

A Cheese Maker's Outlook on Competing in a Changing Dairy Sector



Sue M. Taylor
Leprino Foods

USDA Agricultural Outlook Forum
February 21, 2003



Leprino Foods

Leprino Foods Overview

»»» Background

- »»» Privately held
- »»» Founded in 1950 by Mike Leprino, Sr.
- »»» Headquartered in Denver, Colorado
- »»» Approximately 3,500 employees
- »»» Operate 12 production facilities
 - »»» World's largest mozzarella production facility in Lemoore, California
- »»» Produce mozzarella and value-added whey products



Leprino Foods Overview

- »»» World's largest producer of mozzarella cheese
 - »»» Primary and often exclusive supplier to leading pizza chains, independent pizza operators
 - »»» Supplier to:
 - »»» Restaurants / other foodservice outlets
 - »»» Manufacturers of
 - »»» Frozen foods
 - »»» Appetizers
 - »»» Shredders
 - »»» No direct retail sales



Leprino Foods Overview

- »»» Produce mozzarella in a variety of forms:
 - »»» Shredded / Diced
 - »»» Individually Quick Frozen (IQF)
 - »»» Gas flushed
 - »»» Block
 - »»» Ribbon
 - »»» String



Leprino Foods Overview

»»» Also produce variety of whey products

»»» sweet whey

»»» WPC 35 and 80

»»» lactose

»»» Market whey products worldwide

»»» Formed joint-venture with a Japanese company for specialized production in one plant in 1991



Twelve Domestic Plants



Waverly, NY Facility



Allendale, MI Facility



Remus, MI Facility



Ft. Morgan, CO Facility



Roswell, NM Facility



Roswell, NM Facility



Tracy, CA Facility



Lemoore East, CA Facility



Lemoore West, CA Facility



Glanbia Cheese Ltd.

**Magheralin,
Northern Ireland**

»»» **Acquired 50% interest August 11, 2000**

**Llangefni,
Wales**

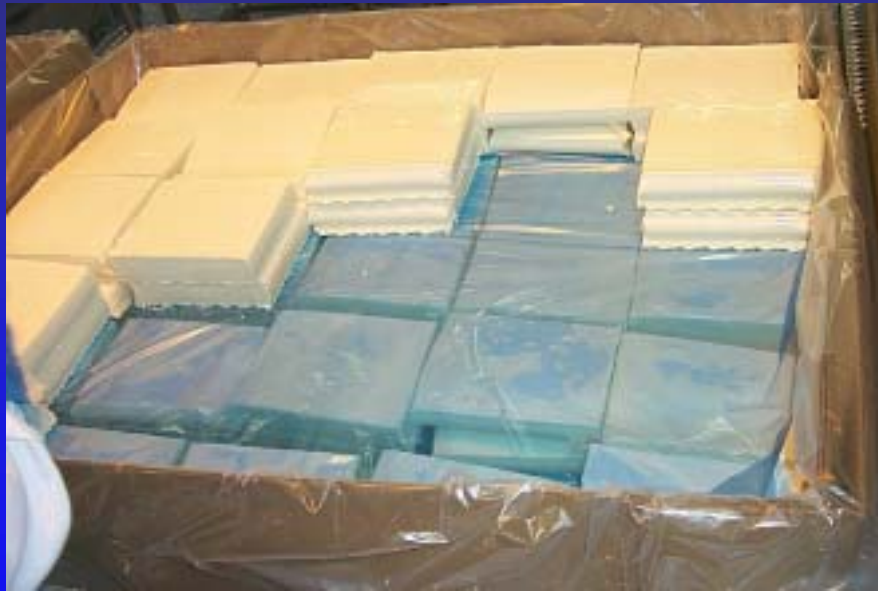
Mozzarella Products - IQF



Mozzarella Products - Block



Mozzarella Products - Ribbon



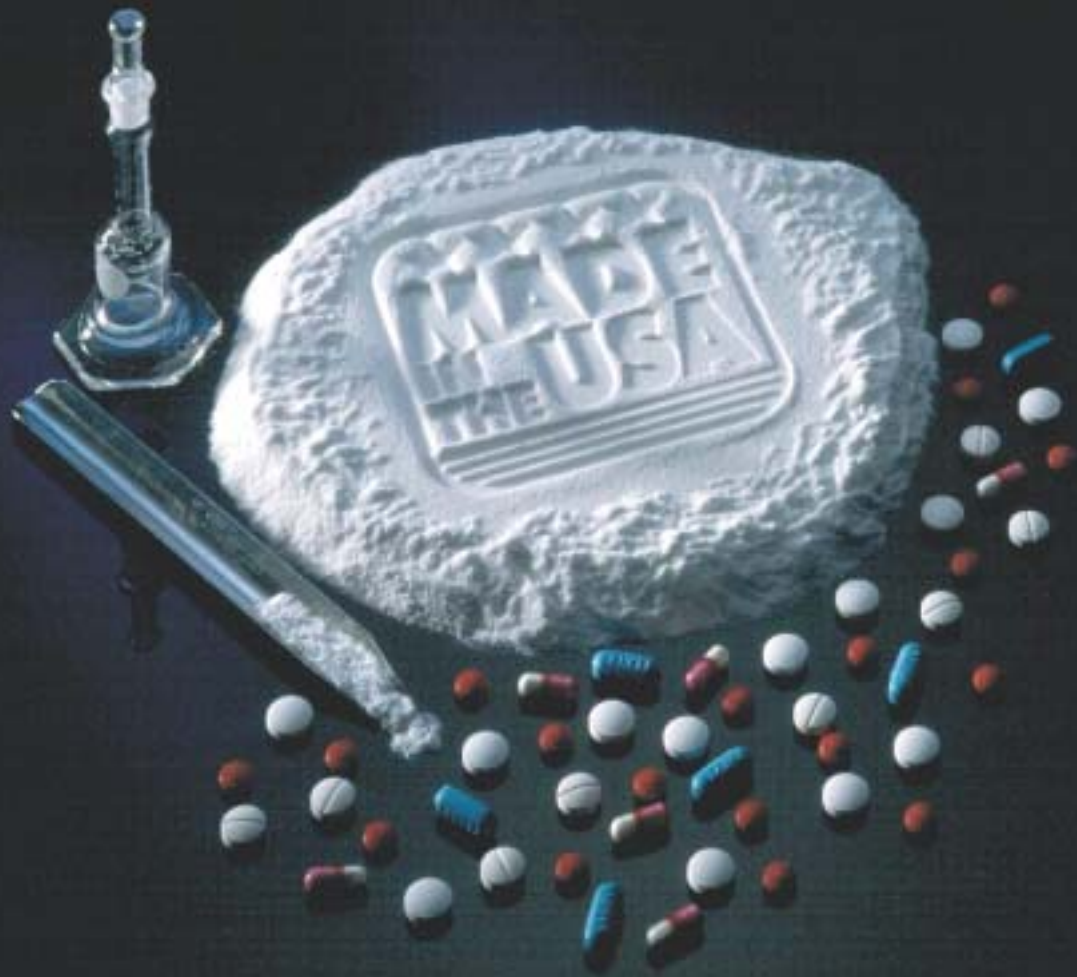
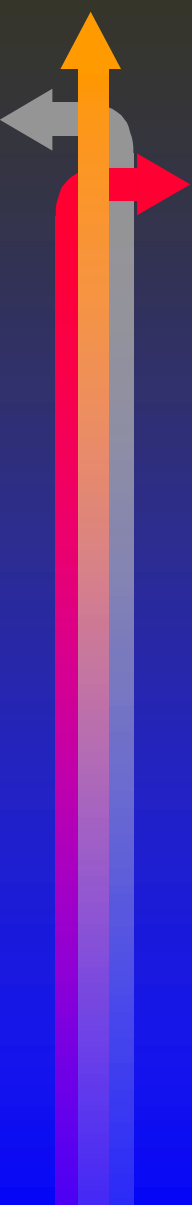
Mozzarella Products – Gas-Flushed



Mozzarella Products - String









Key Strategies

- »»» Specialize / focus
- »»» Achieve scale economies
- »»» Innovate / invest in R & D
- »»» Locate plants strategically



The Changing Dairy Sector: Competitive Challenges for the Industry

Key Dairy Industry Trends

- »»» Markets for historic growth products are maturing.
- »»» International markets will increasingly impact US domestic dairy markets.
- »»» Consolidation in the farm sector will continue.

Markets for historic growth products are maturing

- »»» Meteoric rise of the pizza industry over the last four decades absorbed much of the increased milk production over that period.
 - »»» However, the pizza industry is now showing signs of maturity.
 - »»» Although “take & bake” and frozen pizzas have seen some growth, same-store sales for “fresh” pizza have been slow to recover post-9/11.
- »»» Fast food burger chains that use substantial volumes of processed American slices are similarly struggling.

Future Growth Markets

- »»» Dairy's success in competing for a share of the stomach at retail will be impacted by:
 - »»» Product innovation
 - »»» Consumer convenience
 - »»» Successful incorporation of dairy ingredients in meal replacement products

Future Growth Markets

- »»» Dairy's success in competing as a foodservice ingredient will be impacted by:
 - »»» Delivery of value
 - »»» Delivery of functionality for specific applications
 - »»» String cheese that will melt in the crust
 - »»» Cheese that melts in "Hot Pockets"
 - »»» Nutraceuticals
 - »»» Willingness to sell on fixed forward price basis
 - »»» Requires strong risk management tools

Future Growth Markets

- » Opportunities to expand demand by increasing portions should not be ignored.
- » An increase of 1 ounce of cheese per pizza increases mozzarella cheese sales by 270 million pounds per year or 2.7 billion pounds of milk per year.

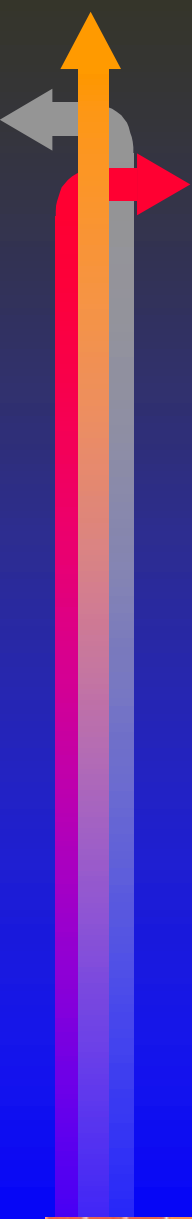


International markets will increasingly impact US domestic dairy markets.

- » Highly subsidized exports from the EU continue to depress world prices.
 - » The lower price surface limits US export potential and creates incentives to formulate ingredients for import in ways that circumvent tariffs.
- » It is critical to both producers and processors of domestically-sourced milk that the next round of WTO negotiations result in a substantial reduction in export subsidies.

Consolidation in the farm sector will continue.

- »»» Consolidation in the dairy producer sector will continue due to:
 - »»» Economies of scale
 - »»» Retirements
 - »»» Lifestyle issues



Consolidation in the farm sector will result in further regional shifts in production.

- »»» Although the large dairy model will be successfully implemented in some traditional dairy areas, population density and climatic dynamics will result in the continued shift of milk production to the west.

Need for Less Intrusive Regulation

- »»» Maturing domestic markets, increasing import pressure from artificially depressed world prices, and the consolidation in the farm sector all point to lower average prices unless significant innovation pushes demand.
- »»» In this environment, it is ever more important that national milk price policy not interfere with:
 - »»» The development of industry infrastructure in places where milk can be most efficiently produced and processed.
 - »»» The development of innovative dairy products that can better serve consumer markets.

Need for Less Intrusive Regulation

- »»» The need for less intrusive regulation is substantially greater when prices are set by an end-product price formula.
- »»» End-product price formulas are rigid.
 - »»» Yields and make allowances are set through a lengthy Administrative Rulemaking process.
 - »»» Changes in finished product prices are translated directly into the milk price.
 - »»» Therefore, if the make allowance is set at historic cost levels, manufacturers have no way to absorb cost increases, such as energy, labor & benefit costs, short of pursuing a change through a multi-year Administrative Rulemaking.
 - »»» Under the former survey mechanism, the changes in costs experience would be reflected in the milk value through the survey price.

Need for Less Intrusive Regulation

- »»» If any factors in an end-product price formula exceed reasonably achievable levels, the entire dairy industry is harmed.
 - »»» Investment in the development and marketing of innovative products is reduced.
 - »»» Private investment in the industry is reduced.
 - »»» The dairy processing function takes on more of a market-clearing objective, rather than a marketing objective.
 - »»» Demand gains are reduced.
 - »»» Disorderly marketing conditions result when processing cooperatives net less than marketing cooperatives that have not invested in capacity.

