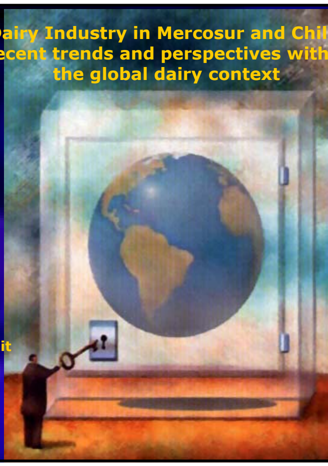
Dairy Industry in Mercosur and Chile, recent trends and perspectives within the global dairy context



World Dairy Summit
Melbourne-Australia

November 2004
Ruben R. Núñez

FEPALE

Ranking of Brazilian and Argentinean Exports

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Product	Production	Export	Notes
Sugar	1º	1º	29% consumption
Orange Juice	1º	1º	82% consumption
Coffee	1º	1º	44%
Soy	2º	1º	38%
Meat	2º	1º	
Chicken	2º	1º	
Tobacco	2º	1º	
Sunflower oil	1º	1º	
Soy oil	3º	1º	
Sunflower	1º	-	
Dairy	6º	-	

Unexploited areas still available for agriculture-
106
(12.5%)

✓World largest alcohol exporter
✓Ranks 1st in tanned hide and leather shoes
✓Leader in chicken and bovine meat exports

Source: SPA/MAPA (Brazilian Agriculture in figures)

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"Those intelligent countries, societies and companies who are able to read the writing on the wall before others see the wall, they guarantee themselves competitive success…"
John D. Kasarda

It seems like in South America we have been looking at the wall much more than at the writing

Agenda

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- **Production / Offer**
- **Consumption / Demand**
- **International trade**
- **Multilateral business rounds (WTO, etc.)**
- **Summary**

World Production

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- **578 million tons of cow and buffalo milk produced in 2003**
- **Only 7% was traded internationally.**
- **93% corresponded to productions consumed locally.**
- **Domestic market is 13 times bigger than international trade.**

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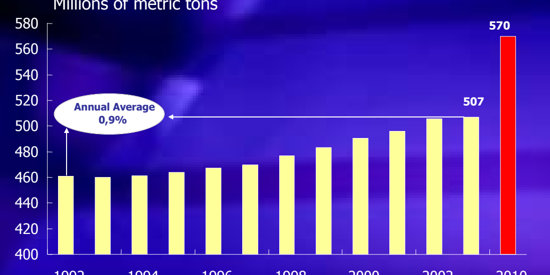
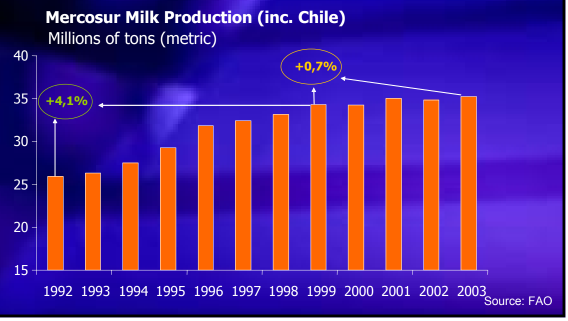
World production of cow milk is showing a steady (though moderate) upward tendency for over ten years...

Milk world production
Millions of metric tons



Source: FAO

In MERCOSUR (including Chile), milk production showed a strong expansion in the 90s, but the economic crisis experienced in the region, together with some climatic problems, caused a significant loss of dynamism during the last years.



Source: FAO

That loss of productive dynamism was mainly due to an important drop in production in Argentina and Paraguay.

- Brazil was the only country of the region to maintain a steady rate of growth during the last years.

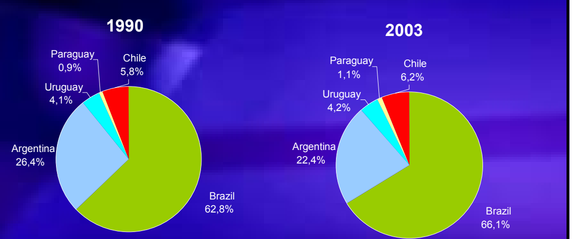
Milk Production
Annual Average Variation

	1990-1999	2000-2003
Brazil	3,1%	4,4%
Argentina	6,0%	-7,2%
Uruguay	4,9%	0,3%
Paraguay	7,8%	-3,9%
Chile	4,5%	1,4%
TOTAL	**4,1%**	**0,7%**

Source: FAO

Likewise, in the last 13 years, Brazil participation in regional production has increased considerably, to the detriment of the participation of Argentina.

- The relative role of the other countries of the region (Uruguay, Chile and Paraguay) has been fairly stable in the period of reference (1990-2003).



Source: FAO

The increase in world production was boosted by the growth of Oceania and the underdeveloped regions (Southern hemisphere).

- In North America, dairy production had a very modest rate of growth in the last decade, while Europe (main productive region), experienced a noticeable contraction.

World milk production per region
Millions of metric tons

	1992	%	2003	%	Annual Average Variation 1992-2003	1992-1999	2000-2003
Africa	15	**3,3%**	21	**4,2%**	3,1%	3,2%	2,9%
Asia	74	**16,0%**	105	**20,7%**	3,2%	3,3%	3,0%
North America	83	**18,1%**	95	**18,7%**	1,2%	1,3%	1,1%
Central America and The Caribbean	3	**0,7%**	4	**0,8%**	2,1%	2,1%	2,0%
South America	34	**7,5%**	46	**9,1%**	2,7%	3,7%	0,9%
Mercosur+Chile	*26*	5,6%	35	7,0%	*2,8%*	*4,1%*	*0,7%*
Others	9	1,9%	11	2,2%	*2,4%*	*2,7%*	*1,8%*
Europe	236	**51,2%**	211	**41,5%**	-1,0%	-1,6%	-0,1%
European Union (15)	*122*	*26,5%*	*122*	*24,0%*	*0,0%*	*0,1%*	*-0,2%*
Rest of Europe	*114*	*24,7%*	*89*	*17,5%*	*-2,2%*	*-3,6%*	*0,2%*
Oceania	15	**3,3%**	25	**4,9%**	4,7%	5,2%	4,0%
WORLD TOTAL	**461**	**100%**	**507**	**100%**	**0,9%**	**0,7%**	**1,2%**

	2010	%
	570	100%
Annual growth-	1,5%	

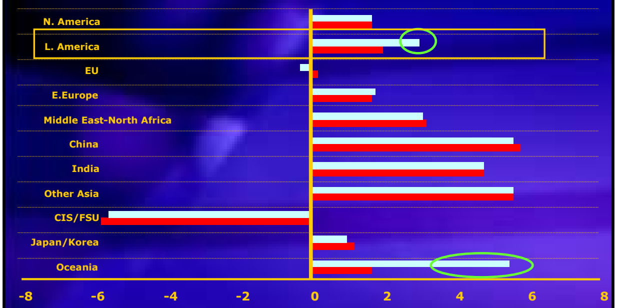
In some aspect, and as a conclusion within the production scheme, all estimations forecast a persistent growth in production in a rate superior to that of the last decade, basically centered on those countries that keep low cost production (South America – Oceania), or, in some cases like India, Pakistan, China and Brazil, mainly to meet an increasing domestic demand. Rise in production in South America and Oceania will be entirely addressed to exterior trade, toward development of their exports.

Production is also growing faster in South America, Oceania and in non-traditional countries

1991 – 2000 CAGR, Percent

Increasing demand will continue to be met mainly from local supply

Production and consumption growth 1991-2000



We expect this divergence in production trends between north and south to continue through the next decade. But again if, in an international basis, trade is expected to reach 7 – 8% of total production, all this growth will be destined to meet internal demand.

A greater liberalization of the dairy business could have a tremendous impact in production and trade and, particularly, it would accelerate the rate of growth.

Consumption

Demand grows in every region: analysing from demand

	Consumption 1999 (mn tones milk eq)	Annual Average Change		Population annual rate of growth
		1997 - 1999	2000 – 2006 est	
World	**556**	**0.6%**	**2%**	**1.1%**
High Income regions	217	1.2%	1 %	0.3 %
Western Europe	118	0.8 %	1 %	0.1 %
USA + Canada	81	1.8 %	1 %	0.7 %
Japan	11	0.5 %	1 %	0.1 %
Australia + New Zealand	7	0.7 %	0.5-1 %	0.7 %
Low and middle income	**314** **56%**	**0.5 %**	**2 %**	**1.2 %**
Central Europe	36	- 0.8 %	1 %	0.2 %
Russia + Ukraine	66	- 2.8 %	1 %	0.5 %
South Asia	99	4.3 %	1.3 %	1.5 %
Latin America	66	2.4 %	4 %	1.3 %
Middle East + North Africa	29	1.5 %	2.3 %	1.8 %
Sub-Saharan Africa	18	1.0 %	1 %	2.2 %
Other	**25**	**1.0 %**	**1 %**	

Source: Rabobank

Dairy products consumption is growing in all regions. However, in terms of per capita consumption, there are substantial differences among the different regions.

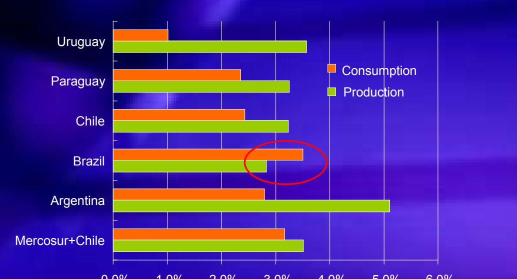
Dairy Products Consumption (excluding butter)

	1991 kg/per capita	2002 kg/per capita	Annual Average Growth 1991-1999	2000-2002
Africa	35,3	37,2	0,2%	2,2%
Asia	32,4	42,1	2,8%	0,7%
Canada and United Estates	251,2	256,5	0,0%	1,0%
Central America and The Caribbean	82,8	96,6	1,4%	1,6%
South America	100,6	111,0	1,6%	-2,1%
Europe	227,8	214,4	-1,0%	0,6%
Oceania	186,3	192,3	-0,1%	2,0%

Source: FAO

In the 90s, dairy consumption grew significantly in the MERCOSUR, within the framework of a strong development of production…

- Production in countries of the region (except for Brazil), developed at a higher rate than consumption, which resulted in an increase in exportations.

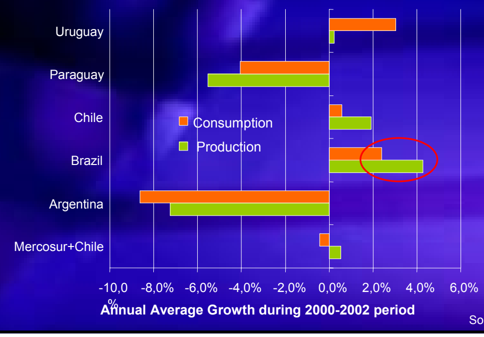


Annual Average Growth during 1992-1999 period

Source: FAO

...but the retraction in production observed during the economic crisis of the last years modified the situation.

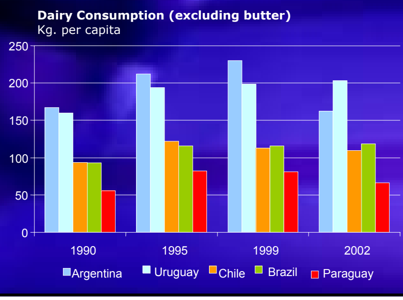
- However, Brazilian dairy industry dealt with the crisis successfully, and growth in production exceeded that of consumption in 2000-2002 period.



Source: FAO

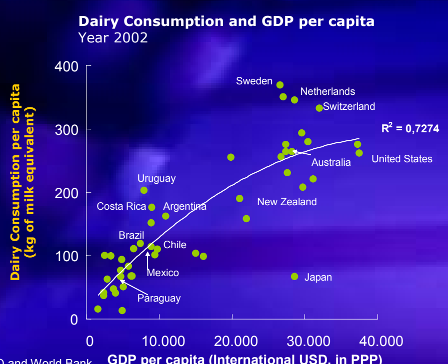
Nevertheless, levels of per capita dairy consumption differ substantially towards the interior of the region.

- Argentina and Uruguay present levels of dairy consumption quite similar to those prevailing in the developed countries.
- On the contrary, per capita dairy consumption in Paraguay is remarkably low.



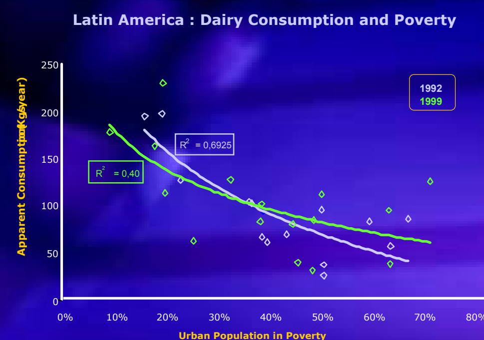
Source: FAO

Levels of per capita dairy consumption and purchasing power of population are strongly connected.



Source: FAO and World Bank

However, income distribution also contributes to explain consumption.



World Economy

	2002 GDP	2003 GDP	2004 GDP	2005 GDP	2005 Imports	2006-09 GDP	2006-09 Imports
World Economy	3,0%	3,9%	4,6%	4,4%	6,6%	4,2%	6,1%
Advanced Economies	1,7%	2,1%	3,5%	3,1%	5,4%	2,9%	5,4%
Emerging Economies	4,6%	6,1%	6,0%	5,9%	9,4%	5,7%	8,4%
Africa	3,5%	4,1%	4,2%	5,4%	8,5%	4,9%	5,1%
Asian Countries	6,4%	7,8%	7,4%	7,0%	13,1%	6,8%	11,1%
Middle East	4,2%	5,4%	4,1%	5,0%	5,1%	5,0%	5,7%
Latin America	-0,1%	1,7%	3,9%	3,7%	6,4%	3,5%	6,4%

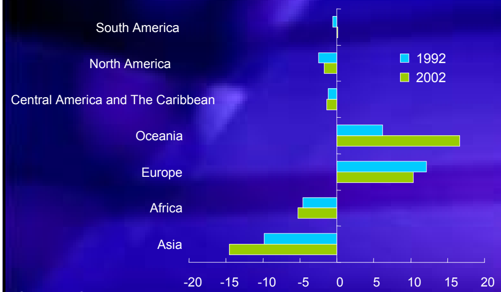
Source: International Monetary Fund

GDP Imports

International Trade

Oceania and Europe have traditionally shown clear favorable dairy balances, while Asia and Africa show the largest deficit.

Dairy Trade Balance
Millions of metric tons (milk equivalent)



Source: FAO

Within MERCOSUR, all members of the bloc strongly expanded their dairy exports during the 1992-2002 period, while imports dropped in some countries (due to economic crisis of the last years).

Dairy Exports 1/

	Thousands of metric tons				Annual Average Variations		
	1992	%	2002	%	1992-2002	1992-1999	1999-2002
MERCOSUR +CHILE	**270**	**100**	**2.226**	**100**	**23,5%**	**134,9%**	**0,5%**
Argentina	70	26	1.426	64	35,3%	155,2%	-1,9%
Brazil	24	9	108	5	16,0%	87,5%	123,8%
Uruguay	161	60	558	25	13,2%	119,6%	-0,3%
Paraguay	0	0	1	0	-.-	-.-	330,2%
Chile	14	5	133	6	24,9%	133,9%	6,1%

Dairy Imports 1/

	Thousands of metric tons				Annual Average Variations		
	1992	%	2002	%	1992-2002	1992-1999	1999-2002
MERCOSUR +CHILE	**978**	**100**	**1.439**	**100**	**3,9%**	**112,0%**	**-12,6%**
Argentina	439	44,9	25	1,8	-24,8%	74,3%	-22,8%
Brazil	285	29,2	1.286	89,4	16,3%	131,7%	-13,1%
Uruguay	2	0,2	4	0,3	6,3%	114,4%	-10,5%
Paraguay	30	3,1	29	2,0	-0,5%	84,6%	45,5%
Chile	221	22,6	94	6,6	-8,1%	92,2%	-9,0%

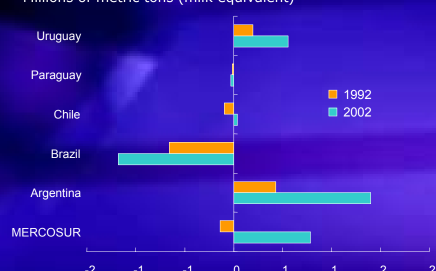
1/ All types of milk included

Source: FAO

Likewise, the region achieved a favorable dairy balance in the last years.

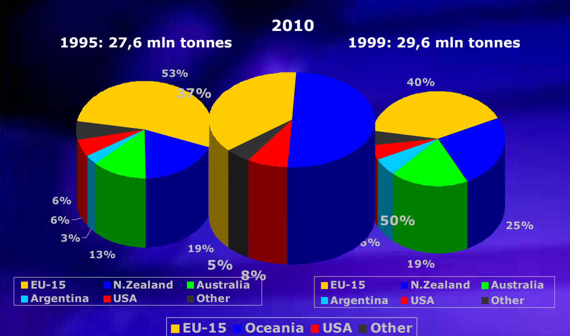
- Uruguay and Argentina largest surplus overcompensated the Brazilian deficit.

Dairy Trade Balance
Millions of metric tons (milk equivalent)



Source: FAO

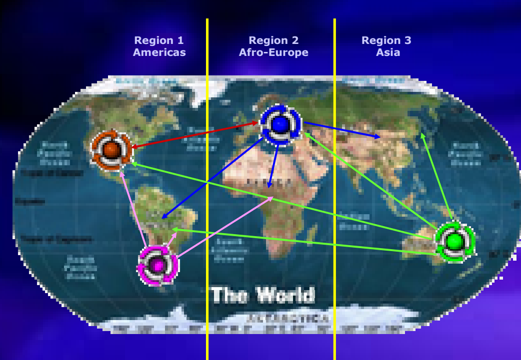
Shifts in world dairy market shares.



Source: Productschap Zuilvel/Rabobank International, 2001

Within this international trade context, only a few countries and blocs of countries will continue to be net exporters, such would be the case of Oceania and South America (Argentina, Chile, Uruguay and eventually Brazil) and also India, who will start having exportable balances.

Emerging-trading zones



"The world economy is slowly but steadily organizing around a series of consolidated and important blocs: the economic unions. These blocs change the relationships of power between regions and countries, between members and non-members; they are very similar to the "nation-states" which showed up during the XVIII century: supporters of free commerce internally, but strongly protectionist externally. European Union is a clear example. NAFTA is moving amazingly quickly. MERCOSUR, with an enormous potential of growth and fuelled by Brazil, the ASEAN (Association of South East Asian Nations) with China as its dominant member. The three island economies –Japan, the United Kingdom and Australia -, who belong to none of these unions and are discussing which to join."

P. Drucker
2004

Multilateral business rounds within the WTO

- We do not believe there would be any substantial results from this Doha Round complex process until 2007 or perhaps 2008.
- Most of developing countries with high poverty levels have agriculture as their main wealth drive, and a progress in this aspect would have a chain effect throughout the exchange of products around the world.
- Main aspects under discussion
  - Elimination of export subsidies.
  - Markets access.
  - Elimination of internal aids.
  - Indications of origin, role of the food CODEX, food aids, sanitary aspects and environmental care issues.

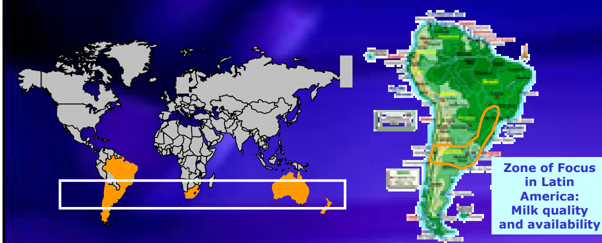
- From a different perspective, the big question here is whether the world progresses towards a system of multilateral agreements or bilateral agreements or a combination of both.
- NAFTA, possibility of ALCA, an agreement European Union/MERCOSUR, the Free Trade Agreement (TLC) celebrated between Australia and the United States, the cases of Chile, Jordan and Israel, well, a systematic strive of the countries to intensify their business relationships with high income and high consumption blocs.

If we look at the strategies of the big corporations within the industry, we see that 16 of the most important and largest dairy companies of the world are European, and globalization is a characteristic of the model of performance of world economy. Main dairy companies are located in the main consumption markets, developed markets (in terms of volume and price). In the next decade the own logic of model growth will position them in the area where the other paradigm of the system operates: low cost of milk production and domestic markets with high potential of growth.

Strategy of large corporations

Summary

Production zone: where to focus



Mercosur: a long term sourcing of dairy products

Supply/Demand balance
In the last 10 years Mercosur has outgrown demand creating significant potential for export growth. It is expected that in 2007 there will be a surplus of over 3 million MT in the international trade, a figure that almost doubles that of 2004 (Brazil case)

Milk Cost
Milk cost comparable to New Zealand with healthy structure.
Animal productivity has doubled in the last decade but remains low. Significant room for improvement without affecting cost efficiency.

Infrastructure
Infrastructure improving and investment progressing (Brazil, Argentina).
High level of multinational influence. Local companies undertaking huge investments for the next five years.

Mercosur: a long term sourcing of dairy products

Macroeconomic & political pre-conditions
Industry deregulated with some key players acting as leaders. Agriculture export starts to be regarded as strategic for economic growth.
Excellent track record in other agricultural commodities (Sugar, soy, meat, fruits)

The political map
There is a clear political alignment between Mercosur & Chile since the administration of all the countries belongs to socialist parties with minor differences among them.
Considering NZ and Australia as examples to be followed these countries will implement public policies which encourage the growth of the dairy sector –particularly by local national companies- and its effects as a multiplier of the whole company.

The End