

U.S. DAIRY PROCESSING IS GOING GLOBAL

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LET'S TAKE A 30,000-FOOT VIEW

What have been the two hottest topics generating the most letters, phone calls, and emails the past five years?

1. Taildocking

2. Canada & the U.S. as it relates to dairy trade & processing

That discussion dried up after running the editorial, "Like a sponge, Canada soaks up U.S. milk" Since then, we only fielded one communication outside of a some correspondence with Congressional leaders.

LET'S TAKE A 30,000-FOOT VIEW WE NEED TO ANALYZE THE U.S.

“If you ask any international dairy company or co-op CEO:

Where (country) do you want to expand your business?

Audience: What are your answers?

LET'S TAKE A 30,000-FOOT VIEW WE NEED TO ANALYZE THE U.S.

Where do dairy companies and co-ops want to expand?

It's not New Zealand, the world's largest dairy exporter.

That's because Fonterra runs the show there with 90-plus percent market share.

It's not the European Union, the world's second largest collective dairy exporter.

The continent has land constraints and significant regulatory burden even after quota has been lifted.

It's not Canada — Diddo on Europe's dairy regulations and then there's supply management that places a muffler on milk.

LET'S TAKE A 30,000-FOOT VIEW WE NEED TO ANALYZE THE U.S.

You guessed it — It's the United States

As more international companies enter the U.S. marketplace, those entities bid up the prices for domestic dairy assets and make it more expensive for domestic players.

There are a number of reasons that international companies want to do business in the U.S.

- 1. We have a steady stream of milk that keeps growing.**
- 2. Stainless prices and modern processing costs are sky high.**
- 3. It's cheaper to buy existing assets and market share.**

Question: Is this a fair of assessment of the marketplace?

Potential answer: Let's look at the facts

LET'S LOOK AT DAIRY PROCESSING 1996 TOP PROCESSORS

What did dairy sales look like in 20 years ago?

- 1. Kraft Foods, \$3.9 billion in the U.S., \$16 billion worldwide**
- 2. Dean Foods, \$1.6 billion**
- 3. Land O' Lakes, \$1.53 billion**
- 4. Mid America Dairymen, \$1.41 billion**
- 5. The Kroger Company, \$1.38 billion**
- 6. Schreiber Foods, \$1.36 billion**
- 7. AMPI, \$1.21 billion**
- 8. Leprino, \$1.2 billion**
- 9. Prairie Farms, \$1.19 billion**
- 10. Conagra, \$1.08 billion, included Beatrice Cheese**

Source: Dairy Foods Magazine

LET'S LOOK AT DAIRY PROCESSING 2006 TOP PROCESSORS

What did dairy sales look like in 10 years ago?

1. Dean Foods, \$10.1 billion, (No. 2 in 1996)
2. Kraft, \$4.3 billion, (No. 1 in 1996)
3. Saputo, \$3.8 billion, (entered U.S. market in 1997)
4. Land O'Lakes, \$3.4 billion, (No. 3 in 1996)
5. Schreiber Foods, \$3.3 billion, (No. 6 in 1996)
6. HP Hood, \$2.3 billion, (No. 27 in 1996)
7. Leprino, \$2.2 billion, (No. 8 in 1996)
8. DFA, \$2.17 billion (did not exist in 1996)
9. Agropur Co-op, \$2.13 (only 1 U.S. plant)
10. The Kroger Company, \$2.1 billion (No. 5 in 1996)

Off the Top 10: AMPI and Prairie Farms

Source: *Dairy Foods Magazine*

LET'S LOOK AT DAIRY PROCESSING 2016 TOP PROCESSORS

What did dairy sales look like last year?

1. Nestlé USA, \$12.1 billion (No. 29 in 1996; No. 35 in 2006)
2. Dean Foods, \$7.7 billion (No. 2 in 1996; No. 1 in 2006)
3. Saputo, \$7.3 billion, (NR 1996; No. 3 in 2006, 24 U.S. plants)
4. DanoneWave, \$6 billion (No. 24 in 1996; No. 24 in 2006)
5. KraftHeinz, \$5.6 billion (No. 6 in 1996; No. 2 in 2006)
6. Schreiber Foods, \$5 billion (No. 6 in 1996; No. 5 in 2006)
7. Agropur, \$4.5 billion (NR 1996; No. 9 in 2006, 11 U.S. plants)
8. DFA, \$4.2 billion (did not exist in 1996; No. 8 in 2006)
9. Lactalis American Group, \$3.9 billion
10. Land O'Lakes, \$3.8 billion, (No. 3 1996; No. 4 2006)

DFA and LOL at their lowest rank, Agropur heads Co-ops

Source: *Dairy Foods Magazine*

LET'S LOOK AT DAIRY PROCESSING HOW MANY FOREIGN OWNED?

What did dairy sales look like in 2016?

1. Switzerland: Nestlé USA, \$12.1 billion
3. Canada: Saputo, \$7.3 billion
4. France: DanoneWave, \$6 billion
7. Canada: Agropur, \$4.5 billion
9. France: Lactalis American Group, \$3.9 billion
16. Mexico: Lala Group, \$2.7 billion
23. Ireland: Glanbia Nutritionals, \$1.8 billion
26. England: Unilever, \$1.7 billion
30. France: Savencia, \$1.4 billion
40. New Zealand: Fonterra, \$874 million
41. Switzerland: Emmi American Divison, \$836 million
49. France: Bel Brands, \$603 million

LET'S LOOK AT DAIRY PROCESSING FOREIGN DAIRY OWNERSHIP

In 2016 . . .

- **12 of the top 50 U.S. dairy processors had headquarters outside the United States.**
- **These “Foreign 12” held 111 processing plants in 2016.**
- **Grew by 72 plants in one decade (only 39 in 2006).**
- **2016 sales ranged from \$12.1 billion to \$603 million.**
- **2006 sales ranged from \$1.45 billion to \$300 million.**
- **Foreign interesst may process 11 to 12 percent of U.S. milk**
- **When combined with foreign-owned grocers, international interests could control up to 25 to 28 percent of U.S. milk.**

Source: Communications with Roger Cady, Elanco

WHAT ABOUT MIDWEST CO-OPS? GROWING, BUT NOT AS FAST

Land O'Lakes:

1996, No.3 at \$1.53 billion

2016, No. 10 at \$3.8 billion

Prairie Farms:

1996, No. 9 at \$1.19 billion

2016, No. 15 at \$2.9 billion

AMPI:

1996, No. 7 at \$1.2 billion* portion now in DFA

2016, No. 27 at \$1.6 billion

Source: *Dairy Foods Magazine*

WHAT ABOUT MIDWEST CO-OPS? GROWING COMPLEXITY

Foremost Farms:

1996, No. 11 at \$1.07 billion

2016, No. 28 at \$1.5 billion

Only one of these four remains in the Top 10, at No. 10.

Organic Valley:

2016, No. 45 at \$705 million

SOLD OR MERGED

Alto Dairy Cooperative

1996: No. 47 at \$294 million

Swiss Valley Farms

1996: No. 48 at \$273 million

Source: *Dairy Foods Magazine*

WHERE DOES THE UPPER MIDWEST FIT IN?

**This is a Western Wisconsin Ag Lenders Meeting (WI & MN)
With that in mind, who has a larger dairy industry?
Canada or . . . Wisconsin plus Minnesota?**

Farms: Canada: 11,280

Farms: Wisconsin and Minnesota: 12,870

Cows: Canada: 959,100

Cows: Wisconsin and Minnesota: 1,734,000

**That means the Upper Midwest should have resources to invest
in its dairy sector.**

However, there is more at play.

WHERE DOES THE UPPER MIDWEST FIT IN?

We all know about last spring's lost milk markets?

Why was it such a big issue?

- 1. Large volumes of milk.**
- 2. Instant border closing to a class of dairy products**

What about picking up the pieces?

Let's talk May 1989 versus May 2017

NOW BACK TO THE QUESTION

Question: Do Canada and European view the U.S. as part of their long-term growth plan?

Answer: Yes, based on U.S. activity. It's already happening.

Question: Have U.S. dairy processors and co-ops kept pace on investment in new facilities?

Answer: No, based on foreign investment & market share.

Question: Where do Upper Midwest co-ops and dairy leadership fit into the picture?

Answer: Good question. We need a robust discussion.

WHERE DOES CANADA FIT IN?

On the plus side:

First, let's acknowledge that Saputo and Agropur have been, for the most part, good players in the dairy community.

Second, their investment has helped soak up milk.

1996: 154 billion pounds of milk from 9.35 million cows

2016: 212 billion pounds of milk from 9.38 million cows

That's 37 PERCENT MORE MILK in 20 years

WHERE DOES CANADA FIT IN?

On the concerning side:

Let's remember that their first loyalty to their home office.

For example, U.S. dairy farmers cannot become members of the Agropur and that speaks to loyalty and returns to membership (profits).

Foreign interests have less at stake in U.S. dairy policy, and perhaps stand counter to it.

WHERE DOES CANADA FIT IN?

Simply said, Canadian co-ops and companies cannot grow at home because of supply management. That makes the U.S., and the Upper Midwest a natural fit.

Let's look at Agropur.

- 1. It's rapidly approaching the tipping point of being a U.S. cooperative with a home base in Canada. In 2016, 44 percent of sales from its U.S. operations.**
- 2. When counting its sales in Canada AND the U.S., its North America's largest dairy cooperative!**

How did it grow to that level?

WHERE DOES CANADA FIT IN?

AGROPUR GROWS

2008: Purchased Trega Foods, a Wisconsin cheese company

2008: Purchased Schroeder Milk, a Minnesota processor

2009: Purchased Farmland Dairies, a Michigan processor

2009: Purchased Green Meadows Foods, an Iowa processor

2010: Purchased Main Street Ingredients, a Wisconsin processor

2014: Purchased Davisco Foods with plants in Minn., S.D. & Idaho

That purchase doubled its U.S. capacity and raised its global intake 50 percent

That's how Canada's largest co-op views the U.S. market

Again, it now ranks No. 7 among Dairy Foods Top 50!

WHERE DOES CANADA FIT IN?

SAPUTO GROWS

1997: Purchased Stella Foods for \$405 million, 12 plants, 5 states

2003: Purchased ConAgra and its Treasure Cove & Nauvoo Blue brands

2007: Purchased LOL plant, Tulare, Calif., for \$216 million,

2008: Purchased Alto Dairy Co-op, a Wisconsin Co-op

Price \$160 million and soaked up the No. 17 U.S. Co-op

2009: Purchased California's F&A Dairy for \$44.5 million

2011: Purchased Fairmount Cheese in Wis., and N.J., for \$270.5 million

2012: Purchased Morningstar Foods from Dean Foods for \$1.5 billion

2017: Purchased Extended Self-Life products from Southeast Milk Co-op (SMI) for \$47 million. It also purchased Wisconsin-based Betin Cheese with \$118 million in annual sales of goat cheese.

WHERE DOES CANADA FIT IN?

SAPUTO GROWS and GROWS

All told, Saputo spent \$2.6 billion to acquire U.S. market share since 1997. That's just the numbers that could be documented from the company's annual reports.

These days, the Canadian company is really an American dairy processor with headquarters in Canada.

In 2016, Saputo had \$11 billion in revenue.

52.6 percent came from the U.S.

34.8 percent came from from Canada

12.6 percent came from other countries.

That's how Canada's largest dairy company views the U.S. market!

WHAT DOES THIS ALL MEAN?

- 1. Canada's largest companies are playing on both side of the fence as a trade dispute begins simmers.**
- 2. While Canada staunchly defends supply management at home, other countrymen come across the border to acquire much needed milk and market share not found at home . . . Because of its own self-imposed rules.**
- 1. It's a complex situation on dairy trade. Canada likes the abundance of U.S. milk . . . Except when selling dairy products to its citizens.**

WHAT DOES THIS ALL MEAN?

4. **Without Canada's investment, where would our plant infrastructure be in the Upper Midwest?**

5. **That's a good question given that the DFA-MMPA-Foremost-Glanbia plant has yet to be sited based on my information after its initial January 2017 announcement. However, Foremost did announce on its own to build a plant in Greenville, Mich., to receive 6 million pounds of raw milk a day. This is just one example of slow investment and upgrades being made by U.S.**

WHAT DOES THIS ALL MEAN?

6. **Those margins are better with higher profits in Canada due to its supply management system. It's the very reason Canada's two largest dairy processors repeatedly invest here in the U.S. It's because they have the cash and assets to do so.**

WHAT DOES THIS MEAN LONG-TERM?

7. **To be long-term effective marketer at home and on the world stage, U.S. dairy co-ops and domestic processors must retool operations. This requires dynamic leadership.**
8. **The question is will there be enough internal capital and human assets to get the job done?**

WHAT DOES THIS MEAN LONG-TERM?

9. **Where do loyalties lie for international processors?**
First, to their home base.
Second, to their U.S. partners.
Let's discuss some real world examples.

WHAT DOES THIS MEAN LONG-TERM?

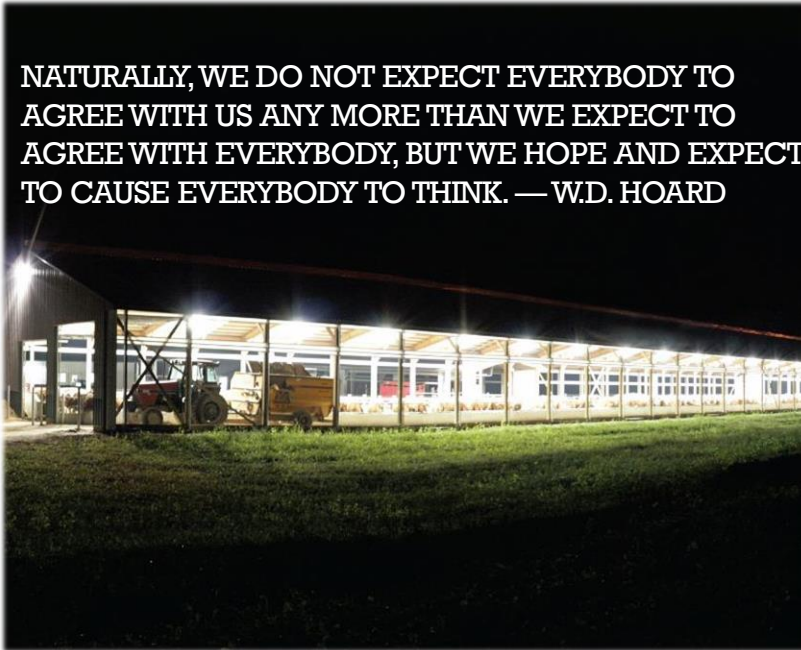
- 10. With minimal investment taking place at home, as compared to Canada and European counterparts, we must broaden our circle for dairy communication. Failure to do so will further fracture the dairy brand in the eyes of consumers because these folks are major players.**

That creates a new paradigm for U.S. dairy farmers.

We now must maintain multiple social licenses

- 1. U.S. consumers, USDA, FDA, EPA, and more.**
- 2. Foreign corporate and consumer demands.**

NATURALLY, WE DO NOT EXPECT EVERYBODY TO AGREE WITH US ANY MORE THAN WE EXPECT TO AGREE WITH EVERYBODY, BUT WE HOPE AND EXPECT TO CAUSE EVERYBODY TO THINK. — W.D. HOARD



QUESTIONS OR COMMENTS?



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