

Dairy Industry in Argentina 2006

Report to the 25th Congress of the IUF

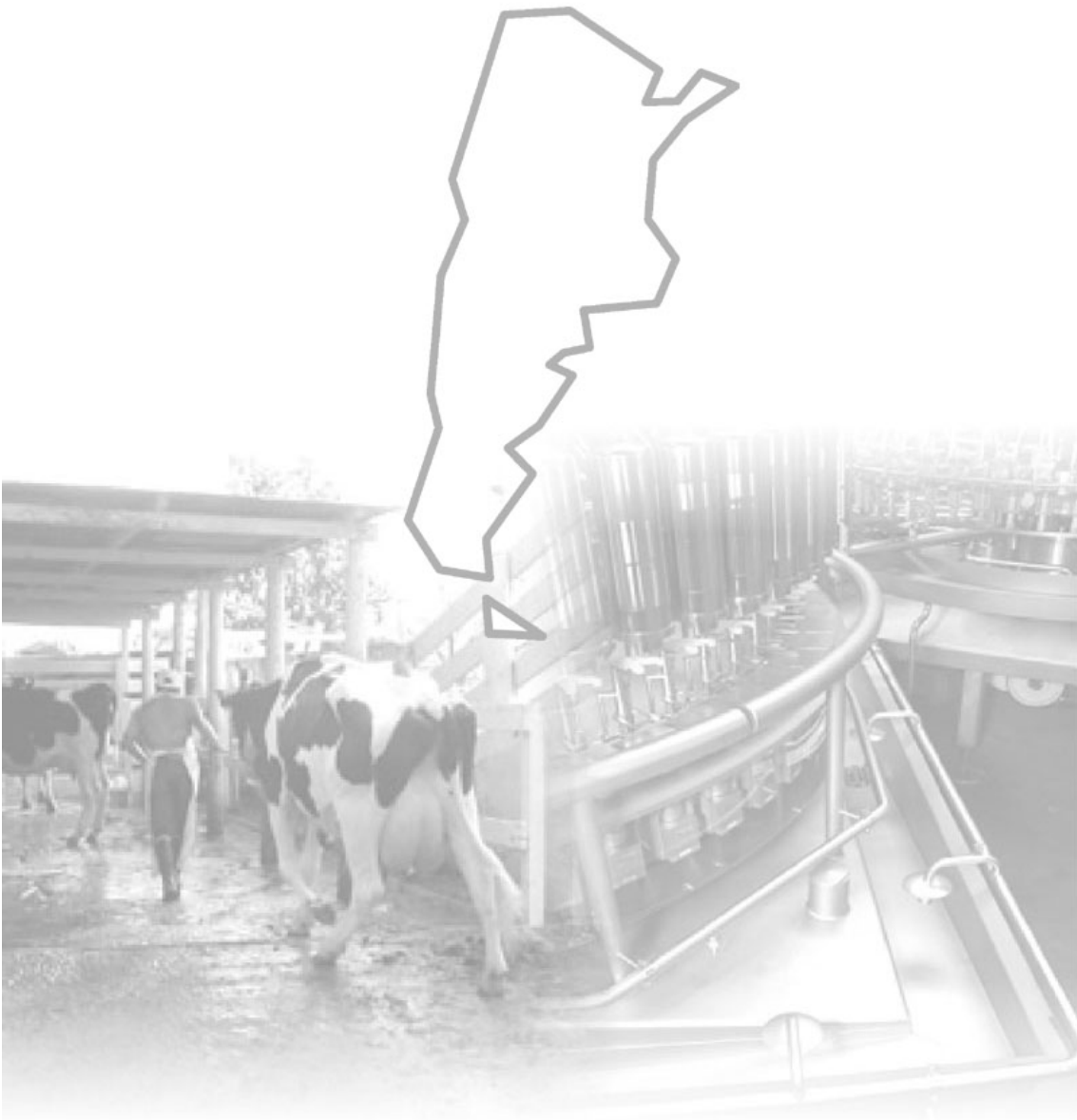


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Dairy Industry in Argentina 2006



2nd Semester 2006

Primary Production

According to preliminary data, 2006 closed with a growth in production of around 6 percent, with figures decreasing at the end of the year after standing at ten percent in the first semester, as compared to the same period of 2005.

In any case, this new annual level consolidates a process of sustained growth that the country has been experiencing after a significant depression suffered by the dairy industry during the 2000-2003 period, which implied a loss of 23 percent of the total production, reaching its lowest point in 2003, with a total of 7,951 million liters processed by all the dairy companies on this side of the River Plate combined.

If the 6 percent growth for 2006 is confirmed, total production will stand at around 10,100 million liters, which is very close to the historical record registered in 1999 with 10,329 million liters of milk processed.

The high demand for dairy products in global markets, the sustained increase of these products' prices, the expansion and strengthening of domestic consumption, plus the privilege enjoyed by Argentina as one of the very few countries in the world where dairy production can still grow at a steady pace, are only a few of the elements of value (there are many more) that attest to the great potential for growth of this economic activity, which will be fully accomplished if only the main players involved can agree to take advantage of these favorable times.

With New Zealand having reached its production roof, Australia facing severe weather issues: droughts and fires; and the European Community lacking the exporting aggressiveness it once had as a result of the significant subsidies it granted its dairy farmers, only Argentina, Brazil, and to a lesser extent Uruguay and Chile, emerge as the world's privileged nations for increasing their volumes of raw materials, satisfying the needs of their populations, and having a strong presence in international markets.

The withholding tax applied by the government in the past to dairy exports, as a way of curbing inflation, discouraged farmers, who feared the worst: that the prices paid by industry would not cover their production costs.

After the government set at 10 and 15 percent the withholding tax imposed on cheese and powdered milk exports, respectively, and discontinued the export refunds, a serious conflict arose

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between producers and industrialists, as a result of the distortion in the price of raw materials paid to dairy farmers.

We have always proclaimed from these very same pages the great differences that exist among Argentinean industrialists and the inability of some, as opposed to others, to satisfy the needs of producers with respect to the price of the raw material supplied.

Those who only dry milk and export it, have low production costs because they work with a single product, and they have a high profitability as a result of good and consistent international prices; This situation contrasts with that of the companies that manufacture a range of products, supply the domestic consumer market, add value through their production lines, and generate an important number of jobs.

The former benefited from the high international prices attained, for example, in the case of powdered milk, with market values ranging from 2,800 and 3,000 US dollars a ton.

The companies that place most of their products in the domestic consumer market face a double problem: greater production costs due to their diversified production, and prices controlled by the Argentinean government.

Consequently, the monetary return is different for both groups, as is also the possibility of paying for the raw material they receive.



The Compensating Fund Is Born

As a way of satisfying the diverse interests of the different groups involved, producers and industrialists were for the first time able to reach a compromise, under the auspices of the State. Thus the Dairy Product Stabilization Program was officially born, and in the framework of this program the withholding tax imposed on powdered milk was reduced to 5 percent.

The decision was made after a meeting presided by the Minister of Economy, Felisa Miceli, with the participation of the new Secretary of Agriculture, Livestock, Fishery and Foods (SAGPyA), Javier de Urquiza, accompanied by the National Dairy Policy Coordinator, Juan Linari. Also present at the meeting were the representatives of the Dairy Group, formed by the four dairy provinces and the industry. The representatives were: Horacio Mihura (Entre Ríos), Juan Aimar (Buenos Aires), Roberto Socín (Santa Fé) and Juan Trossero (Córdoba).

The Dairy Industry Center (CIL) was represented at the meeting by its president, engineer Osvaldo Capellini, and the Inter-Cooperative Board was represented by Alejandro Galetto. Daniel Pellegrina attended on behalf of the Argentinean Rural Association, while Raúl Catta did so for the Association of Dairy Farmers.

As described by SAGPyA spokespersons, the decision refers to a Dairy Product Stabilization Program that includes a mechanism for dairy farmers to improve the price they are paid for primary production by means of a methodology that will be implemented.

The only thing that remains to be done now is to instrument the Program's operating aspects, and among these, that which interests producers the most: how payment of the compensation incentive they are to receive will be determined.

The ideal mechanism would be for the State to deposit directly in the producers' accounts the amounts they are entitled to according to the records that will be taken into account to that effect. Thus the importance of, and the need to take especially into account, the fact that the payments will be made solely in proportion to the volume of milk delivered and declared to the competent bodies. This entails that producers operating in the marginal sector or delivering milk without entering it in their books would be automatically excluded from this benefit.

The Dairy Product Stabilization Program, the withholding tax imposed on powdered milk was reduced to 5 percent.

The payments will be made solely in proportion to the volume of milk delivered and declared to the competent bodies.

In any case, implementing this mechanism will take some time, and therefore, in the first few months payments will most certainly be made through the industry, which would handle the funds provided by the State.

Important Aspects of the **Dairy Product Stabilization Program**

- ✓ Reduction of the export tax on powdered milk to 5 percent, as a starting point for the operation of the system proposed.
- ✓ A mechanism is established that, based on the application of mobile exporting taxes, allows for capturing the difference between the cut value agreed upon by the sector (2,100 US dollars per ton of powdered whole milk in 25-kilo bags and its equivalent for fractional presentations) and prices applicable to export transactions, with the purpose of creating a fund for dairy farmers as system beneficiaries.
- ✓ The SAGPyA is appointed as the body in charge of program application, with the possibility of delegating its operational implementation on ONCCA.
- ✓ The private sector –production and industry– shall have a permanent, active involvement as advisor to the body in charge of program application.
- ✓ The necessary measures are taken to prevent maneuvers tending to under-invoice exports, a practice detrimental to the Argentinean Treasury and to the beneficiaries of the fund to be created.

In accordance with said aspects, the objectives shall be the following:

- ✓ To maintain the prices of dairy products at levels compatible with the purchasing power of Argentinean consumers.
- ✓ To improve prices of primary production paid to dairy farmers
- ✓ To acknowledge the growing role of the Argentinean dairy industry in the international market, by considering a reasonable profitability framework for the exports of dairy products.

Industry

With respect to industrial aspects, the most important issue is the financial assistance agreement obtained by SanCor through the solution provided by the Venezuelan government, an issue that, given its magnitude, will be dealt with in a separate article

This is an important issue, especially if we take into account that, before the end of this first semester, the other large dairy company in our country (La Serenísima) will have to face the difficult situation of refinancing its debt.

On the other hand, Milkaut, the other dairy cooperative located in the dairy region of the province of Santa Fe, has partnered up once again with a foreign company. This time it was with the French firm Bongrain, whose contribution will include, besides the plants, funding for the lines of Santa Rosa, Adler and Bavaria cheeses, in exchange for 40 percent of the cooperative's capital stock. Bongrain owns and operates the plants of Santa Rosa Estancias, located in San Jerónimo Norte, Las Parejas, and Carlos Casares, all within the Province of Buenos Aires.

Dairy companies that are based in our country, continue to grow at a steady pace.

Milkaut is a cooperative whose presence in Buenos Aires is not significant, but nationally it ranks third amongst liquid milk market operators, behind the two giants: La Serenísima and SanCor.

Milkaut is under the control of Asociación Unión Tamberos Cooperativa (the dairy farmers cooperative association) with head offices in Franck (Santa Fe). The union gathers approximately 650 dairy farmers for whom having a foreign partner is nothing new, since 24 percent of the association's capital stock was acquired by the investment funds Laccap and Patagonia back in the year 2000. By mid 2005, these funds had sold their shares to the Chilean dairy company Vialat.

Last July, the same 24 percent was bought by Bongrain. Its participation rose to 40 percent with the introduction of its cheese business, for which the government's approval was necessary. Such approval was granted through a resolution of the Secretary of Commerce, Guillermo Moreno

In Paris, where the firm Bongrain is listed in the stock exchange, there was a news release issued jointly, at the time, by the two companies, where they stated that the agreement allowed a growth for Milkaut of at least 20 percent, right from the beginning of the new business relationship.

The other dairy companies that are based in our country, like Molfino-La Paulina, Verónica and Williner, continue to grow at a steady pace. The latter has a newly operating milk drying plant, with a daily capacity of 700 thousand liters.

Exports

According to official data provided by SENASA, Argentinean dairy exports in 2006 amounted to 378,931 tons –worth 836,550,000 US dollars–, thus showing a growth of 32 percent in volume and 30 percent in tons, as compared to 2005 exports, which had amounted to 284,961 tons, for a total value of 640,689,000 US dollars

As per data from said authority, total cow milk volume was 241,240 tons, 30 percent more than the exports of the previous year. The main destinations of the product were: Algeria (45,550 tons); Venezuela (39,460 tons); Brazil (33,309 tons), Mexico (14,940 tons); and Nigeria (14,448 tons). Other destinations of lesser significance were: Chile, Cuba, Senegal, Jordan and the Democratic Republic of Congo.

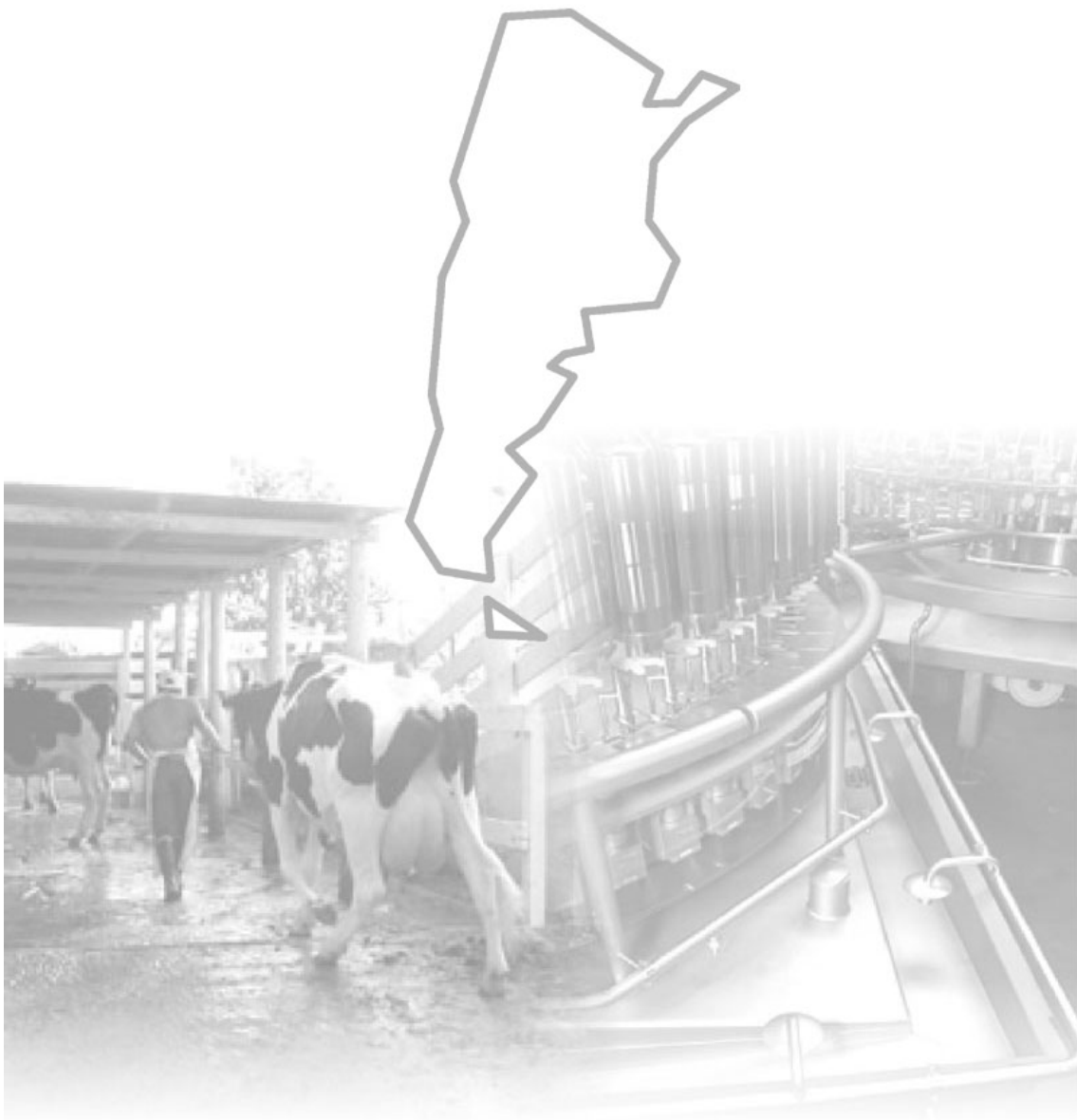
Cheeses:

SENASA certified 57,706 tons of cheese exported for a value of 156,785,000 US dollars, which implied a growth of 8 percent in both monetary terms and volume, as compared to 2005 figures. The main destination were: Russia (14,435 tons); the US (7,415 tons); Chile (7,356 tons); Mexico (5,825 tons); South Korea (5,299 tons); and Japan (5,250 tons).

Other shipments of dairy products abroad –such as “dulce de leche” (milk spread), whey, and butter, among others– amounted to 78,985 tons, for a total value of 138,411,000 US dollars, which implied an increase in monetary terms of 83 percent, and a 70 percent increase in volume.



Dairy Industry in Argentina 2006



SANCOR Case

ATILRA Guarantees Members their Jobs

Background

No one can deny that **SanCor Cooperativas Unidas Ltda.** has always been a company deeply rooted in our society, a company that was the pride of all Argentines. From very early on, our country has heard such unfortunate set phrases as: “There’s no way that giant El Hogar Obrero will ever close down!” And then one day, El Hogar Obrero’s days as a temple for the people came to an end, and it stopped being a haven for the unfortunate. Something similar has happened to the Sunchalense Cooperative company SanCor: it has not and is not in danger of disappearing, but it has suffered the consequences of the generous doses of negligence that in the past many of the individuals in charge have grossly subjected it to.

There is a saying that goes something like ‘being foolish, selfish and healthy are three vital elements to being happy, but if the first is lacking, then everything else is lost’.

This was apparently the maxim held for many years in SanCor, although there were people, honorable exceptions, who tried to open up a different path, aware that in politics two plus two often equals five, or even three, but in business: two plus two will always be four.

SanCor was becoming more and more like a clumsy boat drifting aimlessly.

When public opinion learned of the negotiations that the Great Argentinean Dairy Company was conducting with Adecoagro, we were asked what ATILRA’s position was as an institution.

If our history were truly known, then we wouldn’t have to answer that question. ATILRA has always supported any dairy companies that constituted a hub of development for cities and regions, as is the case of SanCor. That did not in any way mean that we were indulgent towards the unwise policies adopted by the men in charge of guiding the fate of the company. What is more, we have always taken it onto ourselves, as an unavoidable responsibility, to denounce any policies, regardless of where and whom they came from, that went against the company’s normal operations.

We are not quick to lay the blame on the company’s current management because we know that they made true efforts to overcome the situation. Many, many years back, our trade union warned that SanCor was becoming more and more like a clumsy boat drifting aimlessly, with no port of destination, and while the crew below deck rowed and rowed, those above deck trafficked and divided the loot. This ship, whose precious load was guarded by a numerically adequate and technically fit crew, was suddenly weighed down by new crewmembers who merrily got on board the vessel with apparently no specific tasks to perform, on the back of some influential figure or other, thus jeopardizing the craft as a whole and the cargo itself.

To top it all, these new crewmembers, who occupied superfluous positions but were paid high salaries, in time introduced an anachronistic way of justifying their pseudo-hierarchies and

salaries: other crewmembers, to whom they paradoxically assigned new and sumptuous salaries to perform no apparent tasks in particular.

It is a known fact, dictated by logic, common sense and reason, that for a company to be commercially viable it must observe a number of parameters that are basic when it comes time to assess the causes of a company's accomplishments and failures.

No company can expect to do well in business with an indefinite number of employees not contemplated by the Collective Labor Agreement that regulates its activities. That is, high-ranking positions must be well paid. That holds true for any healthy company in the country and in the world. But these high-ranking positions must be small in number, so that the company won't be weighed down by a heavy financial load. In SanCor, moreover, the individuals occupying high-ranking positions have historically acted as a group, striving to protect their own personal and sectorial interests, without looking out for the common good, and without realizing, or perhaps not caring, that the fate of the individual must inexorably be tied to the fate of the whole, and not the other way around. This group of high-ranking officials, already deeply entrenched in their position of power, for years succeeded in convincing managing board after managing board of the cooperative into believing that they were important, and practically ran the company as they wished. Among their arguments for remaining in charge and retaining their privileges was the claim of a potential labor conflict, for which, they said, the company must have a protective front, which time proved not only exceedingly costly but also absolutely worthless.

The fate of the individual must inexorably be tied to the fate of the whole, and not the other way around.

The bases on which this plan rested was the attempt to lure workers away from ATILRA. How? By paying a large number of workers wages above those established by the Collective Labor Agreement N° 2/88, which governs activities. These high salaries were added to those other, even higher salaries of the very large group of high-ranking positions. To make things even worse, that same group played its own ball game, representing no one but its members, and slowly but surely it took over the most important decisions. But in order to carry out its plans, it needed to symbolically use a means that would contain them, and that is why it resorted to a health care fund.

Can a company operate soundly with their most valuable input, its human resources, divided?

Back then, the law required that companies pay their workers' social and health benefits through the original "Obra Social" or welfare union fund, in this case: OSPIL.

But the group did not want the cooperative's bureaucratic and heavy administration to use the services of OSPIL, so it imposed an additional charge on the company –a double and useless expense. On the one hand, and pursuant to law, SanCor paid the corresponding worker benefits to OSPIL for its entire payroll, but a large part of the personnel on the payroll –the members of the high-ranking group– did not use OSPIL's medical and welfare services. On the other hand, without being under any obligation whatsoever, SanCor paid an identical sum to the other health care fund for the services it provided. Workers were divided. Can a company operate soundly with their most valuable input, its human resources, divided? This division was not caused by exogenous factors, but rather by the very same people who were responsible for creating suitable

and harmonious working conditions for their workforce. Is it clear that to get away with these abuses, the group also forced the parent cooperative to pay a huge monetary sum that it had no obligation to pay? Isn't this procedure that we describe unreasonable?

This very expensive plan may have had a half a chance of succeeding with a labor organization lacking in ideas, membership and convictions, something which unfortunately did happen at some point; but when there is a serious, clear-thinking, rational and responsible trade union to deal with, a union with the active involvement of their members, such a perverse plan loses its basis of support and comes crashing down.

The most representative union leaders were violently criticized for upholding this view. It was a way of attacking and discrediting ATILRA as a labor organization.

Who's Up Next

That is why when we were asked what ATILRA's position as an institution is with respect to the company's current situation, we repeated: our history has been ignored.

It was us and no other who when it was necessary conducted all sorts of official and unofficial negotiations with different bodies, with the aim of obtaining the help the cooperative was in need of; having gone as far as the National Executive Branch, to stress how important it was for us for the company to continue to be run by genuinely Argentinean capital.

The union's greatest desire was for SanCor Cooperativas Unidas Ltda. not to lose its cooperative status.

In that same communication delivered to the government, we pointed out that there wasn't a single dairy country in the world that did not have a large dairy company of significance owned by local capital. This explanation is in order to make it clear that the union's greatest desire was for SanCor Cooperativas Unidas Ltda. not to lose its cooperative status. It is also clear that we wanted to prevent its transnationalization, which is why –and without this being one of our specific obligations– we made all the efforts that were in our power towards achieving that aim.

The negotiations –not ours of course, but those conducted by the company– did not yield the results expected, and there followed a period of uncertainty, after which we were officially informed by the company that it was seeking alternatives through an association with anyone who might be interested in this type of business.

SanCor had defaulted in 2002, and was able to restructure its debt in 2004.

Everything seems to indicate that to meet payments on these loans, the cooperative had based their income projection on exports, which make up approximately 30 percent of its total turnover.

The increased withholding tax on dairy exports caused SanCor's income to drop by more than 50 million pesos, a situation that was aggravated by the impossibility of raising the price of their products in the domestic consumer market due to the restrictions imposed to prevent inflation from escalating.

The cooperative, which had honored the obligations incurred in 2005, was, because of the reasons explained above, unable to do the same in 2006. The extent of the debt –a declared 167 million US dollars, which might add up to almost 200 million US dollars if certain variables are updated– is significant, and constitutes a major obstacle hindering any form of solution.

More recently, and as a result of the financial strain it was under, the company had limited its medium and long-term planning, as it had to operate with an almost daily cash flow.

This complex situation is further complicated by the other companies of the industry, which were joined by new agents –Saputo, etc.–, which became heavy players in the dispute for raw materials; so that the scenario of negotiations for SanCor became a serious and hard-to-solve issue.

In this state of affairs, the cooperative's management publicly announced that it had initiated a series of negotiations with Adecoagro, an agribusiness company owned by the investment group whose visible head is George Soros, although he is not a majority shareholder.

When it became known that transnational capital might acquire a controlling stake (62.5 percent) in the management structure of what is today SanCor, questions were immediately raised, and, naturally, ATILRA, which represents all the workers of the industry, was forced –not only in SanCor's case, but also for other cases we already had in the country and for future cases– to conduct an in-depth analysis of the situation and draw conclusions that could be used to implement any strategies that might be necessary.

The scenario of negotiations for SanCor became a serious and hard-to-solve issue.

In that sense, as we explained above, the union believed SanCor should maintain its status of cooperative, managing 100 percent of the company's business.

Now then, if that would have been possible and the final decision, which is the discretion of company management, would have been to transnationalize the company, we would have to logically conclude that:

- Argentina has become one of the five largest countries in the world with the greatest growth possibilities in the field of dairy production.
- In contrast to other major competitors, our country is very far from reaching the ceiling of its current growth.
- In our country, production costs are still relatively low in comparative terms in US dollars.
- Thanks to the many years of efforts by dairy farm producers in cattle genetic improvement, Argentinean cows have achieved optimal production parameters.
- This part of the world has sufficient suitable land to develop a large-scale dairy production.
- Argentina has a significant number of high-technology dairy farms, and the possibility of incorporating many more production units.
- The dairy industry has numerous automated factories, semi-automated factories, modern drying plants, etc.

In view of the above, the protection of the interests of our fellow workers depends on the degree of maturity, strength and capacity for mobilization of our union, and not on the devouring appetite of any investment group that wishes to take over an Argentinean dairy company.



In any case, and towards securing the future integrity of the company as a single operating unit, SanCor's management should have duly guaranteed, regardless of who the potential partner was, that the company would not be dismembered and sold in parts, and if the future partner had no hidden agenda, then it would have raised no objections to including a clause in that respect.

CONCLUSION:

At ATILRA, we were not afraid of the arrival of transnational investment groups. We are responsibly aware of our mobilization capacity and, besides, we are already dealing with multinational corporations, who are respecting the rights of dairy workers throughout the country and maintaining peaceful and cordial relations with ATILRA. Our organization has earned this respect through our struggles and our deep convictions.

But, moreover, and this has to do strictly with a universal rule of common sense, it is impossible to work in an orderly fashion without the logical conciliation of corporate interests and the interests of the union representing the workers.

The protection of the interests of our fellow workers depends on the degree of maturity, strength and capacity for mobilization of our union.

“They're all honest people, so what have they got to hide?”

As soon as it became known that of all the offers received, SanCor's management had chosen Adecoagro's, an endless string of controversies arose inside and outside.

Adecoagro –which had signed a letter of intent whereby it was given 90 days to negotiate in exclusivity the possibility of becoming the controlling shareholder in a future partnership with SanCor– originated only four years ago in our country. Its General Manager is Mariano Bosch, and its dairy business manager is Engineer Raúl Filippi.

With major investments in land and machinery and various new agro-industrial projects, this company became in a very short time one of the most important agribusinesses on this side of the planet.

With an investment of 120 million US dollars and taking over management, Adecoagro would come into the future partnership with the control afforded by the 62.5 percent stake it would have, as stated in the letter of intent. Of that sum, 50 million US dollars would be working capital, and the remaining 70 million would be used to partially cancel SanCor's debt. As SanCor is a cooperative and by law it cannot receive private capital, the plan was to form a new type of company.

Adecoagro became in a very short time one of the most important agribusinesses on this side of the planet.

Adecoagro was born in September 2002 with funds from the international financial market, which were invested with the purpose of developing an agribusiness company. This company's main activities are connected with agriculture, liquid and powdered milk production, cattle raising, coffee, sugar, and ethanol. To conduct such activities, through its various businesses, it acquired 340,000 hectares of land in Argentina, Uruguay, and Brazil.

General Manager Mariano Bosch is originally from the CREA movement, while Engineer Raul Filippi, in charge of dairy consultancy in Argentina, was once closely connected with SanCor, as he held the position of general manager, no less.

The group began by acquiring the Pecom Agropecuaria package, with eight estates and 74,000 hectares in the wet region of the Pampas. They were processing a daily volume of over 200,000 liters of milk from their own dairy farms in different companies of the sector, having gone from a production of 16 liters/cow per day to a production of almost 25 liters/cow per day, with the star being the construction of a model dairy farm with an 84-cow rotary platform, and a capacity for 3,500 cows milking.

No sooner had the signing of the letter of intent between SanCor and Adecoagro become public than the various press media were already reporting another offer. A huge stir was caused by reports informing that another offer had been made, this time by a national consortium formed by Enrique Eskenazi (Petersen Group), Hugo Sigman (Biogénesis Bagó), and Eduardo Eurnekian, which was initially denied and then acknowledged by the Cooperative's management, who said they had turned it down.

The Petersen Group revealed an offer that, oddly enough, was apparently not the same, at least in spirit, as the one received by SanCor. The group informed that its proposal included an investment of 60 million US dollars in working capital, and a range of options for negotiate the debt. Here also, the creation of a new company was envisaged, a company in which the cooperative would have 25 percent of the stock, with future options to purchase up to 49 percent.

After this information came out, a real media battle broke out, with the press taking opposing sides.

While one side stressed the need to protect the company from the devouring appetite of multinational investors, with the Petersen Group presented as the guarantee needed by the Sunchalense dairy company, the other side of the press called attention to the characteristics of the business and the absence of a dairy project on the part of the national consortium.

Cooperativism and Bolivarianism

The press battle continued until a new report informed that the government of Venezuela was interested in providing 120 million US dollars to finance the company's liabilities, in exchange for long-term payments in powdered milk and transfer of technology to develop the dairy industry in the country governed by Hugo Chávez.

The initial sum announced by Ambassador Alicia Castro was considerably reduced some days later when Hugo Chávez himself, after his Presidential reelection, declared in a press conference at Palacio Miraflores, seat of the Venezuelan government, that he was willing to grant a loan SanCor, but only for 80 million dollars.

The sum to be loaned was finally set at 135 million dollars.

Following more than two months of intense negotiations, the much awaited agreement was signed in Hugo Chávez' homeland. The signing took place on Wednesday, February 21, and the agreement includes both economic and financial aspects, as well as the commercial and technology transfer obligations of both parties.

A SanCor spokesperson announced that: *"The Government of the Bolivarian Republic of Venezuela, by way of BANDES, is providing financial aid to SanCor Cooperativas Unidas Ltda. through a loan granted in two parts. The first consists of a sum of 80 million US dollars that will be used to cancel the cooperative's financial debt. The second consists of 55 million US dollars that will be invested as working capital."*

SanCor Cooperativas Unidas Ltda. will repay this loan through two mechanisms: a) with 68 thousand tons of powdered whole milk supplied in 25-kilo bags, according to a timetable established to that effect, setting specific amounts for each year of the contract's duration; b) with transfer of dairy industry technology to be applied in Venezuela, with the collaboration of the INTI (National Institute of Industrial Technology) of Argentina.

With respect to the trade agreement, it was established that over the next twelve years SanCor will supply 15,000 tons a year of whole powdered milk in 25-kilo bags at the prevailing international price listed for that commodity. The total amount supplied will be 180,000 tons."

The government of Venezuela was interested in providing 120 million US dollars to finance the company's liabilities.

The annual interest that the cooperative will have to pay, 3 percent, for the company it is OXYGEN IN ITS PUREST FORM.

Characteristics of the Agreement:

the payback period for the loan will be a term of twelve years, with two highly favorable features for the Sunchalense cooperative.

On the one hand, it was clearly established that the equivalent price of the powdered milk to be supplied as payment for the maturities will be the prevailing international market price. That is

favorable considering that the price outside our country is at its highest and everything seems to indicate that it will continue to rise in the medium term.

The other undeniable advantage is in the annual interest that the cooperative will have to pay on the loan: 3 percent. This, which to some may be simply statistical data, for the company it is OXYGEN IN ITS PUREST FORM, because SanCor was paying interests that were double what it will now have to pay. That is a great deal of money. It should also be noted in this respect that the Bolivarian Republic of Venezuela only grants this prime rate as an exception, as it did in this case with SanCor.

So then, the usual skeptics are probably wondering, what's in it for Venezuela? or is there something hidden behind this deal?

Let's see: the country led by Hugo Chávez is working to build its own food security over the next few years. That is, it seeks to ensure the supply of the essential nutrients to feed its population. As is well known, due to its nutritional value, milk is an irreplaceable food item, and as Venezuela does not produce this vital element, it must import it.

With the loan to SanCor and the parallel trade agreement, this oil-producing country is guaranteeing for the next twelve years the supply, as repayment of the loan, of a certain amount of powdered milk that it would have to import anyway.

In exchange for paying for the milk in advance, Venezuela is obtaining a discount of 3% (three percent), which is the interest rate paid by SanCor for the loan.

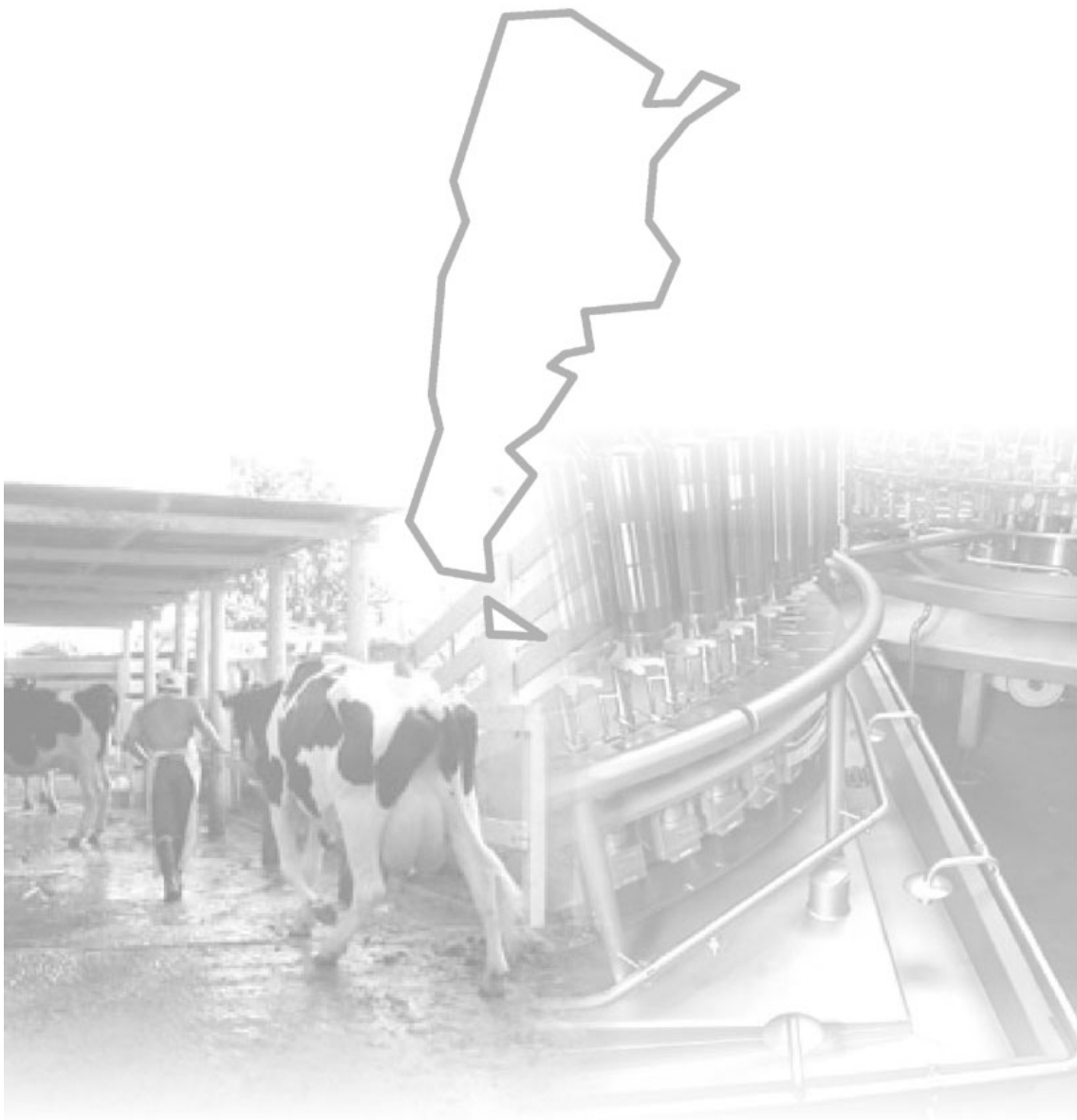
Is this a good deal for Venezuela? Of course it is. Is it a good deal for the cooperative company? It most certainly is!

So let's leave the usual gurus to continue formulating their elaborate theories based on pseudo-ideological considerations. This is a deal that is good for both parties involved.

But careful, because SanCor has not received anything it won't have to give back. Its workforce, everyone involved, must recreate the spirit with which it was created, we need to revise procedures and behaviors, otherwise, it will be like "raising pigs on chocolate."

Let's leave the usual gurus to continue formulating their elaborate theories based on pseudo-ideological considerations. This is a deal that is good for both parties involved.

Dairy Industry in Argentina 2006



1st Semester 2006

Primary Production

According to data from both official and private sources, the first half of 2006 showed an increase in production of approximately 10%, as compared to the same period of 2005.

This significant progress in percentage terms is an indication of a clear trend that evidences an increasingly greater year-to-year variation in production.

As it is expected that –notwithstanding any fortuitous events– the growth in primary production will be consolidated in the second half of the year (particularly as of the upcoming Spring season), all estimations lead to believe that, in 2006, Argentina will regain its production ceiling, achieved in 1999 with 10,329 million liters of milk processed.

In fact, such productive progress follows a significant depression experienced in the sector during the 2000-2003 period, which entailed a loss of 23 percent of the total production, having reached its lowest point in 2003, with a total of 7,951 million liters processed by all the companies on this side of the River Plate combined.

The lack of domestic policies and the volatility of international scenarios have always been obstacles that have virtually been impossible to overcome when it comes to developing a sound project for one of the country's main productive activities.

These are the reasons for the permanent ups and downs and fluctuations of the oscillating trend in Argentina's primary production. Such conditions have allowed for a sustained growth during the 1990s, with an accumulated inter-annual increase that averaged around 7.2 percent, for a total production that increased from the 5,937 million liters accounted for in 1991, to previously mentioned 1999 record of 10,329 million liters processed.

This recovery, which dates from 2004 on, allows for more than one interpretation and a complex conclusion to be drawn.

The ideal situation would be that, given such accumulated growth, the supply of the domestic market would be fully covered, that a significant surplus for exports would be available – considering that international prices will remain favorable, as is expected–, that dairy industries would continue to be profitable, and that dairy farmers would receive a good pay for their raw material. That would be the ideal situation. However, it is quite probable that this will not happen, due particularly to certain factors that we will now set forth.

One of the main fears of producers is that, as a consequence of the increase in raw materials, there will be an oversupply, and milk prices will go down.

One of the main fears of producers is that, as a consequence of the increase in raw materials, there will be an oversupply, and milk prices will go down. The external market would be an alternative, but the withholding tax applied by the government to hold back inflation is apparently restraining such intentions.

Absolutely all dairy farmers, in unison, have hit the roof over the rise in the withholding taxes imposed on exports. It is odd that the same has not happened with industry, which is ultimately the sector on which taxes are levied directly.

Nevertheless, whether farmers like it or not, this attitude, held by quite a significant number of industrialists, is consistent with the interests of their dairy companies.

Farmers, while taking into account the present cash flow, should not lose sight of the medium term.

After the government set at 10 and 15 percent the withholding tax on cheese and powdered milk exports, respectively, and discontinued export refunds, only a few industrialists joined the fray to attack the decisions of the Executive Branch. The only opinion that entrepreneurs seem to share is the impossibility of maintaining the domestic prices of certain dairy products due to rising costs. At this point, no one could possibly ignore the great differences that exist between industrialists, which relate to the nature of their own interests.

While those who stockpile, dry and export milk are fully against the increased withholding tax, the companies that supply the domestic market secretly admit that although the increase on exportable surplus is not the best solution to the sector's problem, it is, however, a way of contributing to level profitability in both groups.

Those who only dry milk and export it have low production costs because they work with a single product, and they have a high profitability as a result of good and sustained international prices. This situation contrasts with that of the companies that manufacture a range of products, supply the domestic consumer market, add value through their production lines, and generate an important number of jobs.

Although it is a fact that the production sector has been making huge efforts to face the fall of the activity's profitability experienced in comparison with the past year, it is also true that farmers, while taking into account the present cash flow, should not lose sight of the medium term.

This means that it is also their responsibility to take into consideration whether the companies that dry and export milk have the same chances of paying for raw material as those companies that place most of their production in the domestic consumer market.

The representatives of dairy farmers have conveyed that the prices that the industry is currently paying should be improved and maintained throughout the year as a form of incentive for farmers to invest in production. The expected 54 cents per liter of milk delivered seem to be too far from the industry's possibilities, except for those companies that export exclusively.

Considering the growth scenario foreseen in general terms for dairy production in 2006, an improvement in the prices offered to producers is quite unlikely. Furthermore, the upcoming spring season will bring along the inherent risk of overproduction, where sums paid for every liter of milk delivered will invariably go down.

Industry

Despite the permanent vicissitudes experienced by the activity in our country, Argentina is indeed valued, throughout the world, for its high growth potential and its low production costs a compared to those of other countries in the globe.

The national dairy industry, based on what has been said before, has gained a significant number of new players who, aware of the advantages available in the country, have settled on these Pampas prepared to play a strong game.

In the year 2003, Pérez Compañc, having acquired Molfino Hnos., by means of which it had, in turn, bought La Paulina at Tío Pujio, decided to withdraw from an activity with which the firm was not familiar, and sold its assets to Saputo of Canada.

As Lino Saputo Jr. stated: “Primarily, we are searching for manufacturing platforms with a great potential for growth. In addition, we are pursuing our international growth from the sales perspective. As we gain access to raw material, the world becomes our market.”

Witnessing a new process of settlement of multinational corporate groups in the dairy industry, which are taking root in our country.

It was surely that which led the corporate group to decide to investment 18 million US dollars to expand and modernize its plants located in Rafaela (Santa Fe) and the abovementioned Tío Pujio plant in Córdoba.

Its greatest investment was in La Perla del Oeste, in western Santa Fe, where its capacity for drying milk increased outstandingly, as did its use of this process to produce liquid whey.

With 1.6 million liters of milk processed daily, Saputo has become a quite considerable competitor in the market, especially if the growth objectives set by the owners are taken into consideration.

According to market data, the company exports 57 percent of its production and places the remaining 43 percent on the local market. Its sales in Argentina during the past year amounted to 483 million pesos, approximately 161 million US dollars.

From the beginning, the representatives of this company, which is Canada’s largest dairy processing company, informed ATILRA officials that they had decided to base their activities in Argentina, following a thorough feasibility analysis comparing Argentina to other countries with greater possibilities for growth in the business. They made it clear to the union’s leaders that they were here to stay, and to invest, as they are indeed doing.

We are clearly witnessing a new process of settlement of multinational corporate groups in the dairy industry, which are taking root in our country, either by means of strategic alliances with other dairy companies, or through direct purchases, as in the case of Saputo.

Milkaut, one the five companies that process the largest volumes of milk in Argentina, opened its doors to the French group Bongrain, the owner of Estancias Santa Rosa. This company was to enter through the purchase of shares in Vialat (part of the Chilean holding Bethia), owned by entrepreneur Liliana Solari (Falabella). We should bear in mind that the Chileans had arrived in 2004, when they bought 24 percent of the company, under the control of the dairy farmers cooperative association AUT (Asociación Unión Tamberos Cooperativa Limitada).

The largest food manufacturer in Peru, the Gloria Group, in partnership with the firm Gonella-La Ramada, is already operating in the country, where it has installed a plant for drying milk, located at Esperanza, in the province of Santa Fe.

La Ramada is a small milk producer that owns a number of dairy farms. The owner is also part of an important furnace factory that also produces containers for transporting liquefied petroleum gas. In turn, the Gloria group, which appeared in 1941 as an affiliate of the multinational group General Milk, was acquired in the 1980s by a Peruvian family (Rodríguez) who is still the company's main shareholder.

The company El Danubio, previously owned by Ruiz and Tremblay, is yet another company controlled by foreigner capital: it was bought by Yparlat of the Basque country.

These firms are actually the continuators of a trend that begun many years ago, following the settlement in our country of important companies with a history, such as Nestlé, and Danone, along with the abovementioned Santa Rosa Estancias.



FONTERRA

Probable disembarking of the New Zealander giant

Argentina is probably heading a series of five dairy producing countries in the world, which have the best possible perspective for future growth.

What advantages does our country have to offer?

The first advantage is the potential for growth, which apparently has no ceiling, at least in the nearest future.

Another advantage is that of the existing production units, with pastoral bases, where animals graze on vast extensions of fields, in the open, and with supplementary feeding only when necessary.

It is almost a miracle that the existing technology and genetics of the Argentinean dairy industry do not match other country variables, for the milk produced here is of high quality but the costs are low in comparison to other locations in the world that also benefit from exchange rates.

Max Parkin, director of International Manufacturing Fonterra is well aware of this.

He is the one that directs the activity, outside New Zealand, of the world's biggest dairy company.

Upon the invitation from executives of the firm, we not only had the chance to see the productive process on site at the company's facilities located in Hamilton (in New Zealand's northern island), but were also provided with an opportunity to find out how the man in charge of Fonterra's control and business strategy in different parts of the world thinks.

The international executive of this New Zealand corporation has a very good knowledge of the competitive advantages offered by Argentina, and he made that clear to us.

It is almost a miracle that the existing technology and genetics of the Argentinean dairy industry do not match other country variables.

Fonterra processes 32 percent in international trade of dairy products.

Even when he did not disclose to us, for obvious reasons, the company's full strategy for this part of the world, he did make comments about Fonterra's need to focus on those nations where the company is liable to obtain larger volumes of raw material.

Even if he had not mentioned it, we would have gathered this from the company's background: Fonterra processes an incredible 95 percent of all the milk from the islands, and has a participation of 32 percent in international trade of dairy products.

Now, of that 32 percent (32%), 25 percent is raw material obtained by the firm outside New Zealand. Since they need to increase their international presence in a market eager to consume dairy products, they have no alternative but to go in search of greater volumes of raw material abroad, considering that New Zealand has practically reached the ceiling of its production.

Max Parkin has not only proven to us that he knows about Argentina's dairy industry, but he also knows the labor union organization in charge of safeguarding the interests of workers in the sector. This was evident when Fonterra's international manufacturing director made a brief mention of two or three current characteristics of ATILRA's labor activities.

Is the disembarking of Fonterra's full potential in Argentina possible? Everything leads us to think that it is possible.

Today, the presence of New Zealand's dairy giant in Argentina is minor, originating with the establishment of the Provisional Union of Companies between SanCor Cooperativas Unidas Ltda. and DPAA, a company formed by the Swiss Nestlé and Fonterra.

This strategic alliance allows them to dispute the market of cold dairy products with the powerful Danone, the indisputable leader in Argentina in sales of fresh dairy products.

It must be taken into account that the segment of fresh products like yogurt and puddings allows the greatest degree of profitability in domestic trade.

The name of the partnership is Unión SanCor CUL-DPAA UTE, with each company owning 50% of all capital stock. UTE is in charge of the production and marketing of yogurts, ultra-fresh cheeses, cultivated and fermented milk, and fresh puddings, while the management has remained in the hands of Nestlé's executives, and SanCor is responsible for distribution and sales.

Although representatives from the associated companies do not discard the possibility of marketing other products together in the future, they presently share the lines Petit, Shimmy, Nestlé Crecimiento, Mendicrim, Mendicota, and DPAA's yogurts, Yogs Yogurt, Sancorito and Vida of San Cor.

In sum, is the disembarking of Fonterra's full potential in Argentina possible? Everything leads us to think that it is possible; at least that was what the International Manufacturing Director hinted during his interview with ATILRA's general secretary; it seems that all they are waiting for is the right time to do it.

The SanCor

A lot has been said in the past, and is currently being said, about the economic and financial situation of the “Great Argentinean Dairy Company.” Indeed, “Nuestra Voz” has access to important information that, due to basic ethical and strategic reasons, will not be made public in this edition.

However, it must be made clear that there are three dairy companies in our country that are facing great liabilities. These are: Milkaut, La Serenisima, and SanCor Cooperativas Unidas Ltda.

In the case of the company with headquarters in the Santa Fe city of Sunchales, the situation might be even more complex than in the other two, and it might call for urgent solution.

It is useless to try to hide the truth, for, sooner than later, the facts will be out in the open.

The cooperative’s economic problems are not a new issue, nor did they originate with current management, so it would be unfair to charge against a handful of men that only inherited a heavy load.

SanCor largest dairy company of Argentina and has the largest labor force.

But these men do have to face the situation in order to find a practical and logical way out.

Of course that, to find practical, immediate and consistent ways out one needs to be powerful enough, and apparently that is not a distinctive feature of those who presently running the company.

It seems quite appropriate to provide details here of what we have considered, for years, as degenerative elements which led the greatest cooperative in this part of the world to its present situation of insolvency.

Among the higher levels of management there are still hierarchical groups that are apparently unaware of the present situation.

They fight for their personal and sectorial interests, but fail to privilege the whole. In such process, they do not notice, or maybe do not care, that the fate of individuals is necessarily linked to the fate of the company and not the other way around.

This brings to mind the tragicomic memory of other individuals who once threw up their hands in horror in favor of SanCor, before us as witnesses, and today are standing on the other side of the street from the cooperative, probably expecting to see the dead body of what is the largest dairy company of Argentina and has the largest labor force.

SanCor had reached the point of economic default in 2002, but was able to conclude the restructuring of its debt in 2004.

Everything seems to indicate that in order to meet payments on these loans, the cooperative had based their income projection on exports, which make up approximately 30 percent of its total turnover.

The increase in the withholding tax brought down SanCor's income by nearly 50 million pesos. In addition, there was no possibility for increasing the sale of certain products in the domestic market, as a result of the restrictions that the government applied with the purpose of curtailing an inflationary pyramid that had grown as of the year 2005.

The cooperative, whose 2005 commitments had been fulfilled, could not do the same in 2006, due the abovementioned reasons.

Rabobank and Citibank are heads of a bank union that also includes Banco Nación, Banco Ciudad, Nuevo Banco de Santa Fe, and HSBC (heir to the credits of Banca Nazionale del Lavoro). All these, along with Banco Do Brasil and the International Finance Corporation (IFC) –the financial arm of the World Bank– would be the ones in a position to offer new help to the dairy cooperative.

The only significant company owned by national capital that still exists in the dairy sector is SanCor.

Of course there is a philosophical difference between what SanCor can mean to Banco Nación, and what the company represents for multinational financial corporations.

The Argentinean government knows that there is no dairy producer in the world without a great local dairy company. In our country, the only significant company owned by national capital that still exists in the dairy sector is SanCor. So the Argentinean Government does well in trying to put a protective net over it. What is clear is that the people at the cooperative cannot expect the government to do for the company what they did not do for themselves, when they had the possibility to do so.



Domestic consumption and global demand

There are a total of 1,200 dairy establishments in our country. However, only nine companies concentrate 51 percent of Argentina's production.

The domestic consumer market, which experienced a decrease as a result of the great crisis suffered by the country, is slowly bouncing back, and has changed from a "per capita" floor of 160 liters consumed per year, to over 210 liters, thanks to the wage recovery that has favored a large portion of Argentina's active labor force.

1,200 dairy establishments in our country.

This is a positive sign for the industry. However, it is limited by the low domestic prices resulting from the strong controls imposed by the government.

In general terms, industrialists have agreed to battle inflation, but they have also declared, not without reason and behind the scenes: Why should we have to pay subsidies for Amalita Fortabat's milk?

What the entrepreneurs mean is that it is important for milk, an irreplaceable product of singular nutritional values, to reach low prices for a certain sector of society. However, they don't think it's logical or fair that those who have enough purchasing power to pay for the product at its normal price don't have to.

In sum, industrialists, mainly those that invested by diversifying their lines of production and placing most of their production in the domestic consumer market, have stated that they now have a negative profitability, because they are forced need to socialize the price of their products, when their production costs have gone up.

This is a complex equation where the government will have to take into account the interests of each party involved in order to achieve a fair solution.

According to the UN Food and Agriculture Organization (FAO), world demand for dairy products will grow at an annual rate of 2.5 percent, while supply will only grow at an annual rate of 1.5 percent.

According to FAO, world demand for dairy products will grow at an annual rate of 2.5 percent, while supply will only grow at an annual rate of 1.5 percent.

Except for the United States, Brazil and India, whose productions have shown a significant growth, the projection for milk production in the main exporting countries are expected to

experience moderate growth; another important reason that makes the Argentinean dairy industry so attractive.

The projection for nations with greater milk production capacity at more competitive prices only goes to show that only our country is in a position to do so at lower prices.

As mentioned above, New Zealand is practically at the ceiling of its possibilities, and if it wants to expand there it would have to intensify production, which would imply producing at higher costs, while Australia has a scarce margin for growth.

We must keep in mind that Argentina and Australia have practically similar volumes of raw material, though the presence of our country in the international dairy market is less significant, for it must place a greater volume of milk in the domestic market, since the country has a population that is twice that of the country in Oceania.

We might think that, as a result of the social inequality prevalent in Argentina, we should have low consumption. However, that is not the case, for our population has been recovering the levels of consumption of dairy products that are placing it close to the levels of developed countries.

This is has to do with the fact that there is usually a direct relationship between production and consumption, that is: consumption is usually high in countries that produce an important quantity of milk, where, as a result, the population is used to consuming the products; this in turn is multiplied when such countries also have a high purchasing power.

Industrialists around the world are foreseeing large increases in consumption in the future, based on the expanding economies of nations with a high population density such as China and India.

Paradoxically, and luckily for the dairy powers, the countries where consumption of dairy products per capita is low are those that show the greatest growth rate in that regard, but also, and as mentioned before, they are the most populated countries in the world, so the volume represented by such growth in consumption per inhabitant has a vital incidence on the demand of dairy products in coming years.

Due to its exchange rate, Argentina has low production costs, it also has significant and consolidated development in the field of genetics, and an industry with full technical and installed capacity, thanks to the investments that are flowing in and which will expand such capacity.

Our country is currently the nation with the greatest potential for dairy growth in the whole world. It is now time to take advantage of that, as second chances do not happen very often.