A Vision for the Irish Dairy Industry

Teagasc National Dairy Conference 2009
19 November 2009

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Presentation in Context

'Vision for the Irish Dairy Industry'

» Recent Discussion

'Imperative that Ireland restructures its dairy industry to compete in global market'

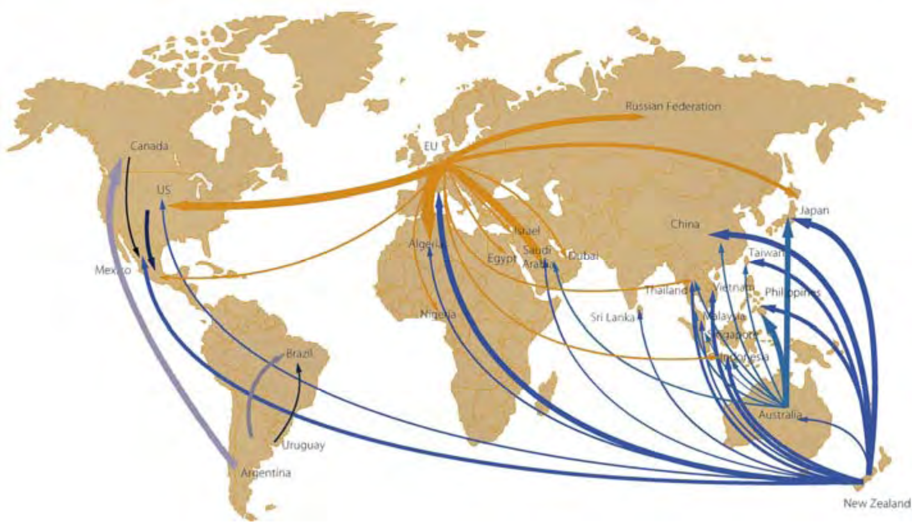
» Solution?

'Evolution or Revolution'

Presentation Outline

- A changed/changing global dairy marketplace
- Ireland's fragmented industry structure
- Competitive positioning
  - at processor level
  - at farm level
- Kerry's market positioning
- A word about short to medium term market/milk price prospects
- Irish dairy industry restructuring
  - potential/issues towards processing restructuring
- The future
  - opportunity for profitable growth

Global Trade Dairy Flows



World Dairy Market Overview

- Excluding intra EU trade, only 7% of world milk production traded internationally
- World trade

	1999	2002	2008
EU	29%	26%	24%
NZ	22%	22%	21%
Aus	16%	11%	9%
USA	5%	8%	13%

Source: Rabobank

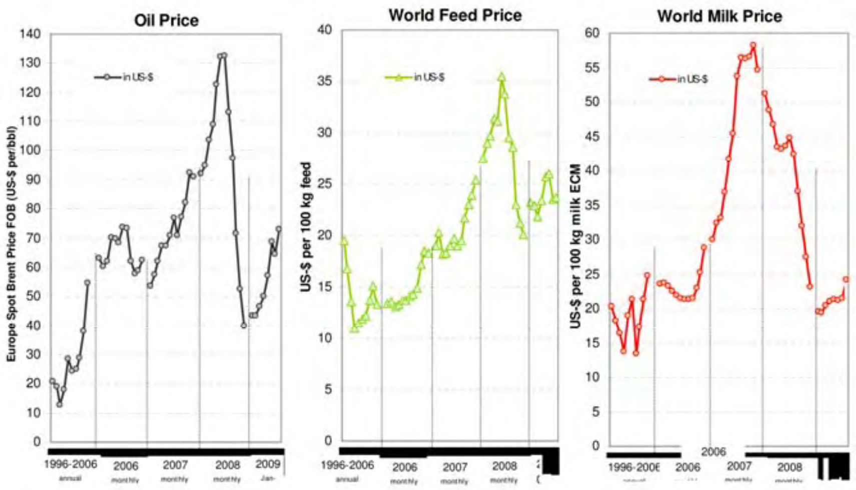
Production by Major Region (M Tns)

Region	2008	08 v 07	08 v 05
EU 27	138,259	+1%	-1%
USA	86,026	+2.2%	+7.2%
China	37,790	+4%	+32%
Brazil	28,890	+8%	+19%
New Zealand	15,141	-3.2%	+4.4%
Australia	9,500	-3.7%	-8.9%
Total	315,606	+1.9%	+6%
% Increase YOY	1.9%	1.9%	6%

Exports
(Butter, Skim Milk Powder, Cheese & Wholemilk Powder in 000's Tns)

Total Exports	Australia	EU - 27	New Zealand	USA	Total
2005	599	1,521	1,387	352	3,859
2006	626	1,319	1,510	381	3,836
2007	597	1,307	1,745	405	4,054
2008	492	1,215	1,522	649	3,878
2008 v 2007	-18%	-6%	-16%	69%	-5%

Oil, Feed and Milk Prices
on the world market 1996 – June 2009



IFCN Dairy Research Center 2009

Summary Global Dairy Market Development

KERRY

- EU adjustment to virtual 'free trade' market conditions
  - pricing now dependent on world prices
- Significant depreciation of US$, NZ$ and Stg£ vs Euro
- Production response potential (USA & NZ)
- Export growth (USA & NZ) recent years
- Significant softening in demand in response to high prices in 2007 (product substitution)
- Impact of global economic conditions
- Milk has become one of the most volatile agricultural commodities
- Dairy farming at risk from output and input side
  - production/price volatility
- EU milk quotas to be eliminated by April 2015

Irish Dairy Industry Structure/Positioning

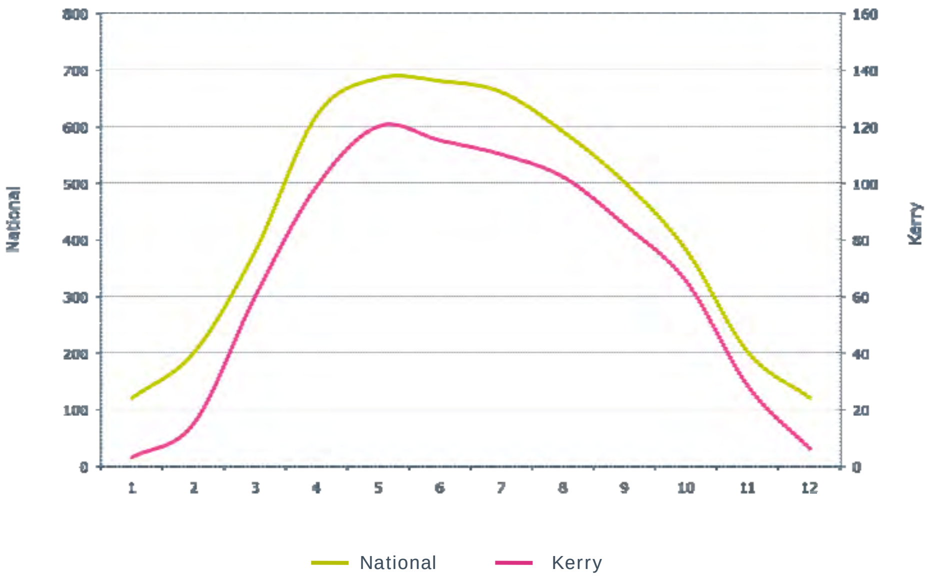
KERRY

- Traditional fragmented industry structure
- Population: 4.2 million (Republic of Ireland)
- Dairy output: 5 million tonnes
- Ireland exports 80%+ of its manufacturing dairy output
- Seasonal grass based production

CAN IRELAND'S DAIRY INDUSTRY

COMPETE IN A 'FREE GLOBAL MARKET' ?

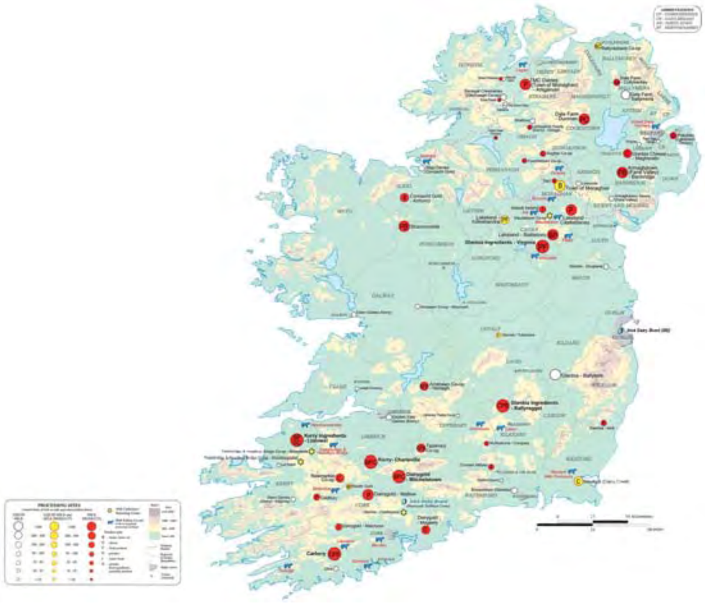
Irish Milk Supply Curve (in 000's Tonnes)



Ireland's Manufacturing Milk Supply Base by Processor

Source: Irish Farmers Journal

Ireland's Processing Structure: Inefficient for Global Markets



Source: Irish Farmers Journal

Competitive Positioning of Dairy Processing Ireland *(National Milk Pool Comparatives)*

	Butter %	WMP %	Cheese %	Other %
Ireland	61%	6%	26%	7%
Denmark	15%	11%	63%	11%
Netherlands	26%	8%	52%	14%
New Zealand	41%	35%	19%	5%
USA	19%	0%	52%	29%

Structural Challenges in Irish Dairy Processing

KERRY

- Loss making ←→ low margin businesses
- Seasonality leads to underutilised processing assets
- Limited access to large consumer fresh dairy product markets
- Predominantly low-value commodity production
- Comparatively higher Irish industry input costs
- Poor investment history
- Multiple selling/trading agents
- Relatively expensive milk assembly cost due to predominant small scale supply base and geographic spread

Irish Milk Suppliers Competitive Positioning

KERRY

- Advantage of grass based systems – favourable climate
- Low cost producers in Ireland most efficient in the world
  - but huge variation in on-farm production costs
- Quality product
- Availability of world class dairy skilled labour
- Land available for dairy production

But how many Irish suppliers will grow to scale required to achieve desired income targets in a competitive cyclical global marketplace?

Note: Most countries have experienced a rapid and continuous rate of upscaling over comparatively short time periods

Kerry Agribusiness/Teagasc: Profit Monitor Results

	2006 c/lr	2007 c/lr	2008 c/lr	Range 2008 c/lr
Dairy output	27.74	35.12	34.41	36.2 - 32.4
Total variable costs	9.05	8.86	10.95	15.6 - 7.9
Total fixed costs	7.83	8.80	9.02	12.5 - 6.5
Total costs	16.88	17.66	19.97	25.3 - 16.2
Dairy income*	10.87	17.46	14.44	19.6 - 9.6

Note: * excludes direct payments and own labour charge

Average Farm Production ('000 litres)

	USA	NZ	Australia	Ireland	Kerry
1990	400	600	450	97	110
1995	490	710	590	132	123
2000	700	1,000	870	175	146
2005	1,000	1,240	1,130	233	192
2008	1,200	1,450	1,150	271	219

Kerry's Business Model Today

KERRY

Ingredients & Flavours	Consumer Foods	Agribusiness
KERRY	KERRY FOODS	KERRY AGRIBUSINESS
Americas Region EMEA Region Asia-Pacific Region	Ireland The UK	Ireland

Kerry's Growth Model

INGREDIENTS & FLAVOURS

- Leveraging Kerry's technology based ingredients, flavours and integrated solutions in global food and beverage growth markets
- Re-alignment of the Group's ingredients, flavours and bio-science businesses around core technology platforms and end-use market applications
- Unique 'Kerry Integrated Approach' to customer specific innovation and product solutions driven by global technology, market application, culinary and sensory teams

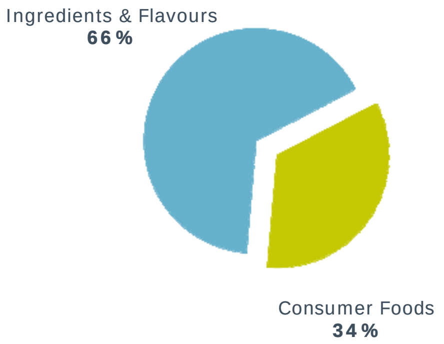
CONSUMER FOODS

- Continued investment in added value meat, dairy, convenience and food-to-go categories
- Capitalising on Kerry Foods' strong customer listings and route to market
- Supported by:
  - Significant brand and marketing investment
  - Lean manufacturing and shared services

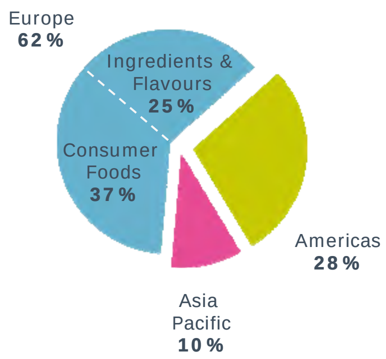
'Kerryconnect' Project: to establish common global systems and business processes

Revenue Distribution 2008

By Business Segment

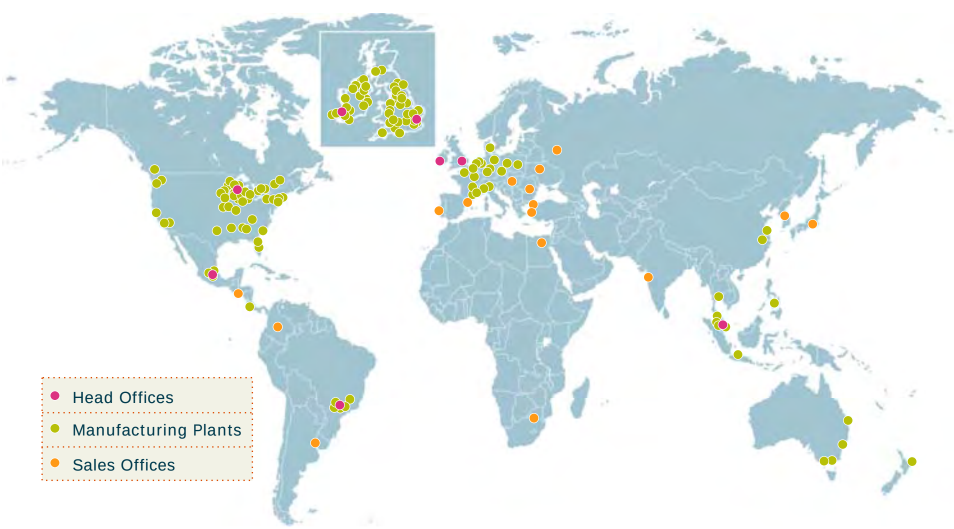


By Destination



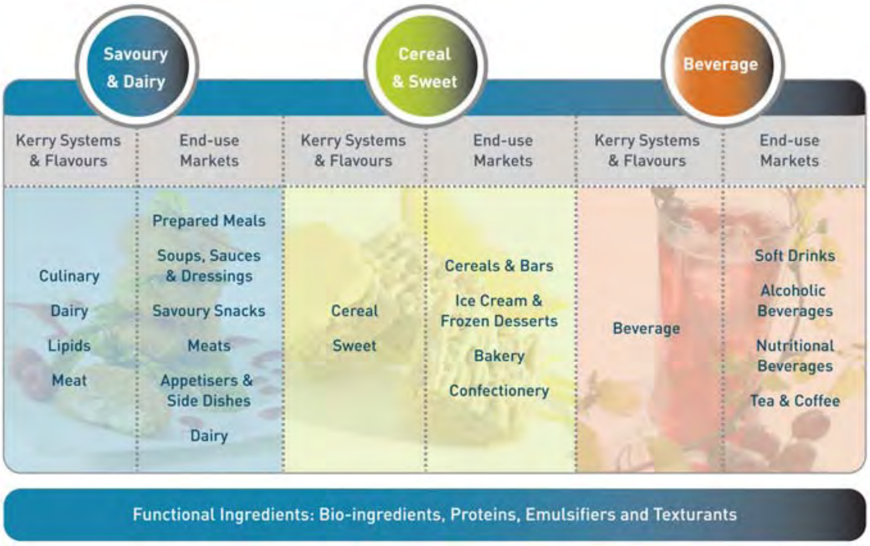
Ingredients & Flavours	€3,388m
Consumer Foods	€1,774m

Kerry Worldwide Locations



Kerry Integrated Customer-Focused Development

Ingredients & Flavours 'Go-to-market' Strategy



Kerry Global Technologies

BIO-INGREDIENTS

- Enzymes
- Fermented Ingredients
- Beverage Processing Aids
- Active Yeasts & Other Yeasts

EMULSIFIERS & TEXTURANTS

- Carrageenan
- Emulsifiers
- Texture & Stabiliser Systems
- Gum Arabic & Other Gums

PROTEINS

- Dairy Proteins
- Soy Proteins
- Specialised Functional Proteins

REGIONAL TECHNOLOGIES

- Bakery Mixes & Supplies
- Colours & Antioxidants
- Soy Ingredients

PHARMA INGREDIENTS

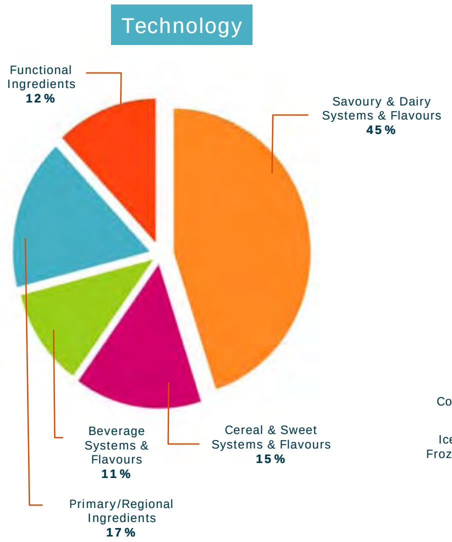
- Pharma Excipients
- Cell Nutrition

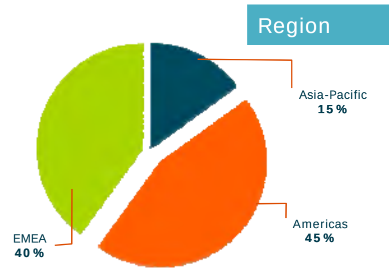
PRIMARY INGREDIENTS

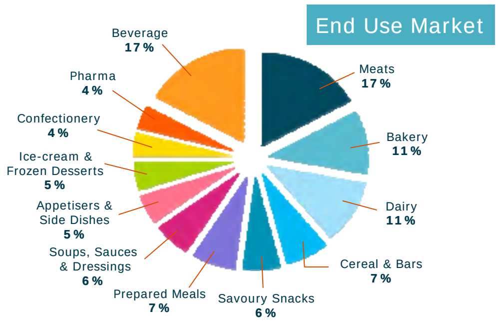
- Primary Dairy Ingredients
- Primary Fruit Ingredients
- Factored Ingredients

Kerry Ingredients & Flavours – *leveraging technology leadership in global food and beverage markets*

KERRY







Based on third party revenue

Kerry Ingredients & Flavours: *Our Customers*

KERRY

Consumer Foods Growth Model

ADDED VALUE DAIRY

- #1 UK cheese snack portion (Cheestrings)
- #1 IRL natural cheese (Charleville, Coleraine, Low Low, Mitchelstown)
- #1 IRL cheese slices (EasiSingles)
- #1 IRL dairy spread supplier (Dairygold, Low Low)
- #1 UK pvt label dairy spread supplier
- #1 UK pvt label cheese slices supplier

CONVENIENCE

- #2 UK chilled ready meals supplier
- #1 UK frozen ready meals supplier

ADDED VALUE MEAT

- #1 UK sausage (Richmond)
- #2 UK sausage (Wall's)
- Biggest sausage/rasher brands in IRL (Denny, Shaws, Galtee)
- #1 IRL cooked meats brands (Denny, Shaws, Ballyfree, Galtee, Roscrea)
- #1 meat snacks (Mattessons Fridge Raiders)

FOOD TO GO

- #1 UK chilled van sales operation
- #1 IRL chilled van sales operation
- #1 IRL sandwich (Freshways)
- #2 IRL chilled juice (Dawn)
- #1 IRL flavoured mineral water (Kerry Spring)

Kerry Foods' On-going Innovation Programme

Kerry Agribusiness Support For Dairy Farming

- Promotes least-cost grass based production
- 'Focus on Profit' programme drives optimum grass management system and low inputs
- Milk suppliers as members of Kerry Co-operative Creameries benefit through
  - Issue of Co-op patronage shares
  - Co-op dividend income
  - Exchange of Co-op to plc shares
  - Kerry Group dividend income

Current Dairy Market Situation

- Commodity markets have improved during Q3 ‘09
- Welcome increases in WMP, SMP and butter prices
- Cheese and casein – slower recovery
- Demand conditions have continued to improve
  - economic growth resumes in key economies
  - Chinese market recovers post melamine scare
- But big overhang of stocks
  - EU SMP intervention stocks 281,000t (30% of annual production)
  - EU Butter intervention + PSA stocks 201,000t (11% of annual production)
  - USA SMP CCC Stocks 100,000t

Dairy Markets: Short-term Considerations

- Milk output 2009 (F): EU -1% USA -1%
  - NZ -2% ytd
  - (weather dependent -09/10 season (f) +2%?
  - Aus -4%
- Seasonality: EU & USA seasonal troughs
- Demand: Global economic conditions?
  - Product substitution at higher prices
- Futures market: Butter - current pricing US$3,500/tonne
  - pricing Q1 2010 US$2,600/tonne

Medium-term – Dairy Market Prospects

- Cautiously optimistic
  - dependent on;
    - rate of economic recovery
    - oil prices
    - policy governing release/run down of stocks (EU 51,000 tonnes butter and 65,000 tonnes SMP to be released between May-Sept 2010
      (USA 63,000 tonnes of SMP already committed for disposal)
    - currency movements
    - US production costs vs market returns
    - weather

Dairy Markets: Summary Long-term Perspectives

- Kerry continues to view longer-term market prospects optimistically
- Quality natural dairy products – global demand growth (2-3% pa)
- Growth in world population
  - 6.5 billion (today) to 8 billion (2028)
- Pace of urbanisation increasing
- Milk: efficient convertor of plant to animal protein
- Scope for significant technical development
  - Nutritional food and beverage products
  - Dairy ingredients with specific health benefits
  - Life-stage focused product development (bio-active components)

Long-term global demand for dairy products to outpace supply growth but 'Free Market' conditions will mean cyclical market volatility for commodity dairy markets

Recap Kerry's Dairy History

- **1972** Listowel plant opens on greenfield site
- **1975-'82** Purchase Killarney, Limerick, Ballinahina (Cork) and Galway Dairies
- **1983** Opening of overseas representative offices
  - expansion into Dairy Ingredients markets
- **1986** Purchase Moate (Snowcream) Dairies
- **2000** Sale of Ballinahina Dairies to Clona Dairies
- **2001** Acquisition of Golden Vale
- **2002** Sale of Baileboro Milk Processing to Lakeland Dairies
- **2009** Acquisition of Breeo Foods

Irish Dairy Industry Restructuring

- Reform is now imperative
  - global market competitiveness
  - to secure profitable growth for processor/milk suppliers
  - optimum structure for national milk pool utilisation
  - potential industry efficiency improvement ⇒ 1-2c/l
- Industry processing – current discussions
  - ‘Milk Ireland’ model
  - ‘Valio Ireland’ model
- Commercial/marketing functions must be considered
- Fragmented R/D must be overcome
  - plus must work closely with restructured Institutional Research for benefit of Ireland inc.

Obstacles/Issues: Dairy Industry Restructuring

- Investment cost
  - depending on ‘buy in’ to model adopted
  - cost of new facilities/ plant closures/ redundancy costs
  - potential for industry funding limited
- Social cost
  - impact on rural communities/development
  - local political resistance
- Solution
  - ‘evolution vs revolution’?

Summary: Opportunity for Profitable Growth

- Favourable long-term outlook for Irish dairy industry
  - dependent on adoption of restructuring plan
  - will restructuring evolve or can the radical urgent necessary new model be achieved?
- Global dairy demand will continue to grow ⇒ 2%+ pa
  - cyclical commodity market volatility inevitable
- Viable dairy farm enterprise for Ireland
  - for low-cost grass based production
  - but upscaling to compete in global market will be necessary over time
  - opportunity for Ireland to increase dairy production post quotas by 30%+
- Long-term good prospects for Irish dairying

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