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The European Dairy Chain:
Past, Presence & Future

Past: Future direction of both CAP and WTO is clear, but the pace of progress differs

- CAP: bringing market prices more in line with world market levels....
 - up to the point that the quota system is no longer relevant
-
- WTO: export subsidies and internal market support will be further reduced ...
 - but market access improvement will be a much tougher issue

Past: Implications of the different elements of market liberalisation

Reduction in internal EU support

- Reduction of +/- 20% already agreed could potentially lead to a similar reduction in milk revenues for farmers ...
- ... but a strong performance of cooperative processors on the EU market as well as the global market could limit the reduction in revenues to some 10%

Reduction in export restitutions

- Given Germany's modest self sufficiency rate of 104 % and a strong focus on cheese within the export portfolio, the direct impact of reduced export refunds on German milk revenues is relatively limited

Improved EU market access

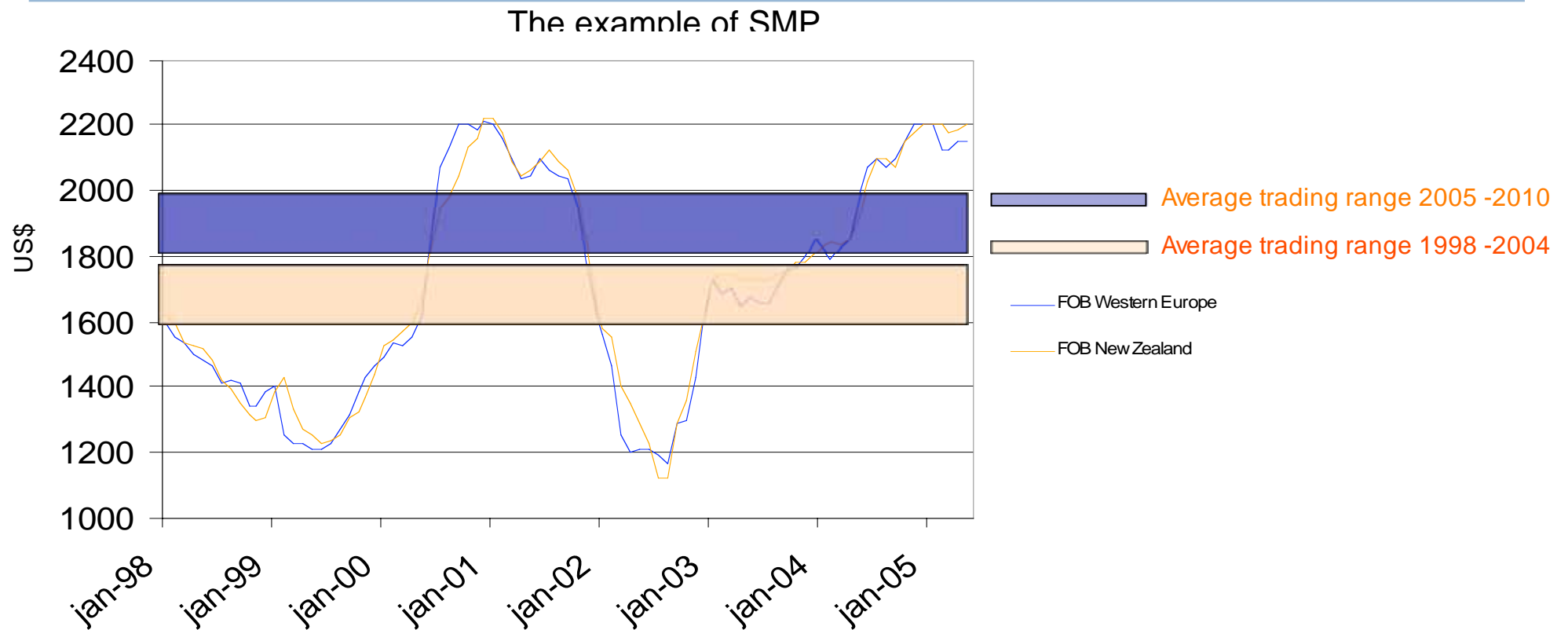
- Possible negative impacts are often overrated
- ... but Germany's relatively large share in internal EU trade of raw milk and semi finished products will be affected

Abolishment of the quota system

- German farmers will probably value the relative stability of prices due to production control quite highly
-, but processors might favour the flexibility to grow their business

Quantifying the impacts of any move towards liberalisation, requires a good understanding of the development of the liberalised global "market price"

Past: The impact of world market price developments



The volatility will not disappear but the average trading range of global commodity prices tends to move upwards in the next five years

Past: Dairy chain needs a solid base in dairy farming

- Efficiency gains will have to be realised in the north-west and east of Germany
- Relationship between co-operatives and their member/suppliers is crucial in turnaround situations

Presence: Surge in global commodity driven by supply / demand imbalance

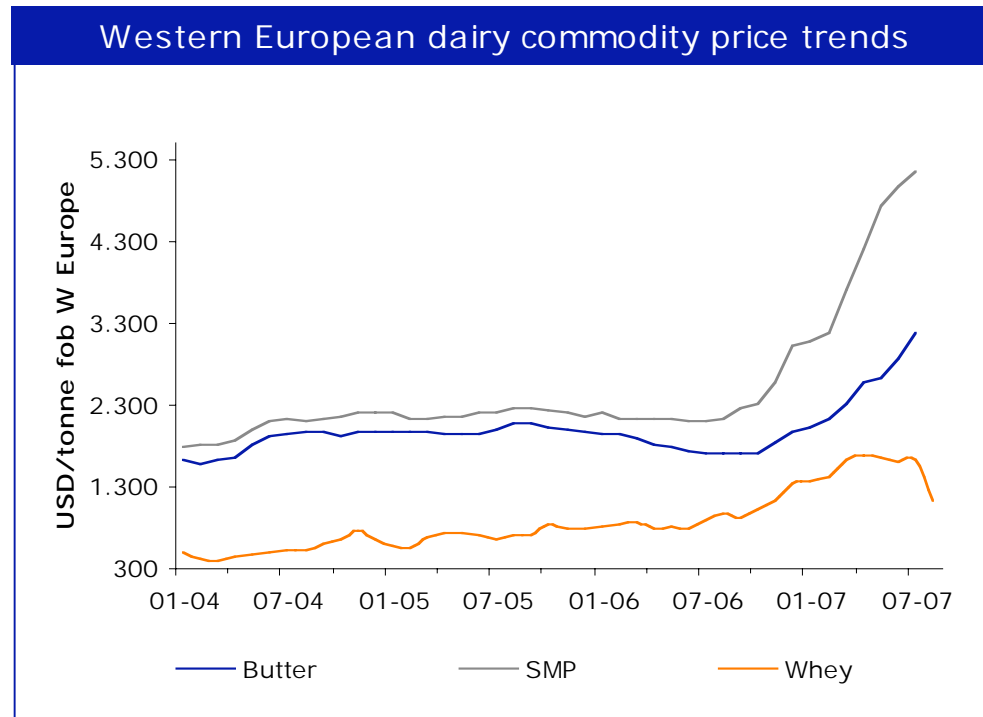
Simultaneous impact of numerous pre-existing factors hugely amplified expected price increases

Demand increased steadily.....

CAGR: 2.6%
Historic growth
'00-'05

Explosive growth as emerging markets discover dairy (eg SMP in China)

Steady growth in large developed markets (eg cheese and yoghurt in Europe)



...supply lagged behind

CAGR 0.8%
Historic growth
'00-'05

Minimal growth in developed markets (quota system in EU, US Herd Retirement Scheme)

Rise of biofuels

Rising input costs

Environmental

Disappearance of EU and US SMP and butter stocks at end of 2006 kick started exponential price rises

Source: ZMP, Rabobank

Future: Prices will remain high for some time

Demand imbalance likely to remain in short term; new equilibrium should return over medium term

Demand will continue to rise.....

**CAGR 2.5%
Forecasted growth
'07-'12**

Continued demand growth in emerging markets (China, India, Brazil, Mexico)

High oil prices enable government subsidies to support demand (Russia, Middle East, North)

Developed world unlikely to be dented by price rises

Potential drop in demand in poorer countries as prices rise beyond incomes

...supply continues to lag behind

**CAGR 1.5 %
Forecasted growth
'07-'12**

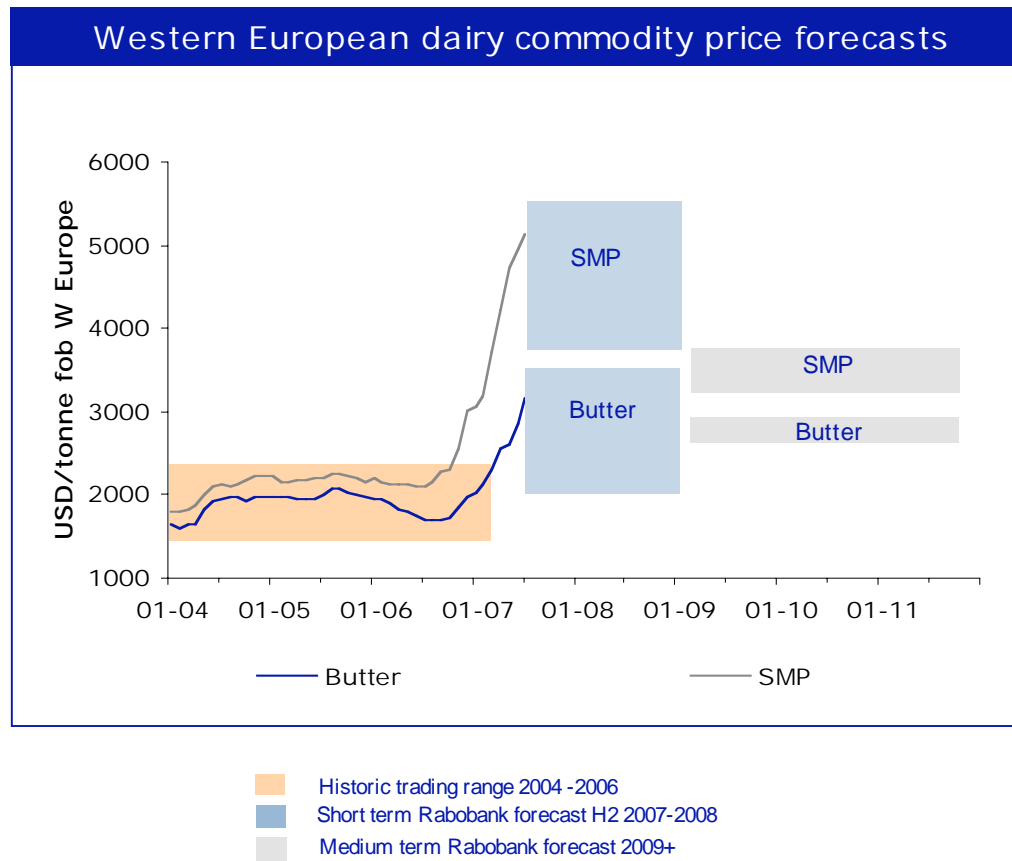
Limited growth potential in major exporting countries

Practical constraints (availability of cows, lead time to production)

Competing demands for land

Continuing high input prices (eg feed)

Continuing demand for biofuels



Source: ZMP, Rabobank

Note: Demand potential is estimated at a CAGR of 2.5%, albeit supply will be challenged to follow suit, depressing demand growth reaching its full potential

Future: Chain relationships are changing



- Farmers are at the receiving end

Voorschotmelkprijs

op basis van gehalten 2006: 4,435 procent vet en 3,483 procent eiwit, incl. BTW, excl. heffingen/toeslagen
in euro per 100 kg melk



- Raw milk market has turned into a sellers market

- Product focus is of only limited relevance as good returns in one product group eventually also feed into other products
- Main change in performance level comes from the strongly improved returns in the commodities segment in the next 2 years compared to the branded part of the business
- putting some pressure on the players in the branded side, as higher raw material costs can not always be fully transferred to the customer
- Raw milk will remain scarce for some time, making life complicated for processors looking for expansion

- The negotiation balance has changed
- ... but raw material cost rises can not always be transferred

Future: Co-operatives need to re-invent themselves

- Possible growing milk supply from their member base following relaxation of the quota system → new production capacity → what product focus?
- The co-operative of the future needs to tie in:
 - loyalty
 - the raw material
 - capital
- There is room for more creativity in capital structures between the member's farm and the co-operative