# Dairy Sector

## Sector Snapshot

The dairy sector includes fluid milk manufacturing, ice cream and frozen dessert manufacturing, and butter, cheese and dry and condensed dairy product manufacturing, comprising 43 per cent, six per cent and 51 per cent of the sector's $13-billion in shipments respectively. Domestic demand for fluid milk and cream absorbs a fairly stable 40-per-cent share of the 48 to 50 million hectolitres of raw milk produced on Canadian dairy farms annually. The remainder is used in the production of butter, cheese, ice cream and other value-added products, including dairy ingredients used in other sectors such as confectionery.

## Export Opportunities

Exports are negligible in the dairy sector due to the high prices producers command for their raw milk under Canada's supply management system, and imports are restricted to protect the domestic market. Exports account for less than five per cent of shipments for major dairy categories, with the exception of skim milk powder, where foreign markets account for 18 per cent. Canada's top three skim milk powder markets, accounting for half of the $29 million in shipments in the first nine months of 2007, were Egypt, Cuba and South Africa. Imports account for less than five per cent of domestic consumption in all but two categories – specialty cheese and creamery butter.

## Major Players

Canada's top three processors – Saputo Inc., Parmalat Canada and Agropur – account for just over 70 per cent of the milk processed in Canada, and over $8 billion in combined dairy and non-dairy food and beverage sales. Other major players, with over $1 billion in Canadian sales, include Kraft Canada, Nestlé Canada and Unilever Canada. Neilson Dairy, a subsidiary of publicly listed George Weston, and three co-operatives – Gay Lea Foods, Scotsburn and Farmers – each with over $100 million in sales, round out the top 10.

## Consumption

Overall consumption of fluid milk and dairy products has until recently been steady or increased modestly thanks to strong demand in two categories, offsetting continued declines in two others. In 2006 and 2007 overall fluid milk consumption shrank by 0.5 per cent and 0.8 per cent respectively on a per capita basis to 58.2 L. Ice cream consumption declined by seven per cent to end 2007 at 5.4 L per person.

Only one of the two growth categories maintained its double-digit pace of the last decade. Consumption of table cream (18 per cent BF) – which has enjoyed 13-per-cent annual increases in per capita consumption since 1995 – grew by a further 10 per cent in 2007 to 2.3 L per person. Yogurt consumption, however, which had increased by an average of 10 per cent annually from 1997 to 2005, slowed to three per cent in 2006 and just under one per cent in 2007, just enough to lift Canadian consumption above five litres per person. Two of the biggest end uses for industrial milk have had fairly stable demand. Butter consumption held steady at 2.2 kg per capita, and in 2007, cheese consumption broke through the 10 kg/pc barrier for the first time in 20 years.

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The fastest-growing categories are quite small. Sales of cottage cheese (eight per cent of overall cheese volume) are up 10 per cent from 2006, as processors developed flavours and single-serve packaging, allowing this high-protein, low-calorie treat to compete directly with yogurt. Organic milk sales are growing by 25 per cent annually, but still comprise just $30 million of the $2-billion Canadian retail market for fluid milk. The double-digit sales growth of soy drinks over the last decade has slowed to high

**Production of Fluid Milk and Dairy Products – Canada – Year-To-Date September 2007 vs. same period of 2006**

| | Units | Production Jan.-Sept. 2007 | Change from Jan.-Sept. 2006 |
|---|---|---|---|
| Creamery butter | '000 tonnes | 59.01 | 0.8% |
| Cheese | '000 tonnes | 275.60 | 3.9% |
| Yogurt | '000 tonnes | 189.55 | 1.5% |
| Ice cream | '000 kilolitres | 242.99 | (4.1)% |
| Standard milk | '000 kilolitres | 292.94 | (1.5)% |
| 2% milk | '000 kilolitres | 921.61 | (0.8)% |
| 1% milk | '000 kilolitres | 445.38 | 1.7% |
| Skim milk | '000 kilolitres | 214.28 | 1.3% |
| Chocolate milk | '000 kilolitres | 136.78 | 3.5% |
| Cereal cream | '000 kilolitres | 3.67 | 10.1% |
| Table cream | '000 kilolitres | 25.71 | 11.1% |
| Whipping cream | '000 kilolitres | 1.48 | 7.5% |
| Sour cream | '000 kilolitres | 10.81 | 19.1% |

Source: Statistics Canada, Dairy Statistics: Third Quarter 2007, Catalogue no. 23-014-X

single digits, as retail sales cross the $100-million mark. The tiny rice drink category, with $12 million in sales, is growing by 15 to 25 per cent.

Premium-priced specialty milks – including organic, lactose-free, calcium-enriched, omega-3 and microfiltered – are steadily displacing the commodity alternatives, and delivering significant margin improvements to processors and grocers. The long dormant, single-serve fluid milk category has recently enjoyed strong sales growth as dairies have adopted packaging, branding and graphics to compete for away-from-home occasions with non-dairy beverage alternatives.

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## Profit Centres

Gross margins in the dairy sector, at 18 per cent of sales, are slightly better than the industry average (14 per cent). The publicly listed processors (including Parmalat, Saputo and Neilson, via George Weston) reported higher margins in 2007 largely due to improved product mix as consumers trade up from commodity to specialty fluid milk and indulge their tastes for probiotic yogurts and premium-priced specialty cheeses.

Margins are higher for fluid milk (21 per cent), ice cream and frozen desserts (33 per cent), and lower for non-frozen dairy foods such as butter, cheese and yogurt, where they match the industry average. Margins are improving as rising disposable incomes and increased interest in nutrition shift consumer spending to higher-margin, value-added dairy foods. In 2007, specialty and organic eggs, fluid milks and probiotic yogurts made significant gains against their conventional alternatives.

Unfortunately, the dairy sector has barely managed any real growth. The fluid milk sub-sector, with volume growth of less than one per cent, is largely to blame, as volume growth in the dairy products sub-sector (including ice cream and frozen desserts) is up 2.4 per cent from the year earlier period based on industrial milk demand.

## The Outlook

All three of the sector's publicly listed manufacturers are forecasting a continuation of their successful strategies of 2006 and 2007, namely capital investments in production and logistics to improve efficiencies and drive down costs, and innovation in products and packaging with an emphasis on nutrition and convenience. In 2007, revenues for Saputo, Parmalat Canada and Neilson Dairy rose by three to five per cent, reflecting stable volumes overall, price increases to recover higher raw material costs, plus a shift in product mix to value-added products. Earnings grew at twice that pace in part due to increased cost efficiencies, but mainly because value-added products command higher margins. This year should see increased innovation and spending in marketing. In particular, expect the major processors to increase their advertising and trade spending in categories where they have lost or risk losing market share to counter the recent expansion of private labels into specialty eggs, soy drinks and yogurts.