ALL EYES ON CHINA

The world’s most populous nation has quickly become an international dairy market mover.

This year’s threatened closure of the Chinese market to food-grade U.S. dairy exports was a wake-up call not only to the United States but to all global dairy suppliers. Should China, for whatever reason, apply controls to its dairy import regime or should the country’s dairy appetite wane, farmers, processors, traders and all involved in milk production and marketing around the world would feel the effect.

That is not hyperbole. Just how significant is China’s role in world dairy trade?

“In a word, huge,” says Saul Rosenberg, CEO, Gerber California. “It will make or break the market.”

Here’s why: Only about 6-7 percent of world dairy production is traded internationally, making it a relatively thin market. New Zealand (NZ) represents about 40 percent of globally traded dairy products. Three years ago, China purchased inconsequential amounts of NZ milk powder. In the 2009/2010 New Zealand production season, China will purchase about 200,000-250,000 tons of NZ whole milk powder (WMP) and around 60,000 tons of its skim milk powder (SMP). And early results in 2010 suggest large volume buying could continue into 2011.

“If China were not buying from New Zealand as in the 2009 season, there would be some additional 250,000-300,000 tons of milk powder that would need to find another home in the world,” says Rosenberg. “That amount of product, at this time, would overbear the market and apply significant downward price pressure. There isn’t another home for it.”

The situation stems from China’s rising appetite for dairy coupled with the 2008 melamine scandal. China’s dairy industry, which was booming prior to 2008, suddenly contracted as consumers shunned domestic product. Farmers, with nowhere to market their milk, slaughtered herds.

All Eyes on China, continued on page 2
The U.S. dairy industry is a little bit like the U.S. World Cup team: Trying to prove itself on the global scale, but still lacking the critical mass and grass roots support needed to mount a credible challenge to the perennial market leaders.

It is an exasperating situation because we are no longer dairy export neophytes. We’ve shown we can perform on the world stage. We have been able to position the industry through collective effort as a market leader and a consistent exporter in lactose and whey.

But we’ve also shown we can’t or don’t want to do it consistently across the dairy universe — especially in areas like milk powder.

The trouble is we are already well into the match. We’ve seen a growing middle class fuel demand expansion in emerging markets. We’ve seen an increase in the price plateau that allows for the United States to be a competitive, profitable and consistent supplier to the global marketplace. The game is on… we are playing on a global field already, but we are not executing.

We need to build and protect volume and market share gains and sustainably and consistently service the global marketplace. To do so we must more adroitly:

- Build in the stomach to protect those gains and commit to service customers when times are challenging.
- Invest in the business — in innovation, supply chain infrastructure, customer service and technical assistance.
- Diversify supply offerings to mitigate risk and foster nimbleness to respond to new and emerging opportunities — and create new opportunities.

The world’s marketplace on numerous occasions has told us they want us and they need us. We have a market environment that allows us to play, so let’s play. Let’s play seriously and be committed so we are a sustainable global marketer.

New Zealand saw an opening, priced product to sell and Chinese consumers ate it up.

With the help of a government food safety crackdown, processors largely have been able to regain consumer trust. However, the herd reductions have reduced output and high grain costs have exacerbated producer profitability problems.

Demand exceeds supply more now than before melamine, and all signs suggest that last year’s pace of Chinese buying could continue at least through the end of 2010.

The implications of China’s position are significant. Increased purchases of New Zealand WMP have left less NZ WMP shipments for other customers. These other markets are looking to the EU for WMP, while other EU milk production is being earmarked for cheesemaking to meet domestic and renewed Russian demand. That leaves opportunities open in the SMP sector and suggests SMP prices will remain well supported.

In other words, China, at least for the short-term, is shaping the market by both pulling in significant volumes of dairy imports but also influencing product needs and sourcing in other developing regions — regions where people are similarly expanding their dairy appetites. It is creating opportunities within its borders and beyond.

China’s dairy imports rose significantly since the 2008 melamine scandal, as consumers redirected demand to more trusted foreign suppliers. In the first four months of 2010, even though whey buying declined, Chinese WMP imports grew 63 percent and SMP purchases increased 87 percent.
A QUIET GIANT

Large and growing food processing and foodservice sectors set the stage for dairy export growth to Indonesia.

The first thing that grabs your attention about Indonesia is its population: 230 million, according to the United Nations, making it the fourth most populous country in the world behind China, India and the United States.

The second thing that should grab any dairy supplier’s attention is Indonesia’s limited milk production capabilities coupled with its rising appetite for dairy, particularly in the country’s burgeoning food processing and foodservice sectors.

“Indonesia is one of the top 10 dairy importing nations in the world and population growth, economic success and further integration of dairy into the diet should keep it there well into the future,” says Dan FitzGerald, USDEC’s Southeast Asia office representative.

Indonesia’s economy, which averaged more than 5.5 percent growth from 2004-2008, only moderately felt the global economic crisis last year. International Monetary Fund projects 6 percent-plus growth in each of the next two years, which should bolster the nation’s middle- and upper-income brackets — prime dairy consumers.

Indonesia already has the largest middle- and upper-income sectors of any member of the Association of Southeast Asian Nations… “and they are starting to live as if the global economic crisis never happened,” says FitzGerald.

That means dining out at Western-style restaurants (“We’re seeing renewed interest in U.S.-style fast-food in Indonesia, and with it cheese,” says FitzGerald) and frequenting modern supermarkets. Both are proliferating in the nation’s densely populated cities.

Indonesia is also part of a network of infant formula, medical nutrition and recombined milk products manufacturers in Southeast Asia (with a growing export business throughout the region and to West Africa), and a major user of SMP and whey protein. Driven by these sectors, the country imported more dairy ingredients than any other nation in Southeast Asia in 2009:

- 100,000 tons of SMP
- 55,000 tons of whey
- 16,000 tons of lactose

However, recombiners and formula makers are requiring increasingly tighter ingredient specs, making U.S. product vulnerable to SMP from Australia, New Zealand and the EU, says FitzGerald.

U.S. lactose on the other hand is well-accepted and demand exceeds U.S. supply, particularly food-grade and that with specs to meet infant formula applications.

And demand for whey, which is not produced commercially in Indonesia, also continues to expand.

“Bread, pastries, samosas, cakes and confectionery are daily staples, eaten by people of all levels in society, and manufacturers are using more whey to maintain freshness, lower cost and provide even browning,” says FitzGerald.

U.S. whey protein suppliers could boost demand in higher value applications if they improve non-hygroscopic whey quality, reduce salt levels, provide consistent color and eliminate benzoic acid residue.

Some education is also necessary.

“We need to change the reputation of whey from a body builder product to an ingredient that is an important protein for general health,” says FitzGerald.

Most importantly, there is room for more U.S. exporters to Indonesia. Several large importers lack U.S. supply, and Indonesia is a finance market, where importers provide up to 90 days credit. It’s a system that ties an end user to an importer and creates a steady, consistent outlet for product.
Q&A: Risk Management

WITH STEVE SHELLEY

Q: Does it make more sense to try to eliminate volatility from the market or live with it and seek to manage risk?

SS: Personally, I believe that some level of volatility in the marketplace is good, and that trying to control it is fruitless. The markets are too thinly traded, and while we have seen some traders try to influence the CME market, they have only been able to do so for a short period of time before the market fundamentals of supply and demand kicked into gear. Therefore, it is crucial that we learn to manage risk through risk management tools and collaboration through the supply chain.

Q: What tools are necessary for companies in the dairy sector to manage risk?

SS: There are several very good tools available today, and it seems as though farmers, producers and end customers are newly collaborating every few months as the dairy industry works together to help ensure long-term sustainability. The utilization of Class III futures on the CME, along with whey contracts, have been a pretty effective way to lock customers into pricing levels they can live with for the next six, nine or 12 months. These are especially attractive for customers that need to lock in their menu costs for many months into the future.

Q: Why aren’t more companies who are affected by dairy volatility utilizing the futures and options that are available today?

SS: There are a few reasons these are not being utilized more effectively. One is the level of complexity with utilizing Class III and whey contracts to hedge cheese costs into the future. While it is a pretty effective hedge, it is not always a perfect hedge. However, there is a lot of excitement right now for the new cheese futures that just started trading on the CME. This should allow more traders at all levels of the supply chain to better manage their risks through a tool that will be relatively easy to understand and execute.

Q: What needs to be done to increase participation and improve liquidity?

SS: Robust tools, education and financing are the three legs of the stool, and there are many folks throughout the industry who are working together to improve these areas. Our subcommittee of the Innovation Center for U.S. Dairy’s Globalization Task Force is working diligently on all three, and we expect to start having results in early 2011.

I am also encouraged by the work several of the processors are doing to educate and assist their farmers with hedging tools. The last hurdle that needs to be dealt with relates to margin calls on hedging contracts. Again, several of the processors are helping in this area, but the level of contracts may still be limited at some point in the future by margin calls, and the inability of processors to maintain enough working capital to cover them.

Steve Shelley is senior vice president — supply chain management of Schreiber Foods, Green Bay, Wis.
HOLD THE PICKLE, ADD THE CHEESE

Burger King drives U.S. cheese sales in Taiwan.

We’re not sure how many Taiwanese Burger King customers chose multiple layers of cheese on their “Big” burgers, but that was almost beside the point. The “Big” burger promotion, which called on customers to determine the number of layers (up to 20) in their sandwiches, was a breakthrough for U.S. cheese suppliers.

“It marked the first time Taiwan’s Burger King chain utilized U.S. cheese on a burger,” says Angélique Hollister, USDEC director, cheese and manufactured products.

In all, the company features U.S. cheese on two “combo menu” items and six a la carte burgers at all 38 of its store locations in Taiwan. USDEC expects the chain to extend U.S. cheese buying to 12 new stores on tap to open this year.

The promotion marked the U.S. cheese debut and proved a big success.

“Burger King sales jumped 20-30 percent during the promotion. And now, even though the campaign ended, we expect the follow-on effect to continue to drive sales for Burger King and, by extension, U.S. cheese slices,” says Hollister.

USDEC was instrumental in convincing Burger King to give U.S. cheese a chance with repeated visits to the company’s Taiwan headquarters to explain U.S. products and applications. The fast-food chain had largely been buying from Australia.

USDEC also backed the Burger King “Big” campaign by sponsoring print ads and in-store tray liners.

Babcock Institute published a rigorous third-party evaluation of the Innovation Center for U.S. Dairy’s Globalization Report by Dr. Bill Dobson, a respected and widely published analyst of the U.S. dairy industry and its role in the global market. The independent evaluation praises the comprehensiveness of the analysis by Bain & Co., while concurring broadly with its major conclusions: Global markets represent a valuable opportunity for U.S. dairy suppliers, but the United States has only a limited time to focus more clearly on servicing the global sector before new sources of low-cost supply make international inroads and make it tougher for the United States to compete. The Babcock Report also expands the study a bit by addressing the global role of some major dairy players, such as Nestlé and Fonterra Co-operative Group. To download a copy, click here.
GENDER SPECIFICS

Studies spell out winning ways to convey the nutritional benefits of whey to women.

The latest USDEC research indicates a whey protein gender gap exists in this country. While whey’s considerable muscle benefits are a compelling prospect to the average male gym-goer, women are significantly less familiar with whey protein and less likely to buy into the nutritional messages that have worked with men in the past.

"Young, active women respond best to claims related to appearance rather than strength," says Laura Gottschalk, USDEC’s vice president, market research, U.S. manufacturing and ingredients marketing.

Gottschalk headed an online panel this January that built on initial female whey messaging research conducted in February 2009. The study asked 400 active women aged 18-34 their opinions on 16 claims for whey protein and muscle protein synthesis, body composition and aging.

The three answers that respondents overwhelmingly rated as most appealing were:

- Helps reduce fat around your waist.
- Helps you slim down and drop a size. (“Women often use clothes as a measuring stick for success,” says Gottschalk.)
- Helps you burn more calories naturally.

“Toning messages are a safe yet compelling message for this audience, which is largely untapped from a whey protein perspective,” says Gottschalk. “Claims related to weight loss and slimming may require more effort to get, but the payoff is worth it.”

Faster muscle recovery, reduction of age-related muscle loss and building of muscle definition all scored low. The claim that whey protein helps build lean muscle garnered only average interest.

“We divided exercisers into two classes — resistance and aerobic — and even resistance exercisers were more interested in body composition messages than muscle messages," says Gottschalk. “Use words like ‘tone’, ‘in shape’ and ‘firm’ rather than ‘bulk’ or ‘mass.’ ‘Optimize your shape,’ is a key message.”

The challenge is that young, active females are less familiar with whey protein. In fact, they are less likely than their male counterparts to be thinking about protein at all in their diets.

“Sampling or other tactics may be needed to overcome taste preconceptions,” says Gottschalk. “And education is needed to boost claim believability and likely purchase intent.”
U.S. dairy exports rose 52 percent to $1.03 billion in the first four months of 2010, as demand strengthened in Asia and the Middle East and supply tightened in Oceania. The EU rebounded strongly from a lackluster start to 2009, and drought curbed New Zealand butter, whey, lactose and cheese shipments, as suppliers there focused on meeting milk powder demand. ■■■

**SMP Exports** Jan. – April (volume, MT)

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<tr>
<th>Country</th>
<th>2009</th>
<th>2010</th>
<th>% change</th>
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**Whey Products Exports** Jan. – April (volume, MT)

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<td>EU-27</td>
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**Cheese Exports** Jan. – April (volume, MT)

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<td>US</td>
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<td>Argentina</td>
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**Butterfat Exports** Jan. – April (volume, MT)

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**Lactose Exports** Jan. – April (volume, MT)

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<td>EU-27</td>
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**WMP Exports** Jan. – April (volume, MT)

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<td>Brazil</td>
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<tr>
<td>BR</td>
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<tr>
<td>SUBTOTAL</td>
<td>539,698</td>
<td>562,423</td>
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Sources: USDA, EuroStat, DairyAustralia, World Trade Atlas

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HARDESTY TAKES USDEC REINS

Veteran dairyman sees opportunities, challenges

Colorado dairyman Les Hardesty was named USDEC chairman in a special election to fill the seat made vacant by Tom Camerlo’s unexpected passing last December. He is the third elected chairman in the organization’s history, following Elwood Kirkpatrick (1995-2004) and Tom Camerlo (2004-2009). He replaces Paul Rovey, who served as interim chairman.

Hardesty is chairman of the Mountain Area Region of Dairy Farmers of America and of the National Dairy Council, and serves on the board of National Milk Producers Federation and United Dairy Industry Association. He has been an active member of the USDEC board for the last seven years.

Hardesty takes over at a critical juncture in the evolution of the United States as a global supplier.

“We have tremendous opportunities to satisfy growing global demand for dairy in the years ahead. I see each and every person in the world as a potential customer for U.S. dairy products,” he said. “Meanwhile, we have great challenges, too. We have to find ways to encourage greater product diversity and better customer service to make U.S. dairy more attractive to the world. And we have to find ways to address the volatility of our domestic prices, overcome trade barriers and improve the perception of U.S. dairy products in the minds of overseas customers.”

MEMBER LIST (as of June 2010)

Abbott Nutrition
Advanced Protein Systems LLC
Agmark Foods Inc.
Agriculture and Livestock Industries Corp.
Agri-Dairy Products Inc.
Agri-Mark Inc.
Alpura International-USA Inc.
American Dairy Products Institute
American Farm Bureau Federation
Arla Foods Ingredients
BelGioioso Cheese Inc.
BIOTWO Corp.
Blimling and Associates Inc.
Bongards’ Creameries
Bongrain of the Americas
California Dairies Inc.
California Dairy Research Foundation
Challenge Dairy Products Inc.
CME Group Inc.
CoBank
Commercial Creamery Co.
Continental Dairy Products
CP Kelco
DairiConcepts LP
Dairy Farmers of America Inc.
Dairy Management Inc.™
DairyAmerica
Dairylena Cooperative Inc.
Darigold Inc.
Davisco Foods International Inc.
EcoVal Dairy Trade Inc.
Elanco Animal Health
EMCA Group
Erie Foods International Inc.
Farmland Dairies LLC
FCStone/Downes-O’Neill
Foremost Farms USA
Fort Forwarding Inc.
Gerber California Inc.
Gia Nabia Nutritional USA
Hercules USA Inc.
Hershey Co.
High Desert Milk
Hilmar Ingredients Division of Hilmar Cheese
Hoogwegt U.S. Inc.
Interfood Inc.
International Dairy Farms
International Dairy Foods Association
International Dairy Ingredients Inc.
International Ingredient Corp.
Iowa Farm Bureau Federation
James Farrell & Co.
Joseph Gallo Farms
Ken-Pak LLC
La Belle Associates Inc.
Lactalis American Group
Land O’ Lakes Inc.
Leprino Foods Co.
Main Street Ingredients
Maryland & Virginia Milk Producers Cooperative Association Inc.
MCT Dairies Inc.
Michigan Milk Producers Association
Milk Specialties Global
Minnesota Department of Agriculture
Mitsubishi International Corp.
Mitsui Foods Inc. (West Coast Division)
National Milk Producers Federation
NorthWoods Group Ltd.
O-AT-KA Milk Products Cooperative Inc.
Olam Americas Inc.
Organic Valley
RS. International Ltd.
Pennsylvania Department of Agriculture
PGP International Inc.
Price’s Creameries
Proliant Dairy Ingredients
Rabobank International
Rice Dairy LLC
SAKE Commodity Group LLC
Saputo Cheese USA Inc.
Sargento Foods Inc.
Schreiber Foods Inc.
SGS North America, Agricultural Services
St. Albans Cooperative Creamery Inc.
Superior Jail International Inc.
Swiss Valley Farms Cooperative
T.C. Jacoby & Co. Inc.
Talmers USA Inc.
Tasti-D-Lite LLC
The Artisan Cheese Exchange
Tropical Foods LLC
United Dairymen of Arizona
Vitusa Corp.
Wisconsin Cheese Makers Association
Wisconsin Department of Agriculture,
Trade & Consumer Protection
Wisconsin Farm Bureau Federation
YUM! Restaurants International Inc.