



Dairy Situation and Outlook

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Dairy Situation and Outlook

- Introductory comments
 - Dairy industry at a crossroads
 - Foundations of U.S. & CA dairy being questioned
 - Level of government involvement
 - Dominance of domestic market
- Dairy situation
 - Four factors shaping dairy for next few years
- Price outlook for 2009

Focus on Factors Shaping the California Dairy Industry

- Processing plant capacity
- Milk supply management
- Vulnerability of the Western dairy model
- Export markets

Plant Capacity

- California - an attractive location for plants
 - Milk supply, location, population, make allowance
- But some huge negatives
 - Cost of building and operating plant is higher
 - Reputation for “rolling out the red tape”, not “rolling out the red carpet”
 - Time to obtain building permits is truly legendary
 - Air and water quality regulations

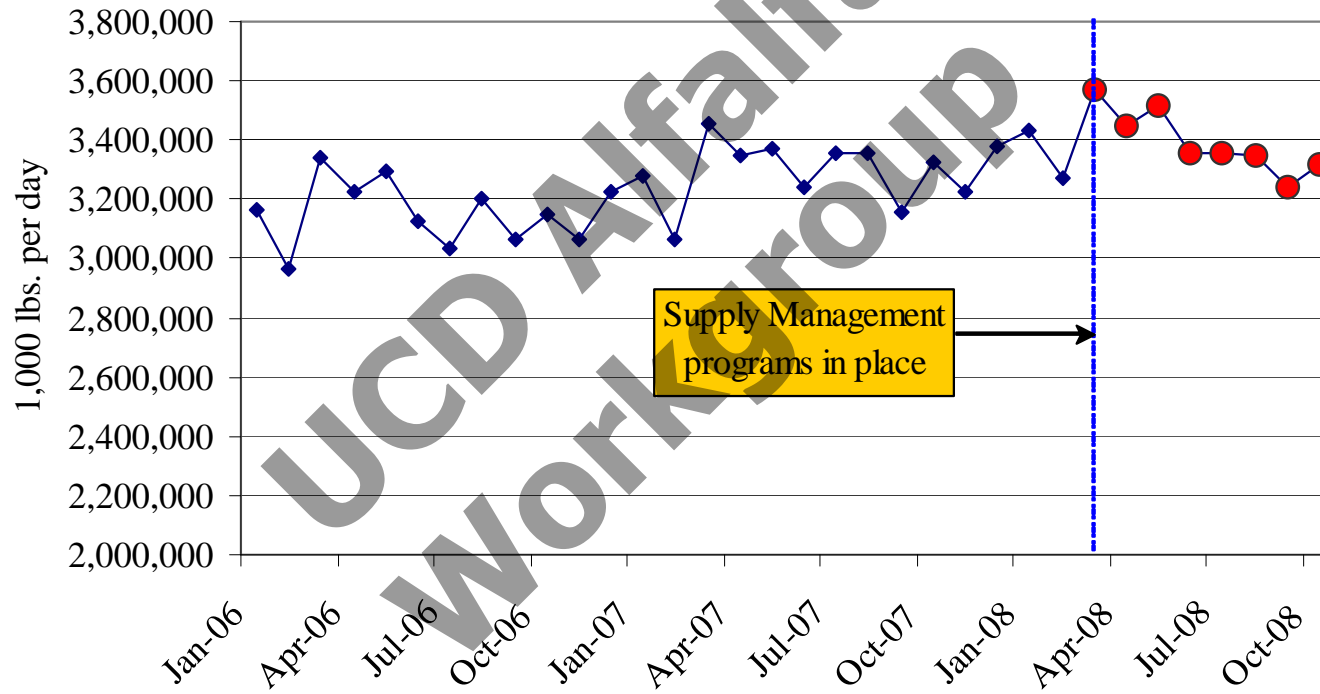
Plant Capacity

- Few bright spots for new or additional capacity
- Also have had closures of milk processing plants in last two years
 - Lost about 12% of processing capacity
- Difficult problem to solve quickly
 - Too many factors out of the control of the dairy industry
- Forced producers to accept new policies, even if somewhat reluctantly

Supply Management

- Historically, dairy producers have not embraced limits on milk production
- Policies started to change in 2007
 - Three major California cooperatives and some proprietary processors implemented supply management programs
 - Purpose – to reduce the amount of milk shipped
 - Potentially significant penalty for overproduction
- Results:
 - Production started to fall off significantly in April 2008
 - Milk production has averaged only about 1% higher since then
 - Year-over-year changes in milk production for July, August and October were negative

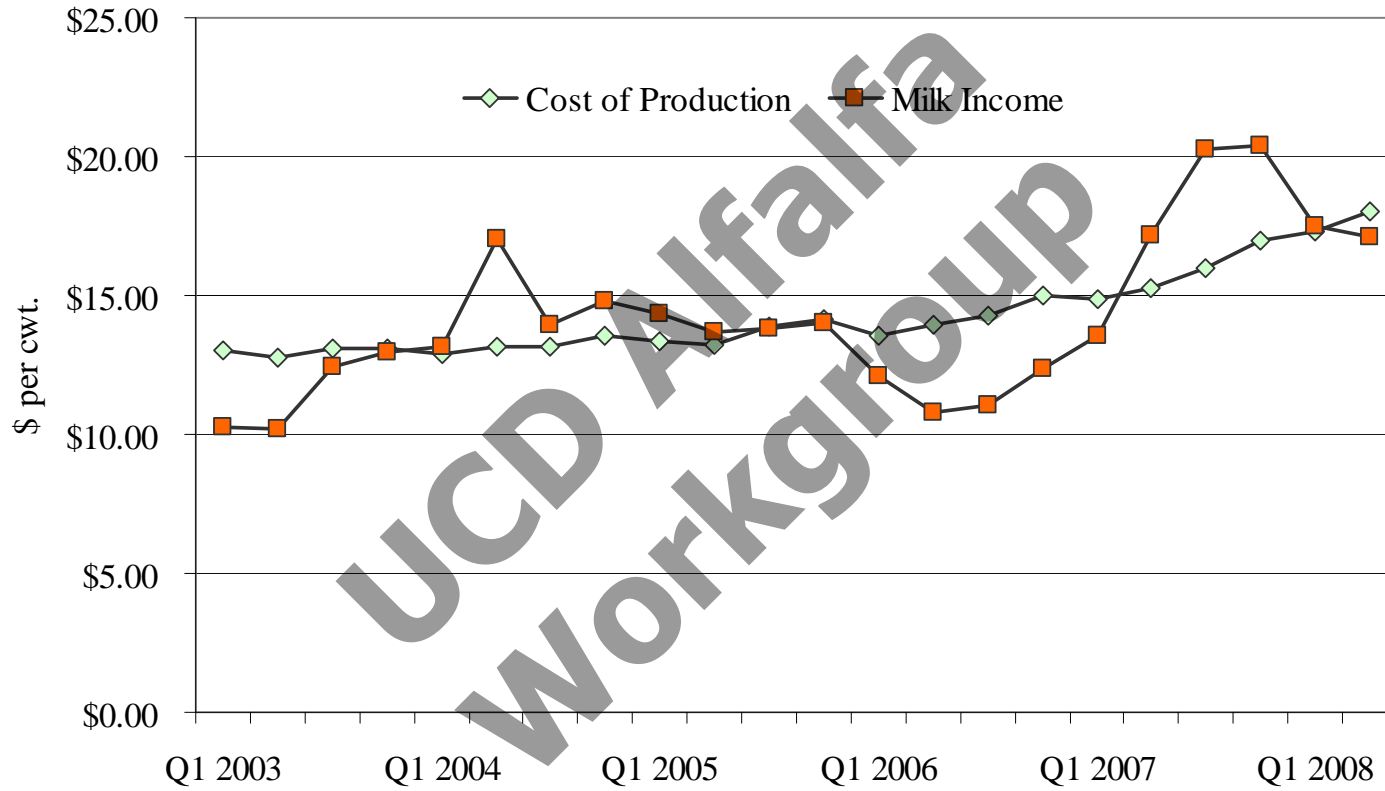
California Milk Production by Month, *January 2006 to October 2008*



Cost of Production

- Feedlot-style dairying a hallmark of CA dairy
- Vulnerability to feed prices exposed in 2007-2008
- Since January 2007:
 - Alfalfa hay price +65%
 - Corn price +45%
 - Cost of all feed used by dairy +44%
 - Cost of producing milk +30%
- Alternative feed rations largely not successful
 - Milk volume or milk components or both affected
 - Profitability unchanged or reduced

Figure 5. Cost of Production vs. Milk Income



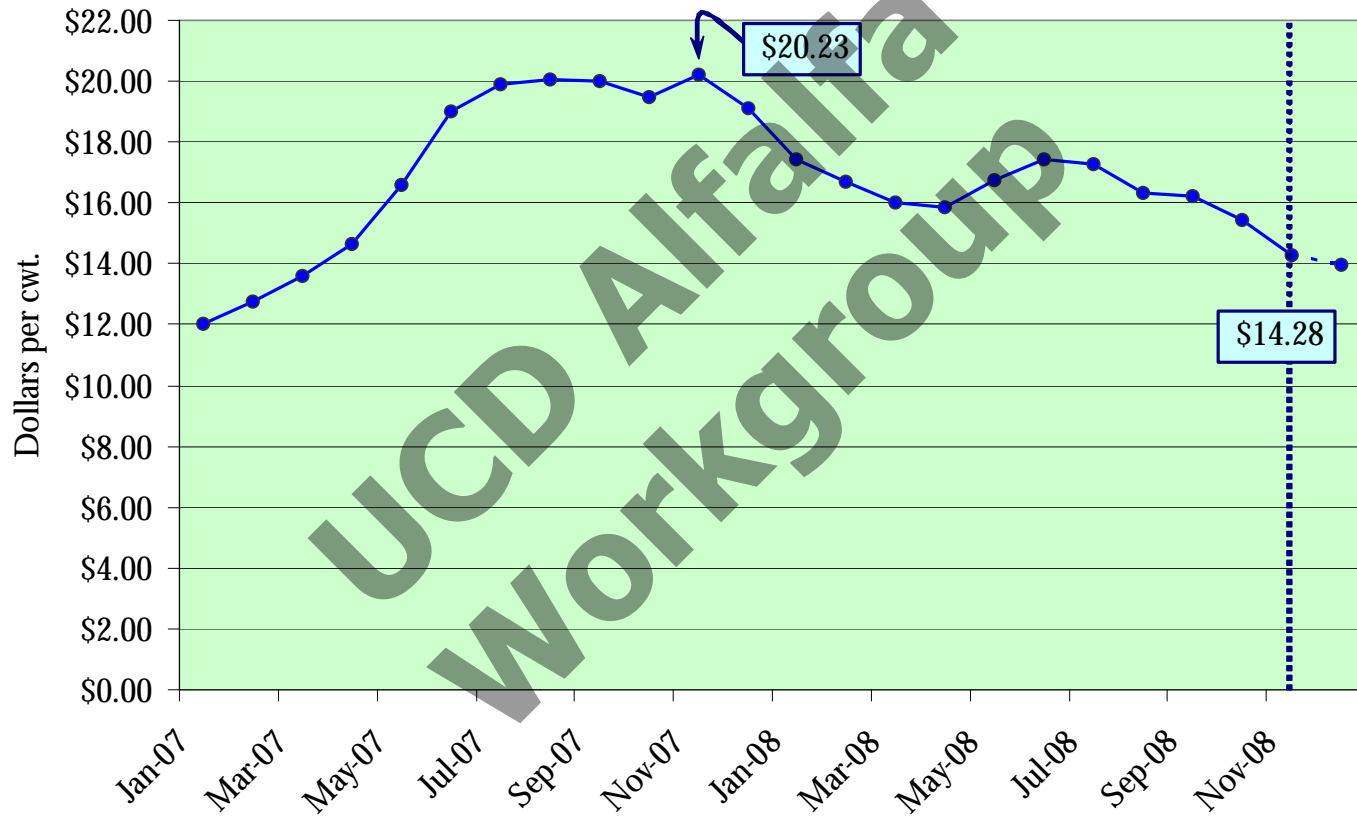
Dairy Product Exports

- CA has not been a reliable international supplier
 - World prices usually below domestic prices
 - Product specifications difficult to meet
- California well-suited to export?
 - Geographically positioned to serve Asian markets
 - State produces mostly storable manufactured products
 - Milk supply is abundant
- Last two years, prices have favored exports
- With global economy changing, will California continue to pursue export markets?

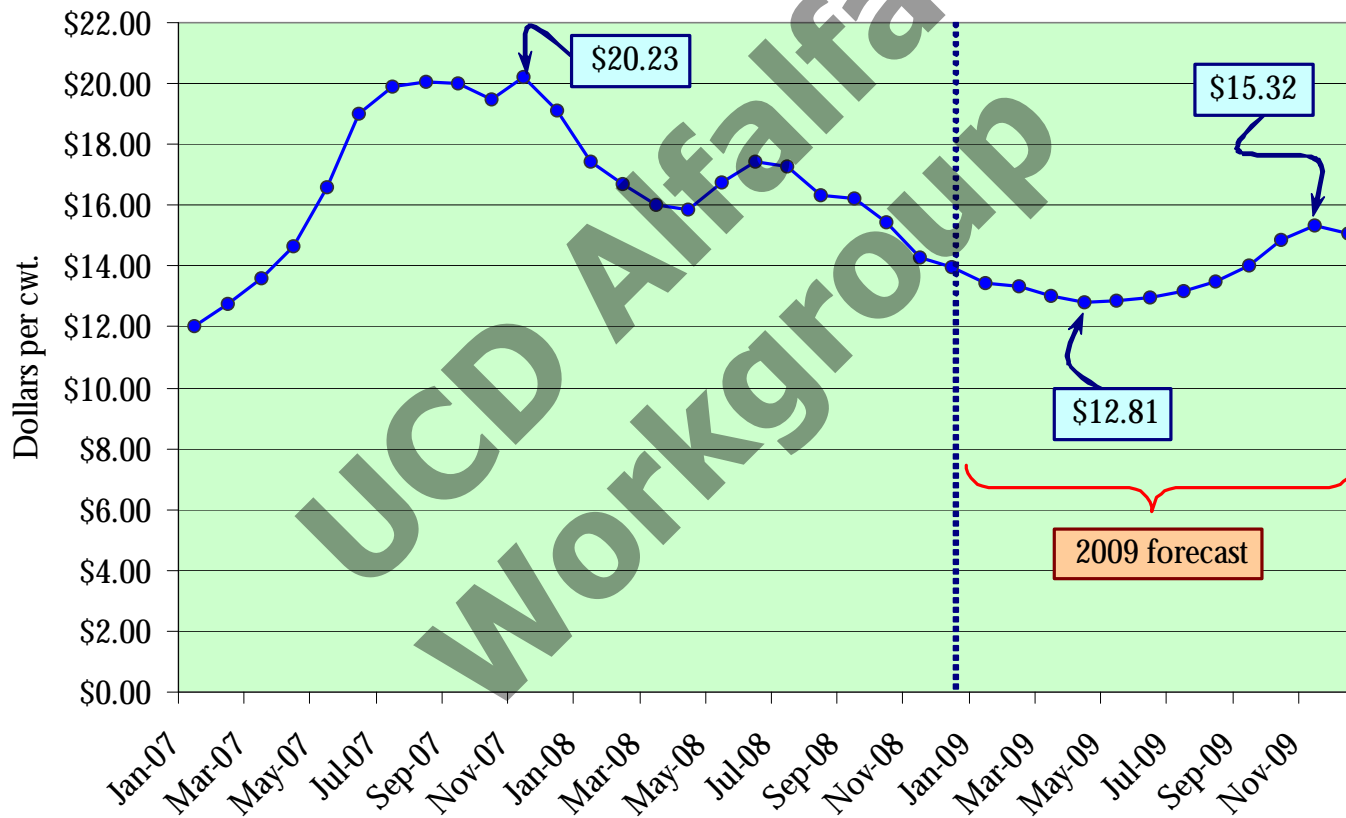
Bottom Lines

- **Plant capacity** – not enough capacity to have CA continue at 4% milk production growth per year
- **Supply Management** – milk production has moderated with much attention on production bases
- **Cost of Production** – feed costs not likely to return to “the old days”; will impact number of dairies operating
- **Exports** – if the industry can commit long-term, great upside potential in international markets
- These are all long-term issues
- However, the price forecasts for 2009 are the result of activities in 2007 and 2008

California Overbase Price
January '07 to December '08 (proj.)



California Overbase Price
January '07 to December '09 (proj.)



Summary

- Cornerstones of the industry are being assessed
 - Are government programs relevant?
 - How valuable is the upside potential of exports markets?
- Four factors will shape the dairy industry
 - Limitations on milk processing capacity
 - Maintaining milk supply management programs
 - Increased feed costs
 - Commitment to dairy product exports
- Dairy product prices and milk prices are expected to be relatively low through Q3 '09