres of milk each year.

The Co-operative's integrated and geographically diverse portfolio of world-class assets produce high-quality dairy products that include base nutrition, foodservice, branded consumer products and advanced nutrition.

Fonterra has an extensive global sales network servicing customers in more than 100 countries.

KEY HIGHLIGHTS:

- **Record New Zealand milk flows, up 11 per cent to 1,493 million kilograms of milksolids (kgMS) in the current milk season**
- **Total Group sales volume growth of 2 per cent to 3.9 million metric tonnes (MT)**
- **Farmer Shareholders with 100 per cent share-backed supply received a payout of $6.40 after retentions for the 2012 year, which was 19 per cent lower than the prior year. Payout includes a Farmgate Milk Price of $6.08 per kgMS, and a dividend of 32 cents per share. Retentions were 10 cents per share[1]**
- **Normalised earnings before interest and tax[2] up 2 per cent to $1.03 billion**
- **Higher operating cash flow of $1.4 billion up $206 million**
- **Our economic gearing ratio[3] was 39.1 per cent as at 31 July 2012, down from 41.8 per cent in 2011**

1 Retentions are calculated as net profit after tax attributable to Co-operative Shareholders divided by number of shares at 31 May 2012, less dividend per share.
2 Earnings before interest, tax and non-recurring items.
3 Based on economic net interest bearing debt to economic net interest bearing debt plus equity. This reflects the effect of debt hedging in place at reporting date. Equity excludes the cash flow hedge reserve.

NORMALISED EBIT[3]

1.03
BILLION

SELECTED FINANCIAL INFORMATION[1]

NZD MILLION	FY2012	FY2011	% CHANGE
Total sales volume ('000 MT)	3,941	3,866	2%
Revenue	19,769	19,871	(1%)
Normalised EBITDA[2]	1,520	1,494	2%
Normalised EBIT[3]	1,028	1,005	2%
Normalised EBIT margin (%)	5.2%	5.1%	
Net finance costs	(310)	(406)	24%
Profit Before Tax	677	622	9%
Tax (expense)/credit	(53)	149	(136%)
Profit for the period	624	771	(19%)
Earnings per share (cents)[4]	42	55	(24%)
Dividends per share (cents)	32	30	7%
Return on Capital Employed[5]	9.3%	9.4%	

1 Historical financial information includes normalisation adjustments to enable a like-for-like comparison.
2 Earnings before interest, tax, depreciation, amortisation, and non-recurring items of $41 million (FY2011: ($23) million).
3 Earnings before interest, tax and non-recurring items.
4 Represents net profit attributable to equity holders of the Company divided by the weighted average number of shares on issue during the year.
5 Pre-tax Return on Capital Employed (ROCE) is calculated as normalised EBIT divided by capital employed. Capital employed is calculated as monthly average net assets excluding net debt, derivatives, taxes and investments (other than equity investments).

GROUP OVERVIEW

Fonterra delivered strong growth in its profit before tax for the financial year to 31 July 2012, despite the challenges in the global economy. This was offset by a significantly higher tax expense for the year due to the recognition of deferred tax credits in FY2011 linked to one-off transactions.

Record milk production and export volumes underpinned a solid operating performance by Fonterra for the year to 31 July 2012 with normalised earnings before interest and tax up 2 per cent to $1.03 billion.

Despite the challenging global environment with volatile dairy commodity prices, Fonterra performed well and the result for the 2012 year reflects success in growing both volumes and value.

The Co-operative delivered strong growth in profit before tax, up 9 per cent on the prior year to $677 million, largely as a result of strong performance from our NZ Milk Products business. A significantly higher tax expense, up $202 million, due to the recognition of deferred tax credits in the prior year linked to one-off transactions, resulted in a 19 per cent decline in net profit after tax to $624 million.

GOOD VOLUME AND VALUE GROWTH

The higher volume was mainly as a result of strong growth in our NZ Milk Products business, up 6.6 per cent[1], following record milk collected last season. This was partly offset by lower sales volumes in our Australia and New Zealand (ANZ) business and the sale of the Western Australia dairy business which we sold in March 2011.

Whilst commodity prices fell during the year exacerbated by the strength of the NZD, sales revenue was only down by 1 per cent due to volume gains.

Normalised EBIT increased by 2 per cent to $1.03 billion. Key drivers behind the improved normalised EBIT performance were higher price achievement in our sales book in NZ Milk Products and effective management of our product mix. This improvement was partly offset by a fall in the profitability of our ANZ business, which continued to be impacted by challenging trading conditions. The stronger NZD also had a negative influence on the earnings of some of our Asian and Latin American consumer operations.

The two key non-recurring items for the 2012 year were impairment losses recorded in Latam of $8 million and restructuring costs of $30 million associated with the Group Strategy Refresh.

Net finance costs were $310 million, which was $96 million lower than last year. Finance costs decreased mainly due to favourable fair value movements in respect of basis spreads and lower average market interest rates.

Our operating cash flow improved by $206 million to $1.4 billion and our gearing ratio improved by 2.7 percentage points to 39.1 per cent at year-end. This is based on economic net interest bearing debt to economic net interest bearing debt plus equity[2].

BUSINESS RESTRUCTURE

The Fonterra business has been reorganised to focus on efficiency and customer opportunities. The new structure took effect from 1 August 2012 for Financial Year 2013. The key geographies are NZ Milk Products, ANZ, Latam, ASEAN/MENA and Greater China/India. These are supported by Fonterra Nutrition which targets product development across the regional businesses and includes specialist areas like Paediatrics and Foodservice. The new business structure aligns our organisation to deliver our Group Strategy Refresh.

GROUP CASH FLOWS AND CAPITAL INVESTMENT

Fonterra continued to invest in new capacity during the year to process growing New Zealand milk volumes. We also had a focused investment in farms in China as part of our strategy to establish offshore milk pools in key strategic regions.

Volatility in commodity prices and currency was a key factor driving the level of investment in working capital last year, mainly through the impact on valuation of inventory and accounts receivable.

1 Total sales volume, external and inter-segment.
2 Reflects the effect of debt hedging in place at reporting date. Equity excludes the cashflow hedge reserve.

RECORD MILK FLOWS (kgMS)

1,493 MILLION

SUMMARY OF GROUP CASH FLOWS

NZD MILLION	FY2012	FY2011	CHANGE
Net cash flows from operating activities	1,390	1,184	17%
Net cash flows from investing activities	(826)	(488)	(69%)
Net cash flows from financing activities	(349)	(433)	19%

1

NZ MILK PRODUCTS

Volume: Sales volume up 7 per cent[1] to 2.8 million MT

Value: Strong normalised EBIT[2] growth to $515 million up 23 per cent

Higher Return on Capital Employed (ROCE) to 7.6 per cent up from 6.7 per cent

Good performance in out-of-home and paediatrics markets

Record milk collection led to record exports

Darfield construction – the first bags of whole milk powder rolled off the production line in August 2012

RECORD MILK FLOWS

The 2012 dairy season (1 June 2011 to 31 May 2012) provided unusually strong conditions for pasture growth in New Zealand resulting in a significant increase in our New Zealand milk collection to 1,493 million kgMS, representing an 11 per cent increase on last season.

Our total sales volume increased by 7 per cent to 2.8 million MT, largely reflecting the significant increase in milk collected in the financial year and the continued demand for high quality dairy nutrition. This volume growth was offset by weaker dairy product prices and was exacerbated by a stronger NZD compared to the USD resulting in revenue growth of only 1 per cent.

PRICE REALISATION, BETTER PRODUCT MIX AND SHORTER CONTRACTS

At a normalised EBIT level, NZ Milk Products delivered a strong performance, up 23 per cent to $515 million, compared to last year. This was mainly as a result of achieving higher prices above GDT™ through our continued efforts to add value to our products, and from effective management of our product mix. We increased our average price premiums relative to GDT™ prices compared to those from the previous period. This reflected a better focus on benchmarking sales prices relative to GDT™ by our sales teams, achievement of premiums for security of supply to our key customers, and some benefit from falling dairy product prices as a result of a limited number of remaining longer-term contracts.

We have swapped most of our long-term customer contracts to shorter tenor pricing arrangements indexed to GDT™. As we move forward, this will progressively shift our sales book closer to the spot market and reduce earnings volatility.

Our improvement in gross profit included a positive product mix effect compared to that of last year. We managed to optimise our sales book effectively to match the most profitable streams and this had a positive influence on profitability for the period.

1 Total sales volume, external plus inter-segment.
2 Earnings before interest, tax and non-recurring items.

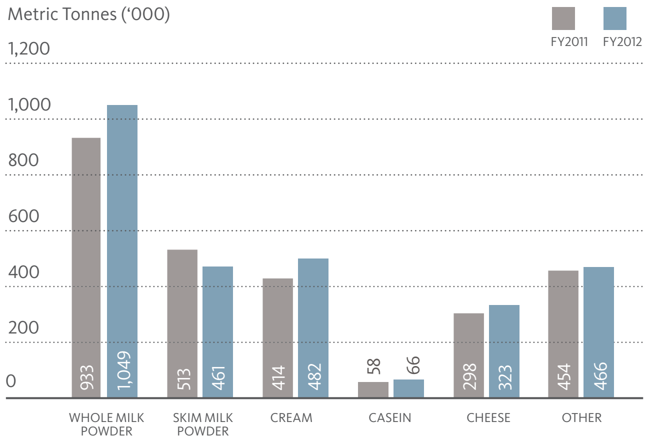
CONTRIBUTION MARGIN PER MT

After taking into account selling, marketing and distribution expenses, our contribution margin per MT was as follows:

NZD MILLION	FY2012	FY2011
Sales volume ('000 MT)[1]	2,847	2,670
Gross profit	**1,406**	**1,212**
Selling, marketing and distribution expenses	(309)	(253)
Contribution margin	**1,097**	**959**
Contribution margin (per MT)	385	359
Growth	*7%*	*25%*

1 Total sales volume, external and inter-segment.

SALES VOLUMES

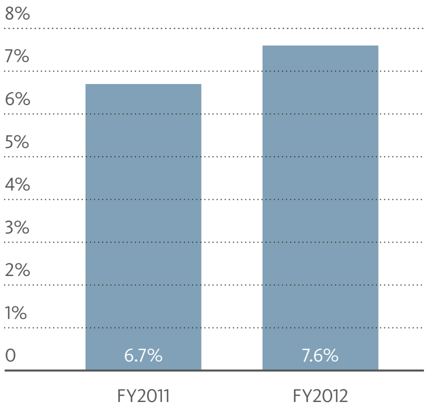


KEY FINANCIALS[1]

NZD MILLION	FY2012	FY2011	CHANGE
Sales volume ('000 MT)[2]	2,847	2,670	7%
Revenue	**15,717**	**15,593**	**1%**
Cost of New Zealand milk	(9,033)	(10,235)	12%
New Zealand manufacturing costs	(2,689)	(2,437)	(10%)
Other costs of goods sold	(2,589)	(1,709)	(51%)
Gross profit	**1,406**	**1,212**	**16%**
Normalised EBIT[3]	**515**	**420**	**23%**
Normalised EBIT margin	3.3%	2.7%	
Normalised EBITDA[4]	**895**	**799**	**12%**
Return on Capital Employed[5]	**7.6%**	**6.7%**	

1 FY2011 has been restated to reflect the movement of Quick Service Restaurants (QSR) into NZ Milk Products from ANZ and China Foodservice out of NZ Milk Products into Asia/AME. These both occurred in FY2012.
2 Total sales volume, external and inter-segment.
3 Earnings before interest, tax, and non-recurring items.
4 Earnings before interest, tax, depreciation, amortisation and non-recurring items.
5 Pre-tax Return on Capital Employed (ROCE) is calculated as normalised EBIT divided by capital employed. Capital employed is calculated as monthly average net assets excluding net debt, derivatives, taxes and investments (other than equity investments).

ROCE[5]



GOOD PERFORMANCE IN OUT-OF-HOME AND PAEDIATRICS MARKETS

During the year we focused on expanding our Foodservice business, which is aimed at the rapidly growing 'out-of-home nutrition' market. This resulted in higher sales volumes which supported strong growth in earnings. Leveraging the growing demand for infant nutritional products globally, NZ Milk Products also benefitted from strong volume growth in semi and fully-finished products, and specialised ingredients that are supplied to the infant formula manufacturers.

CONTINUED COST IMPROVEMENTS

While New Zealand manufacturing costs increased by 10 per cent this year, on a per kgMS of production basis manufacturing costs were consistent year on year. Other costs of goods sold, which primarily relates to non-New Zealand sourced milk, increased by 51 per cent mainly due to the consolidation of RD1 (fully acquired in July 2011), asset impairments, and the sell down of higher valued opening inventory.

Our operating expenses increased by 22 per cent primarily as a result of higher volumes which gave rise to higher storage and distribution costs, and the acquisition of RD1.

A measure of the underlying operational performance of the business is contribution margin per MT of sales. This measure strips out the impact of both volume changes, and dairy product price, and exchange rate fluctuations, which are largely reflected in the cost of New Zealand milk through the Farmgate Milk Price and the cost of globally-sourced milk.

INVESTING IN OUR FUTURE WITH DARFIELD

Darfield, our new manufacturing site in Canterbury started processing milk shortly after the end of the 2012 financial year. This is a significant investment and is a new plant built on Fonterra's first greenfield processing site in approximately 16 years. It will be one of our most efficient powder plants, located in the heart of one of the fastest growing dairying regions in New Zealand. The efficiency, capacity and flexibility of Darfield will help us drive further performance improvements for our New Zealand milk business.

2

AUSTRALIA & NEW ZEALAND

Volume: Sales volume down 4 per cent[1] in Australia after adjusting for the sale of Western Australia

Value: Normalised EBIT[2] down 20 per cent to $204 million

Strong focus on maximising cash flow through working capital management and cutting discretionary spend

Market shares in Australia largely stablilised through increased trade and promotional spend

New Zealand market shares remain strong

Significant reshaping of Fonterra's continuing operations in Australia and New Zealand

The trading environment in Australia has been challenging over the last two years. This was mainly driven by weakening consumer spending which resulted in increased pressure on pricing to drive volume and market share and greater competition in the cheese and yoghurt categories.

LOWER EARNINGS

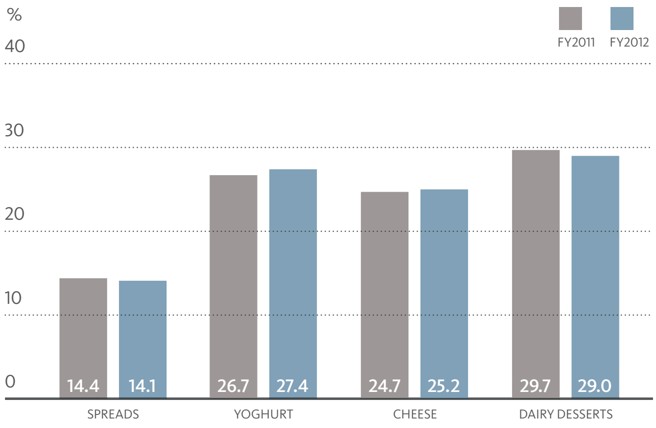
Adjusting for last year's sale of the Western Australia dairy business, our total sales volume in Australia and New Zealand (ANZ) of 959,000 MT was 4 per cent[1] lower than that of the previous financial year. Volume was down 3 per cent in Fonterra Brands Australia as a result of tough trading conditions and loss of private label contract volume, and marginally down in both New Zealand businesses. In Australia, we managed to largely maintain market share across most categories in a very competitive market with higher trade and promotional spend. Our ingredients business in Australia remained broadly stable in 2012, and our Foodservice business continued to achieve solid growth with volume of 30,000 MT.

Normalised EBIT was down 20 per cent to $204 million, with increased trade spend in Australia being one of the main reasons for this decline. Our New Zealand business had marginal growth in EBIT, on the back of our market leading competitive position and our continued focus on operating efficiencies.

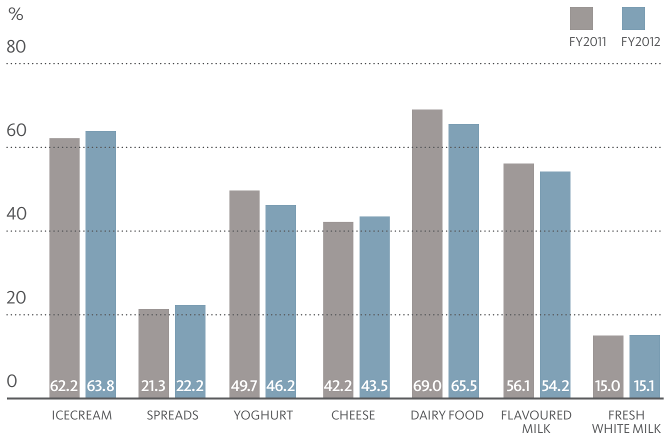
Fonterra Ingredients Australia's milk collection volumes were similar to those recorded for last year, although sales volumes declined 3 per cent to 330,000 MT. EBIT was lower due to the higher milk price paid to our suppliers in response to strong competition for milk supply.

1 Total sales volume, external plus inter-segment.
2 Earnings before interest, tax and non-recurring items.

AUSTRALIA VOLUME MARKET SHARE BY CATEGORY



NEW ZEALAND VOLUME MARKET SHARE BY CATEGORY



Source: Fonterra analysis of published market data.

KEY FINANCIALS[1]

NZD MILLION	FY2012	FY2011	CHANGE
Sales volume ('000 MT)[2]	959	1,096	(13%)
Revenue – consumer and foodservice	2,414	2,582	(7%)
Revenue – dairy nutrition	1,812	1,925	(6%)
Eliminations (intra-segment)	(378)	(267)	42%
Total revenue	**3,848**	**4,240**	**(9%)**
Normalised EBIT[3]	204	256	(20%)
Normalised EBIT margin	*5.3%*	*6%*	
Normalised EBITDA[4]	281	336	(16%)
Sales and marketing as a % of revenue[5]	*3.3%*	*3.6%*	
Return on Capital Employed[6]	**7.1%**	**8.5%**	

1 FY2011 has been restated to reflect the movement of QSR into NZ Milk Products from ANZ. This occurred in FY2012.
2 Total sales volume, external plus inter-segment.
3 Earnings before interest, tax and non-recurring items.
4 Earnings before interest, tax, depreciation, amortisation and non-recurring items.
5 Total revenue, external plus inter-segment.
6 Pre-tax Return on Capital Employed (ROCE) is calculated as normalised EBIT divided by capital employed. Capital employed is calculated as monthly average net assets excluding net debt, derivatives, taxes and investments (other than equity investments).

RESHAPING ANZ

We expect the pricing and retailing pressure in the Australian market to be structural in nature, and this has been a catalyst for Fonterra to address the cost base of our ANZ business. In 2012 significant focus was placed on reducing our working capital and discretionary spend. At the end of 2012 a further range of initiatives commenced, including a reduction in headcount and a rationalisation across the supply chain. In addition to this, our management team at ANZ also commenced the successful implementation of a new enterprise software package to help respond to the challenging environment.

INNOVATION

ANZ benefited from a number of successful product launches as a result of ongoing product innovation. These included the launch of lactose free milk, Zero Lacto™, into New Zealand, the introduction of a new probiotic yoghurt, Symbio™, in New Zealand and diet yoghurt brand, Soleil™, in Australia, all of which appeal to a health conscious audience.

3

ASIA / AME

Volume: Sales volume growth of 3 per cent[1]

Value: Normalised EBIT growth of 8 per cent on a constant currency basis[2]

Maintained market leadership position in Anlene™ in target markets across Asia and the Middle East as well as Shanghai and Guangzhou in China

Continued roll-out of Anlene™ and Anmum™ into China – with strong volume growth

Supply chain issues in Indonesia and flooding in Thailand impacted earnings

Asia, Africa and the Middle East (Asia/AME) achieved good results given the various challenges encountered during the year. These included increases in commodity prices, devaluation of the Asia/AME basket of currencies against the NZD, supply constraints, tightening regulatory environment and the impact of floods.

VOLUME AND REVENUE GROWTH

Despite these challenges, Asia/AME achieved volume growth of 3 per cent and constant currency revenue growth of 10 per cent. The increase in volumes and revenue was driven by a strong performance in Sri Lanka across all categories, and strong growth in Vietnam, Hong Kong, Philippines and Malaysia as a result of good performance in Anlene™ and Anmum™. China Brands had good volume growth with early launch momentum in Jiangsu coupled with market share gains in Shanghai and Guangzhou.

OPERATIONAL CHALLENGES

This strong performance was partially offset by continued supply issues, combined with muted demand and constraints on advertising activities in Indonesia, flooding and UHT supply issues in Thailand and a price premium gap on our product offerings compared with competition in Taiwan (New Young). Middle East volumes were also impacted by sales disruption due to distributor transition and pricing competition.

1 Total sales volumes, external plus inter-segment.
2 Constant currency movement calculated by applying prior period foreign exchange rates to current period results.

ANLENE MARKET SHARE

KEY FINANCIALS[1]

NZD MILLION	FY2012	FY2011	CHANGE
Sales volume ('000 MT)[2]	264	256	3%
Revenue	1,855	1,793	3%
EBIT[3]	194	193	1%
EBIT margin	*10.5%*	*10.8%*	
EBITDA[4]	204	202	1%
Sales & marketing as a % of revenue[5]	*15.4%*	*14.9%*	
Return on Capital Employed[6]	**25.1%**	**26.8%**	

1 FY2011 has been restated to reflect the movement of China Foodservice out of NZ Milk Products into Asia / AME. This occurred in FY2012.
2 Total sales volume, external plus inter-segment.
3 Earnings before interest and tax.
4 Earnings before interest, tax, depreciation and amortisation.
5 Total revenue, external plus inter-segment.
6 Pre-tax Return on Capital Employed (ROCE) is calculated as normalised EBIT divided by capital employed. Capital employed is calculated as monthly average net assets excluding net debt, derivatives, taxes and investments (other than equity investments).

EBIT GROWTH

Selling and marketing expenses were higher than last year mainly because of an increase in advertising and promotions spend of around 11 per cent in constant currency. The higher spend was focussed on our continued expansion in China and ongoing investment in Vietnam and Hong Kong to build brand awareness and fuel another level of growth as well as investments in Indonesia to support new product launches.

Our EBIT of $194 million was 1 per cent higher than last year. On a constant currency basis our EBIT was up 8 per cent reflecting the higher revenue growth, which we achieved after taking into account the higher advertising and promotion spend in China.

CONTINUED SUCCESS WITH ANLENE™ AND ANMUM™

Our Anmum™ brand in Malaysia has a market leadership volume position in the Infant Formula/Follow-On premium segment. This achievement is reflected in the constant currency revenue growth in Malaysia of 6 per cent.

The roll-out of our consumer brands business in China has continued to be successful with Anlene™ maintaining its leadership position in bone health dairy products in Hong Kong, Shanghai and Guangzhou. Our China Foodservice business is now supplying some of the largest food businesses operating in China. Significant growth in out-of-home dining in China continues, being driven by urbanisation, economic prosperity and income growth.

4

LATAM

Volume: Sales volume growth of 2 per cent[1]

Value: Soprole's normalised EBIT grew 13 per cent on a constant currency basis[2]

Investing to upgrade Chilean yoghurt production to address capacity constraints

Continued focus on new product innovation and an improved product mix

Challenging conditions for Dairy Partners Americas (DPA)

Latin America (Latam) achieved a favourable performance with volume growth and improved margins in Soprole. Dairy Partners Americas (DPA) had growth in normalised EBIT, but this was primarily because of a review in our manufacturing cost arrangements and the business faced some challenging conditions in several of its markets.

STRONG PERFORMANCE FROM SOPROLE

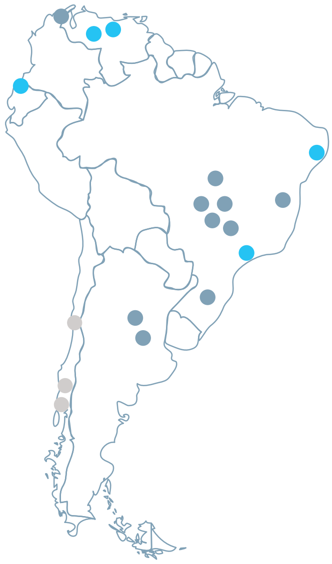
Soprole had total sales volume growth of 2 per cent, as a result of a better product mix although this was constrained to some extent by our capacity constraints in yoghurts and dairy desserts. Our revenue was slightly lower at $805 million mainly because of the strong NZD, but in constant currency revenue was up 4 per cent.

Our focus on improving margins resulted in a normalised EBIT for Soprole of $83 million, which was 6 per cent higher than last year. On a constant currency basis normalised EBIT growth was even higher, up 13 per cent compared to last year. Our continued success with new product innovation resulted in an improved product mix, with an increase in volumes in the higher margin dairy product categories like mature cheese and margarine, and reduced volumes in the lower margin white liquid milk category. This was partially offset by our increased investment in advertising and promotion to support the Soprole™ brand, and higher freight and third party warehousing costs.

A key feature of our Soprole business has been the focus on innovation, with over 35 per cent of consumer sales represented by product innovations introduced in the last three years.

1 Total sales volumes, external plus inter-segment.
2 Constant currency movement calculated by applying prior period foreign exchange rates to current period results.

FONTERRA'S INVESTMENT IN LATIN AMERICA



SOPROLE'S CONSTANT CURRENCY PERFORMANCE[1]

NZD MILLION	FY2012	FY2011	CHANGE
Revenue	863	830	4%
Normalised EBIT	88	78	13%

1 Constant currency movement calculated by applying prior period foreign exchange rates to current period results.

KEY FINANCIALS

NZD MILLION	FY2012	FY2011	CHANGE
Sales volume ('000 MT)[1]	319	312	2%
Revenue	805	830	(3%)
Normalised EBIT[2]	129	119	8%
Normalised EBIT margin for Soprole	*10.3%*	*9.4%*	
Normalised EBITDA[3]	154	140	10%
Sales & marketing as a % of revenue[4]	*6.1%*	*10.2%*	
Return on Capital Employed[5]	**19.2%**	**17.4%**	

1 Total sales volume, external plus inter-segment.
2 Earnings before interest, tax and non-recurring items.
3 Earnings before interest, tax, depreciation, amortisation and non-recurring items.
4 Total revenue, external plus inter-segment.
5 Pre-tax Return on Capital Employed (ROCE) is calculated as normalised EBIT divided by capital employed. Capital employed is calculated as monthly average net assets excluding net debt, derivatives, taxes and investments (other than equity investments).

Soprole began execution of a project to increase its yoghurt production capacity, which will become available from January 2013. Our team is also in the process of developing a new central distribution centre that is likely to be completed late next year.

CHALLENGING CONDITIONS FOR DAIRY PARTNERS AMERICAS

Total DPA-related income of $46 million was 14 per cent up on last year after normalising for an impairment of $8 million in the value of the investment in Venezuela.

DPA faced a number of challenges during the year. In Brazil, higher commodity costs could not be fully recovered through pricing, while our promotional costs increased in response to new competition. Venezuela remained a difficult market, including managing the effect of price controls across major categories and high rate of inflation. In Ecuador, flooding in large parts of the country disrupted distribution channels for a two month period.

FONTERRA AND SUSTAINABILITY

Fonterra is committed to operating sustainably and contributing to the communities in which we operate.

We aim to use resources responsibly, tracking our performance with regard to water, carbon, energy use and waste.

93

PER CENT OF WASTE RE-USED OR RECYCLED

8.2

CUSTOMER VALUE MANAGEMENT SCORE

63

PER CENT REDUCTION IN TRIFR OVER FIVE YEARS

WATER

In the 2012 financial year, Fonterra's New Zealand manufacturing sites used 35.8 million cubic metres of fresh water, recycling or reusing 7.8 per cent. This compares with the prior year's consumption of 35.5 million cubic metres, with 7.3 per cent reused or recycled. The marginally higher consumption in 2012 relates to higher processing volumes in a record season. Recycling reduces the volume of water required for processing and also lessens the wastewater volume.

Our Australian sites withdrew 2.3 million cubic metres of water in the period from 1 July 2011 to 30 June 2012, compared to 2.6 million cubic metres in the prior year.

WASTE

Fonterra's eco-efficiency programme continues to reduce the environmental impact of manufacturing through redesigning operational systems, reusing non-recyclable materials and recycling.

We aim to reuse or recycle at least 90 per cent of the solid waste produced.

In 2012, 92.59 per cent of waste was reused or recycled in our New Zealand operations compared to 92.26 per cent in 2011.

Fonterra has partnered with Envirofert Ltd in New Zealand to divert food waste from landfill. Dairy products that are past their 'best before date', damaged or out of specification are now either converted into stock food or composted. The operation includes a de-packaging plant which recovers product packaging for recycling, with rebates donated to local not-for-profit organisations. Since operations began in January 2012, 1,228 tonnes of product was diverted from landfill.

Fonterra has also installed over 430 recycling bins at schools and milk depots as part of our Milk for Schools pilot programme in Northland. The Tetra Pak milk cartons are collected and shipped to Thailand where they are recycled into fibre or into roofing sheets and composite boards used in the building industry. At year-end, 44 tonnes of cartons had been collected with 24 tonnes exported for recycling.

ENERGY

The efficient use of energy is a key factor in our drive to create a sustainable dairy industry.

Fonterra runs one of the largest energy-efficiency programmes in New Zealand and since 2003 has achieved reductions in our manufacturing intensity per tonne of product. In 2012, energy intensity per tonne was 9.45 GJ/tonne (GJT), a 2.5 per cent reduction on the prior year's 9.69 GJT. The reduction is due to ongoing benefits from our energy-efficiency programme, along with high milk flows during the year improving asset utilisation.

For the period ended 30 June 2012, our Australian operations reduced their energy intensity per tonne by 2.5 per cent to 8.89 GJT for the period, due to a 6 per cent increase in product tonnages and some changes in product mix. This data excludes the Western Australia dairy business sold in March 2011 from the comparative period.

CARBON FOOTPRINT

Fonterra was the first major dairy producer to provide a full life cycle of its greenhouse gas emissions of 2004/05 in NZ. The methodology measured and established a carbon emission baseline for Fonterra to use as a benchmark against future performance. A comprehensive update of this assessment is now underway and will become available in 2013.

SUSTAINABILITY STRATEGY REVIEW

We are committed to embedding sustainability into everything we do as a business. It is a work in progress, with the Co-operative reviewing our global sustainability strategy over the past year with the aim of developing targets and supporting action plans. These will focus on priority areas of water, biodiversity, climate change and carbon, animal welfare and human nutrition.

QUALITY

Quality is the foundation for growing lasting customer partnerships and building trusted brands.

This is everyone's responsibility within Fonterra, from the time we collect milk to the time a customer or consumer uses our products.

Fonterra's customers assessed our overall product performance as being world-class in our 2012 customer value management survey. For the last three years, Fonterra has consistently achieved a value of 8.2 for our overall product performance. Any score over eight is considered best in class. Our customers evaluated our overall product performance as being superior to that of our competitors.

Our drive to improve confidence in our global supply chain continued this year, with quality assessment of milk pools across 16 countries and in excess of 300 food safety audits of contracted manufacturers, ingredient suppliers and packing vendors.

HEALTH AND SAFETY

Fonterra has a goal of being world-class in its health and safety performance by FY2014. We have defined world-class as:

- Zero fatal incidents – employees, contractors and public in operations within our control
- Total Injury Frequency Rate (TRIFR) of less than 10 per million work hours
- Audit scores of 80 per cent or higher on our group-wide health and safety audit

We have put in place a comprehensive health and safety programme to support achievement of these goals, called the "Safe Home System".

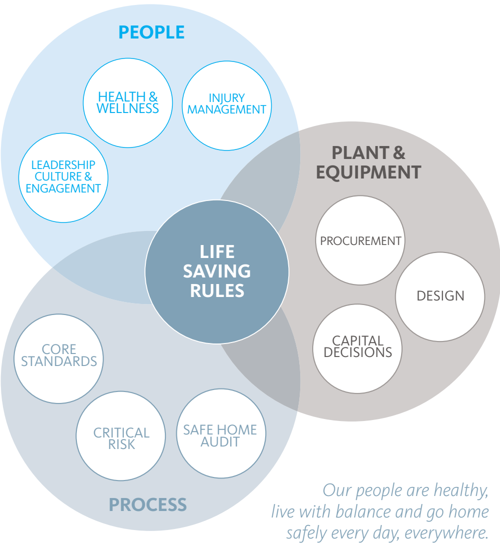
The key elements of this system are:

***People** – build an organisation and people that believe and demonstrate that zero harm is possible – support our people when they are hurt and develop an environment where people are healthy, well and safe*

***Process** – develop core systems, processes and procedures and work to eliminate harm through proactive management of incidents and exposure risk*

***Plant and Equipment** – ensure a healthy and safe work environment through procurement, design, management and maintenance practices.*

THE SAFE HOME SYSTEM



During 2012 we have made good progress towards these goals. Significant work has been done on risk management with active tracking and management now occurring of near-miss events for our highest-rated risks.

We are developing global minimum standards for our key risks to further reduce the risk of fatalities. This includes a strong focus on vehicle and on-road safety as two Fonterra contractors were killed in vehicle-related incidents in Asia in FY2012.

An incident and risk management system, "First Priority", has been rolled out globally, allowing for consistent reporting of incident and management of risk across all countries in which we operate.

Our Group TRIFR was 12.7 for the 2012 year with our operations in China, Asia, the Middle East and South America all having TRIFR rates well below 10.

Significant improvements have been made in group-wide health and safety auditing scores with average scores improving from 52 per cent in 2008 to 83 per cent in the current year.

COMMUNITY

Fonterra recognises that a sustainable business must provide both financial and practical support to social initiatives.

Highlights of the year include our Milk for Schools pilot in the Northland region of New Zealand to inform a potential national rollout in 2013. This is covered in more detail on page 13 of this report, which also details progress with our Soong Ching Ling Foundation partnership in rural China.

As firm believers in dairy nutrition, we share the benefits with communities when we can, with our KickStart Breakfast partnership with Sanitarium a good example. It provides over 22,000 students at over 530 New Zealand decile one-to-four schools with a healthy breakfast twice a week.

With sites across New Zealand, we're very much part of the local community, especially in rural areas. Through our Grass Roots Fund, we provide grants of between $500 and $5,000 to support local initiatives. In the past year the Fund received 1,164 applications, with 345 initiatives supported. Programmes included supporting school environmental initiatives, purchasing locator beacons for rescue services and providing funding for community events which bring rural communities together. In total, we provided $542,513 in funding.

In March 2012, final payments were made from our Fonterra Rebuilding Communities Programme established to support Canterbury's recovery after the earthquakes. Over 2011 and 2012, the programme provided $2 million for initiatives restoring community facilities and getting businesses to function. This was in addition to the more than $3.9 million donated last year to the Red Cross by Fonterra and our staff immediately after the earthquakes.

Other community support includes donations to charities such as Auckland City Mission, Salvation Army and Australia's Foodbank, and financial donations to victims of the Japanese earthquake/tsunami.

Beyond New Zealand, Fonterra is partnering with ChildFund across Indonesia, the Philippines and Sri Lanka to improve access to early childhood care and development services for children up to age five. In Chile, a Soprole programme to get students at more than 1,780 educational institutions involved in sports marked its 11th successful year. The programme is in line with the Chilean Government's efforts to reduce child obesity.

CORPORATE GOVERNANCE

The Board and Management of Fonterra are committed to achieving the highest standard of corporate governance and leadership.

To support our role as a Board, we have developed governance systems that reflect Fonterra's unique characteristics and requirements as a significant New Zealand based co-operative competing in the global dairy market.

IAN BROWN
SHAREHOLDER'S COUNCIL CHAIRMAN

THEO SPIERINGS
CHIEF EXECUTIVE OFFICER

SIR HENRY VAN DER HEYDEN
CHAIRMAN OF THE BOARD

During the financial year ended 31 July 2012, Sir Henry van der Heyden announced his intention to retire as Chairman, effective from the 2012 Annual Meeting in December. John Wilson is Chairman-Elect following a vote by the board. Sir Henry will remain a director until sometime in 2013.

During the same period, John Ballard retired from the board as an Appointed Director, having served since 2006.

Post balance date, Colin Armer resigned as a Elected Director. Mr Armer served on the board from 2006.

Appointed Director Ralph Waters has agreed to extend his tenure for up to six months beyond the 2012 annual meeting, subject to ratification by shareholders at the annual meeting.

WE FOCUS ON GOVERNANCE IN A WAY THAT PROMOTES:

- **The interests of our shareholders**
- **Transparency, giving our shareholders and other stakeholders the information they need to assess our performance**
- **Effective risk management to ensure that Fonterra meets its business objectives and all legal requirements**
- **A good balance between the roles and functions of the Board and management**
- **Communication with important stakeholder groups, including employees, customers, farmers, governments and the communities within which Fonterra works**

OUR BOARD

OUR BOARD

The Board has up to 13 members – nine elected from the shareholder base and four appointed by the Board and ratified at the Annual Meeting by Shareholders.

The Appointed Directors are selected to ensure that the Board has the full complement of skills and competencies needed to lead an enterprise of Fonterra's size, sophistication and complexity. They bring to the Board perspectives and experience to augment the direct industry knowledge and other expertise provided by the Elected Directors.

As the Elected Directors must be shareholders, they will have a supplier relationship with Fonterra and generally will not be classified as independent under best practice definitions. The Appointed Directors, however, do meet the NZX criteria for independence – and are expected by Fonterra to maintain independence for the length of their term.

All Directors comply with the legislative requirements for disclosing interests and with Fonterra's in-house Securities Code of Conduct which regulates both Directors and management in their personal dealings with Fonterra securities and those of related companies. Fonterra does not have executive Directors.

BOARD EFFECTIVENESS

It is important that all members of the Board are appropriately informed of the Group's activities and have access to operations and management.

Directors are supplied with detailed monthly performance reports and analysis in advance of all Board meetings, together with papers on any significant commercial initiatives, and information on the Group's competitive position and general economic indicators.

The Directors also make a point of meeting away from head-office on a semi-regular basis so that they can broaden their understanding of the business through direct contact with managers and customers. Directors also regularly visit key markets to gain a better understanding of the global dairy market.

Following appointment to the Board, Directors undertake an induction programme to familiarise themselves with the Group. Areas covered include:

- business strategy and planning
- an overview of key financial metrics to monitor business performance
- an overview of material areas of the Fonterra business, through meetings with key executives, and
- the Fonterra Constitution and other governance systems.

BOARD ROLE AND CHARTER

Our Board is responsible for leadership, direction and oversight of the Group and is accountable to shareholders for overall performance of the Co-operative. Specific functions in the discharge of this responsibility are:

- review of the dividend policy and declaration of the interim and final dividend
- declaration of the Farmgate Milk Price and Dividends
- declaration of the actual Co-operative share price from the commencement of each season (the Fair Value Share price)
- reviewing and approving the Group strategy and business plans
- appointing the CEO and reviewing the CEO's performance
- delegating authority to management, and monitoring the exercise of that authority
- engaging in the development of the strategic plan and setting the strategy for the Group and for the major business units within the Group
- approving significant acquisitions and disposals outside management's delegated authorities, and
- overseeing the Board Committees and the areas covered by each of those Committees.

The Board Charter outlines the key values and practices of Fonterra and provides a reference point for the Board as a whole, and for individual Directors, in the execution of their duties. The Charter is reviewed regularly, as are the Committee Charters (see www.fonterra.com for the Charter documents).

Board meetings

The Board meets formally at least seven times a year and calls additional meetings to deal with specific issues as they arise. Between full Board meetings, the Board uses Committees and Working Groups to advance its work programme and to enhance the efficiency and effectiveness of its decision-making.

DIRECTORS' REMUNERATION COMMITTEE (DRC)

In accordance with the Constitution, shareholders elect an independent committee of six shareholders to consider and make recommendations to the Annual Meeting on Elected Director remuneration. The members of the DRC are Rodney Wilson (Chair), Murray Holdaway, Murray King, Scott Montgomerie, Philip Wilson and Gerard Wolvers. The Board reviews the DRC's performance against its Terms of Reference but, given the independent nature of the committee, would refer any matters of concern to an Annual or Special Meeting of Shareholders.

The Board sets the remuneration of Appointed Directors.

SHAREHOLDERS' COUNCIL

One of the Board's most important relationships is with the Shareholders' Council. The Council, which is established under the Fonterra Constitution, is independent of the Board and comprises 35 shareholder-elected councillors, each representing a different ward. The functions of the Council are set out in the Constitution. The Council reviews the Board's statement of intentions for the performance and operations of the Group and publishes an Annual Report, commenting on these matters. The Council and the Board meet regularly, as do the Chairs of the Board and the Council and the Chairs of their respective Committees.

COMMUNICATIONS

Fonterra is committed to maintaining and improving dialogue with our shareholder base to ensure that the objectives of both the Group and the shareholders are understood. We run an extensive shareholder and supplier relations programme, managed by the Managing Director Co-operative Affairs. We also provide channels for electronic communication through the www.fonterra.com and Fencepost websites.

Shareholder/supplier meetings

A schedule of regular meetings with shareholders and suppliers is held across the country each year. Often these are run in conjunction with the Shareholders' Council, Area Managers and the Fonterra Farmer Network.

In addition, the Board consults with supplying shareholders on specific issues as they arise.

Fonterra.com and Fencepost

Presentations on the development of the business are available on the www.fonterra.com website. The Group also uses email alerts, including regular updates from the Chairman and regular Shareholder Updates.

The Fencepost website enables Fonterra suppliers, their employees and business partners to transact online with Fonterra and access information and tools on milk production and quality, online statements and up to the minute news and weather.

BOARD COMMITTEES

COMMITTEE OR GROUP	MEMBERSHIP AS AT 1 AUGUST 2012		PURPOSE
Audit, Finance and Risk Committee (AFRC)	David Jackson (Chair) David MacLeod Ian Farrelly	John Waller Malcolm Bailey	To assist the Board in fulfilling its corporate governance responsibilities in relation to Fonterra's risk management and internal control frameworks, financial reporting, audit activities and treasury matters.
Appointments, Remuneration and Development Committee (AR&D)	Sir Henry van der Heyden (Chair) David Jackson (observer) Ian Farrelly John Monaghan	John Wilson Ralph Waters Sir Ralph Norris	To assist the Board in fulfilling its corporate governance responsibilities in relation to the recruitment, retention, remuneration and development of Directors, executives and other employees, and to promote a safe and healthy working environment.
Supplier Relations Committee (SRC)	John Monaghan (Chair) David MacLeod Ian Farrelly	Jim van der Poel Malcolm Bailey Nicola Shadbolt	To assist the Board in fulfilling its corporate governance responsibilities in relation to the supply of milk from Fonterra suppliers, and to seek to resolve supplier complaints before reference to the Milk Commissioner.
Fair Value Share Review Committee (FVSRC)	John Waller (Chair) David Jackson David MacLeod	Jim van der Poel John Monaghan John Wilson	To assist the Board to fulfil its corporate governance responsibilities in relation to the Fair Value Share process, including the adequacy of the information provided to the Valuer and the determination of Restricted Market Value.
External Relations Committee (ERC)	John Monaghan (Chair) David MacLeod	Jim van der Poel Malcolm Bailey	The Committee shall support Fonterra management build aspiration with stakeholders for New Zealand to be the centre of dairying excellence in the world, including regulatory frameworks and infrastructure, creating a shared agenda for Fonterra's ongoing success.
Capital Structure Committee (CSC)	John Wilson (Chair) David Jackson David MacLeod Jim van der Poel	John Monaghan John Waller Nicola Shadbolt	To assist the Board to fulfil its corporate governance responsibilities in relation to the implementation of Trading Among Farmers.
Due Diligence Committee (DDC)	John Waller (Chair) David Jackson Jim van der Poel	John Wilson Nicola Shadbolt	To assist the Board in fulfilling its corporate governance responsibilities by ensuring that appropriate due diligence is undertaken in connection with the proposals, processes, shareholder, investor and external stakeholder communications, and offer documents relating to the implementation of Trading Among Farmers and to assist the Board to ensure that the Board's objectives in proposing Trading Among Farmers and the pre-conditions to commencement of Trading Among Farmers have been addressed in a manner satisfactory to the Board.

Note: Prior to his resignation from the Board on 1 August 2012, Colin Armer was the Chair of the SRC and a member of the AFRC and AR&D Committees.

BOARD AND COMMITTEE ATTENDANCE

	BOARD								
	REGULAR	SPECIAL	AFRC	AR&D	SRC	FVSRC	ERC	DDC	CSC
Sir Henry van der Heyden[1]	7/7	7/8	-	8/8	-	-	-	-	12/17
Colin Armer[2]	7/7	8/8	6/6	8/8	4/4	-	-	-	-
David Jackson	7/7	6/8	6/6	-	-	5/7	-	9/10	15/17
David MacLeod[3]	5/5	6/6	4/4	-	2/2	4/4	2/2	-	8/11
Greg Gent[4]	2/2	2/2	2/2	-	-	1/1	2/2	-	3/6
Ian Farrelly	7/7	8/8	6/6	7/8	4/4	-	-	-	-
Jim van der Poel	7/7	7/8	-	-	2/4	7/7	3/4	10/10	16/17
John Ballard[5]	4/5	5/5	-	6/6	-	-	-	-	-
John Monaghan	7/7	8/8	-	8/8	-	5/7	4/4	-	14/17
John Waller	7/7	7/8	6/6	-	-	7/7	-	10/10	15/17
John Wilson[6]	7/7	7/8	-	8/8	-	7/7	-	10/10	17/17
Malcolm Bailey	7/7	7/8	4/6	-	4/4	-	3/4	-	-
Nicola Shadbolt	7/7	8/8	-	-	4/4	-	-	10/10	15/17
Ralph Waters	7/7	8/8	-	5/8	-	-	-	-	-
Sir Ralph Norris[7]	2/2	3/3	-	1/1	-	-	-	-	-
Total Meetings	**7**	**8**	**6**	**8**	**4**	**7**	**4**	**10**	**17**

1 Announced intention to retire as Chairman effective 2012 Annual Meeting in December. 2 Resigned 01 August 2012. 3 Appointed 17 November 2011. 4 Retired 17 November 2011
5 Retired 30 April 2012. 6 Voted Chairman-Elect by Board on 26 July 2012. 7 Appointed 1 May 2012.

This site is also used to provide information on the business to suppliers.

Annual Meeting

The Board views the Annual Meeting of shareholders, which is held at a different venue around New Zealand each year, as an opportunity to communicate directly with shareholders and ensures that adequate time is provided at these meetings for shareholders to raise issues or ask questions from the floor.

Annual Report

The Group's Annual Report including financial statements, and Annual Review, together with the half-year reports and other material announcements, are designed to present a balanced and clear view of Fonterra's activities and prospects and are available on the website, www.fonterra.com.

Other Disclosures

Information on the Group's performance and the expected Payout, the Fair Value Share, annual and half-year financial results, Director changes, and other significant matters is advised to the market through NZX in accordance with the Disclosure policy. Shareholders and other stakeholders receive regular updates on these and other issues relevant to them.

Fonterra also makes presentations to the Independent Valuer (appointed by the Shareholders' Council to determine the Fair Value range for the Co-operative share price), analysts, rural professionals and financial commentators to coincide with the publication of the Group's half-year and full-year results.

MILK PRICE PANEL

The Board has created the Milk Price Panel for the purpose of providing assurances to it as to the governance of the Farmgate Milk Price and the proper application of the Farmgate Milk Price Manual and the Milk Price Principles.

The Panel does not determine the Farmgate Milk Price as this is a decision for the Board.

The Panel's composition is designed to ensure a large measure of independence. It consists of two Appointed Directors, one Elected Director and two appropriately qualified persons nominated by the Shareholders' Council, at least one of whom must be independent. The Chair must be one of the Appointed Director members.

The Panel is currently chaired by John Waller. Other Board members are David Jackson and John Wilson. The Shareholders' Council appointees are Richard Punter and Patrick Boyle.

KEY POLICIES

Disclosure policy

The Board affirmed Fonterra's commitment to promoting a well-informed and efficient market in its listed debt securities by signing off a new Fonterra Group Disclosure Policy in December 2010.

The Policy applies to all Directors and Officers of Fonterra and its subsidiaries, all Shareholders' Councillors and all employees (including contractors, consultants, advisers or secondees).

The objectives of the Policy are to ensure Fonterra continues to provide timely and accurate information and fully comply with the NZX continuous disclosure regime and with the Securities Markets Act and applicable market rules.

Audit independence policy

The auditor is appointed by the shareholders at the Annual Meeting. Fonterra encourages the rotation of the lead external audit partner in the relationship in accordance with best practice. AFRC approval is required, under the Group's auditor independence policy, for certain activities the auditor may undertake for the Group. The AFRC will not approve the auditor performing any tasks which have the potential to create a conflict except in exceptional circumstances and then only if appropriate safeguards are in place.

Ethics framework

The Board is committed to maintaining high ethical standards across the Group, in all aspects of the business in all parts of the world. Fonterra's Code of Business Conduct – The Way We Work – provides practical guidelines on how to apply Fonterra's values in everyday work situations and when working with customers, shareholders, suppliers and the wider community. This document is available in several languages, to facilitate its accessibility to Fonterra's global employee base.

The Way We Work has been written in simple, straightforward language. An independently run telephone, e-mail and web-based Hotline provides individuals with a confidential channel to raise difficult ethical issues. In the 2012 financial year, 24 calls were raised with the Hotline. All were fully investigated and appropriate action taken, including managing issues through other HR processes.

TRADING AMONG FARMERS

There may be significant and appropriate amendments to governance systems upon the adoption of Trading Among Farmers. These will reflect the various structures and controls relating to Trading Among Farmers.

The Dairy Industry Restructuring Act has also been amended, and provides for further oversight of governance processes.

COMPLIANCE WITH GOVERNANCE STANDARDS

As Fonterra does not currently list equity securities, not all of the provisions in the NZX Corporate Governance Best Practice Code are directly applicable. However, the Board recognises the Code's relevance to the Company and seeks to comply, but notes the following areas where its practices diverge from the Code.

- Appointments to the Board/Nomination Committee (paragraphs 2.2 and 3.10-3.12 of the Code). Under Fonterra's Constitution, the Shareholders' Council conducts the election process for Directors. To the extent the Board is responsible for appointing Directors the AR&D Committee satisfies the role of a nomination committee. The AR&D Committee does not have a majority of independent Appointed Directors due to the proportion of farmer-elected directors on the Board.
- Director Remuneration (paragraph 2.7). Fonterra does not run a performance-based equity security compensation plan. In particular, this is not possible as Appointed Directors are effectively debarred from share ownership as a usual condition of their appointment is that they do not have a supplier relationship with the Company.

The Board has also reviewed compliance with the Principles for Corporate Governance issued by the Financial Markets Authority. While the Board believes it complies with the Principles, there are some points of divergence from specific Guidelines.

- Audit Committee membership (Guideline 3.4). The majority of members are not independent, due to the proportion of farmer-elected Directors on the Board.
- Management representation (Guideline 4.4). The CEO and CFO do not certify in the published accounts their compliance with generally accepted accounting practice in New Zealand. The Board is directly and legally responsible for these documents, and obtains all relevant assurances from management or other parties.

Under Trading Among Farmers Fonterra will continue to observe best practices where appropriate to its circumstances and report divergence from relevant standards.

BOARD OF DIRECTORS

1. SIR HENRY VAN DER HEYDEN DCNZM

BE Ag (Hon), Honorary Doctor of Commerce, Honorary Fellowship from Wintech

Sir Henry van der Heyden has been Chairman of the Fonterra Board since 2002. He steps down as Chairman in December 2012 but he will remain on the Fonterra Board until sometime in 2013. He is also Chairman of the Appointments, Remuneration and Development Committee. Sir Henry is Chairman of Tainui Group Holdings Limited and a director of Auckland International Airport Limited, Pascaro Investments Limited, Manuka Ltda, Rabobank New Zealand Limited and Rabobank Australia Limited. He is a member of New Zealand Business Forums and a member of the Remuneration Committee of ZESPRI International Limited. Sir Henry was made a Distinguished Companion of the New Zealand Order of Merit for services to agriculture in 2007.

2. MALCOLM BAILEY

B. Agr. Econ

Malcolm Bailey was elected to the Fonterra Board in 2004. He sits on the Audit, Finance and Risk Committee, the Supplier Relations Committee, the External Relations Committee and the Milk Payments Working Group. Malcolm also represents Fonterra on the Dairy Companies Association of New Zealand, and is a member of the International Food and Agricultural Trade Policy Council. He is a director of Embryo Technologies Limited, Hopkins Farming Group Limited, Pastoral Dairy Investments Limited, Gleneig Holdings Limited, and Agrico Holdings Limited. Malcolm's dairy farming interests are as a shareholder in Hopkins Farming Group Limited.

3. SIR RALPH NORRIS KNZM

FNZIM, FNZCS

Sir Ralph Norris joined the Fonterra Board in 2012 as an Appointed Director. He sits on the Appointments, Remuneration and Development Committee. Sir Ralph also serves on the board of Origin Energy Limited and on the Council of The University of Auckland. He was Chief Executive of the Commonwealth Bank of Australia for six years until December 2011 and, prior to that, he served as Chief Executive and Managing Director of Air New Zealand Limited from February 2002 to August 2005. Sir Ralph had a 40-year career in banking and served as the Managing Director and Chief Executive Officer of ASB Bank Limited from March 1991 to September 2001, and the Head of International Financial Services for the Commonwealth Bank of Australia from August 1999 to September 2001. Sir Ralph was made a Knight Companion of the New Zealand Order of Merit in 2009 and a Distinguished Companion of the New Zealand Order of Merit for services to business in 2006.

4. IAN FARRELLY

B. Agr.

Ian Farrelly was elected to the Fonterra Board in 2007 following a 20-year career in the banking industry. He is a member of the Audit, Finance and Risk Committee, the Appointments, Remuneration and Development Committee, the Supplier Relations Committee and the Milk Payments Working Group. Ian is also a director of First Mortgage Managers Limited, Spectrum Dairies Limited, Fortuna Group Limited and F.D. Lands Limited. He runs a 400-hectare calf rearing farm in Te Awamutu, owns a 50% share in three Waikato dairy farms and has ownership interests in dairy farms in Canterbury.

5. DAVID JACKSON

M.Com (Hons), FCA

David Jackson joined the Fonterra Board in September 2007 as an Appointed Director. David is Chairman of the Audit, Finance and Risk Committee and serves on the Fair Value Share Review Committee, the Capital Structure Committee and the Milk Price Panel. David also serves on the boards of several other companies including Pumpkin Patch Limited and Nuplex Industries Limited. He is

1. SIR HENRY VAN DER HEYDEN
2. MALCOLM BAILEY
3. SIR RALPH NORRIS
4. IAN FARRELLY
5. DAVID JACKSON
6. JOHN MONAGHAN
7. JIM VAN DER POEL
8. JOHN WALLER
9. RALPH WATERS
10. DAVID MACLEOD
11. JOHN WILSON
12. NICOLA SHADBOLT

1.


4.


2.


5.


3.


Chairman of The New Zealand Refining Company Limited. David spent more than 30 years with accounting firm Ernst & Young in a variety of roles, and served as Chairman of the board of management for the firm in New Zealand from 1999 to 2002.

6. JOHN MONAGHAN

John Monaghan was elected to the Fonterra Board in 2008. John is Chairman of the External Relations Committee and is a member of the Appointments, Remuneration and Development Committee, the Fair Value Share Review Committee and the Capital Structure Committee. John was appointed Chairman of the Shareholder Relations Committee and Milk Payments Working Group in August 2012. He is also a director of CentrePort Limited and CentrePort Properties Limited. He has farming interests in the Wairarapa and Canterbury regions.

7. JIM VAN DER POEL

Jim van der Poel was elected to the Fonterra Board in 2002. He serves on the Fair Value Share Review Committee, the External Relations Committee, the Supplier Relations Committee, the Milk Payments Working Group, the Capital Structure Committee and the Trading Among Farmers Due Diligence Committee, and is Chairman of the International Farming Ventures Group. Jim is also Chairman of the Spectrum Group of companies and a Trustee of the Asia New Zealand Foundation. Jim has won a number of industry awards including the AC Cameron Memorial Award, 2002 New Zealand Nuffield Farming Scholarship, Sharemilker / Equity Farmer of the Year and the Dairy Exporter Primary Performer Award. Jim and his wife Sue live at Ngahinapouri in the Waikato and have farming interests in Waikato, Canterbury and the United States.

8. JOHN WALLER

BCom, FCA

John Waller joined the Fonterra Board in February 2009 as an Appointed Director. John is Chairman of the Fair Value Share Review Committee, the Milk Price Panel and the Trading Among Farmers Due Diligence Committee, and is also a member of the Audit, Finance and Risk Committee and the Capital Structure Committee. John is Chairman of the Bank of New Zealand and the Eden Park Trust. He is a director of National Australia Bank Limited, BNZ Investments Limited, Haydn & Rollett Limited, National Equities Limited, Alliance Group Limited, Sky Network Television Limited, Direct Property Fund Limited, Yealands Wine Group Limited and Donaghys Limited. John was a partner at PricewaterhouseCoopers for over 20 years. He was also a member of their board and led their advisory practice for many years.

9. RALPH WATERS

C.P.Eng. F.I.E. Aust, M Bus

Ralph Waters joined the Fonterra Board in July 2006 as an Appointed Director. He serves on the Appointments, Remuneration and Development Committee. Ralph is Chairman of Fletcher Building Limited and is also a director of Asciano Limited and of Woolworths Limited, where he will assume the role of Chairman later this year. He is also Deputy Chairman of the Local Organising Committee for the ICC Cricket World Cup 2015, to be hosted in New Zealand and Australia. He was Chief Executive of Fletcher Building Limited from May 2001 until his retirement in August 2006. Before joining Fletcher Building Limited, Ralph was Managing Director of the Australian publicly-listed company Email Limited, and has also held a number of engineering and managerial positions in London and the Middle East.

10. DAVID MACLEOD

David MacLeod was elected to the Fonterra Board in 2011. He is a member of the Audit, Finance and Risk Committee, the Capital Structure Committee, the Milk Payments Working Group, the Fair Value Share Review Committee, the External Relations Committee and the International Farming Ventures Group. David also serves on the boards of Port Taranaki Limited and A.J. Greaves Electrical Limited. He is Chairman of the Taranaki Regional Council. David lives near Hawera in South Taranaki and is a director of P.K.W. Farms Limited, one of Fonterra's largest Shareholders.

11. JOHN WILSON

B Agr.Sc

John Wilson joined the Fonterra Board in 2003 and is up for re-election this year. In August, he was appointed by the Fonterra Board as Chairman Elect, subject to being re-elected by Farmer Shareholders. He is Chairman of the Capital Structure Committee and serves on the Appointments, Remuneration and Development Committee, the Milk Price Panel and the Fair Value Share Review Committee. John is also the Chairman of MilkTest NZ Limited, a director of Turners & Growers Limited and a member of the Institute of Directors in New Zealand. In 2000, he was awarded the New Zealand Nuffield Farming Scholarship. John lives on his dairy farm near Te Awamutu and manages a dairy farming business based in Geraldine, South Canterbury, which he owns jointly.

12. NICOLA SHADBOLT

BSc(Hons), MAgrSc(Hons), FNZIPIM(Reg)

Nicola Shadbolt was elected to the Fonterra Board in 2009. She serves on the Capital Structure Committee, the Supplier Relations Committee, the Milk Payments Working Group and the International Farming Ventures Group. Nicola is a Professor at Massey University, Director of the Centre of Excellence in Farm Business Management, a Director of the International Food and Agribusiness Management Association, Trustee of the Agri-Women's Development Trust and represents New Zealand in the International Farm Comparison Network in Dairying. Nicola is a shareholder and a director of five farming and forestry equity partnerships that include two dairy farms in the Manawatu.


6.


7.


8.


9.


10.


11.


12.

FONTERRA MANAGEMENT TEAM

The Fonterra management team roles were announced in May 2012 as part of the reshaping of the organisation to deliver on its "Group Strategy Refresh".

1. THEO SPIERINGS

CEO

Theo joined Fonterra in 2011, bringing with him extensive experience from across the dairy industry, particularly in Asia, Latin America, the Middle East and Europe. Theo has 25 years experience in the global dairy industry in a variety of roles including general management, operations and supply chain, and sales and marketing positions. Theo was previously the acting Chief Executive Officer of Royal Friesland Foods, a Dutch dairy co-operative and, in 2008, led the Dutch dairy co-operative through a merger with Campina. Before taking up his leadership role at Fonterra, Theo ran his own company in the Netherlands focusing on corporate strategy, and mergers and acquisitions, in "fast moving consumer goods". Theo has a Bachelor of Arts in Food Technology / Biotechnology and a Master of Business Administration.

2. JONATHAN MASON

CFO

Jonathan has been with Fonterra since 2009, before which he spent three years as Executive Vice-President and Chief Financial Officer at US-based Cabot Corporation. Jonathan worked in a number of financial management positions at International Paper Company and Exxon Mobil Corporation over the period of 1985 to 2000. From 2000 to 2005, Jonathan was Chief Financial Officer of Carter Holt Harvey Limited and was also a director of that company for a time. Jonathan is on the Advisory Board of the University of Auckland Business School and is a trustee of the University of Auckland Foundation. He has a conjoint BA in International Relations and Economics from Beloit College in Wisconsin, as well as an MA in International Relations and an MBA both from Yale University.

3. JOHN DOUMANI

Managing Director ANZ

John is based in Australia and joined Fonterra in 2007, after 25 years in international business and consumer brands. In addition to his current role, John is also on the boards of Soprole and Dairy Partners Americas. Before joining Fonterra, John was President International of the Campbell Soup Company. Prior to that, he was Managing Director of Meadow Lea Foods Limited, before which he had 13 years with Johnson & Johnson Pacific Pty Limited. In 2008, John was appointed to the board of the Australian Food and Grocery Council, and was appointed Chairman in 2010. He was also appointed to the board of Foodbank Australia Limited in 2010. John has recently joined the board of Double Bay Partnership Incorporated, a not for profit organisation, a position which he held for five years until his resignation in February 2012. John has a Marketing Degree from the University of New South Wales, Australia.

4. GARY ROMANO

Managing Director NZ Milk Products

Gary joined Fonterra in 2005, but has worked in the dairy industry since 1997, including with New Zealand Dairy Group Limited, a predecessor company to Fonterra. His previous roles include management positions at Alcoa of Australia Limited, The Boston Consulting Group and Dairy Partners Americas. In the dairy industry, he has had significant experience in both the manufacturing and supply chain areas, and has led teams charged with the responsibility of achieving world class standards of productivity, quality, safety, cost effectiveness, service and environmental performance. Gary has a Bachelor of Chemical Engineering (Honours) from the University of Queensland, as well as an MBA from the University of Western Australia.

5. ALEX TURNBULL

Managing Director Latam

Alex has more than 20 years experience in the dairy industry, including extensive experience in key senior sales and general management roles within Latin America, and leadership of Fonterra's global paediatrics business since 2008. He is a fluent Portuguese speaker, having spent almost a decade in Brazil. His new role reflects the importance of developing markets as part of Fonterra's strategy. Alex holds a Diploma of Dairy Science and Technology and a Chemical and Materials Engineering Degree.

6. KELVIN WICKHAM

Managing Director Greater China/India

Kelvin is a long-serving Fonterra executive with more than 23 years experience in the dairy industry. Prior to his current role, he was Group Director Supplier and External Relations, Managing Director of Fonterra Global Trade, and Director Group Sales and Operations Planning. Prior to these roles, he was based around the world at a number of Fonterra's operations. Kelvin led the development of Fonterra's innovative GlobalDairyTrade™ platform, and is a product of the New Zealand Dairy Industry Graduate Training Programme. Kelvin is also a director of RD1 Limited, International Nutritionals Limited and Fonterra Brands (Guangzhou) Limited. He holds a Diploma of Dairy Science and Technology, a Masters of Management, and a Chemical and Materials Engineering Degree.

1. THEO SPIERINGS
2. JONATHAN MASON
3. JOHN DOUMANI
4. GARY ROMANO
5. ALEX TURNBULL
6. KELVIN WICKHAM
7. MARK WILSON
8. CHRIS CALDWELL
9. PAUL CAMPBELL
10. SARAH KENNEDY
11. MAURY LEYLAND
12. TODD MULLER
13. IAN PALLISER


1.


2.


3.


4.


5.


6.

7. MARK WILSON

Managing Director ASEAN/MENA

Mark joined Fonterra in 2008, bringing with him more than 35 years experience in the consumer goods sector in Asia, the Pacific, South America and Europe. Prior to joining Fonterra, Mark managed Danone's nutrition business across Asia and the Pacific, and from 1995 to 1998 was the Chief Executive Officer of Dumex. From 1998 to 2007, he was President and Chief Executive Officer of the Danish-listed East Asiatic Company. Mark is also director of Chr. Hansen A/S, a Danish-listed biotech company. Mark holds a Bachelor of Science Degree in Food and Management Science from London University and is a Fellow of the Chartered Institute of Marketing.

8. CHRIS CALDWELL

Managing Director People, Culture and Services

Chris joined Fonterra in 2008 as Commercial Director for the former Global Ingredients and Foodservices business. Chris was General Manager Finance for Fonterra before taking on his current role, in addition to which, he holds a number of board appointments across Fonterra. In his current role, Chris drives initiatives and programmes that enhance the culture of Fonterra, and leads the development of Fonterra's people. He also ensures that the Fonterra Group's internal services are run efficiently and effectively to best serve the needs of its businesses and teams. Before joining Fonterra, Chris spent 10 years with Diageo in different commercial roles across the globe, and earlier in his career held a number of sales and marketing roles. Chris holds a Chemistry degree and is a member of the Chartered Institute of Management Accountants.

9. PAUL CAMPBELL

Group General Manager Mergers and Acquisitions

Paul has been with Fonterra (and before that the New Zealand Dairy Board) since 1984. He is a chemical engineer, and has held a number of general management, marketing, technical and financial roles with Fonterra in New Zealand, Japan, North Africa and the United Kingdom. Since the formation of Fonterra in 2001, Paul has been closely involved in the design of Fonterra's strategy and has managed Fonterra's Mergers and Acquisitions team. He is also a director of a number of Fonterra's international joint ventures.

10. SARAH KENNEDY

Managing Director Fonterra Nutrition

Sarah joined Fonterra in 2011, bringing with her more than 20 years experience in agri-food businesses, including 10 years as Managing Director of Healtheries of New Zealand Limited. Prior to her current role, Sarah was Managing Director of RD1 Limited. Fonterra Nutrition is responsible for the co-ordination and prioritisation of innovation across the Fonterra Group through the exchange of global consumer insights and the centralisation of core research and development resources. Sarah holds a Veterinarian Degree (distinction), and recently completed the Massachusetts Institute of Technology Sloan Fellows Program in Global Leadership and Innovation. Sarah is also a member of the Innovation Board for the Ministry of Science and Innovation, and the Global Women Advisory Board.

11. MAURY LEYLAND

Group General Manager Strategy

Maury has been with Fonterra since 2005 and has recently been driving the development and deployment of the "Strategy Refresh". She has held a number of senior operational and strategic roles across Fonterra. Prior to joining Fonterra, she spent nine years with The Boston Consulting Group. Originally an engineer, Maury was a member of Team New Zealand during the successful 1995 America's Cup campaign. Maury is also on the board of Telecom Corporation of New Zealand Limited. Maury holds a First Class Honours Degree in Engineering Science, is a Fellow of the Institution of Professional Engineers New Zealand and a member of the Institute of Directors in New Zealand.

12. TODD MULLER

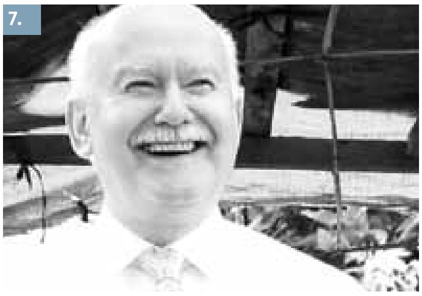
Managing Director Co-operative Affairs

Todd joined Fonterra's External Relations team in 2011 where he managed Local Government and Regional Relations before being promoted to his current role. The Co-operative Affairs role involves the management of Fonterra's relationship with its Farmer Shareholders, Fonterra's Group Identity and its communications and co-operative social responsibility programmes. It also involves policy development and advocacy with central and local government. Todd is also responsible for Fonterra's sustainability strategy. He was previously Chief Executive Officer of Apata Limited, a kiwifruit and avocado post-harvest company, and has held general management roles with kiwifruit marketer ZESPRI International Limited. He has also served in the Office of the Prime Minister of New Zealand. Todd is on the board of The New Zealand Institute for Plant and Food Research Limited, Central Plains Water Limited and The University of Waikato Council. Todd holds a Masters of Social Science from The University of Waikato.

13. IAN PALLISER

Managing Director Group Optimisation and Supply Chain

Ian joined Fonterra in 2010 after more than 30 years experience with British Petroleum (BP), working in a variety of large and complex business units across Australasia, the United States, Europe and the United Kingdom. Immediately before joining Fonterra, he led the British Petroleum (BP) Group procurement function. Prior to taking on his current role in Fonterra, Ian headed Fonterra's Optimisation, Trading and Sourcing team. Ian holds an Honours Degree in Commerce and Administration from Victoria University and is a member of the New Zealand Institute of Chartered Accountants.

7.


10.


12.


8.


11.


13.


9.


FINANCIAL STATEMENTS.

FOR THE YEAR ENDED 31 JULY 2012.

CONTENTS:

DIRECTORS' STATEMENT

FOR THE YEAR ENDED 31 JULY 2012

The Directors of Fonterra Co-operative Group Limited (Fonterra or the Company) are pleased to present to Shareholders the financial statements for Fonterra and its subsidiaries (together the Group) and the Group's interest in its equity accounted investees for the year ended 31 July 2012.

The Directors are responsible for presenting financial statements for each financial year which give a true and fair view of the financial position for the Company and Group and of the financial performance and cash flows for that period.

The Directors consider the financial statements of the Company and Group have been prepared using accounting policies which have been consistently applied and supported by reasonable judgements and estimates, and that all relevant financial reporting and accounting standards have been followed.

The Directors believe that proper accounting records have been kept which enable, with reasonable accuracy, the determination of the financial position of the Company and Group and facilitate compliance of the financial statements with the Financial Reporting Act 1993.

The Directors consider that they have taken adequate steps to safeguard the assets of the Company and Group, and to prevent and detect fraud and other irregularities.

The Directors hereby approve and authorise for issue the financial statements for the year ended 31 July 2012 presented on pages 53 to 104.
For and on behalf of the Board:

SIR HENRY VAN DER HEYDEN
Chairman
25 September 2012

DAVID JACKSON
Director
25 September 2012

INCOME STATEMENT

FOR THE YEAR ENDED 31 JULY 2012

	NOTES	GROUP $ MILLION 31 JULY 2012	GROUP $ MILLION 31 JULY 2011	PARENT $ MILLION 31 JULY 2012	PARENT $ MILLION 31 JULY 2011
Revenue from sale of goods		**19,769**	19,871	**9,050**	10,257
Dividends received		**–**	–	**114**	495
Total revenue		**19,769**	19,871	**9,164**	10,752
Cost of goods sold	1	**(16,721)**	(16,861)	**(9,050)**	(10,257)
Gross profit		**3,048**	3,010	**114**	495
Other operating income		**132**	165	**56**	53
Selling and marketing expenses		**(568)**	(596)	**(10)**	(12)
Distribution expenses		**(501)**	(487)	**–**	–
Administrative expenses		**(784)**	(700)	**(241)**	(218)
Other operating expenses		**(385)**	(336)	**(73)**	(66)
Net foreign exchange losses	3	**(7)**	(91)	**–**	–
Operating profit/(loss)	2	**935**	965	**(154)**	252
Finance income	4	**30**	32	**263**	375
Finance costs	4	**(340)**	(438)	**(287)**	(372)
Net finance (costs)/income		**(310)**	(406)	**(24)**	3
Share of profit of equity accounted investees		**52**	63	**–**	–
Profit/(loss) before tax		**677**	622	**(178)**	255
Tax (expense)/credit	5	**(53)**	149	**226**	183
Profit for the year		**624**	771	**48**	438
Profit for the year is attributable to:					
Shareholders of the Parent		**609**	754	**48**	438
Non-controlling interests		**15**	17	**–**	–
Profit for the year		**624**	771	**48**	438

		GROUP $ 31 JULY 2012	GROUP $ 31 JULY 2011
Earnings per share:			
Basic and diluted earnings per share	25	**0.42**	0.55

The accompanying notes form part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 JULY 2012

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Profit for the year	624	771	48	438
Cash flow hedges:				
– Net fair value (losses)/gains	(229)	1,384	(3)	(36)
– Transferred and reported in revenue from sale of goods	(400)	(863)	–	–
– Tax credit/(expense) on cash flow hedges	176	(146)	–	10
Net investment hedges:				
– Net fair value (losses)/gains on hedging instruments	(33)	49	–	–
– Tax credit/(expense) on net investment hedges	9	(14)	–	–
Foreign currency translation gains/(losses) attributable to Shareholders	37	(164)	–	–
Foreign currency translation reserve transferred to income statement	(7)	(15)	–	–
Foreign currency translation attributable to non-controlling interests	1	(4)	–	–
Share of equity accounted investees' movements in reserves	1	7	–	–
Other comprehensive (expense)/income recognised directly in equity	(445)	234	(3)	(26)
Total comprehensive income for the year	179	1,005	45	412
Attributable to:				
Shareholders of the Parent	163	992	45	412
Non-controlling interests	16	13	–	–
Total comprehensive income for the year	179	1,005	45	412

The accompanying notes form part of these financial statements.

STATEMENT OF FINANCIAL POSITION

AS AT 31 JULY 2012

		GROUP $ MILLION		PARENT $ MILLION	
	NOTES	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
ASSETS					
Current assets					
Cash and cash equivalents		**1,033**	785	**793**	570
Trade and other receivables	8	**2,302**	2,279	**9,125**	9,423
Inventories	9	**2,981**	3,277	**–**	–
Tax receivable		**18**	29	**–**	–
Derivative financial instruments	19(g)	**275**	1,100	**270**	1,088
Other current assets		**83**	90	**–**	–
Total current assets		**6,692**	7,560	**10,188**	11,081
Non-current assets					
Property, plant and equipment	10	**4,569**	4,326	**210**	222
Investment in subsidiaries		**–**	–	**6,895**	6,895
Equity accounted investments	11	**439**	429	**–**	–
Intangible assets	12	**2,882**	2,748	**77**	66
Deferred tax asset	16	**99**	116	**385**	403
Derivative financial instruments	19(g)	**198**	154	**198**	154
Other non-current assets		**238**	197	**9**	10
Total non-current assets		**8,425**	7,970	**7,774**	7,750
Total assets		**15,117**	15,530	**17,962**	18,831
LIABILITIES					
Current liabilities					
Bank overdraft		**42**	23	**–**	–
Borrowings	15	**1,204**	444	**999**	53
Trade and other payables	13	**1,386**	1,350	**7,053**	7,343
Owing to suppliers		**1,083**	1,679	**1,134**	1,729
Tax payable		**28**	19	**–**	–
Derivative financial instruments	19(g)	**255**	58	**247**	41
Provisions	14	**83**	67	**20**	29
Other current liabilities		**44**	6	**–**	–
Total current liabilities		**4,125**	3,646	**9,453**	9,195
Non-current liabilities					
Borrowings	15	**3,745**	4,206	**3,015**	3,799
Derivative financial instruments	19(g)	**413**	718	**413**	718
Provisions	14	**81**	106	**42**	79
Deferred tax liability	16	**85**	295	**–**	–
Other non-current liabilities		**13**	18	**–**	–
Total non-current liabilities		**4,337**	5,343	**3,470**	4,596
Total liabilities		**8,462**	8,989	**12,923**	13,791
Net assets		**6,655**	6,541	**5,039**	5,040
EQUITY					
Co-operative shares		**5,690**	5,261	**5,690**	5,261
Retained earnings		**1,078**	943	**(584)**	(157)
Foreign currency translation reserve		**(211)**	(217)	**–**	–
Cash flow hedge reserve		**63**	516	**(67)**	(64)
Total equity attributable to Shareholders of the Parent		**6,620**	6,503	**5,039**	5,040
Non-controlling interests		**35**	38	**–**	–
Total equity		**6,655**	6,541	**5,039**	5,040

The accompanying notes form part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 JULY 2012

GROUP $ MILLION	ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT						
	CO-OPERATIVE SHARES	RETAINED EARNINGS	FOREIGN CURRENCY TRANSLATION RESERVE	CASH FLOW HEDGE RESERVE	TOTAL	NON-CONTROLLING INTERESTS	TOTAL EQUITY
As at 1 August 2010	5,016	547	(73)	141	5,631	36	5,667
Profit for the year	–	754	–	–	754	17	771
Other comprehensive income/(expense) for the year	–	7	(144)	375	238	(4)	234
Total comprehensive income/(expense) for the year	–	761	(144)	375	992	13	1,005
Transactions with Shareholders in their capacity as Shareholders:							
Dividends paid to Shareholders of the Parent	–	(365)	–	–	(365)	–	(365)
Co-operative shares issued	404	–	–	–	404	–	404
Co-operative shares surrendered	(159)	–	–	–	(159)	–	(159)
Dividends paid to non-controlling interests	–	–	–	–	–	(11)	(11)
As at 31 July 2011	5,261	943	(217)	516	6,503	38	6,541
As at 1 August 2011	**5,261**	**943**	**(217)**	**516**	**6,503**	**38**	**6,541**
Profit for the year	**–**	**609**	**–**	**–**	**609**	**15**	**624**
Other comprehensive income/(expense) for the year	**–**	**1**	**6**	**(453)**	**(446)**	**1**	**(445)**
Total comprehensive income/(expense) for the year	**–**	**610**	**6**	**(453)**	**163**	**16**	**179**
Transactions with Shareholders in their capacity as Shareholders:							
Dividends paid to Shareholders of the Parent	**–**	**(475)**	**–**	**–**	**(475)**	**–**	**(475)**
Co-operative shares issued	**584**	**–**	**–**	**–**	**584**	**–**	**584**
Co-operative shares surrendered	**(155)**	**–**	**–**	**–**	**(155)**	**–**	**(155)**
Dividends paid to non-controlling interests	**–**	**–**	**–**	**–**	**–**	**(19)**	**(19)**
As at 31 July 2012	**5,690**	**1,078**	**(211)**	**63**	**6,620**	**35**	**6,655**

PARENT $ MILLION	CO-OPERATIVE SHARES	RETAINED EARNINGS	CASH FLOW HEDGE RESERVE	TOTAL EQUITY
As at 1 August 2010	5,016	(230)	(38)	4,748
Profit for the year	–	438	–	438
Other comprehensive expense for the year	–	–	(26)	(26)
Total comprehensive income/(expense) for the year	–	438	(26)	412
Transactions with Shareholders in their capacity as Shareholders:				
Dividends paid to Shareholders	–	(365)	–	(365)
Co-operative shares issued	404	–	–	404
Co-operative shares surrendered	(159)	–	–	(159)
As at 31 July 2011	5,261	(157)	(64)	5,040
As at 1 August 2011	**5,261**	**(157)**	**(64)**	**5,040**
Profit for the year	**–**	**48**	**–**	**48**
Other comprehensive expense for the year	**–**	**–**	**(3)**	**(3)**
Total comprehensive income/(expense) for the year	**–**	**48**	**(3)**	**45**
Transactions with Shareholders in their capacity as Shareholders:				
Dividends paid to Shareholders of the Parent	**–**	**(475)**	**–**	**(475)**
Co-operative shares issued	**584**	**–**	**–**	**584**
Co-operative shares surrendered	**(155)**	**–**	**–**	**(155)**
As at 31 July 2012	**5,690**	**(584)**	**(67)**	**5,039**

The accompanying notes form part of these financial statements.

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 JULY 2012

	NOTES	GROUP $ MILLION 31 JULY 2012	GROUP $ MILLION 31 JULY 2011	PARENT $ MILLION 31 JULY 2012	PARENT $ MILLION 31 JULY 2011
Cash flows from operating activities					
Cash was provided from:					
– Receipts from customers		**20,045**	19,490	**9,104**	10,311
– Dividends received		**37**	63	**–**	–
– Tax received		**11**	5	**–**	–
Cash was applied to:					
– Payments to creditors and employees		**(7,905)**	(7,528)	**(299)**	(280)
– Payments for milk purchased		**(10,721)**	(10,780)	**(9,593)**	(9,632)
– Tax paid		**(77)**	(66)	**–**	–
Net cash flows from operating activities	17	**1,390**	1,184	**(788)**	399
Cash flows from investing activities					
Cash was provided from:					
– Proceeds from disposal of property, plant and equipment		**11**	9	**–**	–
– Proceeds from settlement of net investment hedges		**26**	20	**–**	–
– Proceeds from sale of Group entities and other business operations		**–**	184	**–**	–
– Net loans from Group entities		**–**	–	**1,435**	507
Cash was applied to:					
– Acquisition of property, plant and equipment		**(673)**	(488)	**(19)**	(25)
– Acquisition of intangible assets		**(184)**	(135)	**(25)**	(27)
– Outflows on settlement of net investment hedges		**(2)**	(23)	**–**	–
– Acquisition of Group entities and other business operations		**–**	(55)	**–**	–
– Advances made to equity accounted investees		**(4)**	–	**–**	–
Net cash flows from investing activities		**(826)**	(488)	**1,391**	455
Cash flows from financing activities					
Cash was provided from:					
– Proceeds from borrowings		**2,215**	3,648	**1,206**	1,535
– Proceeds from issue of Co-operative shares		**505**	368	**505**	368
– Proceeds for Co-operative shares not yet issued		**44**	25	**44**	25
– Proceeds from settlement of borrowing derivatives		**13**	21	**–**	–
– Interest received		**31**	32	**18**	20
Cash was applied to:					
– Interest paid		**(406)**	(397)	**(309)**	(353)
– Repayment of borrowings		**(2,097)**	(3,548)	**(1,214)**	(1,699)
– Outflows on settlement of borrowing derivatives		**(5)**	(46)	**–**	–
– Surrender of Co-operative shares		**(155)**	(160)	**(155)**	(160)
– Dividends paid to non-controlling interests		**(19)**	(11)	**–**	–
– Dividends paid to Shareholders of the Parent		**(475)**	(365)	**(475)**	(365)
Net cash flows from financing activities		**(349)**	(433)	**(380)**	(629)
Net increase in cash and cash equivalents		**215**	263	**223**	225
Cash and cash equivalents at the beginning of the year		**762**	534	**570**	345
Effect of exchange rate changes on cash balances		**14**	(35)	**–**	–
Cash and cash equivalents at the end of the year		**991**	762	**793**	570
Reconciliation of closing cash balances to the statement of financial position:					
Cash and cash equivalents		**1,033**	785	**793**	570
Bank overdraft		**(42)**	(23)	**–**	–
Closing cash balances		**991**	762	**793**	570

Parent undertakes financing activities for the Group. As a result receipts and payments from and to subsidiaries for operating and financing activities (including dividends) are settled on a net basis and presented in investing activities as net loans from Group entities.

The accompanying notes form part of these financial statements.

STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

FOR THE YEAR ENDED 31 JULY 2012

a) General information

Fonterra Co-operative Group Limited (Fonterra, Parent, the Co-operative or the Company) is a co-operative company incorporated and domiciled in New Zealand. Fonterra is registered under the Companies Act 1993 and the Co-operative Companies Act 1996, and is an issuer for the purposes of the Financial Reporting Act 1993. Fonterra is also required to comply with the Dairy Industry Restructuring Act 2001.

The consolidated financial statements are for the Company, its subsidiaries (together referred to as the Group) and the Group's interests in its equity accounted investees.

The Group is primarily involved in the collection, manufacture and sale of milk and milk derived products and is a profit-oriented entity.

On 30 June 2010, Shareholders approved changes to the Company's constitution that will allow the Board to take steps to implement changes to Fonterra's capital structure that would permit trading of shares among Shareholders. This was re-affirmed in the Special Meeting held on 25 June 2012. Refer to Note 7 for further information.

b) Basis of preparation

These financial statements comply with New Zealand Generally Accepted Accounting Practice (NZ GAAP), and have been prepared in accordance with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS), as appropriate for profit-oriented entities. These financial statements also comply with International Financial Reporting Standards (IFRS).

These financial statements are prepared on a historical cost basis except for derivative financial instruments and the hedged risks on certain debt instruments, which are recognised at their fair values.

These financial statements are presented in New Zealand dollars ($), which is the Company's functional and presentation currency, and rounded to the nearest million.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions of accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimation uncertainty, requiring judgement in applying accounting policies, that have the most significant effect on the amounts recognised in the financial statements, are described in the following notes:

– Note 14 Provisions

– Note 19 Financial risk management – fair value of certain financial instruments

c) Basis of consolidation

Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date that control is transferred to the Group. They are de-consolidated from the date control ceases.

The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Acquisition-related costs are expensed as incurred. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree, over the fair value of the Group's share of the identifiable net assets acquired, is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets acquired, the difference is recognised in the income statement.

Non-controlling interests are allocated their share of profit for the year in the income statement and are presented within equity in the statement of financial position, separately from equity attributable to Shareholders. The effects of all transactions with non-controlling interests that change the Group's ownership interest but do not result in a change in control are recorded in equity. Where control is lost, the remaining interest in the investment is re-measured to fair value and any surplus or deficit arising from that re-measurement is recognised in the income statement.

Equity accounted investees (associates and jointly controlled entities)

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Jointly controlled entities are those entities over whose activities the Group has joint control, established by contractual agreement and requiring unanimous consent for strategic, financial and operating decisions. Equity accounted investees are initially recognised at cost (including any goodwill identified on acquisition). Subsequent to initial recognition they are accounted for using the equity method in the consolidated financial statements.

The consolidated financial statements include the Group's share of the profit or loss after tax of equity accounted investees, after adjustments to align to the accounting policies of the Group, from the date that significant influence or joint control commences until the date that significant influence or joint control ceases. When the Group's share of losses exceeds its interest in an equity accounted investee, the carrying amount of that interest is reduced to nil and no further losses are recognised except to the extent the Group has an obligation or has made payments on behalf of the investee. Dividends receivable from equity accounted investees reduce the carrying amount of the investment.

The Group determines at each reporting date whether there is any objective evidence that its investments in equity accounted investees are impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the investee and its carrying value, and recognises that amount in the income statement.

Transactions eliminated on consolidation

Intra-group transactions, balances, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

d) Foreign currency

Foreign currency transactions

Foreign currency transactions are translated into the respective functional currencies of Group entities using the exchange rate at the dates of transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation, using the exchange rates at the balance date, of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in other comprehensive income as qualifying cash flow or qualifying net investment hedges.

Translation of the financial statements into the presentation currency

Where the Company's presentation currency differs from the functional currency of an entity, the assets and liabilities of the operation are translated from the functional currency into the presentation currency at the exchange rates at the balance date. The income and expenses of these entities are translated at rates approximating the exchange rates at the dates of the transactions. Exchange differences arising on the translation of the financial statements of these entities and of borrowings and other currency instruments designated as hedges of such investments are recognised directly in the foreign currency translation reserve. When an entity is partially disposed of or sold, the exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.

e) Financial assets and liabilities

A financial asset or liability is recognised if the Group becomes a party to the contractual provisions of the asset or liability. A financial asset or liability is recognised initially at its fair value plus, in the case of a financial asset or liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the instrument. Financial assets and liabilities carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in the income statement.

After initial recognition, financial assets are measured at their fair values except for loans and receivables and held-to-maturity investments, which are measured at amortised cost less any provision for impairment. After initial recognition, financial liabilities are measured at amortised cost method except for financial liabilities at fair value through profit or loss.

In the separate financial statements of the Parent, investments in subsidiaries are stated at cost, less any impairment.

Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Financial liabilities are derecognised if the Group's obligations specified in the contract expire or are discharged or cancelled.

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis.

Financial assets are classified on initial recognition into the following categories: at fair value through profit or loss, held-to-maturity investments, loans and receivables, and available-for-sale. Financial liabilities are classified as either fair value through profit or loss, or financial liabilities measured at amortised cost. The classification depends on the purpose for which the financial assets and liabilities were acquired. Management determines the classification of its financial assets and liabilities at initial recognition. The Group has not had any held-to-maturity investments or available-for-sale financial assets in the periods covered by these financial statements.

Financial assets and financial liabilities at fair value through profit or loss

Financial assets and liabilities in this category are either designated as fair value through profit or loss, or classified as held for trading. All derivatives are classified as held for trading except when they are in cash flow, fair value, or net investment hedge relationships (refer to accounting policy j) below). Other financial assets and financial liabilities may be designated at fair value through profit or loss where this eliminates an accounting mismatch, or where they are managed on a fair value basis.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Trade and other receivables are classified as loans and receivables.

Financial liabilities measured at amortised cost

Financial liabilities measured at amortised cost are non-derivative financial liabilities with fixed or determinable payments that are not quoted in an active market. Trade and other payables, and debt instruments are classified as financial liabilities measured at amortised cost.

Financial guarantee contracts

Financial guarantee contracts are those contracts that require the issuer to make specific payments to reimburse the holder for a loss it incurs if a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. Financial guarantee contracts are recognised initially as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequently, the liability is measured at the higher of the best estimate of the expenditure required to settle the present obligation at the balance date, and the amount initially recognised less cumulative amortisation.

f) Cash balances

Cash balances include cash and cash equivalents comprising cash on hand, deposits held at call with banks, other short term highly liquid investments with original maturities of three months or less, and bank overdrafts.

g) Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

h) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortised cost using the effective interest method, with the hedged risks on certain debt instruments measured at fair value. Changes in fair value of those hedged risks are recognised in the income statement, except where they relate to borrowings classified as net investment hedges and are recorded directly in other comprehensive income.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after balance date.

i) Trade and other payables

Trade and other payables are carried at amortised cost.

j) Derivative financial instruments and hedging activities

The Group uses derivative financial instruments within predetermined policies and limits in order to reduce its exposure to fluctuations in foreign currency exchange rates and interest rates.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into (the trade date) and transaction costs are expensed immediately. They are subsequently remeasured to their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either:

- hedges of the fair value of recognised assets or liabilities, or a firm commitment (fair value hedges);
- hedges of a particular risk associated with a recognised liability or a highly probable forecast transaction (cash flow hedges); or
- hedges of a net investment in a foreign operation (net investment hedges).

The Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The full fair value of a hedging derivative is classified as a non-current asset or liability when maturity of the hedged item exceeds 12 months. It is classified as a current asset or liability when the maturity of the hedged item is less than 12 months.

Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recognised in the income statement, together with any changes in the fair value of the hedged asset or liability attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised and recognised in the income statement over the period to maturity.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised directly in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are transferred to the income statement when the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is recognised immediately in the income statement.

When the forecast transaction that is hedged results in the recognition of a non-financial asset (e.g. inventory or property, plant and equipment) the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset.

Net investment hedges

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Gains and losses accumulated in equity are included in the income statement when all or part of a foreign operation is disposed of or sold.

k) Inventories

Inventories are stated at the lower of cost and net realisable value on a first in first out basis.

Net realisable value is the estimated selling price in the ordinary course of business, less the costs of completion and selling expenses.

The cost of dairy product manufactured from milk supplied in New Zealand is established by using the monthly Farmgate Milk Price as the cost for raw milk supplied. In the case of manufactured inventories and work in progress, cost includes all direct costs plus that portion of the fixed and variable production overhead incurred in bringing inventories into their present location and condition.

l) Property, plant and equipment

Owned assets

Items of property, plant and equipment are measured at cost less accumulated depreciation and impairment losses. Cost includes the purchase consideration and those costs directly attributable to bringing the asset to the location and condition necessary for its intended use. Costs cease to be capitalised when substantially all the activities necessary to bring an asset to the location and condition for its intended use are complete. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of any replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

The assets' residual values and useful lives are reviewed and adjusted, if appropriate, at each financial year end.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount, and are recognised in the income statement.

Depreciation

Depreciation is calculated on a straight line basis to allocate the cost of the asset, less any residual value, over its estimated useful life. The range of estimated useful lives for each class of property, plant and equipment is as follows:

– Land	Indefinite
– Buildings and leasehold improvements	15 – 50 years
– Plant, vehicles and equipment	3 – 25 years

Leased assets

Leases of property, plant and equipment where the Group assumes substantially all the risks and rewards of ownership are classified as finance leases.

Assets under finance leases are recognised as property, plant and equipment in the statement of financial position. They are recognised initially at their fair value, or if lower, at the present value of the minimum lease payments. A corresponding liability is established and each lease payment allocated between the liability and interest expense using the effective interest method. The assets recognised are depreciated on the same basis as equivalent property, plant and equipment.

Leases that are not finance leases are classified as operating leases and the assets are not recognised on the Group's statement of financial position. Operating lease payments are recognised as an expense on a straight line basis over the term of the lease.

m) Intangible assets

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary or equity accounted investee at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of equity accounted investees is included in equity accounted investments and is tested for impairment as part of the overall balance.

Goodwill is carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Goodwill is tested annually for impairment or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

Brands and other identifiable intangible assets

Brands and other intangible assets purchased by the Group are recognised if the asset is controlled through custody or legal rights and could be sold separately from the rest of the business. Brands and other intangible assets have a combination of both indefinite and finite useful lives. Items with indefinite useful lives are tested for impairment annually or whenever there is an indication that an asset may be impaired and carried at cost less accumulated impairment losses. Items with finite useful lives are carried at cost less accumulated amortisation and accumulated impairment losses, and are amortised on a straight line basis to allocate the cost over their licence period (18 – 25 years). Assets that have been impaired are reviewed for possible reversal of impairment at each balance date.

Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Costs associated with developing or maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with the development of identifiable and unique software products controlled by the Group, and that will generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Costs include the employee costs incurred as a result of developing software and an appropriate portion of relevant overheads.

Computer software licences and development costs recognised as assets are amortised over their estimated useful lives, being three to ten years.

Research and development expenditure

All research expenditure is recognised in the income statement as incurred. Significant development expenditure is recognised as an asset when it can be demonstrated that the commercial production of the material or product, or use of the process, will commence.

Development expenditure recognised as an asset is stated at cost and amortised over the period of expected benefits on a straight line basis, not exceeding five years. Amortisation begins at the time that commercial production or use of the process commences. All other development expenditure is recognised in the income statement as incurred.

n) Impairment of financial assets

Assets carried at amortised cost

The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:

- significant financial difficulty of the customer;
- a breach of contract, such as a default or delinquency in payments;
- for economic or legal reasons relating to the customer's financial difficulty, granting to the customer a concession that the Group would not otherwise consider;
- it becomes probable that the customer will enter bankruptcy or other financial reorganisation.

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate and is recognised in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the reversal of the previously recognised impairment loss is recognised in the income statement.

o) Impairment of non-financial assets

Intangible assets that have an indefinite useful life are not subject to amortisation and are tested for impairment annually or whenever there is an indication that an asset may be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the estimated recoverable amount of an asset is less than its carrying amount, the asset is written down to its estimated recoverable amount and an impairment loss is recognised in the income statement. The recoverable amount of an asset is the higher of its fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash inflows (cash-generating units).

Non-financial assets, other than goodwill, that have been impaired are reviewed for possible reversal of the impairment at each balance date.

p) Provisions

Provisions are recognised only in those circumstances where the Group has a present legal or constructive obligation as a result of a past event, when it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognised as a finance cost in the income statement.

q) Co-operative shares

Co-operative shares are classified as equity. Incremental costs directly attributable to the issue of co-operative shares are recognised as a deduction from equity.

r) Revenue recognition

Revenue from the sale of goods is recognised at the fair value of the consideration received or receivable, net of returns, discounts and allowances. Revenue is recognised when the amount of revenue can be reliably measured, significant risks and rewards of ownership of the inventory items have passed to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, and there is no continuing management involvement with the goods.

Dividend income is recognised when the right to receive payment is established.

s) New Zealand sourced cost of milk

New Zealand sourced cost of milk includes milk supplied by Shareholders, Supplier Premiums paid, and milk purchased from contract suppliers during the financial year. New Zealand sourced cost of milk is recognised in cost of goods sold.

New Zealand sourced cost of milk supplied by Shareholders comprises the volume of milk solids supplied at the Farmgate Milk Price for the relevant season. The Farmgate Milk Price for each season is calculated in accordance with the principles set out in the Milk Price Manual and is independently audited. The Farmgate Milk Price broadly represents the maximum sustainable amount a New Zealand based manufacturer of milk powders could afford to pay for milk and still make an adequate return on capital.

Supplier Premiums are paid for speciality milks such as winter milk and colostrum.

t) Dividends

All shares are eligible to receive dividends if declared by the Board. Dividends are recognised as a liability in the Group's financial statements in the period in which they are declared by the Board.

u) Employee benefits

Employee benefits primarily include short term employee benefits, long term employee benefits and defined contribution pension plans.

Short term employee benefits include salaries, wages, annual leave and sick leave, and are expensed on an undiscounted basis as the relevant service is provided.

Long term employee benefits are measured at the present value of expected payments required using an appropriate pre-tax discount rate.

Contributions to defined contribution pension plans are recognised as an expense in the period they are due. The Group has no further payment obligations once the contributions have been paid.

v) Finance income and costs

Finance income comprises interest income on funds on deposit. Interest income is recognised as it accrues using the effective interest method.

Finance costs comprise interest expense on borrowings, unwinding of the discount on provisions, gains and losses on the revaluation of debt hedges and the hedged risks on certain debt instruments, and gains and losses relating to translation forward points on forward exchange contracts where revaluation gains and losses on those contracts are included within finance costs. Interest expense and the unwinding of the discount on provisions are recognised in the income statement using the effective interest method. Finance costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of that asset.

w) Tax

Tax expense comprises current and deferred tax. Tax expense, including the tax consequences of distributions to Shareholders is recognised in the income statement. The tax consequences of distributions to Shareholders are recognised in the year to which the distribution relates. Other than distributions to Shareholders, tax consequences of items recognised directly in equity are also recognised in equity.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the balance date, and any adjustment to tax payable or receivable in respect of previous years.

Deferred tax is recognised, using the balance sheet method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is measured at the tax rate that is expected to apply to the temporary differences when they reverse, based on laws that have been enacted or substantively enacted by the balance date.

Deferred tax is not recognised on the following temporary differences:

- the initial recognition of goodwill;
- the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit; and
- differences relating to investments in subsidiaries and equity accounted investees to the extent that the timing of the reversal is controlled by the Group and it is probable that they will not reverse in the foreseeable future.

Deferred tax assets are recognised to the extent it is probable that future taxable profits will be available against which the temporary differences can be utilised.

x) Earnings per share

Earnings per share is calculated as net profit attributable to equity holders of the Company, divided by the weighted average number of ordinary shares on issue during the year.

y) Comparative figures

Where a change in the presentational format of the financial statements has been made during the period, comparative figures have been restated accordingly. Where material, additional disclosure has been provided in the notes to the financial statements.

z) New and amended International Financial Reporting Standards

The accounting policies used are consistent with those used to prepare the consolidated financial statements for the year ended 31 July 2011.

i) New and amended standards adopted by the Group

The Group adopted amendments to various NZ International Financial Reporting Standards (NZ IFRSs) and FRS-44: New Zealand Additional Disclosures during the period. These amendments were introduced by the Financial Reporting Standards Board as part of the joint project with the Australian Accounting Standards Board to harmonise each jurisdiction's accounting standards with source IFRSs. The Group also adopted revised NZ IAS 24 Related Party Disclosures during the period.

These changes have not had a material impact on the Group's financial statements.

ii) New and amended standards issued but not yet effective

New and amended standards which could be expected to have a material impact on the Group's financial statements, which were available for early adoption but have not been adopted, are stated below. At this time it is not possible to reasonably estimate the impact of adoption of these standards.

- NZ IFRS 9: Financial Instruments: Classification and Measurement is the first phase of the NZ IAS 39 replacement project and specifies how an entity should classify and measure financial assets and liabilities.
- NZ IFRS 10: Consolidated Financial Statements replaces the guidance on control and consolidation in NZ IAS 27 Consolidated and Separate Financial Statements.
- NZ IFRS 11: Joint Arrangements introduces criteria for determining the type of joint arrangement which focuses on the rights and obligations of the arrangement rather than the legal form.
- NZ IFRS 12: Disclosure of Interest in Other Entities introduces amended and additional disclosures about interests in other entities.
- NZ IFRS 13: Fair Value Measurement explains how to measure fair value and enhances fair value disclosures.
- Amendments to NZ IAS 19: Employee Benefits incorporates amendments to the definition of short term employee benefits.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 JULY 2012

1 COST OF GOODS SOLD

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Opening inventory	3,277	2,870	–	–
Cost of Milk:				
– New Zealand sourced	9,033	10,235	9,050	10,257
– Non-New Zealand sourced	1,148	1,272	–	–
Other purchases	6,244	5,761	–	–
Closing inventory	(2,981)	(3,277)	–	–
Total cost of goods sold	16,721	16,861	9,050	10,257

Parent Cost of Milk – New Zealand sourced includes milk purchased from Fonterra Group companies of $17 million (2011: $22 million).

2 OPERATING PROFIT

	NOTES	GROUP $ MILLION		PARENT $ MILLION	
		31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
The following items have been included in arriving at operating profit:					
Auditors' remuneration:					
– Fees paid for the audit or review of financial statements		4	4	2	2
– Fees paid for other services[1]		2	2	–	–
Operating lease expense		73	64	–	–
Research and development costs		93	90	11	5
Gain on acquisition of business	18	–	(23)	–	–
Net gain on disposal of investments[2]		–	(26)	–	–
Net loss on disposal of property, plant and equipment		2	–	1	1
Net loss on derecognition of software		9	–	1	–
Donations		3	6	3	4
Research and development grants received from government		(9)	(6)	(4)	(3)
Total employee benefits expense		1,704	1,549	134	113
Included in employee benefits expense are					
– Contributions to defined contribution plans		54	51	2	1

1 Other services include financial reporting, advisory services, financial and information technology controls assurance and other attest services.

2 On 21 March 2011, Fonterra completed the sale of its Western Australia dairy business. The transaction resulted in a pre-tax gain on sale of $26 million, which was recognised in other operating income, as part of the ANZ segment result. It also resulted in a tax credit of $26 million due to the derecognition of the net deferred tax liability associated with the assets and liabilities that were disposed of, which was recognised as a reduction to the tax expense for the year.

3 NET FOREIGN EXCHANGE (LOSSES)/GAINS

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	**31 JULY 2012**	31 JULY 2011
Net foreign exchange (losses)/gains on debt instruments designated in a fair value hedge relationship	**(75)**	262	**–**	–
Net foreign exchange gains/(losses) on derivative instruments designated as a fair value hedge	**71**	(266)	**–**	–
Net foreign exchange (losses)/gains on financial instruments classified as held for trading	**(56)**	127	**–**	–
Net foreign exchange gains/(losses) on financial assets classified as loans and receivables	**137**	(403)	**–**	–
Net foreign exchange (losses)/gains on financial liabilities measured at amortised cost	**(77)**	188	**–**	–
Other net foreign exchange (losses)/gains	**(7)**	1	**–**	–
Net foreign exchange losses	**(7)**	(91)	**–**	–

4 NET FINANCE (COSTS)/INCOME

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	**31 JULY 2012**	31 JULY 2011
Finance income	**30**	32	**263**	375
Interest expense on financial liabilities measured at amortised cost	**(333)**	(358)	**(280)**	(292)
Interest expense on derivatives classified as held for trading	**(31)**	(39)	**(31)**	(39)
Total interest expense calculated on an amortised cost basis	**(364)**	(397)	**(311)**	(331)
Change in fair value of forward points on cash flow hedges and net investment hedges	**–**	(1)	**–**	–
Change in fair value of hedged risks on debt instruments designated in a fair value hedge relationship	**(62)**	6	**(62)**	6
Change in fair value of derivative instruments designated as a fair value hedge[1]	**91**	(33)	**91**	(33)
Change in fair value of financial instruments classified as held for trading	**(5)**	(13)	**(5)**	(14)
Finance costs	**(340)**	(438)	**(287)**	(372)
Net finance (costs)/income	**(310)**	(406)	**(24)**	3

1 This includes the fair value impact of the basis risk adjustment inherent in the valuation of cross currency interest rate swaps that does not form part of the debt instrument hedging relationship.

5 TAX EXPENSE/(CREDIT)

		GROUP $ MILLION		PARENT $ MILLION	
	NOTES	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Current tax expense/(credit)		53	38	(227)	(71)
Prior period adjustments to current tax		1	(1)	(17)	(6)
Deferred tax movements:					
– Origination and reversal of temporary differences	16	(1)	(186)	18	(106)
Tax expense/(credit)		53	(149)	(226)	(183)
Profit/(loss) before tax		677	622	(178)	255
Prima facie tax expense at 28% (2011: 30%)		190	187	(50)	77
Add/(deduct) tax effect of:					
– Effect of tax rates in foreign jurisdictions		(11)	(9)	–	–
– Non-deductible expenses/additional assessable income		21	35	3	8
– Non-assessable income/additional deductible expenses		(38)	(43)	(68)	(158)
– Losses of overseas Group entities not recognised		4	3	–	–
– Prior year under/(over) provision		1	(1)	17	6
– Tax effect of distributions to Shareholders		(128)	(116)	(128)	(116)
– Origination and reversal of other temporary differences		14	(205)	–	–
Tax expense/(credit)		53	(149)	(226)	(183)
Imputation credits:					
Imputation credits available for use in subsequent reporting periods		20	19	9	9

Tax losses					
Gross tax losses available for which no deferred tax asset has been recognised		63	61	–	–

6 SEGMENT REPORTING

The Group operates predominantly in the international dairy industry.

The Group has four reportable segments that are defined by product type and geographic area to reflect how the Group's operations are managed.

The reportable segments presented reflect the Group's management and reporting structure as viewed by the Fonterra Management Team, which is the Group's chief operating decision maker.

Transactions between segments are based on estimated market prices.

REPORTABLE SEGMENT	DESCRIPTION
New Zealand Milk Products (formerly described as Standard & Premium Ingredients)	Represents the collection, processing and distribution of New Zealand milk, global sales and marketing of New Zealand and non New Zealand milk products, international farming, sustainability, external relations, RD1 and group functions.
ANZ	Represents Fast Moving Consumer Goods (FMCG) operations in New Zealand (including export to the Pacific Islands) and all FMCG and Ingredients operations in Australia (including Milk Supply and Manufacturing). It includes foodservice sales in Australia and New Zealand (except for foodservice sales to Quick Service Restaurants).
Asia/AME	Represents FMCG operations in Asia (excluding North Asia), Africa and the Middle East, and foodservice sales in Asia/AME and China.
Latam	Represents FMCG operations in Chile and equity accounted investments in South America.

There have been two changes to the organisation of business units within reported segments during the year ended 31 July 2012:

- Foodservice sales to Quick Service Restaurants has been moved from ANZ to New Zealand Milk Products;
- China foodservice has been moved from New Zealand Milk Products to Asia/AME.

Comparatives have been restated to reflect these changes.

	GROUP $ MILLION					
	NEW ZEALAND MILK PRODUCTS	ANZ	ASIA/AME	LATAM	ELIMINATIONS	TOTAL GROUP
Segment income statement						
Year ended 31 July 2012						
External revenue	14,020	3,089	1,855	805	–	19,769
Inter-segment revenue	1,697	759	–	–	(2,456)	–
Revenue from sale of goods	15,717	3,848	1,855	805	(2,456)	19,769
Cost of goods sold	(14,311)	(3,068)	(1,224)	(560)	2,442	(16,721)
Segment gross profit	1,406	780	631	245	(14)	3,048
Selling and marketing expenses	(106)	(127)	(286)	(49)	–	(568)
Distribution expenses	(203)	(204)	(37)	(57)	–	(501)
Administrative expenses	(499)	(173)	(80)	(45)	13	(784)
Other operating expenses	(263)	(89)	(31)	(12)	10	(385)
Segment operating expenses	(1,071)	(593)	(434)	(163)	23	(2,238)
Other operating income	102	7	8	38	(23)	132
Net foreign exchange gains/(losses)	9	(5)	(11)	–	–	(7)
Share of profit of equity accounted investees	45	6	–	1	–	52
Segment earnings before net finance costs and tax	491	195	194	121	(14)	987
Non-recurring items	24	9	–	8	–	41
Normalised segment earnings before net finance costs and tax	515	204	194	129	(14)	1,028
Non-recurring items						(41)
Finance income						30
Finance costs						(340)
Tax expense						(53)
Profit for the year						624
Profit for the year includes the following amounts:						
Depreciation	(311)	(68)	(7)	(24)	–	(410)
Amortisation	(69)	(9)	(3)	(1)	–	(82)
Royalty income from equity accounted investees	1	–	–	16	–	17
Non-recurring items consist of the following amounts:						
Impairment losses recorded in equity accounted investees	–	–	–	8	–	8
Restructuring costs associated with the Group Strategy Refresh	23	7	–	–	–	30
Other	1	2	–	–	–	3
Total non-recurring items	24	9	–	8	–	41
Segment asset information:						
As at and for the year ended 31 July 2012						
Equity accounted investments	225	6	–	208	–	439
Capital expenditure	645	181	19	43	–	888

6 SEGMENT REPORTING CONTINUED

		GROUP $ MILLION					
	NOTES	NEW ZEALAND MILK PRODUCTS	ANZ	ASIA/AME	LATAM	ELIMINATIONS	TOTAL GROUP
Segment income statement							
Year ended 31 July 2011							
External revenue		13,793	3,459	1,793	826	–	19,871
Inter-segment revenue		1,800	781	–	4	(2,585)	–
Revenue from sale of goods		15,593	4,240	1,793	830	(2,585)	19,871
Cost of goods sold		(14,381)	(3,342)	(1,182)	(558)	2,602	(16,861)
Segment gross profit		1,212	898	611	272	17	3,010
Selling and marketing expenses		(92)	(151)	(268)	(85)	–	(596)
Distribution expenses		(161)	(238)	(35)	(53)	–	(487)
Administrative expenses		(419)	(159)	(89)	(46)	13	(700)
Other operating expenses		(204)	(98)	(25)	(17)	8	(336)
Segment operating expenses		(876)	(646)	(417)	(201)	21	(2,119)
Other operating income		118	39	2	27	(21)	165
Net foreign exchange losses		(75)	(13)	(3)	–	–	(91)
Share of profit of equity accounted investees		40	–	–	23	–	63
Segment earnings before net finance costs and tax		419	278	193	121	17	1,028
Non-recurring items		1	(22)	–	(2)	–	(23)
Normalised segment earnings before net finance costs and tax		420	256	193	119	17	1,005
Non-recurring items							23
Finance income							32
Finance costs							(438)
Tax credit							149
Profit for the year							771
Profit for the year includes the following amounts:							
Depreciation		(316)	(72)	(6)	(20)	–	(414)
Amortisation		(63)	(8)	(3)	(1)	–	(75)
Royalty income from equity accounted investees		–	–	–	21	–	21
Non-recurring items consist of the following amounts:							
Impact of Christchurch earthquakes and Japan earthquake and tsunami		14	4	–	–	–	18
Gain on disposal of Western Australia dairy business	2	–	(26)	–	–	–	(26)
Gain on acquisition of RD1	18	(23)	–	–	–	–	(23)
Impact of 2010 Chilean earthquake		–	–	–	(5)	–	(5)
Other		10	–	–	3	–	13
Total non-recurring items		1	(22)	–	(2)	–	(23)
Segment asset information:							
As at and for the year ended 31 July 2011							
Equity accounted investments		216	–	–	213	–	429
Capital expenditure		470	135	17	22	–	644

	GROUP $ MILLION	
	31 JULY 2012	31 JULY 2011
Entity wide products and services:		
Consumer goods	**4,945**	5,248
Ingredients and other revenue	**14,824**	14,623
Revenue from sale of goods	**19,769**	19,871

	GROUP $ MILLION							
	EUROPE	CHINA	REST OF ASIA	AUSTRALIA	NEW ZEALAND	USA	REST OF WORLD	TOTAL
Geographical segment external revenue:								
Year ended 31 July 2012	**1,169**	**2,031**	**5,676**	**2,300**	**1,928**	**1,445**	**5,220**	**19,769**
Year ended 31 July 2011	1,269	1,877	5,735	2,664	1,560	1,566	5,200	19,871

Revenue is allocated to geographical segments on the basis of the destination of the goods sold.

	GROUP $ MILLION							
	EUROPE	CHINA	REST OF ASIA	AUSTRALIA	NEW ZEALAND	USA	REST OF WORLD	TOTAL
Geographical segment reportable non-current assets:								
As at 31 July 2012	**128**	**123**	**771**	**1,107**	**5,166**	**127**	**706**	**8,128**
As at 31 July 2011	122	63	723	1,011	4,901	124	756	7,700

	GROUP $ MILLION	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Reconciliation of geographical segment non-current assets to total non-current assets:		
Geographical segment non-current assets	**8,128**	7,700
Deferred tax asset	**99**	116
Derivative financial instruments	**198**	154
Total non-current assets	**8,425**	7,970

7 CAPITAL AND RESERVES

GROUP AND PARENT	CO-OPERATIVE SHARES (THOUSANDS)
Balance at 1 August 2010	1,352,843
Issued	89,458
Surrendered	(35,356)
Balance at 31 July 2011	**1,406,945**
Balance at 1 August 2011	**1,406,945**
Issued	**129,157**
Surrendered	**(34,318)**
Balance at 31 July 2012	**1,501,784**

Co-operative Shares

Each Shareholder supplying milk to the Company in a season is required to hold one Co-operative share (share) for each kilogram of milksolids obtainable from milk supplied to the Company by that Shareholder, excluding milk supplied by that Shareholder under contract supply or as unshared supply, in that season. This is known as the share standard. A Shareholder supplying under contract must hold at least 1,000 shares.

In addition, each Shareholder is able to hold further shares up to 20% of the share standard, so that they can hold shares of up to 120% of the number they are required to hold under the share standard.

The rights attaching to shares include:

- voting rights on a poll or postal ballot of one vote per 1,000 kilograms of milksolids obtainable from milk supplied to the Company by a Shareholder during the season preceding that in which a poll or postal ballot is taken, less milksolids supplied under contract supply or as unshared supply;
- rights to any dividends declared by the Board; and
- rights to share in any surplus on liquidation of the Company.

Shares are valued on the basis of a Restricted Share Value. The value of Fonterra shares is determined by the Board on an annual basis, for each season, after having regard to a value range determined by an independent valuer.

The use of a Restricted Share Value represents a constitutional change to the fair value method used before the 31 May 2009 valuation and was expected to result in a lower share valuation. To recognise the impact on the share price from such a change in valuation approach, there is a transition period to the new Restricted Share Value approach, during which the share is valued separately under the Restricted Share Value approach and the Fair Value approach. During the transition period the share price cannot fall below a base price. The current base price is $4.52 per share, but this could fall if the mid-point of the range determined by the Fair Value approach falls below $4.52. If the Restricted Share Value is less than the base price, then the base price at that time will be used as the share value. Once the Restricted Share Value is greater than the base price, the transition period is deemed to have ended and the Restricted Share Value will be used from that point onwards.

The Restricted Share Value for the 2012/13 season has been set by the Board at $4.52 per share (2011: Restricted Share Value of $4.52 per share).

Shareholders may elect, within the application period (which must run, as a minimum, from 15 December to 28 February) to purchase and surrender shares. Shareholders may also elect to purchase additional shares over and above the share standard during a period set by the Board. Shareholders may elect to transact at the June price, which is the share price for the coming season, or under the default price mechanism. This mechanism sets a price range of +/-7.5% of an interim share price set by the Board in the prior December. If the June price falls within the +/- 7.5% price range, Shareholders will transact at the June price. If the June price is above or below the price range, Shareholders will transact at the upper or lower limit of the price range respectively.

If a Shareholder decreases supply during a season, the number of shares held will be re-apportioned between the number of minimum required shares (calculated using the share standard) and the number of any additional shares that may be held.

Shares held in excess of the number required to be held by the share standard can be surrendered at the election of the Shareholder. However shares representing greater than 120% of the number required by the share standard will automatically be surrendered, at the then prevailing share price.

Payment for the surrender of shares may be made at the option of the Company by:

- cash; or
- the issue of Capital Notes.

The Company also has the option to pay the surrender value in special circumstances by the issue of redeemable preference shares.

The expected cash outflow on redemption or repurchase of the shares is dependent on the share value at that time, the number of shares redeemed or repurchased and the instrument used to settle the obligation, and accordingly cannot be reliably estimated.

If a Shareholder increases supply during a season, any additional shares held will be used first to satisfy the increased minimum required shares under the share standard. If no, or insufficient, additional shares are held, the Shareholder must either:

- acquire the extra shares required under the share standard at the current season share price; or
- request unshared supply (if available).

If the Company decides to make unshared supply available, a Shareholder's entitlement to it cannot exceed 20% of that Shareholder's share standard for that season. If a Shareholder is granted unshared supply, they will not be required to purchase shares for the quantity elected. However, they will receive a lower milk payment for this unshared supply.

Shares acquired by Shareholders may be paid by:

- cash; or
- the redemption of any Capital Notes held (at the discretion of the Company).

On 30 June 2010 Shareholders approved constitutional changes that allow the Board to work towards implementation of capital structure changes. This was re-affirmed in the Special Meeting held on 25 June 2012. The key features are:

- the establishment of a platform to enable share trading among Shareholders at a well-discovered market price.
- the establishment of a Fonterra Shareholders' Fund that could acquire from Shareholders the right to receive dividends and the gain/loss from any change in the underlying value of a certain amount of shares, whilst Shareholders retain voting rights and the access to milk payments attached to the shares.

There is no current year impact to the Company's capital structure arising out of the approvals to date.

Dividends paid

All shares are eligible to receive a dividend if declared by the Board. On 21 September 2011, the Board declared a dividend of 22.0 cents per share (totalling $303 million), paid on 20 October 2011 to the Shareholders on the share register at 31 May 2011.

On 27 March 2012, the Board declared an interim dividend of 12.0 cents per share (totalling $172 million), paid on 20 April 2012 to the Shareholders on the share register at 31 March 2012.

The dividend declared after balance date is explained in Note 24.

Foreign currency translation reserve

The foreign currency translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations as well as from the effective portion of translation or fair value changes of instruments that hedge the Group's net investment in foreign operations.

Cash flow hedge reserve

The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

8 TRADE AND OTHER RECEIVABLES

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Trade receivables	2,176	2,141	2	1
Less: provision for impairment of trade receivables	(29)	(21)	–	–
Trade receivables net of provision for impairment	2,147	2,120	2	1
Receivables from related parties[1]	21	16	9,103	9,383
Other receivables	61	65	2	1
Total receivables	2,229	2,201	9,107	9,385
Prepayments	73	78	18	38
Total trade and other receivables	2,302	2,279	9,125	9,423

[1] There were no material provisions for impairment of receivables from related parties.

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Movement in the provision for impairment of trade receivables:				
Opening balance	21	36	–	–
Additional provisions	17	5	–	–
Utilised during the year	(2)	(6)	–	–
Unused amounts reversed	(8)	(13)	–	–
Foreign currency translation	1	(1)	–	–
Closing balance	29	21	–	–

9 INVENTORIES

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Raw materials	603	609	–	–
Finished goods	2,492	2,783	–	–
Impairment of finished goods	(114)	(115)	–	–
Total inventories	2,981	3,277	–	–
Other disclosures:				
Inventories stated at net realisable value	1,679	1,882	–	–
Amount of inventories pledged as security for liabilities	8	–	–	–
Amount of inventories recognised in cost of goods sold during the year	16,721	16,861	–	–

10 PROPERTY, PLANT AND EQUIPMENT

		GROUP $ MILLION				
	NOTES	LAND	BUILDINGS AND LEASEHOLD IMPROVEMENTS	PLANT, VEHICLES AND EQUIPMENT	CAPITAL WORK IN PROGRESS	TOTAL
As at 31 July 2010						
Cost		286	1,545	4,902	299	7,032
Accumulated depreciation and impairment		–	(449)	(2,227)	–	(2,676)
Net book value		286	1,096	2,675	299	4,356
Net book value						
As at 1 August 2010		286	1,096	2,675	299	4,356
Additions[1]		–	–	–	488	488
Acquired as a result of business combinations		6	8	6	1	21
Transfer from capital work in progress		29	77	326	(432)	–
Transfer to intangible assets	12	–	–	–	(8)	(8)
Depreciation charge		–	(66)	(348)	–	(414)
Impairment losses		–	–	–	(9)	(9)
Disposals		(23)	(31)	(50)	–	(104)
Foreign currency translation		1	(6)	(2)	3	(4)
As at 31 July 2011		299	1,078	2,607	342	4,326
As at 31 July 2011						
Cost		299	1,570	5,028	342	7,239
Accumulated depreciation and impairment		–	(492)	(2,421)	–	(2,913)
Net book value		299	1,078	2,607	342	4,326
Net book value						
As at 1 August 2011		**299**	**1,078**	**2,607**	**342**	**4,326**
Additions[1]		**7**	**10**	**19**	**668**	**704**
Transfer from capital work in progress		**13**	**75**	**357**	**(445)**	**–**
Transfer to intangible assets	12	**–**	**–**	**–**	**(12)**	**(12)**
Depreciation charge		**–**	**(70)**	**(340)**	**–**	**(410)**
Impairment losses		**–**	**(8)**	**(29)**	**–**	**(37)**
Disposals		**–**	**(2)**	**(20)**	**–**	**(22)**
Foreign currency translation		**1**	**5**	**10**	**4**	**20**
As at 31 July 2012		**320**	**1,088**	**2,604**	**557**	**4,569**
As at 31 July 2012						
Cost		**320**	**1,652**	**5,322**	**557**	**7,851**
Accumulated depreciation and impairment		**–**	**(564)**	**(2,718)**	**–**	**(3,282)**
Net book value		**320**	**1,088**	**2,604**	**557**	**4,569**

1 Additions include borrowing costs of $10 million (2011: $2 million) capitalised using a rate of 6.94% (2011: 6.44%).

Impairment losses of $37 million were recognised as a result of the Group Strategy Refresh, and of changes to the operating environments in which the affected assets operate. The impairment losses all relate to the New Zealand Milk Products segment. $29 million is recognised within cost of goods sold in the income statement, and $8 million is recognised within distribution expenses in the income statement.

Impairment losses of $9 million recognised in the prior year relate to the New Zealand Milk Products segment and were recorded in cost of goods sold in the income statement.

The net book value of property, plant and equipment subject to finance leases for the Group is $146 million (31 July 2011: $150 million). Of that balance $5 million relates to land (31 July 2011: $5 million), $115 million relates to building and leasehold improvements (31 July 2011: $119 million), and $26 million relates to plant and equipment (31 July 2011: $26 million).

10 PROPERTY, PLANT AND EQUIPMENT CONTINUED

		PARENT $ MILLION				
	NOTES	LAND	BUILDINGS AND LEASEHOLD IMPROVEMENTS	PLANT, VEHICLES AND EQUIPMENT	CAPITAL WORK IN PROGRESS	TOTAL
As at 31 July 2010						
Cost		5	116	96	48	265
Accumulated depreciation and impairment		–	(11)	(47)	–	(58)
Net book value		5	105	49	48	207
Net book value						
As at 1 August 2010		5	105	49	48	207
Additions[1]		–	–	–	25	25
Additions from other Group entities		–	4	12	–	16
Transfer from capital work in progress		–	31	18	(49)	–
Transfer to intangible assets	12	–	–	–	(8)	(8)
Depreciation charge		–	(5)	(13)	–	(18)
As at 31 July 2011		5	135	66	16	222
As at 31 July 2011						
Cost		5	151	124	16	296
Accumulated depreciation and impairment		–	(16)	(58)	–	(74)
Net book value		5	135	66	16	222
Net book value						
As at 1 August 2011		5	135	66	16	222
Additions[1]		–	1	–	18	19
Transfer from capital work in progress		–	1	20	(21)	–
Transfer to intangible assets	12	–	–	–	(8)	(8)
Depreciation charge		–	(5)	(15)	–	(20)
Impairment losses		–	–	(1)	–	(1)
Disposals		–	–	(2)	–	(2)
As at 31 July 2012		5	132	68	5	210
As at 31 July 2012						
Cost		5	153	141	5	304
Accumulated depreciation and impairment		–	(21)	(73)	–	(94)
Net book value		5	132	68	5	210

1 Additions include borrowing costs of nil (2011: $1 million) capitalised using a rate of nil (2011: 6.44%).

The net book value of property, plant and equipment subject to finance leases for the Parent is $143 million (31 July 2011: $149 million). Of that balance $5 million relates to land (31 July 2011: $5 million), $115 million relates to building and leasehold improvements (31 July 2011: $119 million), and $23 million relates to plant and equipment (31 July 2011: $25 million).

11 EQUITY ACCOUNTED INVESTMENTS

A list of significant equity accounted investees is included in Note 23.

In the year ended 31 July 2011, Fonterra completed the purchase of the remaining 50% of RD1 Limited, which resulted in RD1 Limited becoming a subsidiary of Fonterra. Further details are set out in Note 18.

The Group has provided financial guarantees to certain equity accounted investees as set out in Notes 19 and 22.

The Group's equity accounted investees have entered into non-cancellable operating leases, and the Group's share of the future aggregate minimum lease payments under these leases is $8 million (2011: $12 million).

The Group's share of capital expenditure contracted for at balance date but not recognised by equity accounted investees is $14 million (2011: nil).

The following amounts represent the aggregate assets, liabilities, revenue and profit of equity accounted investees:

	GROUP $ MILLION	
	AS AT AND FOR THE YEAR ENDED 31 JULY 2012	AS AT AND FOR THE YEAR ENDED 31 JULY 2011
Assets:		
Non-current assets	**566**	908
Current assets	**859**	896
Total assets	**1,425**	1,804
Liabilities:		
Non-current liabilities	**(210)**	(415)
Current liabilities	**(722)**	(625)
Total liabilities	**(932)**	(1,040)
Net assets	**493**	764
Revenue	**2,632**	3,446
Expenses (including interest and tax)	**(2,557)**	(3,347)
Profit after tax	**75**	99

12 INTANGIBLE ASSETS

		GROUP $ MILLION						PARENT $ MILLION
	NOTES	GOODWILL	BRANDS	SOFTWARE	SOFTWARE WIP	OTHER	TOTAL INTANGIBLES	SOFTWARE
As at 31 July 2010								
Cost		989	1,643	599	29	97	3,357	135
Accumulated amortisation and impairment		(2)	(94)	(416)	–	(89)	(601)	(89)
Net book value		987	1,549	183	29	8	2,756	46
Net book value								
As at 1 August 2010		987	1,549	183	29	8	2,756	46
Additions[1]		–	–	–	129	27	156	27
Acquired as a result of business combinations		30	–	3	–	14	47	–
Transfer from property, plant and equipment	10	–	–	8	–	–	8	8
Transfer from work in progress		–	–	55	(55)	–	–	–
Amortisation		–	(6)	(65)	–	(4)	(75)	(20)
Transfer from other Group entities		–	–	–	–	–	–	5
Disposals		(17)	(99)	–	–	(14)	(130)	–
Foreign currency translation		(1)	(11)	–	(2)	–	(14)	–
As at 31 July 2011		999	1,433	184	101	31	2,748	66
As at 31 July 2011								
Cost		1,001	1,532	664	101	122	3,420	181
Accumulated amortisation and impairment		(2)	(99)	(480)	–	(91)	(672)	(115)
Net book value		999	1,433	184	101	31	2,748	66
Net book value								
As at 1 August 2011		**999**	**1,433**	**184**	**101**	**31**	**2,748**	**66**
Additions[1]		**–**	**–**	**–**	**166**	**18**	**184**	**25**
Transfer from property, plant and equipment	10	**–**	**–**	**12**	**–**	**–**	**12**	**8**
Transfer from work in progress		**–**	**–**	**50**	**(50)**	**–**	**–**	**–**
Amortisation		**–**	**(6)**	**(70)**	**–**	**(6)**	**(82)**	**(21)**
Disposals		**–**	**–**	**(6)**	**–**	**(7)**	**(13)**	**(1)**
Foreign currency translation		**9**	**22**	**1**	**1**	**–**	**33**	**–**
As at 31 July 2012		**1,008**	**1,449**	**171**	**218**	**36**	**2,882**	**77**
As at 31 July 2012								
Cost		**1,010**	**1,555**	**672**	**218**	**133**	**3,588**	**211**
Accumulated amortisation and impairment		**(2)**	**(106)**	**(501)**	**–**	**(97)**	**(706)**	**(134)**
Net book value		**1,008**	**1,449**	**171**	**218**	**36**	**2,882**	**77**

[1] The Group has capitalised borrowing costs of $9 million (2011: $3 million) using a rate of 6.94% (2011: 6.44%). There have been no borrowing costs capitalised by the Parent (2011: nil).

Amortisation is recognised in other operating expenses in the income statement.

Goodwill and other indefinite life intangibles

Goodwill

Goodwill for each cash generating unit (CGU) has been tested for impairment on a fair value less costs to sell basis. Testing was undertaken in May 2012 using external sources of information where appropriate. Cash flow forecasts used as inputs to determine fair value are based on the Group's three year plan, extrapolated for a further seven years, and then using a terminal year with a long term growth rate of between 2.0% and 3.0% (31 July 2011: between 2.0% and 3.0%). Management considers a ten year forecast period to be appropriate given the long term nature of the dairy industry. The discount rate applied to future cash flows was 9.0% (31 July 2011: 9.5%).

There was headroom between the recoverable amount and the carrying value of goodwill by CGU and no impairment was recognised. No reasonably possible change in any of these assumptions would cause the carrying value of goodwill allocated to a CGU to exceed its recoverable amount.

Of those CGUs tested, the goodwill of the Fonterra Brands New Zealand CGU is considered significant in the context of the carrying value of goodwill for the Group. For the Fonterra Brands New Zealand CGU the carrying value of goodwill is $618 million (31 July 2011: $618 million) and the carrying value of indefinite life brands attributable to the CGU is $307 million (31 July 2011: $307 million). These brands are tested for impairment on an individual asset basis (see below).

Indefinite life brands

Of the total brands held, 91% ($1,320 million) have indefinite useful lives (31 July 2011: 91%, $1,299 million). In concluding that a brand has an indefinite life, management considers its intention to acquire, hold and support brands through advertising and promotional spending for an indefinite period.

Individual indefinite life brands are tested annually for impairment through a value-in-use test using a discounted cash flow methodology.

13 TRADE AND OTHER PAYABLES

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011	**AS AT 31 JULY 2012**	AS AT 31 JULY 2011
Trade payables	**1,064**	1,031	**62**	41
Amounts due to related parties	**9**	8	**6,929**	7,242
Other payables	**66**	97	**40**	41
Total trade and other payables (excluding employee entitlements)	**1,139**	1,136	**7,031**	7,324
Employee entitlements	**247**	214	**22**	19
Total trade and other payables	**1,386**	1,350	**7,053**	7,343

14 PROVISIONS

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Restructuring and rationalisation provisions				
Opening balance	7	13	1	3
Additional provisions	19	8	10	1
Unused amounts reversed	(1)	(3)	–	(2)
Charged to income statement	18	5	10	(1)
Foreign currency translation	–	(1)	–	–
Utilised during the year	(4)	(10)	–	(1)
Closing balance	21	7	11	1
Legal claims provisions				
Opening balance	83	86	83	85
Additional provisions	–	6	–	6
Unused amounts reversed	(16)	(5)	(16)	(5)
Charged to income statement	(16)	1	(16)	1
Foreign currency translation	–	(4)	–	(3)
Utilised during the year	(21)	–	(21)	–
Closing balance	46	83	46	83
Other provisions				
Opening balance	83	103	24	16
Additional provisions	57	39	3	15
Unused amounts reversed	(13)	(28)	(6)	(2)
Charged to income statement	44	11	(3)	13
Foreign currency translation	7	(7)	–	(1)
Utilised during the year	(37)	(24)	(16)	(4)
Closing balance	97	83	5	24
Total provisions	164	173	62	108
Included within the statement of financial position as follows:				
Current liabilities	83	67	20	29
Non-current liabilities	81	106	42	79
Total provisions	164	173	62	108

The nature of the provisions are as follows:

- the provision for restructuring and rationalisation includes obligations relating to planned changes throughout the business to improve efficiencies and reduce costs. None of the provisions are individually significant. The value of the obligation is based on project plans, and the provisions are expected to be utilised in the next year.
- the legal claims provisions include obligations relating to tax, customs and duties and legal matters arising in the normal course of business. None of the provisions are individually significant. The timing and amount of the future obligations are uncertain, as they are contingent on the outcome of a number of judicial proceedings. The amount recognised has been based on management's best estimate of the amount that will be required to settle the obligation. The outcome of most of the obligations is not expected to be determined within the next year, and therefore most of the provision is classified as non-current.
- other provisions arise in the normal course of business and relate to provisions for areas such as employee benefits. None of the provisions are individually significant. The value of the obligation is based on management's best estimate of the amount that will be required to settle the obligation, and the majority of the provisions are expected to be utilised in the next year.

15 BORROWINGS

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Current				
Commercial paper	198	50	198	50
Bank loans	150	337	1	–
Finance leases	8	7	3	3
Medium-term notes	848	50	797	–
Total current borrowings	1,204	444	999	53
Non-current				
Bank loans	124	154	–	150
Finance leases	169	172	144	147
Capital notes	35	35	35	35
Retail bonds	943	940	943	940
Medium-term notes	2,474	2,905	1,893	2,527
Total non-current borrowings	3,745	4,206	3,015	3,799
Total borrowings	4,949	4,650	4,014	3,852

- Finance leases are secured over the related item of property, plant and equipment (Note 10).
- Included within bank loans is $8 million (31 July 2011: nil) of borrowings secured over inventories (Note 9).
- Capital notes are unsecured subordinated borrowings.
- All other borrowings are unsecured and unsubordinated.

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Opening balance	4,650	4,924	3,852	4,356
New issues				
Bank loans	1,394	2,298	580	569
Finance leases	2	–	–	–
Commercial paper	626	817	626	817
Retail bonds	–	–	–	–
Medium-term notes	193	533	–	149
	2,215	3,648	1,206	1,535
Repayments				
Bank loans	(1,606)	(2,396)	(731)	(555)
Finance leases	(7)	(9)	(3)	(6)
Commercial paper	(480)	(990)	(480)	(990)
Medium-term notes	(4)	(153)	–	(148)
	(2,097)	(3,548)	(1,214)	(1,699)
Other movements				
Amortisation of discount	7	7	7	7
Changes in fair value	62	(6)	62	(6)
Changes due to foreign currency translation	112	(375)	101	(341)
	181	(374)	170	(340)
Closing balance	4,949	4,650	4,014	3,852

15 BORROWINGS CONTINUED

	GROUP $ MILLION	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Net interest bearing debt position		
Total borrowings	**4,949**	4,650
Cash and cash equivalents	**(1,033)**	(785)
Interest bearing advances included in other non-current assets	**(125)**	(122)
Bank overdraft	**42**	23
Net interest bearing debt	**3,833**	3,766
Value of derivatives used to manage changes in hedged risks and other foreign exchange movements on debt	**396**	565
Economic net interest bearing debt[1]	**4,229**	4,331

[1] Economic net interest bearing debt reflects the effect of debt hedging in place at balance date.

Net interest bearing debt is managed on a Group basis.

	GROUP	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Net tangible assets per security[1]		
$ per listed debt security on issue	**3.58**	3.60
$ per Co-operative share on issue	**2.51**	2.70
Listed debt securities on issue (million)	**1,053**	1,053
Co-operative shares on issue (million)	**1,502**	1,407

[1] Net tangible assets represents total assets less total liabilities less intangible assets.

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Finance leases – minimum lease payments				
Not later than one year	**20**	19	**15**	15
Later than one year and not later than five years	**92**	86	**65**	59
Later than five years	**148**	169	**147**	168
	260	274	**227**	242
Future finance charges on finance leases	**(83)**	(95)	**(80)**	(92)
Present value of finance leases	**177**	179	**147**	150
The present value of finance leases is as follows:				
Not later than one year	**8**	7	**3**	3
Later than one year and not later than five years	**41**	47	**18**	22
Later than five years	**128**	125	**126**	125
Total present value of finance leases	**177**	179	**147**	150

16 DEFERRED TAX

	NOTES	GROUP $ MILLION AS AT 31 JULY 2012	GROUP $ MILLION AS AT 31 JULY 2011	PARENT $ MILLION AS AT 31 JULY 2012	PARENT $ MILLION AS AT 31 JULY 2011
Deferred tax					
Property, plant and equipment		**(108)**	(156)	**9**	5
Intangible assets		**(364)**	(295)	**(22)**	(18)
Derivative financial instruments		**(40)**	(236)	**26**	25
Employee entitlements		**59**	52	**6**	7
Inventories		**37**	16	**–**	–
Receivables, payables and provisions		**42**	34	**9**	11
New Zealand tax losses		**357**	387	**357**	373
Offshore tax losses		**76**	39	**–**	–
Other		**(45)**	(20)	**–**	–
Total deferred tax		**14**	(179)	**385**	403
Movements for the year					
Opening balance		**(179)**	(193)	**403**	287
Recognised in the income statement	5	**1**	186	**(18)**	106
Recognised directly in other comprehensive income		**187**	(160)	**–**	10
Foreign currency translation		**5**	(12)	**–**	–
Closing balance		**14**	(179)	**385**	403
Included within the statement of financial position as follows:					
Deferred tax assets		**99**	116	**385**	403
Deferred tax liabilities		**(85)**	(295)	**–**	–
Total deferred tax		**14**	(179)	**385**	403
Balance expected to be recovered or settled:					
Within the next 12 months		**104**	(119)	**41**	43
After the next 12 months		**(90)**	(60)	**344**	360
Total deferred tax		**14**	(179)	**385**	403

17 OPERATING CASH FLOWS

		GROUP $ MILLION		PARENT $ MILLION	
	NOTES	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Profit for the year		**624**	771	**48**	438
Non-cash items					
Amortisation of intangible assets	12	**82**	75	**21**	20
Depreciation of property, plant and equipment	10	**410**	414	**20**	18
Movement in deferred tax		**(193)**	(14)	**18**	(116)
Gain on acquisition of business	18	**–**	(23)	**–**	–
Net gain on disposal of investments	2	**–**	(26)	**–**	–
Net loss on disposal of property, plant and equipment	2	**2**	–	**1**	1
Net loss on derecognition of software	2	**9**	–	**1**	–
Share of profit of equity accounted investees		**(52)**	(63)	**–**	–
Impairment of property, plant and equipment	10	**37**	9	**1**	–
Other non-cash items		**19**	–	**(1)**	1
Total non-cash items		**314**	372	**61**	(76)
(Increase)/decrease in working capital					
Inventories		**296**	(407)	**–**	–
Trade and other receivables		**(23)**	(191)	**18**	(2)
Other current assets (including derivative financial instruments)		**832**	(638)	**818**	(610)
Tax balances		**20**	(25)	**–**	–
Amounts owing to suppliers		**(596)**	541	**(595)**	591
Trade and other payables		**36**	99	**23**	(9)
Other current liabilities (including derivative financial instruments)		**235**	(53)	**206**	(62)
Provisions		**16**	(25)	**(9)**	10
Increase in working capital		**816**	(699)	**461**	(82)
Items classified as investing and financing activities		**(364)**	740	**(1,358)**	119
Net cash flows from operating activities		**1,390**	1,184	**(788)**	399

18 BUSINESS COMBINATIONS

There were no material business combinations during the year ended 31 July 2012 or 31 July 2011.

On 1 July 2011, the Group completed the purchase of the remaining 50% of RD1 Limited. The Group recorded a gain of $23 million relating to this business combination in the year ended 31 July 2011. This gain represents the difference between the carrying value of the Group's equity accounted investment in RD1 at the time of acquisition of the remaining 50%, and the fair value of that pre-existing interest. This gain was recognised in other operating income, in the New Zealand Milk Products segment result. This transaction is not considered material and therefore no further disclosure has been made.

19 FINANCIAL RISK MANAGEMENT

Overview

Global financial and commodity markets remain volatile. The nature of Fonterra's business is such that managing risks in the foreign exchange, interest rate, commodity, credit and liquidity markets is critical to minimising the volatility in returns to Shareholders.

The Board has overall responsibility for the establishment and oversight of the Group's financial risk management framework. The Board:

- has established risk management policies and procedures to identify, analyse and, where appropriate, manage the risks faced by the Group;
- has approved a Treasury Policy that covers appropriate risk limits and controls (including, but not limited to, delegated authority levels and authorised use of various financial instruments); and
- monitors risks and adherence to approved limits.

The Group's overall financial risk management programme focuses primarily on maintaining a prudent risk profile that provides flexibility to implement the Group's strategies, while ensuring the optimisation of the return on assets. Risk management is predominantly carried out by a central treasury department (Group Treasury), which ensures compliance with the risk management policies and procedures set by the Board.

During the year in order to manage financial risks, the key risk management activities undertaken by the Group included, but were not limited to, the following:

Capital structure

Fonterra continues to work towards establishing Trading Among Farmers. The necessary changes to the Dairy Industry Restructuring Act 2001 (DIRA) to give effect to this have been passed into law, meaning that the Company's obligations under DIRA to redeem Co-operative shares can come to an end on the launch of Trading Among Farmers (provided certain legislative conditions continue to be met). These capital structure changes are significant steps for Fonterra, and further detail is given in Note 7 and the capital management section below.

Bank facility renewal

Fonterra's banking facilities are renewed at least annually with the exception of certain facilities where renewals are required at agreed periods of over one year. On 31 July 2012, Fonterra had $3,565 million (31 July 2011: $3,715 million) of undrawn committed facilities. For further details refer to liquidity risk below in Note 19(d).

Debt to debt plus equity ratio

As a result of the above activities and close management of the financial risks faced by Fonterra, the economic debt to debt plus equity ratio has reduced from 41.8% at 31 July 2011 to 39.1% at 31 July 2012. For more details refer to the capital management section below in Note 19(e).

a) Foreign exchange risk

The Group operates internationally and is exposed to foreign exchange risk on sales, purchases, investments and borrowings that are denominated in foreign currencies. Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities and net investments in foreign operations.

The main impacts of foreign exchange movements on the Group arise from:

- transaction risk: variations in the New Zealand dollar value of the Group's sales receipts and other cash flows; and
- translation risk: the value of the Group's investment in foreign operations and the Group's foreign currency debt.

Approximately 65% (31 July 2011: 67%) of the Group's net foreign exchange exposure is against the United States dollar.

The Group's objective is to ensure foreign exchange exposure is managed in a prudent manner in order to reduce volatility on the returns to Shareholders and Shareholder Suppliers.

19 FINANCIAL RISK MANAGEMENT CONTINUED

In respect of transaction hedging the Group's policy is to hedge 100% of the net recognised foreign currency trade receivables and foreign currency trade payables, and up to 100% of forecast cash receipts from sales for a period of up to 18 months. The level of hedging undertaken is influenced by current exchange rates and the time until the expected cash flows occur, within the limits approved by the Board. The Group seeks to designate items in a hedge relationship where it is practical to do so; therefore some derivative instruments entered into as economic hedges may not be in a designated hedge relationship for accounting purposes.

In respect of translation hedging, during the year the Group amended its policy from hedging between 50% and 100% of material net translation exposures to hedge between nil and 100% of material net translation exposures. Group Treasury uses forward foreign exchange contracts, currency options and cross currency interest rate swaps to hedge its foreign exchange risk. The Group's investments in foreign operations can be hedged by a combination of derivative instruments and borrowings in the relevant currencies.

Exposure to foreign currency risk

The significant notional unhedged exposures to foreign currencies are as follows:

		GROUP $ MILLION		PARENT $ MILLION	
		AS AT 31 JULY 2012	AS AT 31 JULY 2011	**AS AT 31 JULY 2012**	AS AT 31 JULY 2011
USD	United States dollar	**115**	34	**(8,264)**	(7,469)
EUR	Euro	**291**	80	**(123)**	(190)
AUD	Australian dollar	**2,005**	1,002	**(13)**	(654)
GBP	Great Britain pound	**2**	3	**(19)**	(67)
JPY	Japanese yen	**117**	79	**(1)**	–
BRL	Brazilian real	**158**	199	**–**	–
CLP	Chilean peso	**427**	303	**–**	(55)
CNY	Chinese yuan	**55**	39	**(51)**	–
SGD	Singapore dollar	**788**	473	**(3)**	(234)

Parent carries economic hedge derivative contracts for risks that sit elsewhere in the Group.

Included in the analysis above are derivative contracts with notional balances of $6,429 million (31 July 2011: $5,860 million) in respect of forecast and actual sale transactions.

Foreign exchange sensitivity

A 10% movement in the value of the New Zealand dollar against the key currencies to which the Group is exposed would result in the following post-tax (using appropriate tax rates) increase/(decrease) to equity and profit. A 10% movement in exchange rates is considered reasonably possible over the short term given historical fluctuations in the value of the New Zealand dollar.

	GROUP $ MILLION				PARENT $ MILLION			
	31 JULY 2012		31 JULY 2011		**31 JULY 2012**		31 JULY 2011	
	EQUITY	**PROFIT**	EQUITY	PROFIT	**EQUITY**	**PROFIT**	EQUITY	PROFIT
Impact of a 10% strengthening of the NZD	**13**	**(9)**	(46)	3	**(19)**	**–**	(37)	–
Impact of a 10% weakening of the NZD	**35**	**(10)**	132	(21)	**23**	**–**	46	–

The Parent has no sensitivity to foreign exchange movements in the income statement as gains and losses are passed to a subsidiary through a novation agreement.

b) Interest rate risk

The Group's interest rate risk arises from its borrowings and funds on deposit. Borrowings issued and funds on deposit held at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk.

The Group borrows a mixture of fixed and variable rate debt in a range of currencies. The Group actively hedges its repricing profile using interest rate swaps in accordance with its Treasury Policy in order to manage the volatility of finance costs. The Group's benchmark is to ensure between 20% and 55% of interest payments are fixed depending upon the maturity of the debt.

Exposure to interest rate risk

Sensitivities to interest rate risk have been assessed on the basis of a 100 basis point movement in interest rates. A 100 basis point movement is considered reasonably possible over the short term. Sensitivities are presented net of tax, using appropriate tax rates.

Fair value sensitivity analysis

A change in interest rates impacts the fair value of the Group's interest rate derivatives and where changes in hedged risks on certain debt instruments are recognised at fair value. The fair value sensitivity to a 100 basis point movement in interest rates (based on financial assets and liabilities held at the balance date) is as follows:

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	**31 JULY 2012**	31 JULY 2011
Fair value gain/(loss) from 100 bp increase	**64**	74	**64**	74
Fair value gain/(loss) from 100 bp decrease	**(70)**	(81)	**(70)**	(81)

Cash flow sensitivity analysis

A change in the interest rates would also impact on interest payments and receipts on the Group's floating rate debt instruments (including the floating leg of any interest rate derivatives). The cash flow sensitivity to a 100 basis point movement in interest rates (based on financial assets and liabilities held at the balance date) is as follows:

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	**31 JULY 2012**	31 JULY 2011
One year cash flow impact of 100 bp increase	**(13)**	(15)	**(13)**	(15)
One year cash flow impact of 100 bp decrease	**13**	15	**12**	15

c) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers and derivative financial instruments.

The Group operates a policy of only entering into contracts for sale with customers whose credit limits are in accordance with the Group's delegated authorities approved by the Board. For export customers located outside of New Zealand credit risk mitigant tools such as letters of credit may be utilised in conjunction with credit limits.

The ageing profile of Group trade and other receivables (excluding prepayments) is as follows:

		PAST DUE BUT NOT IMPAIRED			
$ MILLION	NEITHER PAST DUE NOR IMPAIRED	LESS THAN 1 MONTH PAST DUE	MORE THAN 1 MONTH BUT LESS THAN 3 MONTHS PAST DUE	MORE THAN 3 MONTHS PAST DUE	TOTAL
As at 31 July 2012	**1,859**	**238**	**84**	**48**	**2,229**
As at 31 July 2011	1,807	230	113	51	2,201

Parent has no trade and other receivables that are past due (31 July 2011: nil).

The Group does not hold collateral or security in relation to credit risk and has no undue concentrations of credit risk.

19 FINANCIAL RISK MANAGEMENT CONTINUED

The Group has a policy to limit its exposure to credit risk by entering into transactions only with financial counterparties that have a credit rating of at least 'A-' from Standard & Poor's or equivalent. Given this high credit rating threshold, management does not expect these counterparties to fail to meet their obligations. Exceptions to this policy are authorised in accordance with the Board-approved Financial Risk Management Standard.

The Group has assessed trade and other receivables requiring specific impairment at balance date. As a result $29 million (31 July 2011: $21 million) has been provided against these balances. This represents 0.15% (31 July 2011: 0.11%) of the total revenue from sale of goods.

The maximum credit risk on cash and cash equivalents, trade and other receivables, derivative financial instruments and other investments is best represented by their carrying values.

d) Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group has a policy in place to ensure that it has sufficient cash or facilities on demand to meet expected operational expenses for a period of at least 80 days, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. In such situations back-up funding lines are maintained and as set out in the Company's constitution, the Company can defer payments to Shareholder Suppliers if necessary.

Group Treasury manages the Group's liquidity by retaining cash and marketable securities, the availability of funding from an adequate amount of committed credit facilities and the ability to close out market positions. At balance date the Group had undrawn lines of credit totalling $3,565 million (31 July 2011: $3,715 million), and the Parent had undrawn lines of credit of $2,080 million (31 July 2011: $2,003 million). The liquidity and refinancing risks are also managed by ensuring that Fonterra can maintain access to funding markets throughout the world. To that end, Fonterra maintains debt issuance programmes in a number of key markets and manages relationships with international investors. An illustration of this is the recent issue in Australia of AUD $150 million of medium-term notes with a maturity of ten years.

Exposure to liquidity risk

	GROUP $ MILLION					
	AS AT 31 JULY 2012					
	CARRYING AMOUNT	CONTRACTUAL CASH FLOWS	3 MONTHS OR LESS	3–12 MONTHS	1–5 YEARS	MORE THAN 5 YEARS
Non-derivative financial assets						
Cash and cash equivalents	1,033	1,033	1,033	–	–	–
Trade and other receivables (excluding prepayments)	2,229	2,229	2,229	–	–	–
Long-term advances	125	149	1	15	97	36
Total non-derivative financial assets	3,387	3,411	3,263	15	97	36
Non-derivative financial liabilities						
Borrowings						
– Commercial paper	(198)	(199)	(199)	–	–	–
– Bank loans	(274)	(305)	(69)	(94)	(142)	–
– Finance leases	(177)	(259)	(5)	(15)	(85)	(154)
– Capital notes	(35)	(42)	–	(1)	(6)	(35)
– Retail bonds	(943)	(1,162)	(21)	(52)	(1,089)	–
– Medium-term notes	(3,322)	(4,165)	(72)	(938)	(1,653)	(1,502)
Bank overdraft	(42)	(42)	(42)	–	–	–
Owing to suppliers	(1,083)	(1,083)	(1,083)	–	–	–
Trade and other payables (excluding employee entitlements)	(1,139)	(1,093)	(1,093)	–	–	–
Financial guarantees issued[1]	–	(100)	(100)	–	–	–
Total non-derivative financial liabilities	(7,213)	(8,450)	(2,684)	(1,100)	(2,975)	(1,691)
Derivative financial instruments						
Gross settled derivatives						
– Inflow	–	17,709	9,343	5,124	2,282	960
– Outflow	–	(18,274)	(9,290)	(5,167)	(2,458)	(1,359)
Total gross settled derivative financial instruments	(228)	(565)	53	(43)	(176)	(399)
Net settled derivatives	33	225	(7)	27	83	122
Total financial instruments	(4,021)	(5,379)	625	(1,101)	(2,971)	(1,932)

1 Maximum cash flows under guarantees provided by the Group.

19 FINANCIAL RISK MANAGEMENT CONTINUED

Exposure to liquidity risk

	GROUP $ MILLION					
	AS AT 31 JULY 2011					
	CARRYING AMOUNT	CONTRACTUAL CASH FLOWS	3 MONTHS OR LESS	3–12 MONTHS	1–5 YEARS	MORE THAN 5 YEARS
Non-derivative financial assets						
Cash and cash equivalents	785	785	785	–	–	–
Trade and other receivables (excluding prepayments)	2,201	2,201	2,201	–	–	–
Long-term advances	122	154	10	31	72	41
Total non-derivative financial assets	3,108	3,140	2,996	31	72	41
Non-derivative financial liabilities						
Borrowings						
– Commercial paper	(50)	(50)	(50)	–	–	–
– Bank loans	(491)	(507)	(52)	(301)	(154)	–
– Finance leases	(179)	(274)	(5)	(14)	(86)	(169)
– Capital notes	(35)	(43)	–	(1)	(7)	(35)
– Retail bonds	(940)	(1,234)	(21)	(52)	(1,161)	–
– Medium-term notes	(2,955)	(3,888)	(70)	(142)	(2,415)	(1,261)
Bank overdraft	(23)	(23)	(23)	–	–	–
Owing to suppliers	(1,679)	(1,679)	(1,679)	–	–	–
Trade and other payables (excluding employee entitlements)	(1,136)	(1,081)	(1,081)	–	–	–
Financial guarantees issued[1]	–	(104)	(104)	–	–	–
Total non-derivative financial liabilities	(7,488)	(8,883)	(3,085)	(510)	(3,823)	(1,465)
Derivative financial instruments						
Gross settled derivatives						
– Inflow	–	17,598	9,045	6,041	1,571	941
– Outflow	–	(17,467)	(8,687)	(5,333)	(2,011)	(1,436)
Total gross settled derivative financial instruments	477	131	358	708	(440)	(495)
Net settled derivatives	1	234	(7)	22	74	145
Total financial instruments	(3,902)	(5,378)	262	251	(4,117)	(1,774)

[1] Maximum cash flows under guarantees provided by the Group.

Exposure to liquidity risk

	PARENT $ MILLION					
	AS AT 31 JULY 2012					
	CARRYING AMOUNT	CONTRACTUAL CASH FLOWS	3 MONTHS OR LESS	3–12 MONTHS	1–5 YEARS	MORE THAN 5 YEARS
Non-derivative financial assets						
Cash and cash equivalents	793	793	793	–	–	–
Trade and other receivables (excluding prepayments)	4	4	4	–	–	–
Long-term advances	3	4	–	–	1	3
Total non-derivative financial assets	800	801	797	–	1	3
Non-derivative financial liabilities						
Borrowings						
– Commercial paper	(198)	(199)	(199)	–	–	–
– Bank loans	(1)	(1)	(1)	–	–	–
– Finance leases	(147)	(228)	(4)	(11)	(59)	(154)
– Capital notes	(35)	(42)	–	(1)	(6)	(35)
– Retail bonds	(943)	(1,162)	(21)	(52)	(1,089)	–
– Medium-term notes	(2,690)	(3,328)	(19)	(904)	(1,149)	(1,256)
Owing to suppliers	(1,134)	(1,134)	(1,134)	–	–	–
Trade and other payables (excluding employee entitlements)	(102)	(63)	(63)	–	–	–
Financial guarantees issued[1]	–	(1,980)	(1,980)	–	–	–
Total non-derivative financial liabilities	(5,250)	(8,137)	(3,421)	(968)	(2,303)	(1,445)
Derivative financial instruments						
Gross settled derivatives						
– Inflow	–	16,774	8,893	5,029	1,892	960
– Outflow	–	(17,345)	(8,837)	(5,071)	(2,078)	(1,359)
Total gross settled derivative financial instruments	(226)	(571)	56	(42)	(186)	(399)
Net settled derivatives	34	226	(7)	28	83	122
Total financial instruments	(4,642)	(7,681)	(2,575)	(982)	(2,405)	(1,719)

1 Maximum cash flows under guarantees provided by the Parent.

Amounts due to and from consolidated Group entities that are repayable on demand (refer to Notes 8, 13 and 22) have been excluded from the above table.

19 FINANCIAL RISK MANAGEMENT CONTINUED

Exposure to liquidity risk

	PARENT $ MILLION					
	AS AT 31 JULY 2011					
	CARRYING AMOUNT	CONTRACTUAL CASH FLOWS	3 MONTHS OR LESS	3–12 MONTHS	1–5 YEARS	MORE THAN 5 YEARS
Non-derivative financial assets						
Cash and cash equivalents	570	570	570	–	–	–
Trade and other receivables (excluding prepayments)	2	2	2	–	–	–
Long-term advances	2	3	–	–	–	3
Total non-derivative financial assets	574	575	572	–	–	3
Non-derivative financial liabilities						
Borrowings						
– Commercial paper	(50)	(50)	(50)	–	–	–
– Bank loans	(150)	(155)	(2)	(3)	(150)	–
– Finance leases	(150)	(242)	(4)	(11)	(59)	(168)
– Capital notes	(35)	(43)	–	(1)	(7)	(35)
– Retail bonds	(940)	(1,234)	(21)	(52)	(1,161)	–
– Medium-term notes	(2,527)	(3,338)	(19)	(119)	(1,941)	(1,259)
Owing to suppliers	(1,729)	(1,729)	(1,729)	–	–	–
Trade and other payables (excluding employee entitlements)	(82)	(41)	(41)	–	–	–
Financial guarantees issued[1]	–	(2,135)	(2,135)	–	–	–
Total non-derivative financial liabilities	(5,663)	(8,967)	(4,001)	(186)	(3,318)	(1,462)
Derivative financial instruments						
Gross settled derivatives						
– Inflow	–	17,253	8,722	6,019	1,571	941
– Outflow	–	(17,118)	(8,359)	(5,312)	(2,011)	(1,436)
Total gross settled derivative financial instruments	481	135	363	707	(440)	(495)
Net settled derivatives	2	234	(7)	22	74	145
Total financial instruments	(4,606)	(8,023)	(3,073)	543	(3,684)	(1,809)

[1] Maximum cash flows under guarantees provided by the Parent.

Amounts due to and from consolidated Group entities that are repayable on demand (refer to Notes 8, 13 and 22) have been excluded from the above table.

e) Capital management

The Board's objective is to maximise Shareholder returns over time by maintaining an optimal capital structure. The Group provides returns to Shareholders through a milk price, dividends, and changes in the Company's share price. In order to maintain an appropriate capital structure, the Board may decide to retain profits within the Group.

The Board undertook a review of the capital structure in 2009, which identified a series of changes as set out in Note 7. These changes are intended to strengthen the statement of financial position, primarily by removing redemption risk and providing a framework conducive to ongoing retentions.

The Board closely monitors the Group's debt to debt plus equity ratio. This ratio is calculated as economic net interest bearing debt divided by total capital. Economic net interest bearing debt is calculated as disclosed in Note 15. Total capital is calculated as equity, as presented on the statement of financial position (excluding the cash flow hedge reserve), plus net interest bearing debt. The economic debt to debt plus equity ratio as at 31 July 2012 was 39.1% (31 July 2011: 41.8%), which is below the Board's target of 45%-50%.

The Group is not subject to externally imposed capital requirements.

f) Dairy commodity price risk

Dairy commodity price risk is the risk of volatility in profit or loss from a movement in dairy commodity prices to which the Group may be exposed.

Dairy commodity price risk arises from transactions for the sale and purchase of a variety of milk and milk derived products.

The Group manages its dairy commodity price risk by adopting a product mix that management considers best reflects the demand trends in dairy product markets globally. Sales contracts for future production of varying lengths are also used to enable the Group to sell its products at prices and times that management considers will maximise revenue.

The Group has also commenced on a limited scale direct trading in dairy commodity derivatives. Due to the limited market for the types of dairy commodity derivatives, such activity is only a small component of management's strategy for managing commodity price risk. Fonterra aims to use its industry knowledge to obtain the best price for future sales, so as markets for such derivatives grows, the scope of such commodity risk management activities may increase.

Commodity price risk sensitivity analysis

The table below summarises the impact on dairy commodity derivatives for increases/decreases of dairy commodity prices on the Group's post-tax profit for the year. The analysis is based on the assumption that dairy based commodity derivative prices had increased/decreased by 10% with all other variables held constant:

	GROUP $ MILLION	
	31 JULY 2012 PROFIT	31 JULY 2011 PROFIT
Impact of 10% increase in quoted dairy commodity prices	(1)	-
Impact of 10% decrease in quoted dairy commodity prices	1	-

g) Financial instrument fair values and classifications

Basis for determining fair values

The fair value of interest rate swaps and cross currency interest rate swaps is based on accepted valuation methodologies. The fair value of these instruments is calculated by discounting estimated future cash flows based on the terms and maturity of each contract, at market interest rates.

The fair values of financial liabilities are calculated by discounting the future contractual cash flows at current market interest rates that are available for similar financial instruments.

Fair values at balance date have been assessed using a range of market interest rates between 0.01% and 5.62% (31 July 2011: 0.05% and 7.00%) across all currencies in which the Group holds financial instruments.

Fair values are allocated to a fair value hierarchy based on the following:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

19 FINANCIAL RISK MANAGEMENT CONTINUED

	GROUP $ MILLION					
	AS AT 31 JULY 2012					
	LOANS AND RECEIVABLES	OTHER AMORTISED COST	HELD FOR TRADING	DERIVATIVES IN HEDGE RELATIONSHIPS	CARRYING VALUE	FAIR VALUE
Financial assets						
Cash and cash equivalents	1,033	–	–	–	1,033	1,033
Trade and other receivables (excluding prepayments)	2,229	–	–	–	2,229	2,229
Long-term advances	125	–	–	–	125	133
Derivative assets – current	–	–	87	188	275	275
Derivative assets – non-current	–	–	117	81	198	198
Total financial assets	3,387	–	204	269	3,860	3,868
Financial liabilities						
Bank overdraft	–	(42)	–	–	(42)	(42)
Owing to suppliers	–	(1,083)	–	–	(1,083)	(1,083)
Total payables and accruals (excluding employee entitlements)	–	(1,139)	–	–	(1,139)	(1,139)
Borrowings						
– Commercial paper	–	(198)	–	–	(198)	(198)
– Bank loans	–	(274)	–	–	(274)	(274)
– Finance leases	–	(177)	–	–	(177)	(208)
– Retail bonds	–	(943)	–	–	(943)	(1,053)
– Medium-term notes	–	(3,322)	–	–	(3,322)	(3,659)
Capital notes	–	(35)	–	–	(35)	(28)
Derivative liabilities – current	–	–	(37)	(218)	(255)	(255)
Derivative liabilities – non-current	–	–	(166)	(247)	(413)	(413)
Total financial liabilities	–	(7,213)	(203)	(465)	(7,881)	(8,352)
Total financial instruments	3,387	(7,213)	1	(196)	(4,021)	(4,484)

Included in the table above are the following instruments that have fair value changes recognised in the statement of financial position:

Level 1 fair value hierarchy						
Derivative assets	–	–	1	–	1	1
Derivative liabilities	–	–	–	–	–	–
Total level 1 fair value hierarchy	–	–	1	–	1	1
Level 2 fair value hierarchy						
Derivative assets	–	–	203	269	472	472
Derivative liabilities	–	–	(203)	(465)	(668)	(668)
Total level 2 fair value hierarchy	–	–	–	(196)	(196)	(196)
Total instruments recognised in the statement of financial position at fair value	–	–	1	(196)	(195)	(195)

	GROUP $ MILLION					
	AS AT 31 JULY 2011					
	LOANS AND RECEIVABLES	OTHER AMORTISED COST	HELD FOR TRADING	DERIVATIVES IN HEDGE RELATIONSHIPS	CARRYING VALUE	FAIR VALUE
Financial assets						
Cash and cash equivalents	785	–	–	–	785	785
Trade and other receivables (excluding prepayments)	2,201	–	–	–	2,201	2,201
Long-term advances	122	–	–	–	122	128
Derivative assets – current	–	–	302	798	1,100	1,100
Derivative assets – non-current	–	–	32	122	154	154
Total financial assets	3,108	–	334	920	4,362	4,368
Financial liabilities						
Bank overdraft	–	(23)	–	–	(23)	(23)
Owing to suppliers	–	(1,679)	–	–	(1,679)	(1,679)
Total payables and accruals (excluding employee entitlements)	–	(1,136)	–	–	(1,136)	(1,136)
Borrowings						
– Commercial paper	–	(50)	–	–	(50)	(50)
– Bank loans	–	(491)	–	–	(491)	(491)
– Finance leases	–	(179)	–	–	(179)	(201)
– Retail bonds	–	(940)	–	–	(940)	(1,042)
– Medium-term notes	–	(2,955)	–	–	(2,955)	(3,238)
Capital notes	–	(35)	–	–	(35)	(30)
Derivative liabilities – current	–	–	(41)	(17)	(58)	(58)
Derivative liabilities – non-current	–	–	(110)	(608)	(718)	(718)
Total financial liabilities	–	(7,488)	(151)	(625)	(8,264)	(8,666)
Total financial instruments	3,108	(7,488)	183	295	(3,902)	(4,298)

Included in the table above are the following instruments that have fair value changes recognised in the statement of financial position:

Level 1 fair value hierarchy						
Derivative assets	–	–	–	–	–	–
Derivative liabilities	–	–	(1)	–	(1)	(1)
Total level 1 fair value hierarchy	–	–	(1)	–	(1)	(1)
Level 2 fair value hierarchy						
Derivative assets	–	–	334	920	1,254	1,254
Derivative liabilities	–	–	(150)	(625)	(775)	(775)
Total level 2 fair value hierarchy	–	–	184	295	479	479
Total instruments recognised in the statement of financial position at fair value	–	–	183	295	478	478

19 FINANCIAL RISK MANAGEMENT CONTINUED

	PARENT $ MILLION					
	AS AT 31 JULY 2012					
	LOANS AND RECEIVABLES	OTHER AMORTISED COST	HELD FOR TRADING	DERIVATIVES IN HEDGE RELATIONSHIPS	CARRYING VALUE	FAIR VALUE
Financial assets						
Cash and cash equivalents	793	–	–	–	793	793
Trade and other receivables (excluding prepayments)	8,866	–	–	–	8,866	8,866
Long-term advances	3	–	–	–	3	3
Derivative assets – current	–	–	263	7	270	270
Derivative assets – non-current	–	–	137	61	198	198
Total financial assets	9,662	–	400	68	10,130	10,130
Financial liabilities						
Owing to suppliers	–	(1,134)	–	–	(1,134)	(1,134)
Total payables and accruals (excluding employee entitlements)	–	(7,031)	–	–	(7,031)	(7,031)
Borrowings						
– Commercial paper	–	(198)	–	–	(198)	(198)
– Bank loans	–	(1)	–	–	(1)	(1)
– Finance leases	–	(147)	–	–	(147)	(176)
– Retail bonds	–	(943)	–	–	(943)	(1,053)
– Medium-term notes	–	(2,690)	–	–	(2,690)	(2,992)
Capital notes	–	(35)	–	–	(35)	(28)
Derivative liabilities – current	–	–	(37)	(210)	(247)	(247)
Derivative liabilities – non-current	–	–	(171)	(242)	(413)	(413)
Total financial liabilities	–	(12,179)	(208)	(452)	(12,839)	(13,273)
Total financial instruments	9,662	(12,179)	192	(384)	(2,709)	(3,143)

Included in the table above are the following instruments that have fair value changes recognised in the statement of financial position:

Level 2 fair value hierarchy						
Derivative assets	–	–	400	68	468	468
Derivative liabilities	–	–	(208)	(452)	(660)	(660)
Total level 2 fair value hierarchy	–	–	192	(384)	(192)	(192)
Total instruments recognised in the statement of financial position at fair value	–	–	192	(384)	(192)	(192)

	PARENT $ MILLION					
	AS AT 31 JULY 2011					
	LOANS AND RECEIVABLES	OTHER AMORTISED COST	HELD FOR TRADING	DERIVATIVES IN HEDGE RELATIONSHIPS	CARRYING VALUE	FAIR VALUE
Financial assets						
Cash and cash equivalents	570	–	–	–	570	570
Trade and other receivables (excluding prepayments)	9,236	–	–	–	9,236	9,236
Long-term advances	2	–	–	–	2	2
Derivative assets – current	–	–	1,088	–	1,088	1,088
Derivative assets – non-current	–	–	110	44	154	154
Total financial assets	9,808	–	1,198	44	11,050	11,050
Financial liabilities						
Owing to suppliers	–	(1,729)	–	–	(1,729)	(1,729)
Total payables and accruals (excluding employee entitlements)	–	(7,324)	–	–	(7,324)	(7,324)
Borrowings						
– Commercial paper	–	(50)	–	–	(50)	(50)
– Bank loans	–	(150)	–	–	(150)	(150)
– Finance leases	–	(150)	–	–	(150)	(169)
– Retail bonds	–	(940)	–	–	(940)	(1,042)
– Medium-term notes	–	(2,527)	–	–	(2,527)	(2,799)
Capital notes	–	(35)	–	–	(35)	(30)
Derivative liabilities – current	–	–	(41)	–	(41)	(41)
Derivative liabilities – non-current	–	–	(113)	(605)	(718)	(718)
Total financial liabilities	–	(12,905)	(154)	(605)	(13,664)	(14,052)
Total financial instruments	9,808	(12,905)	1,044	(561)	(2,614)	(3,002)

Included in the table above are the following instruments that have fair value changes recognised in the statement of financial position:

Level 2 fair value hierarchy						
Derivative assets	–	–	1,198	44	1,242	1,242
Derivative liabilities	–	–	(154)	(605)	(759)	(759)
Total level 2 fair value hierarchy	–	–	1,044	(561)	483	483
Total instruments recognised in the statement of financial position at fair value	–	–	1,044	(561)	483	483

The timing of the maturity of the release of the Parent and Group's cash flow hedge reserve is:

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	**31 JULY 2012**	31 JULY 2011
Current	**143**	740	**(12)**	(13)
Non-current	**(55)**	(23)	**(80)**	(76)
Total carrying value	**88**	717	**(92)**	(89)

The fair value of derivatives in hedge relationships by type of hedging relationship is:

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	**31 JULY 2012**	31 JULY 2011
Cash flow hedge	**96**	732	**(92)**	(97)
Fair value hedge	**(292)**	(464)	**(292)**	(464)
Net investment hedge	**–**	27	**–**	–
Total carrying value of derivatives in hedge relationships	**(196)**	295	**(384)**	(561)

20 CONTINGENT LIABILITIES

The Group and Parent have no contingent liabilities as at 31 July 2012 (31 July 2011: nil).

In the normal course of its business, Fonterra, its subsidiaries and equity accounted investees are exposed to claims, legal proceedings and arbitrations that may in some cases result in costs to the Group. The Directors believe that these have been adequately provided for and disclosed by the Group and that there are no additional legal proceedings or arbitrations that are pending at the date of these financial statements that require provision or disclosure.

21 COMMITMENTS

Capital and intangible asset expenditure commitments

Capital and intangible asset expenditure contracted for at balance date but not recognised in the financial statements are as follows:

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Buildings	62	4	–	–
Plant, vehicles and equipment	241	223	3	4
Intangible assets	5	4	3	1
Total capital commitments	308	231	6	5

Operating lease commitments

The Group leases premises, plant and equipment. The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Less than one year	76	74	–	–
One to five years	162	161	–	–
Greater than five years	31	41	–	–
Total operating lease commitments	269	276	–	–

22 RELATED PARTY TRANSACTIONS

Equity accounted investees (refer to Note 23) and key management personnel are related parties of the Group. Key management personnel comprises the Board and the Fonterra Management Team.

Transactions were entered into and year end balances arose from transactions with related parties as follows:

Key management personnel remuneration

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Short-term employee benefits	12	20	11	19
Long-term employee benefits	3	5	2	4
Termination benefits	1	–	1	–
Directors' remuneration	2	2	2	2
Total key management personnel remuneration	18	27	16	25

Revenue from the sale of goods

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Sale of goods				
Equity accounted investees	76	81	–	–
Other Group entities	–	–	9,050	10,257
	76	81	9,050	10,257

Goods sold to related parties are primarily commodity products and are provided under normal trade terms.

Other operating income

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Sale of services				
Equity accounted investees	5	5	–	–
Other Group entities	–	–	54	52
	5	5	54	52
Royalty and other income				
Equity accounted investees	20	21	–	–

Services provided to related parties include management fees and are provided under normal trade terms. Royalty and other income received from related parties are provided under normal trade terms.

22 RELATED PARTY TRANSACTIONS CONTINUED

Purchases of goods and services

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Purchases of goods				
Equity accounted investees	101	75	–	–
Other Group entities	–	–	16	23
Key management personnel	225	247	225	247
	326	322	241	270
Purchases of services				
Equity accounted investees	5	2	–	–
Other Group entities	–	–	1	3
	5	2	1	3

Goods purchased from related parties are primarily commodity products, which are acquired under normal trade terms.

Services purchased from related parties are primarily commissions paid and are under normal trade terms.

In addition, key management personnel may engage in transactions with other Group entities under normal trade terms.

Transfers of property, plant & equipment and intangible assets

	PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011
Additions of property, plant & equipment from other Group entities	–	16
Additions of intangible assets from other Group entities	–	5
Total	–	21

The Parent entered into transactions with other Group entities to acquire and dispose of property, plant and equipment and intangible assets. These transactions were at the net book value of the assets transferred.

Dividends received

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Equity accounted investees	36	63	–	–
Other Group entities	–	–	114	495
	36	63	114	495

Balances arising from the sale or purchase of goods or services

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Receivables[1]				
Equity accounted investees	21	16	–	–
Other Group entities	–	–	85	142
	21	16	85	142
Payables				
Equity accounted investees	9	8	–	–
Other Group entities	–	–	6	6
Key management personnel[2]	28	41	28	41
	37	49	34	47

1 There were no material provisions for impairment on the receivables from related parties.

2 Payables to key management personnel relate to amounts owing for milk supplied to the Group by farmer Shareholder Directors.

Balances arising from financing arrangements

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Receivables				
Equity accounted investees	59	90	–	–
Receivables from other Group entities	–	–	9,018	9,241
	59	90	9,018	9,241
Payables				
Equity accounted investees	1	–	–	–
Payables to other Group entities	–	–	6,923	7,236
Payables to key management personnel	1	1	–	–
	2	1	6,923	7,236

Payables to key management personnel relate to unsecured bonds held by Directors or members of the Fonterra Management Team.

Interest income/(expense) from financing arrangements

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Interest income				
Equity accounted investees	3	4	–	–
Other Group entities	–	–	247	355
	3	4	247	355
Interest expense				
Other Group entities	–	–	10	(11)
	–	–	10	(11)

Loans to related parties other than equity accounted investees are unsecured and repayable in cash on demand. Loans to equity accounted investees are unsecured and repayable over varying terms of between two years and 14 years.

Financial guarantees

The Group has provided financial guarantees for several equity accounted investees. The aggregate drawn down amount of equity accounted investees' liabilities for which the Group is jointly and severally liable is $39 million (31 July 2011: $38 million). The Parent has provided financial guarantees for other Group entities. The amounts drawn down under those guaranteed facilities are $760 million (31 July 2011: $626 million).

Co-operative share transactions with Directors

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2012	31 JULY 2011	31 JULY 2012	31 JULY 2011
Co-operative shares issued/(surrendered)				
Issued	13	16	13	16
Surrendered	(4)	(15)	(4)	(15)
Net movement	9	1	9	1
Dividends paid to Directors	4	3	4	3

Co-operative shares issued to Directors during the year were 2,765,815 (31 July 2011: 3,587,230) and Co-operative share surrenders were 893,273 (31 July 2011: 3,274,865).

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2012	AS AT 31 JULY 2011	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Balances arising from transactions with Directors				
Receivable from Directors	–	–	–	–
Payable to Directors	–	–	–	–

22 RELATED PARTY TRANSACTIONS CONTINUED

Commitments

In addition to the transactions disclosed above, the Group has prospective commitments with related parties including contracts with equity accounted investees for the supply of dairy products, energy and the provision of various management services. These transactions are to be carried out at normal market prices and on an arm's length basis.

23 GROUP ENTITIES

All subsidiaries and equity accounted investees are involved in the marketing, distribution, processing, technology or financing of dairy products. All Group entities have a balance date of 31 July unless otherwise indicated. Subsidiaries and equity accounted investees with different balance dates from that of the Group are due to legislative requirements in the country the entities are domiciled. Equity accounted investees may also have a different balance date due to alignment with their other investor's balance date or to align with the milk season. The New Zealand Companies Office has given exemptions for a number of Fonterra's subsidiaries to maintain balance dates different to that of the Group.

The Group holds investments in certain countries that have some limited restrictions on the repatriation of funds back to the Parent. This does not result in any significant restriction on the flow of funds for the Group.

The significant subsidiaries and equity accounted investees of the Group are listed below:

		OWNERSHIP INTERESTS (%)	
OVERSEAS SUBSIDIARIES	COUNTRY OF INCORPORATION	AS AT 31 JULY 2012	AS AT 31 JULY 2011
Fonterra Australia Pty Limited	Australia	100	100
Fonterra Brands (Australia) Pty Limited	Australia	100	100
Fonterra (Brasil) Limitada[1]	Brazil	100	100
Soprole S.A.[1]	Chile	99.9	99.9
Fonterra Commercial Trading (Shanghai) Company Limited[1]	China	100	100
Tangshan Fonterra Dairy Farm Limited	China	85	85
PT Fonterra Brands Indonesia	Indonesia	100	100
Fonterra Brands (Japan) Limited	Japan	100	100
Fonterra Brands (Malaysia) Sdn Bhd	Malaysia	100	100
Fonterra (Ing.) Limited	Mauritius	51	51
Fonterra (Mexico) S.A. de C.V.[1]	Mexico	100	100
Fonterra (Europe) Coöperatie U.A.	Netherlands	100	100
Fonterra Brands Phils. Inc.	Philippines	100	100
Saudi New Zealand Milk Products Company Limited	Saudi Arabia	100	100
Fonterra Brands (Singapore) Pte Limited	Singapore	100	100
Fonterra Brands (New Young) Pte Limited	Singapore	51	51
Fonterra (SEA) Pte Limited	Singapore	100	100
Fonterra Brands Lanka (Private) Limited	Sri Lanka	100	100
Fonterra Brands (Thailand) Limited	Thailand	100	100
Fonterra (USA) Inc	USA	100	100
Fonterra Venezuela S.A.	Venezuela	100	100
Fonterra Brands (Viet Nam) Company Limited[2]	Vietnam	100	100

1 Balance date 31 December.

2 Balance date 30 June.

NEW ZEALAND SUBSIDIARIES	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2012	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2011
Anchor Ethanol Limited	100	100
Canpac International Limited	100	100
Fonterra Brands (New Zealand) Limited	100	100
Fonterra Brands (Tip Top) Limited	100	100
Fonterra Limited	100	100
Fonterra (New Zealand) Limited	100	100
New Zealand Dairy Board	100	100
NZAgbiz Limited	100	100
RD1 Limited	100	100
ViaLactia Biosciences (NZ) Limited	100	100

The ownership interest of the following entities is 50% or less. However, they have been consolidated on the basis that the Group controls them based on its capacity to govern the financing and operating policies of the entities so as to obtain benefits from their activities.

OVERSEAS SUBSIDIARIES 50% OR LESS OWNERSHIP	COUNTRY OF INCORPORATION	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2012	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2011
Fonterra (Japan) Limited	Japan	50	50
Fonterra Brands (Middle East) L.L.C.	UAE	49	49

The ownership interest of the following entities is 50% or less and the Group is not considered to exercise a controlling interest. These entities are therefore accounted for as equity accounted investees.

OVERSEAS EQUITY ACCOUNTED INVESTEES	COUNTRY OF INCORPORATION	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2012	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2011
DPA Manufacturing Holdings Limited[1]	Bermuda	50	50
Dairy Partners Americas Brasil Limitada[1]	Brazil	50	50
Ecuajugos S.A.[1]	Ecuador	50	50
DMV Fonterra Excipients GmbH & Co KG[1]	Germany	50	50
Dairy Industries (Jamaica) Limited[1]	Jamaica	50	50
DairiConcepts, L.P.[1]	USA	50	50
DairiConcepts Management, L.L.C.[1]	USA	50	50
Lactaid Holdings Limited[1]	Barbados	50	50

1 Balance date 31 December.

NEW ZEALAND EQUITY ACCOUNTED INVESTEES	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2012	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2011
International Nutritionals Limited[1]	50	50

1 Balance date 31 May.

24 SUBSEQUENT EVENTS

On 25 September 2012, the Board of Directors declared a final dividend of 20 cents per share payable on 20 October 2012 to the Shareholders on the share register at 31 May 2012.

On 14 September 2012, Fonterra completed the purchase of certain assets and liabilities relating to the dairy processing business formerly known as New Zealand Dairies Limited. The accounting for this transaction has yet to be finalised, and the transaction is not expected to be material, therefore no further disclosure has been made.

There were no other material events subsequent to 31 July 2012 that would impact these financial statements.

25 EARNINGS PER SHARE

	GROUP	
	31 JULY 2012	31 JULY 2011
Basic and diluted earnings per share attributable to equity holders of the Company ($)	**0.42**	0.55
Earnings attributable to equity holders of the Company ($ million)	**609**	754
Weighted average number of shares (thousands of shares)	**1,435,793**	1,375,904

INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS OF FONTERRA CO-OPERATIVE GROUP LIMITED

pwc

REPORT ON THE FINANCIAL STATEMENTS

We have audited the financial statements of Fonterra Co-operative Group Limited and its subsidiaries on pages 53 to 104, which comprise the statement of financial position as at 31 July 2012, the income statement, statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and the notes to the financial statements that include a summary of significant accounting policies and other explanatory information for both the Company and the Group. The Group comprises the Company and the entities it controlled at 31 July 2012 or from time to time during the financial year.

Directors' Responsibility for the Financial Statements

The Directors are responsible for the preparation of these financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate and for such internal controls as the Directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand) and International Standards on Auditing. These standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider the internal controls relevant to the Company and the Group's preparation of financial statements that give a true and fair view of the matters to which they relate, in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company and the Group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

We carry out other assignments on behalf of the Company and the Group in the areas of other audit related services and transaction and other advisory services. Partners and employees of our firm may deal with the Company and the Group on normal terms within the ordinary course of trading activities of the Company and the Group. These matters have not impaired our independence as auditors of the Company and the Group.

Opinion

In our opinion, the financial statements on pages 53 to 104:

(i) comply with generally accepted accounting practice in New Zealand; and

(ii) comply with International Financial Reporting Standards; and

(iii) give a true and fair view of the financial position of the Company and the Group as at 31 July 2012, and their financial performance and cash flows for the year then ended.

Report on Other Legal and Regulatory Requirements

We also report in accordance with Sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993. In relation to our audit of the financial statements for the year ended 31 July 2012:

(i) we have obtained all the information and explanations that we have required; and

(ii) in our opinion, proper accounting records have been kept by the Company as far as appears from an examination of those records.

Restriction on Distribution or Use

This report is made solely to the Company's shareholders, as a body, in accordance with Section 205(1) of the Companies Act 1993. Our audit work has been undertaken so that we might state to the Company's shareholders those matters which we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's shareholders, as a body, for our audit work, for this report or for the opinions we have formed.

PricewaterhouseCoopers

Chartered Accountants, Auckland
25 September 2012

STATUTORY INFORMATION

FOR THE YEAR ENDED 31 JULY 2012

EQUITY SECURITIES HELD AT BALANCE DATE

In accordance with NZX Limited Listing Rule 10.5.5(c), the following table identifies the Equity Securities in which each Director and their Associated Persons have a relevant interest as at 31 July 2012. The figure alongside each Director includes beneficially held securities, holdings by Associated Persons and joint holdings with Associated Persons.

	CO-OPERATIVE SHARES
Colin Armer (resigned 1 August 2012)	17,879,495
Malcolm Bailey	3,666,167
Ian Farrelly	2,243,418
David MacLeod	2,701,962
John Monaghan	1,027,895
Nicola Shadbolt	353,162
Sir Henry van der Heyden	502,000
Jim van der Poel	7,592,952
John Wilson	4,198,056

CO-OPERATIVE STATUS

In accordance with Section 10 of the Co-operative Companies Act 1996, the Directors of Fonterra unanimously resolved on 28 August 2012 that the Company was, for the year ended 31 July 2012, a co-operative company. The opinion was based upon the fact that:

- Throughout that period the principal activities of the Company have been the activities stated in Clause 1.2 of the Company's constitution:
  - the manufacture and sale of butter, cheese, dried milk, casein, or any other product derived from milk or milksolids supplied to the Company by its Shareholders
  - the sale to any person of milk or milksolids supplied to the Company by its Shareholders
  - the collection, treatment, and distribution for human consumption of milk or cream supplied to the Company by its Shareholders
- Each of the Company's principal activities are co-operative activities (as defined in Section 3 of the Co-operative Companies Act 1996)
- Throughout that period not less than 60% of the voting rights attaching to shares in the Company have been held by transacting shareholders (as defined in Section 4 of the Co-operative Companies Act 1996).

REMUNERATION OF DIRECTORS

The fees paid to each Director in the 12 month period from 1 August 2011 to 31 July 2012 are scheduled below:

	FEES ($)
Colin Armer (resigned 1 August 2012)	182,624
Malcolm Bailey	154,100
John Ballard (to 30 April 2012)	114,100
Ian Farrelly	154,100
Greg Gent (to 17 November 2011)	41,821
David Jackson	182,624
David MacLeod (from 17 November 2011)	112,820
John Monaghan	182,624
Sir Ralph Norris (from 1 May 2012)	40,000
Nicola Shadbolt	154,100
Sir Henry van der Heyden	374,923
Jim van der Poel	154,100
John Waller	182,624
Ralph Waters	154,100
John Wilson	182,624

SUBSIDIARY COMPANY DIRECTORS

The following companies were subsidiaries of Fonterra as at 31 July 2012. Directors as at that date are listed; those who resigned during the year are denoted with an R. Alternate Directors are denoted with an A.

616059 Limited:
C P Caldwell, S D T Till, S C R Deschamps (R)

Anchor Ethanol Limited:
C P Caldwell, P D Washer

Canpac International Limited:
C P Caldwell, B D Mealings, S J Gajzago (R)

Civil Whey Distributors Limited:
C P Caldwell, B D Mealings, B P D Taylor

Dairy Industry Superannuation Scheme Trustee Limited:
M A Apiata-Wade, B J Kerr, D M Marshall, T P McGuinness, D W C Scott, A K Williams, P D Wynen

Dairy Transport Logistics Limited:
C P Caldwell, J P Coote, G A Hoddinott, G J Cochrane (R), K Harris (R), J P Minkhorst (R)

Fantastic Food Limited:
J A Luskie, P J W McClure

Fonterra (Asia) Limited:
C P Caldwell, M W Smith

Fonterra (International) Limited:
C P Caldwell, C E Rowe, P D Washer (R)

Fonterra (Kotahi) Limited:
C P Caldwell, J P Coote

Fonterra (Middle East) Limited:
C P Caldwell, P D Washer

Fonterra (New Zealand) Limited:
C P Caldwell, C E Rowe, P D Washer (R)

Fonterra (Number One) Limited:
C P Caldwell, S D T Till, S C R Deschamps (R)

Fonterra Brands (China Holdings) Limited:
C P Caldwell, P P Coppes, T L Tan (R)

Fonterra Brands (New Zealand) Limited:
C P Caldwell, D K Mallinson

Fonterra Brands (The Pastryhouse) Limited:
C P Caldwell, D K Mallinson

Fonterra Brands (Tip Top Investments) Limited:
C P Caldwell, D K Mallinson

Fonterra Brands (Tip Top) Limited:
C P Caldwell, D K Mallinson

Fonterra Brands Limited:
C P Caldwell, J P Mason

Fonterra Commodities Limited:
J H Allan, C P Caldwell, I Palliser, P D Washer (R)

Fonterra Dairy Solutions Limited:
C P Caldwell, R McNickle

Fonterra Enterprises Limited:
C P Caldwell, J P Minkhorst

Fonterra Equities Limited:
C P Caldwell, S D T Till, S C R Deschamps (R)

Fonterra Farming Ventures Limited:
C P Caldwell, J P Minkhorst

Fonterra Finance Corporation Limited:
C P Caldwell, S D T Till, S C R Deschamps (R)

Fonterra Holdings (Americas) Limited:
C P Caldwell, K J Murray

Fonterra Holdings (Argentina) Limited:
C P Caldwell, K J Murray

Fonterra Holdings (Brazil) Limited:
C P Caldwell, K J Murray

Fonterra Holdings (Ecuador) Limited:
C P Caldwell, K J Murray

Fonterra Holdings (Venezuela) Limited:
C P Caldwell, K J Murray

Fonterra Insurance Limited:
C P Caldwell, J P Mason

Fonterra Investments (China) Limited:
C P Caldwell, P P Coppes, T L Tan (R)

Fonterra IP Limited:
C P Caldwell, S D T Till, S C R Deschamps (R)

Fonterra Limited:
C P Caldwell, B Connolly, P D Washer (R)

Fonterra Manufacturing (Americas) Limited:
C P Caldwell, K J Murray

Fonterra PGGRC Limited:
C P Caldwell, J P Minkhorst

Fonterra Research Centre Limited:
C P Caldwell, M W Smith

Fonterra TM Limited:
C P Caldwell, S D T Till, S C R Deschamps (R)

Food Solutions Group 2000 Limited:
C P Caldwell, S D T Till, S C R Deschamps (R)

Glencoal Energy Limited:
C P Caldwell, B D Mealings

Global Dairy Trade Holdings Limited:
C P Caldwell, J P Mason

Kapiti Fine Foods Limited:
C P Caldwell, D K Mallinson

Kotahi GP Limited:
C P Caldwell, J P Coote, K G Winders

MIH Limited:
C P Caldwell, J P Minkhorst

New Zealand Dairy Board:
C P Caldwell, C E Rowe, P D Washer (R)

New Zealand Milk (Australasian Holdings) Limited:
C P Caldwell, J P Mason

New Zealand Milk (International) Limited:
C P Caldwell, J P Mason

New Zealand Milk Brands Limited:
C P Caldwell, S D T Till, S C R Deschamps (R)

NZAgbiz Limited:
C P Caldwell, J P Minkhorst

NZM (Dairy Holdings) Limited:
C P Caldwell, K K Gupta

RD1 Limited:
J P Minkhorst, K A Wickham

SAITL Technologies Limited:
P G Brown, P J Spooner, P J van Boheemen, J S Wilson

South Auckland Independent Testing Society Limited:
P G Brown, P J Spooner, P J van Boheemen, J S Wilson, R D Andela (A)

Sovenz Limited:
C P Caldwell, S D T Till, S C R Deschamps (R)

Tangshan Dairy Farm (NZ) Limited:
C P Caldwell, P P Coppes, T L Tan (R)

ViaLactia Biosciences (NZ) Limited:
C P Caldwell, J P Minkhorst

ViaLactia Bovine Limited:
C P Caldwell, J P Minkhorst

ViaLactia Clover Limited:
C P Caldwell, J P Minkhorst

Whareroa Co-Generation Limited:
C P Caldwell, B D Mealings

A.C.N. 008 668 602 Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

A.C.N. 009 163 268 Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

A.C.N. 009 235 492 Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

A.C.N. 111 834 489 Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

A.C.N. 113 345 430 Pty Ltd [Australia]:
C P Caldwell, D K Mallinson, B S Donnison (R), P L Thorn (R)

Anmum (Malaysia) Sdn. Bhd. [Malaysia]:
M F Bin Wahab, D A Ross, M W Smith, K K Gupta (A)

Australasian Food Holdings Pty Limited [Australia]:
C P Caldwell, D K Mallinson

Bonlac Finance Pty Limited [Australia]:
C P Caldwell, D K Mallinson

Bonlac Staff Retirement Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

Bonland Cheese Trading Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

Comercial Dos Alamos S.A. [Chile]:
M Berdichevsky Bizama, H Covarrubias Lalanne, P C Muzzio Castelletto, J M Porraz-Lando, S Tagle Perez, E Aldunate Montes (A), S Benavides Méndez (A), R Cubillos Yañez (A), V Flen Silva (A), G Rencoret Mujica (A), J F Silva Barroilhet (R)

Comercial Santa Elena S.A. [Chile]:
M Berdichevsky Bizama, H Covarrubias Lalanne, P C Muzzio Castelletto, J M Porraz-Lando, S Tagle Perez, E Aldunate Montes (A), S Benavides Méndez (A), R Cubillos Yañez (A), V Flen Silva (A), G Rencoret Mujica (A), J F Silva Barroilhet (R)

Dairy Enterprises (Chile) Limitada [Chile]:
M P Campbell, A J Duncan, K J Murray, R Sepúlveda Seminario, M W Smith, C Bussi (A), J C Gumucio Schönthaler (A), L O Herrera Larraín (A), A Montaner Lewin (A), S Obach González (A) , E A Teisaire (R)

Dairy Enterprises International (Chile) Limited [Cayman Islands]:
M P Campbell, E A Teisaire

Dairy Fresh Pty. Ltd. [Australia]:
C P Caldwell, D K Mallinson

Dairymas (Malaysia) Sdn Bhd [Malaysia]:
M F Bin Wahab, D A Ross, M W Smith, K K Gupta (A)

Fast Forward FFW Limited [United Kingdom]:
K Allum, M P Campbell, S P Faulkner, K Liekelema, M J McQuade (R)

Fazenda MIH Ltda [Brazil]:
A Z Fortuna, F Jorge

Fonterra (Brasil) Ltda [Brazil]:
M M Pérez Ortiz

Fonterra (Canada), Inc. [Canada]:
C P Caldwell, B Kipping, G Vita

Fonterra (Centro America) S.A. [Guatemala]:
M d R García de Pullin, M M Pérez Ortiz, P D Washer, B T Willis (R)

Fonterra (China) Limited [Hong Kong]:
C P Caldwell, P P Coppes, T L Tan, P A Turner

Fonterra (CIS) Limited Liability Company [Russian Federation]:
A Rozanov

Fonterra (Europe) Coöperatie U.A. [Netherlands]:
C P Caldwell, K Liekelema, M W Smith (R)

Fonterra (Europe) GmbH [Germany]:
K Liekelema

Fonterra (France) SAS [France]:
K Liekelema

Fonterra (Ing.) Limited [Mauritius]:
Lee G, P D Washer

Fonterra (Italy) S.P.A. [Italy]:
C P Caldwell, T H D Kühn, K Liekelema, B B Anderson (R), A Lichter (R), P Pennati (R), M W Smith (R)

Fonterra (Japan) Limited [Japan]:
P G Brown, C P Caldwell, R M Kennerley, K Kumagai, H Ono, K Ueta

Fonterra (Logistics) Ltd [United Kingdom]:
T H D Kühn, G R Sharma

Fonterra (Mexico) S.A. de C.V. [Mexico]:
C P Caldwell, M M Pérez Ortiz, P D Washer, L Barona Mariscal (A), F R Camacho (A), G A Castro Palafox (A), M I Arana Soriano (R) (A)

Fonterra (Pacific) Inc. [United States]:
C P Caldwell, M W Smith, G Vita

Fonterra (SEA) Pte. Ltd. [Singapore]:
G N Kane, M W Smith

Fonterra (Switzerland) SA [Switzerland]:
G Roper, M W Smith

Fonterra (Thailand) Limited [Thailand]:
G N Kane, K Vunthanadit

Fonterra (USA) Inc [United States]:
C P Caldwell, M W Smith, G Vita

Fonterra (Yutian) Dairy Farm Company Limited [China]:
J P Minkhorst, P J Moore, P A Turner

Fonterra Australia Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

Fonterra Brands (Asia Holdings) Pte. Ltd [Singapore]:
M W Smith, M A Wilson, K K Gupta (R)

Fonterra Brands (Australia) Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

Fonterra Brands (Centram), S.A. [Panama]:
M P J Bates, M W Smith

Fonterra Brands (Far East) Limited [Hong Kong]:
M W Smith, M A Wilson, K K Gupta (R)

Fonterra Brands (Guangzhou) Ltd [China]:
P P Coppes, P A Turner, K A Wickham, T L Tan (R)

Fonterra Brands (Guatemala), S.A. [Guatemala]:
M P J Bates, M W Smith

Fonterra Brands (Hong Kong) Limited [Hong Kong]:
A M Fitzsimmons, C Sin, M W Smith, K K Gupta (R), D A Ross (R)

Fonterra Brands (Japan) Limited [Japan]:
C P Caldwell, R M Kennerley

Fonterra Brands (Malaysia) Sdn Bhd [Malaysia]:
M F Bin Wahab, D A Ross, M W Smith, K K Gupta (A)

Fonterra Brands (New Young) Pte. Ltd. [Singapore]:
A J Bruce, Y Lin, Lin C, Ling J, M W Smith, M A Wilson, A M Fitzsimmons (A)

Fonterra Brands (Singapore) Pte. Ltd [Singapore]:
M W Smith, M A Wilson, K K Gupta (R)

Fonterra Brands (Thailand) Ltd [Thailand]:
S Aramthip, A M Fitzsimmons, C Phaonimmongkol, M W Smith, M A Wilson

Fonterra Brands (Viet Nam) Company Limited [Viet Nam]:
M W Smith, K K Gupta (R)

Fonterra Brands Indonesia, PT [Indonesia]:
M Handoyo, M W Smith

Fonterra Brands Lanka (Private) Limited [Sri Lanka]:
J H P Gallage, A R R Kasireddy, M W Smith

Fonterra Brands Phils. Inc [Philippines]:
M Magtoto, R A Mendoza, C M Mendoza, E Ogsimer, H Ong, M W Smith, M A Wilson, C Guillermo (R), K K Gupta (R)

Fonterra Commercial Trading (Shanghai) Company Limited [China]:
W F Chu, P P Coppes, T L Tan, P A Turner

Fonterra Egypt Limited [Egypt]:
A Anwar, M W Smith

Fonterra Foods Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

Fonterra Foodservices (USA), Inc. [United States]:
M W Smith, G Vita

Fonterra Holdings (Thailand) Limited [Thailand]:
G N Kane, K Vunthanadit

Fonterra Ingredients Australia Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

Fonterra Investments Netherlands Coöperatie U.A. [Netherlands]:
K Liekelema, A D Turnbull, J van der Windt, A A Mikhalevsky (R)

Fonterra Investments Pty Limited [Australia]:
C P Caldwell, D K Mallinson

Fonterra MIH Holdings Brasil Ltda [Brazil]:
A Z Fortuna, F Jorge

Fonterra Milk Australia Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

Fonterra Tangshan Dairy Farm (HK) Limited [Hong Kong]:
C P Caldwell, P P Coppes, P A Turner

Fonterra Venezuela, S.A. [Venezuela]:
C P Caldwell, F C Ortega Becea, P D Washer, O N de Massiani (A), S Guevara Camacho (A), L A Tinoco (A)

Inversiones Dairy Enterprises S.A. [Chile]:
M P Campbell, A J Duncan, J C Gumucio Schönthaler, A Montaner Lewin, K J Murray, M W Smith, L O Herrera Larraín (A), R Sepúlveda Seminario (A), J P Egaña Bertoglia (A)(R), S Obach González (A)(R)

Key Ingredients, Inc. [United States]:
C P Caldwell, M W Smith, G Vita

Mainland Dairies Pty. Ltd. [Australia]:
C P Caldwell, D K Mallinson

Mainland Foodservice Pty Limited [Australia]:
C P Caldwell, D K Mallinson

Milk Products Holdings (Middle East) EC [Bahrain]:
M W Smith, M A Wilson

Milk Products Holdings (North America) Inc. [United States]:
C P Caldwell, M W Smith, G Vita

Murrumbidgee Dairy Products Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

New Tai Milk Products Co Ltd [Taiwan]:
T H Deane, G N Kane, J Lee, C Lee, Lee G, M Lee, P D Washer, T L Tan (R)

New Zealand Milk (Australasia) Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

New Zealand Milk (Barbados) Ltd [Barbados]:
M P J Bates, M W Smith

New Zealand Milk (LATAM) Ltd [Bermuda]:
C P Caldwell, K J Murray

Newdale Dairies (Private) Limited [Sri Lanka]:
J H P Gallage, A R R Kasireddy, M W Smith

NZAgbiz Australia Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

NZMP (AEM) Ltd [United Kingdom]:
T H D Kühn, G R Sharma

Recombined Dairy Systems A/S [Denmark]:
T H D Kühn, K Liekelema, G R Sharma

Roaming Cow Dairies Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

Saudi New Zealand Milk Products Company Limited [Saudi Arabia]:
J C Fryer

Sociedad Agrícola y Lechera Praderas Australes S.A. ("Pradesur") [Chile]:
M Berdichevsky Bizama, H Covarrubias Lalanne, J M Porraz-Lando, J F Silva Barroilhet (R)

Sociedad Procesadora de Leche Del Sur S.A. [Chile]:
E Alcalde Undurraga, A Cussen Mackenna, J Milic Barros, K J Murray, S Obach González, G Varela Alfonso, J M Alcalde Undurraga (A), J P Matus Pickering (A), A Montaner Lewin (A), S Oddo Gómez (A), J P Orellana Pavón (A), C Perez-Cotapos Subercaseaux (A)

Solid Fresh Food & Beverage (M) Sdn. Bhd. [Malaysia]:
M F Bin Wahab, D A Ross, M W Smith, K K Gupta (A)

Soprole Inversiones SA [Chile]:
G Bitran Dicowsky, M P Campbell, J R Valente Vias, G Varela Alfonso, A Walker Prieto, S Diez Arriagada (A), R Fernández Robinson (A), C Herrera Barriga (A), R Sepúlveda Seminario (A), R Tisi Lanchares (A)

Soprole S.A. [Chile]:
G Bitran Dicowsky, M P Campbell, J R Valente Vias, G Varela Alfonso, A Walker Prieto, S Diez Arriagada (A), R Fernández Robinson (A), C Herrera Barriga (A), R Sepúlveda Seminario (A), R Tisi Lanchares (A)

Tangshan Fonterra Dairy Farm Ltd [China]:
P J Moore, P A Turner, Zhang J L, T L Tan (R)

Unilac Australia Pty Ltd [Australia]:
C P Caldwell, D K Mallinson

United Milk Tasmania Pty Limited [Australia]:
C P Caldwell, D K Mallinson

REMUNERATION FRAMEWORK

Fonterra operates a Pay for Performance approach to remuneration for salaried employees. We provide competitive salaries in the markets in which we operate with incentives and increases to remuneration being based on the performance of individuals and the organisation.

Our remuneration framework for salaried staff is based on a "total remuneration" approach meaning packages include fixed remuneration (e.g. salary and benefits) and variable remuneration (e.g. Short Term Incentive plan (STI)).

To ensure Fonterra remains competitive in the relevant market, our pay bands are based on information obtained from independent remuneration consultants. The framework is designed to reward exceptional performance taking into account factors such as internal equity and budget constraints.

All elements of the framework contribute to building an overall atmosphere of recognition, innovation and challenge.

Remuneration is important for attracting talent into the organisations, but it is not the only consideration. Attracting and retaining talent also depends on people leadership practices which build an emotional connection to the organisation including: opportunities to get involved in work that offers learning and growth; believing that they are working for an organisation that is making a meaningful contribution; feeling like their work matters and is appreciated and receiving praise and recognition from colleagues and peers. Fonterra's annual employee survey measures how successful we are at providing these non-financial rewards to employees and action plans address the gaps.

SHORT TERM INCENTIVE (STI) PLANS

Every permanent salaried employee in Fonterra worldwide is invited to participate in the annual STI plans.

STI plans are an important communication device signalling to employees what is important to Fonterra and how success in Fonterra is measured and rewarded. At the commencement of each year a series of Key Performance Indicators (KPIs) are identified and agreed. These KPIs include important financial measures from our three year strategic plan and also include our goals around Health & Safety and other important operational and qualitative measures.

Incentive programmes drive Fonterra's performance by:

- Aligning the objectives of the Company to ensure collaboration and a one team approach to achieve Fonterra's goals
- Establishing targets which are challenging yet achievable
- Linking specific levels of reward to individual, team and Company performance
- Providing great opportunities when Fonterra's business and people are successful.

At the end of each operating year, performance against the KPIs is determined and independently reviewed and approved by the Appointments, Remuneration and Development Committee (AR&DC).

LONG TERM INCENTIVE PLAN (STRATOS) PLAN

For certain key executives, Fonterra operates the Stratos plan. This plan is by invitation only and is designed to motivate, reward and retain key executives. This plan is based on achievement key profitability goals for the Co-operative.

BENEFITS

As Fonterra operates a total remuneration approach benefits are only provided when required by legislation or typical in a particular market. However, Fonterra works hard with suppliers to offer employees discounted products and services. In the year ended 31 July 2012, New Zealand based salaried employees were offered discounted trauma insurance to help take care of them and their families if serious illness occurred.

FIXED REMUNERATION	STI PLANS	STRATOS PLAN
• Provides "stable" base level of reward • External and internal relativities and budget constraints taken into account • Typically set at market median (for local market) using independent external benchmark data • Varies based on employee skills and performance	• All salaried employees eligible • Comprehensive range of financial and non-financial measures including H&S • When targets are exceeded total remuneration will be above market median • Highest performance receives an additional multiplier, lowest performance receives no STI payment	• Restricted to key executives • Focus on overall profitability of the Co-operative

EMPLOYEE REMUNERATION

The Group operates in a number of countries where remuneration market levels differ widely. During the year ended 31 July 2012, the number of employees, not being Directors of Fonterra, who received remuneration and the value of other benefits exceeding $100,000 was as follows:

REMUNERATION RANGE ($)		NEW ZEALAND[1]	OFFSHORE[2]	CESSATIONS[3]	TOTAL
100,000	110,000	778	210	29	**1,017**
110,001	120,000	401	245	18	**664**
120,001	130,000	188	229	9	**426**
130,001	140,000	134	192	7	**333**
140,001	150,000	134	110	9	**253**
150,001	160,000	79	80	8	**167**
160,001	170,000	72	86	6	**164**
170,001	180,000	59	62	5	**126**
180,001	190,000	53	50	2	**105**
190,001	200,000	34	46	1	**81**
200,001	210,000	26	30	3	**59**
210,001	220,000	27	30	3	**60**
220,001	230,000	21	19	2	**42**
230,001	240,000	17	20	2	**39**
240,001	250,000	16	17	2	**35**
250,001	260,000	19	15	–	**34**
260,001	270,000	7	15	1	**23**
270,001	280,000	8	10	2	**20**
280,001	290,000	6	13	–	**19**
290,001	300,000	4	11	1	**16**
300,001	310,000	8	7	1	**16**
310,001	320,000	8	6	–	**14**
320,001	330,000	13	9	–	**22**
330,001	340,000	5	6	1	**12**
340,001	350,000	4	7	1	**12**
350,001	360,000	6	3	–	**9**
360,001	370,000	3	6	2	**11**
370,001	380,000	8	7	–	**15**
380,001	390,000	4	6	–	**10**
390,001	400,000	4	3	–	**7**
400,001	410,000	4	4	1	**9**
410,001	420,000	1	6	–	**7**
420,001	430,000	1	2	–	**3**
430,001	440,000	2	6	–	**8**
440,001	450,000	2	6	2	**10**
450,001	460,000	2	2	–	**4**
460,001	470,000	2	2	–	**4**
470,001	480,000	5	3	–	**8**
480,001	490,000	1	2	–	**3**
490,001	500,000	1	4	–	**5**
500,001	510,000	1	2	–	**3**
510,001	520,000	1	2	–	**3**
520,001	530,000	–	2	1	**3**
530,001	540,000	4	1	–	**5**
540,001	550,000	1	2	–	**3**
550,001	560,000	–	1	1	**2**
560,001	570,000	–	3	–	**3**
570,001	580,000	2	1	–	**3**
580,001	590,000	1	1	–	**2**
590,001	600,000	–	1	–	**1**

REMUNERATION RANGE ($)		NEW ZEALAND[1]	OFFSHORE[2]	CESSATIONS[3]	TOTAL
600,001	610,000	2	3	–	**5**
610,001	620,000	–	1	–	**1**
630,001	640,000	1	2	–	**3**
640,001	650,000	–	2	–	**2**
650,001	660,000	–	2	–	**2**
690,001	700,000	1	–	–	**1**
700,001	710,000	–	1	–	**1**
720,001	730,000	–	1	–	**1**
730,001	740,000	–	1	–	**1**
740,001	750,000	–	2	–	**2**
760,001	770,000	–	1	–	**1**
810,001	820,000	1	–	–	**1**
840,001	850,000	–	1	–	**1**
860,001	870,000	1	–	–	**1**
870,001	880,000	2	–	–	**2**
900,001	910,000	1	–	–	**1**
910,001	920,000	–	1	–	**1**
920,001	930,000	–	1	–	**1**
940,001	950,000	–	1	–	**1**
980,001	990,000	1	–	–	**1**
1,000,001	1,010,000	1	1	–	**2**
1,010,001	1,020,000	1	–	–	**1**
1,050,001	1,060,000	1	–	–	**1**
1,060,001	1,070,000	–	1	–	**1**
1,140,001	1,150,000	–	2	–	**2**
1,150,001	1,160,000	1	–	–	**1**
1,170,001	1,180,000	–	1	–	**1**
1,190,001	1,200,000	–	1	–	**1**
1,200,001	1,210,000	–	1	–	**1**
1,210,001	1,220,000	–	1	–	**1**
1,230,001	1,240,000	1	–	–	**1**
1,470,001	1,480,000	1	–	–	**1**
1,500,001	1,510,000	1	–	–	**1**
1,520,001	1,530,000	–	–	1	**1**
1,580,001	1,590,000	–	1	–	**1**
1,770,001	1,780,000	–	1	–	**1**
1,790,001	1,800,000	–	1	–	**1**
1,920,001	1,930,000	1	–	–	**1**
2,470,001	2,480,000	1	1	–	**2**
2,510,001	2,520,000	–	1	–	**1**
2,810,001	2,820,000	–	–	1	**1**
3,000,001	3,010,000	1	–	–	**1**
8,220,001	8,230,000	–	–	1	**1**
Total		2,198	1,636	122	**3,956**

[1] Includes employees employed in New Zealand during the reporting period.

[2] Includes employees employed in an offshore operation during the reporting period. Amounts paid in foreign currency have been translated at the average conversion rate for the period.

[3] Cessations include employees that have been terminated or retired during the period. The amounts paid to former employees include salary and bonuses for the current period, prior period bonuses that have been paid in the current period (which were accrued at 31 July 2011) and termination entitlements including those arising from employment arrangements entered into by legacy companies prior to the formation of Fonterra.

CURRENT CREDIT RATING STATUS

Standard & Poor's has rated the Company A+ with a rating outlook of stable. Fitch has rated the Company AA- with a rating outlook of stable. Retail Bonds have been rated the same as the Company by both Standard & Poor's and Fitch. Capital Notes which are subordinate to other Fonterra debt issued are rated A by Standard & Poor's and A+ by Fitch.

EXCHANGE RULINGS AND WAIVERS

NZX Limited (NZX) has ruled that Capital Notes do not constitute "equity securities" under its Listing Rules (Rules). This means that where Capital Notes are quoted on NZX's debt market (NZDX), the Company is not required to comply with certain Rules which apply to an issuer of quoted equity securities.

NZX has granted waivers from NZDX Rule 11.1.1 to enable Fonterra to decline to accept or register transfers of Capital Notes or Retail Bonds (NZDX listed debt securities FCGHA, FCG010 and FCG020) if such transfer would result in the transferor holding or continuing to hold Capital Notes or Retail Bonds with a face value or principal amount of less than $5,000 or if such transfer is for an amount of less than $1,000 or multiple thereof. The effect of these waivers is that the minimum holding amount in respect of the Capital Notes and Retail Bonds will at all times be $5,000 in aggregate and that Retail Bonds can only be transferred in multiples of $1,000.

NZX has also granted a waiver from NZDX Rule 5.2.3 in respect of Retail Bond FCG020 to enable that Bond to be quoted on the NZDX market even though it did not meet the requirement that at least 500 members of the public held at least 25% of the Bonds being issued.

ANALYSIS OF CAPITAL NOTE AND RETAIL BOND HOLDING

Analysis of Fonterra's Capital Note Holding as at 29 August 2012:

FCGHA Capital Notes

FROM – TO	HOLDER COUNT	%	HOLDING QUANTITY	%
1 – 1,000	11	1.3	4,958	0.0
1,001 – 5,000	28	3.3	79,367	0.1
5,001 – 10,000	337	39.2	2,345,524	2.3
10,001 – 100,000	441	51.2	12,241,662	11.9
100,001 and over	43	5.0	87,847,743	85.7

100,001 and over includes Fonterra Co-operative Group Limited's holding of 67,435,575.

Analysis of Fonterra's Retail Bond Holding as at 29 August 2012:

FCG010 $800 million Retail Bond issue

FROM – TO	HOLDER COUNT	%	HOLDING QUANTITY	%
1 – 999	–	–	–	–
1,000 – 4,999	–	–	–	–
5,000 – 9,999	943	11.4	5,393,000	0.7
10,000 – 99,999	6,406	77.6	175,645,000	22.0
100,000 and over	907	11.0	618,962,000	77.3

FCG020 $150 million Retail Bond issue

FROM – TO	HOLDER COUNT	%	HOLDING QUANTITY	%
1 – 999	–	–	–	–
1,000 – 4,999	–	–	–	–
5,000 – 9,999	44	10.3	252,000	0.2
10,000 – 99,999	318	74.7	8,693,000	5.8
100,000 and over	64	15.0	141,055,000	94.0

ENTRIES IN THE INTERESTS REGISTER

Directors' interests in transactions

General disclosures of interest

The following general disclosures of interest were made in the period from 1 August 2011 to 31 July 2012*:*

Malcolm Bailey	Director of Pastoral Dairy Investments Limited, and of companies in the Pastoral Dairy Investments group.
David MacLeod	Director and shareholder of IGN Limited, A.J. Greaves Electrical Limited, Property Portfolio Investments Limited, NGI Limited, and P.K.W. Farms Limited; Director of Port Taranaki Limited; Councillor (Chairman) on the Taranaki Regional Council.
John Monaghan	Director of Waitohi Dairy Limited; Trustee of the Wairarapa Regional Irrigation Trust. Cessation of interest as a director of Waimana Dairy Limited.
Sir Henry van der Heyden	Director of Rabobank in New Zealand and Australia, and Tainui Group Holdings.
John Wilson	Director of Turners and Growers Limited, and Rangitata South Irrigation Limited

ENTRIES IN THE INTERESTS REGISTER CONTINUED

Securities dealings of Directors

The following entries were made in the Interests Register during the year.

New disclosures

Directors disclosed the following holdings of Co-operative shares during the year:

	CO-OPERATIVE SHARES	
	HELD BY ASSOCIATED PERSONS	JOINTLY HELD WITH ASSOCIATED PERSONS
David MacLeod (on appointment, 17 November 2011)	2,393,694	–
John Wilson (interest recorded 17 July 2012)	469,299	–

End of season changes

Directors disclosed the following transactions associated with 2012 end of season adjustments:

	CO-OPERATIVE SHARES	
	HELD BY ASSOCIATED PERSONS	JOINTLY HELD WITH ASSOCIATED PERSONS
Colin Armer (resigned 1 August 2012)		
– Purchased for cash	1,230,374	–
Malcolm Bailey		
– Surrendered for cash	124,833	–
Ian Farrelly		
– Purchased for cash	165,985	–
David MacLeod		
– Purchased for cash	184,178	–
John Monaghan		
– Purchased for cash	41,135	–
Jim van der Poel		
– Purchased for cash	338,628	30,615
John Wilson		
– Purchased for cash	189,570	–
– Surrendered for cash	150,721	–

In all cases the allocations or surrenders relate to the 2011/12 end of season adjustments. Adjustments related to production in the 2011/12 season were made on 22 June 2012 with deemed dates in accordance with the Constitution. The value upon allocation or surrender of these securities was $4.52 per Co-operative share.

Directors disclosed the following transactions which occurred as a result of elections made at the end of the 2011/12 season:

	CO-OPERATIVE SHARES	
	HELD BY ASSOCIATED PERSONS	JOINTLY HELD WITH ASSOCIATED PERSONS
Colin Armer (resigned 1 August 2012)		
– Purchased for cash	15,000	–
– Surrendered for cash	249,258	–
Malcolm Bailey		
– Purchased for cash	100,415	–
David MacLeod		
– Surrendered for cash	4,166	–
Sir Henry van der Heyden		
– Purchased for cash	32,000	10,000
– Surrendered for cash	–	2,000
John Wilson		
– Surrendered for cash	208	–

Adjustments were made on 4 July 2012 with deemed dates in accordance with the Constitution. In all cases the value upon allocation or surrender of these securities was $4.52 per Co-operative share.

Retail Bond transactions

David Jackson advised the registered holder of 100,000 Retail Bonds (FCG010) in which he had an interest had changed from "David Alexander Jackson, Dianne Catherine Jackson, Peter Russell Jackson" to "Tetley Brook Trustees Limited". David Jackson retains a relevant interest in these securities as a director of Tetley Brook Trustees Limited.

There were no other transactions in Retail Bonds reported during the period from 1 August 2011 to 31 July 2012. Current interests held by Directors are as follows:

	Details of Interest
David Jackson	Director of trustee company in respect of 100,000 Bonds (FCG010)
John Waller	Joint trustee in respect of 210,000 Bonds (FCG010)

Other Trading Activities

On 22 June 2012, 325,334 Co-operative shares which were jointly held by Colin Armer and Associated Persons were surrendered upon ceasing supply.

On 24 July 2012, Associated Persons of Colin Armer acquired interests in 240,000 Co-operative shares at $4.52 per share upon commencing supply.

On 4 July 2012, 128,256 Co-operative shares were transferred from an unrelated party to Associated Persons of David MacLeod.

INTERESTS IN THE ISSUES REGISTER CONTINUED

LOANS TO DIRECTORS

Loans were made to Associated Persons of Directors as scheduled below on 20 July 2012 by way of financial assistance, as generally available to Shareholders for the acquisition of shares issued in June 2012, relating to 2011/12 end of season adjustments and 2012/13 new season elections. The total amounts of loans are scheduled below and interest is calculated on a daily basis and compounded monthly and charged at the prevailing Fringe Benefit Tax interest rate plus a margin of 1% (initially 5.90% + 1% = 6.90%). If not repaid earlier, the amounts outstanding will be processed as a deduction from the September, paid October, milk payment and subsequent milk payments until the share debt and accrued interest charges are paid. (In accordance with an offer made by the Company on 19 September 2012 to all Shareholders who received such a loan, the repayment date may be extended to November, paid December, milk payment.) The Board approved the initial loans to Directors on 21 June 2012 and extended the repayment date on 14 September 2012.

RECIPIENT	AMOUNT LOANED ($)	AMOUNT OUTSTANDING AS AT 31 JULY 2012[1] ($)
Associated Persons of Colin Armer	3,894,846	–
Associated Persons of Ian Farrelly	558,807	228,268
Associated Persons of Sir Henry van der Heyden	144,640	144,941
Associated Persons of Jim van der Poel	621,656	–

1 The amount outstanding as at 31 July 2012 includes compounded interest.

DIRECTORS' REMUNERATION

The Directors' Remuneration Committee, comprising six shareholders elected in accordance with the Constitution, makes recommendations for shareholder approval as to the level of Directors' fees.

At the Annual Meeting of Shareholders held on 17 November 2011, shareholders approved, on the recommendation of the Directors' Remuneration Committee, the following amounts of remuneration to apply to Elected Directors from the date of that Annual Meeting of Shareholders.

Chairman	$400,000 p.a.
Directors	$160,000 p.a.
Discretionary additional payments to the Chairmen of permanent Board Committees (except if the Chairman is the Fonterra Chairman)	$30,000 p.a.

The Board has approved payment of the discretionary additional payment, at the prevailing approved rate, to the Chairmen of permanent Board Committees.

The Board has discretion to set the fees for Directors appointed under clause 12.4 of the Constitution. In the period to 31 July 2012 the Board applied the same remuneration levels as above to the Appointed Directors.

In general, fees paid by subsidiary or associate companies in respect of Fonterra Directors or employees appointed by Fonterra as Directors of those companies are payable directly to Fonterra.

DIRECTORS' INDEMNITY AND INSURANCE

Fonterra has given indemnities to, and has effected insurance for, Directors and executives of the Company and its related companies, in accordance with Section 162 of the Companies Act 1993, and Fonterra's Constitution, which, except for specific matters that are expressly excluded, indemnify and insure Directors and executives against monetary losses as a result of actions undertaken by them in the course of their duties. Among the matters specifically excluded are penalties and fines that may be imposed for breaches of law.

FIVE YEAR SUMMARY

	JULY 2012	JULY 2011	JULY 2010	JULY 2009	JULY 2008[1]
SHAREHOLDER RETURNS					
Payout					
Farmgate Milk Price (per kgMS)[2]	**6.08**	7.60	6.10	4.72	7.59
Dividend (per share)[3]	**0.32**	0.30	0.27	0.48	0.07
Cash payout[4]	**6.40**	7.90	6.37	5.20	7.66
Retentions (per share)[5]	**0.10**	0.25	0.23	0.01	0.15
Fair Value Share price ($) set for the next season	**4.52**	4.52	4.52	4.52	5.57
Total shareholder return[6]	**7.1%**	6.6%	6.0%	(10.2%)	(16.9%)
OPERATING PERFORMANCE					
Average commodity prices (US$ per MT FOB)					
Whole Milk Powder	**3,365**	3,841	3,313	2,379	4,605
Skim Milk Powder	**3,230**	3,521	3,020	2,205	4,325
Butter	**3,684**	4,583	3,573	2,343	3,755
Cheese	**3,498**	4,285	3,819	3,114	4,894
Source: Oceania Export Series, Agricultural Marketing Service, US Department of Agriculture					
Average NZD/USD spot exchange rate applying throughout the year[7]	**0.80**	0.77	0.71	0.60	0.77
Fonterra's average NZD/USD conversion rate[8]	**0.77**	0.72	0.67	0.67	0.74
Revenue ($ million)					
Ingredients and other revenue	**14,824**	14,623	11,818	10,987	14,267
Consumer revenue	**4,945**	5,248	4,908	5,048	5,245
Total revenue	**19,769**	19,871	16,726	16,035	19,512
Dairy ingredients manufactured in New Zealand ('000s MT)	**2,353**	2,143	2,058	2,021	2,021
Total ingredients sales volume ('000s MT)	**2,660**	2,486	2,392	2,310	2,633
Segment earnings ($ million)[9]					
New Zealand Milk Products	**491**	419	496	584	340
ANZ	**195**	278	299	240	220
Asia/AME	**194**	193	176	63	(39)
Latam	**121**	121	107	106	129
Eliminations	**(14)**	17	–	(3)	(36)
Segment earnings	**987**	1,028	1,078	990	614
Non-recurring items	**41**	(23)	(174)	29	287
Normalised segment earnings	**1,028**	1,005	904	1,019	901
Profit for the year attributable to Shareholders ($ million)[10]	**609**	754	669	599	272
Earnings per share	**0.42**	0.55	0.51	0.49	0.22

1 On 24 January 2008, Fonterra's Board resolved to change the Company's balance date to 31 July from 31 May, consequently the financial period for 2008 was a 14 month period to 31 July 2008.

2 From the beginning of the 2009 season, the Farmgate Milk Price has been determined in accordance with the Farmgate Milk Price Manual and is independently audited.

3 On 18 November 2009, Shareholders approved stages one and two of the capital structure changes. As a result of the changes to the capital structure all shares are eligible to receive a dividend if declared by the Board. Previously in addition to the Farmgate Milk Price, returns to Shareholder Suppliers were by way of the Value Return payment. The Value Return payment was calculated per kgMS. The dividend payment is calculated on a per share basis using number of shares at 31 May.

4 Average Payout for a 100% share-backed supplier.

5 Retentions are calculated as net profit after tax attributable to Co-operative Shareholders at 31 July divided by number of shares at 31 May, less dividend per share. Profit after tax attributable to Shareholders for 2009 and 2008 has been restated to recognise the tax effects of distributions to Shareholders within tax expense in the income statement. This was previously recorded directly in equity.

6 Total Shareholder Return reflects movements in the Fonterra Fair Value Share (FVS) price plus a return on investment, represented by dividends paid or Value Return payments per share. In 2009 as part of the capital structure changes, the FVS price has been valued on a restricted market basis. The FVS has been held at a base price of $4.52 until the price based on a restricted market value catches up. In 2010, 2011 and 2012 this has meant that Total Shareholder Returns only reflect dividends paid and do not include any movements in the FVS.

7 Average spot exchange rate is the average of the daily spot rates for the financial period.

8 Fonterra's average conversion rate is the rate that Fonterra has converted net US dollar receipts into NZ dollars based on the hedge cover in place.

9 Represents segment earnings before unallocated finance income, finance costs and tax. The years ended 31 July 2011 and 31 July 2010 have been restated to reflect changes to the organisation of business units within reported segments which occurred in the year ended 31 July 2012. For 2009 and 2008, non-recurring items consist of non-recurring items as reported in the segment note plus impairment of equity accounted investees.

10 Profit after tax attributable to Shareholders for 2009 and 2008 has been restated to recognise the tax effects of distributions to Shareholders within tax expense in the income statement. This was previously recorded directly in equity.

	JULY 2012	JULY 2011	JULY 2010	JULY 2009	JULY 2008[1]
CAPITAL EMPLOYED ($ million)					
Total assets employed	**15,117**	15,530	14,169	14,117	14,439
Average net assets[11]	**10,900**	10,772	10,433	10,975	10,702
Total equity	**6,655**	6,541	5,667	4,805	4,269
Equity excluding cash flow hedge reserve	**6,592**	6,025	5,526	4,635	4,357
Net interest bearing debt	**3,833**	3,766	4,268	5,166	5,860
Economic net interest bearing debt[12]	**4,229**	4,331	4,494	5,221	5,931
Return on net assets[11]	**9.4%**	9.3%	8.7%	9.2%	7.4%
Headline debt to debt plus equity ratio[13]	**36.8%**	38.5%	43.6%	52.7%	57.4%
Economic debt to debt plus equity ratio[13]	**39.1%**	41.8%	44.9%	53.0%	57.6%

	JULY 2012	JULY 2011	JULY 2010	JULY 2009	JULY 2008[1]
STAFF EMPLOYED					
Total staff employed (000s, permanent full time equivalents)	**17.3**	16.8	15.8	15.6	15.9
New Zealand	**11.0**	10.8	9.8	9.5	9.5
Overseas	**6.3**	6.0	6.0	6.1	6.4

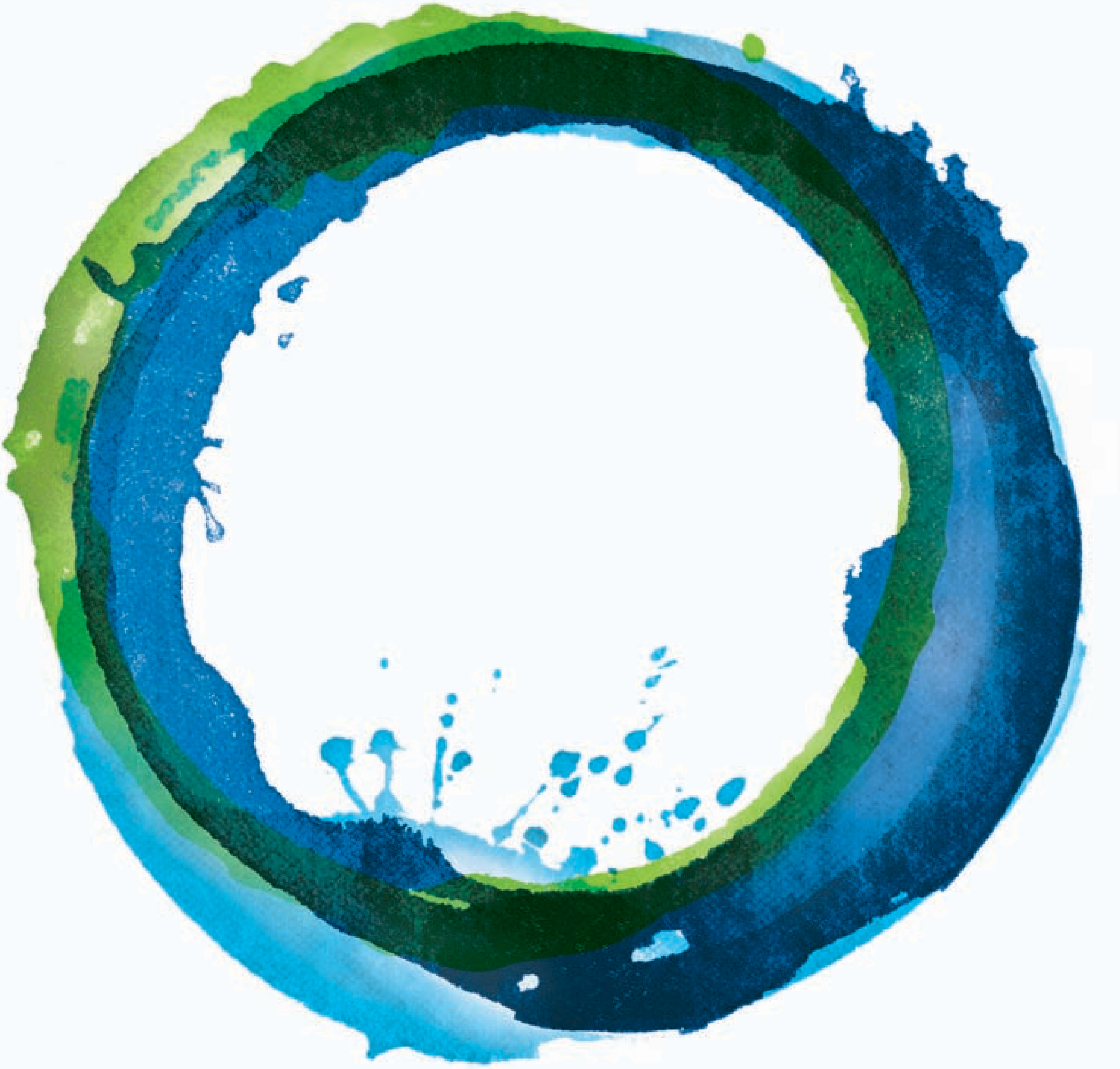
	JULY 2012	JULY 2011	JULY 2010	JULY 2009	JULY 2008[1]
SEASON STATISTICS[14]					
Total NZ milk collected (million litres)	**16,951**	15,427	14,746	14,764	13,862
Highest daily volume collected (million litres)	**81.2**	76.8	72.3	73.7	71.6
NZ Shareholder supply milksolids collected (million kgMS)	**1,463**	1,320	1,256	1,227	1,183
NZ contract supply milksolids collected (million kgMS)	**30**	26	30	54	9
NZ milksolids collected (million kgMS)	**1,493**	1,346	1,286	1,281	1,192
Total number of Shareholders at 31 May	**10,578**	10,485	10,463	10,537	10,724
Total number of sharemilkers at 31 May	**3,595**	3,928	3,733	3,990	3,946
Total number of shares at 31 May (million)	**1,433**	1,377	1,343	1,216	1,261

11 Return on net assets (RONA) is derived by dividing profit before non-recurring items, finance costs and tax (as reported in financial statements, with exception of the 14 month period ended 31 July 2008) by 13 month average net assets (excluding net debt and deferred tax). 2008 RONA is based on unaudited management results for the 12 months to 31 July 2008.

12 Economic net interest bearing debt reflects the effect of debt hedging in place at balance date.

13 Headline debt to debt plus equity ratio is before taking account of the effect of debt hedging. Economic debt to debt plus equity includes the effect of debt hedging.

14 All Season statistics are based on the 12 month milk Season of 1 June – 31 May.



FONTERRA CO-OPERATIVE GROUP LIMITED
PRIVATE BAG 92032
AUCKLAND 1142
NEW ZEALAND

64 9 374 9000 (PHONE)
64 9 374 9001 (FAX)

SHAREHOLDER AND SUPPLIER SERVICES
FREEPHONE 0800 65 65 68

FOR GLOBAL LOCATIONS VISIT WWW.FONTERRA.COM

PRINTED USING 100% MINERAL FREE INKS.

THIS DOCUMENT IS PRINTED ON AN ENVIRONMENTALLY RESPONSIBLE PAPER PRODUCED USING ELEMENTAL CHLORINE FREE (ECF) FSC® CERTIFIED MIXED SOURCE PULP, SOURCED FROM WELL MANAGED AND LEGALLY HARVESTED FORESTS, AND MANUFACTURED UNDER THE STRICT ISO14001 ENVIRONMENTAL MANAGEMENT SYSTEM.