

USDEC Export Profile

THE SOLID POTENTIAL OF FLUID MILK

U.S. dairy suppliers have a new opportunity in UHT milk—if they can address the export challenges.

Ample evidence suggests a global opportunity in ultra high temperature (UHT) milk exports is unfolding as we speak. Chinese UHT milk imports are soaring. Demand scenarios conducted by USDEC suggest China's appetite for imported UHT milk could more than quadruple from 150,000 tons in 2013 to at least 600,000 tons by 2020.

No less than seven major new plant projects are in the works around the world—in Australia, New Zealand, Ireland and Germany—focused on manufacturing UHT milk for export. Their combined output is still insufficient to meet demand projections.

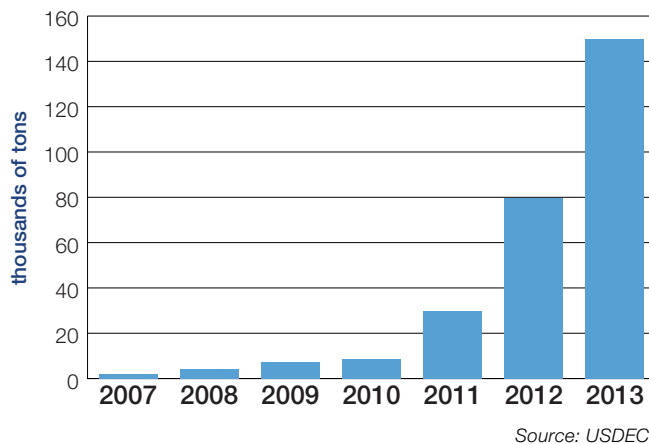
"U.S. suppliers have an opportunity to play a bigger role in China's booming UHT milk market," says Ross Christieson, senior vice president, market research and analysis. "To do so, they need to concentrate on 1) developing the right products and packaging to meet Chinese needs, which are very different from U.S. needs; 2) getting more price competitive (or accepting a smaller, niche share of the market); and 3) establishing price models that use longer pricing periods more akin to those offered by competitors."

Australia, France, Germany and New Zealand are the major UHT suppliers to China. They have tailored their lines to Chinese preferences, specifically 1-liter cartons with no additives, not even vitamins. Their marketing, promotions and packaging have been designed to reinforce that the milk is imported from a quality dairy supply country.

The United States currently has less than 4 percent of the Chinese UHT milk import market.

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Chinese UHT Milk Imports



Source: USDEC

China's interest in imported UHT milk is not a fad. It aligns with long-term structural shifts in the nation's diet and dairy manufacturing, marketing and sales trends.



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The U.S. Dairy Export Council, primarily funded by Dairy Management Inc. through the producer checkoff, works closely with its member processors, trading companies and others to build global demand for U.S. dairy products.

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“But U.S. suppliers have a reputation for high quality food and have also established dairy trade routes with China over the past decade. And Chinese buyers have expressed interest in U.S. UHT milk to meet spiraling demand,” says Christieson. “Tailoring the package size and appearance and eliminating additives are relatively straightforward first steps to meeting that demand.”

Taking on pricing

Price is more challenging. German suppliers offer contracts up to a year long, while New Zealand and Australian suppliers offer 3-6 month contracts. Neither is amenable to U.S. suppliers, who compound the issue by having higher landed costs than competitors, particularly those from Germany.

The rule of thumb is that UHT imports typically sell at retail at about twice their CIF cost. Because the average landed cost for U.S. UHT milk runs anywhere from 22-68 percent greater than rivals from Oceania and Europe, U.S. retail prices top the market.

Due in part to past food safety scares, Chinese consumers have shown they are willing to pay for imported UHT milk up to two-to-three times the price of local labels. That being said, Chinese consumers are cost conscious. Competitive pricing is a key factor in the grocery retail sector, putting U.S. products at a disadvantage next to brands from Europe and Oceania.

Market Drivers of Chinese Dairy and UHT Milk Consumption

- Sustained strong economic growth
- Rising per capita incomes
- Rapid urbanization
- The development of large, relatively wealthy second-tier cities
- The development of a national transportation infrastructure
- Increased commercial and economic freedoms
- A shift to higher protein diets
- The expansion of Western foodservice operators
- The establishment and expansion of modern, national supermarket retail chains



Chinese consumers prefer 1-liter UHT packaging, whereas most U.S.-made UHT milk is produced in smaller sizes.

“Pricing is currently a challenge, but given the potential, one worth accepting,” says Christieson. “We are new to this business, so we don’t currently enjoy the economies of scale that our competitors do. As we build more experience and start to use plants dedicated to manufacturing milk for export, we have the opportunity to get our cost models more in line with our competitors who, if anything, will face cost increases in the future.”

About 300 million people—a mass nearly the size of the entire United States—will move to Chinese cities over the next 17 years, encouraged by government programs aimed at shifting China’s economic model to one based more on internal consumption rather than exports. Urbanization is particularly important because dairy consumption in rural areas is negligible, meaning there is huge room for growth as those rural dwellers move to cities.

“Given the relatively low per capita consumption levels, and the very low penetration of ‘added-value’ products like cheese, butter and ice cream, dairy consumption is likely to continue to grow well into the future,” says Christieson. “The increase in the consumption of imported UHT milk is a part of this greater trend.”

Plus, the potential payback is bigger than simply the Chinese milk market. USDEC sees opportunity for other regions and products, like UHT milk and cream and lactic acid beverages in Southeast Asia. A solid fluid opportunity indeed. ■■■

MARKETUpdate: Mexico

NOT NEARLY SATURATED

The United States' largest dairy customer still offers plenty of opportunity for growth.

U.S. suppliers shipped \$1.4 billion in dairy products to Mexico in 2013, a little more than one-fifth of total U.S. dairy exports by value. According to Mexican Customs data, the United States held a 76 percent share of the Mexican dairy import market last year.

Given the size of U.S. business in Mexico and the United States' dominant position, some might wonder just how much more room U.S. suppliers have to grow.

Quite a bit, as it turns out. In fact, the climate for U.S. dairy business in Mexico is arguably better than it has ever been.

"The same underlying factors that have driven Mexican demand to this point remain in place, and the benefits gained from NAFTA continue to give U.S. suppliers a competitive edge. Those alone would be enough to further propel U.S. volume moving forward," says Rodrigo Fernandez, USDEC's Mexico office representative. "But now we have an additional factor: The evolution of Mexico's domestic food and beverage industry into a regional supplier. Domestic and multinational food and beverage companies are increasingly looking to use Mexico as a base to serve a broader area."

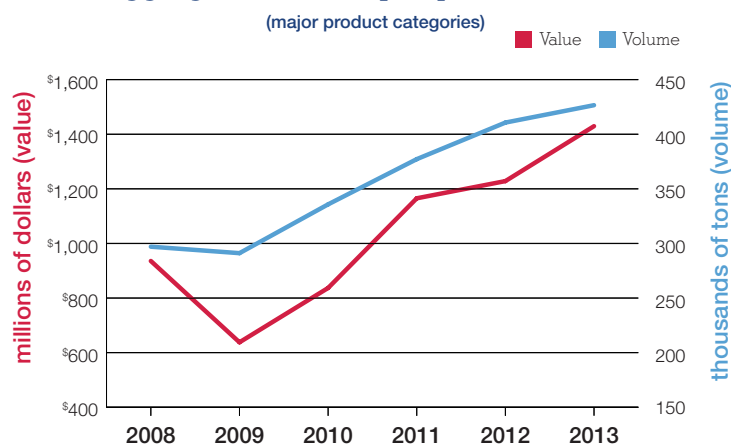
Dairy processor Grupo Lala, for example, after raising more than \$1 billion in an IPO late last year, is looking to expand into Guatemala, Nicaragua and South America. Nestlé expects to ship about 40 percent of the output from a planned Mexican infant formula factory to Latin America and the Caribbean.

Thriving business

At the same time, the domestic food industry is growing 4-5 percent per year and the market is by no means saturated. In fact, despite a history of dairy use and rising demand, per capita dairy consumption in Mexico is relatively low.

A decade of moderate economic gains has helped expand dairy consumption and, by extension, imports of U.S. products. But economic gains have been insufficient to spread to all corners of the nation. More than 40 percent of the population—around 53 million people—still

Aggregate U.S. Dairy Exports to Mexico



Source: USDA's Foreign Agricultural Service

Apart from a temporary dip in 2009 caused by the global financial crisis, U.S. dairy export volume and value to Mexico have climbed steadily.

lives below the poverty line and remains essentially a minimal dairy buyer.

"As that mass of people moves up the economic ladder, we can expect a whole new audience for U.S. dairy," Fernandez says.

And definitely more dairy imports. Even though Mexican milk production has been growing 1.5-2 percent annually for the past decade and is likely to match that growth for the next five years, the country remains a deficit milk producer, relying on imports to satisfy about one-third of its annual dairy needs.

Even within categories the United States dominates, there remains significant room for growth.

According to Mexican Customs data, U.S. share of Mexico's cheese import market grew from 72 percent in 2012 to 77 percent in 2013. However, U.S. suppliers hold only a 14 percent share of the "Hard & Semi-Hard" category. In addition, it has only been in recent years that U.S. suppliers have seriously pursued (and begun winning) gouda market share in Mexico.

Rising cheese consumption and a willingness of U.S. suppliers to cater to buyers' needs, paying close attention to characteristics like flavor, melting properties and color, are likely to make Mexico the United States' first 100,000-ton cheese export market in the coming years. It is one of the many dairy categories in Mexico that holds continued promise for U.S. suppliers. ■■■

Q&A: BRAZIL

WITH SONIA AMADEO



Q: Brazil has been mentioned as a potential dairy export force for years, yet the nation seems to perennially underperform. Why?

SA: Brazilian milk production reached 35 million tons in 2013, but less than 24 million tons is under some form of federal, state

or municipal inspection, meaning nearly one-third of all production ends up in the informal market or is used on-farm.

The industry has infrastructure problems due to long distances between remote dairying areas and coastal ports, and there is a huge degree of automation inequality at both the farm and processing levels. The government enacted regulations to improve milk quality by making refrigerated transport mandatory from the farm and by holding more frequent inspections of dairy plants, but Brazil has a long way to go to achieve a nationwide quality approach.

Most Brazilian dairy processors are not prepared to export. The industry is used to domestic prices being higher than international prices, and it lacks the long-term commitment to stick with the market even when prices decline.

Q: What is Brazil's milk production outlook?

SA: Farmgate milk prices in Brazil reached an all-time high last year due to strong domestic demand and firm international commodity prices. However, national milk production is expected to slow from an average annual growth rate of 3.3 percent in the past 10 years to 2.1 percent in the upcoming decade.

Q: Brazil's dairy exports have plummeted since 2008 while its imports have generally risen. Can we expect those trends to continue?

SA: The appreciation of our currency, the real, has played a big role in dairy import and export trends. A decade ago, a U.S. dollar bought 3.5 reals; it now buys around 2.4 reals. High domestic milk prices and the higher real have given imports a pricing edge for the time being. But according to a recent study by researchers from the University of São Paulo, imports will fall by 10 percent in the years ahead.

The Brazilian dairy industry will continue to make an effort to have some sort of international presence. Currently, the main markets for Brazil's milk powder are Venezuela, Angola and Saudi Arabia. Over the last decade, the strong real made Brazilian exports less competitive, but the causes of Brazil's competitiveness problem go far deeper than the exchange rate. Poor roads and a limited rail network push up freight costs, for example, creating additional challenges for dairy processors looking to export.

Q: Brazil has experienced significant social unrest over the past year due to public discontent with the rising cost of living and the government. How stable is the nation politically and economically?



Rio de Janeiro's Maracanã Stadium in the midst of remodeling. Cost overruns in preparation for the 2014 World Cup and 2016 Olympics have escalated many Brazilians' dissatisfaction with the government.

SA: The nation, politically and economically, is stable, but there are a lot of domestic problems resulting from the government's refusal to implement tax reforms, cost overruns on the Olympics and World Cup, and misuse of funds that should have been better invested in infrastructure. These problems have accumulated over generations, but the federal government has been unwilling or unable to tackle them. In order for Brazil to reignite growth, the government will have to resume the reforms it dropped during the good times and trim pension funds, cut red tape, lower and simplify taxes, and update labor laws. All that combined would help Brazil to tackle its loss of competitiveness. ■ ■ ■

Sonia Amadeo is USDEC's South American office representative based in São Paulo.

MARKET Development

MAKING FRIENDS IN THE MIDDLE EAST

Dairy nutrition helps sow the seeds of partnership in a rising dairy import region.

Whether you are talking about love life or business, long-distance relationships are much tougher to make work than those with frequent face-to-face interaction. That is certainly the case with dairy exports to the Middle East.

Middle Eastern dairy buyers put a premium on personal communication and one-on-one contact. The lack of it gives the impression that a seller may just be looking for a quick profit rather than to establish a long-term partnership.

“U.S. suppliers have exhibited interest in the Middle East, but for many, because of the political situation, that interest has been based on doing business from afar,” says Kristi Saitama, USDEC vice president, export marketing ingredients.

That was a big reason behind USDEC’s U.S. Dairy Business Conference in Dubai late last year. The multifaceted conference, USDEC’s single largest marketing event, included educational sessions, two separate supplier showcases with tabletop displays, a U.S. dairy farmer mission and a culinary conference.

“We wanted to create a face-to-face opportunity—a forum where U.S. suppliers of both cheese and dairy ingredients could demonstrate their interest and explore further areas of opportunity. They did just that,” says Saitama. “The producer mission helped put a farmer face on the U.S. dairy industry, humanize it and show that there was U.S. interest in the Middle East throughout the dairy supply chain.”

A current of “collaborative innovation” ran throughout the conference. Both buyers and suppliers indicated a desire to engage on multiple levels—from pricing to technical support to product specifications to new product development—in order to foster understanding and facilitate a long-term vision rather than spot-buying scenarios. Buyers showed great interest in consumer research and for U.S. suppliers to understand the varying needs of their customers.

Filling the nutritional gap

One place Middle Eastern buyers are looking to U.S. dairy suppliers for help is nutrition. The relationship between diet and health is an increasingly vital issue in the Middle East.

The region’s vitamin D deficiency ranks worst in the world, with rising prevalence of younger patients having lower bone density levels. Adult diabetes rates in Gulf Coopera-



USDEC President Tom Suber (center) moderates the panel discussion “Keys to Success in Forging Win-Win Customer-Supplier Relationships” at the U.S. Dairy Business Conference in Dubai. Panelists sitting with Suber are (left to right) Thomas Cooney, operations director, National Food Industries Co.; Ahmed Sakr, Chairman, Sakr Group; Dave Snyder, vice president global business development—cheese, Glanbia Foods; and David Curta, director of international sales, Davisco Foods International.

tion Council countries are among the highest in the world and are rising. Saudi Arabia, United Arab Emirates, Kuwait and Bahrain rank among some the nations with the highest obesity rates on the planet, with well in excess of 30 percent of the adult population technically obese.

The region’s growing health consciousness, especially among the young population, is a big contributor to rising demand for dairy products. At the Business Conference, Dr. Carla Habib Mourad, project coordinator for Nestlé’s Healthy Kids school program, host of a popular television show on nutrition and distinguished lecturer on health and diet, pointed out opportunities for dairy to help address the region’s nutritional concerns.

Foods rich in protein and low in fat, such as protein bars and dairy shakes, are future growth segments in the Middle East. Consumers are very interested in dairy products that offer multiple health benefits, such as antioxidants and probiotics.

“Going forward, health, the changing role of women in society and the bulging youth population will drive Middle Eastern food and beverage consumption,” says Nina Bakht Halal, USDEC’s Middle East office representative.

U.S. suppliers can play a bigger role. At the Business Conference, customers clearly indicated they are looking for supply security and wanted to buy more U.S. dairy products—in part because of the U.S. reputation. The U.S. food industry is seen as an innovative product developer with strong consumer insights, willing and able to collaborate and invest in continuous improvements to facilities, products and marketing.

In other words, great qualities on which to base a relationship. ■ ■ ■

DATA Snapshot

The United States' share of world dairy exports grew in almost every major product category in 2013. Among the world's nine largest dairy suppliers, aggregate U.S. export share of milk powder, cheese, butterfat and whey products was 19 percent, up from just over 16 percent in 2012. ■■■■

SMP Exports Jan. – Dec. (volume, MT)

Country	2011	2012	2013	% chg
US	434,781	444,707	554,752	+25
EU-28	515,491	520,435	409,933	-21
NZ	361,625	389,624	391,969	+1
Australia	139,898	167,635	119,310	-29
Argentina	18,531	14,136	24,963	+77
SUBTOTAL	1,470,326	1,536,537	1,501,002	-2

Whey Products Exports Jan. – Dec. (volume, MT)

Country	2011	2012	2013	% chg
EU-28	472,445	508,842	533,766	+5
US	450,358	467,855	495,130	+6
Argentina	69,017	64,549	76,321	+18
Australia	33,192	46,368	37,459	-19
NZ	29,995	33,676	24,004	-29
SUBTOTAL	1,055,007	1,121,290	1,166,740	+4

Cheese Exports Jan. – Dec. (volume, MT)

Country	2011	2012	2013	% chg
EU-28	673,001	767,612	787,440	+3
US	224,554	259,852	316,558	+22
NZ	252,858	305,647	276,885	-9
Australia	167,606	163,015	163,385	+0
Argentina	60,105	54,088	51,175	-5
SUBTOTAL	1,378,124	1,550,214	1,595,859	+3

Lactose Exports Jan. – Dec. (volume, MT)

Country	2011	2012	2013	% chg
US	311,845	306,984	341,748	+11
EU-28	144,435	151,978	151,859	-0
NZ	19,159	20,553	26,605	+29
SUBTOTAL	475,439	479,515	520,212	+8

Butterfat Exports Jan. – Dec. (volume, MT)

Country	2011	2012	2013	% chg
NZ	410,335	460,165	458,751	-0
EU-28	116,197	116,301	117,206	+1
US	62,648	46,115	90,734	+97
Australia	38,559	51,065	48,052	-6
Argentina	26,572	20,509	17,692	-14
SUBTOTAL	654,311	694,155	732,544	+6

WMP Exports Jan. – Dec. (volume, MT)

Country	2011	2012	2013	% chg
NZ	1,109,635	1,261,278	1,291,460	+2
EU-28	388,092	385,993	374,387	-3
Argentina	200,630	200,739	182,487	-9
Australia	116,149	109,096	96,101	-12
US	21,555	20,933	39,145	+87
SUBTOTAL	1,836,061	1,978,039	1,984,024	+0

Sources: USDA, Global Trade Atlas

U.S. dairy export data is just a click away!

For the latest export trade data, click [here](#).

For more information about the resources provided by the U.S. ingredients program at USDEC, or to learn the latest information on dairy-related research and information, visit www.innovatewithdairy.com.

To view a current list of USDEC members, click [here](#).



Export Profile is published by the U.S. Dairy Export Council (USDEC), 2101 Wilson Blvd., Suite 400, Arlington, VA 22201, USA, (703) 528-3049, FAX (703) 528-3705, website www.usdec.org.

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