



U.S. Dairy
Export Council.

2003 Annual Report

In others' words



USDEC

Looking Back

Like all years, 2003 had its grab bag of surprises – some good and some bad.



In 2003, we further developed our export markets through promotion, trade policy and market access. But like all years, 2003 had its grab bag of surprises – some good and some bad.

We hadn't counted on SARS (Severe Acute Respiratory Syndrome) to come raging out of Asia, canceling seminars and missions, flattening members' overseas travel plans and laying waste to first and second quarter plans in those markets. Thanks to our work with the U.S. Department of Agriculture we were able to extend many of those programs into 2004.

A happier surprise came when the Dry Ingredients Committee, meeting at the Spring Board Meeting, directed the Council to spearhead an international industry effort to establish health claims for whey and whey products. This type of pre-competitive research is rare in our industry, but in less than a year we have begun the process of building claims that address the challenges competitive proteins use against our products.

In trade policy, lack of progress at the World Trade Organization Cancun Ministerial proved a disappointing surprise. We are working closely with WTO officials, U.S. Trade Representative staff and other dairy groups to maintain progress toward dairy's unified goals in another, more successful round of negotiations.

We ended the year with a crisis triggered by a U.S. dairy cow with BSE. As borders closed to beef products around the world, our Arlington staff, coordinating with other industry teams, the USDA and our overseas offices, worked to ensure the BSE story did not become a dairy story and that dairy products continued to move smoothly across borders around the world.

In the words of people we work with every day, this report provides another perspective on how the U.S. Dairy Export Council meets its mission of increasing the volume and value of U.S. dairy exports.

A handwritten signature in black ink that reads "Elwood Kirkpatrick".

Elwood Kirkpatrick, Chairman, U.S. Dairy Export Council



Marketing Overview

**Through USDEC,
the U.S. dairy
industry invests
in its own future.**

The American dairy industry invests in its future through its commitment to and participation in the U.S. Dairy Export Council. Programs conducted in previous years laid the groundwork for increased sales in 2003. Likewise, activities conducted in 2003 will enable U.S. exporters to enjoy continued sales growth in the years ahead.

U.S. dairy exports exceeded \$1 billion for the fourth straight year in 2003 and exporters were able to move 1.1 billion lbs. of milk solids offshore, about 5% of domestic production. Commercial (unsubsidized) sales made up 78% of exports in 2003, evidence that U.S. exporters have been successful in carving out sustainable channels for products that stand on their own merits.

From 2001–03, U.S. cheese exports increased 29% from the previous three-year period. Exporters followed through on USDEC trade servicing and promotion programs and built distribution in core markets as well as emerging markets. The bulk of the gains came in Mexico, where average annual sales in 2001–03 were more than double (+8,695 metric tons per year) the 1998–2000 level. Significant gains also were realized in South Korea (+1,668 mt/yr.), Japan (+1,035 mt/yr.) and the Caribbean/Central America (+932 mt/yr.).

Whey and lactose continued to be huge success stories for the U.S. dairy industry. Efforts to promote new uses for dairy ingredients in the food, feed and pharmaceutical sectors are leading to increased demand year after year. Over the last three years, U.S. whey exports increased 18% from the prior three-year stretch. Meanwhile, lactose exports jumped 52%.

Whey protein exporters made it a priority to focus on higher-value concentrates and isolates. In the last three years, shipments of whey protein concentrate were 45% higher than the previous three years, while exports of whey protein isolates soared more than seven-fold.

The largest market for U.S. whey was China and Taiwan, with average annual sales of 47,750 mt in 2001–03, up from 27,081 mt/yr. in 1998 – 2000. The second-largest market was Southeast Asia, where annual sales climbed to 30,001 mt from 25,876 mt. Gains in sales to the Caribbean,



Central America and South America offset declines in shipments to South Korea, Japan and Canada, while the Mexican market held steady.

Lactose is a versatile, competitive carbohydrate in infant formula and animal feed, a useful bulking agent in dairy products, confectionery and bakery and an effective excipient in pharmaceutical and personal care applications.

Asia is a particularly strong market for U.S. lactose. Average annual exports of lactose to Southeast Asia more than doubled to 23,075 mt/yr in 2001–03, versus just 9,012 mt/yr in 1998–2000. Lower import tariffs led to a jump in sales to China and Taiwan (+7,244 mt/yr.). Japan remained the largest market for U.S. lactose: 47,786 mt/yr, up 5,610 mt from the previous three-year period. South America, South Korea and Mexico also registered volume increases.

U.S. exports of milk and cream held steady in recent years. Shipments increased 6% in 2001–03 compared with 1998–2000. Three-quarters of U.S. sales go to Mexico, where average annual shipments grew by 2.9 million liters. Sales also increased to Canada, but gains were offset by declines in all other markets.

U.S. ice cream continued to lose share in Asia as companies shifted sourcing to European operations. In the latest three-year period, exports were down 10% from the prior three years. Shipments were up 28% to Mexico, but down 16% elsewhere, with significant losses in Japan.

Exports of skim milk powder declined in recent years due to World Trade Organization caps on Dairy Export Incentive Program subsidies. Shipments in 2001–03 were 6% below 1998–2000. Volumes to Mexico and South Korea increased by 11,763 mt/yr. and 3,346 mt/yr., respectively, but fell off dramatically to the Caribbean, Central America, Middle East and South America.

Exports of butterfat remain relatively small. Suppliers exported 5,613 mt/yr. in 2001–03, down 24% from the prior three years. Exports to the Middle East and Southeast Asia increased slightly, while all other markets showed declines.



Cheese

The USDEC logo adds value to our pizzas because customers perceive they are buying a superior product.



Dulce Martinez
Deli Purchasing Manager
Costco Mexico

Costco-Mexico worked closely with USDEC this year on several programs designed to increase sales of U.S. cheese.

Pre-baked pizzas are one of the more popular items we sell. This year we printed the USDEC logo on 216,700 pizza boxes to tell shoppers that our pizzas contain U.S. cheese. Shoppers identify the USDEC logo with good-quality cheese. Therefore, the logo adds value to our pizzas because customers perceive they are buying a superior product.

We also partnered with USDEC to conduct a week of in-store demos in all 21 of our stores nationwide. Our demonstrators handed out samples of U.S. Swiss, Provolone, Cheddar, Mozzarella and Brie, and gave shoppers information and ideas on how to use the cheese in their recipes at home. This program generated very good incremental sales growth – up 25% during the demo week.

Throughout the year, USDEC participated in Costco’s magazine sponsorship program. USDEC provided five articles for our in-store magazine, which is distributed to 160,000 customers per month. These articles described different U.S. cheese varieties and helped educate consumers about their uses. They reinforced the fact that U.S. cheese is made from a tradition of quality and craftsmanship.

In all these programs, we get very good service from USDEC’s staff in Mexico. We meet regularly to plan projects, all of which have had very good results. USDEC also has helped us source dairy products. USDEC is a valuable partner for us, and we look forward to working with the Council in 2004.



Ingredients

USDEC is a valued resource, providing information about U.S. dairy ingredients and suppliers.

Consumer awareness of nutraceuticals and functional foods is very high in Japan. Shoppers seek out products that deliver health benefits and maintain general wellness. Otsuka Pharmaceutical serves this market by focusing on research and development of pharmaceuticals and consumer products that can make a difference in maintaining people's everyday health.

Ingredient suppliers are very important partners, helping us develop products to meet consumer wellness needs. USDEC is a valuable resource because they provide information about U.S. dairy ingredient suppliers and technical information on the benefits these ingredients deliver.

For instance, this year we participated in a seminar on the role of dairy products in weight management, sponsored by USDEC. Speakers presented the results of studies showing the beneficial role calcium and calcium-rich dairy foods play in weight management, and highlighted the benefits of including whey protein in the diets of people who lead active lifestyles. This message will be well-received by Japanese consumers.

Right now, obesity is one of the most pressing health issues for consumers worldwide. Our product development team is working to create products that can provide solutions for consumers trying to manage weight. As USDEC continues to promote its findings, it will help us market functional dairy foods in Japan and around the world.

In our efforts, USDEC is an important partner. In the past we also have participated in USDEC trade missions to meet U.S. suppliers face-to-face. This type of meeting, where we get to learn about the suppliers and see their facilities and capabilities, is critical to doing business in Japan.



Keizaburo Hirata
Chief
Product Technology Department
Otsuka Pharmaceutical Co., Ltd.



Research

USDEC can provide international market information that is otherwise difficult and expensive to obtain.

When expanding into overseas markets, it's essential to have a solid base of information about consumption trends, competitor dynamics and local conditions. The more we know about our target markets, the better business decisions we make and the more effectively we can serve our customers.

Proliant Dairy Ingredients uses a variety of materials from USDEC, from the market research reports to manuals, monographs and the informative *Facts on Dairy Exports* newsletter. We've always found USDEC's materials to be comprehensive, accurate and credible.

USDEC market research reports are valuable, providing international market information that is otherwise difficult and expensive to obtain. This competitive intelligence is especially important when we are considering a product line extension or entering a new market segment.

The Council's other publications, including its manuals and monographs, are valuable sales and technical support tools for our sales managers and customers. Our sales managers frequently rely on USDEC's information during presentations. They reference the publications, emphasizing that they are from a neutral and reliable third-party organization, and our customers appreciate USDEC as a dependable resource.

In particular, the "Reference Manual for U.S. Whey and Lactose Products," which includes definitions, technologies, nutritional properties, functional properties and application formulas, is highly regarded. We've used this publication extensively with customers to expand uses for our complete line of whey and lactose ingredients.



Mike Matter
Vice President
Marketing and Venture Operations
Proliant Dairy Ingredients



Communications

As the WTO talks continue, USDEC keeps our editors updated on pertinent information and answers questions as they arise.



Kate Sander
Editorial Director
Cheese Market News

In recent years, *Cheese Market News* has greatly expanded its coverage of international dairy news as a result of the growing importance of global trade to the U.S. dairy industry. As we have made our coverage more comprehensive, USDEC has been an excellent resource for *Cheese Market News* and our readers.

Since 1997, USDEC and *Cheese Market News* have successfully teamed up with an exclusive editorial piece called “Export Tool Kit” — a monthly column covering a wide variety of topics pertaining to international trade. Written by various members of USDEC’s staff, this column provides the “tools” exporters need to effectively navigate foreign markets. During the past seven years “Export Tool Kit” has covered issues ranging from how flexible payment plans can aid in winning Asian buyers to utilizing the Internet to access trade data. “Export Tool Kit” is a unique and efficient way for dairy executives to gain important information as it pertains to their trade business.

USDEC’s role in providing information to the industry goes well beyond “Export Tool Kit.” USDEC’s communications department is always ready to provide information and analysis on international trade issues. While the U.S. government was pursuing the trade dispute with Canada over subsidized Canadian dairy exports, USDEC worked closely with dairy and other business media to communicate developments and ensure accurate information was available to all members of the industry.

As the current round of World Trade Organization talks continues, USDEC keeps our editors updated on pertinent information and answers questions as they arise. We value USDEC’s communications department’s ability to direct us to the appropriate expert on any given area in a timely manner and look forward to continuing our working relationship.



Market Access/Regulatory Affairs

USDEC resolved the problem, allowing us to complete a sale and convincing Chinese officials to change their testing methodology.

USDEC's Market Access and Regulatory Affairs (MARA) group has been a great resource to International Ingredients.

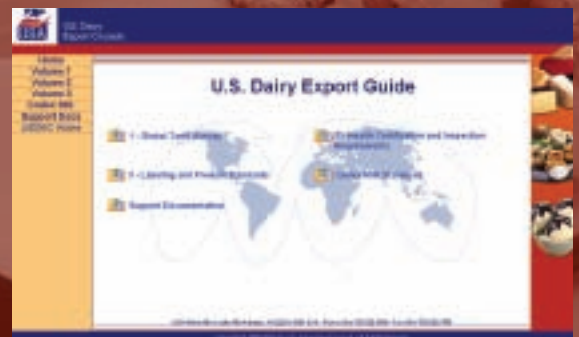
In one instance, we suddenly had difficulty getting whey products into China. The customs officials claimed that our lactose levels were too low, leaving several containers of whey to sit in port. Our tests had shown the lactose levels were within spec, so we called USDEC, and they contacted the appropriate Chinese officials on our behalf. They quickly learned that the customs officials were using an outdated testing methodology that wasn't measuring the levels properly. USDEC resolved the problem, allowing us to complete the sale and also convincing Chinese officials to change their testing methodology.

Another time, the Mexican border was unexpectedly closed to U.S. dairy products over concerns of bovine tuberculosis. We were first notified of this border closure by USDEC. We had several shipments of dairy products en route, and USDEC's advice was most useful during that anxious time, allowing us to keep our shipments moving with minimal disruptions.

Beyond coming to our rescue when access problems arise, USDEC is a great source of information on tariffs, quotas, standards, labeling and documents required for export. Each market has different requirements, but we use the online "U.S. Dairy Export Guide" on a regular basis to make sure we have the right paperwork. One of the real strengths of USDEC is all of the up-to-date reference information available to members.



Jim Sullivan
President
International Ingredients
Corporation



Trade Policy

USDEC has done an excellent job of clearly and effectively communicating the interests of its constituents, the U.S. dairy sector.

Dairy plays a significant role in the U.S. economy. It's the nation's second-largest agricultural sector, generating \$25 billion annually at the farm level, more than \$70 billion at the retail level, and many times more than that in its flow-through impact on the rural economy.

Continued growth and long-term health of the U.S. dairy sector depends on building demand overseas, where 96% of the world's population lives. The United States is the largest, and one of the most efficient dairy industries in the world, but opportunities for growth are stifled because dairy remains one of the most distorted of all globally traded goods. The Bush Administration has fought for trade reform so the United States can compete on a level playing field.

2003 was an important year for U.S. trade negotiations. The U.S. trade team focused on reducing barriers worldwide through the World Trade Organization's Doha Development Round talks. Agriculture is one of the lynchpins of this round. With input and leadership from industry groups like USDEC, we developed a position based on achieving balanced trade without unilaterally opening our markets to unfair competition. Though we did not reach consensus at the ministerial meeting in Cancun last fall, we remain committed to this principle and are committed to move the agenda forward in the coming year.

For all of our trade initiatives – from the WTO talks to the many multi-lateral and bilateral pacts in the works – USDEC has done an excellent job of clearly and effectively communicating the interests of its constituents, the U.S. dairy sector. Through its position papers, testimony and one-on-one visits, USDEC is a valuable resource, enabling the United States Trade Representative to pursue favorable arrangements that expand opportunities for U.S. dairy products.



Ambassador Allen Johnson
Chief Agricultural Negotiator
Office of the U.S. Trade
Representative



Membership

USDEC is an excellent resource and liaison between the U.S. dairy industry and the world marketplace.

USDEC is a valuable business connection.

USDEC assists co-ops like Dairy Farmers of America (DFA) in building bridges between our dairy products and processing capabilities and potential new international customers.

USDEC is an excellent resource and liaison between the U.S. dairy industry and the world marketplace. Over the years, USDEC has provided us with critical information on what motivates the international buyer and has done an excellent job in introducing DFA and its processing strengths to global clients.

Certainly one of USDEC's most important roles in the past few years has been in keeping us informed about the effect trade and regulatory issues have on U.S. dairy exports. This past year, the Council's expertise and knowledge of the world dairy situation was particularly valuable during the negotiations of trade agreements in Central America and with Australia. USDEC's understanding of the terms and conditions of international dairy trade and their ability to keep us informed of the Bush Administration's bilateral negotiations were invaluable.



Gary Hanman
*President and Chief
Executive Officer
Dairy Farmers of America, Inc.*



2003 USDEC Members

USDEC's vision is to realize a growing U.S. dairy industry efficiently and consistently meeting customer demands worldwide.



Agriculture and Livestock Industries Corp.
Agri-Mark, Inc.
Alpura International – USA, Inc.
Amtrade International Inc.
Apollo USA, Inc.
Arla Foods, Inc.
Bemis Company, Inc.
Bongrain North America
Cacique USA
Century Foods International
ConAgra Dairy Foods
Dairy Farmers of America, Inc.
Dairy Management Inc.
DairyAmerica
Dairylea Cooperative Inc.
Davisco Foods International Inc.
EMCA Group
First District Association
Foremost Farms USA
G & R Foods, Inc.
Gerber California, Inc.
Glanbia Nutritionals USA
Hilmar Cheese Company
Hoogwegt U.S., Inc.
Humboldt Creamery Association
International Custom Products, Inc.
International Dairy Foods Association
International Ingredient Corp.
Iowa Farm Bureau Federation
James Farrell & Co.
Kozy Shack Enterprises Inc.

Kraft Foods, Inc.
Lactalis USA/Sorrento Cheese
Land O'Lakes, Inc.
Leprino Foods Company
Maryland & Virginia Milk Producers Cooperative Association, Inc.
Michigan Milk Producers Association
Minnesota Department of Agriculture
Mitsubishi International Corp.
Mitsui & Co. (USA), Inc.
Monsanto Dairy Business
National Milk Producers Federation
P.S. International, Ltd.
Pennsylvania Department of Agriculture
Price's Creameries
Proliant Inc.
Protient Inc.
Ronald A. Chisholm (USA) Inc.
St. Albans Cooperative Creamery, Inc.
Sargento Foods Inc.
Schreiber Foods, Inc.
T.C. Jacoby & Co., Inc.
United Dairymen of Arizona
Vermont Department of Agriculture
Wells' Dairy, Inc.
WestFarm Foods
Wisconsin Dept. of Agriculture
Yum! Restaurants International



DMI Funding

USDEC gives us tremendous bang for our buck and U.S. dairy farmers really benefit from its work.

Exports represent a small portion of U.S. milk production, but they are a very important portion to dairy farmers. If that product remained on the U.S. market, it could devastate farm gate milk prices. About 96% of the world's population lives outside our borders and that's a market we need to learn how to service and supply. USDEC gives us the opportunity to do that.

Dairy farmers benefit from their check-off investment in USDEC because it serves as our defense and also our offense.

For instance, USDEC staff sprang to our defense in December after BSE was discovered in the U.S. herd for the first time. Our largest export market, Mexico, initially stopped U.S. dairy exports, but USDEC jumped in and turned it around to keep product moving.

Meanwhile, USDEC's programs help us get higher value products into new markets outside this country. In China, for example, dairy has not traditionally been part of the diet, but with a fast-growing middle-class sector, milk, cheese and ice cream are being introduced to consumers for the first time. USDEC activities are in place to help people understand how to use dairy products, and to recognize that the United States is a reliable supplier of high-quality, nutritious dairy ingredients and packaged foods.

For these programs, dairy farmers are able to provide direct input to USDEC's strategies and activities through Dairy Management Inc.'s (DMI) eight votes on the USDEC Board. The DMI Board also includes an Export Committee of 20 dairy farmers who follow exports closely.

USDEC gives us tremendous bang for our buck and U.S. dairy farmers really benefit from its work.



Paul Rovey
Chairman
Dairy Management Inc.



USDA Funding

FAS funding supports the creation, expansion and maintenance of long-term export markets for U.S. agricultural products.

The U.S. Department of Agriculture (USDA) is one of USDEC's most important partners, working with dairy producers, exporters, private companies and agricultural trade organizations to encourage activities promoting U.S. agricultural exports. In 2003, USDA provided \$4.278 million to USDEC through a variety of market development programs, including the Market Access Program (MAP) and the Foreign Market Development (FMD) program. Both programs require a substantial "match" from its industry partners, an area where the dairy industry has proven itself especially capable.

FMD funding supports the creation, expansion and maintenance of long-term export markets for U.S. agricultural products. Utilizing overseas promotions that focus on generic U.S. commodities, the program assists in developing new foreign markets and increasing share in existing markets with the ultimate goal of long-term export development. The MAP forms a partnership between trade associations, cooperatives, state-regional trade groups and USDA's Commodity Credit Corp. (CCC) to share the costs of overseas marketing and promotional activities such as consumer promotions, market research, technical assistance and trade servicing.

U.S. Department of Agriculture Secretary Ann Veneman is responsible for the activities of the federal government's largest agency. This statement was prepared by the U.S. Dairy Export Council.



Ann Veneman
Secretary
U.S. Department of
Agriculture



Governance

USDEC's annual business plan reflects extensive member input to ensure programming stays in step with dairy export priorities.



Sue Taylor
Vice President
Dairy Policy and
Procurement
Leprino Foods
Company

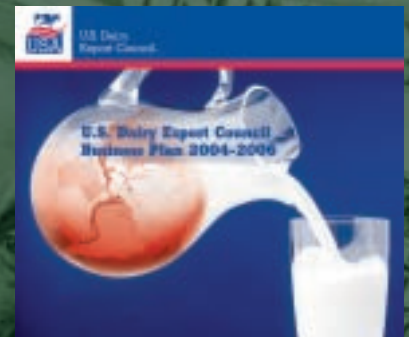
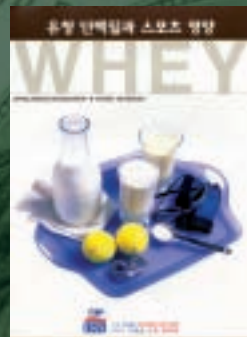
One key to USDEC's success is the way it is structured to facilitate membership participation. We've found both the formal and informal mechanisms to provide input to USDEC to be very important. Through development of the annual business plan, committee participation and conversations with staff as issues arise, Leprino is able to gain valuable market insight and leverage its own activities against those of the Council.

USDEC's annual Business Plan reflects extensive member input to ensure programming is in step with dairy exporter priorities. This planning process keeps USDEC activities on the right track; at the same time, it's beneficial to us because the assessment of market opportunities and situation analyses in the Plan provide important references to compare against our own strategies.

The USDEC committee structure also provides an important opportunity for members to have a direct impact on spending and programs in areas that are important to them. Leprino serves on the Operating Committee and the Trade Policy Committee, and participates in the cheese and dry ingredient committees. Gatherings of these groups are key venues for us to provide input, while learning what's evolving in various target markets.

We particularly value our participation on the Trade Policy Committee. Through USDEC, companies and constituencies who might have different priorities are able to join forces to shape U.S. dairy industry positions on trade policy issues. A unified industry position is critical to achieving meaningful progress toward freer and fairer trade through the WTO.

Finally, the importance of ongoing collaboration with staff on issues as they arise cannot be understated. Not only do we gain insights and have problems solved, but making staff aware of the issues encountered in our markets helps USDEC be more effective in its ongoing activities and as priorities are established for the future.



Structure and Funding

Corporate Structure

The U.S. Dairy Export Council is a nonprofit, independent membership organization representing the export interests of U.S. milk producers, dairy cooperatives, processors, traders and industry suppliers. The Council was established in 1995 by Dairy Management Inc. (DMI), the farmer-funded marketing, promotion and research organization, to build global demand for U.S. dairy products.

In 2003, USDEC members accounted for the vast majority of the \$1 billion in U.S. dairy product exports.

Each year, USDEC's Board of Directors authorizes a strategic business plan to guide marketing programs and ensure that USDEC activities provide the greatest return on investment. The Council's *Marketing* department is organized along product lines (Cheese & Manufactured Products and Ingredients) and is supported by the *Strategic Research and Business Development* department, the *Trade Policy* department, the *Market Access and Regulatory Affairs* department and the *Communications and Membership* department.

The Council is located in Arlington, Virginia, just outside Washington, D.C., with office representation in China, Taiwan, Japan, South Korea, Thailand, Mexico, Brazil, the United Kingdom and Lebanon.

Funding

In 2003, U.S. dairy farmers invested \$7.155 million in USDEC activities through the national dairy promotion check-off program. The U.S. Department of Agriculture provided \$4.278 million through a variety of market development programs – a strong 50% increase in funding from 2002. Annual support from USDA is based on a competitive process that rewards progress and results in identifying and overcoming constraints in overseas market development. Included in the increase was \$197,575 from a new program called the "Pool of Excellence."

USDEC also generated \$700,000 in membership dues, which are the sole source of funding for trade policy programming.

2003 Source of Funds

Source	Funds
Dairy Management Inc.™	\$ 7,155,000
USDA Foreign Agricultural Service	\$ 4,278,066
Membership dues*	\$ 700,000
Other	\$ 50,000
Total	\$ 12,183,066

* Only membership dues are used for trade policy and lobbying activities.

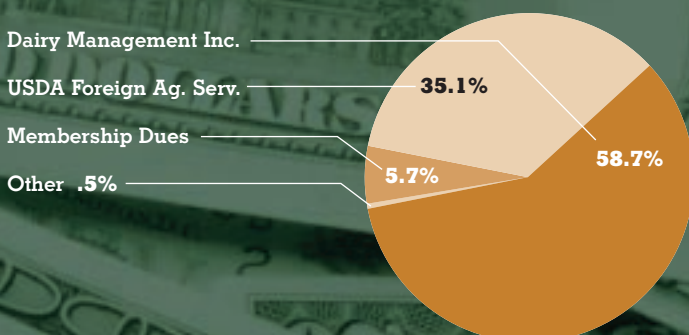
2003 Expenses

Category	Expenses
Market Development	\$ 6,693,066
Program Operations	\$ 2,663,500
Export Environment	\$ 1,465,500
Industry Communications	\$ 661,000
General & Administration	\$ 500,000
Unallocated Revenue (Program Contingency)	\$ 200,000
Total	\$ 12,183,066

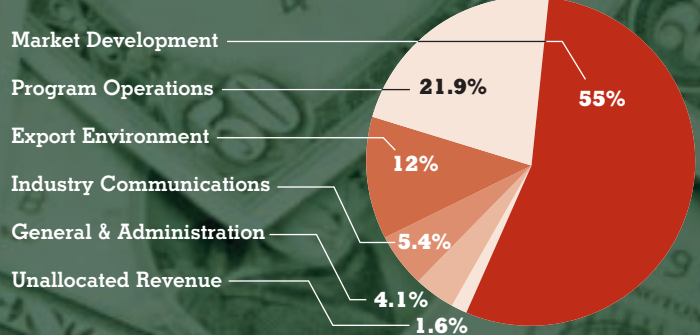
2003 Export Environment Breakdown

Category	Funds
Trade Policy	\$ 750,000
Market Access & Regulatory Affairs	\$ 525,500
International Travel & Misc. Operations	\$ 190,000

2003 Source of Funds



2003 Expenses



Looking Ahead

Unanswered challenges to dairy's health benefits damage the industry inside and outside the United States.

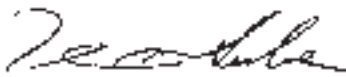
Last year included unplanned challenges and unexpected opportunities that provide perspective on the future growth for U.S. dairy exports.

First, the creation of the USDEC Whey Proteins Health Claim Task Force is an initial step towards a national, integrated Research and Development effort, long discussed by the industry. New Zealand, Australia and the EU have raised this function to an art form and enjoy the resulting global market share benefits.

The Task Force's charge is to develop science-based claims to counter the challenges of non-dairy competitors and its distinction lies in the degree of multinational, pre-competitive interest it's generated. Whether it's soy-based products, calcium-fortified juices or power bars utilizing other protein sources, unanswered challenges to dairy's health benefits damage the industry both inside and outside the United States. But the task is bigger than USDEC alone and we are working with DMI to explore enhancing the domestic marketing of U.S. dairy ingredients. The Council's experience driving dairy ingredient sales around the world can leverage industry efforts in the domestic market.

A second event of importance was what *didn't* happen at the Cancun WTO Ministerial last September. Industry representatives left Cancun disappointed but not dismayed. While the final deadline may be revised, we believe reform achieving a more equitable dairy trade system should, and will, happen. USDEC continues to work with the USTR, USDA and WTO negotiators in Geneva to prepare the ground for change.

Finally, in 2003 members of the U.S. Dairy Export Council continued their focus on growing dairy exports. We look forward to 2004's challenges and opportunities – and to the surprises this year may hold for us all.



Thomas M. Suber, *President, U.S. Dairy Export Council*



2003 AT A GLANCE

Total exports reached \$1.07 billion in 2003, up 4% from the prior year and the fourth straight year in which U.S. dairy exports topped \$1 billion.

One success story in 2003 was lactose, posting a 21% increase in export volume. Exports to New Zealand and Australia, mostly used for the protein fortification of SMP, doubled the previous year's volume. Sales to China, Mexico, South America and Japan also posted significant gains.

Overall whey exports declined 6% on a volume basis, though they increased by 2% on a value basis. Exports of whey protein isolate nearly doubled, while shipments of whey protein concentrate and dry (sweet) whey dropped modestly due to economic recession in some markets and a pullback in sales to the livestock sector.

Cheese exports slipped 3% on a volume basis, with declines in sales to the Far East and South America. Exports increased to Mexico, due in part to exporter commitment and successful USDEC promotional and market development activities.

Increased food aid and commercial sales enabled exporters to boost skim milk powder shipments by one-third in 2003. At a value of \$236 million, SMP exports reached their highest level since 1995. Shipments increased to virtually all markets.

2003 U.S. Dairy Exports

	Volume (mt)	% Change 2003 vs. 2002
Whey Proteins	173,429	- 6
Skim Milk Powder	148,044	+32
Lactose	142,710	+21
Cheese	52,112	- 3
Fluid Milk & Cream*	29,863	+30
Ice Cream	29,203	- 21
Butteroil	7,567	+500
Butter	3,476	+157
Yogurt	2,020	+2

* in KL

Exports of fluid milk and cream expanded by nearly one-third due to increased sales to Canada and a rebound in sales to Mexico. Continuing the long-term pattern, ice cream exports ended the year down by 21%, as customers shifted sourcing to Europe. Exports of butteroil increased five-fold last year, with almost all the volume going to Mexico. Butter sales climbed 57%.


U.S. EXPORTS OF PRODUCT BY COUNTRY IN 2003

In 2003, Mexico and Canada were the largest markets for U.S. dairy products, accounting for about half of export sales.


Exports to Mexico, the Caribbean, Central America and the Middle East all posted sizable gains in 2003. Small increases were recorded in sales to China, Taiwan and South Korea.

On the downside, exporters saw decreases in overall shipments to Japan, Southeast Asia and South America in 2003.

Whey Proteins		Volume (in metric tons)	% Change 2003 vs. 2002
China		43,912	+4
Japan		11,692	- 35
Mexico		20,545	- 16
Middle East/N. Africa		367	+61
South America		6,691	- 38
South Korea		12,514	+55
SE Asia		29,523	+2
Taiwan		10,722	+28
World		173,429	- 6


Lactose		Volume (in metric tons)	% Change 2003 vs. 2002
China		12,443	+81
Japan		46,690	+7
Mexico		12,779	+34
South America		7,449	+58
South Korea		6,299	- 8
SE Asia		25,873	+6
World		142,710	+21

Fluid Milk & Cream		Volume (KL)	% Change 2003 vs. 2002
Mexico		20,391	+13
World		29,863	+30


Yogurt		Volume (in metric tons)	% Change 2003 vs. 2002
Mexico		356	+6
World		2,020	+2

Cheese		Volume (in metric tons)	% Change 2003 vs. 2002
Caribbean		3,006	- 3
China		593	+14
Japan		7,950	- 22
Mexico		16,184	+9
Middle East/N. Africa		3,548	+87
South America		1,979	- 25
South Korea		3,437	- 8
SE Asia		2,360	0
World		52,112	- 3

Ice Cream		Volume (in metric tons)	% Change 2003 vs. 2002
China		1,437	- 54
European Union		7,255	- 23
Japan		2,198	- 51
Mexico		9,352	+6
South Korea		548	- 57
SE Asia		487	- 21
World		29,203	- 21

Skim Milk Powder		Volume (in metric tons)	% Change 2003 vs. 2002
Mexico		57,321	+16
Middle East/N. Africa		19,275	+64
SE Asia		25,053	- 5
World		148,044	+32

Butter		Volume (in metric tons)	% Change 2003 vs. 2002
Mexico		575	+123
World		3,476	+157

Butteroil		Volume (in metric tons)	% Change 2003 vs. 2002
Mexico		6,455	+6,228
World		7,567	+500

2003 PROGRAM HIGHLIGHTS

In 2003, U.S. Dairy Export Council programming adapted to ever-shifting conditions in the global dairy marketplace. Exporters dealt with ongoing security issues in the face of the war in Iraq. An outbreak of SARS (Severe Acute Respiratory Syndrome) in Asia curbed travel and forced USDEC to postpone several events. The world economy improved, boosting demand in Asia in particular. Stronger demand, combined with a weaker U.S. dollar, helped push commodity prices higher in the second half of the year.

Programs for **cheese and manufactured products** improved the international image of U.S. products, focusing on value-added products and increasing penetration in retail and foodservice sectors.

In November, 18 U.S. cheeses won medals at the World Cheese Awards in England, a testament to the craftsmanship of U.S. cheesemakers. USDEC encouraged participation from America's artisans by covering entry and shipping costs.

USDEC successfully partnered with retailers and foodservice operators in key markets on programs that parlayed the value-added cachet of U.S. cheese. The USDEC logo was printed on pizza boxes for Domino's and Costco in Mexico, letting consumers

know the pizza was topped with high-quality cheese from the United States. A "U.S. Cream Cheese Bakery Contest" in South Korea generated good response from chefs nationwide, and led to publication of a cookbook of the best recipes. USDEC also worked with Japanese retailers to resolve supply problems with cup cream cheese, and ran new promotions to recapture sales.

The **dry ingredients** group concentrated on maintaining market awareness of the versatility, functionality and health benefits of whey, and positioning lactose as a competitive source of milk solids. It also reinforced America's reputation as a reliable supplier of milk powder.

At a USDEC weight management seminar in Japan in October, presenters shared new research describing how eating foods with whey proteins and milk minerals can help people lose weight. USDEC hopes to drive dairy consumption with new products that promote the bioactive components of whey, a product in which the United States enjoys a competitive advantage.

Programs sought to encourage new uses for dairy ingredients. USDEC completed a feasibility study to show how adding lactose to poultry feed can prevent salmonella in chickens.

Special attention on higher-value whey protein concentrates helped move U.S. ingredients further into the nutraceutical sector. More than a dozen seminars and reverse trade missions promoted U.S. ingredient supply capabilities to buyers around the globe.

The **strategic research and business development** group takes a long-range view of the competitive and pre-competitive issues that confront the U.S. dairy export industry.

In 2003, the member-inspired Health Claim for Whey Task Force identified areas with the most potential to substantiate meaningful health claims for whey as quickly as possible. Clinical trials are due to start in the first quarter of 2004.

USDEC also worked closely with government-sponsored food aid and development agencies to capitalize on sustainable opportunities to include U.S. dry ingredients. Seminars provided information about applications for milk powders in the context of food aid programs that are driving expanded utilization of U.S. ingredients.

In addition to leading a research mission to Japan and updating research on U.S.-based multinational corporations to gain a better understanding of buyers' needs, USDEC also sponsored a study of heat resistance of



U.S. milk powder in 2003.

USDEC supports its market development efforts with **global market research** on competitive dynamics in key markets. In 2003, USDEC completed a major new study on the dairy market in Japan, updating knowledge and understanding of one of the most important customers to U.S. exporters. USDEC also published its first-ever study of the emerging opportunities in "cosmeceuticals," the use of dairy ingredients in topical cosmetic-pharmaceutical hybrids intended to enhance the health and beauty of skin.

Other new reports included studies of the Caribbean market for cheese, new opportunities and applications for whey permeate, the South Korean dairy market and an analysis of U.S.-Canada dairy trade.

Through its **market access and regulatory affairs** group USDEC helps overcome technical constraints and serves as a valuable resource on standards, certification and documentation.

In 2003, USDEC's involvement in securing an agreement that permits the U.S. Food and Drug Administration to certify U.S. supply plants helped reopen exports to Chile after many years of restrictions. USDEC also was instrumental in removing a potentially troublesome regulation by gaining final

approval from the Codex Alimentarius Commission on a revised standard permitting use of benzoyl peroxide as a bleaching agent in whey.

Other favorable rulings in 2003 included Brazil's revision of its label registration requirements to comply with U.S. labeling regulations, following a two-year diplomatic effort. South Korea amended its yogurt standards to allow the inclusion of whey solids, consistent with the U.S. standard. Japan expanded its list of acceptable food additives, relieving a barrier to export. And China allowed USDEC to provide input into its revised food regulations and standards that will minimize technical barriers to dairy trade.

This year was a critical one for dairy **trade policy**. Armed with Trade Promotion Authority, the administration pursued multilateral negotiations through the World Trade Organization (WTO) and in the Western Hemisphere, and bilateral talks with a number of countries.

To raise the profile of dairy exports on Capitol Hill and ensure the industry's interests are taken into account, USDEC's trade policy group initiated a Congressional Education program in 2003. The campaign included increased contact with lawmakers and publication of a booklet that outlined

the U.S. dairy industry's unified principles of trade.

Through USDEC's position papers, testimony and direct contacts, the Council helped maximize opportunities while minimizing vulnerabilities. For instance, the U.S. trade team walked away from the table rather than make unilateral concessions at the WTO talks in Cancun in September. Meanwhile, free-trade agreements with Chile and Central America provide increased access for U.S. dairy products, while opening U.S. borders only modestly in return.

USDEC's **communications and membership** group keeps stakeholders informed about USDEC programs, market opportunities and news that impacts dairy trade. In addition to providing the weekly *Facts on Dairy Exports* in 2003, USDEC sent special alerts to members as warranted.

USDEC's crisis communications system was tested in December when bovine spongiform encephalopathy (BSE) was found in a U.S. dairy cow for the first time. The Council's quick dissemination of fact-based information helped government and media attention to focus on real issues and ensured uninterrupted U.S. dairy exports.





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