Andrew Ferrier – CEO, Fonterra Co-operative Group
Address to South Island Dairy Event, Invercargill, 23 June 2010

I'm very pleased to share Fonterra's view of the world with you today.

For good reasons, we think it's a world that's hungry for dairy nutrition.

I'll focus a little on size and shape of future demand for dairy, but mostly I wish to share how we're meeting that demand.

We're meeting that demand as the dairy ingredient in our customer's products, and we're meeting it with our own brands in the supermarket aisles of key regions around the world.

POPULATION PRESSURE

6.69 billion – now that's a number that gives me food for thought.

According to the best mathematicians at Google, this was the number of people on our planet on May 10 this year.

But that was six weeks ago. At our current rate of growth there are 200,000 more people per day.

That means 8.8 million more mouths to feed since May 10th. That's 175 new Invercargills in the past 6 weeks alone! Our population has quadrupled over the past 100 years. The latest one billion took just 12 years to arrive.

You can see where all this is going. The world is going to need protein.

TRADE DYNAMICS

Asia, Middle East, Africa and LATAM consume high levels of dairy from imports. These markets represent about 30% of global consumption, but 80% of global trade.

About 10% of China's consumption is derived from imports and for the rest of Asia almost 35% of dairy consumption is derived from imports.

NZ and Australia consume quite a lot derived from trade but are very modest in absolute quantities. Australia and NZ combined, export almost 80% of total milk production.

Around the world, 680 million tonnes of milk are produced each year. Of this 680 million tonnes, the globally traded volume is just 50 tonnes (milk equivalent) or 8.8 million tonnes of dairy products.

That means only around 7% of the world's dairy products are traded globally.

Because NZ exports 95% of our dairy products, that makes us the single largest player. We're almost as big as all the countries in EU combined.

So we're little guys – around just 2% of the global production, but we punch above our weight on the trade side.

If we put aside, for a moment, the complicating factors of global dairy politics, volatile markets and environmental challenges, what I am saying is that the fundamentals are going in the right direction.

The world needs dairy protein, and Fonterra is a natural source.

FONTERRA'S STRATEGIES

Fonterra has three key strategies to establish ourselves as the natural source of dairy nutrition to the world.

Each strategy, broadly aligns with one of the big groups within Fonterra.

Our Trade and Operations group has a big impact on our strategy to achieve *sustainable co-operative performance*.

Our Global Ingredients and Foodservices business heads our strategy to *grow lasting customer partnerships* with the world's leading food companies.

Our ANZ/Asia Middle East and Latin America consumer businesses market Fonterra's spearhead our strategy to *build trusted brands in chosen markets.*

SUSTAINABLE CO-OPERATIVE PERFORMANCE (STRATEGY 1)

My job is to lead the team of more than 15,000 Fonterra employees, based both in New Zealand and all around the world, who work on behalf of our farmer/shareholders.

Our focus is clear – to build a business that drives the best sustainable Milk Price, and that maximises the long term profits from the capital our farmer shareholders have invested in Fonterra. We can't just look to this season, or next.

We've got to secure Fonterra for the future, so its performance and prospects remain positive and promising for the next generation of farmers and beyond.

Manufacturing efficiency

We're continually striving for new benchmarks of efficiency as we seek to lower the cost of processing your milk, to maximise the Milk Price.

Recent projects like Drier 4 at Edendale (ED4) in Southland are showing what can be achieved when massive scale is combined with the latest technology. This is now the most efficient milk powder unit in the world.

In a perfect world, all our plants would be on a par with ED4, or with the likes of our new Drier 3 at Clandeboye. But of course, we can't overnight simply replace perfectly good, if slightly inefficient, stainless steel.

But in those areas where we have a growing milk supply, we can raise the bar on our manufacturing efficiency more quickly as we develop new facilities.

Growing supply helped the business case for ED4, and it's also behind our planning for a new plant at Darfield in central Canterbury, that we're hoping to open in late 2012.

Optimising the supply chain at home

Our sales team is selling 350 tonnes of product every hour of every day, 7 days a week, 365 days of the year.

We have a great opportunity to transform our supply chain, especially out of New Zealand. The sheer scale of our operations across the length and breadth of the country creates a lot of complexity.

Our current supply chain network is also still largely a legacy of the many smaller co-operatives that came together over decades to form the Fonterra we know today.

We currently produce through 80 plants at 26 ingredients manufacturing sites, and move the product out to market via some 80 warehouses and 11 ports.

We used to use third party stores in and around the Waikato. Now, with our Crawford St combined cool and dry store, we've got a central logistics hub in the Waikato.

That's taken more than 65,000 movements off local roads, has allowed us to use rail more and has largely eliminated the need for contracted storage.

By developing more of these hubs, we're reducing the number of warehouses in our network from 80 to 45. That makes a lot of commercial sense and means a better service for our customers.

Global Dairy Trade

Innovation is not just about the way we make products, it's also about the way we sell them.

In this regard, we are proud of our globalDairyTrade electronic trading platform which has hit several milestones this year.

It copped a bit of flack at the start, but years from now, people will look back and see just what a great innovation this was for the industry.

gDT, as we call it, is coming up to its second anniversary and we have just announced it is changing to twice monthly auctions from September.

It's proven itself a credible price discovery mechanism that provides transparency around pricing trends.

So far gDT has sold 500,000 metric tonnes worth US$1.5 billion on the platform. It has grown to 280 qualified bidders from 56 countries, with around half of those bidding in each trading event.

Export supply chain

Every five minutes we close the door on a container of dairy exports out of NZ.

On the transport side, we've started a process of rationalising our port operations around New Zealand's key export ports of Auckland, Tauranga, Lyttelton and Napier.

We're making more extensive use of rail to move product around the country. This will give us access to more frequent, flexible and reliable shipping options – and give our customers greater confidence in our ability to deliver product on time.

Over the three years to 2011, we're aiming for targeted savings of around $200 million in our supply chain. And we believe there's good potential to make further substantial inroads into our supply chain and logistics costs.

20 years ago we exported milk out of New Zealand to different parts of the world.

Now we are a truly global trader of milk. We're sourcing supply from around the world to grow our business. This has changed our customer dynamics.

We service some of the world's largest multinational food companies. They want to partner with us and support our growth, but not if it means taking risks. They do not want to be exposed to the risk of one geographic source. They want year-round supply and they want the most competitive price.

Developing other sources of supply manages risks, and has made us the supplier of choice for many of our customers – which leads in to our second strategy.

GROW LASTING CUSTOMER PARTNERSHIPS (STRATEGY 2)

This is where we really drive our key customer relationships. This is where we plan to achieve significant growth in ingredients and added value products and services for our customers.

It's all about adding value at a wholesale level (with customers) versus at a retail level with consumers.

Customers can use our ingredients in their products they sell to consumers. It's analogous to the 'Intel' which you see on computers. It doesn't matter what brand of computer it is, Intel is part of it

That's why we manufacture our ingredients in around 970 different configurations.

We market these within the three main categories; Dairy ingredients, Value Add ingredients and Specialty ingredients, which I'll look at in turn.

Dairy ingredients

Our range of dairy ingredients includes whole and skim milk powder, butter and AMF, cheese, whey, milk and whey protein, Casein/ate, liquid milks and lactose.

Our customers are some of the biggest names in the food and nutrition industries and increasingly, they are partnering with us in the broader sense of the word.

In some cases our reputation as a reliable global supplier is enabling us now to supply up to 70% of their needs, where-as previously we were only trusted with 30% of their business. Our customers are literally all over the world.

Value-add ingredients

Our value-add ingredients include nutritional bases for infant formula, Growing up Milk Powders and Foodservice solutions.

I have talked before about the huge opportunities in the formulated foods market.

All five of the world's largest infant formula companies have us as their key suppliers and there's strong demand from our customers for us to partner them and expand our business by making and packing their products for them.

Our track record has been outstanding. In 2006, we upgraded plants at two of our New Zealand sites and one of our Australian ones to expand our manufacturing capabilities. We're on track to turn that original $63 million investment into a present day value of over $200 million.

Our sales of nutritional milk powders doubled to $400 million from FY2007 to FY2009.

There's good potential to make similarly healthy returns on future investment. Our key customers have strong growth ambitions and they're looking to us as a preferred source of high-quality paediatric nutrition products.

Our food service solutions are also growing rapidly. Our partnership with one burger chain in Asia Pacific sees our ingredients inside around 200 million burgers, shakes and sundaes per year.

Speciality ingredients

Our third key area for customer partnerships is speciality ingredients. These include: pharmaceutical lactose, paediatric nutrition, functional nutrition such as medical foods, protein solutions, snacks and beverages and our organic ranges.

Ongoing innovation is vital – one of our medical foods in exciting early trials is no ordinary ice-cream – it's called ReCharge, with a dairy protein fraction that's showing promise to counter the side effects of chemotherapy.

We're doing extremely well in pharmaceutical lactose excipients, where we already supply the world's top 100 pharmaceutical companies.

Excipients are inactive substances that are mixed with medications when forming tablets, capsules or powders (such as those used for inhalers). Highly-purified lactose is one of the best.

We've had a 50:50 joint venture with Royal FrieslandCampina in the pharmaceutical lactose space for some time, and the JV has recently acquired another manufacturing unit.

We're in a really strong position to develop and market premium-value lactose solutions that meet the demanding and rapidly evolving requirements of the worldwide pharmaceutical industry.

BUILD TRUSTED BRANDS IN CHOSEN MARKETS (STRATEGY 3)

Our consumer business units are in three key regions: Australia/New Zealand, Asia/Africa/Middle East, and Latin America.

Consumer businesses strengthen our position in key regional markets, where ownership of the supply chain gives us a degree of competitive advantage.

Our consumer businesses have grown profits at a compound annual growth rate of about 20% over the last four years.

Some of our best known brands include Mainland, Bega, Anchor, Ski, Anlene, Anmum and Soprole, however we do not aspire to go truly global with our own consumer brands – we do not have an inherent competitive advantage. It would cost us billions of dollars in new investment, with significant operational risk.

Asia Middle East

I'd like to focus on our Asian/ME Market. The total market is worth NZD$12.5 billion. That's 15 - 20 times the size of New Zealand, and it's growing at 4-5 % per annum.

Consumption will continue to rise. Our consumer and foodservice business stretches across more than 40 countries, with a combined population of around 2 billion people including China.

Fonterra has five plants – two in Malaysia, two in Sri Lanka and one in Saudi Arabia.

We also have 22 co-packing arrangements and more than 1900 staff working in our business.

As you can imagine, each country has very different religious, cultural, political and market entry challenges that come with doing business in Asia and the Middle East.

Our major markets are Malaysia, Sri Lanka, Indonesia, Philippines, and Middle East. Our developing markets include Thailand, Hong Kong, Singapore, Taiwan, Vietnam and Mauritius.

Virtually all of our milk solids come from NZ. Over 80% of our consumer sales volume is now processed or packed in market.

These markets are characterised by low base per-capita consumption and huge populations with increasing incomes. For example current China per capita consumption of 30kg is expected to double to 60kg/capita over the next 10 years.

There's an increasing focus on health and wellness in Asia and Middle East and dairy is widely regarded as gold standard nutrition. Consumers are looking for other formats for dairy, and research-backed nutritional products command a premium in market.

We used to have over 130 brands in Asia – but many of them weren't paying their way. We've pruned them right back to what we call our true power brands Anchor, Anlene and Anmum, supported by our foodservices solution business.

The Anlene example

Anlene - is a great example of our brand strategy at work.

Created in Asia in 1991 to support bone health, Anlene is now the clear number one high-calcium milk brand across Asia and the Middle East. Sales now represent almost one-fifth of total revenue in our Asia/AME segment, bringing in over $320 million per year.

Last year, the brand had an exceptional year, with all countries in Asia/AME improving their market shares for Anlene products by at least 5%. We also launched the brand in China.

We're also investing $2-3 million annually on bone health research, as we look to develop new formats and formulations to extend Anlene use within Asian households.

Since 2006 we've conducted over three million bone scans in Asia/Middle East educating consumers about the risks of osteoporosis.

A research report from the International Osteoporosis Foundation showed that 286 million people in China will suffer from osteoporosis or low bone mass by 2020, and this figure may rise to 533 million by 2050.

A successful recent innovation is Anlene Concentrate, a ready-to-drink format where just one small pack gives four times the calcium of regular milk.

Anlene Concentrate was first launched in Thailand and then in Malaysia, Singapore, Hong Kong, Vietnam, Indonesia and Philippines. It's now a $30 million business with lots of potential for growth.

Priced at 30-50% above regular milks, Anlene is a premium brand and we need to invest accordingly to support it.

Like successful consumer brands the world over, our recent market success with AnleneTM follows a step change in our promotional approach utilising the customer pulling power of our bone health ambassadors such as former 'Bond Girl' Michelle Yeoh, a much-loved action movie star in Asia whose mobility is fundamental to her lifestyle & career.

Watching our footprint

Sustainability is an important aspect of the way we do business. Some of our recent successes include cutting energy use per tonne of product by 34% since 1990, delivering an annual saving over the past five years equivalent to the electricity use of about 100,000 households.

Through our investments in manufacturing, our CO^2 emissions are 300,000 tonnes lower than they would have been for milk processing. We're making further gains in milk collection and transporting our finished product.

More than 90% of Fonterra's waste is reused or recycled and the on-farm emissions efficiency of farmers has been improving at a rate of about 1% per year since 1990. We have active programmes targeting energy use, water and waste with new 'Every Farm Every Year' initiative.

We are active supporting the communities where we live and work. Community initiatives include the KickStart Breakfast programme providing nutritious breakfasts at well over 400 schools, Fonterra Science Roadshow, support for Soong Ching Ling Foundation in China, and local programmes run in all our global businesses.

Summing up

To wrap up today, I wish to take it back to where it all starts – with our farmer's milk. I don't have to tell you all the wonders of the milk. Suffice to say there are more than 3,600 components – and scientists are nowhere near the bottom of it all.

The new buzz word is nutrient density – and milk's got that in spades.

It's a pretty smart product that can help solve two of the world's greatest nutritional problems – help meet the needs of the 80% of people who need to grow *and* the people who need to lose a lot or a little, depending on how its processed.

So Fonterra's in a great place right now. Dairy and dairy protein is increasingly becoming a preferred choice for healthy nutrition.

We already have a strong reputation as a key global player in dairy. We've a robust business footprint and brand presence in emerging market regions such as Asia, the Middle East and South America where demand is growing the strongest.

Fonterra's roots are most definitely in New Zealand, in our reputation for quality, integrity and Kiwi ingenuity.

But the value in the Fonterra brand now extends well beyond the shores of New Zealand. It represents a powerful asset that's been built up over decades of hard work, risk-taking and bold innovation by farmers and the people of Fonterra.

New Zealand farmers own this asset and have a great opportunity to build on their foundation.

We're excited about what the future holds for Fonterra and for New Zealand as we take our natural dairy nutrition to the world.

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