Review of the Greater China tragedy
(all figures in NZD mln)

<u>Conclusions</u>

The spreadsheet on Greater China EBIT makes for sober reading.
Total cumulative EBIT over the 10 years period 2008-2017 is showing a loss of 186, not discounted.

Total investments are not easy to retrace but I have made the following assumptions:
2007: SanLu 220.
2012-2016: farms 900
2015: Beingmate minus Darnum 650
2013-2017: food service, working capital, sundry 50
Total Investments 1,820.

Many conclusions can be drawn from these figures. Let me focus on just two.

<u>1. Value lost</u>
Suppose that the Board would have had to decide on a proposal brought forward by management in 2007 that would roughly read like this:
Invest 220 in SanLu now, followed by 900 in farms in the period 2012-2016, another 650 net in the Beingmate/Darnum deal in 2015 plus some additional investment of 50 in building our consumer/foodservice business (e.g working capital). Total cumulative income over the period will be (186) as in the spreadsheet.

I assume that the Board would have rejected the proposal without further discussion. But suppose that they would have asked for a proper DCF calculation. How would that have looked like?
I cannot do a precise DCF calculation here as detailed cashflow figures are not available. Doing a very crude calculation, though, on the basis of a 12% return and based on the figures above, the result is outright shocking. If NPV would be held at zero (that is to say that we would not make more than the default 12% return), our present Greater China business has to be valued at $3billion as of today.

Whatever way one would look at the actual value of our existing Greater China business (farms, consumer/food service and Beingmate), it would be safe to say that we won't be finding a purchaser today wanting to pay more than $ 1billion for it. We would probably be very happy if we could sell our China business for that amount, be relieved of the headache and feel free exploring more promising options.

<u>**Simple arithmetic is, therefore, telling us that 10 years of Greater China strategy has evaporated $2billion value into thin air**</u>. In other words, if Fonterra would have invested the $1,82billion (as above) in a sound and "normally" performing business, it would have expected to end up with a business now valued at $3billion.
Instead, we have ended up with a business that may not even be worth $1billion.

Managerial failure, strategic incompetence, international naivety, organisational shortsightedness and cultural insensitivity are just a few of the reasons that I can think of while trying to explain the loss of $2billion. The amount itself places the whole venture beyond the realms of normal business jargon.
That is why I have no qualms calling it a tragedy.

<u>2. Process of strategic decision making</u>
The $2billion lost value has been lost forever and will never be recouped. We cannot change the present, not to mention the past. We can, however, learn from it for the future.
<u>**The obvious lesson from this Greater China tragedy relates to the process and skills in strategic decision making by management and Board.**</u>

It is a foregone conclusion that Fonterra's strategic decision making in all its aspect needs considerable improvement, to say the least. From my perspective it appears to be seriously flawed and that is putting it mildly.

I would, therefore, propose a thorough review of the decision making process at Board and managent level. That needs to be done independently; by a third party not related to Fonterra. All info including minutes of management and Board meetings should be made available; interviews to be permitted at all levels. It should be a bit like writing an all encompassing history of the Greater China tragedy in the period 2005-2018; the analogy with the Pentagon Papers comes to mind.

The purpose should not be and must not be laying blame at individuals or trying to find the evil genius. The objective, however, should be to build a robust system of strategy development and strategic decision making within Fonterra, that would stand the test of time and avoid the costly errors that we have seen made in China.

Let's not make the mistake in thinking that it is China that we need to focus on as if it were a one-off.
Strategy development and subsequent decision making should be the primary focus instead. That is where it all starts and ….. ends!

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