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Fonterra Co-operative Group Ltd. Ratings Placed On CreditWatch Negative On Weakening Market Conditions

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MELBOURNE (Standard & Poor's) Aug. 13, 2015--Standard & Poor's Ratings Services said today it has placed its 'A' long-term and 'A-1' short-term ratings on New Zealand-based Fonterra Co-operative Group Ltd., and its associated debt issues, on CreditWatch with negative implications.

"The CreditWatch placement reflects our concerns regarding potential weakness in Fonterra's key financial metrics given its high debt levels at a low point in the global price cycle. This follows Fonterra's announcement of a lower forecast milk price due to weak demand and surplus supply in the global dairy market," said Standard & Poor's credit analyst Brenda Wardlaw.

This ongoing weakness in the global dairy market has occurred when Fonterra's debt is at very high levels due to a large acquisition and peak capital expenditure, placing downward pressure on Fonterra's key financial metrics. While the lower forecast payout to its supplier shareholders supports our view of the co-operatives' superior financial flexibility, the likely weakness in its key financial metrics in the short term may place downward pressure on the credit ratings on the company.

On Aug. 7, 2015, Fonterra announced a revised forecast payout for the year ending July 31, 2016, of NZ\$3.85 per kilogram of milksolids, down from the opening forecast of NZ\$5.25 per kilogram of milksolids announced on May 28, 2015. We view the reduction in the forecast payout and advance price as ongoing evidence of Fonterra's superior flexibility in price setting for its key raw material, milk. We also viewed favorably the announced sizable reduction in capital expenditure (NZ\$500 million-NZ\$600 million lower than that in 2015), which should temper the deterioration in Fonterra's key credit metrics during this challenging period. However, high debt levels reflecting the sizable acquisition of a shareholding in China-based Beingmate, combined with peak capital expenditure, at this low point in the dairy price cycle will place Fonterra's key credit metrics under pressure in the short term.

Fonterra also announced support for its shareholder farmers, given the difficult market conditions. This support for supplier shareholders will be in the form of a loan (up to NZ\$0.50 per kilogram of milksolids). The loan will be interest-free for two years and paid back when the farmgate milk price or the advance rate goes above NZ\$6.00 per kilogram of milksolids. In our view, the loan to suppliers implies there may be limited headroom to lower the payout at the bottom of the global price cycle. However, we note that loan payments will be phased as savings from the co-operatives' transformation program are delivered. Further, we expect that Fonterra will conservatively

manage the level of advance payments, loans to farmers, and dividends during this challenging period.

Ms. Wardlaw added: "We expect to resolve the CreditWatch following a review of Fonterra's financial results for fiscal 2015, which will provide further visibility on the level of buffer in its key financial metrics. The CreditWatch negative indicates that we could affirm or lower the ratings on Fonterra following our review. We would expect that if we were to lower the ratings, the downgrade would not exceed one notch."

RELATED CRITERIA AND RESEARCH

Related Criteria

[Key Credit Factors For Agricultural Cooperatives](#), March 17, 2015

[Key Credit Factors for the Agribusiness and Commodity Foods Industry](#), Jan. 29, 2015

Methodology And Assumptions: [Liquidity Descriptors For Global Corporate Issuers](#), Dec. 16, 2014

[Corporate Methodology](#), Nov. 19, 2013

[Methodology: Industry Risk](#), Nov. 19, 2013

[Country Risk Assessment Methodology And Assumptions](#), Nov. 19, 2013

[Corporate Methodology: Ratios And Adjustments](#), Nov. 19, 2013

[General Criteria: Group Rating Methodology](#), Nov. 19, 2013

[Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers](#), May 7, 2013

Methodology: [Management And Governance Credit Factors For Corporate Entities And Insurers](#), Nov. 13, 2012

[2008 Corporate Criteria: Rating Each Issue](#), April 15, 2008

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Primary Credit Analyst: Brenda E Wardlaw, Melbourne (61) 3-9631-2074;
brenda.wardlaw@standardandpoors.com

Secondary Contact: Paul R Draffin, Melbourne (61) 3-9631-2122;
paul.draffin@standardandpoors.com

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