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Mutual Benefit: JVs with Foreign Dairy Companies on the Rise

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Inside...

Key Points:

- Interest in the U.S. dairy market is accelerating with foreign dairy companies. These firms are seeking partners to own and operate processing plants that enable access to the growing milk supply and the value-added consumer market in the U.S.
- While the U.S. has focused investment in the milk production sector of the dairy industry, other global players like the EU and New Zealand have been investing in dairy processing technology and product development.
- These partnerships offer U.S. dairy companies cost and risk sharing, while tapping into the marketing and management expertise of their partners.
- Dairy industry partnerships are most often vertically structured to include participants along the supply chain from milk producers downstream to branded distributors.
- At least 15 percent of the U.S. milk supply is processed by plants that are at least partially foreign owned.
- U.S. companies may look to the model of joint ventures as a method for international growth and participation to expand their own reach and compete for global market share, but should carefully consider the risks.

Introduction

As the dairy industry evolves and modernizes, the processing sector has become increasingly capital intensive. At the same time, high-quality, reliable milk supply, manufacturing expertise, and strong branding and marketing are more important than ever to compete in the global marketplace. By forming joint ventures between producers or cooperatives who can supply the milk, companies with experience in manufacturing dairy products, or companies with greater networking and marketing expertise, each participant can reduce cost and focus on their specialties. These joint ventures that increasingly include a foreign partner can help propel the industry into the future. (*See Exhibit 1.*)

Exhibit 1: Notable 2017 Joint Ventures, Mergers and Acquisitions

JV Name	Companies Involved (international in bold)	Location	Products	Details
Columbia River Technologies	**Fonterra**, Tillamook, Threemile Canyon Farms	Oregon	WPC/Lactose	Joint Venture for WPC production and distribution
Southeast Milk	**Saputo**, Southeast Milk	Florida	ESL milk processing	Saputo acquisition of Southeast Milk facility
Stoneyfield	**Lactalis, Danone**	New Hampshire	Organic Yogurt	Lactalis buys Stoneyfield from Danone as part of DanoneWave merger
Franklin Foods	**Hochland**, Franklin Foods	Arizona / New York	Cream Cheese	Hochland of Germany acquired U.S. cream cheese capabilities.
Western New York Cheese	**Arla**, DFA	New York	Cheddar	Joint Venture
Prairie Farms	Swiss Valley Farms, Prairie Farms	Wisconsin	Swiss, European Style Cheeses	Merger
Danonewave	**Danone**, Whitewave	Colorado	Organic	Danone acquisition of WhiteWave foods.

Source: Press Releases and Company Websites

International interest in the U.S. market has been a factor for several years in the dairy industry, but movement toward international joint ventures and mergers picked up steam in 2017. While the U.S. dairy industry has historically invested heavily in cows and milk production over many years, Europe and other regions that faced production constraints focused their efforts and investment in technology for the processing sector instead. Joint ventures offer a means to match the reliable and efficient milk production of the U.S. with the processing expertise of other international partners.

Global dairy companies will continue to jockey for position in the value-added consumer market and the American consumer is a valuable target in whom many marketers still see the potential for growth. As new milk processing capacity is added and new products are developed in the U.S. in years to come, international companies will continue to seek opportunities to take advantage of the growing U.S. milk supply and position themselves for potential long-term market growth. Likewise, U.S. companies and cooperatives may consider investigating opportunities to expand abroad.

Increasing Collaboration

Over the past several years, processors and coops in the United States embarked on a wave of investments in milk powder processing plants. This was driven by a combination of the need to improve milk powder processing capabilities to compete on a global scale, and the relative affordability with which a milk powder plant can be built. When the need for current powder processing capacity eventually was met, attention shifted to other opportunities to modernize and invest in building new cheese plants.

Many cooperatives lack the available capital to take on a new large-scale modern cheese plant. Building a new cheese manufacturing plant can cost $300 million to $500 million. Joint ventures can be a means of dividing those costs between partners while bringing specialized expertise to specific aspects of the business.

From a branded consumer product perspective, joint ventures provide an opportunity to diversify product offerings and incorporate new products into a portfolio.

Exhibit 2: Foreign Ownership of U.S. Dairy Plants

Source: The McCully Group, CoBank

A recent example of this is the merger between Danone and WhiteWave, forming DanoneWave. While Danone, based in France, already had a strong presence in the U.S. with 34 percent market share in yogurt, the merger with U.S.-based WhiteWave, which held the popular Horizon organic milk brand, provided a relatively quick path to diversify and gain a presence in the organic market, skipping years of grassroots development.

Increasingly, the dairy industry in the U.S. is realizing the importance of collaboration as an opportunity to focus on specializations, continue to innovate and develop new products. A cooperative alone may be supply-driven and build plants solely to fill a need to process milk. A branded business, meanwhile, may want to develop new products in response to marketplace demands but face challenges in finding a reliable competitive milk supply. But together, partners from along the supply chain can efficiently collaborate and share in the costs and profits.

Interest from Abroad

Interest from International companies in establishing a manufacturing and marketing presence in the U.S. has been accelerating in recent years. In some cases this has taken the form of establishing new greenfield plants, as was the case with French company Bel Brands and their most recently constructed cheese plant in Brookings, SD. Other times, foreign companies will acquire existing U.S. processing assets. This has been a common practice among Canadian companies acquiring processing plants in the upper Midwest. Most recently, foreign brands have entered the U.S. market as partners in joint ventures with U.S. dairy producers and coops.

Today, roughly 15 percent of U.S. milk is processed in a plant with at least partial foreign ownership. (*See Exhibit 2.*) Much of this foreign ownership is from Canadian companies Saputo and Agropur that have had a strong presence in the U.S. for many years as

they expanded outside of quota-restricted Canada. The appeal of the U.S. market to foreign brands is that it is a developed, stable society that has room for growth in value-added products. It is also free from supply constraints and quota systems that would limit milk production growth.

There are a number of challenges to entering the U.S. market from abroad. One is tariff rate quotas that increase the cost of moving many dairy products into the U.S. Alongside quotas there are the normal logistical challenges and expenses associated with moving finished product around the world. Finally, upon entering the U.S. market, establishing presence on retail store shelves as a new entrant is an additional challenge.

As a result, many foreign companies look for opportunities to establish a manufacturing presence on U.S. soil. However, the Federal Milk Marketing Order system in the U.S., which uses a complex set of formulas to determine prices paid for milk by manufacturers, poses a unique challenge to those unfamiliar with it. Most foreign companies investigating the prospect of building a manufacturing plant in the U.S. find that procuring a milk supply at prices that would be competitive with those paid to producers by cooperatives would be prohibitive when compared to the cost and expected payback of building a new plant. A more feasible system achieved through partnership with producers is to buy the milk at a base manufacturing class price and share profits from the venture with the producers.

In some ways, the influx of investment into the U.S. dairy processing industry has had a positive impact for producers. With production growing steadily and with some regions struggling with limited processing capacity, the processing assets are necessary to provide a home for farm milk that may have otherwise struggled to find a market. In markets that have lagged behind in new processing capacity investments, milk can trade at a significant discount, or must be dumped in extreme cases, and producer pay prices suffer.

Drivers of Success

The goals of most recent joint ventures in the dairy industry are two-fold. One of the biggest benefits is sharing start-up costs. The other major benefit is reducing the costs and risks of transactions along the supply chain. The most successful ventures work toward these goals and generally take the form of a vertically integrated joint venture.

Competing for raw milk supply is often costly and can be challenging against the backdrop of the federal milk marketing order system. While federal orders establish minimum prices that manufacturers must pay for their milk, competitive prices paid for the milk involve layers of premiums on top of that minimum price. In times where milk is short, it is not uncommon for producers to seek competitive bids from other cooperatives or processors in an attempt to increase their leverage and price. By incorporating a producer or group of producers as partners in a joint venture, ownership is shared in the success of the plant and the risk of a disruption to the milk supply is minimized.

Additional partners alongside the milk supply would ideally include a company with manufacturing experience and a marketer with the ability to market the product. These vertically oriented partnerships along the supply chain allow for a clear definition of roles and responsibilities with specializations that do not overlap. They also mitigate risks that would be associated with other types of procurement arrangements along the supply chain since the producers supplying the milk and the processor running the plant have a stake in the project.

As compared to a horizontally oriented merger where two similar companies form a partnership that could result in tension and overlap, the varying roles along the dairy supply chain from raw milk production to manufacturing to marketing are very specialized with minimal crossover.

Risk Factors

Though the benefits of partnerships and collaboration across global supply chains are many, these ventures involve risk and not all succeed. The market risks that every product faces will be present regardless of how the underlying business is structured. The joint venture between PepsiCo and Müller Quaker came to an end due to weaker than expected sales in 2015, only two years after building a $200 million yogurt plant in New York.

Vertically integrated ventures that focus on one particular project typically have one primary partner responsible for managing the project. If a non-managing partner feels that performance expectations are not being met as a result of poor management on the part of the managing partner, divisions can form and non-managing partners may seek to exit the partnership, which impacts the capital backing of the project.

Structural risks that joint ventures and partnerships face stem mostly from a misalignment of goals or a lack of preparation ahead of the venture. Particularly with international joint ventures, there is a risk of cultural values clashing or differing views on near-term profits and long term growth. Most of these risks can be mitigated by thorough planning and discussion in advance of the venture, including contingency and exit plans.

Outlook

The continued expansion of dairy production capacity in the U.S. portends more joint venture opportunities for the manufacturing and marketing of value-added dairy products in the years ahead. Given the benefits of vertically oriented ventures, groups of producers and cooperatives will continue to use these opportunities with both domestic and international partners to expand their reach without facing the often prohibitive costs of building a new manufacturing plant on their own and incurring the challenges and costs of managing that plant.

Likewise, processors will continue to pursue joint ventures as an alternative to competitive milk procurement and join with a branded or marketing partner who will handle the marketing of the finished product.

International brands that face access hurdles in the U.S. such as tariffs and brand recognition can use participation in a joint venture as a first step toward establishing a presence in the U.S. The U.S. dairy industry has benefited from the international partnerships, which have made the expansion of processing capacity possible. These partnerships have developed a model for international participation between cooperatives and could potentially open the door for U.S. cooperatives and companies to expand market share outside the U.S. in a growing global market.

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