

# EXPORTProfile

## Demanding an Explanation

A number of factors influence U.S. dairy industry export success, but the driving force is global demand. Demand for milk, cheese, butter, yogurt and dairy ingredients in foreign nations is booming as rising incomes move populations from traditional regional diets to ones higher in protein.

Demand is the key word, but it's also one of those words that often gets tossed about without anyone really defining it: What is per capita dairy consumption around the world, how has it grown, why has it grown, what exactly does it mean in terms of volume, and perhaps most importantly, can it continue to drive global dairy demand growth and U.S. dairy exports into the future?

This issue of *Export Profile* takes a microscope to demand growth and demonstrates why it is likely to power the industry for years to come.

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## Dairy Desire on Fire

Total global milk demand can be expected to rise with population growth. It's a simple equation: More people, with more or less the same average income, equals more milk consumed at any given price. On a per person basis, the United States consumes less dairy today than it did in 2002, but total U.S. dairy consumption is up by virtue of some 14 million more people on the census rolls today than five years ago.

Imagine how much more milk we would need to produce if we were drinking an additional cup, eating an extra cheeseburger or consuming a few whey-laden energy bars every week.

Well, you don't have to imagine. In much of the developing world, not only is population growth creating more people to consume dairy, each person is eating or drinking more of it, driving global demand and fueling U.S. cheese, milk powder, whey protein, butter and fluid milk exports.

The world is, in fact, experiencing unprecedented growth in per capita dairy consumption. The biggest example is China.

Per capita dairy consumption in China grew from 32.8 lbs. milk equivalent in 2002 to 62.8 lbs. in 2007—a steep

*Dairy Desire continued on page 3*

# Export Perspectives

## It's Official: Consume More Dairy



The proliferation of U.S. restaurant chains and Western-style food retailers is pretty influential in moving consumers in developing nations toward higher protein diets. The overtures of food suppliers and organizations like USDEC extolling the nutritional benefits of dairy products for consumers and the functional and application benefits for food and beverage manufacturers helps further inculcate potential buyers.

Together, they put dairy products and foods containing dairy ingredients in front of millions who sample, enjoy and come back for more. All of it made possible by rising incomes.

As if consumers needed further reason to try dairy or increase their consumption, governments around the world are stepping up efforts to improve their national diets – including telling their citizens that in order to lead healthier lives, they should consume more dairy.

In one of the most significant government efforts to improve a nation's diet, China's Ministry of Health last year commissioned the Chinese Nutrition Society to evaluate the country's 10-year-old Dietary Guidelines and "Dietary Tower" (similar to the U.S. Food Pyramid). The previous guidelines recommended that people consume 100g of milk or other dairy products per day, far below U.S. standards and those of other developed nations.

After extensive research into national standards around the world, as well as inviting input from the U.S. Dairy Export Council, the Society recommended that daily dairy intake be tripled to 300g. In addition, due to USDEC comments, which included data on the nutritional benefits of whey proteins, the guidelines specifically list whey protein concentrate as a desirable, "quality protein."

The Chinese government has undertaken a nationwide educational campaign to disseminate the recommendations, paying special attention to rural regions, where consumption lags behind urban areas. The goal is not only to raise awareness of the new guidelines, but to emphasize the

variety of dairy choices. As in many developing countries, consumers may have experience with milk and yogurt, but they are just learning about cheese, whey proteins and other dairy products and their applications.

The new standards became effective Jan. 1, 2008, and they are an unqualified positive for Chinese dairy demand and, by extension, U.S. dairy suppliers.

At the old 100g per day recommendation, Chinese per capita dairy demand rose from 41g per day to 78g from 2002 to 2007. That means that China consumed a staggering 18 million metric tons more milk in 2007 than it did just five years earlier.

Boosting recommended levels to 300g suggests growth will not stop at 22 more grams per day (the increase needed to put people on average at 100g), but will continue rising toward that higher mark. A steady increase to just 150g would make the 18 million metric ton-gain over the previous five years seem small.

Better yet, China is just one example of governments intervening in an attempt to better a population's general health. Similar activity is taking place all over the developing world. School milk programs are an important demand driver in developing countries and even in the face of rising prices, governments are going all out to continue them, creating a new generation of dairy consumers.

Without a doubt, dairy suppliers in the United States have a vested interest in seeing developing nations shift toward higher protein diets. USDEC takes pains to objectively lay out the benefits of dairy, but even the less cynical of the world might be suspicious of association and food company motives. It is business after all.

So when an official arm of the government comes out and tells people they should be consuming more dairy or backs programs to get more dairy products to consumers, it legitimizes other efforts and instills a sense of veracity that might otherwise have been lacking. And the upshot of it all is greater demand.

A handwritten signature in black ink, appearing to read "Tom Suber".

**Tom Suber**  
*President, U.S. Dairy Export Council*

*Dairy Desire continued from page 1*

incline that translates into a need for nearly 40 billion lbs. more milk annually in just five years. To put that in perspective, 40 billion lbs. is about equal to a full year of California milk production.

And that's only China.

Other examples are rampant throughout the developing world. Indian consumption increased by 8.5 lbs. per person, while Brazil's jumped almost 19 lbs. from 2002-2007, creating the need for an additional 9.9 and 3.6 billion lbs. of milk in each country, respectively.

Complete 2007 dairy data for the world will not be available until later this year, but 2002-2006 numbers show per capita consumption in the Middle East/North Africa rose from 195 lbs. to 217 lbs., in Central America from 253 to 261 lbs. and in Southeast Asia from 34 to 41 lbs. Together, those three regions required 568 million lbs. more dairy products to meet 2006 demand than they did in 2002.

Based on general milk production estimates and export trends in 2007, both per capita consumption and dairy demand grew across almost all major developing markets last year, and all are positioned to expand again in 2008.

The full potential of future growth is astonishing when viewed against the backdrop of developed countries. Per capita consumption is up significantly in numerous nations around the world, but still pales compared to the United States or the European Union (about

580 lbs. and 600 lbs. per person per year, respectively).

**Roots of change**

Dairy demand growth should come as no surprise when you consider economic growth in developing nations coupled with the transformation of the foodservice and food retail sectors.

Economic growth in emerging markets accelerated starting in the late 1990s and has been running more than double the growth in "high-income" countries ever since, according to World Bank statistics.

Even as the United States grapples with an economic slowdown and world food prices rise to historic highs, the economies in Chile, China, Colombia, India, Indonesia, Malaysia, the Philippines, Russia, the oil-producing countries of the Middle East and others continue humming along.

That growth has translated to greater income. The developing world is developing a large middle class with more money to spend on food, facilitating a shift to diets higher in protein, including dairy. The food distribution infrastructure in urban areas has both hastened the transformation and benefited from the change.

That is most clearly seen in the food-service sector.

U.S. restaurant chains are proliferating around the globe, led by McDonald's and Yum! Brands, who operated more than 33,000 non-U.S. stores combined

at the end of 2007. Yum, which added more than 1,000 new stores outside the United States in 2007, plans to open another 1,200 restaurants in 2008, and others are plotting aggressive growth of their own (see chart on page 5).

"You have more and more people that are moving into the middle class and are coming into our space. That's been a big benefit in lots of countries in Asia . . . Certainly the same can be said for Latin America in a lot of our markets there," Burger King Chief Executive Officer John Chidsey told analysts at the company's third quarter conference call in May.

Comparable sales were up almost everywhere you look in 2007 and the first quarter of 2008—from Yum to Burger King to Papa John's International.



Not only are chains expanding in countries where they already have a foothold, they keep pressing into new markets—Burger King in Colombia, Indonesia, Poland and Egypt; Taco Bell in India, Dubai, Mexico and Spain; Papa John's in El Salvador, Jordan, Poland and Turkey; California Pizza Kitchen in South Korea.

Food retailers are similarly proliferating. A 2007 IGD Global Retail Outlook survey reported in Supermarket News found that 77 percent of food industry leaders predict that future global growth will come from emerging markets, the top five being China, India, Russia, Brazil and Turkey.

Retailers say they are now entering countries through second and third-tier cities, figuring consumers there are ready for modern retail formats. Food-service chains are spreading to smaller urban areas as well. Yum says the Pizza Hut brand is only in 50 cities in China whereas KFC is in 450, leaving plenty of room for growth.

It all plays into demand and suggests greater opportunity awaits ■

<b>Rising Appetites for Dairy</b>			
<b>Country</b>	<b>Annual per capita consumption 2002 (in lbs.)</b>	<b>Annual per capita consumption 2007 (in lbs.)</b>	<b>Required milk equivalent to meet new consumption (in millions of lbs.)</b>
Brazil	291.4	310.1	3,551
Mexico	277.3	279.6	244
India	184.1	192.9	9,915
China	32.3	62.3	39,705

Source: USDEC; USDA's Foreign Agricultural Service; Global Trade Information Services; U.S. Census Bureau

A note on methodology: USDEC calculated per capita consumption by taking annual domestic milk production per country, adding milk equivalent imports, subtracting exports, and then dividing that number by population for the given year.

# But Can They Pay?

The biggest question mark to future dairy demand is whether the burgeoning consumer base will continue to purchase dairy if prices continue to rise. No one has a definitive answer.

On the one hand, during its fourth quarter conference call earlier this year, Nestlé confessed that it saw an impact in consumer purchases of milk powder in certain demographics. Roddy Child-Villiers, head of investor relations, noted: "You do see consumers at the low end either using less milk in their glass or giving their children milk only at weekends as treats as a way of saving money."

"Our view is that we will see continued demand growth in developing countries, but the rate of growth is likely to slow in light of higher prices," says Deborah Perkins, managing director at Rabobank International.

A return to 2007 prices could heighten the impact on consumption, she adds. Higher prices hit particularly hard in price sensitive markets where dairy has only been recently introduced to the diet.

On the other hand, a number of positive signs suggest that the consumer fallout for higher global prices may be relatively minimal. Rising incomes in developing nations, greater operational and logistical efficiencies, consumer desires for more nutritious foods and a shift in lifestyles are helping take the edge off price hikes.

Economic growth in developing nations, particularly the BRIC countries (Brazil, Russia, India and China) shows no signs of abating and is fueling the economies of neighboring countries, even as U.S. economic performance falters. Developing nations, Mexico in particular, have

done a good job of decoupling from U.S. money troubles. Historically, recessions in the U.S. economy have crippled the Mexican economy. Now, due to export diversification, healthy domestic consumption and increased infrastructure investment, Mexico is demonstrating greater strength in the face of a U.S. economic slowdown.

Infrastructure improvements are boosting consumers in a number of nations, bringing jobs, raising output and facilitating growth.

Emerging markets are expected to spend \$1.2 trillion on roads, ports, railways, electricity and other projects this year, according to a report in *The Economist*, a huge increase and a sign of future economic health.

Infrastructure improvements also contribute directly to cost control by creating greater efficiencies, as does the increasingly greater scale of foodservice chains, food manufacturers and retailers in foreign markets.

In general, suppliers, distributors and retailers are looking to minimize price increases to avoid alienating buyers, and any increase in efficiency helps.

"Many companies have been absorbing a portion of the raw material price increases and so this is protecting consumers to a certain extent and will slow any fall-off in demand," says Perkins.

It's a strategy that can only last so long, given margin deterioration, but it has helped limit price hikes. And with commodity prices down from the peaks of late last fall, it might be enough to get suppliers and retailers through the toughest periods.

Perhaps the biggest positive is that the global urban middle class – the primary driver behind demand gains – is larger and better positioned to handle price hikes than in past years.

China's middle class is about 250 million, projected to hit 400 million by 2010 (more than the entire U.S. population) and 600 million by 2020.

Middle class earnings "will increase their ability to eat better," Carlos Caiani, owner of Australian consulting firm Caiani & Co., recently told *The Australian*. "Once people start eating better, that is one thing they never stop."

Caiani points to Chinese cheese consumption, predicting the country is going to be importing 40,000 tons of cheese in the not-so-distant future (about four times its current level), as annual consumption rises to 180,000 tons (more than triple its current level).

"This is not going to abate," Caiani said.

## Dairy: Just better

Dairy specifically has a few other advantages in its favor. First, while dairy prices are up, so are prices of alternatives, such as soy- and palm-oil-based substitutes.

Second, dairy has a nutritional profile that few other food categories can claim, and that appeals directly to consumers in developed and developing regions alike.

Third, this isn't just a shift in dietary patterns – it's a shift in lifestyles. Developing nations are seeing more two-income families, a faster pace of life, and an increased need for convenience foods, be it a home delivered pizza (one of many emerging growth sectors in China, where

## Giving the Dollar its Due

The low value of the U.S. dollar is often cited as benefiting the price competitiveness of U.S. dairy exports vs. exports from other major exporting nations, such as Australia and New Zealand. That characterization is not exactly correct. The benefit of the depressed value of the U.S. dollar is in reality much broader. The weak U.S. dollar primarily benefits consumers in importing countries.

Here's why. Global dairy trade is generally priced in U.S. dollars. The impact of higher international prices is moderated in countries with currencies that have appreciated against the U.S. dollar. That is, for a given price increase in

the international market, the price increase is less in terms of a domestic currency that has appreciated against the dollar. So the domestic consumer benefits from the change in the exchange rate.

The low dollar, in other words, is just as likely to benefit demand for products exported from New Zealand and Australia, which are priced in U.S. dollars, as it is to benefit demand for products exported from the United States. A weaker U.S. dollar makes global demand for dairy in general more robust.



Yum! Brands is adding 20 Pizza Hut home delivery units this year) or a nutritional drink to get them through a busy work day. Convenience is a more compelling proposition in a growing middle class and one people appear willing to pay for.

Three quarters of McDonald's Chinese locations are open 24 hours, aiming to service customers at all times, and the company says it is seeing very strong comparable sales during the extended hours.

Referring to dairy growth in Indonesia, Dairy Australia spokesperson Phil Good recently told *The Australian*: "You are see-

ing two things: You are seeing that the middle class in particular are wanting to have a healthy diet for their children, and that means milk; and you are seeing their teenagers are wanting hamburgers and pizzas. That is good for dairy."

In less than a month, the Olympics will open in China and dozens of Western-style restaurant chains will be introducing millions to dairy-laden foods, which is bound to stir consumption.

Quick-service restaurant chains say, for the most part, they haven't seen a negative impact on sales. They've taken price hikes and, while seeing slight mar-

gin erosion due to efforts to minimize increases, posted strong comparable sales in 2007 and into the first quarter of 2008 – some in the double digits. Customer traffic remains vibrant, particularly in China.

"The economy obviously growing at least 10 percent has been a big driver for everybody there that has a strong franchise," said David Novak, chairman and chief executive officer of Yum told analysts at the company's first quarter conference call. Novak pointed to the 16-24 age demographic. "That group is getting more and more disposable income, and that's only going to get better as we go down the road." ■

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USDEC was formed by Dairy Management Inc. in 1995 to enhance the U.S. dairy industry's ability to serve international markets. USDEC is an independent membership organization that leverages the investments of dairy processors, exporters, milk producers and industry suppliers and funding from the U.S. Department of Agriculture's Foreign Agricultural Service. USDEC is staffed by Dairy Management Inc., a non-profit management organization that conducts integrated programs in marketing, communications, promotion and research for U.S.-produced dairy products on behalf of America's dairy farmers. USDEC staff includes Tom Suber, president; Marc Beck, senior vice president, export marketing; Véronique LaGrange, vice president, strategic research and business development; Diane Lewis, vice president, market access and regulatory affairs; Matt McKnight, vice president, export ingredient marketing and industry affairs; Margaret Speich, vice president, communications and membership; Charles Timpko, vice president, research and operations.

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## The Spread of Restaurant Chains

Company	Overseas units (fiscal 2007)	Number of countries & territories (fiscal 2007)	Planned additional overseas units in 2008
McDonald's	17,515	>100	<1,000
Yum! Brands*	15,440	>110	1,215
Burger King	4,112	68	200-240
Domino's Pizza	3,469	>55	200-250
Papa John's International	448	29	135-150
CKE Restaurants**	282	13	45
Brinker International***	152	21	36

\*Includes KFC, Pizza Hut, Taco Bell, Long John Silver's, A&W and East Dawning

\*\*Includes Hardee's and Carl's Jr.

\*\*\*Includes Chili's, Maggiano's, On the Border and Macaroni Grill



# Dairy Product Research

## For Selected Overseas Markets



Report Title: **Korea: Dairy Market**  
Product: All Dairy  
Country: South Korea  
Subject: Domestic Market (02/08)  
Number: 08-R-1  
Price: \$50



Report Title: **Taiwan: Cheese Market**  
Product: Cheese  
Country: Taiwan  
Subject: Domestic Market (08/07)  
Number: 07-R-5  
Price: \$50



Report Title: **Mexico: Dairy Market**  
Product: All Dairy  
Country: Mexico  
Subject: Domestic Market (04/08)  
Number: 08-R-2  
Price: \$50



Report Title: **China & Hong Kong: Cheese Market**  
Product: Cheese  
Country: China  
Subject: Domestic Market (08/07)  
Number: 07-R-6  
Price: \$50



Report Title: **Middle East: Dairy Ingredients Market**  
Product: Ingredients  
Country: Middle East  
Subject: Domestic Market (05/08)  
Number: 08-R-3  
Price: \$50



Report Title: **Global Dairy Blends Update 2006**  
Product: Blends  
Country: Worldwide  
Subject: Situation Analysis (09/07)  
Number: 07-R-7  
Price: \$50



Report Title: **East Asia: Dairy Ingredient Demand in the Retail Packed Dry Milk Industry**  
Product: SMP  
Country: East Asia  
Subject: Situation Analysis (05/07)  
Number: 07-R-1  
Price: \$50



Report Title: **Global Pet Food Industry**  
Product: Ingredients  
Country: Worldwide  
Subject: Situation Analysis (08/07)  
Number: 07-R-8  
Price: \$50



Report Title: **Russia: Cheese Market**  
Product: Cheese  
Country: Russia  
Subject: Domestic Market (05/07)  
Number: 07-R-2  
Price: \$50



Report Title: **Argentina: Dairy Export Prospects**  
Product: All Dairy  
Country: South America  
Subject: Situation Analysis (12/07)  
Number: 07-R-10  
Price: \$50



Report Title: **China: Health Nutrition Market**  
Product: Ingredients  
Country: China  
Subject: Domestic Market (08/07)  
Number: 07-R-3  
Price: \$50



Report Title: **Brazil: Dairy Export Prospects**  
Product: All Dairy  
Country: South America  
Subject: Situation Analysis (12/07)  
Number: 07-R-11  
Price: \$50



Report Title: **Global Cheese Varietal Demand**  
Product: Cheese  
Country: Worldwide  
Subject: Situation Analysis (08/07)  
Number: 07-R-4  
Price: \$50



Report Title: **Chile: Dairy Export Prospects**  
Product: All Dairy  
Country: South America  
Subject: Situation Analysis (12/07)  
Number: 07-R-12  
Price: \$50



Report Title: **Uruguay: Dairy Export Prospects**  
 Product: All Dairy  
 Country: South America  
 Subject: Situation Analysis (12/07)  
 Number: 07-R-13  
 Price: \$50



Report Title: **Russia, Ukraine and Belarus: Dairy Industry**  
 Product: All Dairy  
 Country: Russia  
 Subject: Domestic Market (04/06)  
 Number: 06-R-2  
 Price: \$50



Report Title: **South America: Dairy Export Prospects (full set)**  
 Product: All Dairy  
 Country: South America  
 Subject: Situation Analysis (12/07)  
 Number: 07-R-14  
 Price: \$150 (full set)



Report Title: **China: Dairy Ingredients Market**  
 Product: Ingredients  
 Country: China  
 Subject: Domestic Market (10/06)  
 Number: 06-R-3  
 Price: \$50



Report Title: **India: Dairy Industry**  
 Product: All Dairy  
 Country: India  
 Subject: Domestic Market (03/06)  
 Number: 06-R-1  
 Price: \$50



Report Title: **The Chinese Dairy Sector: Milk Supply and Demand**  
 Product: All Dairy  
 Country: China  
 Subject: Situation Analysis (10/06)  
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# Producing for Demand

The world of rising demand creates opportunities for U.S. dairy exporters.

U.S. suppliers have benefited from increased demand. But making a long-term go of international business requires serious customer service, starting with creating products to specifications needed overseas.

Even though dairy consumption is rising, people won't eat just any dairy product. For example, butter everywhere outside the United States is unsalted and 82 percent fat. Here, butter is traditionally made salted and 80 percent fat. To

tap international demand, U.S. suppliers have had to adapt their operations – and they have done so, as skyrocketing U.S. butter exports would attest.

Another international opportunity lies in gouda. Gouda, though not consumed widely in the U.S. market, is the third most popular cheese in the world after cheddar and mozzarella. Mexico alone imports more than 80 million lbs. of gouda per year, Japan and Russia more than 50 million lbs. each.

Yet annual U.S. gouda manufacturing capacity stands at less than 5 million

lbs. Although total U.S. cheese exports are growing (up 40 percent in 2007 and 55 percent through the first four months of 2008), by not producing to the tastes of overseas users, the country is not capitalizing on the even broader growth potential that is out there.

The foodservice industry is a good example of tailoring product to better meet local tastes.

In fiscal 2007, Burger King rolled out a rice/bean/sour cream tortilla sandwich in its Costa Rican stores, flank steak churrasco in Argentina and its Steakhouse Burger in four flavor options for the South Korean market, among other adjustments.

“One of the things the industry as a whole has done well globally is really innovated the quality of their product offerings, and I think you're just attracting more and more people globally,” Burger King Chief Executive Officer John Chidsey told analysts at the company's third quarter conference call in May.

For dairy, attracting more and more people could come from continued strong focus on nutrition. It is a misapprehension that only U.S. consumers are concerned about health, diet and obesity. Households in China, Mexico, Saudi Arabia – across the world – are increasingly focused on providing their families with foods that work to prevent disease, encourage brain and body development, maintain bone strength and density and generally keep people healthier.

It's an ideal situation for dairy: inherent product benefits that meet demand. ■



## Export Profile

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