Overview of the Italian Dairy Market

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*Head of Business Analysis*

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*Senior Analyst*

30th November 2015
Summary

- Supply
  - Demand
  - Market
  - External Trade
  - Economic and financial analysis
The Italian Dairy Industry

- 3,420 companies
- 39,209 employees
- Milk production 2014: 3.2 million tons
- Cheese production 2014: 1 million tons
- 11.5% of total Italian food production

Source: Business Analysis - UBI Banca on ISTAT data
## The Italian Milk Market

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015F</th>
<th>2016F</th>
<th>var.% 16/15</th>
<th>var.% 15/14</th>
<th>var.% 14/13</th>
<th>var.% 13/12</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Production</strong></td>
<td>2,401.0</td>
<td>2,337.0</td>
<td>2,327.0</td>
<td>2,245.0</td>
<td>2,235.0</td>
<td>-0.4%</td>
<td>-3.5%</td>
<td>-0.4%</td>
<td>-2.7%</td>
</tr>
<tr>
<td><strong>Import</strong></td>
<td>350.5</td>
<td>375.4</td>
<td>344.6</td>
<td>307.0</td>
<td>305.3</td>
<td>-0.6%</td>
<td>-10.9%</td>
<td>-8.2%</td>
<td>7.1%</td>
</tr>
<tr>
<td><strong>Export</strong></td>
<td>4.7</td>
<td>5.3</td>
<td>7.3</td>
<td>8.5</td>
<td>9.5</td>
<td>11.8%</td>
<td>16.4%</td>
<td>37.7%</td>
<td>12.8%</td>
</tr>
<tr>
<td><strong>Balance</strong></td>
<td>-345.8</td>
<td>-370.1</td>
<td>-337.3</td>
<td>-298.5</td>
<td>-295.8</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Domestic Market</strong></td>
<td>2,746.8</td>
<td>2,707.1</td>
<td>2,664.3</td>
<td>2,543.5</td>
<td>2,530.8</td>
<td>-0.5%</td>
<td>-4.5%</td>
<td>-1.6%</td>
<td>-1.4%</td>
</tr>
<tr>
<td><strong>Export/Production</strong></td>
<td>0.2%</td>
<td>0.2%</td>
<td>0.3%</td>
<td>0.4%</td>
<td>0.4%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Import/Market</strong></td>
<td>12.8%</td>
<td>13.9%</td>
<td>12.9%</td>
<td>12.1%</td>
<td>12.1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Milk Market (value – million of euro)**

Business Analysis
## The Italian Cheese Market

### Cheese Market (value – million of euro)

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015F</th>
<th>2016F</th>
<th>var.% 16/15</th>
<th>var.% 15/14</th>
<th>var.% 14/13</th>
<th>var.% 13/12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production</td>
<td>4,235.0</td>
<td>4,180.0</td>
<td>4,250.0</td>
<td>4,195.0</td>
<td>4,275.0</td>
<td>1.9%</td>
<td>-1.3%</td>
<td>1.7%</td>
<td>-1.3%</td>
</tr>
<tr>
<td>Import</td>
<td>1,179.0</td>
<td>1,297.9</td>
<td>1,297.6</td>
<td>1,290.0</td>
<td>1,292.0</td>
<td>0.2%</td>
<td>-0.6%</td>
<td>0.0%</td>
<td>10.1%</td>
</tr>
<tr>
<td>Export</td>
<td>676.8</td>
<td>733.2</td>
<td>791.7</td>
<td>788.0</td>
<td>826.0</td>
<td>4.8%</td>
<td>-0.5%</td>
<td>8.0%</td>
<td>8.3%</td>
</tr>
<tr>
<td>Balance</td>
<td>-503.1</td>
<td>-564.7</td>
<td>-505.9</td>
<td>-502.0</td>
<td>-466.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic Market</td>
<td>4,738.1</td>
<td>4,744.7</td>
<td>4,755.9</td>
<td>4,697.0</td>
<td>4,741.0</td>
<td>0.9%</td>
<td>-1.2%</td>
<td>0.2%</td>
<td>0.1%</td>
</tr>
<tr>
<td>Export/Production</td>
<td>16.0%</td>
<td>17.5%</td>
<td>18.6%</td>
<td>18.8%</td>
<td>19.3%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Import/Market</td>
<td>24.9%</td>
<td>27.4%</td>
<td>27.3%</td>
<td>27.5%</td>
<td>27.3%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The Italian Dairy Industry

Companies’ Breakdown by Number of Employees

- 0-9 employees: 77.5%
- 10-49 employees: 18.8%
- 50-249 employees: 3.4%
- >=250 employees: 0.3%

Year 2013

Source: Business Analysis - UBI Banca on ISTAT data
The Italian Dairy Industry

Average Revenue per Company (million of euro)

- 2008: 5.8
- 2009: 5.2
- 2010: 5.3
- 2011: 5.6
- 2012: 5.5

Source: Business Analysis - UBI Banca on ISTAT data
The Italian Dairy Industry

Companies’ Breakdown by Type of Ownership

- Cooperative: 16%
- Corporations: 31%
- Sole proprietorship or Limited partnership: 53%

Year 2013

Source: Business Analysis - UBI Banca on ISTAT data
The Italian Dairy Industry

Regions with Higher Concentration of Dairy Companies

Companies’ Regional Breakdown

Source: Business Analysis - UBI Banca on ISTAT data
The quest for quality in the Italian Food Industry

Quality as competitive key factor

Main competitive factors (in % of total companies – 2011)

According to the last ISTAT Census on Italian companies, quality represents the key competitive factor for the Food Industry. Price is far less relevant and production flexibility and product diversification are even less important.

Source: Business Analysis - UBI Banca on ISTAT data
The Italian Cheese Industry

PDO
Protected Denomination of Origin

Brand of juridical protection assigned by European Union to food products whose characteristics are exclusively connected to the specific territory of production.

The characteristics are related to:

- the natural environment
- traditional production processes which have been developed over time in a specific geographical area
- raw materials produced locally.

All these factors are designated in a production protocol which has to be complied with by all companies which manufacture DOP products.

DOP
Denominazione di Origine Protetta

Source: Business Analysis - UBI Banca on Ismea data
Brand of juridical protection assigned by European Union to food products whose characteristics are exclusively connected to the specific territory of production. However, while for DOP products the entire production process must be run in the typical geographical area, for PGI products at least one phase of the entire production process must be done in the designated area.

The typical phases of production process, as well as other specific aspects, are indicated in a production protocol which has to be complied with by all companies which manufacture PGI products.
## The Italian Cheese Industry

### DOP, IGP e STG food products recognized by European Union (31th December 2013)

<table>
<thead>
<tr>
<th>Country</th>
<th>DOP</th>
<th>IGP</th>
<th>STG</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>67</td>
<td>10</td>
<td>50</td>
<td>208</td>
</tr>
<tr>
<td>Germany</td>
<td>5</td>
<td>15</td>
<td>7</td>
<td>96</td>
</tr>
<tr>
<td>Greece</td>
<td>2</td>
<td>-</td>
<td>21</td>
<td>101</td>
</tr>
<tr>
<td>Italy</td>
<td>5</td>
<td>37</td>
<td>47</td>
<td>261</td>
</tr>
<tr>
<td>Netherlands</td>
<td>7</td>
<td>-</td>
<td>-</td>
<td>10</td>
</tr>
<tr>
<td>Portugal</td>
<td>30</td>
<td>36</td>
<td>12</td>
<td>120</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>11</td>
<td>4</td>
<td>15</td>
<td>54</td>
</tr>
<tr>
<td>Spain</td>
<td>15</td>
<td>16</td>
<td>28</td>
<td>173</td>
</tr>
<tr>
<td>UE</td>
<td>142</td>
<td>146</td>
<td>220</td>
<td>1,181</td>
</tr>
<tr>
<td>Extra-UE</td>
<td>1</td>
<td>-</td>
<td>7</td>
<td>16</td>
</tr>
<tr>
<td>World</td>
<td>143</td>
<td>146</td>
<td>220</td>
<td>1,220</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Country as % of World</th>
<th>DOP</th>
<th>IGP</th>
<th>STG</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Italy</td>
<td>3.5%</td>
<td>25.3%</td>
<td>21.4%</td>
<td></td>
</tr>
</tbody>
</table>

### Quality agrifood products

<table>
<thead>
<tr>
<th>Country</th>
<th>DOP</th>
<th>IGP</th>
<th>STG</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Italy</td>
<td>158</td>
<td>101</td>
<td>2</td>
<td>261</td>
</tr>
<tr>
<td>Netherland</td>
<td>5</td>
<td>3</td>
<td>2</td>
<td>10</td>
</tr>
<tr>
<td>Portugal</td>
<td>62</td>
<td>61</td>
<td>-</td>
<td>123</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>22</td>
<td>30</td>
<td>2</td>
<td>54</td>
</tr>
<tr>
<td>Spain</td>
<td>92</td>
<td>77</td>
<td>4</td>
<td>173</td>
</tr>
<tr>
<td>UE</td>
<td>559</td>
<td>579</td>
<td>43</td>
<td>1,181</td>
</tr>
<tr>
<td>Extra-UE</td>
<td>5</td>
<td>11</td>
<td>-</td>
<td>16</td>
</tr>
<tr>
<td>World</td>
<td>587</td>
<td>590</td>
<td>43</td>
<td>1,220</td>
</tr>
</tbody>
</table>

Source: Business Analysis - UBI Banca on Ismea data
The Italian Cheese Industry

Italian DOP Cheese

Source: Business Analysis - UBI Banca on Ismea data
Summary

- Supply

- Demand

- Market

- External Trade

- Economic and financial analysis
## Milk Consumption – European Union (Year 2013 - litres per capita)

<table>
<thead>
<tr>
<th>Country</th>
<th>Milk Consumption (litres)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ireland</td>
<td>137.9</td>
</tr>
<tr>
<td>Finland</td>
<td>127.3</td>
</tr>
<tr>
<td>Estonia</td>
<td>113.8</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>102.1</td>
</tr>
<tr>
<td>Latvia</td>
<td>91.9</td>
</tr>
<tr>
<td>Sweden</td>
<td>89.4</td>
</tr>
<tr>
<td>Denmark</td>
<td>85.6</td>
</tr>
<tr>
<td>Spain</td>
<td>81.0</td>
</tr>
<tr>
<td>Austria</td>
<td>74.3</td>
</tr>
<tr>
<td>European Union (28)</td>
<td>61.6</td>
</tr>
<tr>
<td>Croatia</td>
<td>61.6</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>57.7</td>
</tr>
<tr>
<td>France</td>
<td>52.3</td>
</tr>
<tr>
<td>Germany</td>
<td>52.1</td>
</tr>
<tr>
<td>Italy</td>
<td>52.1</td>
</tr>
<tr>
<td>Hungary</td>
<td>48.9</td>
</tr>
<tr>
<td>Belgium</td>
<td>47.8</td>
</tr>
<tr>
<td>Netherlands</td>
<td>47.5</td>
</tr>
<tr>
<td>Slovakia</td>
<td>46.6</td>
</tr>
<tr>
<td>Poland</td>
<td>40.9</td>
</tr>
<tr>
<td>Lithuania</td>
<td>31.0</td>
</tr>
</tbody>
</table>
Cheese Consumption – European Union (Year 2013 - Kilos per capita)

<table>
<thead>
<tr>
<th>Top 10 cheese consumers, per capita</th>
<th>Middle of the road</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>France</strong></td>
<td>U.S.</td>
</tr>
<tr>
<td>25.9 kilograms</td>
<td>15.4</td>
</tr>
<tr>
<td><strong>Iceland</strong></td>
<td>U.K.</td>
</tr>
<tr>
<td>25.2</td>
<td>11.6</td>
</tr>
<tr>
<td><strong>Finland</strong></td>
<td></td>
</tr>
<tr>
<td>24.7</td>
<td></td>
</tr>
<tr>
<td><strong>Germany</strong></td>
<td></td>
</tr>
<tr>
<td>24.3</td>
<td></td>
</tr>
<tr>
<td><strong>Estonia</strong></td>
<td></td>
</tr>
<tr>
<td>21.7</td>
<td></td>
</tr>
<tr>
<td><strong>Switzerland</strong></td>
<td></td>
</tr>
<tr>
<td>21.3</td>
<td></td>
</tr>
<tr>
<td><strong>Italy</strong></td>
<td></td>
</tr>
<tr>
<td>20.7</td>
<td></td>
</tr>
<tr>
<td><strong>Lithuania</strong></td>
<td>Bottom five consumers</td>
</tr>
<tr>
<td>20.1</td>
<td>South Korea</td>
</tr>
<tr>
<td><strong>Austria</strong></td>
<td>2.2</td>
</tr>
<tr>
<td>19.9</td>
<td>South Africa</td>
</tr>
<tr>
<td><strong>Sweden</strong></td>
<td>1.7</td>
</tr>
<tr>
<td>19.8</td>
<td>Colombia</td>
</tr>
<tr>
<td></td>
<td>0.9</td>
</tr>
<tr>
<td></td>
<td>Zimbabwe</td>
</tr>
<tr>
<td></td>
<td>0.3</td>
</tr>
<tr>
<td></td>
<td>China</td>
</tr>
<tr>
<td></td>
<td>0.0</td>
</tr>
</tbody>
</table>
The Italian Dairy Industry

Average monthly expense of Italian families for ‘Milk, cheese and eggs’
Year 2014: 59.7 euro (+1% on 2013)

Source: Business Analysis - UBI Banca on ISTAT data
The Italian Dairy Industry

Daily consumers of dairy products

- Milk: 33%
- Grana cheese: 25%
- Fresh cheese: 24%
- Fruit yogurt: 10%
- Plain yogurt: 15%
- Hard cheese: 6%

Source: MIPAAF-SINAB-Bio Bank-IFOAM-Nomisma
The Italian Dairy Industry

Italian domestic consumption of dairy products
(% annual change Jan-Sept 2015 / Jan-Sept 2014)

Source: Ismea
Summary

- Supply
- Demand

**Market**

- External Trade
- Economic and financial analysis
Key recent developments

End of quota system

As of last April, the EU Quota system has been Abolished.

Farmers are allowed to Produce freely.

This has led to an increase Of quantity supplied Not just in Italy, but At the European level.

Russian embargo

The Russian government Has imposed tight Restrictions to the Import of dairy Products from the European Union.

This has caused a fall In demand at the time Supply is rising As a result of the End of the quota system.

The two factors are exerting a strong downward pressure on milk prices across the EU.
Indexes of prices at the factory gate

- Milk price
- Hard cheese price

Source: CRPA-APROLAV
Milk/Feed Ratio is defined as milk price divided by the cost of purchased feed.
The Italian Dairy Industry

Index of Business Climate

Food & Beverage Industry

EXPO Effect

Dairy Industry

Source: Ismea
Comparative historical overview of the price of some cheeses

Source: ZMP, USDA, CCIA A Milano
Summary

- Supply
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The Italian Dairy Industry

Export, Import and External balance

Source: Business Analysis - UBI Banca on ISTAT data
The Italian Dairy Industry

Export

Source: Business Analysis - UBI Banca on ISTAT data
The Italian Dairy Industry

Total, domestic and foreign revenue

Source: Business Analysis - UBI Banca on ISTAT data
The Italian Dairy Industry

Export Revenue/Total Revenue

Source: Business Analysis - UBI Banca on ISTAT data
Summary

- Supply
- Demand
- Market
- External Trade

- Economic and financial analysis
The sample is made up of 117 companies selected according to the following criteria:

1. Companies classified as operating in the Industry of Operation of dairies and cheese making by ISTAT – Italian National Statistical Office
2. Company accounts available from 2008 through 2014
3. Detailed company accounts available
4. Sales in 2014 over €5 million
5. Legal form: companies/corporations (excluding cooperatives, consortiums, etc…)

The sample of selected companies is closed.
Selected Sample of SME Companies in the Italian Dairy Industry

Sales

In the last five years the average sales of sample companies have increased constantly.

Source: Business Analysis - UBI Banca
Selected Sample of SME Companies in the Italian Dairy & Cheese Industry

Profit margins

The NOPAT margin of the sample companies has declined as a result of the increase of input prices and the pressure on selling prices due to soft domestic demand.

Source: Business Analysis - UBI Banca
Selected Sample of SME Companies in the Italian Dairy & Cheese Industry

Capital turnover

**Fixed assets as % of sales**

- 2009: 36%
- 2010: 35%
- 2011: 32%
- 2012: 29%
- 2013: 27%
- 2014: 25%

**Net operating working capital as % of sales**

- 2009: 1.75
- 2010: 1.93
- 2011: 2.37
- 2012: 2.15
- 2013: 2.31
- 2014: 2.31

**Turnover of invested capital**

- 2009: 1.75
- 2010: 1.93
- 2011: 2.37
- 2012: 2.15
- 2013: 2.31
- 2014: 2.31

Fixed assets have declined as a % of sales thanks to the growth of the latter, whereas the net operating working capital as a % of sales has remained fairly stable. Hence the capital turnover (Sales / Invested capital) has been stable at just over 2x.
Selected Sample of SME Companies in the Italian Dairy & Cheese Industry

**Debt**

Net debt of the sample companies has trended down since 2011. As a result, the financial structure looks quite strong.

*Source: Business Analysis - UBI Banca*
Selected Sample of SME Companies in the Italian Dairy & Cheese Industry

**ROI – Return on Invested Capital**

The Return on Invested Capital of sample companies has declined in the last years as a consequence of the fall in the NOPAT margin, while the capital turnover ratio has remained fairly constant.

Source: Business Analysis - UBI Banca
The quest for value in the Italian Food Industry

The value chain

Given at 100 the price paid by final customers for food products, in 2011 the added value share of the food industry was only 10.3%, compared with an added value share of 24% for the distribution sector (transport and retail).

Source: Business Analysis - UBI Banca on ISMEA/ISTAT data
In 2011 the operating pre-tax profit margin of the Italian Food Industry was equal to only 2.0% of the total price paid by final customers.
The quest for value in the Italian Food Industry

New supply contracts

How is it possible to make quality food products that provide an adequate economic returns to both raw material producers and food manufacturing companies?

Probably by building new supply relationships that cut away trading intermediaries and offer other advantages to both parts.

Indeed, in recent years in Italy new contracts have been developed to create direct supply channels between farmers and food companies (so called ‘Contratti di fornitura’ – Supply Contracts).

Source: Business Analysis - UBI Banca
The quest for value in the Italian Food Industry

The advantages of direct supply contracts

For the Farmers

- Safer income thanks to pre-defined supply price
- Higher income thanks to superior quality
- Better agriculture techniques thanks to collaboration with food processing companies

For the Food Company

- Safer supply
- Reduction of transport costs
- Higher quality of supply
- ‘Made in Italy’ label
- Full trackability of products
- Less volatility of supply prices

Source: Business Analysis - UBI Banca
The quest for value in the Italian Food Industry

Direct supply contract – Dairy sector

September 2015
Dairy and Cheese Supply

5 Production Organisations

AOP – Associazione di Organizzazioni di Produttori - Latte Italia
1,000 members
1 million of tons of milk

Source: Business Analysis - UBI Banca
Conclusions

The Italian Food Industry is characterised by small companies whose negotiating power is low with regard to companies operating in the distribution system of food products.

However, a small improvement in the profitability of SME sampled in the Italian Food Industry would be sufficient to make it possible for them to create shareholders’ value, i.e. to bring the level of ROI above that of WACC.

Many companies, even the small ones, are trying to achieve this improvement in profitability by increasing the quality of their products. Indeed, quality is considered by the vast majority of Italian food companies as the most important competitive factor.

Therefore, the ‘quest for value’ has become a ‘quest for quality’. In this respect, it is becoming increasingly important the creation of direct supply channels between farmers and the food processing companies. On the one side, these contracts facilitate the realisation of integrated ‘Made in Italy’ supply chain to further elevate the quality of products. On the other side, these direct supply contracts allow both farmers and food processing companies to increase their profitability.

Source: Business Analysis - UBI Banca
Thank You for Your Attention