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

[Graph showing milk production from January 2006 to October 2008]

1,000 lbs. per day

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Supply Management programs in place
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.)

Dollars per cwt.

Jan-07  Mar-07  May-07  Jul-07  Sep-07  Nov-07  Jan-08  Mar-08  May-08  Jul-08  Sep-08  Nov-08


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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