

KPMG Phase 1 - Analysis Conclusions

The ICOS Dairy Industry Review Group met on Wednesday, 1st June 2011 to review the findings from phase one of the KPMG dairy processing industry analysis. The study was commissioned collectively by the members of ICOS and carried out by KPMG.

Phase one of this process has been an in-depth information gathering exercise, which has provided an accurate assessment of current dairy industry positioning.

The analysis highlighted the amount of collaboration and co-operation which is currently taking place between processors as well as highlighting the key areas of competitiveness that need to be addressed.

"The extent of collaboration that has taken place within the industry to co-

operate with the study is very encouraging. On this basis, we can reasonably look forward to further significant progress," said ICOS President Pat McLoughlin.

Some of the key findings included:

Milk Price

With respect to milk price, the return to Irish milk producers compares favourably with that received by their counterparts in Europe. However, Ireland's seasonality driven product mix is not delivering as favourable a return per litre to the processor when compared with our international competitors.

Processing Costs

Irish milk processing costs compare favourably with the international peer

companies selected. Key areas that do merit further attention include improving energy cost per tonne, together with plant utilisation at peak and optimisation off peak.

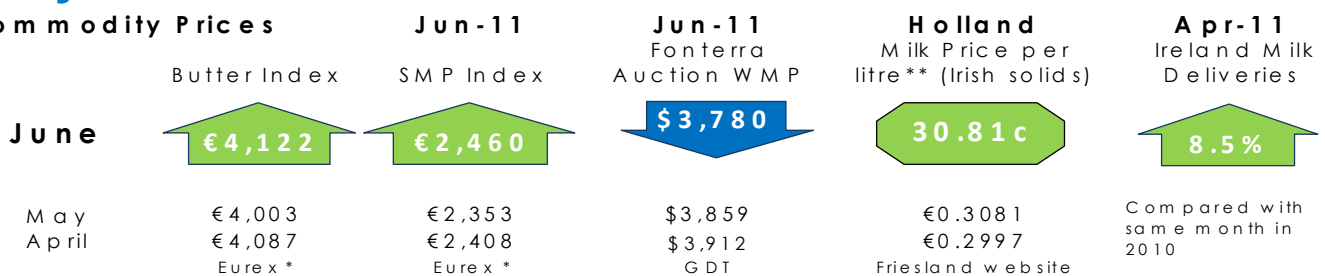
Business Models

Variations in business models, gross margin performance, seasonality, working capital requirements, expansion potential, and route to market identified in the analysis highlight challenges and opportunities for the industry. Developing new markets and the basket of products demanded by these global customers will require newer, more novel approaches to working capital requirements.

Continued on Page 4.

Dairy Markets

Commodity Prices



*: Eurex Futures Cash Settlement Price

** : Friesland Campina Price Recalculated to reflect Irish Standard Constituents of 3.6% Butterfat, 3.3% Protein.

Global Production

Global milk production for the 1st quarter of 2011 is up 2.9% on the same period last year, with EU milk production up 2.7%. In the case of Ireland production in the 1st quarter was up 17.3% on the same period in 2010. Across the main milk producing countries of the EU milk volumes are up with production up 6% in France and just under 3% in Germany. But dry weather conditions across central Europe is curtailing output at present and is impacting on market sentiment. Elsewhere New Zealand is expected to report close to a 5% uplift in milk production for the 2010/11 season, boosted by favourable weather conditions and higher milk returns.

Markets

Overall cheese markets are currently relatively stable but much will depend on export performance. The strong US dollar is not helping EU exports. Butter markets look stable to firm. Weather permitting, EU butter output is expected to rise due to higher returns relative to, for example, cheese.

Skim Milk powder production is up on last year as prices are stimulating production but record exports from the USA being favoured by a weak dollar is impacting on EU exports. Some major buyers have not yet entered the market. Intervention stocks remain in the background. Whole milk powder markets remain fragile. It is important that Chinese demand remains strong.

ICOS AGM

The 116th Annual General Meeting of ICOS took place at the Killeshin Hotel in Portlaoise on May 30th. It was well attended by many of Ireland's co-op leaders. Mr. Donie Cashman, nominated by IFAC, was selected as the Plunkett Award winner for Co-operative endeavour. The future

direction of ICOS was discussed during the meeting, namely our focus on;

- Vision
 - Governance & Structure
 - Greater Member Participation
 - Attracting New Co-op Members & Future Co-op Leaders
- Leadership
 - Embracing Change
 - Enabling greater cooperation, collaboration and competition amongst Irish co-ops
- Value
 - Education & Communication
 - Promoting Best Practice

Sustainability - An Opportunity for the Irish Dairy Industry

The word 'Sustainability' is fast becoming a key component in international best practice among the major players in the global dairy industry.

With the continued rapid growth of the world population and the increased demands for dairy products, the middle of the last decade saw the birth of the 'Sustainable Dairying' concept. Its development is built around 5 key goals:

1. Environmental protection
2. The continual improvement of milk quality
3. Ensuring nutritional balance
4. Promoting the viability and development of farms
5. Gaining recognition for the industry for these efforts

Dairy co-operatives and companies around the world have engaged positively in the challenge of managing scarce natural resources.

Fonterra set up a "Sustainability Leadership Team" in the late 2000's, where they identified sustainability Indicators in areas such as resource consumption, by-product management, governance and certification standards, and on farm performance. Within each of these indicators they targeted measurable improvements to be achieved within specific time frames. These included the reduction of consumption of resources such as water, energy, packaging etc. To guarantee the credibility and public 'buy-in' of the achievement of these targets, they ensured that there were third party audits and certification of their results such as the attainment of ISO14001 for all of their manufacturing sites.

Arla have stated that the implementation of a functioning sustainability strategy is key to 'making the business an attractive partner for both retailers and consumers.' One of their key targets is the reduction of their Greenhouse Gas (GHG) emissions by 34% from their 2005 baseline. They are on target to achieve this goal, through the implementation of 'Energy desktop Audits' of their farms and plants, capital investment, training and education programmes and the use of innovations in technology and processes.

Friesland-Campina have developed their 'Route2020' strategy, where farm member participation is the focal point across a scheme that looks at all aspects of the production chain. 6,000 members took part in the formulation of the strategy in discussion groups and January 2012 is the official start date of the programme. Interestingly from our perspective, the merits of the outdoor grazing system were highlighted as best practice, and this caused much debate and controversy among the members of Friesland, many of whom follow a more intensive Dairy system.

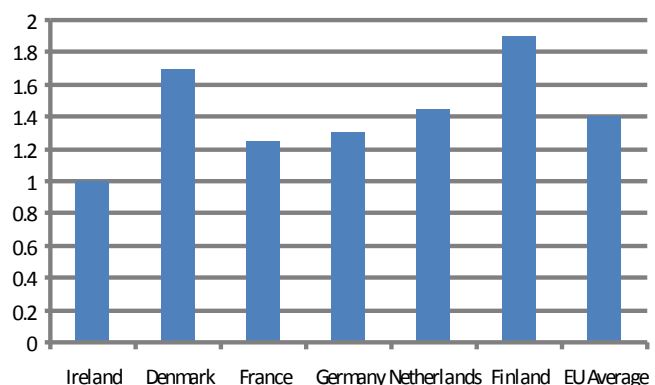
Danone have achieved participation rates on their sustainability programme of 80% already among their suppliers.

The Irish dairy industry has been active in the area also, with players developing their own plans. The end of May saw Glanbia announce the extension of its "Dairy Farm Assurance Scheme" that it had initiated in 2005. To enhance the credibility and confidence in their sustainability strategy, they have linked in with state agencies such as Bord Bia and Teagasc to ensure that on farm audits comply to the highest standards of best practice and innovation. It is hoped that the scheme will be extended to all of its 4,300 suppliers by 2012. The company also plan a sustainability awards scheme in late 2011 for its participating suppliers. Other Irish industry players are also quite active in the area of sustainability.

The worldwide growth of 'Sustainability' strategies provides a tremendous opportunity for our industry for a number of reasons. Primarily our outdoor grass based grazing system is already seen as best practice in the area. This has been backed up by recent European Commission studies on GHG emissions per litre of milk produced where Ireland is in the top percentile of performers. Also European law is moving towards the imposition of legally binding targets on emissions and animal welfare and nutrition standards.

Irish systems are very sustainable and this is an advantage for us, not just from an environmental point of view, but also from a marketing point of view. We have an opportunity at present to get the message out to consumers and retailers globally about the strength of our green credentials, that our farms have been implementing sustainable practices for decades and that we intend to build on this.

**GHG Emissions from Milk Production
in Kg CO₂ equivalent (approx)**



Source: European Commission Joint Research Centre, Evaluation of the Livestock Sectors Contribution to the EU Greenhouse Gas Emissions

The Plunkett Award 2011

At our AGM on the 30th May in The Kileshin Hotel, Portlaoise, Mr Donie Cashman was announced as Winner of the prestigious Plunkett Award.

Donie Cashman, a former president of ICOS, former IFA National President, former President of COGECA, founder of the Irish Farm Accounts Co-operative, a board member of the Agricultural Trust, chairman of Enable Ireland and a life long contributor to national and community based causes has been recognised by the Irish co-operative movement's highest honour - the Plunkett Award for Co-operative Endeavour. A native of Coole, Whitescross, Co. Cork, Mr. Cashman has served on the Board of ICOS for some 25 years, including roles as vice-president from 1997 - 2001 and president, 2003 - 2005.

Speaking at the Award ceremony, Pat McLoughlin, President of the Irish Co-operative Organisation Society (ICOS) said; "In a lifetime of endeavour to date, Donie Cashman has contributed selflessly to the co-operative movement, to the advancement of Irish agriculture and to the betterment of society in general. His unstinting personal contribution and his exemplary humanity and generosity of spirit are recognised by this prestigious award which bears the name of Plunkett, the founder of the Irish co-operative movement."

He Chaired the Irish Farm Accounts Co-operative (IFAC) between 1978 to 2006. He served on the Board of FBD, the Central Bank of Ireland, CMP, and Dairygold. Mr. Cashman was also a board member of Cork Marts from 1997 to 2001.

Along with colleagues from IFAC, Mr. Cashman was accompanied at the presentation ceremony by his wife Peggy and son Teddy.



From left to right; Pat McLoughlin, ICOS, Willie Fahey, IFAC, Donie Cashman, Plunkett Award Winner, Seumas O'Brien, IFAC, Peadar Murphy, formally IFAC

Profile - Group Danone

From time to time the *icos DairyDigest* will profile major international dairy companies. In this edition we will take a look at the French based company Danone.



Late last year Danone Ireland announced a €50 million investment to expand its manufacturing facility in Macroom, Co Cork. The expansion will result in a trebling of capacity to 100,000 tonnes annually. The investment also helps strengthen their relationship with Dairygold Co-op. Dairygold is a key supplier of raw materials used in the manufacturing process at Macroom.

Danone in Ireland is comprised of Danone Baby Nutrition, Danone Dairy Ireland and Nutricia Advanced Medical Nutrition. A total of 350 people are directly employed by the Group in Ireland. Danone manufactures products for the Baby Nutrition business in Macroom in Cork and in Wexford Town. Danone Baby Nutrition products sold in Ireland include Cow & Gate and Aptamil.

Danone – Interesting Facts;

- Annual Sales: €17 billion (equivalent of 10% of Ireland's economy)
- 49% of Danone's total business is in emerging economies
- Danone cut its carbon emissions footprint by 22% from 2008 to 2010
- Number of Employees: >100,000
- Number of Factories: 160
- Danone is N°1 in Europe in medical nutrition
- Danone is N°1 Worldwide in fresh dairy products
- Danone is N°2 Worldwide in baby nutrition

In 2010 Danone increased their presence in Russia and neighbouring countries by merging with Unimilk to form Danone-Unimilk. This new company commands 20%+ of the Russian market, has 18,000 employees and 1.5 billion Euros in Annual Sales.

More information

<http://danone10.danone.com/uk/>

Milk Quota and Quality

Temporary Leasing

The 1st Stage of Temporary Leasing Scheme has a closing date of 24th June 2011, with a fixed price of 2 cent/litre. 2nd Stage will have a fixed price of 1 cent/litre and a closing date of 13th January 2012.

New Entrants Allocation

0.25 of the 1% allocation increase awarded to Ireland from 1st April 2011 is allocated to new entrants and new entrants through the Milk Quota Trading Scheme. In total 13.7m litres is available under this allocation with 10m litres going to 50 successful applicants who will receive 200,000 litres each. Over 200 applications were received for the 50 allocations. 60 applications were received from the new entrants and successor category who had purchased quota in the Milk Quota Trading Scheme. Successful applicants will share 3.7m litres. Decisions on both allocations is expected within the coming week.

Dairy Hygiene Grant Scheme

Over 750 applications were made for the first tranche of the Dairy Hygiene Grant Scheme which closed on 3rd May. Funding allocated to this tranche was €6.92m but the applications exceeded that amount by €1.75m. The second tranche which has a funding allocation of €3.46m will close at the end of July. Applicants unsuccessful from the first tranche will be rolled over for consideration under subsequent tranches. Applicants will be advised of their status in September.

Snippets

Continued from Page 1

Working Capital

The analysis stresses that significant working capital is consumed in providing capacity to handle a peak milk supply which, by its nature, goes into long life commodity products. Significant consideration will need to be given to peak milk supply and related working capital funding if we are to provide a more favourable return to enable better R&D, investment and marketing.

Marketing

The analysis shows that investment in new product innovation is low when compared with our international peer companies. It also highlights the potential product and value-added growth opportunities for the Irish dairy industry that can be exploited through strategic, market-led innovation and focused marketing.

ICOS CEO, Tom O'Callaghan said: "The analysis conducted by KPMG has been invaluable in that it has laid out the facts in relation to the actual position of the Irish dairy industry in its global context. The work to date highlights the tangible efforts and achievements made to date,

while demonstrating that there is no room for complacency.

"With considerable expansion on the cards, the industry can be well positioned to match the ambitions of Irish dairy farmers in the years to come. Further progress can and must be made in the weeks and months to come.

"We look forward to the members of the industry group consulting with their own boards, and reconvening in the coming weeks to consider an appropriate way forward"

ICOS Rebranding

Over the coming months you will see this new ICOS logo replace our old logo on all ICOS publications, Twitter page and also on our website.

We feel that the new logo is a good blend of the old, (maintaining the green shamrock spelling 'co-op') and the new. We feel it reflects a more modern and revitalised ICOS!



- ICOS to speak at inaugural Food & Agribusiness Conference

Conor Mulvihill from the ICOS Brussels office to speak at the inaugural iQuest Food & Agribusiness Conference. Conor's paper is titled; *The Abolition of the Quota Regime in 2015: A Revolution for Irish dairy?*

- Irish Dairy Sector Visit to China 7-13 June, 2011

Enterprise Ireland is organising a Dairy Sector Visit focused around attendance at the World Dairy Expo China 7-13 June, 2011. Enterprise Ireland will have a booth at this Expo.

- Major European Co-ops Co-operating

Arla Foods Ingredients and Germany's largest dairy company, DMK, permission to proceed with joint venture. They have agreed to a €35m joint venture in a new whey processing facility in northern Germany. An extra €9m will go into expanding the Arla Foods whey processing plant in Denmark.

- Co-operative crowned European Champions

Congratulations to the victorious Barcelona team on winning the European Champions League against Manchester United in Wembley. Barcelona is a Member owned co-op, with 170,000 members. Co-operative ownership of soccer clubs is popular in Spain. Of the 11 players who started on the field for Spain's winning World Cup team, 10 of them play for a co-operative.

EU 'Dairy Package' vote delayed

The European Parliament Agricultural Committee vote on the 'Dairy Package', initially scheduled for May 25, has been postponed until the end of June, due to on-going divisions between political groups. The key issues of contention are whether contracts for suppliers should be mandatory or voluntary, their content (cost-based price formula, minimum duration etc.) and how much of the national market Producer Organisations are allowed to have. Negotiations are on-going between the Northern Ireland MEP James Nicholson of the Conservative party, who is in charge of the Parliament response and the European Commission & Council.

Diary Dates:

National Dairy Council (NDC) Annual Conference, Tuesday, 14 June, Conrad Hotel, Dublin.

Conor Mulvihill, ICOS Brussels to deliver paper at National Food & Agribusiness Conference, Thursday, 14 June, Croke Park, Dublin.

| | Oil Price (Brent) - US\$ pbl | Carbon Spot: 1 EUA |
|-------|---------------------------------|-----------------------|
| June | \$1.461 | €16.70 |
| May | \$1.438 | €16.92 |
| April | \$1.443 | €16.18 |

Market Movement



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Please forward this newsletter to your colleagues, farmer friends & discussion group members!