

feast

A WEALTH OF AGRIBUSINESS DATA AND INSIGHT

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INTERNATIONAL MARKET FOCUS

China. Threat and Promise to U.S. Agribusiness.

By Julie Zavan, World Perspectives, Inc.

Chinese and U.S. agribusiness are intertwined both bilaterally and on the world stage. To some segments of U.S. agribusiness, China is a major market, yet to others it is a growing competitor albeit on an inconsistent basis. China will continue in this dual role, as both threat and promise to U.S. farms and agribusiness. The opportunities and challenges are evolving, as illustrated in the examples that follow, and if global strategists like McKinsey & Company are correct, U.S. agribusiness will need to be alert to the changes and incorporate them into their business strategies. Even where there are threats, these can sometimes be turned into opportunities by those who venture into China and leverage

“China can do anything, but it cannot do everything”

Robert Kohlmeyer, Retired, Cargill, Inc.

their expertise into a business prospect. Yet, in the larger dynamic of U.S. and Chinese trade and diplomatic relations, the interests of individual segments of U.S. agribusiness are only a component of a much larger whole.

China is a major market for U.S. soybeans, cotton, grain and animal products. U.S. cotton supplies the Chinese textile and apparel industries, which in turn export product back to the U.S. and elsewhere around the world. U.S. soybeans and grain support China's expanding livestock, aquaculture and poultry production. At the same time, some Chinese fruits, vegetables and meat exports have begun to impact U.S. producers at home, in Asia, and potentially in the European Union.

Chinese Feed Industry Impact on U.S. Agribusiness.

China is the largest overseas market for soybeans and imported nearly one-fifth (490 million bushels) of U.S. production in 2008. As China's animal production continues to modernize, its feed demand is expanding beyond traditional commodities and primary processed products. For instance, increased use of scientifically formulated feed—currently estimated at 35-40 percent for both poultry and swine—is boosting demand for the specialty feed ingredients typically used in the rations of young animals. These ingredients include milk products, rendered ingredients, soy protein concentrate and many others that represent diversified, value-added products for different sectors of U.S. agribusiness.

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Dairy markets in 2009 are in the dumps compared to the record highs of 2007 and 2008. The January 2009 all milk price, for example, stood at \$13.80/cwt, compared to \$20.50/cwt in January 2008 and down from the historic monthly high of \$21.90/cwt in November 2007. Bears overtook the market in December 2008, driven down by the economic collapse in the U.S. as well as around the world.

Dairy Falling from Record Heights

By Dave Juday, World Perspectives, Inc.

Slumping demand and relatively high production are likely to pressure milk prices downward to federal support levels for the first time since 2006.

Indeed, the high domestic milk prices of the past couple of years were driven in good measure by larger than usual dairy exports. In 2007, the value of U.S. dairy exports was 48 percent higher than 2006; moreover, dairy export value through November 2008 was up another 32 percent over 2007, when, for the first time in a decade, the U.S. exported more dairy production than it imported. A growing demand for dairy products in the developing world, drought-restricted production in Australia, a low valued U.S. dollar, and expanded milk production in the U.S. necessary to meet global demand all added up to the new export peaks.

U.S. DAIRY EXPORTS	2007 VOLUME 2008		2007 VALUE 2008	
	MILLIONS OF GALLONS		MILLIONS OF DOLLARS	
Fluid Products Exports	225.2	252.5	\$60.6	\$76.7
Non-Fluid Products Exports	2677.2	3032.6	\$2976.5	\$3755.0
TOTAL	2902.4	3285.1	\$2976.5	\$3755.0

Source: IDFA, WPI

Exports, however, are forecast down this year. Moreover, so is domestic demand – both victims of the sluggish economy. Domestically, milk is a commodity that is very sensitive to economic recessions and/or expansions because cheese consumption – the top use of milk – is driven largely by sales of prepared foods, restaurant sales and other meals eaten outside the home. Slumping demand and relatively high production are likely to pressure milk prices downward to federal support levels for the first time since 2006.

Long term growth projections.

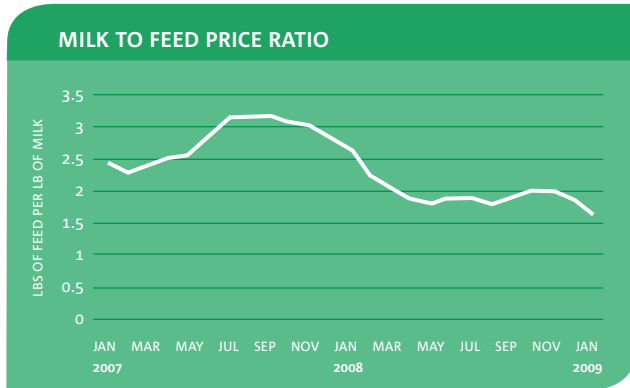
The good news is that USDA's Agricultural Baseline Projections released in February 2009 project increased longer term total domestic commercial use of dairy with growth "somewhat faster than the growth in U.S. population over most of the next decade," and that "commercial exports of U.S. dairy products, ... will decline in the coming decade from the high point but remain high by historical standards."

For the rest of this year, though, producers will get squeezed by tight milk-to-feed ratios. The January milk-to-feed price ratio was 1.69, meaning

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that a pound of milk could purchase only 1.69 pounds of feed. This is the lowest value since the USDA began reporting this statistic in 1985. High milk prices had helped producers maintain a wider margin in 2007 and 2008 despite record feed grain prices.



Source: IDFA, WPI

Herd reduction likely.

While feed grain prices have dropped dramatically, their ratio to milk prices will force a reduction in milk production this year versus last year. In 2008 production grew as a result of not only the long term trend of more milk output per cow (now up 14.8 percent since 1999), but also because of an expansion of the dairy herd.

Though Cooperatives Working Together had two herd buyouts in a single year for the first time in 2008 – a reduction of 24,585 cows in May, and 61,000 cows in November – the U.S. dairy herd continued to grow 1.4 percent last year. Given the high cost of milk production, the herd is likely to be culled. Cow slaughter is up 9 percent so far this year, and more buy outs are planned.

The West is the most likely region to be impacted by herd reduction, as that is where the recent growth of milk production occurred. Moreover, most farmers in this region grow little – or none – of their own feed. Most dairies in the eastern half of the U.S. have at least some home-grown feeds, while most of those in the West buy most or all their feed. Western producers have been facing the biggest cash flow deficits in recent months, and are likely to remain in that position in the coming months.

Market Forecasts

Wheat: Production will be down and prices will fall 25% as Black Sea supplies remain large and Asian countries return to rice consumption.

Feed Grains: USDA predicts a draw for corn in the annual battle for acres but market players see less inputs and lower production in 2009/10.

Oilseeds: Soybeans may generally outperform corn on returns per acre this year; globally sunflower and rapeseed/canola expand.

Biofuel: Plants have been losing money but the government is contemplating new measures, and is offering loan guarantees plus other incentives.

Inputs: While prices rose 100% for some applications, motor fuel and natural gas are down, and other products should follow suit for a 5% average decline in 2009.

Capital: The cost of capital is very favorable, and agricultural balance sheets make it one of the surest sectors to finance.

Land: Despite the falling commodity prices, farm land values are expected to rise 1.6% in 2009.

Farm Income: Total farm income in 2009 will fall \$16.1 billion to \$77.3 billion, though crop receipts will still be considerable.

Dollar: The dollar has become a safe haven for investors and its higher value will burden U.S. agricultural exports.

Exports: U.S. agricultural exports will fall by \$20 billion to \$95.5 billion, still the second highest amount on record.

Processing: Brand names will battle it out with store brands as consumers seek shortcuts in their food bills.

Retailing: Downscale food service benefits at the expense of white tablecloth restaurants, and grocery sales pick-up from restaurateurs' losses.

World Perspectives, Inc.

Food Safety

By Gary Blumenthal, World Perspectives, Inc.

Today's food system delivers a trillion calories a day to consumers, some of which is highly biologically active material.

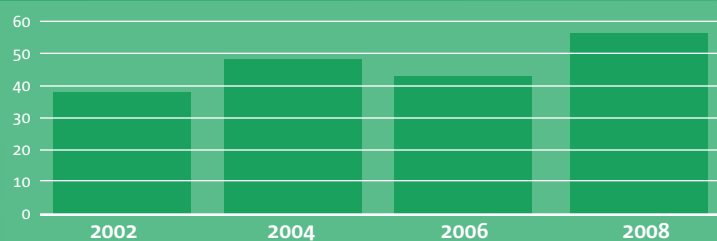
Conventional Wisdom

History records document mankind's concern about food safety since ancient times. The past few years' outbreaks from Bovine Spongiform Encephalopathy (BSE) to peanut butter, plus adulteration issues such as melamine-tainted pet food and dairy products from China, have built a strong interest in overhauling U.S. food safety policy. There are dozens of legislative proposals with proponents in key positions on Capitol Hill, and a new Secretary of Agriculture that share their aspirations. This leads to a conventional wisdom in Washington that this year will see an increase in FDA enforcement authority, including mandatory recall, increased inspections, traceability and possibly the creation of a single federal food safety agency. Yet conventional wisdom could be off by a year for both economic and logistical reasons.

Cost to Industry and Government

Food safety is an economic issue: the more disposable income, the more money that consumers are willing to spend on food safety. Eccentric millionaire Howard Hughes was known to have his food completely sterilized. But most American consumers today have little interest in either the taste or the cost of UHT (ultra-high temperature) milk.

PERCENT AGREEING:
"FOOD IS LESS SAFE THAN 10 YEARS AGO"



Source: Ohio State University

Congress just added 2009 funds for increased food safety work and the Obama Administration has proposed increasing spending on food safety in fiscal 2010, but even marginal improvements in food safety can cost billions of dollars. One study on preparing relatively special meals (without allergens, etc.) for the school lunch program estimated costs run 260 percent higher, and preparing one at the immune-suppressed level would require considerably more. After the food industry incurred \$250 million in market damages last year due to the tomato/peppers outbreak, it began to recalculate the cost of investing in a full traceability system versus the risk and cost of flailing government recalls. But that was before the current economic crisis and now the livestock industry has put on hold its plans for full traceability.

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On The Horizon

World Perspectives, Inc.

A look at emerging issues that will have an impact on U.S. agriculture.

Cold Economy

The hottest topic is the larger economy and how to spur a recovery. While the demand for food is more inelastic than other goods and services, exports and farm income are falling.

Agri-food Relatively Strong

The negative assessment is that crop prices have fallen, ethanol and livestock sectors are stressed, and farm real estate values have flattened. The upside is that it's far worse in many other sectors, agri-food equities are a safer haven in recessions, crop prices remain above the 10 year average, and the farm debt-to-asset ratio is projected to fall this year to just 9 percent.

Direct Payments

The Obama Administration proposed phasing out over three years any direct payments to farms with annual sales revenues greater than

\$500,000. If Congress agrees, the change is expected to largely affect producers of rice, peanuts, cotton and corn; geographically it would have greater impact on the South and the upper Midwest. However, there are significant political hurdles facing the proposal on Capitol Hill.

Crop Insurance Rates

The Administration also proposed reducing crop insurance premium subsidies benefiting farmers, and underwriting gains to agents by an average of \$600 million per year. More immediately impacting farmers though is the February closing futures prices for crops that determine the crop revenue insurance program rates for production in 2009/10. Indications are that crop prices covered will be down significantly from last year but they were not disparate enough between crops to skew planting decisions.

Inputs and Spring Planting

Two dynamics echoing right now are the prospect of reduced input sales this spring, and the lack of selling by farmers, either of old crop or new crop corn. Farmers report intentions to reduce fertilizer applications and new variety seed purchases due to the high prices being charged. The lack of earlier farmer selling of old corn could mean a flood of poor condition corn coming out of the bins once they defrost this spring, and the paltry amount of forward selling (10 percent) new crop corn could mean foregone higher pricing later this year if demand remains soft.

FOOD SAFETY – CONTINUED FROM PAGE 4

Relative Risk

Today’s food system delivers a trillion calories a day to consumers, some of which is highly biologically active material. While not all of it is pristine, food safety does not even get mentioned by the Copenhagen Consensus of Nobel Laureates as a priority for advancing global welfare. Indeed, one of the ironies in food safety is that consumers often worry about agriculture’s use of chemicals, the very substances that government regulators have carefully assessed and approved, while failing to appreciate data from the U.S. Centers for Disease Control showing that the vast majority of food borne illnesses are propagated through poor practices in the kitchens of homes and restaurants. This may explain the dichotomy in a McKinsey & Company survey where 27 percent of consumers expressed a desire for safer food products but just 18 percent of food industry executives perceived it as a worthy business investment.

The good news is that globally, the agri-food sector is viewed more positively than other industries; the bad news is that consumers indicate they are quicker to abandon a food company based on reputation (see graph below). Thus, the most appropriate risk management practice may be to invest in practices that will retain consumer trust.



Source: McKinsey Global Research

CHINA – CONTINUED FROM PAGE 1

Chinese Produce Industry Impact on U.S. Agribusiness

From dehydrated garlic to frozen strawberries, production of many fruits and vegetables has been outsourced to China, and that country’s role as green grocer will continue to expand. The labor cost structure in China is obviously lower than in the U.S., and it benefits from the shorter transportation distance to key Asian markets like Japan, Taiwan, and elsewhere. Yet China faces several major hurdles in maximizing its potential:



Food safety problems

Last year’s melamine problem highlights the huge deficiencies in the country’s production methods and regulatory enforcement.

Transportation hurdles

Current investments will someday make it a logistics center but for now, moving farm product is challenging.

Extremely small farms

The average U.S. agricultural worker farms 44 times as much land as his Chinese counterpart. Sourcing and aggregating product from numerous tiny land holdings multiplies problems with product quality, consistency, traceability, and food safety.

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