



Responding to
a world of change

[A Year in Review]

2008



2008 USDEC Members

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New Challenges, New Records



The old saying, “You have to take the bad with the good,” proved to be the theme of 2008. Last year’s global dairy market was one characterized by dichotomy.

On the one hand, U.S. dairy suppliers obliterated previous records, exporting 10.8 percent of the milk solids produced in this country (vs. 9.5 percent in 2007), an amount worth \$3.83 billion (compared to \$3.06 billion in the previous year).

On the other hand, export shipments gradually weakened as the year progressed, and U.S. suppliers finished 2008 with the first negative quarter (minus 29 percent) since January-March 2006.

At the root of the problem was softened demand. Consumers the world over were already struggling with inflation, facing historically high food prices, when the global economy began to crack last summer. The combination was deadly to business.

Global dairy demand growth halted—right about the time that milk production from Oceania and South America ramped up.

The conditions that were so favorable to U.S. exporters at the start of the year vanished. Stockpiles grew and prices plummeted. The dairy supply chain the world over—farmers to processors to retailers from Australia to Britain to the United States—felt the effects. And they will continue to feel the fallout in what undoubtedly will be a challenging 2009.

But the dairy export business has never been one of instant gratification.



It was a long-term mindset—long-range USDEC programs and deepening supplier commitment—that originally prepared the industry to capitalize when the market offered unprecedented opportunity these past few years. Few if any business sectors could boast the 200 percent-plus sales growth that the U.S. dairy export industry generated from 2006-2008. Nor should one forget the steady compounded annual growth of 11 percent since 1995, when USDEC was founded.

That growth was not a fluke. It was driven by more than a decade of rising global dairy consumption—a long-term trend that government and industry forecasters adamantly assert will return. And when it returns, demand growth will again squeeze customary supply sources, bringing tighter global markets and greater global trade opportunities.

USDEC helped lay the groundwork for the extraordinary growth of the past few years, growth of which U.S. suppliers should be extremely proud. We will continue to work to maintain those hard-fought market gains and again prepare U.S. suppliers to take advantage when economic recovery begins and dairy consumption resumes the robust trajectory that made 2008 a record year.

Handwritten signature of James P. (Tom) Camerlo in black ink.

James P. (Tom) Camerlo
Chairman, U.S. Dairy Export Council

Handwritten signature of Tom Suber in black ink.

Tom Suber
President, U.S. Dairy Export Council

Another record performance

First half boom more than offsets fourth quarter swoon.

U.S. dairy suppliers shipped more than \$2.1 billion worth of butter, cheese, lactose, milk powder, whey proteins and other products to overseas buyers in the first half of 2008—a gain of 74 percent over the first six months of 2007 and by far a record for a half year—more money in fact than all of 2006.

Building on an exemplary 2007, conditions couldn't have been much more positive from January-June, with robust world demand, supply shortages, suspended European subsidies and favorable exchange rates. International prices, while trending slowly downward, were still well above historical averages.

People the world over were consuming more dairy products than ever before, and despite a hike in the EU's milk quotas that allowed the bloc to lift production, traditional suppliers lacked sufficient product.

Reinforcing its growing reputation as a dairy supplier to the world, the United States stepped up to fill that demand.

But around July, the dairy climate grew decidedly chillier. Severe food inflation caught up to people's pocketbooks and demand softened. Oil markets crashed, dulling the purchasing power of ever-hungrier dairy buyers in the Middle East and Russia.

The U.S. banking crisis came to a head in September and quickly blossomed into a global economic crisis. With the United States buying fewer goods from overseas, foreign manufacturers laid off millions. Rising unemployment abroad forced many back to lower-cost and lower quality grain-based diets.

Many dairy export buyers saw their balance sheets weakened and bought less. Others were unable to obtain credit to buy and hold inventory, which further eroded sales.

China learned that a large portion of its milk supply was contaminated with the industrial chemical melamine, and dairy demand there plummeted as much as 80 percent, according to some estimates, and negatively impacted consumption in neighboring nations.

Global dairy demand growth that had characterized the previous 10-plus years abruptly ceased.

At the same time, Oceania milk output began to recover from drought. World dairy stockpiles grew, sending prices into a tailspin. Export prices for milk powder, cheese and butter declined 40-60 percent in 2008, with the majority of the reductions coming in the second half of the year.

U.S. dairy export volume and value slipped, leading to a fourth quarter decline of 29 percent compared with October-December 2007. U.S. suppliers shipped \$1.67 billion from July-December—21 percent lower than the first half.

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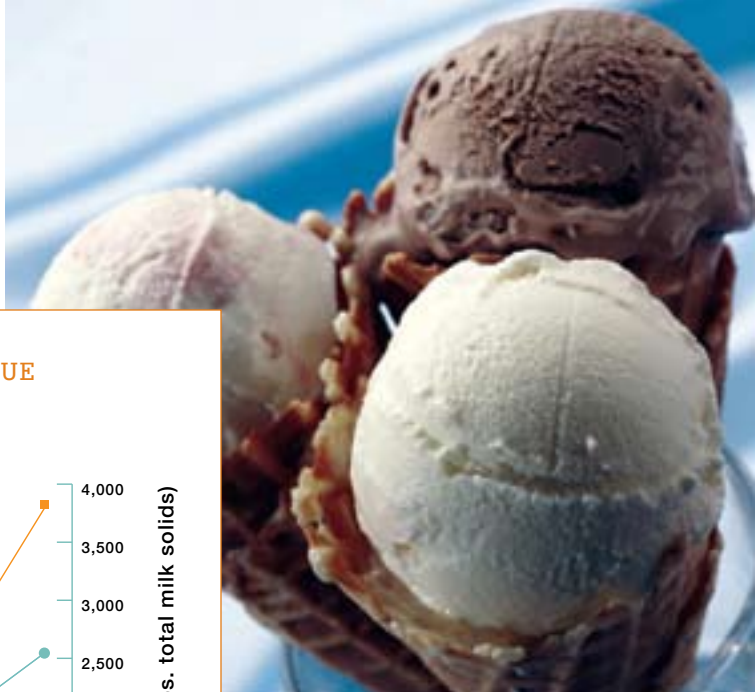
Overall Gains

Despite deteriorating conditions, robust sales from January through June carried U.S. dairy exports to a new record. Export value in 2008 rose a hefty 25 percent to \$3.83 billion. Export volumes were equivalent to 10.8 percent of U.S. milk production, also an all-time high.

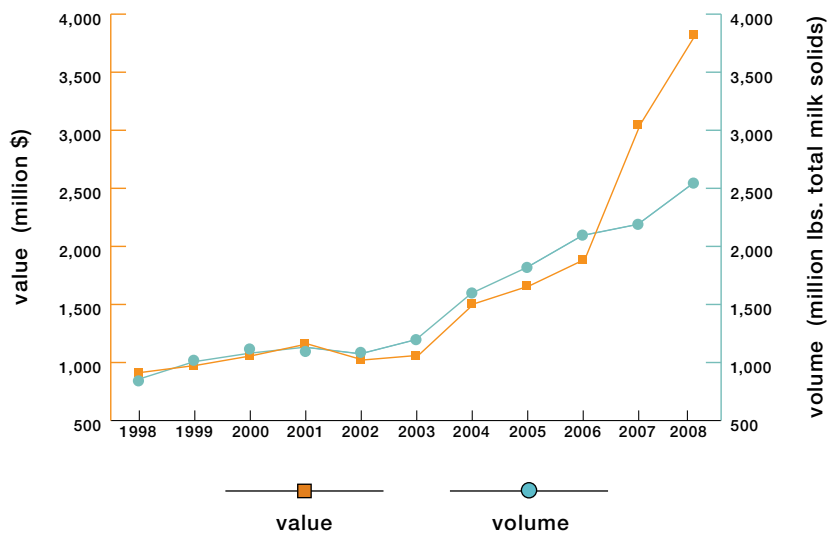
It was the sixth straight year of overall dairy export growth. For the fourth straight year, no government subsidies were used.

Product-by-product, most sectors posted gains:

Nonfat dry milk/skim milk powder (NDM/SMP) volume grew 51 percent to a record 402,507 tons. Increases were evident in virtually all key markets. Full zero-tariff access to Mexico helped grow U.S. shipments there by 68 percent to 125,223 tons. Other major gains were seen in Southeast



U.S. DAIRY EXPORT VOLUME AND VALUE



Source: U.S. Department of Agriculture, U.S. Dairy Export Council

purchases went from virtually nothing in 2007 to 12,694 tons last year.

U.S. **whey protein** exports fell 17 percent to 362,305 tons, as high prices from 2007 caused food formulators and livestock operators to seek lower-cost alternatives. Sales declined across all categories. Exports of sweet whey decreased 24 percent to 201,282 tons; whey protein concentrate (WPC) and other modified whey proteins dropped 13

percent to 120,997 tons; and whey protein isolates (WPIs) slipped 14 percent to 11,967 tons. On a positive note, whey protein shipments to China, now the largest U.S. whey market, increased 24 percent, driven by strong WPC and WPI gains.

Asia (+32 percent), Algeria (+62 percent), Egypt (+86 percent), Central America (+132 percent), China (+134 percent), the Caribbean (up more than 200 percent) and South America (up nearly 400 percent). Japanese NDM/SMP sales neared 10,000 tons, vs. only 320 tons in 2007.

U.S. **cheese** exports hit a record 131,434 tons in 2008, up 32 percent from the prior year. U.S. suppliers picked up share in their top three markets: Mexico, South Korea and Japan. South Korea surpassed Japan to become the No. 2 U.S. cheese export market, as volume rose 56 percent to 13,024 tons. U.S. suppliers also recorded big gains in the Middle East/North Africa (+145 percent), Southeast Asia (+78 percent) and the Caribbean and Central America (+40 percent). For the second straight year, Australia was one of the top 10 individual markets for U.S. cheese.

Despite deteriorating conditions, robust sales from January through June carried U.S. dairy exports to a new record.

Shipments of **butterfat** more than doubled (+125 percent) to 89,360 tons—the most since 1994, when the majority of U.S. exports were via government programs. The Middle East/North Africa accounted for more than one-third of U.S. volume. The biggest single markets in 2008 were Russia (+418 percent to 16,258 tons) and Japan, where butterfat

Among other U.S. products, **whole milk powder** (WMP) sales more than doubled to 29,311 tons; **lactose** exports grew 2 percent to 185,717 tons; **fluid milk** shipments increased 8 percent to slightly more than 50 million liters, a 14-year high; and **ice cream** volume dropped almost 2 percent to 25,354 tons.

A new level of sophistication

U.S. suppliers step up using USDEC market support.

One thing 2008 clearly showed was the continuing maturation of the U.S. dairy industry. U.S. suppliers went from simply trying to get a foot in the door of overseas markets to expanding product lines, widening their customer bases and penetrating deeper into the everyday eating habits and food manufacturing networks of foreign nations.

With nearly 11 percent of U.S. milk solids being exported in 2008, including 55 percent of the lactose produced in this country, 49 percent of the whey proteins, 47 percent of the NDM/SMP, 12 percent of the butter and 3 percent of the cheese, it is clear that processors and producers have come to rely on exports as fundamental to the health and growth of the industry.

USDEC market support programs have adapted along with member needs and goals to help take U.S. suppliers to that next level, and will continue to adapt to suit market conditions.

Case in point: Mexico.

U.S. share of Mexico's cheese import market grew to 60 percent in 2008, as volume increased 3 percent despite overall Mexican cheese imports declining by 20 percent.

U.S. business advanced beyond making a cheese sale to cultivating a long-term partnership and establishing the United States as the cheese supplier of choice. To that end, USDEC sponsored a risk management seminar to help buyers better manage cheese purchasing in today's volatile marketplace.

The meeting, which covered futures, options and hedging tools, generated high interest from the Mexican trade, indicative of their desire to create a mutually beneficial relationship with U.S. suppliers and keep trade flowing no matter the international market conditions.

Another example occurred in South Korea.

U.S. cheeses earned a prominent position in South Korea's foodservice sector over the last five years, but retail success had been slower in coming—until 2008.

In the third quarter, a South Korean cheese importer and long-time USDEC partner rolled out single-serve U.S. string cheese to two of the nation's largest c-store chains: Family Mart and GS Mart, with more than 7,000 outlets combined. Sales took off, backed by USDEC point-of-sale materials.

Initial success prompted two other large convenience retailers, 7-Eleven and Buy the Way, to put the products into 40 percent of their 3,100 stores by year-end.

Korean sales data indicated that string cheese quickly became the second largest selling dairy product in the convenience channel. Stores were having so much success that they planned to introduce additional single-serve varieties, including smoked mozzarella, cheddar and pepper jack.

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Both examples represented U.S. suppliers stepping up to a new level of business—a move for which they seemed eager.

U.S. companies were more focused on building long-term overseas markets last year than ever before. And judging by the growth in membership—the Export Council ended 2008 with 89 members, 17 more than 2007—more U.S. suppliers were seeking to avail themselves of USDEC services to capitalize on strong dairy market performance.

MEETING MARKET NEEDS

Gouda is the No. 1 cheese import in Russia and Mexico and No. 2 in Japan. Together, the three countries purchased 85,000 tons in 2005, projected to grow to nearly 110,000 tons by 2010. Yet U.S. share in and prospects for international gouda growth were practically nonexistent prior to 2008.

USDEC created the Gouda Initiative to capitalize on untapped opportunity. The initiative made great strides in 2008, starting when USDEC brought together U.S. cheesemakers with Mexican buyers and end users. That led to a gouda sampling program and commercial discussions.

By late 2008, cheesemakers sent their first commercial shipments to Mexico, and buyers lauded the product. In fact, they wanted more. Now the only thing required to realize major new incremental cheese export growth is commitment by U.S. suppliers to service the market.



revamped website, unveiled in August 2008. USDEC's new online home features enhanced navigation and a simplified design, including a "virtual library" link that puts U.S. and global dairy trade information in one place. Trade data, manuals, guides, brochures, monographs, sourcebooks, strategic market reports, news, photos and other facts and figures can all be accessed in the "library," allowing members to quickly and easily track down information.

The website, as well as two 2008 webinars dissecting export market conditions and challenges, expanded USDEC's reputation as the go-to source for all things related to dairy trade.

Such efforts to enhance the sophistication and capabilities of U.S. dairy suppliers extended far beyond online resources.

With food safety lapses growing increasingly common not only in the United States but around the world, USDEC takes a proactive stance to minimize potential future disruptions to dairy export business. In 2008, USDEC co-sponsored with Dairy Management Inc. the Quality, Safety and Traceability (QST) Initiative. The program seeks to meet the rising expectations of customers and regulators for food traceability and source integrity.

The first tangible portion of the initiative was the Quality & Safety Initiative Toolkit, an informational communications tool for U.S. dairy processors. A multi-disciplinary advisory panel of manufacturers, scientists and academics is currently plotting a roadmap to what might become "next generation" traceability, thereby aiding the U.S. competitive advantage in our internal and external markets.

The project, in other words, is long-term, like the commitment needed for dairy export success.

Providing the tools

In addition to promotional programs, educational seminars, trade missions and other activities, USDEC supports all members with a variety of communications tools and informational resources. Export Council reports keep members well-versed in the latest dairy trade developments—from regulatory revisions to foreign competitor intelligence to market condition updates. The information is geared to help U.S. suppliers build their knowledge of export markets, avoid pitfalls involved in international trade and target their company efforts for the best results.

A centerpiece of those tools is the *U.S. Dairy Export Guide*. The members-only online reference manual is the most comprehensive guide available to global dairy tariffs, health certification and inspection requirements, and labeling and product standards. Staff made more than 110 revisions in 2008 to ensure it presented the most current information to facilitate business.

The *U.S. Dairy Export Guide* and reams of relevant trade information are now easier to find than ever at USDEC's

A well-laid foundation

USDEC staff works to set the cornerstone for future growth.

Dairy export success is a long-term proposition dependent in part on participants playing by a fair, transparent set of rules and regulations. Part of USDEC's mission, through its trade policy and market access and regulatory affairs staffs, is to ensure that the rules are indeed even handed.

That mission means an ever-expanding caseload, requiring ongoing staff efforts with the understanding that in the end they will yield long-term benefits. Work in previous years laid the foundation for 2008 successes; work in 2008 on many fronts laid important groundwork for issues that USDEC will continue to deal with in 2009 and even 2010.

For example, 2008 marked the first year of unlimited duty-free milk powder access to Mexico under the North American Free Trade Agreement (NAFTA). With it, U.S. suppliers shipped 133,391 tons of SMP/NDM and WMP South of the Border, 72 percent more than the previous year. That's aside from significant volumes of cheese and other products shipped to Mexico as their tariffs phased out at earlier stages of NAFTA. For milk powder, it took the 15-year NAFTA phase-out, preceded by years of negotiations to secure the market opening provisions.

The NAFTA agreement has been a boon to the U.S. dairy industry and is one reason why U.S. exports increased six consecutive years. It stands as proof that balanced FTAs undergird the competitiveness of U.S. dairy suppliers.

USDEC consistently works to ensure that the U.S. dairy industry's voice is heard during FTA talks by working closely with negotiators. Once deals are signed, staff lobbies for their timely passage.

In 2008, they contended with Congressional decisions to put off consideration of signed FTAs with Colombia, Panama and South Korea. USDEC particularly pushed and will continue to advocate for the U.S.-Korea FTA, which holds more potential dairy trade opportunities than any deal since NAFTA.

On the other hand, USDEC was quick to point out problems where potential FTAs would not be in the best interest of the industry, such as the Trans-Pacific Partnership. In light of

the absence of any significant additional export potential from the agreement and the reality of the anti-competitive structure of New Zealand's dairy industry, USDEC is working to ensure that U.S.-New Zealand dairy trade is excluded from any such deal.

USDEC also provided ongoing advice to U.S. negotiators throughout the year in World Trade Organization (WTO) Doha Round talks to ensure that U.S. dairy industry goals and priorities were given full attention.

The importance of completing a deal that's meaningful for the U.S. dairy industry became perfectly clear in early 2009 when the EU reinstated its dairy export subsidy program, despite a Doha Round pledge to fully eliminate the trade-distorting payments by the end of 2013 if an agreement is reached.

USDEC continues to work toward a successful Doha conclusion that would hold the EU to its promise, as well as increase market access for U.S. dairy suppliers. WTO negotiations by their very nature, being built piece by piece, demand USDEC involvement every step of the way.

One way USDEC ensures that the people who influence trade policy understand the importance of creating





KEEPING TRADE FLOWING

When the melamine-tainted milk scandal decimated Chinese dairy consumption in September, dairy buyers and importers requested that imports be certified to comply with specified melamine limits. Since USDA had no system to certify the absence of melamine, U.S. suppliers saw that USDEC's reputation for objective information could play a vital role.

USDEC quickly responded to member requests, spearheading an effort to create a testing program and certificate. Staff, meeting with members and USDA experts, settled on a system in which random samples are taken at the plant level and tested by USDA. Those that comply receive a melamine certificate explaining the procedure and signed by USDEC.

The program went from concept to reality in less than a month and was so well received that the Operating Committee reauthorized it in January 2009.

balanced trade agreements is through its Congressional Education Program (CEP). The heart of the CEP are events held around the country and attended by local dairy industry leaders to focus on the dairy benefits that can be had from well-negotiated and carefully selected FTAs.

The events have proved to be an excellent outreach tool to help increase awareness of the significance of balanced trade to the U.S. industry and to build stronger relationships with members of Congress who share USDEC's views. These efforts are particularly critical at times such as these, when protectionism threatens free trade progress.

Hurdling technical barriers

Trade agreements are only part of USDEC's ongoing responsibilities. Market access and regulatory affairs staff—at times in tandem with trade policy staff—are constantly on guard for unwarranted technical barriers to trade.

Some long-term efforts yielded major results in 2008. USDEC scored a victory in April when Japan designated polysorbates 20, 60, 65 and 80 as safe and authorized food additives, expanding formulation and export opportunities for U.S. ice cream and cheese manufacturers. USDEC was instrumental in obtaining the approval of the additives, submitting supportive documentation to Japanese authorities in 2005.

On a larger scale, USDEC staff played key roles in creating the Draft Model Export Certificate for Milk and Milk Products that was adopted last year by the Codex Alimentarius Commission. In the works for more than a decade, the standardized certificate removes the complexity and confusion created by myriad national requirements and will, as it is phased in, facilitate global dairy trade. Staff have already begun working with U.S. government officials to explore ways to use this certificate to help create breakthroughs on difficult certificate issues with our trading partners.

Among the many new challenges staff faced in 2008 were Chinese whey standards that bar whey permeate imports for food applications.

To resolve the issue, USDEC is working to update the Chinese whey powder standard to include specific references to whey permeate and concentrated whey products, an effort that carried over into 2009.

In all, USDEC market access staff helped clear dozens of detained shipments from customs officials in 2008 totaling nearly 2.1 million pounds of dairy products and addressed nearly 400 requests for technical assistance involving import regulations and requirements, avoiding any halt to the flow of products overseas.

Governance/Structure/Funding

Corporate Structure and Governance

The U.S. Dairy Export Council is a nonprofit, independent membership organization representing the export interests of U.S. milk producers, dairy cooperatives, processors, traders and industry suppliers. The Council was established in 1995 by Dairy Management Inc.™ (DMI), the farmer-funded marketing, promotion and research organization, to build global demand for U.S. dairy products.

The U.S. Dairy Export Council is structured to facilitate membership participation. Each member-company is represented on the Board of Directors, and delegates provide valuable input and leadership to USDEC's four program committees: Cheese & Manufactured Products, Dry Ingredients, Trade Policy and Finance.

A 13-member Operating Committee, including USDEC officers (Chairman, Vice Chairman, Treasurer), leadership from the program committees and four at-large members elected by the Board of Directors, is responsible for day-to-day operations of the organization. An experienced staff of marketing and technical experts, based in Arlington, Va., just outside Washington, D.C., executes the programming of the Council on behalf of the Operating Committee and the membership.

Each year, USDEC's Board of Directors authorizes a strategic business plan to guide marketing programs and ensure that USDEC activities provide the greatest return on investment. The Council's marketing department is organized along product lines (Cheese & Manufactured Products and Dry Ingredients) and is supported by four departments: Strategic Research and Business Development; Trade Policy; Market Access and Regulatory Affairs; and Communications and Membership.

USDEC's mission is facilitated by office representation in China, Taiwan, Japan, South Korea, Thailand, Mexico, Brazil, United Kingdom, Vietnam, Lebanon, Caribbean, Russia and Central America. These overseas offices provide in-country intelligence, program guidance and technical assistance—all critical components to enhancing international demand for U.S. dairy products.

Funding

In 2008, U.S. dairy farmers invested \$11.9 million in USDEC activities through the dairy promotion check-off program. USDA provided \$5.9 million through a variety of market development programs. USDEC also generated \$829,000 in membership dues, which are the sole source of funding for trade policy programming.

2008 SOURCE OF FUNDS

Dairy Management Inc.	\$11,882,500
USDA/FAS	\$5,869,000
Membership dues	\$829,000
Other	\$1,400,000

Total	\$19,980,500
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2008 EXPENSES

Market development	\$12,530,500
Program operations	\$3,640,000
Export enhancement	\$2,110,000
Industry communications	\$994,000
General and administration	\$615,000
Unallocated revenue	\$91,000

Total	\$19,980,500
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2008 EXPORT ENHANCEMENT

Trade policy	\$1,010,000
Market access and regulatory affairs	\$775,000
International travel and misc. operations	\$325,000

2008 U.S. DAIRY EXPORTS

	Volume (mt)	% change 2008 vs. 2007
Skim Milk Powder	402,507	+51
Whey Proteins	362,309	-17
Lactose	185,717	+2
Cheese	131,434	+32
Butter	80,077	+143
Fluid Milk & Cream (KL)	50,088	+8
Whole Milk Powder	29,317	+134
Ice Cream	25,354	-2
Butteroil	9,283	+36
Yogurt	5,661	+11

U.S. EXPORTS OF PRODUCT BY COUNTRY IN 2008

Whey Proteins	Volume (mt)	% change 2008 vs. 2007
Caribbean	4,511	-4
Central America	6,841	-14
China/Hong Kong	76,337	+24
Japan	32,004	-19
Mexico	60,526	-38
Middle East/North Africa	16,562	-98
South America	16,587	-4
South Korea	14,301	-50
Southeast Asia	68,141	-1
Taiwan	7,461	+55
World	362,309	-17

Cheese	Volume (mt)	% change 2008 vs. 2007
Australia	3,626	+62
Canada	11,321	+28
Caribbean	8,293	+27
Central America	6,727	+69
China/Hong Kong	3,173	+53
Japan	9,375	-7
Mexico	36,967	+10
Middle East/North Africa	19,888	+144
South America	2,495	+2
South Korea	13,024	+56
Southeast Asia	6,575	+78
World	131,434	+32

Skim Milk Powder/Nonfat Dry Milk	Volume (mt)	% change 2008 vs. 2007
Caribbean	9,273	+234
Central America	5,856	+132
Japan	9,893	*
Middle East/North Africa	54,658	+31
South America	11,890	+388
Southeast Asia	149,251	+32
World	402,507	+51

*Only 320 tons in 2007.

At-a-Glance

U.S. dairy suppliers shipped 2.55 billion pounds of total milk solids overseas in 2008—16 percent greater than the previous year and a new record. Export value rose 25 percent to \$3.83 billion, also a record. Over the last five years, U.S. dairy export value grew more than 250 percent, while total solids volume increased nearly 160 percent.

Lactose	Volume (mt)	% change 2008 vs. 2007
China/Hong Kong	25,927	+38
EU	14,489	+52
Japan	37,678	-20
Mexico	16,902	-17
South America	12,066	+50
Southeast Asia	40,716	+2
World	185,717	+2

Butter	Volume (mt)	% change 2008 vs. 2007
EU	3,153	-72
Japan	12,690	*
Mexico	2,864	-20
Middle East/North Africa	32,833	+194
Russia	15,392	+413
World	80,077	+143

*Only 6 tons in 2007

Butteroil	Volume (mt)	% change 2008 vs. 2007
Central America	1,401	+208
EU	1,516	-63
Mexico	3,229	+167
World	9,283	+36

Ice Cream	Volume (mt)	% change 2008 vs. 2007
Caribbean	3,210	+32
EU	865	-63
Mexico	13,607	-1
World	25,354	-2

Fluid Milk	Volume (mt)	% change 2008 vs. 2007
Canada	21,722	+55
Mexico	22,945	-23
World	50,088	+8

Yogurt	Volume (mt)	% change 2008 vs. 2007
Mexico	941	+37
World	5,661	+11

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