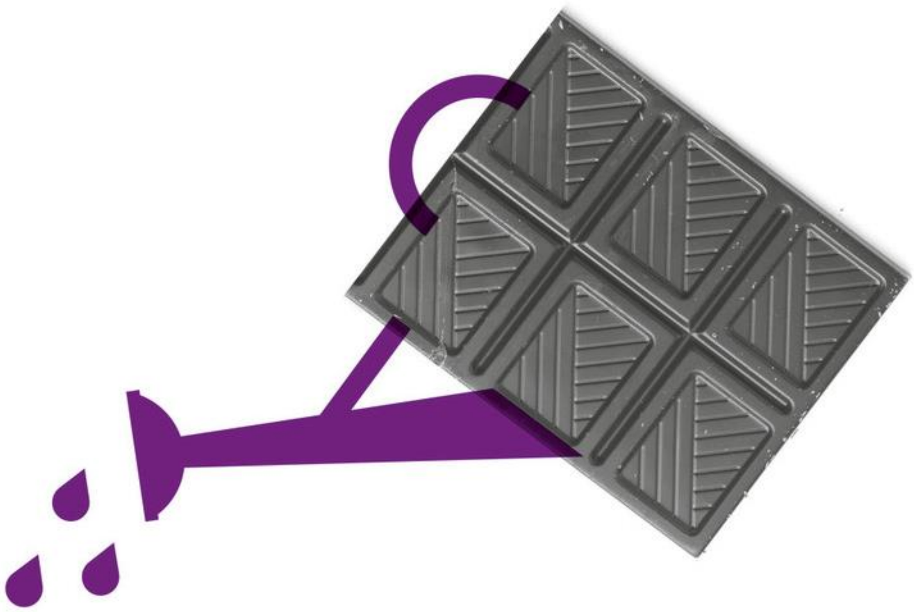
Commodities bulletin: dairy

Keeping you up to date on the legal issues affecting the commodities industry in Africa



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EU/Africa

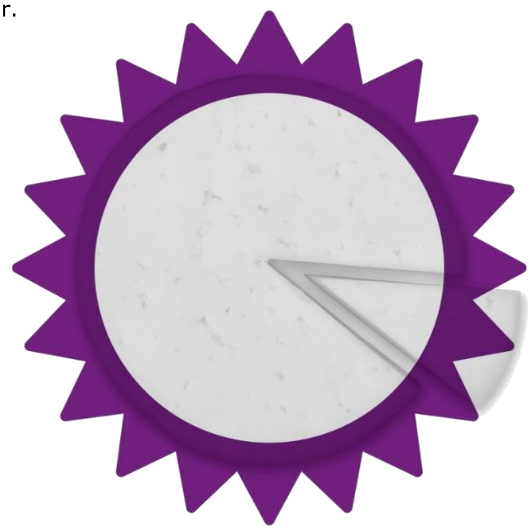
Local farms at risk as EU milk floods the African continent

Milk is money to many African communities. Pastoralist communities depend on income from livestock to pay for health services, school fees and food. Scaling up milk production is not easy though, as access to finance to grow the dairy business, training on dairy husbandry, business practices and operations and marketing of dairy products is almost non-existent – particularly in the more remote rural areas.

The last decade has seen a number of projects implemented throughout Africa with the aim of creating sustainable dairy businesses to support local communities. The East Africa Dairy Development (EADD) Project, the dairy project established and implemented by, amongst others, Heifer International, the Bill & Melinda Gates Foundation and Elanco, is just one example of a project which is designed to boost the milk yields and incomes of small-scale farmers in Africa (Kenya, Uganda and Tanzania), so that they can lift their communities out of hunger and poverty. Programmes, such as the EADD, are designed to incentivize and support local communities at all levels of the value chain through: (i) the creation of dairy cooperatives (in which dairy farmers own shares) through which dairy farmers collectively invest in necessary milk-chilling plants and related technology etc. to improve the quantity and quality of milk; (ii) the improvement of transportation routes to ensure the collection of milk is consistent; (iii) the access to third party business financing; and (iv) education and training in animal health, feeding, new technology etc, until a sustainable and self-supporting model is achieved. The programmes have been a huge success and local dairy farmers and their communities are benefitting from the consistent and reliable returns.

However, despite all efforts at a local level, the local dairy farmers and their communities are now suffering from an unexpected external factor: the flood of milk being imported from the EU.

Over the last 4 years, various events have caused a milk surplus in the EU, not least the Russian agricultural product embargo imposed on the US, the EU and various other countries in 2014 and the abolition of the EU milk quota in March 2015 which removed the restrictions on milk production levels. As EU milk production levels continue to exceed demand resulting in a stagnation in low milk prices, EU dairy businesses look to generate profits through increasing milk exports to emerging markets. In 2017, global exports of milk from the EU increased by 38% on the previous year.



China

China is the largest importer of milk in the world and has been a key target market for EU dairy exports. As a traditionally dairy-free nation, China has relied on the importation of dairy produce. However, China is on its own path to "revitalize" the Chinese dairy industry. Already, it is the 4th largest producer of milk in the world and, in an announcement by the General Office of the State Council on 11 June 2018, the Chinese Government has released a guide for the dairy industry development. By 2025, it expects the dairy industry: "to increase its own production capacity through technological innovation, system reform in management and cost reduction, while at the same time increasing efficiency." China may no longer remain the dairy exporters' golden child.

Africa

With this in mind, the EU dairy industry's interest has shifted towards the African continent. Africa appeals to the dairy industry on several fronts:

- There is a growing middle-class population in a number of African countries (such as West Africa and Kenya) who can afford dairy products and are interested in improving their diet
- Africa's population generally is estimated to increase from 1.2 billion people (2015 estimation) to 2.5 billion people by 2050
- Annual milk consumption levels in most African countries are well below WHO recommended levels of 200 litres per capita and
- Food safety and food security remain key areas of concern for almost all African countries. Malnutrition and diet-related non-communicable diseases (NCDs) are prevalent in children across the continent. Milk and milk products have the potential to fill identified nutrient intake gaps and to reduce the risks of developing NCDs

Recently, the EU has flooded the African continent with cheap milk. Although it eases the pain somewhat of the EU dairy businesses, the deluge of milk into the continent has merely shifted the pain to local dairy farmers who are struggling to compete with the low prices and better quality of milk entering the market.

Efforts made to release countries from dependency on non-African countries, now risk being thrown into turmoil. In an Article published on 4 August 2018 by Politico, the American political journalist company, it was reported that Adama Ibrahim Diallo, the president of Burkina Faso's milk producers and mini-processors union, had indicated that: "farmers in his region are gradually giving up, explaining that his processor receives 200 litres of milk a day where once it took 300". He further indicated that this was directly aggravating the security system in the Sahel. "The problem … is tied to overproduction" he said. "The multinational companies' strategy is to implant themselves in West Africa to sink their milk in." In a similar vein, Bacar Diaw of Senegal's dairy association, Fédération nationale des acteurs de la filière lait local au Sénégal (FENAFILS), stated to Politico: "When large quantities of milk powder from the EU … are sent to West Africa, our local milk producers have to shoulder the burden".

Needless to say, the longer the situation continues, the more politically sensitive it becomes. Local farmers are looking to their respective governments to protect their local dairy industries and reduce the levels of dairy imports into their respective countries. So what options are available to local governments to protect their respective dairy industries?

1. Will trade embargoes on dairy protects be implemented, similar to those imposed by Algeria earlier this year?

2. Will tariffs/duties be imposed or increased on imported dairy products? For example, Rwanda already imposes a 10% duty on imported SMP. Will this be increased as a protectionist measure? Morocco has recently (April 2018) hiked up its tariffs on SMP and WMP to 50% and 100% respectively for most-favoured nation, non-licensed importers.

3. Will anti-dumping measures be required, similar to those imposed by Brazil on New Zealand and the EU in respect of milk powder?

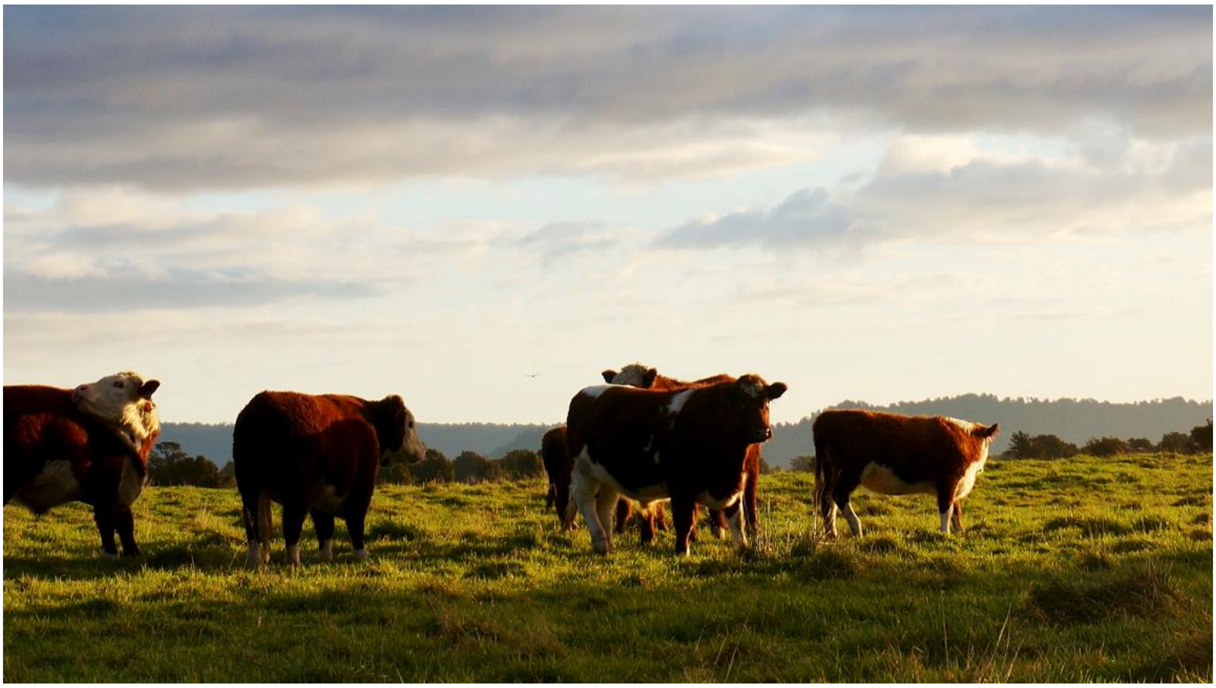
4. Will foreign direct investment into the dairy industry be restricted, so that foreigners are required to partner with local processors and producers (like the FDI restrictions in Uganda)?

5. Alternatively, will unrestricted foreign investment in related industries (eg dairy technology, health care, feeding) be encouraged and supported by governments so that the quality of local dairy products can be improved, and the quantity of dairy products be increased?

6. Will the EU's new Task Force Rural Africa, which seeks to advise governments on agricultural policy and help EU companies invest responsibly in Africa, be implemented in a manner that will reduce the impact that the importation of cheap milk from the EU is having on the African continent?

7. Will Governments follow the Chinese route and look towards self-sufficiency by investing State funds into the dairy industry, education, animal husbandry, dairy technology, thus increasing its respective country's local production and quality and reducing its reliance on imports?

Whichever route local Governments choose to take, consideration will need to be given to the impact that any restrictions on importation / foreign investment will have on each country's food security. In most African countries, dairy production levels are far below consumption levels and even further below recommended WHO consumption requirements. A balanced approach will be necessary to ensure both the local dairy industry and the local population as a whole are suitably protected.



Uganda

Seeking to achieve 100% milk processing capability

In June 2018, the Ugandan Dairy Development Authority (UDDA) announced that milk production in Uganda for 2017/2018 had exceeded 2.2 billion litres per year, a 6% increase from the 2.08 billion litres recorded in 2015. 80% of the milk produced is understood to be sold into the market while the rest is used for home consumption. The UDDA has further stated that, milk per capita annual consumption in Uganda increased to 62 litres in 2017, but this still remains well below the WHO's recommended annual consumption of 200 litres per capita.

Uganda's dairy industry has grown significantly over the last 15 years as a result of the Ugandan Government's and foreign investors' increased investment into the sector. From being a key importer of dairy products from neighbouring countries back in the early 2000's (mainly due to having a limited infrastructure to collect and process milk in country), Uganda is now becoming a net exporter for a variety of dairy products including processed UHT milk, milk powder, butter and cream. Some even have Uganda poised to become the largest dairy exporter in Africa competing against the likes of Sudan, South Africa, Kenya and Ethiopia.

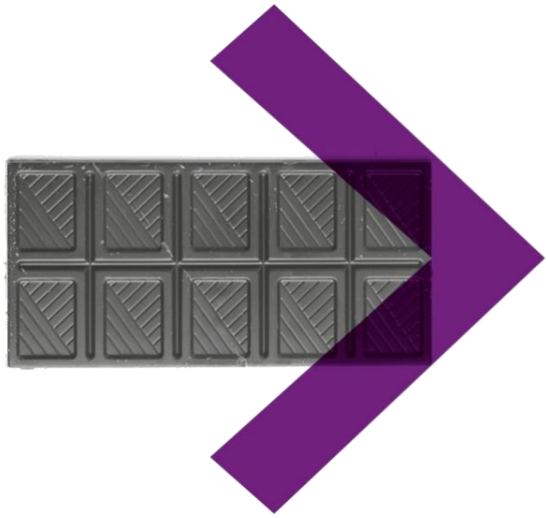
However, the UDDA has indicated that only 33% of the milk marketed is processed, the remaining 67% is sold raw. The consumption of raw milk across the African continent is far from uncommon, however, the ever-increasing health concerns associated with the consumption of raw dairy products (such as Salmonella, E. coli and Listeria) are likely to result in an increased preference towards processed milk.

At present, there is a small network of licensed dairy processing companies in Uganda with an estimated total national installed capacity of about 1.4 million litres per day (August 2017). Some of the processors are subsidiaries of or joint ventures with foreign entities such as Fresh Dairy (a subsidiary of the Kenyan conglomerate, Brookside Dairy), Pearl Dairy (part of the Midlands Group of Dubai), Amos Dairies (part of the Indian Amos Dairy group) and Vital Tomosi (a joint venture with the Israeli private equity fund: Vital Capital Fund); and others are locally owned such as: Jesa Farm Dairy and Paramount Dairies. Fresh Dairy, Pearl Dairy and Amos Dairies currently dominate the Ugandan export dairy market with sales of various dairy products to, amongst others, Kenya and other neighbouring African countries, the Gulf, Japan, India and the US markets.

The Ugandan Assistant Commissioner for Animal Health in the Ministry of Agriculture recently indicated, at the launch of Fresh Dairy's re-branded yoghurt selection: "Fresh Dairy Yoghurt", that Uganda is targeting 100% milk processing and the country is looking for other investors globally to invest in the dairy sector.

Given that only 33% of the current marketed milk is processed, and demand for quality and quantity in dairy products is increasing (both in-country and for export), there is considerable opportunity to invest in existing processing units to increase capacity and/or invest in new processing units in Uganda. There is equally a wealth of opportunities to improve the milk production, milk collection, transportation and distribution elements of the dairy industry.

With this in mind and with the push for global investment by the Ugandan Government, it will be interesting to see if the foreign direct investment restrictions on crops and animal production will be reduced to encourage increased foreign investment into the industry or whether the need to invest through a Ugandan-based entity will still remain.



Ethiopia

The talk of the town

Ethiopia is fast becoming the hot topic of investment conversation for Governments, private equity funds and corporates alike. As President, Abiy Ahmed, cements relationships with Eritrea, Djibouti, Sudan, Kenya, Somalia and Somaliland, the attractiveness of the country to foreign investors has heightened, not least in the agricultural space.

Ethiopia is the second most populous country in Africa with approximately 108 million people. According to the Ethiopian Investment Commission, 74.3 million hectares (ha) of the total land area coverage is suitable for agriculture and over 3 million ha of land has been made available for investment. With its temperate climate and fertile soils, Ethiopia is suitable for the production of key food crops such as cereals, pulses, oil seeds, fruits and vegetables, coffee, tobacco and sugar cane. In addition, Ethiopia's transportation infrastructure has improved considerably over the last few years with Ethiopia increasing its multi-port access, the Addis-Djibouti electric railway opening in 2017 and Ethiopia's on-going road network construction (now over 136,000km) enabling goods to be transported in much shorter time-frames.

From a dairy farming perspective, according to a report published in April 2018 by Ethiopia's Livestock State Ministry, the Ministry of Livestock and Fisheries and the International Livestock Research Institute, Ethiopia is home to over 55 million cattle, 29 million sheep, 29 million goats and 4.5 million camels which in aggregate produce 5.2 billion litres of milk each year.

The report goes on to state that the direct contribution of livestock to Ethiopia's gross domestic product (GDP) is estimated to be ETB 150.7 billion per year (17% of Ethiopia's GDP). The direct contributions are from milk (34%) and meat (32%). The demand for milk in Ethiopia is currently met mainly from domestic production, however as the population grows (estimated to reach 140 million people by 2030) and the demand for milk increases on a per capita level (currently between 20-40 litres per year per capita which is well below the consumption level of 200 litres per year per capita recommended by the World Health Organisation), a deficit of approximately 3.185 million litres (29%) of milk is expected by 2028. Closing the milk gap will require substantial investments in dairy genetics, farm management (eg education in reproduction, milk hygiene and handling and marketing systems), as well as feed and health services for both traditional dairy farms and commercial dairy production units. The report suggests that if investment plans are followed, there could be a surplus of approximately 2 billion litres of milk by 2028.

Foreign Direct Investment is actively encouraged in Ethiopia. In the dairy/agriculture industry, foreign investors are entitled to hold up to 100% equity in an Ethiopian entity, but they may prefer to partner with a domestic, established partner who is more au fait with local regulations and culture. In order to encourage private investment into the country, the Ethiopian Government offers various incentive packages to domestic and foreign investors alike including various exemptions on customs import and export duties and income tax holidays (up to 7 years for investors engaged in manufacturing and agro-industry activities).

As Ethiopia's reform programme looks to be going from strength to strength, caution should still be heeded to the potential challenges foreign investors are likely to face:

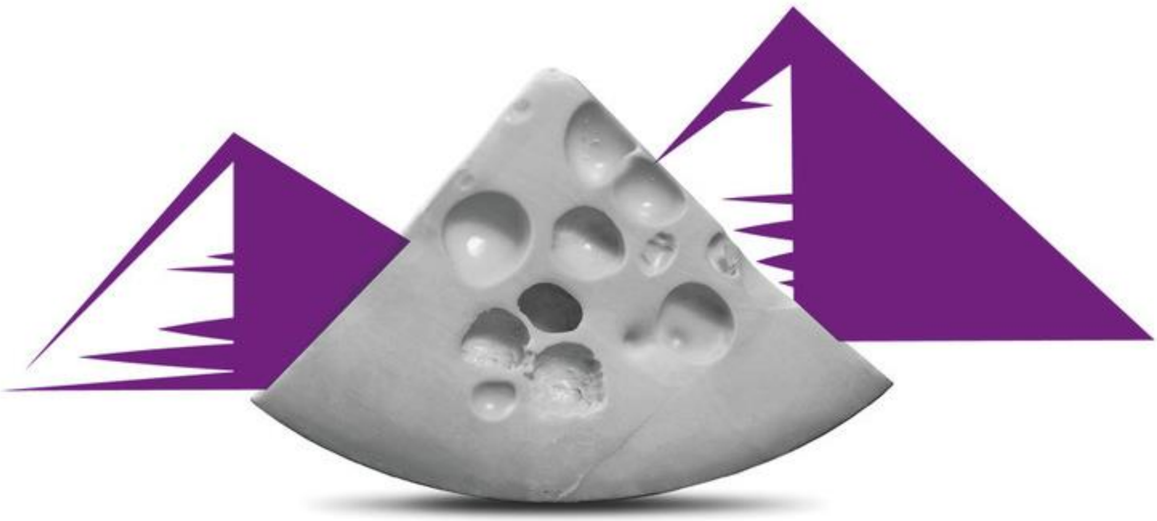
- Corruption is still an issue. Ethiopia is considered to be the 107th least corrupt country in the world according to the 2017 Corruption Perceptions Index reported by Transparency International
- Complex border clearance of goods remains the key logistics bottleneck in Ethiopia. Multiple inspections by different agencies are not uncommon and exporting and importing can take approx. 50 hours and 170 hours respectively
- Foreign exchange shortage is still an issue in Ethiopia and is likely to remain an issue for the next 15 to 20 years according to President Abiy, unless the private sector assists in finding a solution. On 16 April 2018, Reuters reported that: "the International Monetary Fund said in January 2018 that Ethiopia's foreign reserves at the end of the 2016/17 fiscal year stood at USD 3.2 billion, less than what it spends on imports in two months"
- Political backlash may arise as a result of the staggering changes implemented by President Abiy in such a short time frame. As stated in the Mail & Guardian on 11 July 2018 in an interview with Hallelujah Lulie, program director at Amani Africa: "Change this dramatic never goes unchallenged, as evidenced by the grenade attack last month on the crowd at an Abiy speech in Addis Ababa, which killed two people and injured 150. There are powerful elements within the country's ruling elite and its security sector with strong motivations to maintain the status quo"

As with any emerging economy though, the path to success is never without its stumbling blocks. President Abiy's awareness of the problems and willingness to openly tackle them at all levels, makes for a refreshing change and will hopefully provide a solid basis for Ethiopia to develop as a competitive economy.

Egypt

Beyti receives US$44 million support from EBRD

On 15 August 2018, the European Bank of Reconstruction and Development (EBRD) announced that it had provided Beyti, the Egyptian dairy and juice producer, with a US$44 million loan. The loan will be used for Beyti's investment and development projects and will refinance Beyti's existing short-term loans. EBRD also confirmed that the loan will fund new investments to expand Beyti's production and logistical capacities as the national and regional dairy and juice sectors grow within Egypt. According to EBRD's announcement, "this includes increasing production of raw milk and fruit concentrate at local dairy farms and juice concentrate producers and expanding Beyti's logistical capacity in both sectors by increasing the number of distribution centres and delivery capacity, hence achieving a higher number of sales points in the country". Beyti was established in 1998 and was acquired by International Dairy & Juice (IDJ), the joint venture between PepsiCo International (52%) and Almarai (48%) in 2009. Beyti is now one of the largest producers of milk, yoghurt and juice in Egypt. Beyti's investment and development plan is designed to enable the company to handle the rapidly growing population in Egypt (c. 90 million people) and cater for the changing preferences of its consumers.



Recent M&A activity

Ethiopia

In May 2018, Veris Investment, an investment company focused on investments in the food value chain in Sub-Saharan Africa, and Friesland Campina, the Dutch multinational dairy cooperative, combined forces and invested an undisclosed amount into Holland Dairy Ethiopia PLC - a leading Ethiopian dairy processing company situated near Addis Ababa. Holland Dairy is an established dairy brand in Ethiopia – particularly in the yoghurt and milk sector. Holland Dairy has an integrated milk supply chain and mainly sources its milk from local smallholder farmers. The investment will enhance FrieslandCampina's export position in Ethiopia, which already exports milk powder and UHT milk to Ethiopia.

South Africa

In January 2018, the Competition Commission conditionally cleared the merger between Woodlands Dairy, one of South Africa's largest milk processors controlled by Gutsche Family Investment (PTY) Ltd, and Fairfield Dairy, the KZN Dairy Company. The merger will take place over 5 years by way of staggered share purchases in Fairfield Dairy; the initial share purchase will be for a stake of 40%. In an interview with South African Herald, Lex Gutsche indicated that Woodlands Dairy is required to acquire a majority stake in Fairfield Dairy within two years of its initial acquisition. The amount of the acquisition has not been publicly disclosed. The merger results in the unification of Fairfield and Woodlands strengths in dairy, UHT milk, and fresh and dairy-related juices and their respective renowned brands: First Choice and Fairfield.

Sub-Saharan Africa

It appears that the Abraaj Group's woes are set to continue for a while longer. On 21 June 2018, the Financial Times announced the acquisition by Colony Capital of four of Abraaj Group's emerging market funds including its Sub-Saharan Fund which holds stakes in, amongst other things, Brookfield Dairy, the largest milk processing company in East Africa, controlling more than 60% of the market, and Fan Milk, the leading manufacturer and retailer of ice cream and frozen dairy products in West Africa. The initial deal fell through allegedly due to some investors wanting to block-the sale pending a review of Abraaj's handling of funds. Revised offers were submitted by both Cerberus Capital and Colony Capital in early July 2018, but on 20 July 2018, Bloomberg reported that Cerberus Capital had walked away from negotiations. The status of bids for the Abraaj Group's assets is currently unclear. The liquidation of Abraaj's assets is the direct result of the review of Abraaj's finances following the accusation back in February 2018 by four of its key investors in the health care business that their money wasn't used for its stated purpose in Kenya and two other countries. According to a summary of a report by Deloitte that was presented to creditors on 4 June 2018 and reported on by Bloomberg News, the investigation discovered commingling of Abraaj's own money in the health-care fund and its fourth private-equity fund.

South Africa

On 28 August 2018, Cape Harvest Food Group Proprietary Limited (Cape Harvest), a subsidiary of the Sea Harvest Group (the JSE-listed food and fishing business) announced its acquisition of the entire issued share capital of Ladismith Cheese Company Proprietary Limited (Ladismith Cheese), a value adding dairy processing company based in Ladismith in the Western Cape for R527 million. The company's primary business is the production, distribution, marketing and sale of cheese, butter and milk powders to South African retail, wholesale and food service markets. In Sea Harvest's 2018 Interim Results also released on 28 August 2018, Felix Ratheb, the CEO of Sea Harvest Group, and Fred Robertson, the Chairman of Sea harvest Group, stated that the acquisition supported the Group's strategic objectives which include: "acquisitions in complementary sectors of the South African food and agricultural industry which exhibit strong fundamentals, growth and where the Group is able to leverage its core competencies and strengths". They went on to state that: "The transaction represents an acquisition of a profitable branded FMCG food manufacturer of significant scale in the food and agricultural sector with a long track record, strong national brand and a proven management team". The transaction is expected to complete in the 4th quarter of 2018.

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