

25 October 2022



## Fonterra Shareholders Fund (FSF)

The company will hold its Annual Shareholders Meeting at **10.00am Monday 14 November 2022.**

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

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

### **Company Overview**

The Fund was established in 2012 to allow non-dairy farmers to trade the economic rights in Fonterra shares. The Fund is externally managed by FSF Management Company Ltd. It derives its income from the dividend paid by the Co-Operative on the shares held by the Fund.

Essentially, an investor in the FSF is a minority investor in a larger organisation that has some commercial incentive to work against the interests of minority investors. NZSA remains concerned about the ability of the FSF to influence Fonterra for the benefit of Fonterra shareholders as compared with suppliers.

John Shewan the Chair and Kim Ellis both of whom were appointed in 2012 when the Fund was established will retire at this ASM. Donna Smit is retiring from the Fonterra Board and the Fund Manager Board in November 2022.

We note the Chair's comments in his Chair's report (emphasis added):

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

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

### **Current Strategy**

To provide a platform to allow non-dairy farmers to trade the economic rights in Fonterra shares.

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**Key**

The following sections calculate an objective rating against criteria contained within NZSA policies.

Colour	Meaning
G	Strong adherence to NZSA policies
A	Part adherence or a lack of disclosure as to adherence with NZSA policies
R	A clear gap in expectations compared with NZSA policies
n/a	Not applicable for the company

## Governance

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Directors Fees	G	See below.
Director unit ownership	A	See below.
Executive Remuneration	n/a	The Fund is externally managed.
Golden parachutes/handshakes	n/a	See above.
Director Independence	G	See below.
Board Composition	A	See below.
Director Tenure	G	See below.
ASM Format	G	Hybrid. See below.
Independent Advice for the Board	G	See below.

**Director's Fees:** We note these are paid by Fonterra (the Manager). They comprise \$80,000 for the Chair and \$53,000 for each independent director.

**Director Unit Ownership:** There is no disclosure as to whether directors are required to own units. While NZSA encourages unit ownership by independent directors, it does not support compulsion as this reduces the pool of available directors, may compromise independence and removes the 'market signal' associated with unit purchases.

**Director Independence:** Three of the five Directors including the Chair are independent, with the remaining two appointed by the Manager Fonterra.

**Board Composition:** There is no skills matrix to demonstrate how the individual Directors skill sets contribute to the governance of the fund.

We also note that the Annual Report does not include all other governance roles associated with Directors – although does show changes in their governance roles occurring during the year.

**Director Tenure:** NZSA looks for evidence of ongoing succession or 'staggered' appointment dates that reduce the risks associated with effective knowledge transfer in the event of succession. We also prefer a term maximum of 9-12 years, unless there are exceptional circumstances that may apply.

We note the Chair and one other Director who have served since 2012 are retiring at the ASM.

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

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

The Board Charter of FSF is unable to be downloaded from the website. However, NZSA believes that the FSF Board has good access to internal Fonterra (FCG) staff (the Manager). However, the FSF Board has little impact on decisions made by the Fonterra Co-operative Group (FCG).

### Audit

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Audit independence	G	Good disclosure.
Audit rotation	A	See below.

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

### Ethical and Social

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Whistleblowing	n/a	There are no employees.
Political donations	G	No donations were made.

### Financial & Performance

Policy Theme	Assessment	Notes
Dividends and Imputation	G	Good disclosure.
Capital Raise process	n/a	n/a if no capital raised
Takeover or Scheme	n/a	n/a if no takeover

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

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

Metric	2020 (m)	2021 (m)	2022 (m)	Change
Revenue	\$20,282	\$20,565	\$22,953	12%
Gross Profit	\$3,062	\$2,984	\$3,216	8%
NPAT	\$686	\$578	\$661m	24%

Gross Profit Margin	15%	15%	14%	-3%
EPS <sup>1</sup>	\$0.426	\$0.358	\$0.362	1%
PE Ratio	10	10	8	
Current Ratio	1.43	1.29	1.34	4%
Debt Equity	1.67	1.52	1.72	13%
Operating CF	\$1,565	\$1,278	\$193m	-85%
NTA Per Share <sup>1</sup>	\$2.77	\$2.87	\$2.94	1%
Dividend Per Share <sup>12</sup>	\$0.05	\$0.20	\$0.20	n/c

<sup>1</sup> per share figures based off actual shares at balance date (not weighted average)

<sup>2</sup> Dividends relate to FSF

Fonterra Shareholders Fund (FSF) is basically a holding company that owns shares in Fonterra Co-operative Group Limited (FCG). How much influence, if any, the directors of FSF have on FCG is debateable. This structure was established to allow non-supplying investors to invest in Fonterra. There are 107.4 million units of FSF and there are a total of 1,614 million FCG shares.

This raises an interesting dilemma, including the conflict of interest between suppliers and shareholders. Suppliers would rather receive a higher price for their commodity, but a higher price means a higher cost of sales and subsequently a lower profit and thus earnings for shareholders. The FSF has noted in previous discussions with NZSA the benchmark controls aimed at curbing this conflict of interest.

Revenues improved by 12% for FCG to \$23m and NPAT attributable to shareholders of the company was up 1% at \$584m. The gross profit margin declined by 3% to 14% and EPS delivered to shareholders of the company was \$0.362, placing FSF on a PE of 8. (Assuming earnings flow through directly)

The company is in reasonably sound financial position with a current ratio above 1 and a debt equity ratio of 1.72. This is high and the company took on an additional \$646m of long-term debt during the year but did retire \$462m of short-term debt. However, this is a net increase in borrowings of \$184m. Total non-current interest-bearing debt is \$4.9b. If the cost of debt were to rise this could become problematic.

Inventory levels rose by 33% to \$5.0b and this impacted the operating cashflow which fell from \$1,278m to \$193m in FY22.

In a [75 page results presentation](#) Fonterra explained the high year-end inventory reflects late season milk production coinciding with shipping constraints and that 88% of total inventory was priced and contracted but not shipped at year end. In addition, the FY23 sales profile and shipping schedule supports inventory levels returning to normal levels.

The company paid \$0.20 cents in dividends for the year. Dividends are not imputed.

## Resolutions

### 1. To elect Carlie Eve as an Independent Director.

Carlie Eve has over 25 years' experience in financial markets and the corporate sector. She has held executive roles across equity research, investment banking, investor relations, corporate strategy, and funds management. She is currently a Trustee of the Diocesan School Heritage Foundation and was previously a Director of Hobsonville Land Company Limited.

We will vote undirected proxies **IN FAVOUR** of this resolution.

## **2. To elect Alastair Hercus as an Independent Director.**

Alastair Hercus has been a Partner at Buddle Findlay since 1995, following an earlier career as a diplomat in the Ministry of Foreign Affairs and Trade. He is a former Deputy Chair of the Medical Assurance Society and is currently Chair of Co-operative Life Limited. In the public sector he is a Commissioner at Toka Tū Ake EQC, a Director of Invercargill Airport Limited and Chair of the Risk & Advisory Committee at the Ministry of Business, Innovation and Employment

We will vote undirected proxies **IN FAVOUR** of this resolution.

### ***Proxies***

**You can vote online or appoint a proxy at <https://www.investorvote.com.au/>**

Instructions are on the Proxy/voting paper sent to you.

Voting and proxy appointments close **10.00am Saturday 12 November 2022.**

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

**The Team at NZSA**