THE NATURAL SOURCE OF DAIRY NUTRITION

FONTERRA ANNUAL REPORT 2010

FONTERRA CO-OPERATIVE GROUP LIMITED

…FOR EVERYBODY, EVERYWHERE, EVERY DAY

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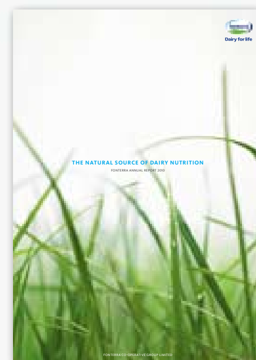
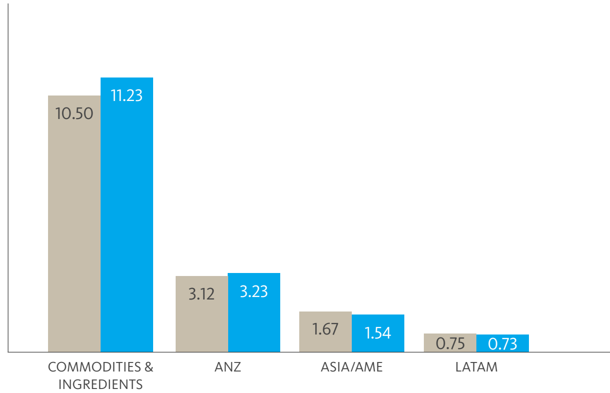


COVER GRASS SUPPLIED BY KELVIN REEVES,
FONTERRA SUPPLIER # 71238

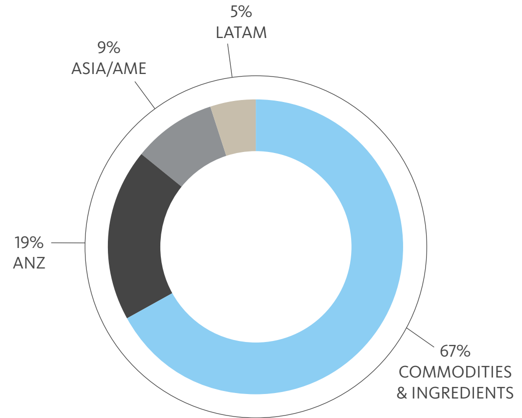
2010 AT A GLANCE

SEGMENT REVENUE

$ BILLION

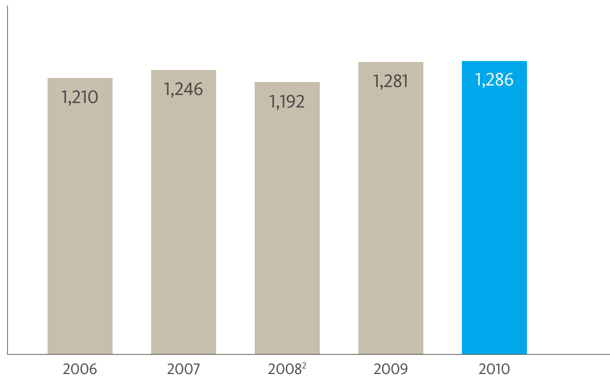


SHARE OF REVENUE 2010



SEASON[1] MILK PRODUCTION

MILLION kgMS

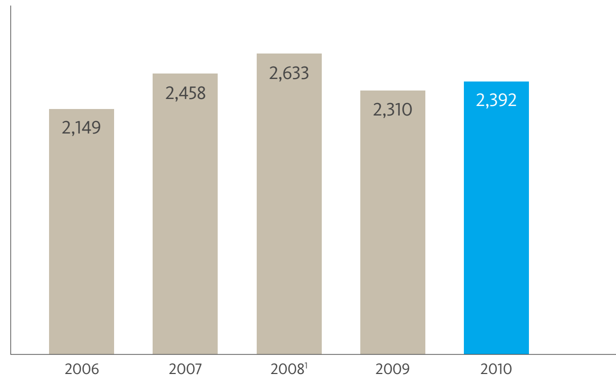


1 Season is the year ended 31 May

2 2008 affected by drought

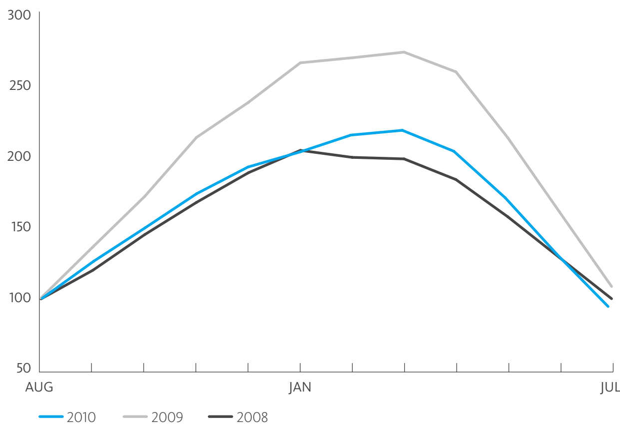
TOTAL INGREDIENTS SALES VOLUME

THOUSAND TONNES

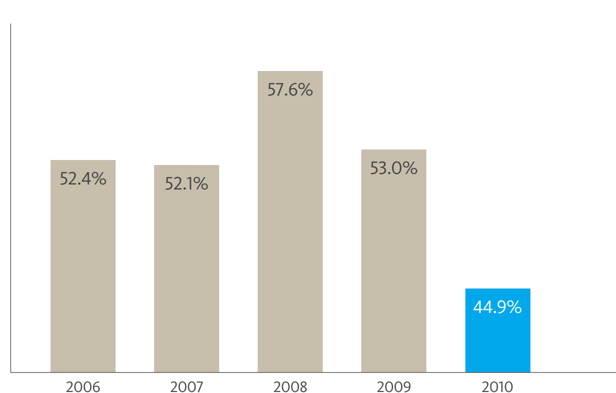


1 2008 = 14 months

INVENTORY VOLUME INDEX



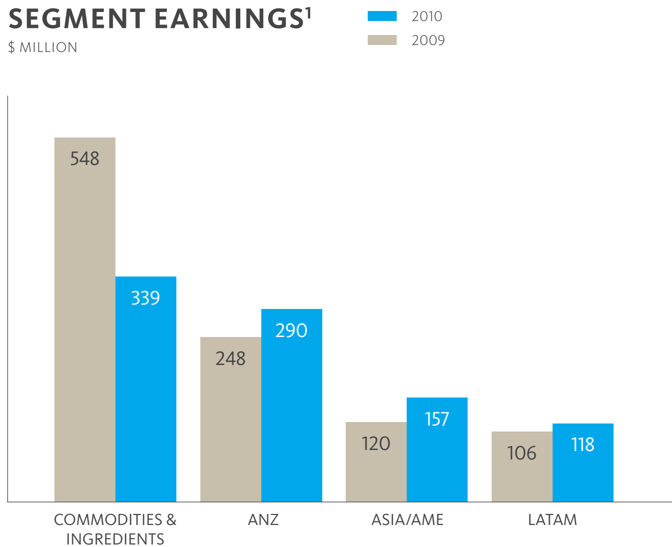
GEARING[1]



1 Gearing is measured in terms of economic net interest bearing debt over economic net interest bearing debt plus equity (reflecting the effect of debt hedging in place at balance date). Equity excludes cash flow hedge reserve.

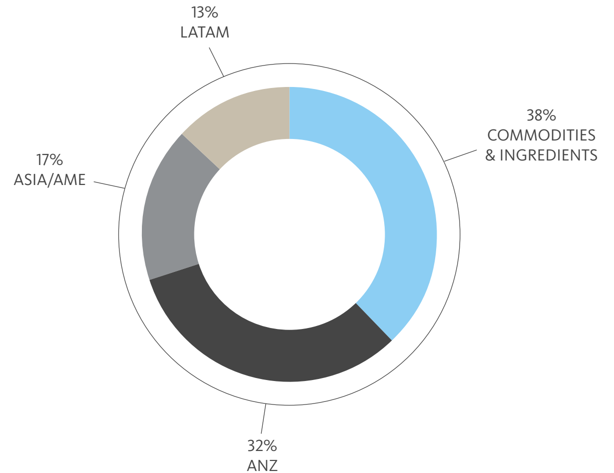
SEGMENT EARNINGS[1]

$ MILLION



1 Normalised segment earnings adjusted for non-recurring items, before impairment of equity accounted investees

SHARE OF EARNINGS 2010



FONTERRA IN THE WORLD

OFFICE LOCATIONS

Auckland, New Zealand
Hamilton, New Zealand
Melbourne, Australia
Singapore
Shah Alam, Malaysia
Bangkok, Thailand
Ho Chi Minh City, Vietnam
Pasig City, Philippines
Quezon City, Philippines

Biyagama, Sri Lanka
Jakarta, Indonesia
Hong Kong
Taipei, Taiwan
Seoul, South Korea
Tokyo, Japan
Beijing, China
Shanghai, China
Guangzhou, China

Cairo, Egypt
Dubai, United Arab Emirates
Dammam, Saudi Arabia
Jeddah, Saudi Arabia
Algiers, Algeria
Midrand, South Africa
Amsterdam, Netherlands
Cernusco Lombardone, Italy
Moscow, Russia

Chicago, USA
Mexico City, Mexico
Sao Paulo, Brazil
Santiago, Chile
Caracas, Venezuela

TECHNICAL CENTRES

Palmerston North, New Zealand
Melbourne, Australia
Chicago, USA
Hamburg, Germany*

Does not include all manufacturing sites, or all global offices.

* The technical centre in Hamburg is moving to Amsterdam in March.

CHAIRMAN'S REPORT

SIR HENRY VAN DER HEYDEN CHAIRMAN

"The strength we have in our Co-operative is a strength for New Zealand. Fonterra is in good heart."

$6.70
PAYOUT
(BEFORE RETENTIONS)

$6.10
MILK PRICE
(PER kgMS)

27c
DIVIDEND
(PER SHARE)

33c
RETENTIONS
(PER SHARE)

2010 STANDS OUT as our most significant financial year since Fonterra was formed almost a decade ago. Notably, our farmer shareholders voted for capital structure improvements to provide the Co-operative with a stronger foundation for the future. It was also a successful year for farmer returns, with much stronger international dairy prices driving the second-highest Milk Price and improved business performance leading to higher profits in our consumer businesses. As a result, the farmer Payout was the second-highest achieved by Fonterra, a total distribution of $8.0 billion. We also made excellent progress in strengthening the balance sheet.

Perhaps most significantly, the intensive consultation we went through over many months as part of capital structure evolution required everyone involved to think hard about Fonterra. About what we stand for as a co-operative. About our collective contribution to New Zealand's economic prosperity. About the business strategies to achieve the best sustainable returns for farmer shareholders.

This robust discussion has increased everyone's awareness of the excellent prospects for New Zealand dairying in a world that is increasingly attracted to dairy as a healthy, natural source of nutrition. It has increased our collective understanding of the need to make the most of profitable business opportunities and maintain Fonterra's industry leadership both in New Zealand and internationally. It has refreshed our co-operative spirit and galvanised support for Fonterra's vision and strategy – not just from farmer shareholders but among our other stakeholders. I firmly believe our Co-operative has never been in better heart.

We have also seen a reassessment of the important place that dairying and Fonterra have in New Zealand. This has been a year in which our strong dairy returns stood out as an economic backbone – our *global*DairyTrade™ events have become a widely followed economic indicator. With the debate around foreign ownership, rural and urban New Zealand have been contemplating the protection of our pastoral land and dairying as key strategic assets. There has also been continued healthy public scrutiny of our industry, particularly around the environment.

We are seeing New Zealanders discussing what is in our country's best interests and looking at it through fresh eyes. The level of involvement and debate ensures that we will make the right decisions and keep building and enriching New Zealand's economic, social and cultural future.

Among our farmers too, I have seen a renewed recognition of the value of the Co-operative. Not just in driving returns right now, but in sustaining this benefit for our children and grandchildren. As a Co-operative we have collective strength and scale in the world. By controlling the value chain from our farm gates through to the market, we can maximise our returns and the contribution of dairy to New Zealand. We can avoid the fate of other sectors who have failed to work together and have become weak sellers, price takers.

The strength we have in our Co-operative is a strength for New Zealand. So I repeat that Fonterra is in good heart.

Looking back on the past 18 months, it's rewarding to see how well Fonterra came through some of the worst market and economic conditions experienced in living memory. We improved our profits and significantly strengthened our balance sheet in each of the past two years. This performance has underlined the Co-operative's resilience and inherent strengths of operational scale, solid market positions and strong customer relationships.

Although business conditions remained volatile and uncertain, and parts of the country were again affected by drought, the overall environment was generally much better for our farmer shareholders over this financial year. With customer demand returning, dairy prices rose sharply. In addition, Fonterra's hedging policy shielded farmer shareholders from the full brunt of a strengthening New Zealand Dollar.

FARMER RETURNS & PROFIT PERFORMANCE

Fonterra achieved a Payout (before retentions) for the 2009/10 season of $6.70, significantly ahead of the previous year's $5.21. This year's Payout comprises a Milk Price of $6.10 per kilogram of milksolids (kgMS) and a dividend of 27 cents per share, with retentions of 33 cents per share. As the annual dividend includes an interim dividend of 8 cents per share paid in April 2010, a final dividend of 19 cents per share will be paid on 20 October 2010.

"I have seen a renewed recognition of the value of the Co-operative. Not just in driving returns right now, but in sustaining this benefit for our children and grandchildren."

"Our farmer shareholders voted for capital structure improvements to provide the Co-operative with a stronger foundation for the future."

This result means farmer shareholders will on average receive a cash Payout of $6.37 for each share backed by milk production they hold and an annual dividend of 27 cents for each additional 'dry' share they hold.

The $6.10 per kgMS Milk Price is well up on last season's $4.72 per kgMS, only beaten by the $7.59 per kgMS achieved in 2007/08, and has put some health back into farm cash flows. It is also substantially ahead of the season's opening forecast of $4.10 per kgMS, reflecting the strong recovery in global dairy prices that occurred during the year.

The Distributable Profit of 60 cents per share is substantially ahead of the 49 cents per kgMS achieved in 2008/09.

The improved profitability primarily reflects another excellent year of earnings growth by our consumer businesses despite the adverse effects of a higher New Zealand dollar against most of the overseas currencies in which these businesses operate. Our profit was also helped by non-recurring items, especially one-off gains from asset sales as we reshaped our business portfolio in line with our strategy.

The level of retentions this year reflects the Board's decision to retain all earnings from non-recurring items as well as its previously-stated intention to increase the use of retentions to fund ongoing investment in New Zealand manufacturing and offshore activities.

CAPITAL STRUCTURE EVOLUTION

During the year, our farmer shareholders made a series of important decisions to strengthen Fonterra's capital structure and secure the Co-operative's future in an increasingly competitive and volatile environment.

On 30 June, we voted in changes to the Co-operative's constitution that will allow steps to be taken to implement share trading among farmers. This was the third of a three-step process, with the first two steps gaining shareholder approval at the annual meeting in November 2009. All three steps received almost 90 per cent support from farmers voting and the voter turnout was particularly strong for the June special meeting, with those who voted representing almost 80 per cent of our Co-operative's milksolids. This is a clear mandate for change and signalled a strong sense of unity among our farmers.

Under Trading Among Farmers, farmers will buy and sell shares from one another through a market, rather than via the Co-operative. Fonterra will no longer be obliged to pay cash to farmers redeeming shares when they are leaving the Co-operative or reducing milk supply. The change will provide Fonterra with permanent share capital, meaning money will no longer wash in and out of the balance sheet from season to season. This will improve our ability to make long-term business and investment decisions to shape the Co-operative's ongoing success. We can now invest with confidence in projects without the concern that money might be needed to fund redemptions. Permanent share capital will also make profit retentions a more effective means of strengthening the balance sheet, as the Board can decide to retain profits safe in the knowledge the money will stay in the Co-operative.

Conditional on legislative changes being approved by Parliament, we are currently targeting a start for Trading Among Farmers sometime in 2011/12. Fonterra management have already begun work on implementation steps and the Shareholders' Council will continue to be closely involved in the process over the period ahead.

INDUSTRY ISSUES

When Fonterra was formed in 2001, the Government was rightly concerned at the impact such a large co-operative would have on the ability of other processors to compete for milk supply. Under the Dairy Industry Restructuring Act (DIRA), we were required to supply up to 600 million litres of raw milk (representing about four per cent of our current supply) to other processors each year. We expect to get close to this threshold in the 2010/11 season.

We are now supplying raw milk to 25 different companies on this basis. We accept this obligation to help start-ups and processors without their own milk supply. However a significant proportion of this milk now goes to larger processors who have their own local milk supply, are increasingly foreign-owned and are competing with us in overseas markets.

Additionally, these competitors use the regulated milk to fill their own processing plants at times of the year when milk supply is low. For instance, during one week in August 2010, almost 60 per cent of the supply to our

Clandeboye site in South Canterbury was diverted to other processors – leaving just 40 per cent for use at our own plant. This erodes returns to our farmers.

Although the Government has increased the regulated milk price with effect from the 2010/11 season to be priced at a margin of 10 cents per kgMS above Fonterra's Milk Price, it decided in August 2010 to extend our regulated supply obligations beyond previous trigger points. While we are disappointed in this extension, we welcome the Government's intention to review the eligibility criteria for access to regulated milk. We look forward to providing input in relation to this review.

BOARD OF DIRECTORS

Following Director elections, Stuart Nattrass stepped down from the Board at the 2009 annual meeting. Stuart was elected in 2003 and on behalf of my fellow Directors, I would like to thank Stuart for his valued contribution during an important phase in Fonterra's development. Nicola Shadbolt was elected as a farmer Director and we have welcomed her contribution and perspective at Board and committee level over the past year.

SHAREHOLDERS' COUNCIL

The Fonterra Shareholders' Council was especially valued during the capital structure deliberations. There was plenty of healthy discussion as we worked towards a quality solution that addressed the Co-operative's strategic needs while meeting the aspirations and concerns of shareholders.

Following the successful 30 June vote, Council Chairman Blue Read and Deputy Chairman Campbell Shearer stepped down after three years and two years respectively in their roles. On behalf of my fellow Directors, I would like to thank Blue and Campbell for their individual contributions. We look forward to working with their successors, Simon Couper as Chairman and Ian Brown as Deputy Chairman.

CONCLUSION/OUTLOOK

In May 2010, we announced an opening forecast Payout (before retentions) for the 2010/11 season of \$6.90-\$7.10. In September, we firmed up this forecast to a range of \$7.00 -\$7.10. It combines a forecast Milk Price of \$6.60 per kgMS and a forecast Distributable Profit range of 40-50 cents per share. The Board is targeting a dividend range for 2011 of 25-35 cents per share, which is consistent with our stated dividend policy to distribute 65-75 per cent of Distributable Profit (taking into account factors such as non-recurring items).

The year ahead is shaping up as another very good year for our Co-operative. A Payout at this level would mean the four seasons 2007/08 to 2010/11 would rank among the top five in terms of total cash returns.

While the fundamentals for global dairy markets continue to point to balanced supply and demand, there is still considerable volatility and uncertainty in both dairy prices and the New Zealand Dollar. Global market prices have fluctuated significantly in recent months.

Dairy is in a real sweet spot, with huge and growing opportunities across Asia, the Middle East and Latin America as a result of global population growth and trends towards foods with health and nutrition benefits.

Our business operations are in good shape. We have an excellent reputation globally as a leading dairy provider, a strong business footprint and brand presence in the world's fastest-growing dairy markets. We have a great strategy to build on some exceptional opportunities to continue to strengthen our business and drive the best returns for our shareholders. We have addressed capital structure issues and can look forward to the benefits of a more stable capital base for our business in future years.

We have a renewed spirit and passion for the Co-operative. While there are bound to be unexpected challenges, everyone involved with Fonterra should approach the new financial year with optimism.

SIR HENRY VAN DER HEYDEN
Chairman

BOARD OF DIRECTORS

SIR HENRY VAN DER HEYDEN has been Fonterra Chairman since 2002. He is also Chairman of the Appointments, Remuneration and Development Committee. Sir Henry is a Director of Auckland International Airport Ltd, King St Advertising Ltd, Independent Egg Producers Ltd, Northern Feed Mill Ltd, Elevation Capital Ltd, Pascaro Investments Ltd and Manuka SA Ltd. He is a member of Rabobank's Australasian Food & Agribusiness Advisory Board.

COLIN ARMER was elected to the Board in 2006 and chairs the International Milk Sourcing Advisory Group. Colin sits on the Audit, Finance and Risk Committee, the Appointments, Remuneration and Development Committee, the Government and Trade Relations Committee and the Governance Development Programme. He is also a Director of Dairy Holdings Ltd. Over the past 30 years Colin and his wife Dale have built up dairy farming interests in the Bay of Plenty and Central Plateau region of the North Island.

MALCOLM BAILEY was elected to the Board in 2004, and chairs the Shareholder Relations Committee and the Milk Price Working Group. Malcolm is also a member of the Audit, Finance and Risk Committee and the Government and Trade Relations Committee. Malcolm is Fonterra's representative on the International Food and Agriculture Trade Policy Council and the Dairy Companies Association of New Zealand. He is also a Director of Embryo Technologies Ltd, Hawke's Bay Dairies Ltd, Hopkins Farming Group Ltd and Agrico Holdings Ltd. His farming interests are as a shareholder in the Hopkins Farming Group and he lives on a 200 hectare dairy support block near Feilding.

JOHN BALLARD was appointed as an independent Director in May 2006. He serves on the Appointments, Remuneration and Development Committee and the Health and Safety Committee. He has served on the Boards of several listed companies including Woolworths Ltd, CSR Ltd, Rinker Ltd, Email Ltd and Southcorp Ltd, where he was CEO. He is currently Chairman of Elders Ltd, a Director of Magellan Flagship Fund Ltd, a Director of International Ferro Metals Ltd and Chairman of the Advisory Boards of Pacific Equity Partners. His farming interests extend to a property producing milk-fed veal in New South Wales.

IAN FARRELLY was elected to the Board in 2007 and is a member of the Audit, Finance and Risk Committee, the Shareholder Relations Committee and the Milk Price Working Group. He is a Director of First Mortgage Managers Ltd, FD Lands Ltd and the Spectrum Group of Companies. He runs a 400 hectare calf rearing farm in Te Awamutu, owns a 50% share in three Waikato dairy farms and also has ownership in dairy farms in Canterbury.

GREG GENT has been a Board member since Fonterra's formation. Greg is a member of the Audit, Finance and Risk Committee, the Fair Value Share Committee, the Government and Trade Relations Committee, the Milk Price Working Group and the International Milk Sourcing Advisory Group. He is also Chairman of FMG Insurance Ltd, a Director of Equestrian Sports NZ Ltd and a Director of the Northland District Health Board.

DAVID JACKSON was appointed to the Board as an independent Director in August 2007. David is Chairman of the Audit, Finance and Risk Committee and serves on the Fair Value Share Committee and the Health and Safety Committee. David serves on the Boards of several companies including Pumpkin Patch Ltd, Nuplex Industries Ltd and is Chairman of The New Zealand Refining Company Ltd. David spent more than 30 years with accounting firm Ernst & Young in a variety of roles. He served as Chairman of the Board of Management for Ernst & Young Ltd New Zealand from 1999 to 2002.

JOHN MONAGHAN was elected to the Fonterra Board in 2008. He is the Chairman of the Government and Trade Relations Committee and a member of the Appointments, Remuneration and Development Committee, Shareholder Relations Committee, Fair Value Share Committee, the Milk Price Working Group, the Capital Structure Committee and the Governance Development Programme. He is also a Director of Waimana Dairy Ltd. John's dairy farming interests include farms in the Wairarapa and Canterbury.

NICOLA SHADBOLT was elected to the Board in November 2009 and is a member of the Shareholder Relations Committee, the Milk Price Working Group and the Capital Structure Committee. She is the NZ representative on the International Farm Comparison Network in Dairying. Nicola's farming interests include membership of five farmer co-operatives and she runs two dairy farms in the Manawatu. Nicola is a Fellow of the New Zealand Institute of Primary Industry Management.

JIM VAN DER POEL was elected to the Board in 2002 and serves on the Fair Value Share Committee, the Government and Trade Relations Committee, the Shareholder Relations Committee, the Milk Price Working Group and the International Milk Sourcing Advisory Group. He is Chairman of the Spectrum Group of Companies and a trustee of the Asia NZ Foundation. Jim has won a number of industry awards including the AC Cameron Award, 2002 Nuffield Scholarship, Sharemilker of the Year and the Dairy Exporter Primary Performer Award. Jim and his wife Sue live at Ngahinapouri in the Waikato.

JOHN WALLER joined the Board as an independent Director in February 2009. John chairs the Fair Value Share Committee and is a member of the Audit, Finance and Risk Committee. John is Chairman of BNZ, the Eden Park Redevelopment Board, the Eden Park Trust and a member of the Auckland Transition Agency. John is also a Director of National Australia Bank Ltd, BNZ Investments Ltd, Haydn & Rollett Ltd, National Equities Ltd, Alliance Group Ltd, Sky Network Television Ltd and Donaghy's Ltd. John was a partner at PricewaterhouseCoopers for more than 20 years. He was a member of the Board and led their Advisory practice for many years.

RALPH WATERS was appointed to the Board as an independent Director in July 2006 and chairs the Health and Safety Committee. Ralph also serves on the Appointments, Remuneration and Development Committee. Ralph also serves as Chairman of Fletcher Building Ltd and Fisher & Paykel Appliances Holdings Ltd and a Director of Westpac New Zealand Ltd. He was Chief Executive of Fletcher Building from May 2001 until his retirement in August 2006. Before joining Fletcher Building, Ralph was managing director of the Australian publicly-listed company Email Ltd, and has also held a number of engineering and managerial positions in London and the Middle East.

JOHN WILSON was elected to the Board in 2003. He is on the Appointments, Remuneration and Development Committee, the Fair Value Share Committee, Government and Trade Relations Committee, Health and Safety Committee and the Candidate Assessment Panel. He chairs the Capital Structure Committee. John is the Chairman of South Auckland Independent Testing Society Ltd and a member of the Institute of Directors. In 2000 he was awarded the Nuffield Scholarship. John lives on his dairy farm near Te Awamutu and also manages a dairy farming business based in Geraldine, South Canterbury, which he holds joint ownership in.

CHIEF EXECUTIVE'S REPORT

ANDREW FERRIER CHIEF EXECUTIVE

"While much of the world continued to battle its way out of the recession, Fonterra delivered a good year for our farmer shareholders."

$16.7b
REVENUE

$685m
PROFIT

2,392
TOTAL INGREDIENTS SALES VOLUME
(THOUSAND TONNE)

44.9%
GEARING

AT FONTERRA, our goal is to build a business that pays our farmer shareholders the maximum sustainable price for their milk in accordance with the Milk Price Principles, and that maximises profits from the capital invested in the Co-operative. While much of the world continued to battle its way out of the recession, Fonterra delivered a good year for our farmer shareholders:

- We achieved our second-highest Milk Price on the back of improved world dairy markets.
- Although the impact of the higher Milk Price reduced underlying earnings within our ingredients operations, our consumer businesses achieved record earnings despite their contribution being eroded by a stronger New Zealand dollar. We also booked significant one-off gains from asset divestments as we reshaped our business portfolio in line with our strategy.
- The net outcome was a profit of $685 million, 12 per cent higher than the prior year.
- Our balance sheet is in its best shape in Fonterra's history, with reduced debt levels and a stronger equity position.
- After very strong consultation with our farmer shareholders and amid great co-operation between the Board, Shareholders' Council and management, our shareholders overwhelmingly supported crucial improvements to our capital structure, helping secure Fonterra's longer term future.

The Milk Price for the 2009/10 season of $6.10 per kilogram of milksolids (kgMS) was 29 per cent higher than the previous season's $4.72 per kgMS – reflecting a strong improvement in international prices for standard dairy ingredients as customer demand recovered from the effects of the global financial crisis.

The profit reflected a year of mixed underlying earnings within our key business units. The consumer businesses had another excellent performance, despite the significant impact of foreign exchange movements that reduced earnings when translated into New Zealand Dollars. On a normalised basis (adjusting for one-off items), combined earnings were 19 per cent higher. Our Australia/New Zealand (ANZ), Asia/Africa, Middle East (Asia/AME) and Latin America (Latam) segments all posted higher normalised earnings.

Our ingredients businesses had a challenging time as the sharp rise in dairy market prices eroded profit margins. On a normalised basis, earnings from our Commodities & Ingredients (C&I) segment were 38 per cent lower than the previous year.

The profit included $174 million of non-recurring gains, primarily arising from sales of non-strategic assets. Profitability was also helped by a $135 million reduction in net finance costs, as reduced borrowing requirements flowed through into lower interest payments. At 31 July 2010, our economic net interest bearing debt was $4.5 billion, $727 million lower than a year earlier.

We were able to reduce debt levels primarily because of increased support of Fonterra by our farmer shareholders, who invested $459 million in additional shares. This, as well as a higher level of retentions, drove an increase of $862 million in equity. In addition, we had a strong push across the Group to reduce the amount of working capital in the business. As a result, Fonterra's economic gearing ratio reduced to 44.9 per cent at 31 July 2010, down from 53.0 per cent a year earlier.

We had two strong shows of confidence from our shareholders in the past year, with votes in November 2009 and June 2010 in favour of important improvements in Fonterra's capital structure. With these two votes paving the way for the implementation of the Trading Among Farmers market for Fonterra shares, Fonterra is poised to remove redemption risk. We will also be in a position to access further capital to strengthen our competitive position through investment and growth, both directly from our farmers through subscriptions of 'dry' shares, as well as through ongoing retentions.

But we shouldn't just look at this year's performance in isolation. Our business today has a rich heritage that extends all the way back to 1871, when New Zealand's first co-operative dairy factory was opened. In respecting this legacy, we have to secure Fonterra for the next generation of farmers and beyond, and ensure dairying continues its important contribution to the New Zealand economy.

Managing Fonterra over recent years has been a bit like assembling a giant jigsaw puzzle. Following the 2001 merger, it wasn't just a case of bolting together three very different organisations, each with their distinct business footprints and fiercely competitive cultures. That would have been a big enough job in itself. Rather, we have had to paint a new picture of what Fonterra should aspire to be, take a good hard look at all the component parts across a myriad of businesses, systems and brands spread around the world, and begin to put the pieces together according to this new vision. And we have had to do this carefully and progressively, making sure that every day of the year we continue to collect, process and market our farmers' milk.

Our challenging journey since 2001 has given us a stronger sense of vision. We know we want to be: *The natural source of dairy nutrition for everybody, everywhere, every day*. Like any good vision, this is aspirational. But it is grounded in reality – starting with the lush green grass found on every New Zealand dairy farm. It speaks to our strengths, the fact that we bring the goodness of dairy to the world through our products, our people, our customers and business relationships. It says we want Fonterra to be the first choice, the natural, obvious choice, for dairy nutrition.

DELIVERING SUSTAINABLE CO-OPERATIVE PERFORMANCE

At the heart of Fonterra is a vast engine fuelled by New Zealand farmers' milk. In 2009/10, this engine collected 14.7 billion litres of raw milk from 4.5 million cows, representing about 89 per cent of the milk produced in New Zealand.

That milk is turned into dairy products at 86 manufacturing plants across 26 sites and moved out to market through more than 90 warehouses and 11 ports. It's delivered to a large number of end customers, through the efforts of our sales team that sells on average 250 tonnes of New Zealand product every hour, every day throughout the entire year.

Our objective is clear: to make and supply dairy products more efficiently than anyone else, and get the best possible prices by meeting customer demand with the right products, in the right quantities at the right time.

A strong incentive for us to get this right is our goal to pay the maximum sustainable Milk Price. This is derived using a methodology based on international market prices for a range of standard dairy products, less what it would cost an efficient producer to make those same products. This gives farmers confidence their milk cheque fairly reflects what their milk is worth on global markets. That is vitally important in ensuring we maintain our strong milk supply, in what is an increasingly competitive New Zealand marketplace.

Fonterra's ingredients-focused businesses earn a margin by producing and selling a mix of dairy products at higher average prices than those

MANUFACTURING GAINS ADD EXTRA CAPACITY OVER THE PEAK

Productivity gains achieved this year of up to 4.5 per cent in some of Fonterra's largest milk processing plants have allowed greater volumes of milk powders to be produced over the peak months.

For some plants this has added the equivalent of nine additional days' production (or about 4,000 tonnes of production for a single drier).

As part of a focus on 'Operational Excellence', the incremental gains across Fonterra's 86 manufacturing plants in New Zealand have been achieved by improving plant reliability, reducing cleaning and start-up times, pre-emptive maintenance and problem-solving.

The overall gain of nearly one per cent in the utilisation of existing manufacturing plants in New Zealand has allowed greater processing flexibility and increased production of key dairy ingredients in response to global pricing signals. This is akin to adding another small processing plant to Fonterra's New Zealand capacity over the peak months, when more than 70 million litres of milk can be processed in a single day.

making up the Milk Price, while keeping operating costs as low as possible. As pricing movements can vary significantly across ingredient categories, getting our product mix right is important, although switching production among categories can be a challenge, especially when our plants are full during seasonal peaks. We are also continuing our push into more higher-value ingredients. The better we can do these things, the more profit we can make for our farmer shareholders.

The Milk Price is a demanding benchmark. In 2010, margins within our C&I reporting segment were pressured as the strong rise in global dairy prices meant that the prices for some products, such as cheese and casein, lagged international powder prices that are the main drivers of the Milk Price. With the strong rise in powder prices, the pricing of some of our customer contracts also lagged the rapid increase in spot market prices and the rise in the Milk Price. These two factors put pressure on profit margins in the ingredients businesses.

The net result of this margin squeeze was that normalised profit before net finance costs and tax from our C&I segment was $339 million, $209 million (38 per cent) lower than the prior year.

Although the impact of these factors has been negative in 2010, it is important to note that, in years of global price downturns, the lag effect of contracts and of certain non-powder streams can have a contrasting positive impact on C&I's profits. We are undertaking measures that will, over time, reduce the volatility of these factors on our income.

At the start of the 2010 financial year, we brought our manufacturing, supply and trading activities together under the leadership of Gary Romano into Fonterra Trade & Operations (FTO), which forms part of the C&I reporting segment. The aim was to get all these activities, spread across New Zealand and around the world, working together more effectively. This will help us become even better at collecting farmers' milk and turning it into the most valuable product, as efficiently as possible, every day. The scale and reach of Fonterra's operations creates enormous logistics complexities. But it also means the prize is bigger if we make the right step-change. We're on track to achieving our goal of targeted savings of $200 million in our supply chain over the three years to 31 July 2011.

It starts right from the farm gate. In the past year, we've driven further cost efficiencies in milk collection. That said, the trade-off between lower costs and improved service quality in milk collection is an ongoing challenge. We've stepped up our personal contact, with farm visits by area managers increasing from 13,200 to around 17,500. We've also made good use of technology to improve farmer communication; around 90 per cent of farmers are now regularly using our Fencepost website, which was re-launched during 2009.

When it comes to processing, size does matter as we push for new benchmarks of efficiency. Projects like Drier 4 at Edendale (ED4) in Southland, which had a successful first season of operation in 2009/10, show what can be achieved when massive scale is combined with the latest technology. ED4 is the most efficient powder drier in the world and can produce a tonne of milk powder at around 30 per cent lower cost than our other Edendale plants.

Ideally, all our plants would be on a par with ED4, or our new Drier 3 at Clandeboye, but we can't simply replace overnight perfectly good but less efficient processing plants. However, in those places where we have a growing milk supply, we can raise the bar on our manufacturing efficiency more rapidly as we develop new facilities. Growing supply helped the business case for ED4 and it is also behind our planning for a new $200 million factory at Darfield in central Canterbury, expected to open in late 2012. Darfield will be our first greenfield development since Lichfield, which opened in 1995.

We are also making good progress in streamlining our supply chain so we can deliver product to our customers as efficiently as possible. In warehousing, the expansion of our Crawford Street site in Hamilton into a key cool and dry store logistics hub has taken more than 50,000 truck movements off local roads and largely eliminated the need for contracted storage around the Waikato. A similar hub with dry and cool stores at Mosgiel, near Dunedin, opened in October 2010.

On the transport side, we are making more extensive use of rail to move product around New Zealand, from manufacturing sites to logistics hubs and onto export ports. We have started a process of rationalising our port operations around New Zealand's key export ports of Auckland, Tauranga, Lyttelton and Port Chalmers.

This port consolidation will give us access to more frequent, flexible and reliable shipping options – and give customers greater confidence in our ability to deliver product on time. In 2010, we set a new export record of 2.1 million tonnes of product – enough to fill approximately 140,000 shipping containers. During the peak period, we were closing the doors on a container on average every three minutes.

We have made big strides not only in how we make and distribute our products, but also in how we sell them. In July 2010, our *global*DairyTrade™ trading platform turned two years old. In 2010, we sold 359,000 metric tonnes, representing approximately 15 per cent of total ingredients sales volumes, via *global*DairyTrade™. The *global*DairyTrade™ platform means both our farmers and our customers have a real-time view on global market conditions, and has given added impetus to the development of risk management tools such as futures that will help dairy market players better manage pricing volatility. The greater transparency of dairy ingredient prices also helps underpin a Milk Price that is sufficiently robust and credible to support the capital structure changes recently voted in by our shareholders.

Each of these steps are pieces of the jigsaw puzzle that illustrate how our strategy is building a sustainable co-operative. Investments in best-of-class manufacturing, transport and logistics enable Fonterra to achieve significant scale benefits. They also help us become more adept at changing our product mix and sales phasing in response to pricing changes. This is critical to our ability to pay the maximum sustainable Milk Price while delivering more stable future earnings from our core ingredients activities.

GROWING LASTING CUSTOMER PARTNERSHIPS

Over the years, we have built an extensive network to provide ingredients to some of the most recognised names in the global food and nutrition industries. These customers want Fonterra to be their supply partner because they like what we stand for – a source of high quality, reliable dairy solutions. They want security of supply, focus on quality, technology leadership, innovation in processing and an efficient global supply chain – all of which we can provide. Further to this, our functional and nutritional dairy ingredient expertise and intellectual property allows us to provide differentiated end-products to consumers.

At the start of the 2010 financial year, we brought renewed impetus to our customer relationships through Global Ingredients & Foodservices (GIF), under the leadership of Andrei Mikhalevsky. GIF, which forms part of our C&I reporting segment, is focused on developing our customer partnerships and product portfolios in premium ingredients, and in foodservice solutions.

Premium ingredients are products that are more advanced than standard dairy ingredients. Examples are nutritional bases for infant formula and growing-up milk powders. Fonterra is already a key supplier to the world's five largest infant formula companies, and there is strong demand from our customers for us to grow with them by making and packing more of their products. Since we expanded our manufacturing capabilities at four sites (three of them in New Zealand) in 2006, our sales of nutritional bases have doubled.

In 2010, we entered into a partnership to commercialise Fonterra's groundbreaking CHEDDAR*plus*™ cheese ingredient in the United States. We are in the process of commercialising functional milk protein DeluxeProtein™ (produced using our proprietary Textured White Base technology) for yoghurts, which represent one of the fastest-growing dairy segments globally.

At the high-end of premium ingredients are products that have unique propositions – examples are some of our advances in functional nutrition (such as protein for sports and medical beverages as well as for snack foods). Although these products are niche contributors, they earn higher margins and are among our faster growing businesses.

A premium ingredients category with exciting prospects is pharmaceutical lactose, with Fonterra a world leader in lactose excipients through our joint venture with Royal FrieslandCampina.

Fonterra is also the global market leader supplying protein concentrates used in beverages in a variety of applications including sports, weight management and nutritional beverages for medical use. With populations ageing in many markets around the world, demand for medical nutrition is growing fast. There is also emerging science to support the role of high quality protein for addressing muscle atrophy in bedridden patients and helping their recovery. Our market leadership

position in medical nutrition is due in part to innovations developed by the Fonterra Research Centre in Palmerston North.

A key sector in which we are strengthening our customer relationships is the foodservices industry, where we partner with some of the biggest names worldwide in convenience and fast-service restaurants. Fonterra is now regarded by McDonald's™ as its number one dairy supplier in McDonald's™ Asia Pacific, Middle East and Africa region. In New Zealand and Australia, we supply McDonald's™ with milk, soft-serve and shake mix, slice-on-slice cheese, specialty cheese, pastries and yoghurt. Our partnership was strengthened early in the financial year when McDonald's™ decided to include CalciYum™ flavoured milk in their healthy choices for children's Happy Meals. For some time, we have supplied Starbucks™ Coffee Company in New Zealand with milk and in March 2010, we commenced supplying milk, butter and yoghurts to Starbucks™ Coffee Company in Australia.

Our primary goal is to add value to our farmer shareholders' milk. To achieve this over the longer term, we must build lasting global customer partnerships. This includes Fonterra having the ability to service our customers from multiple geographies to complement our New Zealand milk. Our global sourcing strategy is important in this regard.

By improving our ability to source and add value to dairy supply from around the world, we can strengthen our position as supplier of choice and give customers the confidence to form stronger partnerships with us. In 2010, Fonterra sourced almost seven billion litres of milk from around the world, including Australia, United States, South America, China, Sri Lanka and Thailand. In total, milk sourced offshore equated to almost half Fonterra's New Zealand milk collection.

We also made good progress during the year building our domestic sourcing capability for cheese in the United States. With the current limited quotas and high tariffs on cheese restricting access to the US, local manufacturing capability is crucial to developing a presence in this important market.

In May 2010, DairiConcepts, our joint venture with Dairy Farmers of America, bought the hard Italian cheese business of Swiss Valley Farms. Hard Italian cheese is one of the fastest-growing and most attractive categories in the US market and the acquisition cements DairiConcepts' number two position.

DRIVING DEMAND IN THE US$6 BILLION UNITED STATES PROCESSED CHEESE MARKET

The successful commercialisation of Fonterra's groundbreaking CHEDDAR*plus*™ ingredient at Los Banos, California, this year – using local milk and Fonterra's home-grown expertise – is driving new sales growth in the US$6 billion United States processed cheese market.

CHEDDAR*plus*™ technology is another innovation from our Palmerston North research centre and offers customers significant yield and process benefits, along with a superior 'natural' cheese consistency in their products.

We began commercial manufacture of CHEDDAR*plus*™ cheese in May 2010 and expect to produce more than 13,000 tonnes in the first year for customers in the US. Current demand is already outstripping supply and we are focusing on opportunities to expand production at Los Banos and other locations in the US. We are applying unique Fonterra technology to US milk to meet our customer needs – and these profits flow back to New Zealand.

It also brings a more diverse product and customer mix, with scale in fresh products, and strategic synergies and benefits.

China is a market which has become increasingly important to Fonterra. In 2010, it represented our largest single market for ingredients sales, reflecting the strong demand from Chinese customers and consumers for quality dairy products. During the year, our successful Anlene™ brand was re-introduced to consumers in selected Chinese cities, and our foodservices business achieved promising growth. Our pilot farm at Tangshan in northern China is demonstrating that we can profitably produce high quality local milk at good volumes, as part of our commitment to build a safe, secure and sustainable milk supply for our customers in China. The farm now has more than 5,800 cows and we are progressing negotiations on two more dairy farm sites in nearby Yutian County.

Our focus on growing lasting customer partnerships in global markets goes hand in hand with our efforts to build a sustainable co-operative in New Zealand. It's all about shaping our business and capabilities so we become more agile at responding as quickly as possible to changing market dynamics and the needs of our customers. By doing so, we help secure long-term access into global markets for our farmer shareholders' milk.

BUILDING TRUSTED BRANDS IN CHOSEN MARKETS

Our consumer businesses play an important role in creating value for our farmer shareholders. They are significant and growing profit contributors and their more stable earnings profile provides a buffer to the market volatility experienced with standard dairy ingredients. Additionally, the consumer businesses provide an important and secure outlet for New Zealand farmers' milk, taking around 13 per cent of the product manufactured from Fonterra's New Zealand supply.

Rather than aspiring to go truly global with our consumer businesses, our strategy is to strengthen our positions in key regional markets where ownership of the supply chain gives us a degree of competitive advantage. Our focus is therefore on growth markets within Asia/AME and LATAM, and our existing strong market franchises in ANZ.

In Asia/AME, under the leadership of Mark Wilson, our business is growing strongly. Normalised segment profit before net finance costs and tax of $157 million was 31 per cent higher than the prior year. This impressive profit growth was achieved despite the unfavourable impact of a higher New Zealand Dollar against a basket of Asian currencies – on a constant currency basis, normalised segment profit was up 48 per cent.

Fonterra is focused on leveraging our consumer brands to capitalise on rising dairy consumption across key Asian markets and an expanding middle class that is caring more about healthy nutrition for the whole family. Anlene™ is an excellent 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.

In ANZ, under the leadership of John Doumani, we are demonstrating that good growth can be achieved in mature markets through strong marketing and by investing in dairy categories that offer superior growth and margin prospects. Normalised segment profit before net finance costs and tax was $290 million, 17 per cent higher than the prior year.

In New Zealand and Australia, Fonterra holds leading market positions in cheese, spreads, yoghurts and dairy desserts as well as leading market positions in New Zealand in milk, flavoured milk and ice-cream. Looking across most key categories, we grew market share and revenue in the last year, in many cases outpacing market growth, in increasingly competitive environments. We did this through a consistent and disciplined approach to new and innovative Fonterra brand offerings and superior sales and marketing.

In LATAM, where our consumer businesses and investments are overseen by Andrei Mikhalevsky, we had another solid year of performance overcoming several challenges, notably the severe earthquake that struck Chile in February 2010. Normalised segment profit before net finance costs and tax was $118 million, an 11 per cent increase on the prior year.

A key dairy category that is growing rapidly globally is cultured foods, such as yoghurts. As well as providing ingredient solutions for our customers, we are growing shareholder value by strengthening our own cultured foods brands. In Australia, we have made excellent progress since the prior year acquisitions of the licences for the Ski™ and Nestlé™ brands.

We are investing significantly in marketing and launching new yoghurt ranges to drive growth in these brands. We are also spending $26 million to treble the capacity of our Euchuca manufacturing site in northern Victoria so we can bring production of our entire Ski™ yoghurt range in-house. In Malaysia, we recently invested $12 million expanding our plant producing yoghurts and other products for the local market using New Zealand milk. This follows a similar $18 million investment the previous year in Sri Lanka.

We are continually reshaping our business portfolio to ensure we can capitalise on the most promising market opportunities. During the year we strengthened our business footprint in the Middle East with the purchase of the remaining 51 per cent stake in Saudi New Zealand Milk Products, a dairy manufacturing facility in Saudi Arabia. Conversely, we sold our 25 per cent interest in AFF P/S, our UK consumer products joint venture with Arla Foods. Although the joint venture had been successful, it was no longer considered core to our long-term strategy. We will continue to license the Anchor™ brand and supply New Zealand butter to AFF P/S.

We are building our brands through extensive marketing and advertising. As well as traditional channels such as television and print advertising, we are increasing our use of alternative marketing strategies. In Australia and New Zealand, Fonterra's involvement with the extremely popular *MasterChef*™ reality television series represents one of our biggest sponsorship marketing campaigns to date and has spurred growth across the various brands showcased in the programmes. Several of our campaigns received recognition in international marketing effectiveness awards and in New Zealand, the Tip Top™ brand was named New Zealand's 4th most trusted brand in an annual Readers Digest survey. The same survey also placed the Anchor™ brand in the top 10 preferred food manufacturers.

As in every other part of Fonterra, our consumer businesses are very focused on using our shareholders' capital efficiently. Our Asia/AME unit has led the way with a programme to reduce working capital requirements through initiatives such as inventory optimisation, vendor management and product line rationalisation. Two years ago, Asia/AME set a target of $200 million of working capital savings in three years and they achieved the target in 2010, 12 months ahead of plan. The project, which also aims to improve employees' understanding of the importance of cash in a successful business model, has now been rolled out across Fonterra globally.

SUCCEEDING THROUGH OUR PEOPLE

Fonterra's success relies on the skills and passion of our almost 16,000 people. We continue to strengthen a talented workforce that embraces our rich heritage and shares a strong vision to take the Co-operative forward.

FONTERRA'S PHARMA LACTOSE JV NOW WORLD'S NO.1 SUPPLIER

Fonterra's pharmaceutical lactose joint venture with Royal FrieslandCampina, DMV-Fonterra Excipients (DFE), has cemented its place as the world's leading supplier of lactose excipients in 2010.

The acquisition of another pharmaceutical lactose business and manufacturing unit from Royal FrieslandCampina this year has strengthened DFE's R&D capability and sales network to deliver premium-value lactose solutions to the pharmaceutical industry globally.

DFE is the world's number one supplier of lactose excipients – used in tablets, capsules and powders for medical inhalers – with customers including most of the world's top pharmaceutical companies. DFE now accounts for around half of the global sales of lactose excipients and 5-10 per cent of oral solid-dose excipients. Production is at four locations – Kapuni in Taranaki, New Zealand, and three plants in Europe.

A number of strategic investments are planned in the next five years to ensure DFE realises the growth opportunities forecast for this sector.

With an employee presence in more than 50 countries, it's important to have a common direction and set of values, uniting our team. More than 300 people were involved during the year in developing 'This is Fonterra', – a compelling story in our own words about who we are and what we stand for, along with a refresh of our vision, strategy and values. Our core values were recast around the four themes of 'Co-operative Spirit', 'Do What's Right', 'Challenge Boundaries' and 'Make it Happen'. Along with the rest of 'This is Fonterra', these values have generated a very positive response from our people.

In March 2010, we began a new process, using a globally benchmarked Gallup survey, of assessing the level of employee engagement within Fonterra. Our survey told us that, although our employees are generally satisfied working at Fonterra, we need to work hard to improve their engagement. There is a strong correlation between employee engagement and business performance. Team by team, across the organisation, we have developed specific follow-up plans to lift employee engagement.

We have continued to place emphasis on developing strong leaders as they make a great difference to performance of the organisation and our employees' experience at work. We introduced a consistent performance template for our top 200 executives. In addition to business outcome measures, it assesses the executive's ability to lead the culture and values, and engage with and develop employees. A new front-line leadership programme 'It Starts Here' was launched, our mid-level programme 'Good to Great' continued, and two professors from international business schools presented workshops on strategy for some of our senior executives. Succession planning processes aim to ensure that we have management strength for the future and that potential gaps are identified well in advance.

Our graduate recruitment programme has been energetic in the science and technology field, and we support the First Foundation – providing scholarships and work opportunities to talented students from financially disadvantaged backgrounds.

We have redoubled our efforts to build a safety-first culture, and proactively identify and remove hazards from the workplace. Aspects of our progress in this area were recently recognised with a New Zealand National Safeguard award for 'Best Large Organisation Safety Initiative'. There was steady progress across the business in reducing injury rates for Fonterra people, which saw the Total Recordable Injury Frequency Rate (TRIFR) fall from 23.7 to 18.2 per million work-hours. Over the past three years, our

SAUDI INVESTMENT REINFORCES MIDDLE EAST GROWTH

A $45 million investment to take full ownership of Saudi New Zealand Milk Products' (SNZMP) factory in Dammam, Saudi Arabia, has secured manufacturing capacity to support growth plans in the Middle East.

The manufacturing site, established by Fonterra as a joint venture with a local Saudi company in 1996, is pivotal to Fonterra's growth plans to expand value-add sales and its in-market presence in the Gulf Co-operation Council countries – Bahrain, Oman, Kuwait, Saudi Arabia, the UAE and Qatar.

Currently packing Anchor™ and Anlene™ milk powders and producing processed cheese and recombined feta-style cheese, the plant supplies 20 countries in the region. Fonterra's buy-out of the joint venture will allow improved utilisation and a planned capacity expansion to meet market demand. The Middle East is a substantial dairy market and Fonterra Brands is pursuing the development of Fonterra's business throughout the Middle East with Anchor™ and Anlene™ milk powder sales to consumers, cream, feta and butter for the foodservice sector and milk powder and cheese sales into North Africa.

TRIFR has been cut by 83 per cent as we aim for a near-term TRIFR target of below five per million work-hours.

LIFTING OUR GAME IN SUSTAINABILITY

We must deliver sustainable co-operative performance in environmental as well as economic terms. Our sustainability strategy sets out work programmes and priorities on-farm, within Fonterra, in our local communities and in the global dairy community.

On-farm is clearly a priority, particularly as confidence in dairy's future has seen rapid growth in both New Zealand's national herd and the amount of land converted to dairying. Since 2003, Fonterra, along with regional councils and the Ministries of Agriculture and the Environment, has been party to a voluntary Dairying and Clean Streams Accord, which sets targets to mitigate dairy's impact on water quality.

The most recent Accord snapshot shows strengths and weaknesses. We now have 99 per cent of farmers with nutrient budgets compared with just one in five in 2003 and 98 per cent of regular water crossing points have bridges or culverts. The weak point was non-compliance with regional council effluent rules, with national non-compliance rising from 12 per cent to 15 per cent. These results are concerning and overshadow the work of farmers who are consistently working within the rules.

To lift performance Fonterra is, from August 2010, checking dairy effluent infrastructure on every supplier's farm, every year as part of the annual Farm Dairy Assessment. Where systems are not compliant, or even at risk of non-compliance, referrals are being made to our team of Sustainable Dairying Specialists. Remedial programmes will be put in place, with a timetable for completion. This includes taking immediate action if a non-compliant system is found.

This is a serious step-up and has been welcomed by the regional councils who set and enforce effluent compliance rules. In March we set the goal to halve non-compliance within 18 months, trending to zero. Early indications are that progress is being made with better compliance results being reported on farms in the Auckland, Wellington and Canterbury regions. We are also seeing farmers taking the initiative and seeking advice from their councils and from Fonterra to ensure they are meeting local rules.

A priority is to equip farmers with more scientifically advanced tools which will lift productivity and lower their environmental impacts.

EXTENDING ANLENE'S™ LEADERSHIP IN BONE HEALTH

A focused marketing investment has extended Fonterra's leadership as the number one high calcium adult milk product in Asia with the Anlene™ brand, growing revenues by more than 17 per cent this year.

Anlene™ milk now contributes over 20 per cent of total revenues from consumer sales in the Asia/AME region.

Fonterra Brands has increased investment in advertising and promotion with a new integrated marketing campaign highlighting the potentially crippling effects of osteoporosis on joint and bone health. The advertising campaign is being fronted by high profile celebrity regional ambassadors: Malaysian actress Michelle Yeoh, Indonesian pop star Anggun Cipta Sasmi and Filipino actress Charlene Gonzales. This was also supported by the Anlene™ Bone Health Check, which has now reached more than four million people across the region. Fonterra's previous 'Anlene™ Movement' campaign was acknowledged in 2010 at the Asian Marketing Effectiveness Awards as the Best Sustained Success in Indonesia with results demonstrated over a three year period.

Pictured: Anggun Cipta Sasmi.

As part of the Pastoral Greenhouse Gas Consortium, we are helping fund research to find practical ways of reducing agricultural greenhouse gases. With the Ministry of Agriculture and Forestry, DairyNZ and FertResearch, we are funding trials testing the effectiveness of nitrification inhibitors in different regions throughout New Zealand, enabling farmers to make educated management decisions on their use.

New Zealand's Emissions Trading Scheme (ETS) came into effect on 1 July 2010. Increased energy and fuel costs were the immediate impact for Fonterra and our farmer shareholders. The initial direct impact for farmer shareholders is a $500 average increase in annual energy and fuel costs. Fonterra's cost in meeting emissions liabilities is $25 million a year, from 31 July 2010, rising to more than $50 million after 2013.

A particular concern is the method used to allocate emission units where operations are considered to be both emissions intensive and exposed to the risk of competition from overseas trading competitors. Under this regime, Fonterra receives allocations for less than five per cent of emissions generated from processing dairy products. This fails to recognise that New Zealand is an emissions-efficient contributor to global food production, at a time when food demand is increasing. It seems counterintuitive to us to create a disincentive for agricultural production in an emissions-efficient country like New Zealand, while there are no disincentives in much more emissions-intensive countries.

The ETS legislation requires a review of the scheme before the end of 2011 and we will advocate for changes to this allocation method as part of the review. In principle, we support the ETS and believe it is more efficient than a carbon tax. The position we have advocated to Government is that while our competitors do not face equal emissions prices, sensible measures are needed to reduce the competitive risk to efficient New Zealand exporters.

We are very proud of our progress in reducing the emissions per tonne of product. Our energy efficiency programme has reduced our energy consumption per tonne of production by 14 per cent since 2003, achieving a total annual reduction of 320,000 tonnes of carbon dioxide equivalent. Our emissions were further

WINNING IN THE WORLD OF FAST MOVING CONSUMER GOODS

In Australia and New Zealand, Fonterra is demonstrating its ability to drive growth from its consumer brands in highly competitive and well developed markets.

Fonterra holds leading positions in cheese, spreads, yoghurts and dairy desserts across both countries as well as market leadership in milk, flavoured milk and ice cream in New Zealand.

In the past year, Fonterra brands outpaced market growth across many key categories. In New Zealand, Fresh'n'Fruity™ yoghurts achieved a record share of the yoghurt market and Anchor™ butter grew four times faster than the category. In Australia, Perfect Italiano™ cheese and Western Star™ butter experienced accelerated growth on the back of the *MasterChef*™ reality television series sponsorship.

This growth was achieved despite the battle for space in the supermarket chiller intensifying due to new brands from competing manufacturers and new house brand offerings from our retail customers. We were able to take on these challenges and emerge with even stronger market results due to a focus on understanding consumer insights, translating those insights into brand innovations which would appeal to consumers and following this through with superior sales and marketing.

reduced by 3,300 tonnes last year through our eco-efficiency programme which is now reusing or recycling 92 per cent of our waste such as cardboard and plastic. In our supply chain we use trains rather than trucks whenever feasible to transport product to export ports and we further lower emissions through tanker scheduling which reduces kilometres travelled. Work is also underway to develop a Fonterra Carbon Action plan identifying priority actions and targets for further emissions reductions per unit of output throughout our supply chain. On-farm, we began a dairy energy assessment pilot project which aims to reduce average electricity consumption at 150 farms by 10 per cent over the next year.

As the Government contemplates a range of policy changes with the potential to impact on dairying, Fonterra is advocating on behalf of dairy farmers in the Land and Water Forum, which is facing the challenging task of developing a water management framework for New Zealand.

In addition to our on-farm and manufacturing activities, our ANZ business unit has appointed a sustainability team to increase the focus on sustainability initiatives within the business.

CONTRIBUTING TO OUR COMMUNITIES

The communities in which Fonterra operates are integral to our success and long-term viability. As a sustainable dairy business, we are conscious of our social responsibilities within these communities. During the year we supported many events and activities that make our local communities vibrant, engaging places to live and work.

Major initiatives in New Zealand included our KickStart Breakfast™ programme, a co-sponsorship with Sanitarium which went from strength to strength during the year. It now provides milk and cereal for a healthy breakfast twice weekly to more than 15,000 children at over 400 low-decile schools, up from 300 schools a year earlier. The Fonterra Science Roadshow reached 90 communities and 700 schools throughout New Zealand, giving children aged eight to 13 the chance to explore science and technology through a range of interactive exhibits and resources. Another national initiative is Catchment Care, a partnership with non-profit organisation Conservation Volunteers to provide support for practical water-catchment care projects across New Zealand. We work in communities, alongside landowners, councils and community groups, on projects that enhance and protect waterways and wetlands.

Post balance date, Fonterra contributed $1 million to the Canterbury Earthquake Appeal Fund following the serious earthquake that caused widespread damage across the Canterbury region in early September 2010.

In Australia, we donated product to Foodbank Australia to distribute to welfare agencies. We have donated more than $1 million worth of product since we began supporting Foodbank in 2005. We also donate product to FareShare, which prepares healthy, nutritious meals for the hungry and homeless in Victoria. Fonterra people also support this initiative by working in the FareShare kitchen helping prepare meals.

In China, the Fonterra Rural Maternity and Infant Healthcare Community Programme, a partnership with the Soong Ching Ling Foundation, helped deliver better healthcare services to more than 50,000 women and children in China's Hebei province in its first year. As part of the programme, more than 7,000 healthcare workers have received training to improve their skills and 15 newly-donated ambulances have ferried more than 1,600 patients. Now in its second year, the partnership has extended its reach to Gansu province – another poorer rural area in China.

Building on the success of the community healthcare programme, Fonterra has funded scholarships, also through the Soong Ching Ling Foundation, to provide tuition in China for 100 agricultural and food science university students every year, for four years.

In Chile, together with our subsidiary Soprole, Fonterra donated $1 million to a telethon held to raise money for disaster recovery, following the major earthquake that hit the country in February 2010.

ANDREW FERRIER
Chief Executive

EXECUTIVE COMMITTEE

ANDREW FERRIER has been Chief Executive of Fonterra Co-operative Group since September 2003, bringing with him a background of generating stronger performances from companies in both the consumer products sector and the commodities market. He has more than 25 years experience at senior executive level, with 16 years as a Chief Executive.

GARY ROMANO joined the dairy industry in 1997 with the New Zealand Dairy Group of Companies, after working for Alcoa of Australia, The Boston Consulting Group and Dairy Partners Americas. In the dairy industry he has had significant experience in both manufacturing and supply chain where he has led teams responsible for driving to achieve world class standards of productivity, quality, safety, cost effectiveness, service and environmental performance.

JONATHAN MASON joined Fonterra in February 2009 as the Chief Financial Officer (CFO). He came from US-based Cabot Corporation, where he was Executive Vice President and CFO from 2006, and also worked in a variety of financial management positions at International Paper and ExxonMobil Corporations from 1985 to 2000. Before moving to New Zealand for Fonterra, Jonathan had also worked here when he was CFO for Carter Holt Harvey from 2000 to 2005.

JENNIFER KERR has worked in senior human resources roles in the oil industry for Mobil in the US and Europe and in the leisure industry in the UK for Whitbread. On her return to New Zealand, Jennifer started up her own consultancy, Jennifer Kerr and Associates, before joining Fonterra in July 2006.

ANDREI MIKHALEVSKY joined Fonterra in February 2007. Previously he was Global President of the flavours division in the German listed company Symrise, a leading manufacturer of flavours, fragrances and sensory ingredients. Andrei spent seven years with Georgia Pacific and related companies, including heading the North American retail business, and 21 years in executive positions with the Campbell Soup Company. He resides in the United States with offices in Chicago and Auckland.

JOHN DOUMANI joined Fonterra in 2007 after a 25 year career in international business and consumer brands. Most recently he was President International of the Campbell Soup Company. Prior to joining Campbell's, John was Managing Director of Meadow Lea Foods and he had 13 years experience with Johnson & Johnson. He is based in Australia.

MARK WILSON has more than 35 years experience in the consumer goods sector in Asia, the Pacific, South America, and Europe. Before joining Fonterra in February 2008, he managed Danone's nutrition business across Asia and the Pacific. From 1995 to 1998 he was CEO of Dumex, before becoming President and Chief Executive Officer of the Danish listed East Asiatic Company from 1998 to 2007. He is based in Hong Kong.

LEFT TO RIGHT:

GARY ROMANO
Managing Director, Fonterra Trade and Operations

JONATHAN MASON
Chief Financial Officer

JENNIFER KERR
Group Director, Human Resources

ANDREW FERRIER
Chief Executive

ANDREI MIKHALEVSKY
Managing Director, Global Ingredients and Foodservices

JOHN DOUMANI
Managing Director, Australia/New Zealand

MARK WILSON
Managing Director, Asia/Africa, Middle East

MANAGEMENT DISCUSSION & ANALYSIS

INTRODUCTION

On the following pages we review the financial results, operating performance and key business trends for the 2010 financial year. A summary of Fonterra's financial position and reportable segment results is also provided. Readers are referred to the notes and accounting policies as set out in the financial statements for a full understanding of the basis on which the financial results are determined.

INCOME STATEMENT

Revenue

Total revenue for the 2010 financial year was $16.7 billion, $691 million (four per cent) higher than for 2009. This improvement was driven by a $721 million (seven per cent) increase in revenue (including hedging gains) within the Commodities & Ingredients (C&I) segment, while combined revenues for the consumer businesses remained steady.

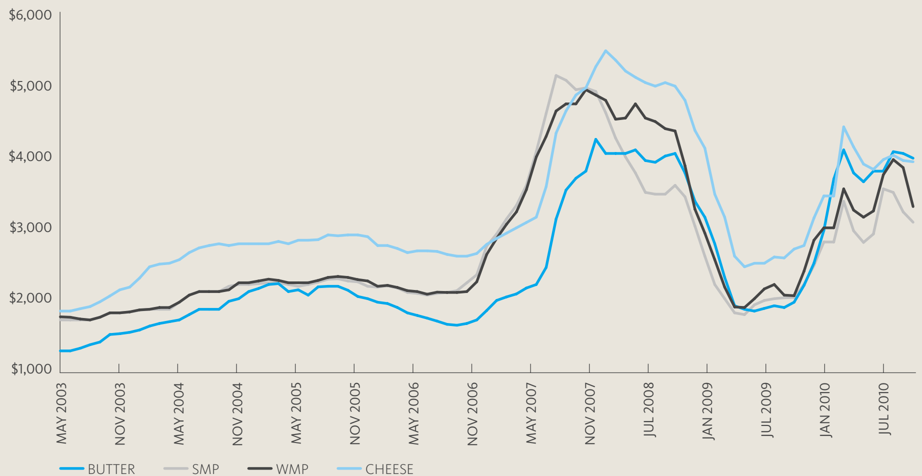
The increase in C&I revenue, to $11.2 billion, was mostly due to higher prices for dairy products on world markets, combined with a slight increase in external sales volumes. Fonterra adopts a policy of hedging its revenue from ingredients sales against foreign exchange movements to provide greater certainty of returns in its business. In the 2010 financial year, these hedges resulted in a Fonterra Average Conversion Rate (FACR) of US66.7 cents, significantly lower than the average spot rate for the year of US70.8 cents and very similar to the previous year's FACR of US66.5 cents. Hedging gains more than offset translation losses when converting revenue back to New Zealand dollars.

Combined revenues for the consumer business segments remained steady at $5.5 billion, as the benefit of higher volumes and prices across most consumer business units was offset by adverse foreign exchange movements. The majority of this impact was felt in Asia/Africa, Middle East, due to an appreciation of the New Zealand dollar against many Asian currencies.

Cost of goods sold

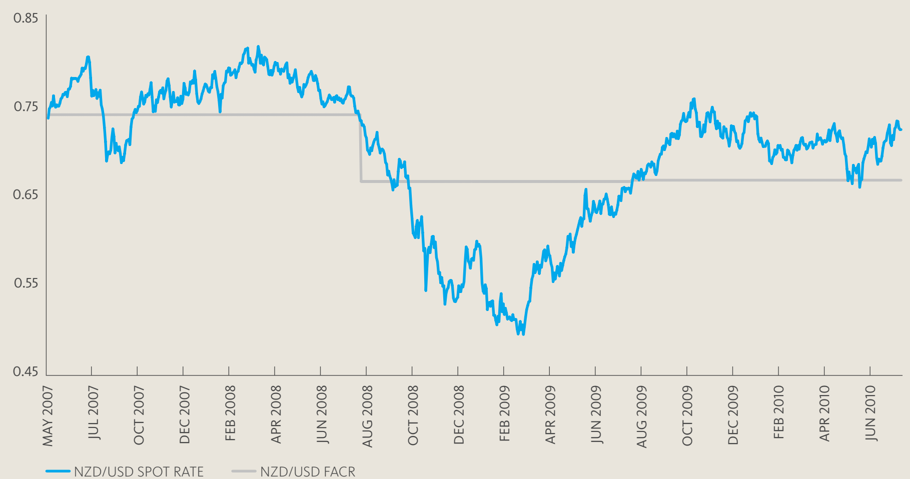
As a co-operative company, Fonterra pays the Milk Price to its farmer shareholders for the milk they supply each season. The total cost of goods sold in the 2010 financial year was

MONTHLY AVERAGE COMMODITY PRICES
USD/MT FOB



Source: Oceania Export Series, Agricultural Marketing Service, US Department of Agriculture.

NZD/USD EXCHANGE RATE
1 JUNE 2007 TO 31 JULY 2010



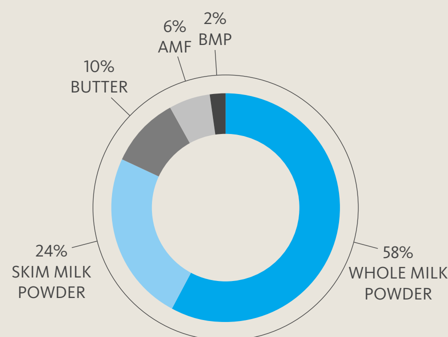
$14.0 billion, compared with $13.2 billion in the previous year. The increase was primarily driven by a higher Cost of Milk and, to a much lesser extent, a small increase in the volume of milk supplied.

The higher Milk Price for the 2009/10 season reflected an increase in global market prices across five dairy ingredients used to inform the Milk Price: whole milk powder, skim milk powder, butter, anhydrous milk fat and buttermilk powder.

For 2009/10, Fonterra's total Cost of Milk, calculated in accordance with the Milk Price Manual, was $7.7 billion which equates to $6.10 per kilogram of milksolids (kgMS). Of this Cost of Milk, $26 million was paid for a portion of the total winter milk premiums and

net capacity rebates. The remainder was paid on a fat and protein basis and represents $6.08 per kgMS. An additional $29 million was paid for other premiums.

MILK PRICE
BASKET OF PRODUCTS



Milk supply
Milk collection for the 2009/10 season totalled 14.7 billion litres, representing 1,286 million kgMS. This included contract milk supply of 30 million kgMS. This was Fonterra's largest volume collected to date and an increase of 0.4 per cent from the 2008/09 season. Fonterra collected approximately 89 per cent of total New Zealand milk produced in 2009/10.

Production growth over the previous season was impacted by drought conditions in the north of the country. It was also affected as some farmers responded to the global financial crisis of the previous year by removing some input costs and de-intensifying farm systems.

Production from the North Island decreased 4.3 per cent to 819 million kgMS as a result of both poor spring conditions and another summer drought which particularly affected the top half of the island. There was also the loss of some supply to a newly-established plant in Wanganui operated by an independent processor. In contrast, production from the South Island increased 9.8 per cent to 467 million kgMS as a result of favourable conditions, a continuation of dry farm conversions and recent conversions reaching full potential in Canterbury and Southland. The peak milk collection day for 2009/10 was 3 November 2009, when 72.3 million litres were supplied.

This represents a 1.9 per cent decrease on the previous season's peak of 73.7 million litres on 22 October 2008. Both the decrease and the later timing of the peak can be attributed to poor spring conditions especially in the top half of the North Island.

Although the drought presented production difficulties towards the end of the 2009/10 season, on-farm conditions through June and July 2010 were mainly favourable with mild temperatures and manageable rainfall allowing a near complete recovery from the preceding summer/autumn drought. Despite these favourable conditions, milk volumes were lower than expected as "carry-over" cows were dried off in autumn instead of being milked through the winter.

Other operating income
Other operating income was $277 million, compared with $119 million in the previous year. The main reason for the increase was a gain on the sale of Fonterra's 25 per cent share in AFF P/S, a UK consumer products joint venture with Arla Foods.

Operating expenses
Operating expenses decreased $37 million to $2.0 billion, however this was driven by a $76 million favourable movement in translation of overseas costs from a stronger New Zealand currency. Underlying operating expenses increased primarily from higher advertising and promotional costs to support consumer brands.

Share of profit of equity accounted investees
Fonterra's share of reported profits from equity accounted investments was $56 million, a $73 million decrease from the previous year. The decrease reflects the strengthening of the New Zealand dollar against the base currencies in which the investments operate and the exclusion in 2010 of any share of earnings from Fonterra's 25 per cent share in AFF P/S, sold during the year. The main investments contributing to share of profits of equity accounted investees were DMV Fonterra Excipients (DFE), DairiConcepts, and the DPA joint ventures in Latin America. There were no impairments of equity accounted investments during the year.

EBIT
Earnings before finance costs and tax, including equity accounted earnings (EBIT), were $1,078 million, compared with $990 million in 2009. Normalised EBIT (excluding non-recurring items and impairment of equity accounted investees) was $904 million, compared to $1,019 million last year. Higher earnings from the consumer businesses were offset by reduced earnings from the ingredients businesses as margins were pressured due to volatile prices in international dairy markets.

NORMALISED EBIT

$ MILLION	2010	2009
Reported EBIT	**1,078**	990
Non-recurring items	*(174)*	*(32)*
Impairment of equity accounted investees	–	*61*
Normalised EBIT	**904**	1,019

Net finance costs
Net finance costs were $313 million, a decrease of $135 million from the previous year, as interest costs were lower due to a lower level of borrowings throughout the year, combined with lower floating interest rates.

Taxation
Tax expense was $80 million, compared with a credit of $68 million in the previous year. Key reasons for this change were the recognition of a $61 million deferred tax expense following the Government's decision not to allow tax depreciation on buildings with a life greater than 50 years and a $68 million lower tax credit as a result of lower distributions relating to this year.

Tax credits arising from distributions are now recognised within the tax expense/(credit) line on the income statement. Previously, the income tax consequences of the Value Return payment were recognised directly in equity. The tax effect of dividends has been recognised as a $109 million credit in the income statement for the year. The accounting policy change has been applied retrospectively, resulting in a restatement of the financial statements for the 2009 financial year to recognise a $177 million credit in the tax expense/(credit) line in the comparative income statement rather than directly in equity.

Profit

As a result of the above factors, the profit for the 2010 financial year was $685 million, a 12 per cent increase compared with the restated previous year.

After adjusting for non-controlling interests and the tax effect of retentions, the Distributable Profit was $800 million (2009: $603 million) or 60 cents per share, an increase from the 49 cents per kgMS achieved in 2009.

DIVIDEND

The Fonterra Board has resolved to pay an annual dividend of 27 cents per share. This is within the target dividend range for the year of 20-30 cents per share announced earlier. A final dividend of 19 cents per share, declared on 22 September 2010, payable on 20 October 2010, in addition to the 8 cents per share interim dividend paid on 20 April 2010. This means that 33 cents per share will be retained within the Co-operative. The level of retentions reflects the Board's intention to retain all earnings from non-recurring items as well as its previously stated intention to fund ongoing investment in New Zealand manufacturing and offshore activities.

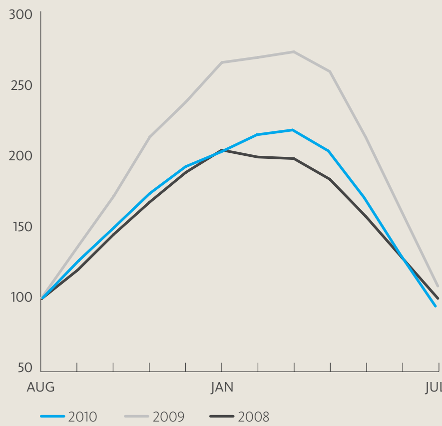
From the 2011 financial year, the Board has adopted a dividend payment ratio target of 65-75 per cent of adjusted Distributable Profit (after taking into account any non-recurring items) and having regard to other commercial considerations the Board considers to be relevant. Consistent with the dividend policy, the Board is targeting a dividend range of 25-35 cents per share for 2011.

BALANCE SHEET

Inventories

Inventory volumes as at 31 July 2010 were 10 per cent lower than a year earlier, but a higher Milk Price has resulted in the value of inventories increasing $214 million to $2.9 billion. Also contributing to this increase was a change to using a monthly Milk Price rather than an annual Milk Price for valuing inventory. As a result of this change, the inventory value at 31 July 2010 was $179 million higher than would have been the case using the previous annual Milk Price method. In contrast, the inventory value at 31 July 2009 would have been $124 million lower than reported if the monthly Milk Price had been used at that time. Inventory continues to be valued at the lower of cost and net realisable value.

INVENTORY VOLUME INDEX



Working capital

Average working capital days have improved by 24 per cent this year. This has been driven largely by a reduction in average monthly inventory volumes and an increased focus on faster collection of receivables.

Gearing

Total net interest bearing debt as at 31 July 2010 was $4.3 billion, a decrease of $898 million from 31 July 2009. This decline primarily reflects a continuing focus on strengthening Fonterra's balance sheet through:

- increased cash receipts from new co-operative share issues and lower end of season share redemptions;
- the restriction of non-essential capital expenditure and sale of non-strategic assets, allowing the Group's longer term debt levels to be reduced; and
- strong operating cash flows, meaning lower short term borrowing requirements.

After allowing for hedging, the Group's economic net interest bearing debt was $4.5 billion ($5.2 billion as at 31 July 2009).

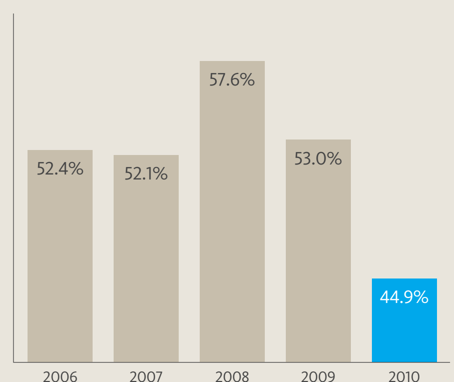
As at 31 July 2010, Fonterra's total equity stood at $5.7 billion, an increase of $862 million from 31 July 2009. The key drivers of this increase were an increase in retained earnings and an increase in co-operative shares held.

As a result of reduced debt and increased equity, Fonterra's economic debt to debt plus equity ratio (which takes account of the carrying value of debt hedges) was 44.9 per cent as at 31 July 2010, an improvement from 53.0 per cent a year earlier.

A change in capital structure approved by shareholders during the 2010 financial year has resulted in dividend payments being made in place of Value Return payments. Accounting standards do not permit the recognition of a dividend until it has been declared. Consequently, the final dividend of 19 cents per share ($255 million) cannot be accrued as a liability at balance date. In contrast, the Value Return payment of $591 million was recognised as a liability at balance date in 2009. This change has had a positive impact on the debt to debt plus equity ratio. Had last year's ratio been calculated on the same basis as for this year, the economic debt to debt plus equity ratio as at 31 July 2009 would have been 50.0 per cent rather than 53.0 per cent.

During the year ended 31 July 2010, net share issues generated an increase in share capital of $459 million. Of this increase, a net $263 million was raised in January 2010 after farmer shareholders were given the opportunity to adjust their shareholdings following the capital structure changes approved in November 2009. The remainder of the share transactions took place following the end of the 2009/10 season. As at 31 July 2010, there were 1,353 million co-operative shares on issue, an 8 per cent increase from the 1,251 million shares on issue as at 31 July 2009. Of these shares, 68 million or approximately 5 per cent were "dry" shares not required to cover 2009/10 season production.

GEARING



CAPITAL STRUCTURE CHANGES

During the year ended 31 July 2010, Fonterra farmer shareholders voted in favour of a series of changes impacting the Co-operative's capital structure.

The first steps of this process received shareholder approval at the November 2009 annual meeting and took effect from mid-season in 2009/10. Shareholders were given more flexibility in the number of co-operative shares they can own. They can now hold anywhere between 1.0 and 1.2 shares for each kgMS produced, rather than the previous limit of 1.0 share for each kgMS produced. As an incentive for farmer shareholders to hold "dry" shares in excess of production, Fonterra's profit is now distributed as a dividend based on all shares held, rather than the previous method of distributing profit as a Value Return payment based on milksolids produced.

The way Fonterra shares are valued was also changed to recognise that ownership is restricted to Fonterra farmers only. As this would have meant a reduction in the Fair Value Share price, a transition arrangement was put in place to effectively hold the Fair Value Share price at a "Base Price" (currently $4.52) until the valuation on a restricted ownership basis catches up.

At a special meeting on 30 June 2010, shareholders voted in favour of changes to the Co-operative's constitution that allow for steps to be taken to implement share trading among farmers at a future date. Under Trading Among Farmers, farmers will buy and sell shares from one another through a market, rather than via the Co-operative. Fonterra will no longer be obliged to pay out cash to farmers redeeming shares because they are leaving the Co-operative or reducing milk supply. Farmers will also have increased flexibility with their Fonterra shareholdings, with individual farmers able to own up to 2.0 shares for each kgMS produced. Farmers will have up to three years to buy shares to cover additional production or to sell shares when reducing production or leaving the Co-operative. There is an overall threshold on dry shares not backed by milk production of 25 per cent of the total number of Co-operative shares on issue, with a Board target of 20 per cent. Individual holdings of dry shares will also be limited to 5 per cent of total wet and dry shares on issue.

The Trading Among Farmers initiative will also provide shareholders with the opportunity to free up share capital by selling the underlying rights of some of their shares to a new Fonterra Shareholders' Fund. This Fund will pay farmers for the underlying rights to those shares, including the rights to distributions and the gain/loss from any change in the market value of those shares, but the farmer will continue to retain all Fonterra voting rights and rights relating to milk payments. The Fund will raise the money needed to buy underlying rights from farmers by issuing securities to the public. These securities will enable the public to have an investment linked to Fonterra's financial performance, while ensuring Fonterra remains 100 per cent farmer controlled.

Conditional on legislative changes being approved by Parliament, Fonterra is currently targeting a start for Trading Among Farmers sometime in 2011/12.

FAIR VALUE SHARE

Fonterra currently issues and redeems co-operative shares at a Fair Value Share price, which is set annually by the Board based on the views of the Independent Valuer.

For the 2010/11 season, the Fair Value Share price has been set at $4.52 per share. The Independent Valuer assessed the midpoint of a Restricted Market Value range at $4.27. Because the midpoint is below the $4.52 Base Price established as part of the transition to the restricted market valuation approach, the Fair Value Share price is held at this Base Price.

The Independent Valuer assessed the Restricted Market Value of Fonterra shares at a 25 per cent discount to the unrestricted market value. The unrestricted range midpoint was $5.69, which is 26 per cent higher than the $4.52 assessed on a comparable basis a year earlier. The increase largely reflects a higher value for Fonterra's consumer businesses, which continue to perform very strongly. It is also broadly consistent with share price movements for large listed FMCG (fast moving consumer goods) companies.

CASH FLOWS

Operating cash flows for the 2010 financial year were a net inflow of $1.5 billion, $115 million lower than in the year ended 31 July 2009. The decrease reflects the higher advance rate for the payment of shareholder milk, which was greater than the increase in cash receipts from customers due to average selling prices not increasing as quickly as the Milk Price. Partially offsetting this shortfall were lower payments to creditors, reflected in a higher trade and other payables balance at year end. Operating cash flows have improved from a net outflow of $129 million in the six months ended 31 January 2010. This is to be expected as cash outflows are usually higher during the first half of the financial year, when milk payments to farmers reflect the seasonal production peak period.

Investing cash flows were a net outflow of $354 million, compared with an outflow of $756 million in the previous year. The key reasons for the reduction in net investing cash outflow were higher receipts from the sale of non-strategic investments and other business operations ($222 million compared with $44 million previously) and lower capital expenditure ($437 million compared with $590 million previously). In addition, settlement of investment hedges resulted in a net cash gain of $11 million compared with a $112 million loss in 2009.

There was a net cash outflow from financing activities of $1.2 billion, compared with a $929 million outflow in 2009. This is primarily attributable to a decrease in Fonterra's net borrowings position, as funds were used to pay down debt. There was also a much larger outflow of cash in shareholder distributions in 2010 compared with the previous year. Distributions in 2010 totalled $698 million, comprising the 2010 interim dividend and the 2009 Value Return (which was paid in August and October 2009). In contrast, shareholder distributions in 2009 were just $12 million, representing a small final proportion of the 2008 Value Return (most of which had already been paid during 2008).

BUSINESS SEGMENT OVERVIEW

Fonterra has four reportable segments that are defined by product type and geographic area to reflect how the Group's operations are managed. A description of the segments can be found in the Segment Reporting note to the Financial Statements.

Commodities & Ingredients

The C&I segment principally comprises the businesses of Fonterra Trade & Operations (FTO) and Global Ingredients & Foodservices (GIF). FTO includes the core New Zealand processing activities and most global sales of standard dairy ingredients.

GIF also sells standard dairy ingredients in certain markets but is increasingly focused on higher value specialty ingredients and is a leading provider of innovative dairy solutions – sourcing, partnering and supplying globally. Innovation and marketing efforts are aligned along four strategic categories: cheese, paediatric nutrition, functional nutrition and cultured milk products. GIF also manages the DFE and DairiConcepts joint ventures.

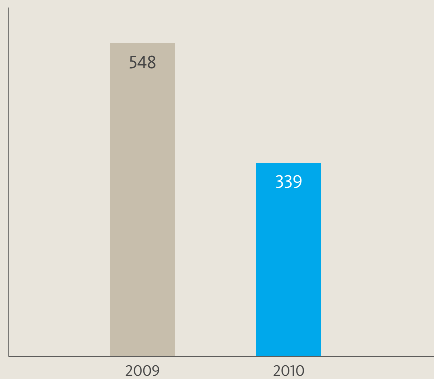
C&I external revenue was $11.2 billion, $721 million or seven per cent higher than the previous year. The increase in revenue was due to an increase in the average selling price achieved, with selling price increases for nine of the 12 C&I dairy ingredient categories, combined with a slight increase in sales volumes. Fonterra adopts a policy of hedging its foreign currency denominated ingredients revenues which more than offset translation losses when C&I revenue was converted back to New Zealand dollars.

Normalised segment profit before net finance costs and tax was $339 million, $209 million (38 per cent) lower than the prior year. The decrease reflects that average margins were put under pressure as market volatility meant prices for some products lagged rises in powder prices that are the main drivers of the Milk Price. The pricing of some of our customer contracts lagged the rapid increase in spot market prices and the rise in the Milk Price, also putting pressure on margins.

External sales volumes increased by 2.5 per cent as a result of higher demand as the global market showed more confidence and customers returned to the market to replenish stocks run down during the global financial crisis. This increase was partially offset by a slowdown in North America where local market prices were significantly lower than New Zealand prices, resulting in a fall in demand for Fonterra sourced product in that region.

During the 2010 financial year, a total of 359,300 MT was sold via Fonterra's *global*DairyTrade™ online platform, a substantial increase from the 213,500 MT sold via the platform in the previous 12 months and representing approximately 15 per cent of total ingredients sales volumes. Because *global*DairyTrade™ contracts are for delivery between two to eight months after each trading event, a substantial proportion of sales contracted in the latter stages of the 2010 financial year will be fulfilled from Fonterra production in the 2010/11 season. Three categories of product were sold via the *global*DairyTrade™ platform in 2010, compared with just one category (whole milk powder) in 2009. Whole milk powder (from both New Zealand and Australia) comprised 78 per cent of sales by volume in 2010, with the balance comprising skim milk powder and anhydrous milk fat. From August 2010, buttermilk powder also began to be sold and from September 2010 trading events increased from monthly to twice monthly. NZX Limited also announced that it will use *global*DairyTrade's™ whole milk powder contract period one (for delivery in the third month after the trading event) as the reference price for cash settlement of its new whole milk powder futures contract from October 2010.

COMMODITIES & INGREDIENTS NORMALISED EBIT
$ MILLION



Australia/New Zealand
External revenue for the Australia/New Zealand (ANZ) segment was $3.2 billion, a $117 million (four per cent) increase over 2009. Of this increase, $47 million was due to a lower New Zealand dollar against the Australian dollar.

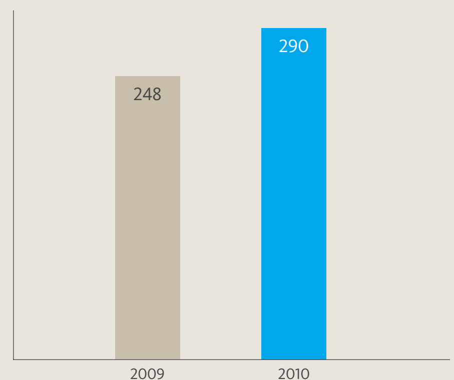
Normalised segment profit before net finance costs and tax of $290 million was $42 million (17 per cent) higher than the prior year. The main driver of the revenue improvement was volume growth, offset partly by pricing pressure across some categories. ANZ sales volumes increased four per cent over the prior year. Across most key categories, Fonterra's volumes grew faster than the overall market, increasing share. In New Zealand, Fonterra has retained strong leadership positions across all key categories, with number one rankings in cheese, spreads, yoghurts, milk and ice cream. Market shares grew in cheese and flavoured milk, but reduced in some ice cream market segments.

In Australia, Fonterra is ranked number one in cheese and spreads and number two in yoghurts. Market shares in Australia have experienced growth in all key categories. The cultured segment share continues to grow as a result of the earlier acquisition of Nestlé's yoghurt and dairy desserts business in Australia including the licences for the Nestlé™ and Ski™ brands. Sales volumes of yoghurts and dairy desserts grew 21 per cent after adjusting to reflect that the prior period did not include a full 12 months contribution from the acquired licences. Offsetting this growth was a reduction in sales due to the prior year divestment of the Western Australia ice cream business.

Average consumer selling prices in Australia remained steady across all key categories with the exception of spreads and cheese which decreased due to higher trade spend to grow and protect market share. Selling prices in New Zealand remained steady for cheese and butter, while ice cream prices increased reflecting non-dairy based raw material price increases.

Pricing of dairy ingredients (sales of which represented approximately 19 per cent of ANZ revenue) decreased compared with the previous year due to lower commodity prices and the stronger Australian dollar which impacted market price returns.

AUSTRALIA/NEW ZEALAND NORMALISED EBIT
$ MILLION



Asia/Africa, Middle East
External revenue for the Asia/Africa, Middle East (Asia/AME) segment was $1.5 billion, $129 million (eight per cent) lower than 2009 due to the unfavourable appreciation of the New Zealand dollar against a basket of Asian currencies. Excluding the exchange rate impact, revenue would have been up by $98 million (six per cent).

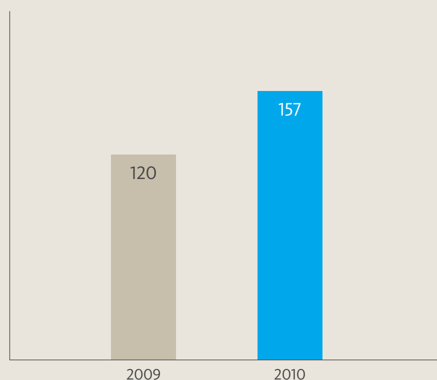
Normalised segment profit before net finance costs and tax of $157 million was $37 million (31 per cent) higher than the prior year. Operating margin improvements were driven by a higher mix of nutritional products and foodservice solutions.

Sales volumes across Asia/AME increased three per cent due to better performance from Anlene™ and Anmum™ milk products in Malaysia, Indonesia and Vietnam, and increased market share in Sri Lanka. A switch to high value dairy categories in some markets also had a positive impact on average prices. These benefits were partially offset by supply issues with some products across markets in the first half of the year and the impact of a typhoon that hit the Philippines in September 2009. Typhoon damage to co-packing operations and warehouses disrupted product availability for about four months.

The Asia/AME region's power brands are Anchor™, Anlene™ and Anmum™, collectively representing around two-thirds of revenue. In 2010, Anlene™ and Anmum™ milk products were the standout performers, growing revenue on a constant currency basis by 17 per cent and 29 per cent respectively. The year also saw the re-entry of the Anlene™ brand in selected Chinese cities, as well as the launch of Anchor Pedia-Pro™ a growing-up milk in Sri Lanka.

The foodservices business represents over a fifth of Asia/AME revenues. Foodservices revenues grew on a constant currency basis by 14 per cent in 2010, as the business targeted chefs with innovative solutions and specialised products geared for the commercial kitchen. A key strategy to build customer demand is an increasing emphasis on products that deliver unique benefits and solutions. Products are presented in the kitchen environment by demonstrating the use of Fonterra dairy products to chefs and other industry representatives.

ASIA/AFRICA, MIDDLE EAST NORMALISED EBIT
$ MILLION



Latin America
External revenue for the Latin America (Latam) segment was $731 million, an $18 million (two per cent) decrease over 2009. Revenue was $48 million lower due to appreciation of the New Zealand dollar against the Chilean peso. Normalised segment profit before net finance costs and tax was $118 million, a $12 million (11 per cent) increase on the prior year.

Sales volumes remained in line with the previous year. Higher sales of liquid and powder milk were partially offset by lower sales of juice and margarine. In the high value consumer segment, all key categories showed volume growth with the exception of UHT milk, yoghurts and desserts. The overall sales performance was achieved despite production constraints across some categories which included the effects of the earthquake that struck Chile in late February.

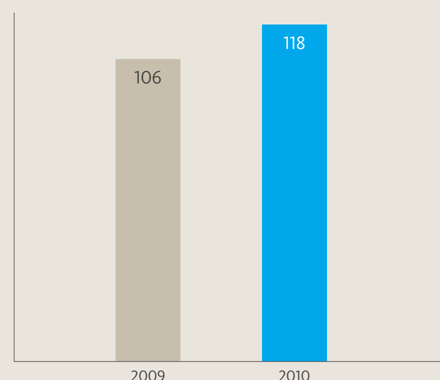
Average selling prices for consumer brands were higher as a result of an improvement in category yields, product mix and continuation of a brand innovation programme. Significant pricing uplifts were achieved in the juice, margarine and fresh cheese categories.

Dairy Partners Americas (DPA), our joint-venture with Nestlé in five countries, made a steady contribution to the financial results. Fonterra's share of earnings from the partnership were lower than last year as a result of the devaluation of the Venezuelan Bolivar, making that market challenging.

DPA Manufacturing purchased four per cent more milk than last year with a strong uplift in the second half of the year. The cost of milk increased sharply during the year in Argentina, Brazil and Ecuador.

Production capacity was increased during the year with the integration of the Brazilian Ibia site in DPA and the successful completion of major capital works to meet the JV partner's future product demand and quality standards.

LATIN AMERICA NORMALISED EBIT
$ MILLION



The Directors hereby approve and authorise for issue the financial statements for the year ended 31 July 2010 presented on pages 32 to 82.
For and on behalf of the Board:

SIR HENRY VAN DER HEYDEN
Chairman
22 September 2010

DAVID JACKSON
Director
22 September 2010

	2010			2009		
	$ MILLION	**MILLION**	**$**	$ MILLION	MILLION	$ PER kgMS
Payout (before retentions)						
Cost of Milk	**7,664**	**1,256 kgMS**	**6.10**	5,793	1,227 kgMS	4.72
Distributable Profit	**800**	**1,343 shares[1]**	**0.60**	603	1,227 kgMS	0.49
Payout (before retentions)	**8,464**		**6.70[2]**	6,396	1,227 kgMS	5.21
Payout						
Distributable Profit	**800**	**1,343 shares[1]**	**0.60**	603	1,227 kgMS	0.49
Less retentions	**(438)**	**1,343 shares[1]**	**(0.33)**	(12)	1,227 kgMS	(0.01)
Dividend paid & declared/Value Return paid	**362**		**0.27**	591	1,227 kgMS	0.48
Cost of Milk	**7,664**	**1,256 kgMS**	**6.10**	5,793	1,227 kgMS	4.72
Payout	**8,026**		**6.37[2]**	6,384	1,227 kgMS	5.20

1 At season end (31 May 2010).

2 Average for a 100% share backed supplier.

Note: Supplier premiums of $29 million equating to $0.02 per kgMS will be paid in addition to the Milk Price (2009: $35 million, $0.03 per kgMS).

The accompanying notes form part of these financial statements

INCOME STATEMENT
FOR THE YEAR ENDED 31 JULY 2010

	NOTES	GROUP $ MILLION 31 JULY 2010	GROUP $ MILLION RESTATED[1] 31 JULY 2009	PARENT $ MILLION 31 JULY 2010	PARENT $ MILLION RESTATED[1] 31 JULY 2009
Revenue from sale of goods		**16,726**	16,035	**7,952**	6,000
Dividends received		**–**	–	**458**	1,030
Total revenue		**16,726**	16,035	**8,410**	7,030
Cost of goods sold	1	**(13,975)**	(13,217)	**(7,952)**	(6,000)
Gross profit		**2,751**	2,818	**458**	1,030
Other operating income		**277**	119	**62**	38
Selling and marketing expenses		**(590)**	(554)	**(3)**	(6)
Distribution expenses		**(474)**	(481)	**–**	–
Administrative expenses		**(632)**	(634)	**(186)**	(186)
Other operating expenses		**(303)**	(367)	**(19)**	(72)
Net foreign exchange (losses)/gains	3	**(7)**	21	**–**	–
Operating profit	2	**1,022**	922	**312**	804
Finance income	4	**21**	41	**301**	344
Finance costs	4	**(334)**	(489)	**(279)**	(418)
Net finance (costs)/income		**(313)**	(448)	**22**	(74)
Share of profit of equity accounted investees	11	**56**	129	**–**	–
Impairment of equity accounted investees	11	**–**	(61)	**–**	–
Profit before tax		**765**	542	**334**	730
Tax (expense)/credit	5	**(80)**	68	**92**	261
Profit for the year		**685**	610	**426**	991
Profit for the year is attributable to:					
Shareholders of the Parent		**669**	599	**426**	991
Non-controlling interests		**16**	11	**–**	–
Profit for the year		**685**	610	**426**	991

	GROUP 31 JULY 2010	GROUP RESTATED[1] 31 JULY 2009
Reconciliation to Group Distributable Profit		
Profit attributable to Shareholders	**669**	599
Tax effect of retentions	**131**	4
Distributable Profit	**800**	603
Group Distributable Profit is apportioned to:		
Interim dividend paid	**107**	–
Final dividend declared	**255**	–
Value Return	**–**	591
Retentions	**438**	12
Distributable Profit	**800**	603

1 The Group has changed its accounting policy in respect of the recognition of the tax effect of distributions to Shareholders, refer to Statement of Significant Accounting Policies b).

The accompanying notes form part of these financial statements

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 JULY 2010

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2010	RESTATED[1] 31 JULY 2009	31 JULY 2010	RESTATED[1] 31 JULY 2009
Profit for the year	**685**	610	**426**	991
Cash flow hedges:				
– Net fair value gains/(losses)	**584**	(803)	**(53)**	–
– Transferred and reported in revenue from sale of goods	**(631)**	1,171	**–**	–
– Tax credit/(expense) on cash flow hedges	**18**	(110)	**15**	–
Net investment hedges:				
– Net fair value gains/(losses)	**65**	(6)	**–**	–
– Transferred and reported in the income statement	**–**	8	**–**	–
– Tax expense on net investment hedges	**(19)**	(1)	**–**	–
Foreign currency translation (losses)/gains attributable to Shareholders	**(150)**	12	**–**	–
Foreign currency translation reserve transferred to income statement	**19**	–	**–**	–
Foreign currency translation attributable to non-controlling interests	**(2)**	5	**–**	–
Other comprehensive (expense)/income recognised directly in equity	**(116)**	276	**(38)**	–
Total comprehensive income for the year	**569**	886	**388**	991
Attributable to:				
Shareholders of the Parent	**555**	870	**388**	991
Non-controlling interests	**14**	16	**–**	–
Total comprehensive income for the year	**569**	886	**388**	991

1 The Group has changed its accounting policy in respect of the recognition of the tax effect of distributions to Shareholders, refer to Statement of Significant Accounting Policies b).

The accompanying notes form part of these financial statements

BALANCE SHEET
AS AT 31 JULY 2010

	NOTES	GROUP $ MILLION AS AT 31 JULY 2010	GROUP $ MILLION AS AT 31 JULY 2009	PARENT $ MILLION AS AT 31 JULY 2010	PARENT $ MILLION AS AT 31 JULY 2009
ASSETS					
Current assets					
Cash and cash equivalents		**559**	600	**345**	349
Trade and other receivables	8	**2,088**	1,948	**8,215**	6,853
Inventories	9	**2,870**	2,656	**–**	–
Tax receivable		**18**	38	**–**	–
Derivative financial instruments	19(g)	**488**	613	**478**	610
Assets held for sale	11	**–**	67	**–**	–
Other current assets		**64**	66	**–**	–
Total current assets		**6,087**	5,988	**9,038**	7,812
Non-current assets					
Property, plant and equipment	10	**4,356**	4,403	**207**	142
Investment in subsidiaries		**–**	–	**6,895**	6,887
Equity accounted investments	11	**458**	506	**–**	–
Intangible assets	12	**2,756**	2,792	**46**	46
Deferred tax asset	16	**100**	103	**287**	327
Derivative financial instruments	19(g)	**214**	174	**214**	174
Other non-current assets		**198**	151	**28**	87
Total non-current assets		**8,082**	8,129	**7,677**	7,663
Total assets		**14,169**	14,117	**16,715**	15,475
LIABILITIES					
Current liabilities					
Bank overdraft		**25**	58	**–**	–
Borrowings	15	**902**	1,627	**397**	1,021
Trade and other payables	13	**1,251**	1,132	**5,770**	4,625
Owing to suppliers		**1,138**	1,207	**1,138**	1,207
Tax payable		**33**	25	**–**	–
Derivative financial instruments	19(g)	**113**	216	**103**	215
Provisions	14	**92**	143	**19**	37
Other current liabilities		**4**	6	**–**	–
Total current liabilities		**3,558**	4,414	**7,427**	7,105
Non-current liabilities					
Borrowings	15	**4,022**	4,167	**3,959**	3,983
Derivative financial instruments	19(g)	**496**	322	**496**	322
Provisions	14	**110**	78	**85**	57
Deferred tax liability	16	**293**	305	**–**	–
Other non-current liabilities		**23**	26	**–**	–
Total non-current liabilities		**4,944**	4,898	**4,540**	4,362
Total liabilities		**8,502**	9,312	**11,967**	11,467
EQUITY					
Co-operative shares		**5,016**	4,557	**5,016**	4,557
Retained earnings		**547**	26	**(230)**	(549)
Foreign currency translation reserve		**(73)**	12	**–**	–
Cash flow hedge reserve		**141**	170	**(38)**	–
Total equity attributable to Shareholders		**5,631**	4,765	**4,748**	4,008
Non-controlling interests		**36**	40	**–**	–
Total equity		**5,667**	4,805	**4,748**	4,008
Total liabilities and equity		**14,169**	14,117	**16,715**	15,475

The accompanying notes form part of these financial statements

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 JULY 2010

	ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT						
GROUP $ MILLION	CO-OPERATIVE SHARES	RETAINED EARNINGS	FOREIGN CURRENCY TRANSLATION RESERVE	CASH FLOW HEDGE RESERVE	TOTAL	NON-CONTROLLING INTERESTS	TOTAL EQUITY
As at 1 August 2008	4,297	18	(1)	(88)	4,226	43	4,269
Profit for the year (restated)[1]	–	599	–	–	599	11	610
Other comprehensive income for the year	–	–	13	258	271	5	276
Total comprehensive income for the year	–	599	13	258	870	16	886
Transactions with Shareholders in their capacity as Shareholders:							
Value Return paid to Shareholder Suppliers	–	(591)	–	–	(591)	–	(591)
Co-operative shares issued	766	–	–	–	766	–	766
Co-operative shares surrendered	(506)	–	–	–	(506)	–	(506)
Dividend paid to non-controlling interests	–	–	–	–	–	(19)	(19)
As at 31 July 2009	4,557	26	12	170	4,765	40	4,805
As at 1 August 2009	**4,557**	**26**	**12**	**170**	**4,765**	**40**	**4,805**
Profit for the year	**–**	**669**	**–**	**–**	**669**	**16**	**685**
Other comprehensive expense for the year	**–**	**–**	**(85)**	**(29)**	**(114)**	**(2)**	**(116)**
Total comprehensive income for the year	**–**	**669**	**(85)**	**(29)**	**555**	**14**	**569**
Transactions with Shareholders in their capacity as Shareholders:							
Dividends paid to Shareholders	**–**	**(107)**	**–**	**–**	**(107)**	**–**	**(107)**
Co-operative shares issued	**617**	**–**	**–**	**–**	**617**	**–**	**617**
Co-operative shares surrendered	**(158)**	**–**	**–**	**–**	**(158)**	**–**	**(158)**
Purchase of non-controlling interest	**–**	**(41)**	**–**	**–**	**(41)**	**(6)**	**(47)**
Dividend paid to non-controlling interests	**–**	**–**	**–**	**–**	**–**	**(12)**	**(12)**
As at 31 July 2010	**5,016**	**547**	**(73)**	**141**	**5,631**	**36**	**5,667**

PARENT $ MILLION	CO-OPERATIVE SHARES	RETAINED EARNINGS	CASH FLOW HEDGE RESERVE	TOTAL EQUITY
As at 1 August 2008	4,297	(949)	–	3,348
Profit for the year (restated)[1]	–	991	–	991
Other comprehensive income for the year	–	–	–	–
Total comprehensive income for the year	–	991	–	991
Transactions with Shareholders in their capacity as Shareholders:				
Value Return paid to Shareholder Suppliers	–	(591)	–	(591)
Co-operative shares issued	766	–	–	766
Co-operative shares surrendered	(506)	–	–	(506)
As at 31 July 2009	4,557	(549)	–	4,008
As at 1 August 2009	**4,557**	**(549)**	**–**	**4,008**
Profit for the year	**–**	**426**	**–**	**426**
Other comprehensive expense for the year	**–**	**–**	**(38)**	**(38)**
Total comprehensive income for the year	**–**	**426**	**(38)**	**388**
Transactions with Shareholders in their capacity as Shareholders:				
Dividends paid to Shareholders	**–**	**(107)**	**–**	**(107)**
Co-operative shares issued	**617**	**–**	**–**	**617**
Co-operative shares surrendered	**(158)**	**–**	**–**	**(158)**
As at 31 July 2010	**5,016**	**(230)**	**(38)**	**4,748**

1 The Group has changed its accounting policy in respect of the recognition of the tax effect of distributions to Shareholders, refer to Statement of Significant Accounting Policies b).

The accompanying notes form part of these financial statements

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 JULY 2010

	NOTES	GROUP $ MILLION		PARENT $ MILLION	
		31 JULY 2010	31 JULY 2009	31 JULY 2010	31 JULY 2009
Cash flows from operating activities					
Cash was provided from:					
– Receipts from customers		**16,549**	16,257	**7,996**	6,036
– Dividends received		**55**	68	**–**	–
– Tax received		**32**	19	**–**	–
Cash was applied to:					
– Payments to creditors and employees		**(6,784)**	(7,141)	**(231)**	(281)
– Payments for milk purchased		**(8,322)**	(7,519)	**(7,410)**	(6,413)
– Tax paid		**(51)**	(90)	**–**	–
Net cash flows from operating activities	17	**1,479**	1,594	**355**	(658)
Cash flows from investing activities					
Cash was provided from:					
– Proceeds from disposal of property, plant and equipment		**22**	69	**–**	23
– Gains on settlement of net investment hedges		**50**	–	**–**	–
– Proceeds from sale of Group entities and other business operations		**222**	44	**23**	–
– Repayment of advances from equity accounted investees		**–**	15	**–**	–
– Net loans from Group entities		**–**	–	**562**	681
Cash was applied to:					
– Acquisition of property, plant and equipment		**(437)**	(590)	**(105)**	(111)
– Acquisition of intangible assets		**(55)**	(47)	**(17)**	(20)
– Losses on settlement of net investment hedges		**(39)**	(112)	**–**	–
– Acquisition of Group entities and other business operations		**(14)**	(110)	**–**	(27)
– Purchase of non-controlling interests		**(48)**	(2)	**–**	–
– Advances made to equity accounted investees		**(50)**	(17)	**–**	(17)
– Acquisition of other non-current assets		**(5)**	(6)	**(1)**	(1)
Net cash flows from investing activities		**(354)**	(756)	**462**	528
Cash flows from financing activities					
Cash was provided from:					
– Proceeds from borrowings		**2,960**	3,854	**1,036**	3,080
– Proceeds from issue of Co-operative shares		**590**	687	**590**	687
– Gains on settlement of borrowing derivatives		**13**	228	**–**	–
– Proceeds for Co-operative shares not yet issued		**20**	63	**20**	63
– Interest received		**21**	41	**13**	30
Cash was applied to:					
– Interest paid		**(304)**	(324)	**(181)**	(186)
– Repayment of borrowings		**(3,549)**	(4,915)	**(1,443)**	(3,146)
– Losses on settlement of borrowing derivatives		**(37)**	(26)	**–**	–
– Surrender of Co-operative shares		**(158)**	(506)	**(158)**	(506)
– Dividends paid to non-controlling interests		**(12)**	(19)	**–**	–
– Dividends paid to Shareholders		**(107)**	–	**(107)**	–
– Value Return paid to Shareholder Suppliers		**(591)**	(12)	**(591)**	(12)
Net cash flows from financing activities		**(1,154)**	(929)	**(821)**	10
Net decrease in cash and cash equivalents		**(29)**	(91)	**(4)**	(120)
Cash and cash equivalents at the beginning of the year		**542**	614	**349**	469
Effect of exchange rate changes on cash balances		**21**	19	**–**	–
Cash and cash equivalents at the end of the year		**534**	542	**345**	349
Reconciliation of closing cash balances to the balance sheet:					
Cash and cash equivalents		**559**	600	**345**	349
Bank overdraft		**(25)**	(58)	**–**	–
Closing cash balances		**534**	542	**345**	349

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

There were no material non-cash transactions during the year ended 31 July 2010, or for the year ended 31 July 2009.

The accompanying notes form part of these financial statements

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.

At Fonterra's Annual Meeting on 18 November 2009, Shareholders approved the first two stages of changes to the Company's Capital Structure. As a result of these changes, all shares, whether supply backed or not, are now eligible to receive a dividend if declared by the Board. Previously, a Value Return payment was made in respect of supply backed shares only.

On 30 June 2010, Shareholders approved changes to the Company's constitution that will allow the Board to take steps to implement a third stage of changes to Fonterra's Capital Structure that would permit trading of shares among Shareholders. Refer to Note 7 for further information.

b) Change in accounting policy

As a result of the changes to Capital Structure during the year, Fonterra has commenced payment of dividends. Previously, in addition to the Milk Price, returns to Shareholder Suppliers were by way of the Value Return payment.

In March 2010 the International Financial Reporting Interpretations Committee recommended that the recognition of tax credits on distributions to holders of equity instruments in the income statement should be permitted. The Board has concluded that the recognition of tax credits in the income statement provides more relevant information to the users of the financial statements as it reflects Fonterra's actual tax position. Therefore Fonterra has changed its accounting policy to now recognise the tax consequences of distributions to Shareholders within tax expense in the income statement.

This change in accounting policy has been applied retrospectively and the tax effect of distributions to Shareholders of $177 million recognised in equity for the year ended 31 July 2009 is now presented in the income statement. There is no impact on the comparative balance sheet as a result of this change. The tax effect of distributions to Shareholders of $109 million has been recognised in the income statement for the year ended 31 July 2010.

c) 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

d) 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 directly 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 balance sheet, separately from equity attributable to Shareholders.

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.

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.

e) 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 reporting 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 reporting 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 (FCTR). 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.

f) 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 trade date) 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. 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 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 k) 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.

Held-to-maturity investments
Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity for which there is a positive intention and ability to hold to maturity, other than those

that are designated on initial recognition as either fair value through profit or loss or available-for-sale, or meet the definition of loans and receivables.

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.

Available-for-sale financial assets
Available-for-sale financial assets are non-derivative financial assets that are either designated in this category or not classified in any of the other categories. Fair value changes are recognised directly in other comprehensive income until the investment is either derecognised or determined to be impaired, at which time the cumulative gain or loss that was reported in equity is recognised in the income statement.

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 only recognised upon the failure of the debtor to make payment, but the full potential exposure is disclosed.

g) 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.

h) Trade receivables
Trade receivables are carried at their net realisable value.

i) 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 borrowings classified as net investment hedges.

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.

j) Trade and other payables
Trade and other payables are carried at amortised cost.

k) 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.

l) 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 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.

m) 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 balance sheet. 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 balance sheet. Operating lease payments are recognised as an expense on a straight line basis over the term of the lease.

n) 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. Any negative goodwill arising on an acquisition is recognised immediately in the income statement.

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.

o) 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 issuer or obligor;
- A breach of contract, such as a default or delinquency in interest or principal payments;
- For economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the Group would not otherwise consider;
- It becomes probable that the borrower will enter bankruptcy or other financial reorganisation;
- The disappearance of an active market for that financial asset because of financial difficulties; or
- Observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
  - (i) Adverse changes in the payment status of borrowers in the portfolio; and
  - (ii) National or local economic conditions that correlate with defaults on the assets in the portfolio.

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.

p) 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 reporting date.

q) 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.

r) 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.

s) 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.

t) Payout
Payout comprises Cost of Milk, and dividends (2010 and subsequent years) or Value Return (2009 and prior periods).

Cost of Milk
The Cost of Milk comprises the volume of milksolids supplied by Shareholders at the Milk Price for the season. The Milk Price for the season is calculated in accordance with the principles set out in the Milk Price Manual and is independently audited. The 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. Milk Price is recognised within cost of goods sold.

Dividends
As a result of the change to the capital structure, Value Return payments are no longer made. 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.

Value Return
Value Return attributable to Shareholder Suppliers was the component of Payout that remained after deducting the Cost of Milk and retentions. The Value Return payment was recognised directly in equity.

For accounting purposes the Value Return attributable to Shareholder Suppliers was treated as a transaction with Shareholder Suppliers in their capacity as Shareholders. For presentation in the financial statements, the Value Return attributable to Shareholders was presented as a deduction directly from equity.

Supplier Premiums and Contract Milk
Supplier Premiums are paid for specialty milks, such as winter milk and colostrum. Supplier Premiums are recognised within cost of goods sold.

Payment for contract milk supplied is included in other purchases within cost of goods sold.

u) Employee benefits
Employee benefits primarily include short 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.

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 reporting 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 reporting 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) 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.

y) New and amended International Financial Reporting Standards
Except for the changes explained below and the change in accounting policy outlined in b) above, the accounting policies used are consistent with those used to prepare the consolidated financial statements for the year ended 31 July 2009. The Group has adopted the following new and amended NZ IFRSs and NZ IASs during the year which had an impact on the financial statements:

NZ IFRS 3 (revised): Business Combinations requires all payments to purchase a business to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the income statement and all acquisition related costs expensed. The change has not impacted reported earnings but can reasonably be expected to impact future business combinations.

NZ IFRS 7: Financial Instruments – Disclosures requires in particular, the disclosure of fair value measurements by level of a fair value measurement hierarchy. As the change in accounting policy is presentational, there has been no impact on reported earnings as a result of adoption of this amendment.

NZ IAS 1 (revised): Presentation of Financial Statements requires that a statement of changes in equity and a statement of comprehensive income be presented as primary financial statements. As the change in the accounting policy is only presentational, there has been no impact on reported earnings as a result of adoption of this standard.

NZ IAS 27 (revised): Consolidated and Separate Financial Statements requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control. Where control is lost, the remaining interest in the entity is re-measured to fair value and a gain or loss is recognised in the income statement. The acquisition of non-controlling interests since 1 August 2009, has resulted in a $41 million reduction in retained earnings.

New standards and amendments to existing standards which could be expected to have an impact on the Group's financial statements, which were available for early adoption but have not been adopted, are stated below:

NZ IFRS 7: Financial Instruments – Disclosures requires qualitative disclosures to be made which better enable users to evaluate an entity's exposure to risks arising from financial instruments. The disclosure of past due or impaired financial assets has been removed, and clarification provided in relation to credit risk disclosures. As the change in accounting policy is only presentational, there will be no impact on reported earnings as a result of the adoption of this standard.

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, including some hybrid contracts. NZ IFRS 9 uses a single approach based on how an entity manages and the contractual cash flow characteristics of its financial instruments, to determine whether a financial asset is measured at amortised cost or fair value and a single impairment method. At this time it is not possible to reasonably estimate the impact of adoption.

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1 COST OF GOODS SOLD

		GROUP $ MILLION		PARENT $ MILLION	
	NOTES	31 JULY 2010	31 JULY 2009	31 JULY 2010	31 JULY 2009
Opening inventory		**2,656**	3,288	**–**	–
Cost of Milk		**7,664**	5,793	**7,664**	5,793
Supplier Premiums		**29**	35	**29**	35
Other purchases		**6,496**	6,757	**259**	172
Closing inventory	9	**(2,870)**	(2,656)	**–**	–
Total cost of goods sold		**13,975**	13,217	**7,952**	6,000

Fonterra collects approximately 89% of all New Zealand milk and accordingly there is not a market based price for raw milk acquired in New Zealand. The Cost of Milk is based on the Milk Price for the season, calculated in accordance with the Milk Price Manual.

2 OPERATING PROFIT

		GROUP $ MILLION		PARENT $ MILLION	
	NOTES	31 JULY 2010	31 JULY 2009	31 JULY 2010	31 JULY 2009
The following items have been included in arriving at operating profit:					
Auditors' remuneration:					
– Audit fees		**4**	4	**2**	2
– Other audit related services[1]		**2**	2	**1**	1
– Other services[2]		**1**	1	**–**	–
Operating lease expense		**54**	64	**–**	4
Restructuring and rationalisation costs	14	**9**	6	**–**	(1)
Research and development costs		**98**	86	**7**	8
Gain on acquisition	18	**–**	(13)	**–**	–
Net (gain)/loss on disposal of investments	11	**(127)**	3	**–**	–
Net loss/(gain) on disposal of property, plant and equipment		**3**	(8)	**–**	–
Receipt for amendments to equity accounted investee arrangements		**41**	–	**–**	–
Donations and grants		**6**	8	**–**	8
Total employee benefits expense		**1,460**	1,364	**87**	75
Included in employee benefits expense are:					
– Contributions to defined contribution plans		**42**	42	**1**	1

1 Other audit related services include services for financial and information technology controls assurance and other attest services.

2 Other services include financial reporting and advisory services.

3 NET FOREIGN EXCHANGE (LOSSES)/GAINS

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2010	31 JULY 2009	31 JULY 2010	31 JULY 2009
Net foreign exchange gains/(losses) on debt instruments designated in a fair value hedge relationship	**311**	(219)	**–**	–
Net foreign exchange (losses)/gains on derivative instruments designated as a fair value hedge	**(317)**	220	**–**	–
Net foreign exchange gains/(losses) on financial instruments classified as held for trading	**85**	(170)	**–**	–
Net foreign exchange (losses)/gains on financial assets classified as loans and receivables	**(196)**	318	**–**	–
Net foreign exchange gains/(losses) on financial liabilities measured at amortised cost	**109**	(135)	**–**	–
Other net foreign exchange gains	**1**	7	**–**	–
Net foreign exchange (losses)/gains	**(7)**	21	**–**	–

4 NET FINANCE (COSTS)/INCOME

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2010	31 JULY 2009	31 JULY 2010	31 JULY 2009
Finance income	**21**	41	**301**	344
Interest expense on financial liabilities measured at amortised cost	**(343)**	(486)	**(288)**	(418)
Accrued and realised interest expense on derivatives classified as held for trading	**(61)**	(41)	**(61)**	(38)
Total interest expense calculated on an amortised cost basis	**(404)**	(527)	**(349)**	(456)
Change in fair value of forward points on cash flow hedges and net investment hedges	**1**	168	**–**	–
Change in fair value of hedged risks on debt instruments designated in a fair value hedge relationship	**(82)**	(23)	**(82)**	(23)
Change in fair value of derivative instruments designated as a fair value hedge[1]	**141**	70	**141**	70
Change in fair value of financial instruments classified as held for trading	**10**	(177)	**11**	(9)
Finance costs	**(334)**	(489)	**(279)**	(418)
Net finance (costs)/income	**(313)**	(448)	**22**	(74)

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)

	NOTES	GROUP $ MILLION 31 JULY 2010	GROUP $ MILLION RESTATED[1] 31 JULY 2009	PARENT $ MILLION 31 JULY 2010	PARENT $ MILLION RESTATED[1] 31 JULY 2009
Current tax expense/(credit)		**118**	70	**(147)**	(82)
Prior period adjustments to current tax		**(24)**	(26)	**–**	(1)
Deferred tax movements:					
– Origination and reversal of temporary differences	16	**(67)**	(117)	**31**	(178)
– Change to tax depreciation on buildings	16	**61**	–	**4**	–
– Change in New Zealand corporate tax rate	16	**(8)**	5	**20**	–
Tax expense/(credit)		**80**	(68)	**(92)**	(261)
Profit/(loss) before tax		**765**	542	**334**	730
Prima facie tax expense at 30%		**230**	163	**100**	219
Add/(deduct) tax effect of:					
– Effect of tax rates in foreign jurisdictions		**(16)**	8	**–**	–
– Non-deductible expenses/additional assessable income		**73**	94	**48**	8
– Non-assessable income/additional deductible expenses		**(90)**	(161)	**(155)**	(310)
– Losses of overseas Group entities (recognised)/not recognised		**(37)**	26	**–**	–
– Over provision prior year		**(24)**	(26)	**–**	(1)
– Tax effect of distributions to Shareholders[1]		**(109)**	(177)	**(109)**	(177)
– Impact of change in tax rate[2]		**(8)**	5	**20**	–
– Effect of change to tax depreciation on buildings[3]		**61**	–	**4**	–
Tax expense/(credit)		**80**	(68)	**(92)**	(261)
Imputation credits:					
Opening balance				**9**	8
Imputation credits attached to dividends received				**–**	1
Closing balance				**9**	9
The imputation credits are available to the Shareholders of the Parent company:					
– Through the Parent company				**9**	9
– Through Group entities				**10**	10
				19	19
Dividend withholding payment credits:					
The dividend withholding payment credits are available to the Shareholders of the Parent company:					
– Through the Parent company				**–**	–
– Through Group entities				**1**	1
				1	1
Tax losses					
Gross tax losses available for which no deferred tax asset has been recognised		**56**	188	**–**	–

1 The Group has changed its accounting policy in respect of the recognition of the tax effect of distributions to Shareholders, refer to Statement of Significant Accounting Policies b).

2 As a result of the change in the New Zealand corporate tax rate from 30% to 28% which was enacted on 27 May 2010 and will be effective from 1 August 2011, deferred tax expected to reverse in the year to 31 July 2012 or later has been measured using 28%.

3 As a result of the change in tax legislation which was enacted on 27 May 2010 and will be effective from 1 August 2011, the tax depreciation rate on buildings with an estimated useful life of 50 years or more will be reduced to nil. This reduction in the tax depreciation rate has significantly reduced the tax base of the Group's buildings as future tax deductions will no longer be available from the 2011/12 income year. This has resulted in an increase to the deferred tax liability of $61 million which has been recognised in tax expense in the current year.

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 Parent operates in one reportable segment that is defined by product type and geographic area, being the collection and sale of milk (to a subsidiary) in New Zealand.

The reportable segments presented reflect the Group's management and reporting structure as viewed by the Fonterra Executive Committee, who are the chief operating decision makers.

Transactions between segments are based on estimated market prices.

Reportable segment	*Description*
Commodities & Ingredients	Includes New Zealand Milk Supply, New Zealand Manufacturing, Global Portfolio Optimisation, Global Trade (including the China Ingredients business), Global Supply Chain, Fonterra Ingredients and Specialty Ingredients operations in North Asia, North America and Europe (including equity accounted investments), and Corporate.
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).
Asia/AME	Represents FMCG operations and equity accounted investments in Asia (excluding North Asia), Africa and the Middle East.
Latam	Represents FMCG operations in Chile and equity accounted investments in South America.

$ MILLION	COMMODITIES & INGREDIENTS	ANZ	ASIA/AME	LATAM	ELIMINATIONS	TOTAL GROUP
Segment revenue from sale of goods						
Year ended 31 July 2010						
External revenue	**11,225**	**3,233**	**1,537**	**731**	**–**	**16,726**
Inter-segment revenue	**1,532**	**570**	**–**	**7**	**(2,109)**	**–**
Revenue from sale of goods	**12,757**	**3,803**	**1,537**	**738**	**(2,109)**	**16,726**
Year ended 31 July 2009						
External revenue	10,504	3,116	1,666	749	–	16,035
Inter-segment revenue	1,502	702	39	49	(2,292)	–
Revenue from sale of goods	12,006	3,818	1,705	798	(2,292)	16,035
Segment profit						
Year ended 31 July 2010						
Segment operating profit before depreciation, amortisation, share of royalty income and non-recurring items	**675**	**372**	**166**	**94**	**–**	**1,307**
Depreciation	**(317)**	**(74)**	**(6)**	**(19)**	**–**	**(416)**
Amortisation	**(57)**	**(8)**	**(3)**	**–**	**–**	**(68)**
Share of royalty income	**5**	**–**	**–**	**20**	**–**	**25**
Non-recurring items	**190**	**(4)**	**–**	**(12)**	**–**	**174**
Segment operating profit	**496**	**286**	**157**	**83**	**–**	**1,022**
Share of profit of equity accounted investees	**33**	**–**	**–**	**23**	**–**	**56**
Segment profit before unallocated finance income, finance costs and tax	**529**	**286**	**157**	**106**	**–**	**1,078**
Finance income						**21**
Finance costs						**(334)**
Tax expense						**(80)**
Profit for the year						**685**

6 SEGMENT REPORTING (CONTINUED)

$ MILLION	COMMODITIES & INGREDIENTS	ANZ	ASIA/AME	LATAM	ELIMINATIONS	RESTATED[1] TOTAL GROUP
Year ended 31 July 2009						
Segment operating profit before depreciation, amortisation, share of royalty income and non-recurring items	846	322	129	67	(3)	1,361
Depreciation	(327)	(70)	(7)	(20)	–	(424)
Amortisation	(67)	(4)	(2)	–	–	(73)
Share of royalty income	6	–	–	20	–	26
Non-recurring items	35	(8)	5	–	–	32
Segment operating profit	493	240	125	67	(3)	922
Share of profit of equity accounted investees	62	–	–	39	–	101
Share of profit of equity accounted investees classified as assets held for sale	28	–	–	–	–	28
Impairment of equity accounted investees	1	–	(62)	–	–	(61)
Segment profit before unallocated finance income, finance costs and tax	584	240	63	106	(3)	990
Finance income						41
Finance costs						(489)
Tax credit[1]						68
Profit for the year						610

1 The Group has changed its accounting policy in respect of the recognition of the tax effect of distributions to Shareholders, refer to Statement of Significant Accounting Policies b).

$ MILLION	COMMODITIES & INGREDIENTS	ANZ	ASIA/AME	LATAM	ELIMINATIONS	TOTAL GROUP
Segment assets						
As at and for the year ended 31 July 2010						
Total assets	**9,007**	**3,558**	**1,126**	**867**	**(389)**	**14,169**
Equity accounted investments (included in total assets)	**231**	**–**	**–**	**227**	**–**	**458**
Capital expenditure	**378**	**74**	**13**	**27**	**–**	**492**
As at and for the year ended 31 July 2009						
Total assets	8,734	3,599	1,156	936	(308)	14,117
Equity accounted investments (included in total assets)	245	–	–	261	–	506
Assets held for sale	67	–	–	–	–	67
Capital expenditure	506	180	18	30	–	734

	GROUP $ MILLION	
	31 JULY 2010	31 JULY 2009
Entity wide products and services		
Consumer goods	**4,908**	5,048
Ingredients	**11,818**	10,987
Total Group revenue	**16,726**	16,035

6 SEGMENT REPORTING (CONTINUED)

$ MILLION	NEW ZEALAND	AUSTRALIA	USA	REST OF WORLD	ELIMINATIONS	TOTAL
Geographical segment revenue						
Year ended 31 July 2010						
Total external revenue	**9,073**	**2,333**	**1,234**	**4,086**	**–**	**16,726**
Inter-segment revenue	**3,489**	**531**	**31**	**152**	**(4,203)**	**–**
Total revenue	**12,562**	**2,864**	**1,265**	**4,238**	**(4,203)**	**16,726**
Year ended 31 July 2009						
Total external revenue	6,784	2,218	1,762	5,271	–	16,035
Inter-segment revenue	4,120	693	44	189	(5,046)	–
Total revenue	10,904	2,911	1,806	5,460	(5,046)	16,035
Geographical segment reportable non-current assets						
As at 31 July 2010	**4,790**	**1,077**	**136**	**1,765**	**–**	**7,768**
As at 31 July 2009	5,105	1,176	129	1,442	–	7,852

	GROUP $ MILLION	
	AS AT 31 JULY 2010	AS AT 31 JULY 2009
Reconciliation of geographical segment non-current assets to total non-current assets		
Geographical segment non-current assets	**7,768**	7,852
Deferred tax asset	**100**	103
Derivative financial instruments	**214**	174
Total non-current assets	**8,082**	8,129

Revenue is allocated to geographical segments on the basis of where the sale is legally recorded.

7 CAPITAL AND RESERVES

GROUP AND PARENT NUMBERS (THOUSANDS)	CO-OPERATIVE SHARES
Balance at 1 August 2008	1,199,913
Issued	147,981
Surrendered	(96,603)
Balance at 31 July 2009	1,251,291
Balance at 1 August 2009	**1,251,291**
Issued	**136,415**
Surrendered	**(34,863)**
Balance at 31 July 2010	**1,352,843**

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 under contract supply or as unshared supply, in that season. This is known as the share standard. Shareholders supplying under contract must hold at least 1,000 shares.

In addition, suppliers are able to hold further shares up to 20% of the number of Co-operative shares determined in accordance with the share standard for that season.

Rights attaching to the 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 dairy farm 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.

On 18 November 2009 Shareholders voted to approve stages one and two of the Capital Structure changes. As a result of the implementation of stages one and two, 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 taking the advice of an independent valuer.

The use of a Restricted Share Value represents a constitutional change to the fair value method used previously 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 under both the Restricted Share Value approach and the fair value method. During the transition period the 2009 fair value operates as a current base price. If the Restricted Share Value is less than the fair value, then the fair value price at that time will be used as the share value. Once the Restricted Share Value is greater than the fair value 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 2010/11 season has been set by the Board at $4.52 per share (2009: fair value of $4.52 per share).

Shareholders may elect, within the application period (15 December–28 February) to purchase and surrender shares. Shareholders may elect to transact at the June price, which is the Co-operative share price for the coming season, or under the default price mechanism. This mechanism sets a price range of +/- 7.5% of the interim share price set by the Board. 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 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 current season share price.

7 CAPITAL AND RESERVES (CONTINUED)

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 may:

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

Shareholders may be permitted to hold an unshared supply entitlement not exceeding 20% of a 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.

Additional 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 stage three of Capital Structure changes which have the following key objectives:

- The establishment of a platform to enable share trading amongst Shareholder Suppliers at a market price.
- The establishment of the Fonterra Shareholders' Fund that would acquire from Shareholders the right to receive dividends and the gain/loss from any change in the value of the shares, whilst Shareholder Suppliers retain voting rights and the access to milk payments attached to the shares.

There is no current year impact arising out of the approval granted on 30 June 2010.

Dividends paid
As a result of the change to the Capital Structure, all shares are eligible to receive a dividend if declared by the Board. On 23 March 2010, the Board declared an interim dividend of 8 cents per share (totalling $107 million), paid on 20 April 2010 to all shares on issue at 31 March 2010.

On 22 September 2010 the Board of Directors declared a final dividend of 19 cents per share payable on 20 October 2010 to the Shareholders on the share register at 31 May 2010.

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 2010	AS AT 31 JULY 2009	AS AT 31 JULY 2010	AS AT 31 JULY 2009
Trade receivables	**1,993**	1,891	**2**	7
Less: provision for impairment of trade receivables	**(36)**	(57)	**–**	–
Trade receivables less provision for impairment	**1,957**	1,834	**2**	7
Receivables from related parties[1]	**20**	19	**8,178**	6,833
Other receivables	**59**	57	**–**	–
Total receivables	**2,036**	1,910	**8,180**	6,840
Prepayments	**52**	38	**35**	13
Total trade and other receivables	**2,088**	1,948	**8,215**	6,853

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

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2010	31 JULY 2009	31 JULY 2010	31 JULY 2009
Movement in the provision for impairment of trade receivables:				
Opening balance	**57**	29	**–**	–
Additional provisions	**8**	41	**–**	–
Utilised during the year	**(3)**	(4)	**–**	–
Unused amounts reversed	**(22)**	(11)	**–**	–
Foreign currency translation	**(4)**	2	**–**	–
Closing balance	**36**	57	**–**	–

9 INVENTORIES

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2010	AS AT 31 JULY 2009	AS AT 31 JULY 2010	AS AT 31 JULY 2009
Raw materials	**328**	328	**–**	–
Finished goods	**2,658**	2,480	**–**	–
Impairment of finished goods	**(116)**	(152)	**–**	–
Total inventories	**2,870**	2,656	**–**	–
Other disclosures:				
Inventories stated at net realisable value	**1,414**	1,052	**–**	–
Amount of inventories pledged as security for liabilities	**100**	118	**–**	–
Amount of inventories recognised in cost of goods sold during the year	**13,975**	13,217	**–**	–

Prior to 2010, Fonterra used the annual Milk Price as a basis for valuing inventory. During the year, Fonterra has adopted the monthly Milk Price for valuing inventory. Had this change in accounting estimate been reflected in opening inventory, costs of goods sold for the year ended 31 July 2010 would have been $124 million lower than reported. The impact of the adoption of a monthly Milk Price is reflected in the Commodities and Ingredients segment. Due to the nature of Fonterra's business, Fonterra is unable to determine the ongoing impact of this change in estimate on future years.

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 2008						
Cost		281	1,352	4,405	298	6,336
Accumulated depreciation and impairment		–	(327)	(1,717)	–	(2,044)
Net book value		281	1,025	2,688	298	4,292
Net book value						
As at 1 August 2008		281	1,025	2,688	298	4,292
Additions		9	–	–	588	597
Acquired as a result of business combinations		–	11	30	–	41
Transfer from capital work in progress		–	90	332	(422)	–
Transfer to intangible assets	12	–	–	–	(36)	(36)
Depreciation charge		–	(67)	(357)	–	(424)
Impairment losses		–	–	(11)	–	(11)
Disposals		(4)	(35)	(24)	–	(63)
Foreign currency translation		–	3	1	3	7
As at 31 July 2009		286	1,027	2,659	431	4,403
As at 31 July 2009						
Cost		286	1,414	4,630	431	6,761
Accumulated depreciation and impairment		–	(387)	(1,971)	–	(2,358)
Net book value		286	1,027	2,659	431	4,403
Net book value						
As at 1 August 2009		286	1,027	2,659	431	4,403
Additions		4	–	–	438	442
Transfer from capital work in progress		–	121	424	(545)	–
Transfer of assets between classes		–	23	(23)	–	–
Transfer to intangible assets	12	–	–	–	(20)	(20)
Depreciation charge		–	(66)	(350)	–	(416)
Impairment losses		–	–	(2)	–	(2)
Disposals		(2)	(1)	(20)	–	(23)
Foreign currency translation		(2)	(8)	(13)	(5)	(28)
As at 31 July 2010		286	1,096	2,675	299	4,356
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

The net book value of property, plant and equipment subject to finance leases for the Group is $141 million (31 July 2009: $67 million). Of that balance $5 million relates to land (31 July 2009: $5 million), $120 million relates to building and leasehold improvements (31 July 2009: $62 million), and $16 million relates to plant and equipment (31 July 2009: nil).

Impairment losses of $2 million recognised in the current year relate to the Latam segment and are recognised within other operating expenses in the income statement. Prior year impairment losses of $11 million were recognised as a result of the discontinuation of an immaterial non-strategic business operation, and all relate to the ANZ segment and are recognised within other operating expenses in the income statement.

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 2008						
Cost		6	40	64	14	124
Accumulated depreciation and impairment		–	(11)	(39)	–	(50)
Net book value		6	29	25	14	74
Net book value						
As at 1 August 2008		6	29	25	14	74
Additions		5	–	–	88	93
Additions from other Group entities		–	24	3	–	27
Transfer from capital work in progress		–	42	18	(60)	–
Transfer to intangible assets	12	–	–	–	(11)	(11)
Depreciation charge		–	(3)	(10)	–	(13)
Disposals		–	(25)	(3)	–	(28)
As at 31 July 2009		11	67	33	31	142
As at 31 July 2009						
Cost		11	81	82	31	205
Accumulated depreciation and impairment		–	(14)	(49)	–	(63)
Net book value		11	67	33	31	142
Net book value						
As at 1 August 2009		11	67	33	31	142
Additions		–	–	–	108	108
Transfer from capital work in progress		–	51	30	(81)	–
Transfer to intangible assets	12	–	–	–	(10)	(10)
Depreciation charge		–	(3)	(10)	–	(13)
Disposals		–	–	(1)	–	(1)
Disposals to other Group entitles		(6)	(10)	(3)	–	(19)
As at 31 July 2010		5	105	49	48	207
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

The net book value of property, plant and equipment subject to finance leases for the Parent is $141 million (31 July 2009: $67 million). Of that balance $5 million relates to land (31 July 2009: $5 million), $120 million relates to building and leasehold improvements (31 July 2009: $62 million), and $16 million relates to plant and equipment (31 July 2009: nil).

11 EQUITY ACCOUNTED INVESTMENTS

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

Acquisitions during the year to 31 July 2010 included a further capital injection into DairiConcepts L.P. to finance its acquisition of the US hard Italian cheese businesses of Swiss Valley Farms. The movement in the carrying value of equity accounted investees is as follows:

	GROUP $ MILLION	
	31 JULY 2010	31 JULY 2009
Opening balance	**506**	592
– Share of profit after tax	**56**	101
– Share of profit from assets held for sale	**–**	28
Total share of profit after tax	**56**	129
Acquired	**14**	1
Disposals	**–**	(8)
Transfer to assets held for sale	**–**	(67)
Impairment of equity accounted investees	**–**	(61)
Foreign currency translation	**(63)**	(13)
Dividends received	**(55)**	(67)
Closing balance	**458**	506

Amount of goodwill in carrying value of equity accounted investees:		
Opening balance	**241**	268
Closing balance	**218**	241

At 31 July 2009 Fonterra's interest in AFF P/S was presented as held for sale following the Board's commitment to dispose of this investment at that time. The carrying value at 31 July 2009 was $67 million. On 19 November 2009, Fonterra disposed of its 25% interest in AFF P/S. Amongst the ongoing arrangements Fonterra will continue to licence the Anchor™ brand to AFF P/S and will continue to supply butter. The transaction and wider arrangements resulted in a net pre-tax gain of $127 million. The gain forms part of the Commodities & Ingredients segment and has been included within other operating income.

Disposals during the year to 31 July 2009 included the sale of Fonterra's 49% interest in Britannia New Zealand Foods PVTE Limited and 30% interest in Ba'Emek Advanced Technologies F.A. Limited (Ba'Emek).

In the year ended 31 July 2009 Fonterra's investment in San Lu of $62 million was written down to nil and a $1 million reversal of a prior year impairment was also recognised on the disposal of the Group's interest in Ba'Emek.

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

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

	$ MILLION	
	AS AT AND FOR THE YEAR TO 31 JULY 2010	AS AT AND FOR THE YEAR TO 31 JULY 2009
Assets:		
Non-current assets	**1,050**	970
Current assets	**1,021**	839
	2,071	1,809
Liabilities:		
Long-term liabilities	**(433)**	(293)
Current liabilities	**(735)**	(531)
	(1,168)	(824)
Net assets	**903**	985
Revenue	**3,603**	4,189
Expenses (including interest and tax)	**(3,518)**	(3,974)
Profit after tax	**85**	215

12 INTANGIBLE ASSETS

		GROUP					PARENT
$ MILLION	NOTES	GOODWILL	BRANDS	SOFTWARE	OTHER	TOTAL INTANGIBLES	SOFTWARE
As at 31 July 2008							
Cost		1,003	1,553	512	89	3,157	101
Accumulated amortisation and impairment		–	(84)	(310)	(83)	(477)	(71)
Net book value		1,003	1,469	202	6	2,680	30
Net book value							
As at 1 August 2008		1,003	1,469	202	6	2,680	30
Additions		1	–	33	5	39	17
Acquired as a result of business combinations		–	106	–	–	106	–
Transfer from capital work in progress	10	–	–	36	–	36	11
Amortisation		–	(5)	(64)	(4)	(73)	(12)
Impairment losses		(2)	–	–	(1)	(3)	–
Disposals		(4)	(18)	(1)	–	(23)	–
Foreign currency translation		4	24	2	–	30	–
As at 31 July 2009		1,002	1,576	208	6	2,792	46
As at 31 July 2009							
Cost		1,004	1,665	579	94	3,342	129
Accumulated amortisation and impairment		(2)	(89)	(371)	(88)	(550)	(83)
Net book value		1,002	1,576	208	6	2,792	46
Net book value							
As at 1 August 2009		**1,002**	**1,576**	**208**	**6**	**2,792**	**46**
Additions		**–**	**–**	**44**	**6**	**50**	**14**
Acquired as a result of business combinations		**–**	**–**	**–**	**–**	**–**	**–**
Transfer from capital work in progress	10	**–**	**–**	**20**	**–**	**20**	**10**
Amortisation		**–**	**(6)**	**(58)**	**(4)**	**(68)**	**(14)**
Transfer to other Group entities		**–**	**–**	**–**	**–**	**–**	**(10)**
Disposals		**–**	**–**	**(2)**	**–**	**(2)**	**–**
Foreign currency translation		**(15)**	**(21)**	**–**	**–**	**(36)**	**–**
As at 31 July 2010		**987**	**1,549**	**212**	**8**	**2,756**	**46**
As at 31 July 2010							
Cost		**989**	**1,643**	**628**	**97**	**3,357**	**135**
Accumulated amortisation and impairment		**(2)**	**(94)**	**(416)**	**(89)**	**(601)**	**(89)**
Net book value		**987**	**1,549**	**212**	**8**	**2,756**	**46**

Amortisation, impairment losses and reversal of impairment losses are recognised in other operating expenses in the income statement.

Other intangibles comprises internally generated capitalised development costs. Software may include internally generated capitalised costs.

12 INTANGIBLE ASSETS (CONTINUED)

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 2010 using external sources of information where appropriate, and past experience. Cash flow forecasts 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 between 2.0% and 3.0% (31 July 2009: 2.0%). 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 9.5% (31 July 2009: 9.75%).

There was a significant amount of headroom between the recoverable amount and the carrying value of goodwill by CGU and no impairment was recognised. No realistic change in any of these assumptions would create a situation where the carrying value of goodwill allocated to a particular CGU would 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 $616 million (31 July 2009: $616 million) and the carrying value of indefinite life brands attributable to the CGU is $307 million (31 July 2009: $307 million). These brands are tested for impairment on an individual asset basis (see below).

During the year ended 31 July 2009, in considering specific business divestments, a $2 million impairment of goodwill was identified and recognised within the ANZ segment. Testing confirmed there were no other impairments to the carrying value of the Group's goodwill at that time.

Indefinite life brands

Of the total brands held, 91% ($1,412 million) have indefinite useful lives (31 July 2009: 91%, $1,433 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. The Group has no other intangibles that have indefinite useful lives other than brands.

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

During the year ended 31 July 2010 there were no material impairments or reinstatements to any indefinite life brands (31 July 2009: nil).

13 TRADE AND OTHER PAYABLES

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2010	AS AT 31 JULY 2009	**AS AT 31 JULY 2010**	AS AT 31 JULY 2009
Trade payables	**536**	467	**–**	–
Accruals	**377**	355	**29**	27
Amounts due to related parties	**7**	20	**5,660**	4,523
Other payables	**105**	95	**66**	57
Total trade and other payables (excluding employee entitlements)	**1,025**	937	**5,755**	4,607
Employee entitlements	**226**	195	**15**	18
Total trade and other payables	**1,251**	1,132	**5,770**	4,625

14 PROVISIONS

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2010	31 JULY 2009	31 JULY 2010	31 JULY 2009
Restructuring and rationalisation provisions				
Opening balance	14	14	3	6
Additional provisions	14	14	3	4
Unused amounts reversed	(5)	(8)	(3)	(5)
Charged to income statement	9	6	–	(1)
Reclassification within note	–	1	–	1
Foreign currency translation	(1)	1	–	–
Utilised during the year	(9)	(8)	–	(3)
Closing balance	13	14	3	3
Legal claims provisions				
Opening balance	68	58	67	54
Additional provisions	44	16	44	16
Unused amounts reversed	(21)	(4)	(21)	(2)
Charged to income statement	23	12	23	14
Foreign currency translation	(4)	–	(4)	–
Utilised during the year	(1)	(2)	(1)	(1)
Closing balance	86	68	85	67
Long term supply contracts provisions				
Opening balance	–	93	–	–
Unused amounts reversed	–	(80)	–	–
Charged to income statement	–	(80)	–	–
Utilised during the year	–	(13)	–	–
Closing balance	–	–	–	–
Other provisions				
Opening balance	139	132	24	53
Additional provisions	58	101	10	20
Unused amounts reversed	(40)	(52)	(7)	(32)
Charged to income statement	18	49	3	(12)
Reclassification within note	–	(1)	–	(1)
Reclassification to other balance sheet categories	–	–	–	(2)
Foreign currency translation	(5)	3	–	–
Utilised during the year	(49)	(44)	(11)	(4)
Transferred from Parent to other Group entities	–	–	–	(10)
Closing balance	103	139	16	24
Total provisions	202	221	104	94
Included within the balance sheet as follows:				
Current liabilities	92	143	19	37
Non-current liabilities	110	78	85	57
Total provisions	202	221	104	94

14 PROVISIONS (CONTINUED)

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.
- The provisions for long term supply contracts held at the beginning of the prior year represented the estimated unavoidable losses expected to arise in relation to long term supply contracts entered into by the Group. Given the significant movement in commodity pricing during the year ended 31 July 2009 a provision was no longer required at that date.
- Other provisions arise in the normal course of business and relate to provisions for areas such as employee benefit provisions. 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	
	NOTES	**AS AT 31 JULY 2010**	AS AT 31 JULY 2009	**AS AT 31 JULY 2010**	AS AT 31 JULY 2009
Current					
Commercial paper		**244**	334	**244**	334
Bank loans		**445**	539	**1**	–
Finance leases		**8**	6	**3**	1
Medium term notes		**205**	748	**149**	686
Total current borrowings	19	**902**	1,627	**397**	1,021
Non-current					
Bank loans		**178**	289	**150**	150
Finance leases		**186**	123	**153**	81
Capital notes		**35**	35	**35**	35
Retail bonds		**937**	784	**937**	784
Medium term notes		**2,686**	2,936	**2,684**	2,933
Total non-current borrowings	19	**4,022**	4,167	**3,959**	3,983
Total borrowings		**4,924**	5,794	**4,356**	5,004

- Finance leases are secured over the related item of property, plant and equipment (Note 10).
- Included within bank loans is $129 million (31 July 2009: $105 million) of borrowings secured over inventories (Note 9).
- Capital notes are unsecured subordinated borrowings.
- All other borrowings are unsecured and unsubordinated.

15 BORROWINGS (CONTINUED)

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2010	AS AT 31 JULY 2009	AS AT 31 JULY 2010	AS AT 31 JULY 2009
Opening balance	**5,794**	6,553	**5,004**	4,761
New issues				
Bank loans	**2,051**	1,264	**127**	490
Finance leases	**75**	82	**75**	82
Commercial paper	**612**	1,050	**612**	1,050
Retail bonds	**150**	784	**150**	784
Medium term notes	**72**	674	**72**	674
	2,960	3,854	**1,036**	3,080
Repayments				
Bank loans	**(2,223)**	(2,100)	**(127)**	(365)
Finance leases	**(5)**	(26)	**(1)**	–
Commercial paper	**(710)**	(2,492)	**(710)**	(2,492)
Medium term notes	**(611)**	(297)	**(605)**	(289)
	(3,549)	(4,915)	**(1,443)**	(3,146)
Other movements				
Amortisation of debt	**13**	50	**13**	50
Changes in fair value	**82**	32	**82**	32
Changes due to foreign currency translation	**(376)**	220	**(336)**	227
	(281)	302	**(241)**	309
Closing balance	**4,924**	5,794	**4,356**	5,004

	GROUP $ MILLION	
	AS AT 31 JULY 2010	AS AT 31 JULY 2009
Net interest bearing debt position		
Total borrowings	**4,924**	5,794
Cash and cash equivalents	**(559)**	(600)
Interest bearing advances included in other non-current assets	**(122)**	(86)
Bank overdraft	**25**	58
Net interest bearing debt	**4,268**	5,166
Value of derivatives used to manage changes in hedged risks and other foreign exchange movements on debt	**226**	55
Economic net interest bearing debt[1]	**4,494**	5,221

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 2010	AS AT 31 JULY 2009
Net tangible assets per security[1]		
$ per listed debt security on issue	**2.76**	2.23
$ per Co-operative share on issue	**2.15**	1.61
Listed debt securities on issue (million)	**1,053**	903
Co-operative shares on issue (million)	**1,353**	1,251

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

15 BORROWINGS (CONTINUED)

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2010	AS AT 31 JULY 2009	AS AT 31 JULY 2010	AS AT 31 JULY 2009
Finance leases – minimum lease payments				
Not later than one year	**21**	16	**15**	10
Later than one year and not later than five years	**80**	83	**61**	60
Later than five years	**203**	225	**185**	200
	304	324	**261**	270
Undrawn lease principal	**–**	(75)	**–**	(75)
Future finance charges on finance leases	**(110)**	(120)	**(105)**	(113)
Present value of finance leases	**194**	129	**156**	82
The present value of finance leases is as follows:				
Not later than one year	**8**	6	**3**	1
Later than one year and not later than five years	**33**	32	**17**	14
Later than five years	**153**	91	**136**	67
Total present value of finance leases	**194**	129	**156**	82

16 DEFERRED TAX

		GROUP $ MILLION		PARENT $ MILLION	
	NOTES	AS AT 31 JULY 2010	AS AT 31 JULY 2009	AS AT 31 JULY 2010	AS AT 31 JULY 2009
Deferred tax					
Property, plant and equipment		**(186)**	(141)	**15**	14
Intangible assets		**(391)**	(388)	**(13)**	(13)
Derivative financial instruments		**(72)**	(77)	**15**	–
Employee entitlements		**56**	54	**4**	5
Inventories		**29**	(8)	**–**	–
Receivables, payables and provisions		**53**	69	**13**	13
New Zealand tax losses		**292**	308	**253**	308
Offshore tax losses		**39**	13	**–**	–
Other		**(13)**	(32)	**–**	–
Total deferred tax		**(193)**	(202)	**287**	327
Movements for the year					
Opening balance		**(202)**	(149)	**327**	149
Recognised in the income statement	5	**67**	117	**(31)**	178
Change in New Zealand corporate tax rate	5	**8**	(5)	**(20)**	–
Recognised directly in the statement of comprehensive income		**(5)**	(139)	**15**	–
Net effect of business combinations		**–**	(28)	**–**	–
Change to tax depreciation on buildings	5	**(61)**	–	**(4)**	–
Foreign currency translation		**–**	2	**–**	–
Closing balance		**(193)**	(202)	**287**	327
Included within the balance sheet as follows:					
Deferred tax assets		**100**	103	**287**	327
Deferred tax liabilities		**(293)**	(305)	**–**	–
Total deferred tax		**(193)**	(202)	**287**	327

Of the total deferred tax balance, $273 million is not expected to be recovered or settled in the next 12 months (31 July 2009: $211 million).

17 OPERATING CASH FLOWS

		GROUP $ MILLION		PARENT $ MILLION	
	NOTES	31 JULY 2010	RESTATED[1] 31 JULY 2009	31 JULY 2010	RESTATED[1] 31 JULY 2009
Profit for the year		**685**	610	**426**	991
Non-cash items					
Amortisation of intangible assets	12	**68**	73	**14**	12
Depreciation of property, plant and equipment	10	**416**	424	**13**	13
Impairment of intangible assets	12	**–**	3	**–**	–
Movement in deferred tax		**(9)**	53	**40**	(178)
(Gain)/loss on disposal of investments	2	**(127)**	3	**–**	–
Gain on acquisition	18	**–**	(13)	**–**	–
Gain on disposal of property, plant and equipment	2	**3**	(8)	**–**	–
Share of profit of equity accounted investees	11	**(56)**	(129)	**–**	–
Impairment of equity accounted investees	11	**–**	61	**–**	–
Impairment of property, plant and equipment	10	**2**	11	**–**	–
Other non-cash items		**(9)**	36	**1**	1
		288	514	**68**	(152)
Movement in working capital decrease/(increase)					
Inventories		**(214)**	632	**–**	–
Trade and other receivables		**(140)**	268	**(17)**	18
Other current assets (including derivative financial instruments)		**194**	(505)	**132**	(431)
Tax balances		**28**	(214)	**–**	–
Amounts owing to suppliers		**(69)**	138	**(69)**	138
Trade and other payables		**119**	(139)	**8**	(30)
Other current liabilities (including derivative financial instruments)		**(105)**	(138)	**(112)**	(133)
Provisions		**(51)**	(90)	**(18)**	(29)
		(238)	(48)	**(76)**	(467)
Items classified as investing and financing activities		**744**	518	**(63)**	(1,030)
Net cash flows from operating activities		**1,479**	1,594	**355**	(658)

1 The Group has changed its accounting policy in respect of the recognition of the tax effect of distributions to Shareholders, refer to Statement of Significant Accounting Policies b).

18 BUSINESS COMBINATIONS

There were no material business combinations during the year ended 31 July 2010.

During the year ended 31 July 2009, the Group acquired the chilled dairy business of Nestlé Australia, acquired the Australian Ski™ dairy food business and disposed of its Western Australia ice cream business. None of these transactions, either individually or in total, were considered material and therefore no further disclosure has been made. The acquisition of the Australian Ski™ dairy food business resulted in a gain on acquisition of $13 million being recognised as the fair value of the net assets purchased were higher than the consideration paid. The gain on acquisition is included within other operating income in the income statement.

19 FINANCIAL RISK MANAGEMENT

Overview
Global financial and commodity markets remain highly 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 maximising returns to shareholders.

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

- has established risk management 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 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's shareholders voted in favour of changes to the Company's capital structure and gave the Board a mandate to establish a platform permitting Shareholders to trade shares amongst themselves. These capital structure changes are significant steps for Fonterra, on which further detail is given in Note 7 and the capital management section below.

Bond issues
On 4 March 2010, Fonterra issued $150 million of six year unsecured fixed rate bonds. A US$50 million European medium term note was also issued on 17 February 2010 in the amount of $71 million.

Bank facility renewal
Fonterra's banking facilities are renewed annually. On 31 July 2010, Fonterra had $3,687 million of undrawn committed facilities. For further details refer to liquidity risk below.

Debt to debt plus equity ratio
For the 12 months to 31 July 2010, the Board had set a target debt to debt plus equity ratio of less than or equal to 50%. As a result of the above activities and close management of the financial risks faced by Fonterra, including sale of certain non-strategic assets and restriction of non-essential capital expenditure, along with the different accounting treatment for paying dividends compared to making Value Return payments, the debt to debt plus equity ratio has reduced from 52.7% at 31 July 2009 to 43.6% at 31 July 2010. For more details refer to the capital management section below.

a) Financial risks

Foreign exchange risk
Foreign exchange risk is the risk of cash flow volatility arising from a movement in foreign exchange rates to which the Group may be exposed.

The Group operates internationally and is exposed to foreign exchange risk on sales, purchases, investments and borrowings that are denominated in foreign currencies.

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 77% 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 Shareholder Suppliers.

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. Hedge accounting is only sought where it is practical to do so. Therefore some derivative instruments entered into for economic hedges maybe classified as not being in a hedge relationship.

In respect of translation hedging, the Group hedges its material net translation exposure.

19 FINANCIAL RISK MANAGEMENT (CONTINUED)

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 are 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 2010	AS AT 31 JULY 2009	**AS AT 31 JULY 2010**	AS AT 31 JULY 2009
USD	United States dollar	**10**	212	**(9,399)**	(5,821)
EUR	Euro	**95**	15	**(127)**	(317)
AUD	Australian dollar	**983**	824	**(258)**	(1,281)
GBP	Great Britain pound	**5**	146	**(72)**	–
JPY	Japanese yen	**11**	29	**(1)**	(34)
BRL	Brazilian real	**104**	119	**(84)**	(96)
CLP	Chilean peso	**264**	240	**(14)**	(8)
CNY	Chinese yuan	**18**	23	**–**	–
SGD	Singapore dollar	**174**	104	**(245)**	(298)

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 $7,845 million (31 July 2009: $4,395 million) in respect of forecast 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 2010		31 JULY 2009		**31 JULY 2010**		31 JULY 2009	
	EQUITY	**PROFIT**	EQUITY	PROFIT	**EQUITY**	**PROFIT**	EQUITY	PROFIT
Impact of a 10% strengthening of the NZD	**158**	**(29)**	(7)	(34)	**(44)**	**–**	–	–
Impact of a 10% weakening of the NZD	**(37)**	**(59)**	42	16	**53**	**–**	–	–

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.

19 FINANCIAL RISK MANAGEMENT (CONTINUED)

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 reporting date) is as follows:

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2010 PROFIT	31 JULY 2009 PROFIT	**31 JULY 2010 PROFIT**	31 JULY 2009 PROFIT
Fair value gain/(loss) from 100 bp increase	**63**	30	**63**	30
Fair value gain/(loss) from 100 bp decrease	**(68)**	(32)	**(68)**	(32)

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 reporting date) is as follows:

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2010 PROFIT	31 JULY 2009 PROFIT	**31 JULY 2010 PROFIT**	31 JULY 2009 PROFIT
One year cash flow impact of 100 bp increase	**(13)**	(16)	**(11)**	(12)
One year cash flow impact of 100 bp decrease	**13**	16	**11**	12

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.

Contracts for sale are only entered into with customers whose credit limits are in accordance with the Group's delegated authorities approved by the Board.

The analysis 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 2010	**1,712**	**217**	**57**	**50**	**2,036**
As at 31 July 2009	1,560	237	73	40	1,910

Parent has no trade and other receivables that are past due (31 July 2009: nil).

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

The Group limits its exposure to credit risk by investing in liquid securities and entering into derivative instruments with 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.

The Group has assessed trade and other receivables requiring specific impairment at balance date. As a result $36 million (31 July 2009: $57 million) has been provided against these balances. This represents 0.22% (31 July 2009: 0.36%) 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.

The maximum credit risk in relation to financial guarantees Parent and Group have provided to the Group's equity accounted investees is $61 million (31 July 2009: $65 million). Parent and Group have not provided any financial guarantees to external parties in the year to 31 July 2010 (31 July 2009: nil). Parent has provided financial guarantees to other Group entities for which the maximum credit risk is $424 million (31 July 2009: $352 million).

19 FINANCIAL RISK MANAGEMENT (CONTINUED)

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.

Typically the Group ensures 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 constitution, the Company can defer payments to Supplier Shareholders 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 $3,687 million (31 July 2009: $3,647 million), Parent $2,024 million (31 July 2009: $2,050 million).

The timing of the maturity of the carrying value of the Group's cash flow hedges is as follows:

	GROUP $ MILLION	
	AS AT 31 JULY 2010	AS AT 31 JULY 2009
Current	293	263
Non-current	28	48
Total carrying value	**321**	311

Exposure to liquidity risk

	AS AT 31 JULY 2010					
GROUP $ MILLION	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	559	559	559	–	–	–
Trade and other receivables (excluding prepayments)	2,036	2,035	2,035	–	–	–
Long term advances	122	149	1	11	45	92
Total non-derivative financial assets	2,717	2,743	2,595	11	45	92
Non-derivative financial liabilities						
Borrowings						
– Commercial paper	(244)	(247)	(97)	(150)	–	–
– Bank loans	(623)	(670)	(45)	(429)	(196)	–
– Finance leases	(194)	(303)	(6)	(14)	(80)	(203)
– Capital notes	(35)	(43)	–	(1)	(7)	(35)
– Retail bonds	(937)	(1,306)	(21)	(52)	(1,073)	(160)
– Medium term notes	(2,891)	(3,928)	(78)	(283)	(1,912)	(1,655)
Bank overdraft	(25)	(25)	(25)	–	–	–
Owing to suppliers	(1,138)	(1,138)	(1,138)	–	–	–
Trade and other payables (excluding employee entitlements)	(1,025)	(973)	(973)	–	–	–
Financial guarantees issued	–	(61)	(61)	–	–	–
Total non-derivative financial liabilities	(7,112)	(8,694)	(2,444)	(929)	(3,268)	(2,053)
Derivative financial instruments						
Gross settled derivatives						
– Inflow	–	17,710	9,214	5,579	1,668	1,249
– Outflow	–	(18,115)	(9,107)	(5,335)	(1,995)	(1,678)
Total gross settled derivative financial instruments	80	(405)	107	244	(327)	(429)
Net settled derivatives	13	299	(12)	24	97	190
Total financial instruments	(4,302)	(6,057)	246	(650)	(3,453)	(2,200)

19 FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Exposure to liquidity risk (continued)

	AS AT 31 JULY 2009					
GROUP $ MILLION	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	600	600	600	–	–	–
Trade and other receivables (excluding prepayments)	1,910	1,910	1,910	–	–	–
Long term advances	86	91	–	1	50	40
Total non-derivative financial assets	2,596	2,601	2,510	1	50	40
Non-derivative financial liabilities						
Borrowings						
– Commercial paper	(334)	(338)	(176)	(162)	–	–
– Bank loans	(828)	(879)	(197)	(367)	(312)	(3)
– Finance leases	(129)	(249)	23	36	(83)	(225)
– Capital notes	(35)	(43)	–	(1)	(7)	(35)
– Retail bonds	(784)	(1,157)	(15)	(47)	(248)	(847)
– Medium term notes	(3,684)	(5,148)	(88)	(840)	(2,184)	(2,036)
Bank overdraft	(58)	(58)	(58)	–	–	–
Owing to suppliers	(1,207)	(1,207)	(1,207)	–	–	–
Trade and other payables (excluding employee entitlements)	(937)	(891)	(891)	–	–	–
Financial guarantees issued	–	(65)	(65)	–	–	–
Total non-derivative financial liabilities	(7,996)	(10,035)	(2,674)	(1,381)	(2,834)	(3,146)
Derivative financial instruments						
Gross settled derivatives						
– Inflow	–	18,367	11,052	4,361	1,527	1,427
– Outflow	–	(18,349)	(10,957)	(4,063)	(1,668)	(1,661)
Total gross settled derivative financial instruments	328	18	95	298	(141)	(234)
Net settled derivatives	(79)	227	(22)	12	54	183
Total financial instruments	(5,151)	(7,189)	(91)	(1,070)	(2,871)	(3,157)

19 FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Exposure to liquidity risk (continued)

	AS AT 31 JULY 2010					
PARENT $ MILLION	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	345	345	345	–	–	–
Trade and other receivables (excluding prepayments)	2	2	2	–	–	–
Long term advances	19	22	–	1	19	2
Total non-derivative financial assets	366	369	347	1	19	2
Non-derivative financial liabilities						
Borrowings						
– Commercial paper	(244)	(247)	(97)	(150)	–	–
– Bank loans	(151)	(167)	(5)	(6)	(156)	–
– Finance leases	(156)	(261)	(4)	(11)	(61)	(185)
– Capital notes	(35)	(43)	–	(1)	(7)	(35)
– Retail bonds	(937)	(1,306)	(21)	(52)	(1,073)	(160)
– Medium term notes	(2,833)	(3,872)	(24)	(283)	(1,912)	(1,653)
Owing to suppliers	(1,138)	(1,138)	(1,138)	–	–	–
Trade and other payables (excluding employee entitlements)	(95)	(51)	(51)	–	–	–
Financial guarantees issued	–	(424)	(424)	–	–	–
Total non-derivative financial liabilities	(5,589)	(7,509)	(1,764)	(503)	(3,209)	(2,033)
Derivative financial instruments						
Gross settled derivatives						
– Inflow	–	17,834	9,239	5,678	1,668	1,249
– Outflow	–	(18,237)	(9,132)	(5,432)	(1,995)	(1,678)
Total gross settled derivative financial instruments	81	(403)	107	246	(327)	(429)
Net settled derivatives	12	301	(9)	23	97	190
Total financial instruments	(5,130)	(7,242)	(1,319)	(233)	(3,420)	(2,270)

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

19 FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Exposure to liquidity risk (continued)

	AS AT 31 JULY 2009					
PARENT $ MILLION	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	349	349	349	–	–	–
Trade and other receivables (excluding prepayments)	7	7	7	–	–	–
Long term advances	19	21	–	–	19	2
Total non-derivative financial assets	375	377	356	–	19	2
Non-derivative financial liabilities						
Borrowings						
– Commercial paper	(334)	(338)	(176)	(162)	–	–
– Bank loans	(150)	(167)	(2)	(4)	(161)	–
– Finance leases	(82)	(195)	25	40	(60)	(200)
– Capital notes	(35)	(43)	–	(1)	(7)	(35)
– Retail bonds	(784)	(1,157)	(15)	(47)	(248)	(847)
– Medium term notes	(3,619)	(5,083)	(26)	(840)	(2,184)	(2,033)
Owing to suppliers	(1,207)	(1,207)	(1,207)	–	–	–
Trade and other payables (excluding employee entitlements)	(84)	(42)	(42)	–	–	–
Financial guarantees issued	–	(352)	(352)	–	–	–
Total non-derivative financial liabilities	(6,295)	(8,584)	(1,795)	(1,014)	(2,660)	(3,115)
Derivative financial instruments						
Gross settled derivatives						
– Inflow	–	17,952	10,725	4,273	1,527	1,427
– Outflow	–	(17,934)	(10,629)	(3,976)	(1,668)	(1,661)
Total gross settled derivative financial instruments	328	18	96	297	(141)	(234)
Net settled derivatives	(81)	229	(19)	11	54	183
Total financial instruments	(5,673)	(7,960)	(1,362)	(706)	(2,728)	(3,164)

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

19 FINANCIAL RISK MANAGEMENT (CONTINUED)

e) Capital management

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

The Board has undertaken a review of the capital structure, which identified a series of changes as set out in Note 7. These changes will strengthen the balance sheet, primarily by reducing redemption risk and providing a framework for ongoing retentions.

The Board closely monitors the Group's debt to debt plus equity ratio. This ratio is calculated as net interest bearing debt divided by total capital. Net interest bearing debt is calculated as disclosed in Note 15. Total capital is calculated as equity, as presented on the balance sheet (excluding the cash flow hedge reserve), plus net interest bearing debt.

The debt to debt plus equity ratio as at 31 July 2010 was 43.6% (31 July 2009: 52.7%), which is below the Board's target of 50%. The improvement in this ratio is a result of the sale of certain non-strategic assets, the restriction of non-essential capital expenditure and stronger operating cash flows. The changes in capital structure which have encouraged increased ownership of dry shares has increased equity and therefore also had a positive impact.

Further to these movements the change in capital structure has resulted in dividend payments being made in place of Value Return payments. NZ IAS 10: Events After the Balance Sheet Date does not permit the recognition of a dividend until it has been declared. Consequently the final dividend of 19 cents per share (total final dividend of $255 million) cannot be accrued as a liability at 31 July 2010. Last year the Value Return payment of $591 million was recognised as a liability at balance date. This change has had a positive impact on the debt to debt plus equity ratio. Had the ratio been calculated on the same basis last year, debt to debt plus equity would have been 49.7% rather than the reported 52.7%.

For the 12 months to 31 July 2011, the Board has set a target debt to debt plus equity ratio 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 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. However 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		PARENT $ MILLION	
	31 JULY 2010 PROFIT	31 JULY 2009 PROFIT	**31 JULY 2010 PROFIT**	31 JULY 2009 PROFIT
Impact of 10% increase in quoted dairy commodity prices	**(1)**	–	**–**	–
Impact of 10% decrease in quoted dairy commodity prices	**1**	–	**–**	–

19 FINANCIAL RISK MANAGEMENT (CONTINUED)

g) Financial instrument fair values and classifications

	AS AT 31 JULY 2010					
GROUP $ MILLION	LOANS AND RECEIVABLES	OTHER AMORTISED COST	HELD FOR TRADING	DERIVATIVES IN HEDGE RELATIONSHIPS	CARRYING VALUE	FAIR VALUE
Financial assets						
Cash and cash equivalents	559	–	–	–	559	559
Trade and other receivables (excluding prepayments)	2,036	–	–	–	2,036	2,036
Long term advances	122	–	–	–	122	130
Derivative assets – current	–	–	134	354	488	488
Derivative assets – non-current	–	–	32	182	214	214
Total financial assets	2,717	–	166	536	3,419	3,427
Financial liabilities						
Bank overdraft	–	(25)	–	–	(25)	(25)
Owing to suppliers	–	(1,138)	–	–	(1,138)	(1,138)
Total payables and accruals (excluding employee entitlements)	–	(1,025)	–	–	(1,025)	(1,025)
Borrowings						
– Commercial paper	–	(244)	–	–	(244)	(245)
– Bank loans	–	(623)	–	–	(623)	(623)
– Finance leases	–	(194)	–	–	(194)	(213)
– Retail bonds	–	(937)	–	–	(937)	(1,032)
– Medium term notes	–	(2,891)	–	–	(2,891)	(3,203)
Capital notes	–	(35)	–	–	(35)	(30)
Derivative liabilities – current	–	–	(89)	(24)	(113)	(113)
Derivative liabilities – non-current	–	–	(45)	(451)	(496)	(496)
Total financial liabilities	–	(7,112)	(134)	(475)	(7,721)	(8,143)
Total financial instruments	2,717	(7,112)	32	61	(4,302)	(4,716)

Included in the table above are the following instruments that have fair value changes recognised in the balance sheet:

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	–	–	165	536	701	701
Derivative liabilities	–	–	(134)	(475)	(609)	(609)
Total level 2 fair value hierarchy	–	–	31	61	92	92
Total instruments recognised in the balance sheet at fair value	–	–	32	61	93	93

19 FINANCIAL RISK MANAGEMENT (CONTINUED)

Financial instrument fair values and classifications (continued)

	AS AT 31 JULY 2009					
GROUP $ MILLION	LOANS AND RECEIVABLES	OTHER AMORTISED COST	HELD FOR TRADING	DERIVATIVES IN HEDGE RELATIONSHIPS	CARRYING VALUE	FAIR VALUE
Financial assets						
Cash and cash equivalents	600	–	–	–	600	600
Trade and other receivables (excluding prepayments)	1,910	–	–	–	1,910	1,910
Long term advances	86	–	–	–	86	88
Derivative assets – current	–	–	135	478	613	613
Derivative assets – non-current	–	–	21	153	174	174
Total financial assets	2,596	–	156	631	3,383	3,385
Financial liabilities						
Bank overdraft	–	(58)	–	–	(58)	(58)
Owing to suppliers	–	(1,207)	–	–	(1,207)	(1,207)
Total payables and accruals (excluding employee entitlements)	–	(937)	–	–	(937)	(937)
Borrowings						
– Commercial paper	–	(334)	–	–	(334)	(334)
– Bank loans	–	(828)	–	–	(828)	(829)
– Finance leases	–	(129)	–	–	(129)	(138)
– Retail bonds	–	(784)	–	–	(784)	(858)
– Medium term notes	–	(3,684)	–	–	(3,684)	(4,010)
Capital notes	–	(35)	–	–	(35)	(30)
Derivative liabilities – current	–	–	(63)	(153)	(216)	(216)
Derivative liabilities – non-current	–	–	(116)	(206)	(322)	(322)
Total financial liabilities	–	(7,996)	(179)	(359)	(8,534)	(8,939)
Total financial instruments	2,596	(7,996)	(23)	272	(5,151)	(5,554)

Included in the table above are the following instruments that have fair value changes recognised in the balance sheet:

Level 1 fair value hierarchy						
Derivative assets	–	–	–	–	–	–
Derivative liabilities	–	–	–	–	–	–
Total level 1 fair value hierarchy	–	–	–	–	–	–
Level 2 fair value hierarchy						
Derivative assets	–	–	156	631	787	787
Derivative liabilities	–	–	(179)	(359)	(538)	(538)
Total level 2 fair value hierarchy	–	–	(23)	272	249	249
Total instruments recognised in the balance sheet at fair value	–	–	(23)	272	249	249

19 FINANCIAL RISK MANAGEMENT (CONTINUED)

Financial instrument fair values and classifications (continued)

	AS AT 31 JULY 2010					
PARENT $ MILLION	LOANS AND RECEIVABLES	OTHER AMORTISED COST	HELD FOR TRADING	DERIVATIVES IN HEDGE RELATIONSHIPS	CARRYING VALUE	FAIR VALUE
Financial assets						
Cash and cash equivalents	345	–	–	–	345	345
Trade and other receivables (excluding prepayments)	8,180	–	–	–	8,180	8,180
Long term advances	19	–	–	–	19	19
Derivative assets – current	–	–	472	6	478	478
Derivative assets – non-current	–	–	66	148	214	214
Total financial assets	8,544	–	538	154	9,236	9,236
Financial liabilities						
Owing to suppliers	–	(1,138)	–	–	(1,138)	(1,138)
Total payables and accruals (excluding employee entitlements)	–	(5,755)	–	–	(5,755)	(5,755)
Borrowings						
– Commercial paper	–	(244)	–	–	(244)	(245)
– Bank loans	–	(151)	–	–	(151)	(151)
– Finance leases	–	(156)	–	–	(156)	(171)
– Retail bonds	–	(937)	–	–	(937)	(1,032)
– Medium term notes	–	(2,833)	–	–	(2,833)	(3,147)
Capital notes	–	(35)	–	–	(35)	(30)
Derivative liabilities – current	–	–	(103)	–	(103)	(103)
Derivative liabilities – non-current	–	–	(52)	(444)	(496)	(496)
Total financial liabilities	–	(11,249)	(155)	(444)	(11,848)	(12,268)
Total financial instruments	8,544	(11,249)	383	(290)	(2,612)	(3,032)

Included in the table above are the following instruments that have fair value changes recognised in the balance sheet:

Level 2 fair value hierarchy						
Derivative assets	–	–	538	154	692	692
Derivative liabilities	–	–	(155)	(444)	(599)	(599)
Total level 2 fair value hierarchy	–	–	383	(290)	93	93
Total instruments recognised in the balance sheet at fair value	–	–	383	(290)	93	93

19 FINANCIAL RISK MANAGEMENT (CONTINUED)

Financial instrument fair values and classifications (continued)

	AS AT 31 JULY 2009					
PARENT $ MILLION	LOANS AND RECEIVABLES	OTHER AMORTISED COST	HELD FOR TRADING	DERIVATIVES IN HEDGE RELATIONSHIPS	CARRYING VALUE	FAIR VALUE
Financial assets						
Cash and cash equivalents	349	–	–	–	349	349
Trade and other receivables (excluding prepayments)	6,840	–	–	–	6,840	6,840
Long term advances	19	–	–	–	19	20
Derivative assets – current	–	–	551	59	610	610
Derivative assets – non-current	–	–	73	101	174	174
Total financial assets	7,208	–	624	160	7,992	7,993
Financial liabilities						
Owing to suppliers	–	(1,207)	–	–	(1,207)	(1,207)
Total payables and accruals (excluding employee entitlements)	–	(4,607)	–	–	(4,607)	(4,607)
Borrowings						
– Commercial paper	–	(334)	–	–	(334)	(334)
– Bank loans	–	(150)	–	–	(150)	(150)
– Finance leases	–	(82)	–	–	(82)	(92)
– Retail bonds	–	(784)	–	–	(784)	(858)
– Medium term notes	–	(3,619)	–	–	(3,619)	(3,947)
Capital notes	–	(35)	–	–	(35)	(30)
Derivative liabilities – current	–	–	(203)	(12)	(215)	(215)
Derivative liabilities – non-current	–	–	(119)	(203)	(322)	(322)
Total financial liabilities	–	(10,818)	(322)	(215)	(11,355)	(11,762)
Total financial instruments	7,208	(10,818)	302	(55)	(3,363)	(3,769)

Included in the table above are the following instruments that have fair value changes recognised in the balance sheet:

Level 2 fair value hierarchy						
Derivative assets	–	–	624	160	784	784
Derivative liabilities	–	–	(322)	(215)	(537)	(537)
Total level 2 fair value hierarchy	–	–	302	(55)	247	247
Total instruments recognised in the balance sheet at fair value	–	–	302	(55)	247	247

h) Basis for determining fair values

The fair value of forward foreign exchange contracts, currency options, dairy commodity derivatives and collars is based on their market price or accepted valuation methodologies.

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 6.90% (31 July 2009: 0.02% and 7.29%) 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).

20 CONTINGENT LIABILITIES

The Group and Parent have no contingent liabilities as at 31 July 2010 (31 July 2009: 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 by the Group and 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 2010	AS AT 31 JULY 2009	**AS AT 31 JULY 2010**	AS AT 31 JULY 2009
Buildings	**9**	86	**–**	75
Plant, vehicles and equipment	**132**	135	**3**	–
Intangible assets	**8**	1	**5**	1
Total capital commitments	**149**	222	**8**	76

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 2010	AS AT 31 JULY 2009	**AS AT 31 JULY 2010**	AS AT 31 JULY 2009
Less than one year	**62**	60	**–**	6
One to five years	**130**	134	**–**	20
Greater than five years	**58**	75	**–**	8
Share of equity accounted investees operating lease commitments	**23**	19	**–**	–
Total operating lease commitments	**273**	288	**–**	34

22 RELATED PARTY TRANSACTIONS

Equity accounted investees (Refer to Note 23) and key management personnel are related parties of the Group. Key management personnel include the Board and the Executive Committee (previously the Fonterra Leadership Team).

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

Key management personnel remuneration
The Board received Directors' fees totalling $2 million for the 12 months to 31 July 2010 (31 July 2009: $2 million). As part of Fonterra's total remuneration policy the Executive Committee receive short term employee benefits, which include a base salary and an annual incentive plan, and long term employee benefits which relates to a medium term (deferred cash) incentive plan. During the period the Executive Committee received base salaries of $7 million (31 July 2009: $9 million), annual incentive payments of $7 million (31 July 2009: $8 million), medium term incentives payable over three years of $5 million (31 July 2009: $4 million). There were no termination benefits paid during the year (31 July 2009: $1 million). For the current year variable components of remuneration have been calculated at the amounts expected to be paid given all current information available. The prior year comparatives reflect actual payments made in respect of the prior year.

Revenue from the sale of goods

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2010	31 JULY 2009	**31 JULY 2010**	31 JULY 2009
Sale of goods				
Equity accounted investees	**145**	280	**–**	–
Other Group entities	**–**	–	**7,952**	6,000
	145	280	**7,952**	6,000

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 2010	31 JULY 2009	**31 JULY 2010**	31 JULY 2009
Sale of services				
Equity accounted investees	**6**	6	**–**	–
Other Group entities	**–**	–	**38**	31
	6	6	**38**	31

Services provided to related parties include management fees and are provided under normal trade terms.

Purchases of goods and services

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2010	31 JULY 2009	**31 JULY 2010**	31 JULY 2009
Purchases of goods				
Equity accounted investees	**176**	296	**–**	–
Other Group entities	**–**	–	**15**	12
Key management personnel	**199**	146	**199**	146
	375	442	**214**	158
Purchases of services				
Equity accounted investees	**3**	1	**–**	–
Other Group entities	**–**	–	**2**	2
	3	1	**2**	2

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

In addition shareholder Directors may engage in transactions with other Group entities under normal trade terms.

22 RELATED PARTY TRANSACTIONS (CONTINUED)

Dividends received

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2010	31 JULY 2009	31 JULY 2010	31 JULY 2009
Equity accounted investees	55	67	–	–
Other Group entities	–	–	458	1,030
	55	67	458	1,030

Balances arising from the sale or purchase of goods or services

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2010	AS AT 31 JULY 2009	AS AT 31 JULY 2010	AS AT 31 JULY 2009
Receivables[1]				
Equity accounted investees	20	19	–	–
Other Group entities	–	–	109	53
	20	19	109	53
Payables				
Equity accounted investees	7	20	–	–
Other Group entities	–	–	6	6
Key management personnel	33	14	33	14
	40	34	39	20

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

Balances arising from financing arrangements

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2010	AS AT 31 JULY 2009	AS AT 31 JULY 2010	AS AT 31 JULY 2009
Receivables				
Equity accounted investees	126	63	17	17
Receivables from other Group entities	–	–	8,071	6,782
	126	63	8,088	6,799
Payables				
Payables to other Group entities	–	–	5,654	4,517
Payables to key management personnel	1	1	1	1
	1	1	5,655	4,518

Payables to key management personnel relate to bonds held by Directors or members of the Fonterra Executive Committee.

22 RELATED PARTY TRANSACTIONS (CONTINUED)

Interest income/(expense) from financing arrangements

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2010	31 JULY 2009	31 JULY 2010	31 JULY 2009
Interest income				
Equity accounted investees	4	6	–	–
Other Group entities	–	–	288	315
	4	6	288	315
Interest expense				
Other Group entities	–	–	(11)	(49)
	–	–	(11)	(49)

All loans to related parties are unsecured and repayable in cash on demand.

Financial guarantees

The Group has provided financial guarantees for several equity accounted investees. The aggregate amount of equity accounted investees' liabilities for which the Group is jointly and severally liable is $61 million (31 July 2009: $65 million). The Parent has provided financial guarantees for other Group entities totalling $424 million (31 July 2009: $352 million).

Co-operative share transactions with Directors

	GROUP $ MILLION		PARENT $ MILLION	
	31 JULY 2010	31 JULY 2009	31 JULY 2010	31 JULY 2009
Co-operative shares issued/(surrendered)				
Issued	5	19	5	19
Surrendered	(2)	(15)	(2)	(15)
Net movement	3	4	3	4
Dividends paid to Directors	3	–	3	–
Value Return paid to Directors	–	15	–	15

	GROUP $ MILLION		PARENT $ MILLION	
	AS AT 31 JULY 2010	AS AT 31 JULY 2009	AS AT 31 JULY 2010	AS AT 31 JULY 2009
Balances arising from transactions with Directors				
Receivable from Directors	–	1	–	1
Payable to Directors	–	(15)	–	(15)

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 reporting 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 2010	AS AT 31 JULY 2009
Fonterra Brands (Australia) Pty Ltd	Australia	**100**	100
Fonterra Australia Pty Ltd	Australia	**100**	100
Fonterra (Brazil) Limitada[1]	Brazil	**100**	100
Soprole S.A.[1, 2]	Chile	**99.8**	99.8
Fonterra Commercial Trading (Shanghai) Company Limited	China	**100**	100
Fonterra (Europe) GmbH	Germany	**100**	100
Fonterra (Italy) SpA	Italy	**100**	100
PT Fonterra Brands Indonesia	Indonesia	**100**	100
Fonterra Brands (Malaysia) Sdn Bhd	Malaysia	**100**	100
Fonterra (Mexico) S.A. de C.V.[1]	Mexico	**100**	100
Fonterra Brands Phils. Inc.	Philippines	**100**	100
Fonterra Brands (Singapore) Pte Ltd	Singapore	**100**	100
Fonterra Brands (New Young) Pte Ltd	Singapore	**51**	51
Fonterra (SEA) Pte Ltd	Singapore	**100**	100
Fonterra Brands Lanka (Private) Ltd	Sri Lanka	**100**	100
Fonterra Brands (Thailand) Ltd	Thailand	**100**	100
Fonterra (USA) Inc	USA	**100**	100
Fonterra (Venezuela) S.A.[1]	Venezuela	**100**	100
Saudi New Zealand Milk Products Company Ltd[3]	Saudi Arabia	**100**	49

1 Balance date 31 December (comparative ownership interest % consistent at 31 December 2008).

2 On 18 August 2008 Sociedad Productores de Leche S.A., Soprole was renamed Soprole S.A.

3 Balance date 31 May. During the period the ownership interest in this entity was increased from 49% to 100%. Previously this entity was included within overseas subsidiaries with 50% or less ownership.

		OWNERSHIP INTERESTS (%)	
NEW ZEALAND SUBSIDIARIES	COUNTRY OF INCORPORATION	AS AT 31 JULY 2010	AS AT 31 JULY 2009
Anchor Ethanol Limited	New Zealand	**100**	100
Canpac International Limited	New Zealand	**100**	100
Fonterra Brands Limited	New Zealand	**100**	100
Fonterra Brands (New Zealand) Limited	New Zealand	**100**	100
Fonterra Brands (Tip Top) Limited	New Zealand	**100**	100
Fonterra Limited	New Zealand	**100**	100
Fonterra (New Zealand) Limited	New Zealand	**100**	100
New Zealand Dairy Board	New Zealand	**100**	100
NZagbiz Limited	New Zealand	**100**	100
Vialactia Biosciences (NZ) Limited	New Zealand	**100**	100

23 GROUP ENTITIES (CONTINUED)

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 2010	AS AT 31 JULY 2009
Fonterra (Japan) Ltd	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 NOT CONSOLIDATED	COUNTRY OF INCORPORATION	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2010	AS AT 31 JULY 2009
Dairy Partners Americas Argentina S.A.[1]	Argentina	**50**	50
DPA Manufacturing Holdings Limited[1]	Bermuda	**50**	50
Dairy Partners Americas Brasil Limitada[1]	Brazil	**50**	50
Shijiazhuang San Lu Group Company Limited[1]	China	**43**	43
AFF P/S[1, 2]	Denmark	**–**	25
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
Corporacion Inlaca, C.A.[1]	Venezuela	**25**	25

1 Balance date 31 December (comparative ownership interest % consistent at 31 December 2008).

2 On 19 November 2009 the Group disposed of its interest in AFF P/S.

NEW ZEALAND EQUITY ACCOUNTED INVESTEES NOT CONSOLIDATED	COUNTRY OF INCORPORATION	OWNERSHIP INTERESTS (%) AS AT 31 JULY 2010	AS AT 31 JULY 2009
RD1 Limited[1]	New Zealand	**50**	50

1 Balance date 31 May (comparative ownership interest % consistent at 31 May 2009).

24 SUBSEQUENT EVENTS

On 22 September 2010 the Board of Directors declared a final dividend of 19 cents per share payable on 20 October 2010 to the Shareholders on the share register at 31 May 2010.

There were no other material events subsequent to 31 July 2010 that would impact these financial statements.

For the year ended 31 July 2009, subsequent events relating to potential changes to Fonterra's capital structure were disclosed. At the Annual Meeting on 18 November 2009, Shareholders approved changes to the Company's constitution in relation to the capital structure. Further information is provided in Note 7 – Capital and Reserves.

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Private Bag 92162
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Facsimile +64 9 355 8001
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We have audited the financial statements on pages 32 to 82. The financial statements provide information about the past financial performance and cash flows of the Company and Group for the year ended 31 July 2010 and their financial position as at that date. This information is stated in accordance with the accounting policies set out on pages 38 to 44.

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.

Directors' Responsibilities

The Company's Directors are responsible for the preparation and presentation of the financial statements which give a true and fair view of the financial position of the Company and Group as at 31 July 2010 and their financial performance and cash flows for the year ended on that date.

Auditors' Responsibilities

We are responsible for expressing an independent opinion on the financial statements presented by the Directors and reporting our opinion to you.

Basis of Opinion

An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. It also includes assessing:

(a) the significant estimates and judgements made by the Directors in the preparation of the financial statements; and

(b) whether the accounting policies are appropriate to the circumstances of the Company and Group, consistently applied and adequately disclosed.

We conducted our audit in accordance with generally accepted auditing standards in New Zealand. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

We carry out other assignments on behalf of the Company and Group in the areas of taxation compliance, transaction services, financial assurance, and international accounting standard advisory services. Partners and employees of our firm may deal with the Company and Group on normal terms within the ordinary course of trading activities of the Company and Group. The firm has no other relationship with, or interest in, the Company and Group.

Unqualified Opinion

We have obtained all the information and explanations we have required.

In our opinion:

(a) proper accounting records have been kept by the Company as far as appears from our examination of those records; and

(b) the financial statements on pages 32 to 82:

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

  (ii) comply with International Financial Reporting Standards; and

  (iii) give a true and fair view of the financial position of the Company and Group as at 31 July 2010 and their financial performance and cash flows for the year ended on that date.

Our audit was completed on 22 September 2010 and our unqualified opinion is expressed as at that date.

PricewaterhouseCoopers

Chartered Accountants
Auckland

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 2010. The figure alongside each Director includes beneficially held securities, holdings by Associated Persons and joint holdings with Associated Persons.

	CO-OPERATIVE SHARES
Colin Armer	17,065,848
Malcolm Bailey	3,540,585
Ian Farrelly	1,981,126
Greg Gent	423,752
John Monaghan	960,000
Nicola Shadbolt	353,162
Sir Henry van der Heyden	483,720
Jim van der Poel	7,096,546
John Wilson	3,522,904

CO-OPERATIVE STATUS

In accordance with Section 10 of the Co-operative Companies Act 1996, the Directors of Fonterra unanimously resolved on 22 September 2010 that the Company was, for the year ended 31 July 2010, 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 2009 to 31 July 2010 are scheduled below:

	FEES $
Colin Armer	135,000
Malcolm Bailey	126,250
John Ballard	120,000
Ian Farrelly	120,000
Greg Gent	128,750
David Jackson	140,000
John Monaghan	126,250
Stuart Nattrass (to 18 November 2009)	36,308
Nicola Shadbolt (from 18 November 2009)	84,154
Sir Henry van der Heyden	250,000
Jim van der Poel	120,000
John Waller	135,000
Ralph Waters	120,000
John Wilson	120,000

SUBSIDIARY COMPANY DIRECTORS

The following companies were subsidiaries of Fonterra as at 31 July 2010. 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.

236752 Limited:
S C R Deschamps, M W Smith

616059 Limited:
S C R Deschamps, M W Smith

Anchor Ethanol Limited:
M W Smith, P D Washer

Canpac International Limited:
S J Gajzago, M W Smith

Civil Whey Distributors Limited:
S J Gajzago, B P D Taylor

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

Dairy Transport Logistics Limited:
K Harris, G A Hoddinott, J P Minkhorst, J L Winser

Fantastic Food Limited:
J A Luskie, P J W McClure, A M Smith (R) (A)

Fencepost.com Limited:
J P Minkhorst, M W Smith

Fonterra (APV) Limited:
S C R Deschamps, M W Smith

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

Fonterra (International) Limited:
M W Smith, P D Washer

Fonterra (Middle East) Limited:
K K Gupta, M W Smith

Fonterra (New Zealand) Limited:
D K Mallinson, M W Smith

Fonterra (Number One) Limited:
S C R Deschamps, M W Smith

Fonterra Brands (China Holdings) Limited:
M W Smith, T L Tan

Fonterra Brands (New Zealand) Limited:
D K Mallinson, M W Smith

Fonterra Brands (The Pastryhouse) Limited:
D K Mallinson, M W Smith

Fonterra Brands (Tip Top Investments) Limited:
D K Mallinson, M W Smith

Fonterra Brands (Tip Top) Limited:
D K Mallinson, M W Smith

Fonterra Brands Investments (NZ) Limited:
D K Mallinson, M W Smith

Fonterra Brands Limited:
J P Mason, M W Smith

Fonterra Commodities Limited:
M W Smith, P D Washer

Fonterra Corporate Research and Development Limited:
C P Caldwell, M W Smith

Fonterra Dairy Solutions Limited:
K K Gupta, M W Smith

Fonterra Enterprises International Limited:
S C R Deschamps, M W Smith

Fonterra Enterprises Limited:
J P Minkhorst, M W Smith

Fonterra Equities Limited:
S C R Deschamps, M W Smith

Fonterra Finance (N.Z.) Limited:
S C R Deschamps, M W Smith

Fonterra Finance Corporation Limited:
S C R Deschamps, M W Smith

Fonterra Holdings (Americas) Limited:
K J Murray, M W Smith

Fonterra Holdings (Argentina) Limited:
K J Murray, M W Smith

Fonterra Holdings (Brazil) Limited:
K J Murray, M W Smith

Fonterra Holdings (Ecuador) Limited:
K J Murray, M W Smith

Fonterra Holdings (Venezuela) Limited:
K J Murray, M W Smith

Fonterra Holdings Limited:
S C R Deschamps, M W Smith

Fonterra Insurance Limited:
J P Mason, M W Smith

Fonterra Investments (China) Limited:
M W Smith, T L Tan

Fonterra IP Limited:
S C R Deschamps, M W Smith

Fonterra Limited:
M W Smith, P D Washer

Fonterra Manufacturing (Americas) Limited:
K J Murray, M W Smith

SUBSIDIARY COMPANY DIRECTORS (CONTINUED)

Fonterra PGGRC Limited:
J P Minkhorst, M W Smith

Fonterra Projects Limited:
S C R Deschamps, M W Smith

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

Fonterra TM Limited:
S C R Deschamps, M W Smith

Food Solutions Group 2000 Limited:
S C R Deschamps, M W Smith

General Foods Corporation (N.Z.) Limited:
D K Mallinson, M W Smith

Glencoal Energy Limited:
S J Gajzago, M W Smith

Kapiti Fine Foods Limited:
D K Mallinson, M W Smith

Key Ingredients New Zealand Limited:
S C R Deschamps, M W Smith

Milk Products Finance Limited:
S C R Deschamps, M W Smith

Milk Products International Limited:
M W Smith, P D Washer

New Zealand Dairy Board:
M W Smith, P D Washer

New Zealand Dairy Exporter Limited:
S C R Deschamps, M W Smith

New Zealand Milk (Australasian Holdings) Limited:
J P Mason, M W Smith

New Zealand Milk (Denmark) Limited:
C P Caldwell, M W Smith

New Zealand Milk (International) Limited:
J P Mason, M W Smith

New Zealand Milk (Mauritius Investments) Limited:
K K Gupta, M W Smith

New Zealand Milk Brands Limited:
S C R Deschamps, M W Smith

New Zealand Milk Products Limited:
S C R Deschamps, M W Smith

Nzagbiz Limited:
J P Minkhorst, M W Smith

NZM (Dairy Holdings) Limited:
K K Gupta, M W Smith

On-Farm Productivity Services Limited:
J P Minkhorst, M W Smith

Peters Ice Cream Company (N.Z.) Limited:
D K Mallinson, M W Smith

Promak No. 2 Limited:
S C R Deschamps, M W Smith

Promak Technology (NZ) Limited:
S C R Deschamps, M W Smith

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), E Gardener (A)

Sovenz Limited:
S C R Deschamps, M W Smith

Tangshan Dairy Farm (NZ) Limited:
M W Smith, T L Tan

The Lactose Company of New Zealand Limited:
S C R Deschamps, M W Smith

ViaLactia Biosciences (NZ) Limited:
J P Minkhorst, M W Smith

ViaLactia Bovine Limited:
J P Minkhorst, M W Smith

ViaLactia Clover Limited:
J P Minkhorst, M W Smith

Waratah Irrigation Company Limited:
S J Gajzago

Whareroa Co-Generation Limited:
S J Gajzago, M W Smith

A.C.N. 009 163 268 Pty Limited [Australia]:
D K Mallinson, M W Smith

A.C.N. 009 235 492 Pty Limited [Australia]:
D K Mallinson, M W Smith

A.C.N. 111 834 489 Pty Limited [Australia]:
D K Mallinson, M W Smith

A.C.N. 113 345 430 Pty Limited [Australia]:
B S Donnison, P L Thorn

Anchor Foods (Malaysia) Sdn Bhd [Malaysia]:
M F Bin Wahab, D J McKay, M W Smith, K K Gupta (A)

Anchor Foods Limited [United Kingdom]:
G R Sharma, M W Smith

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

Arctic Foods Pty Limited [Australia]:
D K Mallinson, M W Smith

SUBSIDIARY COMPANY DIRECTORS (CONTINUED)

Australasian Food Holdings Pty Limited [Australia]:
D K Mallinson, M W Smith

Bonlac Finance Pty Limited [Australia]:
D K Mallinson, M W Smith

Bonlac Staff Retirement Pty Limited [Australia]:
G P Nicholson, P L Thorn, M J West

Bonland Cheese Trading Pty Limited [Australia]:
D K Mallinson, M W Smith

Bonland Dairies Superannuation Pty Limited [Australia]:
B White

Brownes Foods Pty Limited [Australia]:
D K Mallinson, M W Smith

Comercial Dos Alamos S.A. [Chile]:
H Covarrubias Lalanne, P Muzzio, J M Porraz, J F Silva Barroilhet, S Tagle

Comercial Santa Elena S.A. [Chile]:
H Covarrubias Lalanne, P Muzzio, J M Porraz, J F Silva Barroilhet, S Tagle, E F Rojas Bravo (R)

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

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

Dairy Fresh Pty Limited [Australia]:
D K Mallinson, M W Smith

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

Dommeldal Dairy B.V. [Netherlands]:
A Kent, M W Smith

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

Fonterra (Canada), Inc. [Canada]:
M P J Bates, B Kipping, M W Smith

Fonterra (Central America) S.A. [Panama]:
M d R García de Pullin, B T Willis

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

Fonterra (China) Limited [Hong Kong]:
M W Smith, T L Tan, P A Turner, K A Wickham, D T Moore (R)

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

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

Fonterra (Europe) GmbH [Germany]:
K Liekelema, B Anderson (R), G D Wafelbakker (R)

Fonterra (Ing.) Limited [Mauritius]:
Lee G, B M Ryan, G Roper (R)

Fonterra (Italy) S.P.A. [Italy]:
B Anderson, P Pennati, M W Smith, G D Wafelbakker (R)

Fonterra (Japan) Limited [Japan]:
C P Caldwell, R M Kennerley, K Kumagai, D T Moore, K Ueta, S Yoshifuku, T Chaki (R), A A Mikhalevsky (R), T Morii (R)

Fonterra (Latam) Limited [Bermuda]:
G Roper, M W Smith

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

Fonterra (Mexico) S.A. de C.V. [Mexico]:
E A Teisaire, B T Willis, M I Arana Soriano (A), L Barona Mariscal (A)

Fonterra (Netherlands) Coöperatie U.A. [Netherlands]:
A Kent, M W Smith

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

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

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

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

Fonterra (USA) Inc [United States]:
M P J Bates, C P Caldwell, M W Smith, K L Wallace (R)

Fonterra Australia Pty Limited [Australia]:
D K Mallinson, M W Smith

Fonterra Brands (Americas), Inc. [United States]:
M P J Bates, M W Smith

Fonterra Brands (Asia Holdings) Pte. Limited [Singapore]:
K K Gupta, M A Wilson

Fonterra Brands (Australia) Pty Limited [Australia]:
D K Mallinson, M W Smith

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

Fonterra Brands (China) Limited [Hong Kong]:
D A Matthews, M W Smith, T L Tan

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

Fonterra Brands (Guangzhou) Limited [China]:
T L Tan, P A Turner, K A Wickham, D T Moore (R)

SUBSIDIARY COMPANY DIRECTORS (CONTINUED)

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

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

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

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

Fonterra Brands (Mauritius Holdings) Limited [Mauritius]:
K K Gupta, J Jingree, S K Jogoo, M W Smith

Fonterra Brands (New Young) Pte. Limited [Singapore]:
A J Bruce, K K Gupta, Lin C, Ling J, M A Wilson, D A Ross (A), Lin S (R)

Fonterra Brands (Singapore) Pte. Limited [Singapore]:
K K Gupta, M A Wilson

Fonterra Brands (Thailand) Limited [Thailand]:
S Aramthip, C Phaonimmongkol, D A Ross, M W Smith, M A Wilson

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

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

Fonterra Brands Phils. Inc [Philippines]:
C Guillermo, K K Gupta, M Magtoto, R A Mendoza, C M Mendoza,
M W Smith, M A Wilson

Fonterra Commercial Trading (Shanghai) Company Limited [China]:
Kwok H Y, M W Smith, T L Tan, P A Turner, K A Wickham, D T Moore (R)

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

Fonterra Foods Pty Limited [Australia]:
D K Mallinson, M W Smith

Fonterra Holdings (Mexico), S.A. de C.V. [Mexico]:
E A Teisaire, B T Willis, M I Arana Soriano (A), L Barona Mariscal (A)

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

Fonterra Ingredients Australia Pty Limited [Australia]:
D K Mallinson, M W Smith

Fonterra Investments Netherlands Coöperatie U.A. [Netherlands]:
FTC Trust B.V., A Kent, A A Mikhalevsky, D T Moore, K A Wickham (R)

Fonterra Investments Pty Limited [Australia]:
D K Mallinson, M W Smith

Fonterra Milk Australia Pty Limited [Australia]:
D K Mallinson, M W Smith

Fonterra Servicios, S.A. de C.V. [Mexico]:
M W Smith, E A Teisaire, B T Willis, M I Arana Soriano (A),
L Barona Mariscal (A)

Fonterra Tangshan Dairy Farm (HK) Limited [Hong Kong]:
M W Smith, P A Turner

Fonterra Venezuela, S.A. [Venezuela]:
F C Ortega Becea, M M Pérez Ortiz, M W Smith, M P de Alexandre (A),
O N de Massiani (A), S Guevara Camacho (A)

Halve Maan Zuivel B.V. [Netherlands]:
A Kent, M W Smith

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

Key Ingredients, Inc. [United States]:
M P J Bates, C P Caldwell, M W Smith, K L Wallace (R)

Krabbebosschen Zuivel B.V. [Netherlands]:
A Kent, M W Smith

Mainland Dairies Pty Limited [Australia]:
D K Mallinson, M W Smith

Mainland Foodservice Pty Limited [Australia]:
D K Mallinson, M W Smith

Milk Products Holdings (Middle East) EC [Bahrain]:
M W Smith, M A Wilson

Milk Products Holdings (North America) Inc. [United States]:
M P J Bates, C P Caldwell, M W Smith, K L Wallace (R)

Murrumbidgee Dairy Products Pty Limited [Australia]:
D K Mallinson, M W Smith

New Tai Milk Products Co Limited [Taiwan]:
G N Kane, Kwok H Y, J Lee, M Lee, C Lee, Lee G, B M Ryan, B T Willis,
R M Major (R), G Roper (R)

New Zealand Dairy Services (Latin America) Inc. [United States]:
M P J Bates, M W Smith

New Zealand Milk (Australasia) Pty Limited [Australia]:
D K Mallinson, M W Smith

New Zealand Milk (Barbados) Limited [Barbados]:
M P J Bates, M W Smith

New Zealand Milk (LATAM) Limited [Bermuda]:
C P Caldwell, M W Smith

Newdale Dairies (Private) Limited [Sri Lanka]:
K K Gupta, A R R Kasireddy, M W Smith, J H P Gallage (A),
V Wijesinghe (R) (A)

SUBSIDIARY COMPANY DIRECTORS (CONTINUED)

NZagbiz Australia Pty Limited [Australia]:
D K Mallinson, M W Smith

NZMP (AEM) Limited [United Kingdom]:
T H D Kühn, G R Sharma

Ooijevaarsnest Zuivel B.V. [Netherlands]:
A Kent, M W Smith

Pax Zuivel B.V. [Netherlands]:
A Kent, M W Smith

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

PT. Fonterra Indonesia [Indonesia]:
G N Kane, G Roper, M W Smith

Recombined Dairy Systems A/S [Denmark]:
T H D Kühn, K Liekelema, G R Sharma, G D Wafelbakker (R)

Saudi New Zealand Milk Products Company Limited [Saudi Arabia]:
K P Williams, M Al Nassor (R), M Atar (R), P G Brown (R), A W A H Farghal (R), W Matthijs (R), M A Wilson (R), Z Cably (R) (A), B Greaney (R) (A), K K Gupta (R) (A), S Satherly (R) (A), K P Williams (R) (A)

Sociedad Agrícola y Lechera Praderas Australes S.A. ("Pradesur") [Chile]:
H Covarrubias Lalanne, J M Porraz, J F Silva Barroilhet

Sociedad Procesadora de Leche Del Sur S.A. [Chile]:
E Alcalde Undurraga, G M Cowan, A Cussen Mackenna, J Milic Barros, K J Murray, J R Valente Vias, G Varela Alfonso, J M Alcalde Undurraga (A), S Diez Arriagada (A), O Ferrari García (A), G Grez Jordán (A), G Jiménez Barahona (A), J E Montero León (A), S Oddo Gómez (A)

Solid Fresh Food & Beverage (M) Sdn Bhd [Malaysia]:
M F Bin Wahab, D J McKay, M W Smith, K K Gupta (A)

Solid Milk Industries Sdn Bhd [Malaysia]:
M F Bin Wahab, D J McKay, M W Smith, K K Gupta (A)

Soprole Alimentos S.A. [Chile]:
G M Cowan, F Léniz, A Montaner Lewin, R Sepúlveda, J R Valente Vias, G Varela Alfonso, S Diez Arriagada (A), O Ferrari García (A), J C Gumucio Schönthaler (A), C Herrera Barriga (A), G Jimenez Barahona (A), J E Montero León (A)

Soprole Inversiones S.A. [Chile]:
M P Campbell, A J Duncan, K J Murray, R Sepúlveda, M W Smith, J P Egaña Bertoglia (A), J C Gumucio Schönthaler (A), L O Herrera Larraín (A), A Montaner Lewin (A), S Obach González (A)

Soprole S.A. [Chile]:
G M Cowan, F Léniz, J R Valente Vias, G Varela Alfonso, S Diez Arriagada (A), O Ferrari García (A), J E Montero León (A), R Sepúlveda (A), E A Teisaire (R)

Susumas Sdn Berhad [Malaysia]:
M F Bin Wahab, D J McKay, M W Smith, K K Gupta (A)

Tangshan Fonterra San Lu Dairy Farm Limited [China]:
P J Moore, T L Tan, P A Turner, Wu J S, D T Moore (R)

Unilac Australia Pty Limited [Australia]:
D K Mallinson, M W Smith

United Milk Tasmania Pty Limited [Australia]:
D K Mallinson, M W Smith

REMUNERATION FRAMEWORK

Fonterra operates a Pay for Performance approach to remuneration for salaried employees. We aim to 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 labour market, the framework is based on relevant market 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 while the *This is Fonterra* project aims to inform, excite and connect employees to our vision and strategy.

SHORT TERM INCENTIVE (STI) PLANS

Every permanent salaried employee in Fonterra worldwide is invited to participate in an annual STI plan.

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&D).

MEDIUM TERM INCENTIVE (MTI) PLAN

For certain key executives, Fonterra operates a MTI plan. This plan is by invitation only and is designed to motivate, reward and retain key executives.

The plan rewards participants for achievements against relative Payout. The plan operates over a one year cycle but any payments are made over a three year period to maximise retention of key executives. Any payments made under the MTI plan are approved by the AR&D.

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 2010, New Zealand based salaried employees were offered significantly discounted life insurance and income protection to help employees take care of their families when they can't.

Fixed remuneration	STI plans	MTI plan
• Provides "stable" base level of reward	• All salaried employees eligible	• Restricted to key executives
• External and internal relativities and budget constraints taken into account	• Comprehensive range of financial and non financial measures	• One year scheme vested over a three year period to encourage retention
• Typically set at market median (for local market) using independent external benchmark data	• When targets are exceeded total remuneration will be above market median	
• Varies based on employee skills and performance	• Highest performance receive an additional multiplier, lowest performance receive no STI payment	

BASE REMUNERATION

The Group operates in a number of countries where remuneration market levels differ widely. During the year ended 31 July 2010, 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	432	285	14	731
110,001	120,000	190	241	8	439
120,001	130,000	126	127	9	262
130,001	140,000	106	102	7	215
140,001	150,000	56	81	5	142
150,001	160,000	64	76	10	150
160,001	170,000	51	61	2	114
170,001	180,000	27	55	3	85
180,001	190,000	34	42	4	80
190,001	200,000	17	22	2	41
200,001	210,000	15	24	5	44
210,001	220,000	17	13	1	31
220,001	230,000	6	25	4	35
230,001	240,000	15	21	4	40
240,001	250,000	8	20	1	29
250,001	260,000	10	16	3	29
260,001	270,000	10	18	1	29
270,001	280,000	3	8	4	15
280,001	290,000	7	20	1	28
290,001	300,000	10	8	2	20
300,001	310,000	4	13	1	18
310,001	320,000	1	8	1	10
320,001	330,000	3	3	1	7
330,001	340,000	6	8	–	14
340,001	350,000	3	5	1	9
350,001	360,000	7	4	–	11
360,001	370,000	3	8	2	13
370,001	380,000	2	4	1	7
380,001	390,000	2	3	–	5
390,001	400,000	4	7	1	12
400,001	410,000	1	4	–	5
410,001	420,000	3	7	–	10
420,001	430,000	2	3	–	5
430,001	440,000	1	1	–	2
440,001	450,000	1	5	–	6
450,001	460,000	–	4	–	4
460,001	470,000	2	1	–	3
470,001	480,000	–	1	–	1
480,001	490,000	–	2	–	2
490,001	500,000	1	3	–	4
500,001	510,000	1	–	–	1
510,001	520,000	–	1	1	2
520,001	530,000	–	1	–	1
530,001	540,000	2	1	–	3
540,001	550,000	–	1	–	1
550,001	560,000	1	–	–	1
560,001	570,000	1	2	1	4

BASE REMUNERATION (CONTINUED)

REMUNERATION RANGE ($)		NEW ZEALAND[1]	OFFSHORE[2]	CESSATIONS[3]	TOTAL
580,001	590,000	1	1	–	2
590,001	600,000	–	1	–	1
600,001	610,000	1	–	–	1
610,001	620,000	–	4	–	4
620,001	630,000	–	1	–	1
630,001	640,000	1	–	1	2
640,001	650,000	2	1	–	3
650,001	660,000	2	2	–	4
660,001	670,000	–	1	–	1
670,001	680,000	–	1	–	1
690,001	700,000	1	2	–	3
700,001	710,000	–	1	–	1
710,001	720,000	1	–	–	1
720,001	730,000	1	1	–	2
730,001	740,000	–	1	–	1
740,001	750,000	–	1	–	1
760,001	770,000	–	1	–	1
780,001	790,000	1	–	–	1
790,001	800,000	–	2	–	2
820,001	830,000	–	1	–	1
850,001	860,000	–	1	–	1
870,001	880,000	–	1	–	1
880,001	890,000	1	1	–	2
910,001	920,000	–	1	–	1
920,001	930,000	–	1	–	1
930,001	940,000	–	1	–	1
980,001	990,000	1	1	–	2
990,001	1,000,000	2	–	–	2
1,000,001	1,010,000	–	1	–	1
1,020,001	1,030,000	1	–	–	1
1,060,001	1,070,000	–	1	–	1
1,080,001	1,090,000	–	1	–	1
1,150,001	1,160,000	1	–	–	1
1,160,001	1,170,000	–	1	1	2
1,180,001	1,190,000	–	–	1	1
1,240,001	1,250,000	1	–	–	1
1,340,001	1,350,000	1	–	–	1
1,350,001	1,360,000	1	–	–	1
1,370,001	1,380,000	1	–	–	1
1,460,001	1,470,000	–	1	–	1
1,490,001	1,500,000	1	–	–	1
1,650,001	1,660,000	1	–	–	1
1,800,001	1,810,000	–	1	–	1
1,870,001	1,880,000	–	1	–	1
2,280,001	2,290,000	1	–	–	1
2,430,001	2,440,000	–	1	–	1
5,100,001	5,110,000	1	–	–	1
Total		**1,280**	**1,402**	**103**	**2,785**

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 2009) 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 have rated the Company A+ with a rating outlook of stable. Fitch have 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. The ratings were last affirmed in December 2009 by Standard & Poor's and in March 2010 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 3 September 2010:

FCGHA capital notes

FROM – TO	HOLDER COUNT	%	HOLDING QUANTITY	%
1 – 1,000	10	1.0%	4,858	0.0%
1,001 – 5,000	28	3.0%	79,391	0.1%
5,001 – 10,000	384	41.0%	2,667,801	2.6%
10,001 – 100,000	470	50.1%	13,051,618	12.7%
100,001 and over	46	4.9%	86,715,586	84.6%

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 3 September 2010:

FCG010 $800 million retail bond issue

FROM – TO	HOLDER COUNT	%	HOLDING QUANTITY	%
1 – 999	–	–	–	–
1,000 – 4,999	–	–	–	–
5,000 – 9,999	952	10.8%	5,408,000	0.6%
10,000 – 99,999	6,873	77.8%	189,215,000	20.6%
100,000 and over	1,007	11.4%	605,377,000	78.8%

FCG020 $150 million retail bond issue

FROM – TO	HOLDER COUNT	%	HOLDING QUANTITY	%
1 – 999	–	–	–	–
1,000 – 4,999	–	–	–	–
5,000 – 9,999	31	8.6%	174,000	0.1%
10,000 – 99,999	271	75.3%	7,482,000	5.0%
100,000 and over	58	16.1%	142,344,000	94.9%

ENTRIES IN THE INTERESTS REGISTER

Directors' interests in transactions

General disclosures of interest

The following general disclosures of interest were made in the period 1 August 2009 to 31 July 2010:

Colin Armer	Shareholder of Liberty Genetics Limited
John Ballard	Director of International Ferro Metals Limited; Cessation of interest as a trustee of the Sydney Opera House Trust; Chairman-designate of Elders Limited
Ian Farrelly	Director and shareholder of Jamieson Dairies Limited and Kahuterawa Farms Limited; Shareholder of Cartrum Dairies Limited and Netherbrook Dairies Limited; Shareholding interest in Liberty Genetics Limited
Greg Gent	Director of Equestrian Sports New Zealand Inc. and Director of Northland District Health Board; Cessation of interest as a director of Rugby World Cup (Northland) Limited
David Jackson	Cessation of interest as a Member of the Securities Commission
Nicola Shadbolt	Director and shareholder of Pohangina Land Co (No 1) Limited and North Grove Dairy Limited
Sir Henry van der Heyden	Director of Auckland International Airport Limited and Pascaro Investments Limited
Jim van der Poel	Director and shareholder of Frontier Dairies Limited; Shareholding interests in Koromiko Grazing Limited and Liberty Genetics Limited; Cessation of interest as a director of Dexcel Holdings Limited
John Waller	Director and shareholder of Donaghys Limited and JAW Advisory Limited; Member of the Takeovers Panel; Trustee (Chairman) of The Eden Park Trust
John Wilson	Limited partner of Lochan Mor LP; Shareholding interest in Liberty Genetics Limited; Cessation of interest in Cairndhu Dairies Limited

Specific disclosures

Ian Farrelly	Fonterra Co-operative Group Limited has agreed to supply from time to time I and D Farrelly, a partnership between Ian Farrelly and Associated Persons, with liquid milk which is not suitable for processing into products for human consumption. This contract is in the ordinary course of Fonterra's business and on usual terms and conditions. Fonterra generally needs to be able to dispose of such liquid milk, and the partnership is willing to accept the milk from Fonterra, without charge by either party
Nicola Shadbolt	Interest on appointment, and continuing thereafter, as the Principal Investigator for Massey University in a two year research contract, which expires on 1 July 2010, between Fonterra and Massey University regarding the International Farm Comparison Network. The contract value is not more than $20,000, payable by Fonterra to Massey University

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
Nicola Shadbolt (balance on appointment)	308,753	–
Jim van der Poel (interest advised 8 July 2010)	162,200	–

Transition changes
Following the adoption at the 2009 Annual Meeting of steps one and two of the capital structure changes, shareholders were able to make mid-season elections to acquire or surrender shares. Directors disclosed the following transactions associated with this transitional provision:

	CO-OPERATIVE SHARES	
	HELD BY ASSOCIATED PERSONS	JOINTLY HELD WITH ASSOCIATED PERSONS
Colin Armer		
• Purchased for cash	1,070,556	–
Malcolm Bailey		
• Purchased for cash	591,462	–
Ian Farrelly		
• Purchased for cash	292,560	–
John Monaghan		
• Purchased for cash	170,299	–
Nicola Shadbolt		
• Purchased for cash	41,247	–
Sir Henry van der Heyden		
• Purchased for cash	4,483	12,833
Jim van der Poel		
• Purchased for cash	568,681	–
John Wilson		
• Purchased for cash	32,085	472,693
• Surrendered for cash	13,432	–

In all cases the allocations or surrenders were made on 26 January 2010. The value upon allocation or surrender of these securities was $4.52 per Co-operative share.

ENTRIES IN THE INTERESTS REGISTER (CONTINUED)

End of season changes

Directors disclosed the following transactions associated with 2010 end of season adjustments:

	CO-OPERATIVE SHARES	
	HELD BY ASSOCIATED PERSONS	JOINTLY HELD WITH ASSOCIATED PERSONS
Colin Armer		
• Purchased for cash	356,144	–
• Surrendered for cash	212,526	2,392
Malcolm Bailey		
• Surrendered for cash	89,797	–
Ian Farrelly		
• Purchased for cash	59,236	–
• Surrendered for cash	24,969	–
Greg Gent		
• Surrendered for cash	5,911	345
Nicola Shadbolt		
• Purchased for cash	3,162	–
Sir Henry van der Heyden		
• Surrendered for cash	4,078	27,101
Jim van der Poel		
• Purchased for cash	128,618	–
John Wilson		
• Purchased for cash	9,290	13,459

In all cases the allocations or surrenders relate to the 2009/10 end of season adjustments. Adjustments related to production in the 2009/10 season were made on 3 June 2010 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 2009/10 season:

	CO-OPERATIVE SHARES	
	HELD BY ASSOCIATED PERSONS	JOINTLY HELD WITH ASSOCIATED PERSONS
Colin Armer		
• Purchased for cash	152,693	2,392
• Surrendered for cash	178,099	–
Malcolm Bailey		
• Purchased for cash	72,382	–
Ian Farrelly		
• Surrendered for cash	62,172	–
Greg Gent		
• Purchased for cash	5,911	345
Sir Henry van der Heyden		
• Purchased for cash	4,078	27,101
John Wilson		
• Surrendered for cash	5,655	8,770

Adjustments were made on 2 July 2010 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.

ENTRIES IN THE INTERESTS REGISTER (CONTINUED)

Retail bond transactions

There were no transactions in retail bonds reported during the period from 1 August 2009 to 31 July 2010. Current interests held by Directors remain as follows:

	Details of interest
David Jackson	Joint trustee in respect of 100,000 bonds (FCG010)
John Waller	Joint trustee in respect of 210,000 bonds (FCG010)

Other trading activities

On 27 August 2009, Associated Persons of Ian Farrelly and Jim van der Poel acquired interests in 449,549 Co-operative shares at $4.52 per share upon commencing supply.

On 31 May 2010, John Wilson ceased his association with Persons holding 352,650 Co-operative shares.

Loans to Directors

There have been no loans to Directors.

Directors' remuneration

The Directors' Remuneration Committee, comprising six Shareholders appointed under the Constitution, makes recommendations for Shareholder approval as to the level of Directors' fees.

At the Annual Meeting of Shareholders held on 18 November 2009, Shareholders approved, on the recommendation of the Directors' Remuneration Committee, the following amounts of remuneration to apply from the date of that Annual Meeting of Shareholders.

Chairman	$250,000 p.a.
Directors	$120,000 p.a.
Discretionary additional payments to the Chairman of the Audit, Finance and Risk Committee (except if the Chairman is the Fonterra Chairman)	$20,000 p.a.
Discretionary additional payments to the Chairmen of other permanent Board Committees (except if the Chairman is the Fonterra Chairman)	$15,000 p.a.

The Board has approved payment of the discretionary additional payment, at the prevailing approved rate, to the Chairmen of the Audit Finance and Risk Committee, and other permanent Board Committees.

The Board has a policy of applying the same remuneration levels to Directors appointed under Clause 12.4 of the Constitution.

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.

GOVERNANCE

Fonterra is New Zealand's largest co-operative as well as being a major company in the context of the New Zealand economy and the global dairy industry.

The Company has approximately 10,500 New Zealand dairy farmer suppliers who are Shareholders, and has issued capital notes and retail bonds which are listed on the NZDX.

The Board and management are committed to a system of corporate governance that meets the unique requirements of Fonterra's Shareholders and best practice appropriate to a co-operative and also takes into account recommendations by the New Zealand Securities Commission and NZX.

THE BOARD OF FONTERRA

Composition

The composition of the Fonterra Board is important to the governance of the Co-operative. It comprises up to 13 Directors and under the Fonterra Constitution, nine of the Directors are elected from the Shareholder base (Elected Directors), and four are appointed by the Board and approved by Shareholders at the Annual Meeting (Appointed Directors). There are no executive Directors.

During the year Stuart Nattrass retired as a Director and from his position on committees of the Board and Nicola Shadbolt was elected as a Director by Shareholders with effect from the close of the 2009 Annual Meeting.

Appointed Directors provide a balance of independence, skills and experience to the Board, complementing the deep understanding of the dairy industry provided by the Elected Directors. Appointments are made after an extensive search based on detailed criteria. Appointed Directors are appointed for a term specified by the Board, subject to Shareholder approval. Elected Directors are appointed for a three year period through a postal ballot.

The Director election process for Elected Directors is timed so that Shareholders have the most up-to-date financial results available before voting. This also ensures that the Director elections coincide with the Annual Meeting. The structure of the Board will continue to be reviewed in consultation with Shareholders to ensure that it best meets the demands of the Co-operative.

Independent Directors

The Fonterra Constitution specifies the composition of the Board and does not distinguish between "independent" and "non-independent" Directors. The Appointed Directors are independent and free of any supplier relationship with the Company. However, the co-operative nature of the Company means that Elected Directors, who must be Shareholders, will have a supplier relationship with the Company.

None of the Elected Directors would generally be classified as independent under the NZX definitions because their supplier relationship with Fonterra is material to their business activity.

The Board considers that the mix of Elected and Appointed Directors, as mandated in the Constitution, provides an appropriate balance so that the Board operates in the best interests of the Co-operative's Shareholders.

All Directors comply with the legislative requirements for disclosing interests, and Fonterra has a Securities Code of Conduct, which guides and regulates both Directors and management in their personal dealings with Fonterra securities and those of related companies.

BOARD, PERMANENT COMMITTEES AND WORKING GROUP MEETING ATTENDANCES

The table below shows the number of eligible meetings attended by each Board and committee member during the year.

	BOARD								
	REGULAR	SPECIAL	AFRC	AR&D	SRC	FVS	GTRC	IMSAG	MPWG
Colin Armer	8/8	6/6	3/3	7/7	2/2		2/2	6/6	1/1
Malcolm Bailey	8/8	6/6	5/6		5/6		2/2		2/2
John Ballard	8/8	6/6		7/7					
Ian Farrelly	8/8	6/6	6/6	3/3	6/6				2/2
Greg Gent	8/8	5/6	5/6	4/4		17/22	2/2	6/6	2/2
David Jackson	8/8	6/6	6/6			13/22			
John Monaghan	8/8	6/6		3/3	2/2	14/15	2/2		1/2
Nicola Shadbolt[1]	5/5	3/3			3/4	11/12			1/1
Sir Henry van der Heyden	8/8	6/6		7/7					
Jim van der Poel	8/8	6/6			3/4	18/22	1/2	5/6	1/1
John Waller	7/8	3/6	5/6			19/22			
Ralph Waters	8/8	6/6		7/7					
John Wilson	8/8	6/6		7/7		21/22	1/2		
Stuart Nattrass[2]	3/3	2/3	1/1			4/4			
Total meetings	**8**	**6**	**6**	**7**	**6**	**22**	**2**	**6**	**2**

1 Nicola Shadbolt was appointed with effect from 18 November 2009.

2 Stuart Nattrass retired with effect from 18 November 2009.

BOARD ROLE AND CHARTER

The Board has the responsibility to direct and supervise the management of the business and affairs of the Co-operative. Key activities in discharging this responsibility are: determination of the dividend; determination of Payout; setting of the Fair Value Share price after determination of the fair value range by the Independent Valuer; review and approval of the budget and business plan; the appointment and review of the performance of the CEO; engagement in the strategic planning process and in the setting of the strategy for the Company and the major business units; approval of significant acquisitions and disposals outside management's delegated authorities; oversight of the Board Committees and the areas covered by each of those Committees.

The Board has issued a written delegation of authority to management, which it regularly reviews, and has reporting and review processes in place to monitor performance of management in conducting the operations of the Company.

The Board has adopted a Charter, which defines its manner of operation and relationship with management. This Charter is posted on the Fonterra website, www.fonterra.com. The Charter is reviewed regularly to ensure that it reflects the role of the Board as it develops.

Board meetings

The Board meets formally at least seven times each year to conduct business. The business at those regular meetings includes consideration of the ongoing operations of the Fonterra business, plans and budgets, and major strategic proposals and governance matters (including statutory responsibilities and continuous disclosure issues).

The Board also addresses business issues at special meetings that are called as specific matters arise from time to time, often at relatively short notice.

In addition, the Board also holds a number of workshops each year to consider matters of significance such as the Fonterra strategy and Fonterra's capital structure. As well, Directors visit significant global markets to enhance their understanding of the business of the Company and its strategies. These market visits include briefings from management and meetings with joint venture partners, major customers and local political leaders.

Board Committees and Working Groups

The Board uses Committees or Working Groups to facilitate more effective and efficient decision-making. Committees and Working Groups have written terms of reference, and report on their activities to the Board.

Committees are made up of Directors only, although other people may be present as observers, whereas Working Groups may have employees, Shareholders, or others as members in addition to Directors.

The terms of reference and membership of each Committee or Working Group are reviewed annually by the Board. The Committees and Working Groups of the Board as at 31 July 2010 are identified below. Other committees may be formed as required – for example, in the event of major merger and acquisition activity. During the 2009/2010 year the Board constituted temporary committees to (i) consider and address Heath and Safety issues and initiatives; and (ii) perform due diligence on the Capital Structure proposals. The Health and Safety Committee is to be reviewed in late 2010; the Due Diligence Committee completed its initial brief during the year and the Board will consider its ongoing role in late 2010.

Audit, Finance and Risk Committee (AFRC)
The AFRC is comprised of at least five Directors, and must include an Appointed Director and the Chairman of the Company. At least one member of the Committee is required to have an accounting or financial background.

The Chairman of the Committee (who must not be the Board Chairman) is David Jackson. He and John Waller, who also sits on the Committee, have accounting and financial backgrounds. All other members of the AFRC (Malcolm Bailey, Ian Farrelly, Greg Gent and Colin Armer) have relevant accounting or finance experience. Messrs Jackson and Waller are Appointed Directors.

The AFRC has significant roles in (i) assisting the Board to ensure the quality and integrity of financial reports, (ii) reviewing the risk and assurance processes, and (iii) overseeing Treasury operations and policies. Principal activities of the AFRC include establishing and reviewing internal audit and global assurance processes; reviewing the internal control framework, significant risks, exposures and mitigation strategies; reviewing financial reports to Shareholders and offering documents; reviewing and overseeing financial risk strategies, hedging policies and other Treasury functions; ensuring the timeliness and balance of disclosures on the affairs of the Company; and overseeing the appointment of external auditors and the external audit process.

Appointments, Remuneration and Development Committee (AR&D Committee)
The AR&D Committee is comprised of up to six Directors, at least one of whom is an Appointed Director. The Chairman of the Committee is the Chairman of the Board, Sir Henry van der Heyden. It comprises John Monaghan, Colin Armer, John Wilson, John Ballard and Ralph Waters. David Jackson has observer status. Messrs Ballard, Jackson and Waters are Appointed Directors.

Principal activities of the AR&D Committee include obtaining assurance that the Company's human resources' policies and practices support achievement of the Company's goals; overseeing appointments of the CEO, roles reporting to the CEO, and key professional legal and public relations advisors; reviewing remuneration strategies and plans; and overseeing the development of key employees.

Shareholder Relations Committee (SRC)
The SRC is comprised of five Directors. Up to four Shareholder Councillors also attend SRC meetings as observers. The Chairman of the Committee is Malcolm Bailey. It also comprises Ian Farrelly, Nicola Shadbolt, Jim van der Poel and John Monaghan. Principal activities of the SRC include monitoring the interface between Fonterra and Shareholders; reviewing the delivery of services to Shareholders and the terms and conditions of supply and acting as an intermediary for Shareholders with complaints against the Company and liaising with the Milk Commissioner in relation to complaints that cannot be resolved. The SRC also provides a significant interface with the Shareholders' Council on Shareholder Supplier issues.

Fair Value Share Review and Milk Price Committee (FVS Committee)
The FVS Committee is comprised of six Directors. The Board Chairman and CEO may also attend ex-officio. Two members of the Shareholders' Council attend as observers. The Chairman of the FVS Committee is John Waller. It also comprises Greg Gent, Jim van der Poel, John Monaghan, John Wilson and David Jackson. Nicola Shadbolt is a member for any Capital Structure matters. The principal activities of the FVS Committee are providing advice to the Board on the setting of the Fair Value Share price from within the fair value range determined by the Valuer, which the Board is required to do under the Constitution; overseeing the governance of the Milk Price Manual; and reviewing material and providing the Board with recommendations relating to Stage three of Fonterra's Capital Structure review. In order to fulfil the former role, the FVS Committee reviews information provided by management to the Independent Valuer and interacts with the Independent Valuer to the extent required to enable the FVS Committee to obtain a high level understanding of the process and factors underpinning the determination of the fair value range.

Government and Trade Relations Committee (GTRC)
The GTRC (formerly the External Relations Committee) is comprised of six Directors. The Chairman of the GTRC is John Monaghan. It also comprises Malcolm Bailey, Greg Gent, Jim van der Poel, Colin Armer and John Wilson. The purpose of the GTRC is to assist the Board in building relationships with political contacts and international trade policy contacts as well as with selected joint venture partners.

International Milk Sourcing Advisory Group (IMSAG)
The IMSAG (formerly the Farm Development Governance Board) comprises at least two Directors, one appointed independent member, and management representatives. The Chairman of the IMSAG is Colin Armer. Other Directors currently appointed are Greg Gent and Jim van der Poel. The IMSAG is established as a permanent Committee of the Board, and its principal activities include reviewing and advising on profitable solutions to secure long term traceable quality milk supply to support customer demand in targeted growth regions.

Milk Price Working Group (MPWG)
The MPWG is comprised of six Directors, up to two external appointees, and a management representative. The current Chairman of the Working Group is Malcolm Bailey. It also comprises Ian Farrelly, Nicola Shadbolt, Jim van der Poel, Greg Gent and John Monaghan. The purpose of the MPWG is to assist the Board with the development of milk pricing signals in co-ordination with the development of the Capital Structure.

CANDIDATE ASSESSMENT PANEL (CAP)

In addition to the Board Committees, the Board and Shareholders' Council agreed to establish the CAP as a joint initiative to aid the development and assessment of future candidates for the Elected Director positions on the Board and provide Shareholders better information on the electoral process.

The CAP is independently chaired by John Loughlin and has two Board appointees and two Shareholders' Council appointees as members.

DIRECTORS' REMUNERATION COMMITTEE (DRC)

The DRC is independent of the Board and the Shareholders' Council, being separately elected by Fonterra Shareholders. Under the Constitution, the DRC considers and recommends for Shareholder approval, the form and amount of remuneration for Elected Directors.

The Board is responsible for setting remuneration of Appointed Directors, but generally follows the remuneration levels approved for Elected Directors.

The Board is authorised to approve special remuneration for a Director who is engaged to carry out work other than as a Director of Fonterra or where a Director is called upon to exercise special skills for the benefit of the Company.

The current members of the DRC are Rodney Wilson (Chairman), Ron Ferriman, Murray Holdaway, Murray King, Philip Wilson and Gerard Wolvers.

SHAREHOLDER RELATIONS AND STAKEHOLDER INTERESTS

The Board continues to promote the co-operative nature of the Company and reflects this in its dealings with its supplying Shareholders. This year has seen a continuation of the Board's programmes for fostering and enhancing relationships with its supplying Shareholders.

The Board and management have maintained regular direct contact through a significant number of meetings held throughout New Zealand. These meetings have also been supported by the Shareholders' Council, Area Managers and the Fonterra Farmer Network.

They provide an important forum for Shareholders to engage with Directors and management and gain a better understanding of the Fonterra business.

The Fonterra Milk Supply Service Centre also continues to provide an important service through which Shareholders can contact the Company to make comments, or to raise questions or complaints, and ensures that Shareholders' concerns are addressed.

Fonterra also maintains the Fencepost website (accessed through the Fonterra website, www.fonterra.com) which provides a wide range of information and other services to Shareholders, as well as a corporate Fonterra website which contains general information on the Company and is accessible to the general public.

INFORMATION DISCLOSURE

The Board is committed to providing information to its Shareholders and other investors in a timely manner. The Board regularly reviews the expected Payout to suppliers, and communicates its best estimate. The Board also uses shareholder meetings to update Shareholders on the Company's performance and strategic issues.

Shareholders also receive information relating to the Fair Value Share, annual and half-year financial results, and elections of Directors and Shareholders' Councillors. As a listed issuer of debt securities, Fonterra also keeps the market informed of material information through announcements to the NZX.

Fonterra publishes an annual Sustainability Report, detailing its performance against a range of key environmental and social indicators. Fonterra's supplier prospectus is kept current, and contains detailed information on the risks that may impact on the returns to investors. These documents are available on the Fonterra website, www.fonterra.com.

SHAREHOLDERS' COUNCIL

The Board has a significant and unique relationship with the Shareholders' Council (Council), which is established under the Constitution. The Council is independent of the Board and comprises 35 Shareholder-elected councillors, each representing a different ward. The Council's functions include reviewing the Board's statement of intentions for the performance and operations of the Company, and commenting on reports from the Board on the Company. The Board and Council share common interests in Shareholder issues, which are generally addressed through the SRC, MPWG, or similar mechanisms.

The Board receives regular feedback from the Council, both at its regular meetings, and through regular meetings between the Chairmen of the Board and the Council and the Chairmen of their respective Committees. To assist the working relationship, the Board and Council have approved a written protocol detailing the working interface between the Board, Executive and the Council.

ETHICS FRAMEWORK

Fonterra's board is committed to the ethical conduct of business around the world.

The ethics programme is the responsibility of the Fonterra Executive Committee (EXCO). Serious ethical issues are referred to the EXCO who act as Fonterra's Ethics Committee with advice from the General Counsel and Chief Internal Auditor. The Ethics programme is overseen by the Group Director Human Resources who reports to the AR&D Committee in relation to ethical matters. The Group Director Human Resources reports at least annually on ethics matters to the AR&D Committee.

The Way We Work, Fonterra's Code of Business Conduct remains the cornerstone to support Fonterra's people to do what's right during the working day and to apply high ethical and business standards at all times. With the launch of *This is Fonterra,* The Way We Work will shortly be re-issued to every employee with a focus on simple language and a straight-talking tone.

The Way We Work covers matters such as:

- How Fonterra's Values apply to The Way We Work
- How to Apply The Way We Work
- Working with Customers
- Working with Shareholders
- Working with Suppliers
- Working with our Communities

During the 2010 financial year a number of actions were taken to improve the common view of, and commitment to ethical standards and behaviours. Specifics actions were:

- A review and re-launch of the Fonterra ethics helpline
- An update of the Ethical Behaviour Group Policy
- Workshops with the top 250 senior managers from Fonterra around the world. These workshops will be the basis for individual Strategic Business Units actions, but will also drive a number of global initiatives
- A review and re-launch of the Fonterra ethics helpline. In February 2010 a new ethics hotline was launched on a global basis called The Way We Work Hotline. The Way We Work Hotline which is run for Fonterra by independent consultants Deloitte is there to provide individuals who may feel uncomfortable raising issues such as theft, fraud, harassment or misconduct with internal management a channel to raise confidential (they do not have to give their name if they don't wish to) concerns and have these fully investigated

Individuals have a number of contact channels including a website, e-mail, and for certain countries a phone line to call and can do so in their own language.

In the five month period from February to July 2010 17 calls were raised with the Hotline. All were thoroughly investigated and appropriate actions taken. None were significant and all were dealt with through internal governance and disciplinary procedures.

The Ethical Behaviour Group policy was reviewed to broaden its scope. In the past the policy focused mainly on corporate hospitality and gifts in relation to conflicts of interest but was broadened to include guidance on conflicts relating to business and personal and family relationships.

AUDIT INDEPENDENCE POLICY

The Board, primarily through the AFRC, ensures that the external auditors appointed by the Company are independent. Fonterra operates a rigorous selection process to appoint its auditors and concurs with its auditors' policy of rotating their lead external audit partner in accordance with best practice. AFRC approval is required for any activities the auditor undertakes for the Company other than those specified in their engagement as auditor. In general, the AFRC will not approve the auditor performing any potentially conflicting tasks unless exceptional circumstances exist and appropriate safeguards to ensure independence are put in place.

COMPLIANCE WITH GOVERNANCE STANDARDS

The Board recognises the need to continually review its Governance Standards to ensure they are in line with developing best practice. In so doing, the Board considers material published by a range of parties in New Zealand and internationally. An objective of the Board is to continue to structure and develop the governance systems and disclosures to provide meaningful and effective governance that is appropriate in the particular context of Fonterra as a major co-operative based in New Zealand.

As Fonterra does not list equity securities, the matters in the NZX Corporate Governance Best Practice Code (the Code) may not be directly applicable. However, the Board recognises the general relevance of the Code, and notes the following areas in which its practices differ from the Code:

- Appointments to the Board/Nomination Committee (paragraphs 2.2, 3.10-3.12): As a co-operative, most Directors are Shareholders, nominated and elected in accordance with the Constitution. The Board and the Shareholders' Council have established a CAP as discussed above to enhance aspects of this process. The AR&D Committee also takes a lead in identifying and evaluating potential appointed Directors. None of these bodies has a majority of independent Directors.
- Director Remuneration (paragraph 2.7): A performance-based equity security compensation plan is not available. Elected Directors must have an interest in shares under Clause 12.3 of the Constitution. Appointed Directors have not been suppliers, and thus have been able to retain their status as independent Directors. The DRC also considers whether Director remuneration should have any performance-based component.
- Remuneration Committee (paragraph 3.9): The DRC is a Shareholder-elected committee, and it is inappropriate for the Board to review the performance of the DRC. The Board will refer any matters relating to the DRC to an Annual or Special Meeting of Shareholders.

The Board has also reviewed compliance with the Principles for Corporate Governance issued by the Securities Commission. While the Board believes it complies with the Principles, the following areas of divergence from Guidelines are noted:

- Board Committees (guidelines 3.2, 4.6): The terms of reference for Board Committees are currently not made publicly available, although the scope of activities of each standing committee is described above.
- Audit Committee membership (guideline 3.4): The majority of members are not independent.
- 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.

	JULY 2010[1]	JULY 2009[1]	JULY 2008[1,2]	MAY 2007[1]	MAY 2006[1]
SHAREHOLDER RETURNS					
Payout ($)					
Milk Price[3]	**6.10**	4.72	7.59	3.87	3.85
Distributable Profit[4]	**0.60**	0.49	0.31	0.59	0.25
Payout (before retentions)	**6.70**	5.21	7.90	4.46	4.10
Less retentions	**(0.33)**	(0.01)	(0.24)	–	–
Payout[5, 6]	**6.37**	5.20	7.66	4.46	4.10
Fair Value Share price ($) set for the next season	**4.52**	4.52	5.57	6.79	6.56/5.80[7]
Total Shareholder Return[8]	**6.0%**	(10.2%)	(16.9%)	12.5%	9.6%
OPERATING PERFORMANCE					
Average commodity prices (US$ per MT FOB)					
Whole Milk Powder	**3,313**	2,379	4,605	2,687	2,220
Skim Milk Powder	**3,020**	2,205	4,325	2,748	2,192
Butter	**3,573**	2,343	3,755	1,848	2,004
Cheese	**3,819**	3,114	4,894	2,806	2,802
Source: Oceania Export Series, Agricultural Marketing Service, US Department of Agriculture					
Average NZD/USD spot exchange rate applying throughout the year[9]	**0.71**	0.60	0.77	0.68	0.68
Fonterra's average NZD/USD conversion rate[10]	**0.67**	0.67	0.74	0.67	0.66
Revenue ($ million)					
Ingredients and other revenue	**11,818**	10,987	14,267	9,755	9,211
Consumer revenue	**4,908**	5,048	5,245	3,932	3,790
Total revenue	**16,726**	16,035	19,512	13,687	13,001
Dairy ingredients manufactured in New Zealand (000s MT)	**2,058**	2,021	2,021	2,082	2,031
Total ingredients sales volume (000s MT)	**2,392**	2,310	2,633	2,458	2,149
Segment profit ($ million)[11]					
Commodities & Ingredients	**529**	584	340	918	–
ANZ	**286**	240	220	200	–
Asia/AME	**157**	63	(39)	49	–
Latam	**106**	106	129	58	–
Eliminations	**–**	(3)	(36)	41	–
Segment profit	**1,078**	990	614	1,266	702
Profit for the year attributable to Shareholders ($ million)[12]	**669**	599	272	862	–

1 2010, 2009, 2008 and 2007 figures are prepared under NZ IFRS with 2006 figures prepared under previous NZ GAAP.

2 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.

3 The Milk Price for the 2006 season is based on the Historical Commodity Milk Price (HCMP). At the beginning of the 2007 season Fonterra replaced the HCMP with the Milk Price. From the beginning of the 2009 season the Milk Price has been determined in accordance with the Milk Price Manual and is independently audited.

4 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 Milk Price, returns to Shareholder Suppliers were by way of the Value Return payment. Distributable Profit per share for the year ended 31 July 2010 has been calculated as Distributable Profit divided by the number of shares on issue as at 31 May 2010. For the years ended 31 July 2009 and prior Distributable Profit was calculated per kgMS.

5 Average Payout for a 100% share-backed supplier.

6 Payout to Shareholder Suppliers for 2007 is based on the actual Payout calculation and does not incorporate subsequent adjustments relating to the transition to New Zealand Equivalents to International Financial Reporting Standards.

7 At May 2006 the Fair Value Share price was set at $5.80 subsequently revised to $6.56 in September 2007 following the redemption of peak notes and conversion of supply redemption rights into additional shares.

	JULY 2010[1]	JULY 2009[1]	JULY 2008[1, 2]	MAY 2007[1]	MAY 2006[1]
CAPITAL EMPLOYED ($ million)					
Total assets employed	**14,169**	14,117	14,439	13,494	13,080
Average net assets	**10,433**	10,975	10,702	10,333	9,553
Equity attributable to Shareholders[13]	**5,526**	4,635	4,357	4,829	5,145
Net interest bearing debt	**4,268**	5,166	5,860	4,971	5,600
Economic net interest bearing debt[14]	**4,494**	5,221	5,931	5,250	5,663
Return on net assets[15]	**8.7%**	9.2%	7.4%	12.7%	4.3%
Headline debt to debt plus equity ratio[16]	**43.6%**	52.7%	57.4%	50.7%	52.1%
Economic debt to debt plus equity ratio[16]	**44.9%**	53.0%	57.6%	52.1%	52.4%
STAFF EMPLOYED					
Total staff employed (000s, permanent full time equivalents)	**15.8**	15.6	15.9	16.4	17.4
New Zealand	**9.8**	9.5	9.5	10.0	11.0
Overseas	**6.0**	6.1	6.4	6.4	6.4

	MAY 2010	MAY 2009	MAY 2008	MAY 2007	MAY 2006
SEASON STATISTICS[17]					
Total NZ milk collected (million litres)	**14,746**	14,764	13,862	14,340	14,051
Highest daily volume collected (million litres)	**72.3**	73.7	71.6	70.5	68.5
NZ Shareholder supply milksolids collected (million kgMS)	**1,256**	1,227	1,183	1,243	1,210
NZ contract and tactical supply milksolids collected (million kgMS)	**30**	54	9	3	–
NZ milksolids collected (million kgMS)	**1,286**	1,281	1,192	1,246	1,210
Total number of Shareholders at 31 May	**10,463**	10,537	10,724	10,921	11,286
Total number of sharemilkers at 31 May	**3,733**	3,990	3,946	3,857	3,962
Total number of shares at 31 May (million)	**1,343**	1,216	1,261	1,280	1,208

8 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. 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 this has meant that Total Shareholder Returns only reflect dividends paid and do not include any movement in the FVS.

9 Average spot exchange rate is the average of the daily spot rates for the financial period.

10 Fonterra's average conversion rate is the rate that Fonterra has converted net foreign currency receipts into NZ dollars based on the hedge cover in place.

11 Represents segment profit before unallocated finance income, finance costs and tax. The segment information was not available in this format for the 2006 year. 2007 and 2008 have been restated to be on a consistent basis with 2009 and 2010.

12 Profit after tax attributable to Shareholders for 2009, 2008 and 2007 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.

13 Equity attributable to Shareholders excludes cash flow hedge reserve.

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

15 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.

16 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.

17 All Season statistics are based on the 12 month milk Season of 1 June – 31 May.

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