

Dairy Industry Globalisation and the Trade Agenda



San Antonio, Texas
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About Fonterra

- Five year old private cooperative owned by 12,000 farmers.
- Assets \$8.3 bn, revenue \$7.8 bn, returning approx \$3.5 bn/year to farmers.
- Approximately 3.7 million cows, collecting 14 bn litres/40 bn pounds milk/year.
- About 6th largest dairy company globally.



Fonterra Production

- Produce 2 mn tonnes/4.5 bn pounds of products for export
- 25 manufacturing sites in NZ
- Key products WMP, SMP, cheese, butter, casein/other proteins, AMF
- Fonterra Ingredients – Fonterra Brands



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Fonterra Trade

- Total Fonterra production is equivalent to 2% world milk production.
- But, export approximately 95 % milk collected.
- World's largest exporter of dairy products.
- Export to more than 140 countries
 - Asia 32%, Americas 25%, Oceania 21%, Other 22%
- Increasingly trading non-NZ product,
eg in 2005 nearly 20 percent sourced from other countries:
 - Latin America
 - Australia
 - United States



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Fonterra in the United States

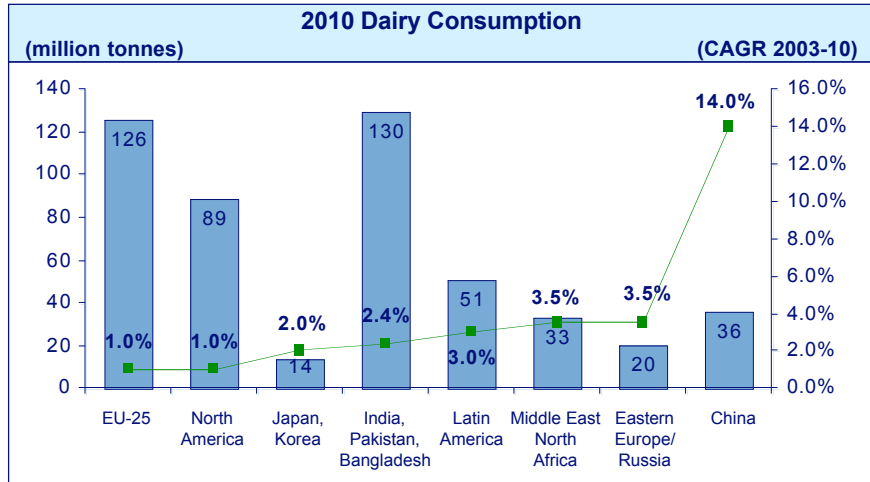
- The US is Fonterra's largest economic partner and Fonterra is part of the fabric of the US dairy industry:
 - *Importer* (Fonterra USA).
 - *Partner* (Dairy Farmers of America, UDA).
 - *Investor and manufacturer* (DairiConcepts).
 - *Exporter* (DairyAmerica).

The global dairy industry

- Key issues in the global dairy market



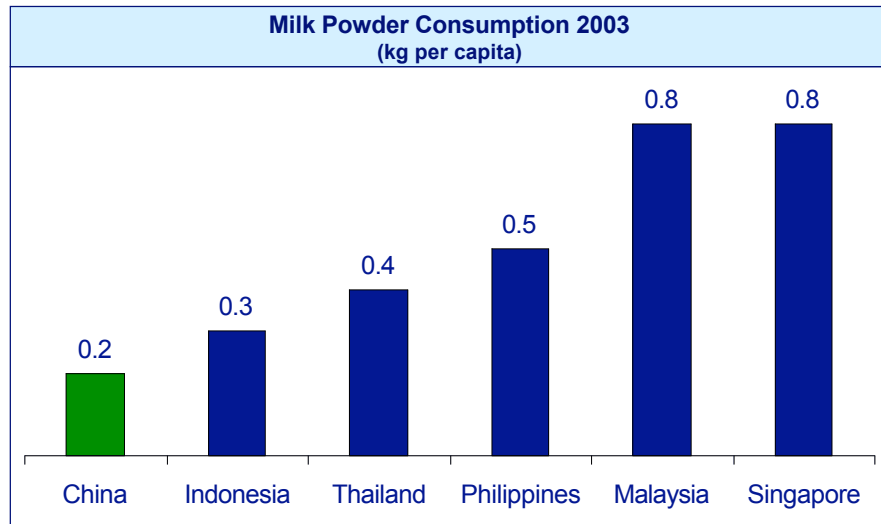
Global demand is growing at 2% - but main opportunities will come from the developing world



Source: Rabobank Forecast

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Enormous scope for growth in per capita demand

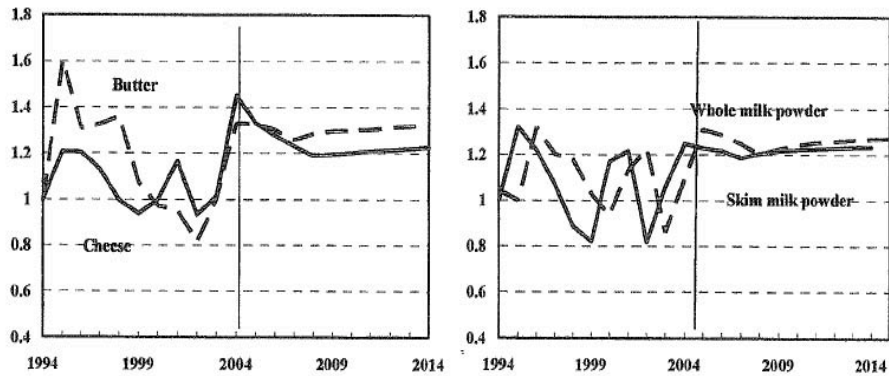


Source: Fonterra Internal Analysis

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Outlook for world prices 2004-2014

(OECD/FAO: 2005: nominal prices to 2014, 1994=1)



Source: OECD and FAO Secretariats



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A benign outlook, with the key question mark over supply

- Demand looks steady, prices should be firm(ish) – but who will supply?
- Traditional players: EU, Oceania?
- Where are the new suppliers?



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EU will retreat before it can recover

Momentum of reform will continue:

- drastic consolidation of dairy farms
- shift east in milk supply
- shift in product mix from butter/SMP towards cheese/fresh products
- consolidation of the processing sector
- restrictions on milk production likely to end around 2014
- end of subsidised EU exports

Will this lead to the eventual return to global market of the EU as a significant unsubsidised exporter?



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Flattish growth in Oceania

Australia:

- 2005/06 milk production forecast to grow 1-1.5 percent
- Still climate dependent
- Domestic consumption robust at 1.5 percent plus constraining export growth
- More industry consolidation likely

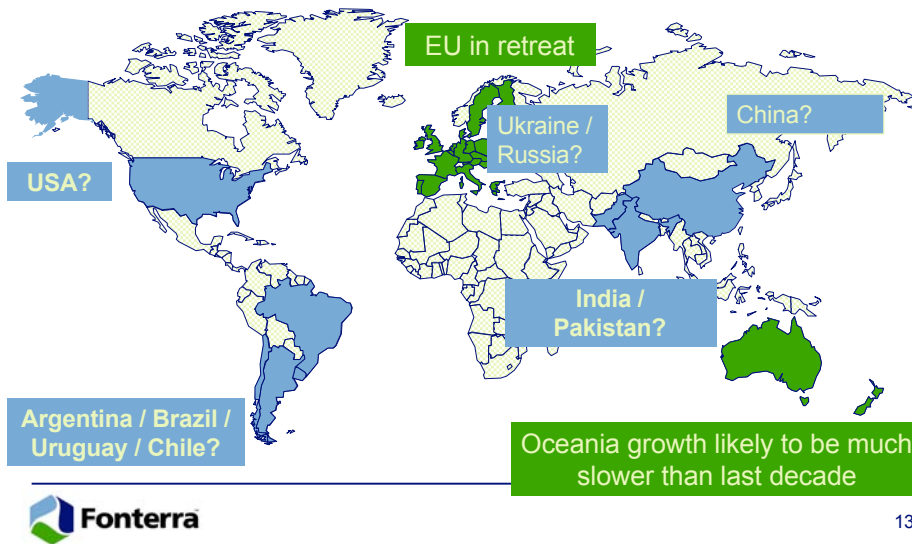
New Zealand:

- 2005/06 season likely to be approx 3 percent above 04/05, ie flat on 2003/04 levels
 - Fonterra forecast payout of NZ\$4/kg ms
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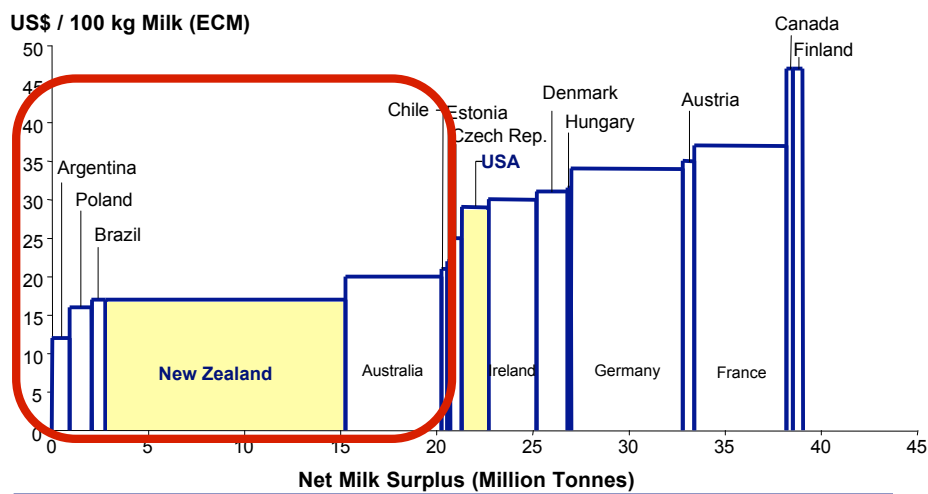


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So where will milk growth come from in the next decade?



Global supply curve shows significant gap to next marginal suppliers



List of potential suppliers starts with Brazil

- **Brazil:** poised to be big player; plenty of land; already leading world exporter in 8 agricultural products
- **Argentina:** expanding now again, but presents significant governance risk
- **US:** shift to serious exporting beyond SMP/whey unlikely without reform of market supports
- **Ukraine:** needs stability and rule of law
- **India:** major growth but nearly all internal

Latin America

- **2005 milk production volumes and growth versus 2004:**
 - **Brazil** 23.5 bn litres, +9 percent vs 2004
 - **Argentina** 9.5 bn litres, +7 percent vs 2004
 - **Chile** 1.8 bn litres, +3 percent vs 2004
 - **Uruguay** 1.2 bn litres, +6 percent vs 2004
- But exports below expectations: strong domestic growth, supply unreliability, milk quality issues, export taxation
- Exports focussed on traditional markets: Cuba, Venezuela, Mexico, Africa
- Future development dependent on political landscape, cost of investment capital, farm efficiency gains

China

- What will be China's role in the global dairy market?

- Major importer?
- Largely self sufficient?
- Exporter?

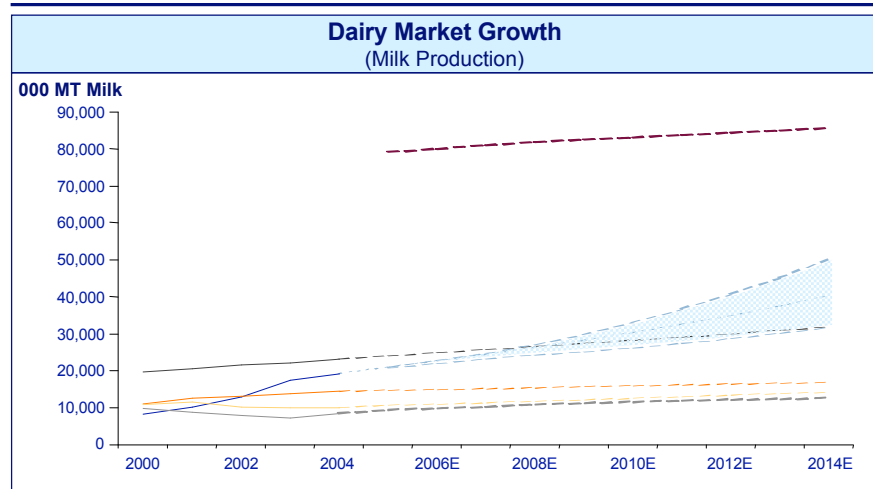
“a riddle wrapped in a mystery inside an enigma.”

Winston Churchill



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China is hard to predict

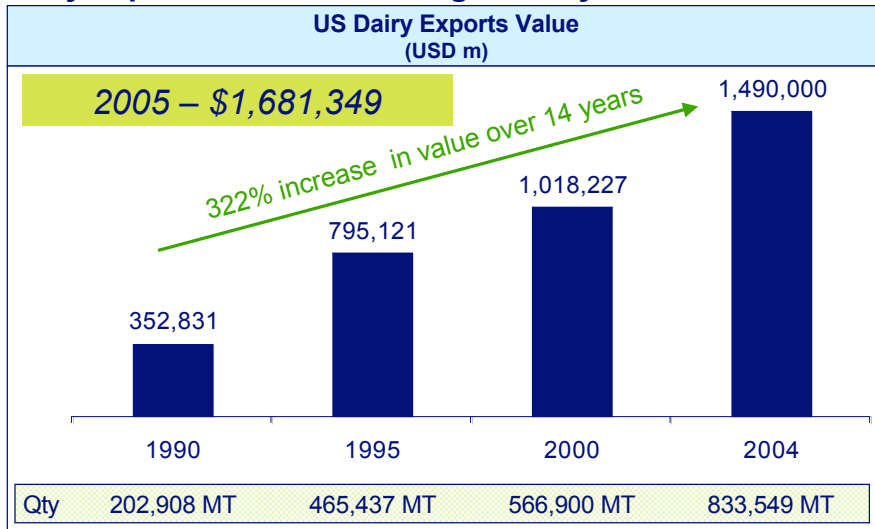


US
China
Brazil

NZ
Australia
Argentina

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Though the US is a small player in the world market, US dairy exports have been rising steadily

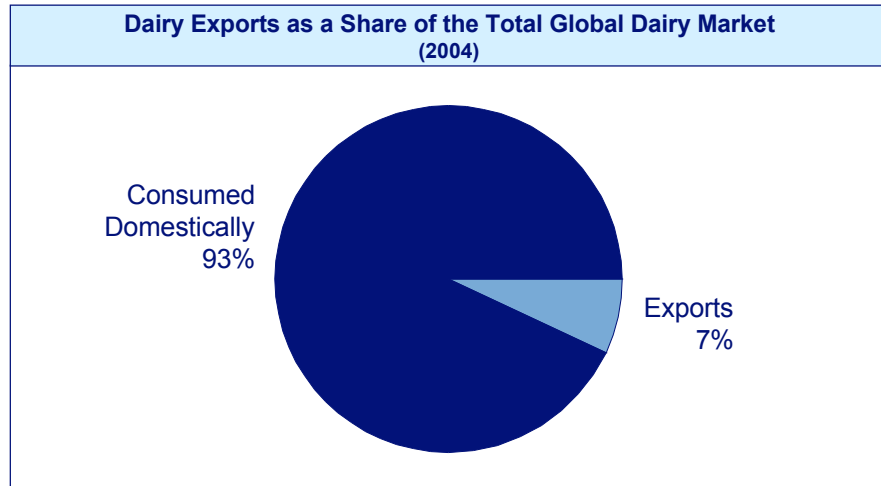


The global dairy industry

- What will be the impact of the trade agenda?

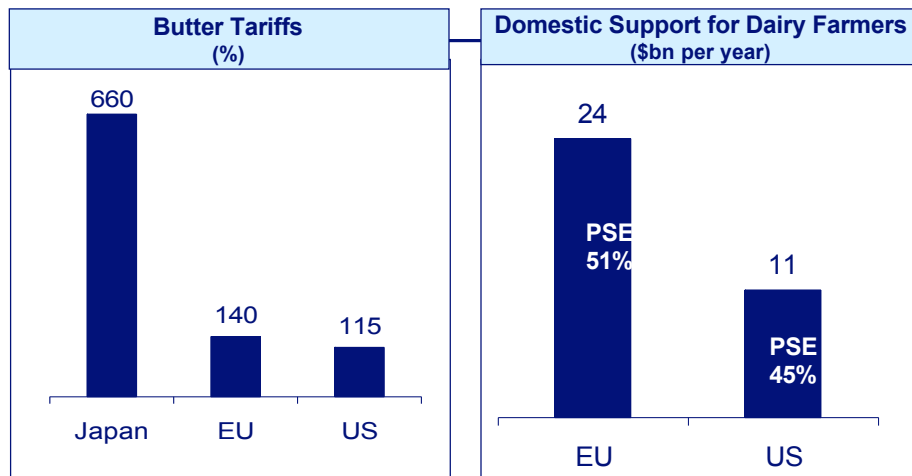


Only a fraction of world demand is met through trade...



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This partly reflects barriers to trade



The EU spends approximately \$2 billion per year on dairy export subsidies



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In the future, world dairy trade will be a bit more free - either through WTO or FTAs



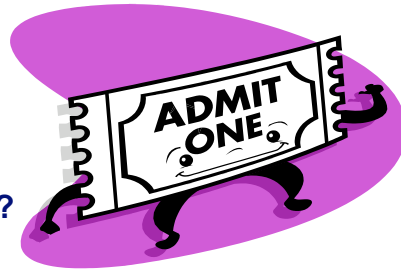
Impact of WTO Doha Round will be significant but not revolutionary

- Still the prospect of deal by December 2006 but the clock is ticking
- If successful, export subsidies will be gone by 2013
- This will raise prices in the short-run....
- ...but accelerate new players entering market
- Where will supply and demand equalise?
- Relatively little impact on trade to developing markets
- Potential for bigger market access gains in developed markets – Japan, Canada, EU. But for this we need ambitious modalities!

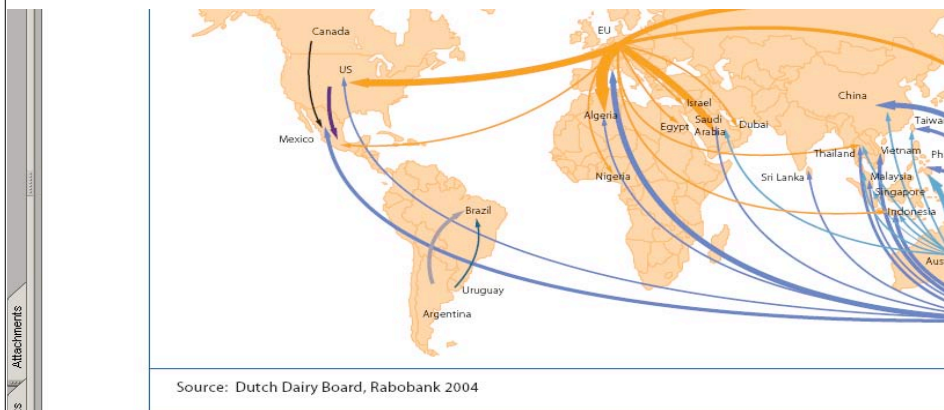
Free Trade Agreements and dairy

- NAFTA: US/Mexico free trade in 2008
- AUSFTA: the classic case of a dairy carve-out
- US/Chile FTA: free trade eventually
- US/Korea FTA?

Stepping stones or diversions?

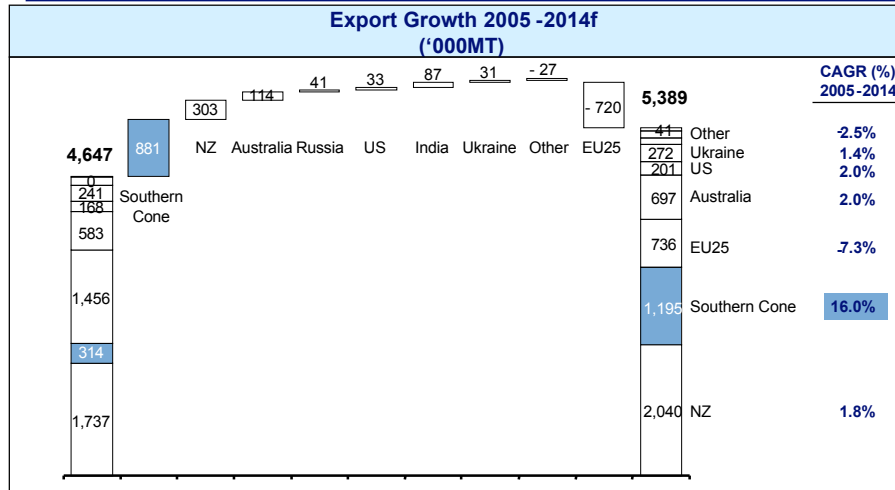


The pattern of global trade will evolve from this...



Declining market shares for the EU Since 1995 the EU's global market shares have been on the decline for dairy products except for whey. Lower levels of price support in the EU

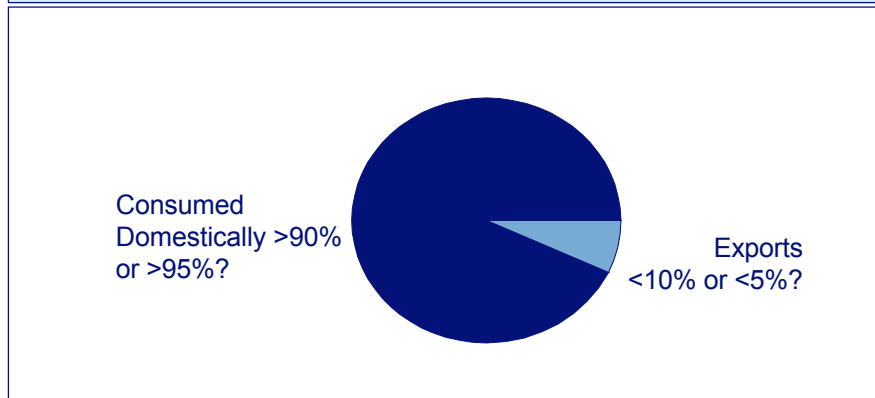
...maybe to this. Latin America likely to be the big winner in trade terms



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But what will the trade picture look like in 2015 if exports grow only 16 percent and total consumption grows strongly as predicted?

Dairy Exports as a Share of the Total Global Dairy Market in 2015?



...this globalisation? Will trade decrease as a share of global dairy?



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Globalisation is more than increasing trade flows...

“As international dairy companies recognize the potential benefits from supplying milk and dairy products in different countries and the prospects for demand growth, they are repositioning themselves to source milk and products from multiple locations. This trend is spawning partnerships and joint ventures among firms seeking to benefit by controlling all stages of the production process. Direct investment across borders has also altered competition in dairy markets. Globalization has tended to emphasize the strength of multinational dairy firms, with the most prominent being Nestlé (Switzerland), Arla Foods (Denmark-Sweden), Danone (France), the Fonterra Co-operative Group (New Zealand), Lactalis (France), Unilever (Netherlands-U.K), and Kraft Foods (U.S.).”

Amber Waves, Nov 2005, ERS/USDA



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China

- Investment in China is a difficult proposition: Nestle, Kraft, Danone and Parmalat all led the way, and all have had problems...
- ...but, hard to ignore a growing production and consumption trend this dramatic.
- Recent investment in China's dairy industry includes:
 - Fonterra - \$91 mn on 43% stake in San Lu Group
 - Danone - \$3 mn investment in R&D centre in Shanghai
 - Arla Foods JV with Mengniu to supply Chinese powders to Chinese consumers



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Fonterra in Latin America

- Dairy Partners America (JV Fonterra/Nestle) to process and manufacture Brazilian milk for the local market.
- DPA also active in Columbia, Ecuador, Argentina.
- Partnership with Sancor in Argentina for the export of Argentinean dairy products.



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Foreign Investment in the US dairy sector

- Multinational dairy companies investing in the US dairy sector to take advantage of the growth in domestic consumption. For example:
 - Glanbia in large scale cheese and whey production through Southwest Cheese in Clovis NM.
 - Fonterra through DairiConcepts MPC facility (Portales, NM), hydrolysates and caseinate facility (Allerton, IA) and through strategic partnership with United Dairymen of Arizona to manufacture MPC 70 (Tempe, AZ).
- Will more US dairy companies invest in fast growing foreign dairy markets in the future?



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In conclusion: over the next 10-15 years we are likely to see...

- More dairy products will be traded by more players, but nearly all the growth in global dairy consumption will be met by domestic production.
- Therefore, a larger world market in value terms but smaller as a proportion of consumption.
- Developing country growth underpinned by Asian, particularly Chinese, consumption. Developed country growth underpinned by cheese consumption.
- Half the current number of farmers in most countries.
- Two or three new major new exporters: Brazil + ??
- Multinational dairy companies increasingly investing internationally to broaden milk supply and take advantage of huge internal markets.

But the biggest changes may come from outside dairy...

Biotech

Health

Dairy substitutes

Biofuels

Threats or opportunities for the global dairy industry?



TO LEAD IN DAIRY

