Presentation to the Dairy Industry Advisory Committee

By Connie Tipton
President & CEO
International Dairy Foods Association
April 14, 2010
Today's US dairy industry is very different than when dairy policies were enacted

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Farms with Cows</th>
<th>Number of Cows</th>
<th>Total Farm Milk Production</th>
<th>Number of Co-ops</th>
<th>Co-ops’ Share of U.S. Milk</th>
<th>Number of Processing Plants</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>4,663,431</td>
<td>22 mln.</td>
<td>120 bln.</td>
<td>2,270</td>
<td>48%</td>
<td>22,000</td>
</tr>
<tr>
<td>2008</td>
<td>67,000</td>
<td>9.2 mln.</td>
<td>189.98 bln.</td>
<td>155</td>
<td>84%</td>
<td>1,254</td>
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</tbody>
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Source: USDA
Milk Production Continues to Grow While Fluid Product Use Does Not

Bil lbs

Non-Fluid Consumption

Fluid Consumption


Source: USDA

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The percent of farm milk used in fluid milk products has declined for over 30 years.

Source: USDA
Per Capita Consumption of Fluid Milk Products in Long Term Decline

Gallons/Person

- Flavored Milks
- Nonfat Milk
- Lower Fat Milks
- Whole Milk

Source: USDA, ERS

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Thanks to yogurt, per capita production of cultured products is rising

<table>
<thead>
<tr>
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<th>Lbs/Person</th>
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<tbody>
<tr>
<td>Cottage Cheese</td>
<td>14</td>
</tr>
<tr>
<td>Yogurt</td>
<td>16</td>
</tr>
<tr>
<td>Sour Cream</td>
<td>10</td>
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</tbody>
</table>

Source: USDA, ERS
Per capita cheese consumption is growing, mostly for non-American types

<table>
<thead>
<tr>
<th>Year</th>
<th>Other Natural Cheese</th>
<th>Italian Type</th>
<th>American Type</th>
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<tbody>
<tr>
<td>1975</td>
<td>10</td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td>1980</td>
<td>15</td>
<td>7</td>
<td>10</td>
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<td>1985</td>
<td>20</td>
<td>10</td>
<td>15</td>
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<td>1990</td>
<td>25</td>
<td>15</td>
<td>20</td>
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<td>1995</td>
<td>30</td>
<td>20</td>
<td>25</td>
</tr>
<tr>
<td>2000</td>
<td>35</td>
<td>25</td>
<td>30</td>
</tr>
<tr>
<td>2005</td>
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</table>

Source: USDA, ERS
Long term growth for milk used in cheese, more recent growth in dry milks

Source: USDA, NASS
Consumer perceptions changing

Sodium
Fat
Sugar
Food 2020: trends and preferences

Consumers:

- Care about how food is produced
- Want healthier foods
- Care about the cost
- Don’t want “processed” food
- Want to support local farmers
- Want a clean environment
For us, that means understanding...

- A new market mix
- Interest in locally grown products
- Consumer expectations for their health and well-being
- Consumer interest in sustainability
Today's consumer sees dairy in a different light

Labels may call out what to avoid, instead of what's healthy

Consumers increasingly equate sustainable eating with eliminating meat and dairy
Competitiveness is the Key for Dairy

Figure 1

PER CAPITA AVAILABILITY OF MILK AND CARBONATED SOFT DRINKS IN THE UNITED STATES MARKETPLACE, 1945-1997


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Why Innovate?
Protein ingredients in demand -- will dairy or other proteins serve that market?
The market for US dairy products has substantially broadened in scope.
Without commercial exports, where would all our milk production go?

**Exports as a Percentage of U.S. Milk Production**
(total solids basis)

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<tr>
<td></td>
<td>3.7%</td>
<td>4.5%</td>
<td>4.7%</td>
<td>5.0%</td>
<td>5.5%</td>
<td>5.5%</td>
<td>5.1%</td>
<td>5.7%</td>
<td>7.5%</td>
<td>8.3%</td>
<td>9.3%</td>
<td>9.8%</td>
<td>11.0%</td>
<td>9.3%</td>
</tr>
</tbody>
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Source: US Dairy Export Council
Greater price volatility is real, but so are higher annual average prices

Source: USDA, NASS and OCE
How does dairy volatility compare?

COMMODITY MARKET VOLATILITY

Source: Blimling and Associates calculations using FutureSource data
30-Day Historic Volatility
* Class III milk is second nearby contract

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Two approaches to manage price volatility

- Government Intervention on a market-wide level
  - Regulated pricing schemes
  - Production quotas/supply management
  - Regional winners & losers

- Farm and firms manage their own individual risk
  - Most agricultural commodities in the US
  - Government subsidized revenue protection
  - Innovation and dairy demand growth
How do current dairy policies measure up?

1. Do current dairy policies allow the U.S. to utilize our abundant U.S. milk supply and provide a safety net so that producers can operate successful businesses?

2. Do current dairy policies allow producers to manage price risk with the same or better tools available to other commodity sectors?

3. Do current dairy policies encourage innovation and increase demand for the types of dairy products consumers want?
Should we go back to spending billions to buy butter, cheese, and non-fat dry milk?

Price Support Program Purchases

- Cheese
- Butter
- NFDM

Source: USDA

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Why are Canadian dairy companies moving south to invest?

Total Milk Production: US and Canada

Source: USDA and Statistics Canada
Canada per-capita consumption of dairy is declining while the U.S. continues to grow.

Per-Capita Dairy Consumption Index

*U.S. consumption on a milk equivalent basis
* Canada consumption on a milk solid equivalent basis

Source: USDA and Statistics Canada
Dairy producers using forward contracts experienced less price volatility

Source: USDA, AMS
Policy should support efforts to help dairy industry use risk management tools

- Subsidize dairy focused insurance programs
  - *No USDA premium subsidies offered for LGM-Dairy*

- Other ag commodities receive high premium subsidies
  - *Total premium subsidies were $5.42 billion in 2009*
    - Corn: $2.04 billion
    - Soybeans: $1.19 billion
    - Wheat: $1.09 billion

- Dairy options pilot program
  - *Something similar needed today*
Greater use of risk management tools is hindered by existing dairy policies

- Complex price formulas and classified pricing under Federal Orders make it more difficult for farmers and processors to use risk management tools.

- Dairy product price support program encourages investment in and production of low-value, commodity dairy products, rather than value-added dairy products increasingly demanded by the market.

- Livestock Gross Margin Insurance for dairy would benefit from some changes and some funding.
Increasing the support prices had little if any positive impact

- Announced July 31, 2009
  - *In following months more sales of product to the government were cancelled at the prior lower price than there were new sales at the higher price*

- Product purchased has been coming back on the market
  - *Recent sales of NFDM for animal feed use competes directly with sales of whey products for that market*

- Government owned stocks hang over the marketplace
  - *International prices slow to increase in recent months due to USDA and EU stocks purchased in 2009*
Elements needed for future dairy policy

- A safety net for dairy farmers that works and minimizes market distortions
  - *Insurance program instead of price supports and MILC*

- The ability for dairy buyers and sellers to forward contract like every other commodity

- Simplify milk price regulations to increase ability to innovate and compete both domestically and globally
Summary points

- The dairy industry has changed significantly since the Federal Order and Dairy Price Support programs were implemented in the 1930's and 1940's

- There is great potential for growth in demand for US dairy products both here and abroad

- But we face real marketplace challenges and must find the best ways to position our products, innovate and meet new market opportunities

- Our current policies and programs limit opportunities for growth rather than encourage it
The dairy industry can be most successful by working together to develop a new farm safety net for dairy that works in all market conditions coupled with tools to manage price volatility.

Thank you!

Connie Tipton
President & CEO
International Dairy Foods Association

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