

Turning around the milk tanker

- After a poor 2014/15, Fonterra has posted improved 2015/16 results.
- And, signals further improvement over 2016/17.
- For our part, we are cautiously optimistic on further financial improvements, while maintaining our confidence on a lifting milk price.

Summary

Fonterra has had a better year. Normalised EBIT was up 39%. Net profit after tax was up 65%. Debt was reduced by \$1.6 billion. And return on capital lifted to 12.4% from 8.9%.

At first glance, these numbers were all very positive – but, in short, they needed to be. Last year’s results were, to put it plainly, poor. As a result, comparisons with last year will always flatter this year’s results. Indeed, the improvement this year was both needed and expected.

In that context, it is not the turnaround in this year’s results that will shed light on Fonterra’s performance and strategy. **Instead, it is what happens from here that matters.**

Looking ahead, the signs are positive so far. Fonterra has signalled further improvements are likely over 2016/17. However, of course there is a lot that can happen between now and the end of the new financial year. As such, the proof will be in the pudding.

Comments

Fonterra has announced improved financial results over the 2015/16 financial year. Earnings per share settled at 51 cents, compared to 29 cents in 2014/15. The cash dividend was also confirmed at the previously-indicated 40 cents.

However, the cash payout for farmers fell from 2014/15. All up and with the milk price confirmed at \$3.90/kg, the cash payout settled at \$4.30/kg. This was 35 cents lower than the \$4.65/kg for 2014/15.

Nonetheless profits were better, with normalised EBIT lifting 39% from 2014/15 to \$1.4 billion. This translated into net profit after tax of \$834 million (up 65%). And all up this higher profit generated a return on capital of 12.4%, compared to 8.9% last year.

Similarly, Fonterra’s balance sheet ended the year in a stronger position. Debt reduced by \$1.6 billion to \$5.5 billion, while Fonterra’s gearing ratio fell to 44.3% from 49.7%.

Fonterra is also looking to build on this year’s result over 2016/17. It has signalled an earnings per share range of 50 to 60 cents. When combined with the freshly-minted milk price forecast of \$5.25/kg, Fonterra forecasts the cash payout to be \$5.60/kg or above.

Implications

For us, Fonterra has made financial par over 2015/16. But as stated above, the proof that its strategy is starting to work will be more evident in the 2016/17 and subsequent years.

On the milk price side, we are more confident - we maintain our 2016/17 milk price forecast of \$6.00/kg. In that sense, Fonterra achieving its forecast earnings this year would be the cherry on top of a much improved milk price this year.

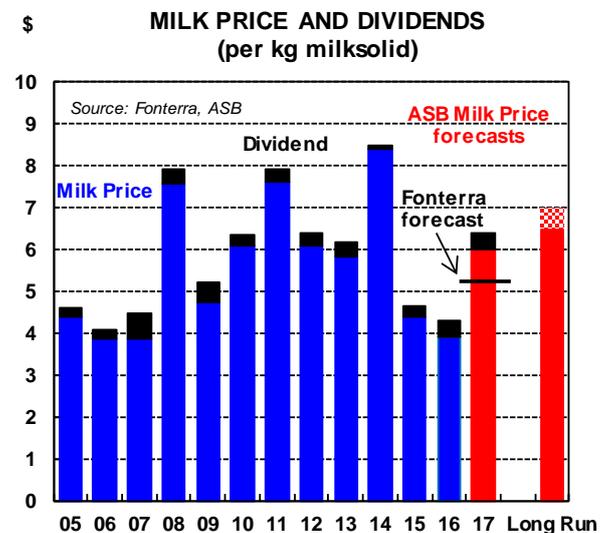
2015/16 Financial Results

	2015/16	2014/15	Change
Revenue	\$17.2bn	\$18.8bn	-9%
Normalised EBIT	\$1.358 bn	\$0.974 bn	+39%
Net profit after tax	\$834m	\$506m	+65%
Return on capital	12.4%	8.9%	+3.5 pts
Debt	\$5.5bn	\$7.1bn	-23%
Gearing ratio	44.3%	49.7%	-5.4 pts
Earnings per share	\$0.51	\$0.29	+76%
Cash payout (per kg MS)	\$4.30	\$4.65	-8%
Farmgate milk price	\$3.90	\$4.40	-11%
Cash dividend per share	\$0.40	\$0.25	+60%

Season end milk price forecasts

	2015/16	2016/17		Long Run
	Final	Fonterra	ASB	ASB
Milk Price*	\$3.90	\$5.25	\$6.00	\$6.50-\$7.00

* per kg of milk solids (excluding dividend).



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