

The New Scenario



Given the depth and speed of changes, we conducted a preliminary report before December Report, analyzing the possible scenarios that may arise in the coming months.

As we always say from Economía Láctea, at this moment more than ever, this analysis is a snapshot of something very dynamic and subject to changes based on numerous variables that will need to be monitored day by day to make the necessary adjustments.

After months of uncertainty about who would win the elections and consequently what direction the macroeconomics of the new government would take, there are now some definitive actions being taken.

In the first week of Javier Milei's government, specific measures and announcements were made that seem to clearly define the direction they want to take with their management.

The number one priority is fiscal balance, as they believe that without achieving this balance, it's impossible to move forward with the rest of the reforms, and there's also a danger of falling into hyperinflation.

One of the initial measures was to devalue the official dollar by 116%, from 370 \$/US\$ prior to the change in government to 800 \$/US\$. Regarding the export dollar, there was a 38% increase, shifting from a 50% official dollar - 50% CCL scheme to 80% official dollar - 20% CCL, resulting in a value of 860 \$/US\$ for exporters.

Another change is that all imported goods will now be subject to a 17.5% "country tax." This has a more significant impact because, under the previous government, many inputs were exempt, meaning they entered at 370 \$/US\$, whereas now they will enter at 17.5% above the official dollar value.

This results in a loss of competitiveness across the entire chain, both in primary production and in the industry.

A second change concerns the modification of Export Duties (DEX). This measure needs to pass through Congress. The executive branch has sent a bill to set export duties at 15% for all products, with the only exceptions being the soybean complex,



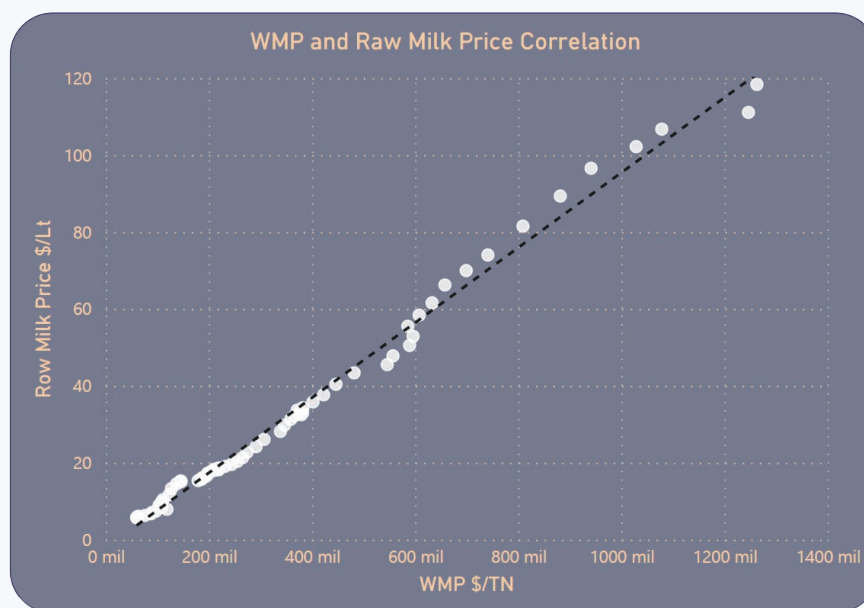
which will remain at 33%. Meanwhile, regional economies and **all dairy products will maintain a 0% DEX**, or at least that's how the project is expected to be presented.

This way, we begin to have certainties about the payment capacity of the dairy product export industry, a key reference for what might happen in the coming months with the entire dairy business.

Based on this data, we can start to estimate scenarios for the upcoming months in an industry that history indicates always faces challenges in the months following significant devaluations.

Raw milk price – WMP export price and Creamy cheese price

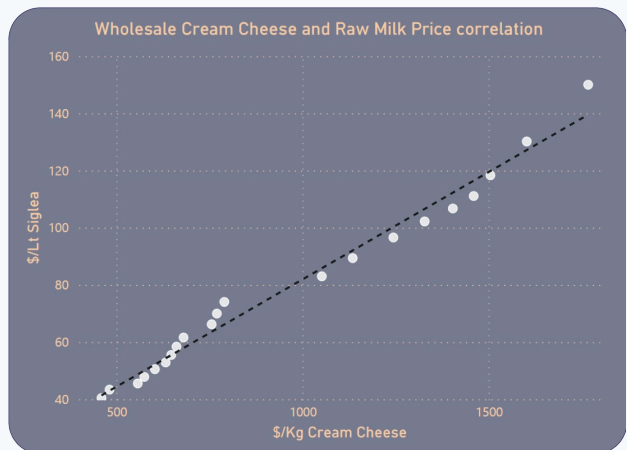
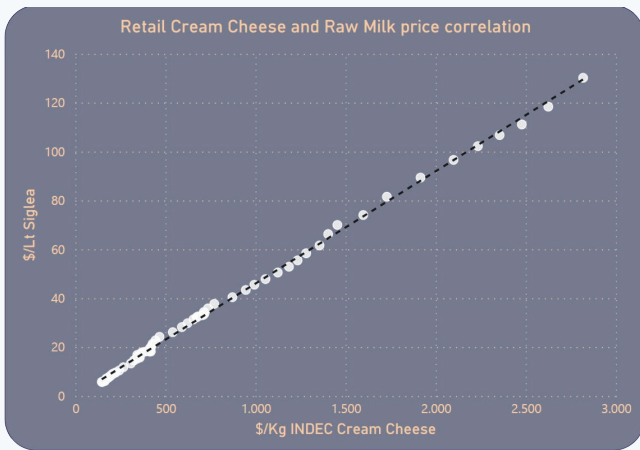
There is a very high correlation between the WMP export price expressed in pesos and the raw milk price ($R^2 = 0.991$), which, as we always emphasize from Economía Láctea, is the main driver for setting the milk price for producers.



Raw Milk Price – Creamy Cheese Price

We also monitor the relationship between the raw milk price and the creamy cheese price, both at the consumer level ($R^2: 0.998$) and at the factory exit ($R^2: 0.982$). It's noteworthy that in these cases as well, there is an extremely high correlation observed.





Therefore, the same occurs between the WMP export price expressed in pesos and the creamy cheese price, highlighting the interconnectedness between the domestic market and exports.



The problem that arises after significant devaluations is associated with the dynamics of these interconnected vessels.

Following a sharp devaluation, the payment capacity of exports adjusts immediately, whereas the domestic market has a different inertia associated with the purchasing power of the population. Consequently, it takes several months for them to converge. This delay in adjusting domestic market prices hampers the convergence of the raw milk price to the payment capacity of the export industry.

Most inputs for milk production are dollar-denominated, either because they are imported, such as many fertilizers, agrochemicals, semen, etc., or because they are exportable, like concentrates.



Additionally, there's the issue of leasing costs. Half of the land dedicated to dairy farming is leased, and leasing prices reference soybeans, which adjusted immediately to the new dollar price. The longer it takes for milk prices to adjust, the greater the risk that some leasing producers won't be able to renew their contracts.

The production is already affected by drought and asymmetric devaluations that have increased costs.

In this context, the speed of convergence will be the main variable to monitor for at least the next 3 or 4 months. This will determine the evolution of production, the slaughter of cows, and the closure of more dairy farms.

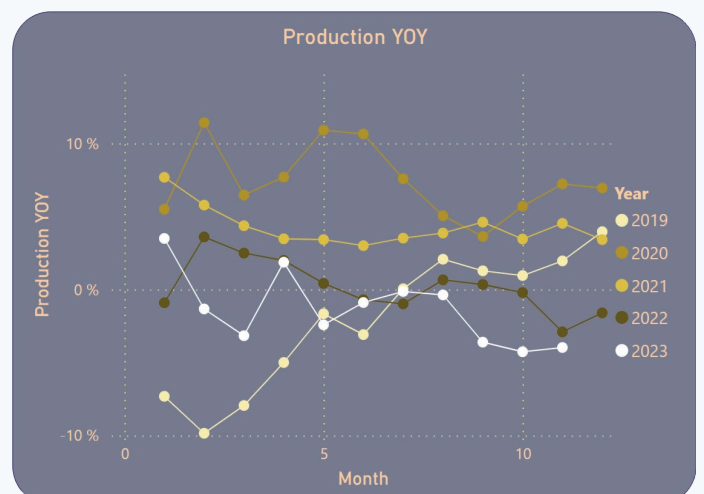
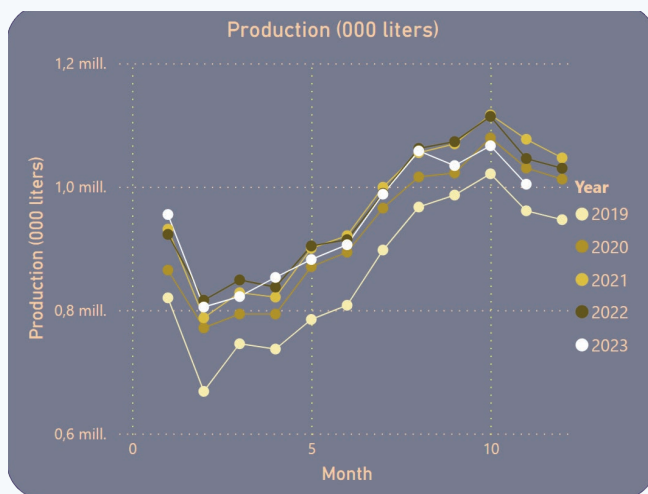
Therefore, the evolution of domestic market prices will be a focal point.

Undoubtedly, domestic consumption will experience a significant decline due to the impact of the devaluation on the population's purchasing power. At first glance, this suggests that price convergence could take a long time to occur.

However, unlike past significant devaluations, convergence might happen faster for several reasons:

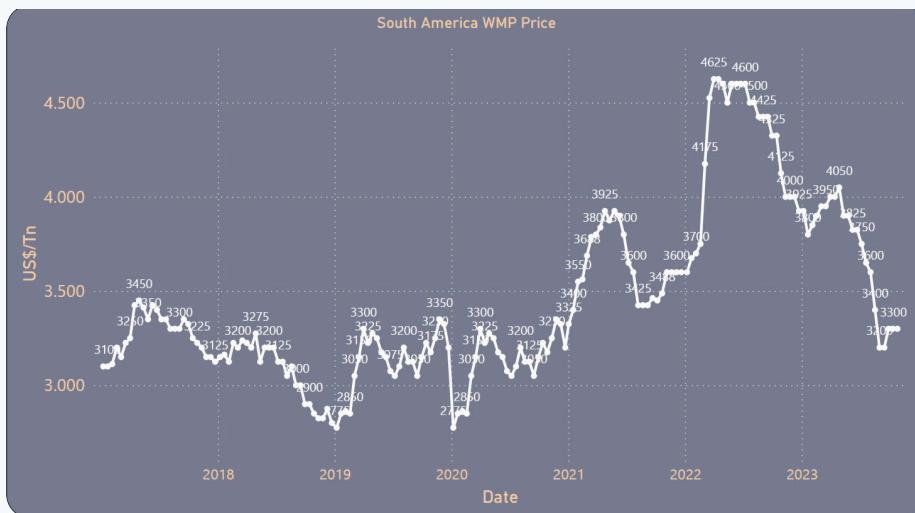
1- The devaluation occurred when the seasonal production decline was compounded by a growing year-over-year drop due to drought and relative food price increases. November's production was the lowest in the last 4 years.

If the YOY decline for the first four months were around 5%, during that period, there would be approximately 175 million fewer liters of milk than in the first four months of 2022 when the volume reaches its seasonal low.



2- International prices, while not at their best, are also not poor. A range of 3,000-3,300 US\$/Tn can be considered as “decent prices” for WMP and aligns with those of the three years before the pandemic (even though current costs are higher). Moreover, by the end of December, the market sentiment tends to strengthen. Algeria’s tender acted as a bullish driver in terms of volume and prices, setting a potential price floor reference for negotiations with Brazil.

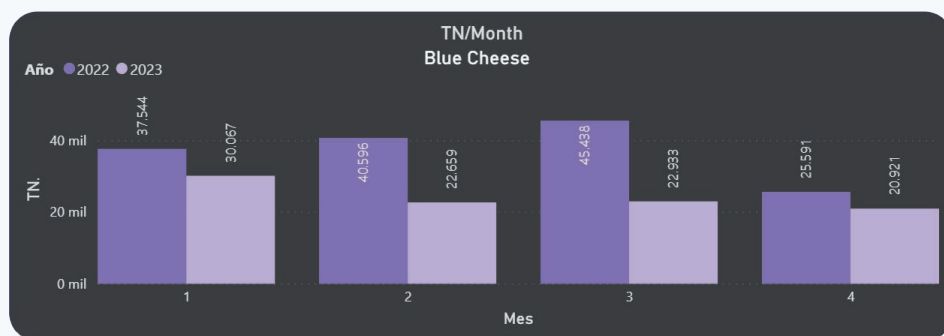
This is a significant difference compared to other significant devaluations in the past that coincided with international price crises, as seen in 2001 and 2016.



3- In this scenario, the export industry, with reasonable prices and without DEX, has favorable conditions to significantly increase export volumes.

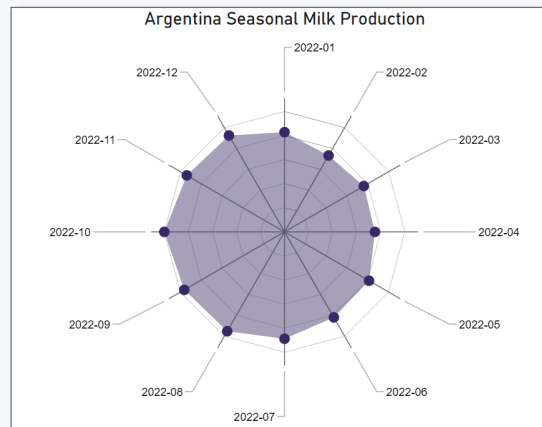
In this context, the uncertainty about whether DEX would be imposed on dairy product exports led to an acceleration of foreign sales in the early days of the new government to capitalize on the period while DEX remained at 0%.

4- The volume of exports for the first four months of 2023 was 35% lower than the same period in 2022, approximately 130 million liters.



5- Due solely to a drop in milk supply and growth in exports up to 2022 levels in the first four months, domestic supply could decrease by approximately 10% compared to the same period last year. This percentage could be even greater as exports grow beyond 2022 levels.

6- Given that this is the period of lowest seasonal production, there shouldn't be any issues with the installed drying capacity. However, this capacity could become stressed by springtime if production rebounds and domestic demand remains unresponsive.



Scenario

Based on this analysis, we outline a potential scenario speculating on the increases that the milk price could experience under these assumptions and considering the futures market prices for the dollar, soybean, and corn.

Export Payment Capacity

As a starting point, we analyze the export payment capacity of the WMP export industry using our simulator to calculate the "Theoretical FOB Milk Price."

We estimated a reference price for exports at 3,200 US\$/Tn (the average price at which WMP was exported in 25 Kg bags during November was 3,240 US\$/Tn).

Taking an industrial cost reference of 500 US\$/Tn, though this is a topic of ongoing debate due to the cost dispersion among different drying plants, and adding other industry expenses and margins, we arrive at a raw milk payment capacity of 0.295 US\$/Lt.

Assuming an export dollar value of 850 \$/US\$, the payment capacity would be 251



\$/Lt.

While, as already mentioned, it is expected that the international price will remain at these levels (a table summarizing the payment capacity for different industrial costs and WMP export prices is included).

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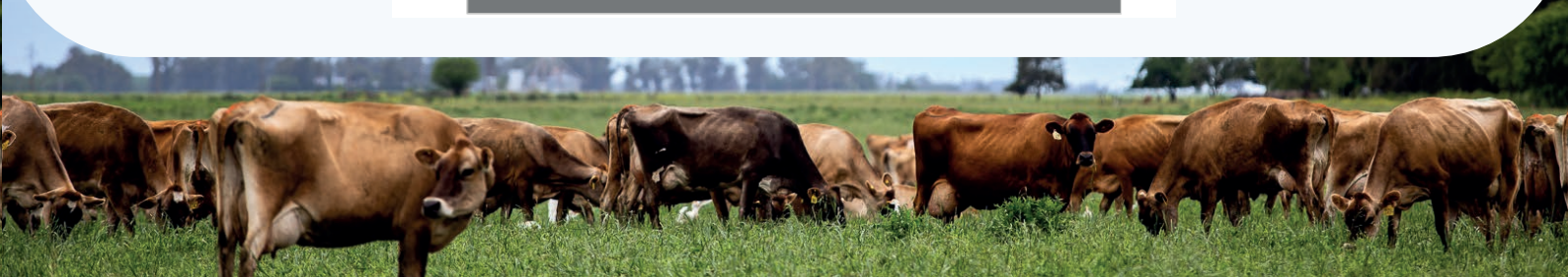
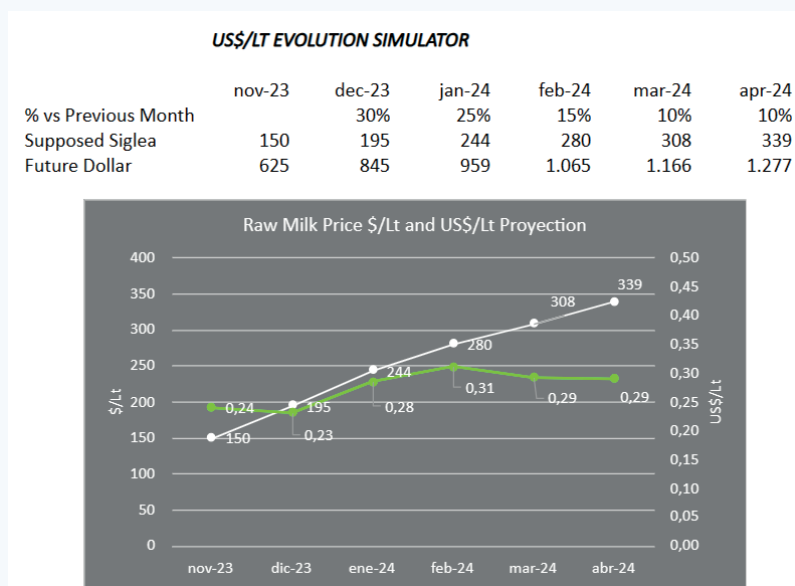
THEORETICAL FAS FOR RAW MILK (US\$/LT) ACCORDING TO INDUSTRIAL COST AND VALUE OF THE WMP (US\$/TN)

	Unit	Supposed	Value	Unit	Sensitivity US\$/Lt.						
					Industrial Cost US\$/Tn						
WMP FOB Price US\$/Tn	US\$/Tn	3.200	3.200	US\$/Tn	3.000	3.100	3.200	3.300	3.400	3.500	3.600
DEX	%	0,00%	0,00	\$/US\$	0,30	0,31	0,32	0,33	0,34	0,35	0,36
FOB - DEX			3.200	US\$/Tn	0,28	0,28	0,28	0,28	0,28	0,28	0,28
Industrial Cost	US\$/Tn	500	500	US\$/Tn	0,30	0,31	0,32	0,33	0,34	0,35	0,36
Industrial Margin	%	5,0%	160	US\$/Tn	0,27	0,27	0,27	0,27	0,27	0,27	0,27
Freight	US\$/Tn	20	20	US\$/Tn	0,26	0,26	0,26	0,26	0,26	0,26	0,26
Marketing Expenses	%	1,0%	32	US\$/Tn	0,25	0,25	0,25	0,25	0,25	0,25	0,25
Total Expenses			712	US\$/Tn	0,31	0,32	0,33	0,34	0,35	0,36	0,37
Balance to Milk			2.488	US\$/Tn	0,37	0,38	0,39	0,40	0,41	0,42	0,43
Liters/TN		8.000	8.000	Lts	0,38	0,38	0,38	0,38	0,38	0,38	0,38
US\$/Lt			0.311	US\$/Lt	0,39	0,39	0,39	0,39	0,39	0,39	0,39
Freight US\$/Lt			0.016	US\$/Lt	0,40	0,40	0,40	0,40	0,40	0,40	0,40
Raw Milk Price			0.295	US\$/Lt	0,41	0,41	0,41	0,41	0,41	0,41	0,41
\$/US\$		850,00	850,00	\$/US\$	0,42	0,43	0,43	0,43	0,43	0,43	0,43
\$/Lt			250,8	\$/Lt	0,43	0,44	0,44	0,44	0,44	0,44	0,44
% de US	%	7,0%			0,44	0,45	0,45	0,45	0,45	0,45	0,45
US\$/Kg de US			4,21	US\$/Kg de SU	0,45	0,45	0,45	0,45	0,45	0,45	0,45
\$/Lt			3582,1	\$/Kg de SU	0,40	0,40	0,40	0,40	0,40	0,40	0,40

We know that the Siglea price for November was 150 \$/Lt, and the current export payment capacity would be 251 \$/Lt, 67% higher than the November Siglea price.

Once again, the question is, how long might it take for the domestic market to converge with the export payment capacity?

Based on our own projections and industry references, the increase in milk prices was estimated until April 2024 according to the following scheme. However, **this should be taken merely as a snapshot, given that there's a variable that still remains uncertain.**



A 30% price increase in **December** would push the **raw milk value close to 200 \$/Lt. This assumption is likely to materialize.**

For January, a 25% increase is projected, bringing the price to 244 \$/Lt.

However, based on futures markets, this price would be equivalent to 0.28 US\$/Lt, below the export payment capacity. It remains to be seen whether the domestic market can validate these prices.

For instance, for the wholesale price of creamy cheese from Villa María's SMEs to justify this raw material price, cheese would need to be priced at 3,300 \$/Kg, a value 70% higher than reported on December 15, 2023.

If we consider the final price reported by Indec, the retail price would need to reach 5,400 \$/Kg, 91% more than November's value.

Will consumers endorse these price hikes?

If they do, there won't be issues; otherwise, the milk price increase might be limited while witnessing a growing shift of milk from non-exporting dairy SMEs to exporting companies. This shift could occur as dairy farms seek better-paying companies or due to inter-industry milk sales for those SMEs receiving high-quality milk. Essentially, it's a process to "decompress" the domestic market until, due to supply reduction, the domestic market regains its price, aligning with export payment capacity.

From February onwards, smaller increases are speculated, in line with inflation. According to this projection, by April, the price would be 339 \$/Lt or 0.29 US\$/Lt, based on future dollar rates.

Again, if international prices hold, the projection would align with exporters' payment capacity, despite being 126% higher than the 150 \$/Lt from November's Siglea.

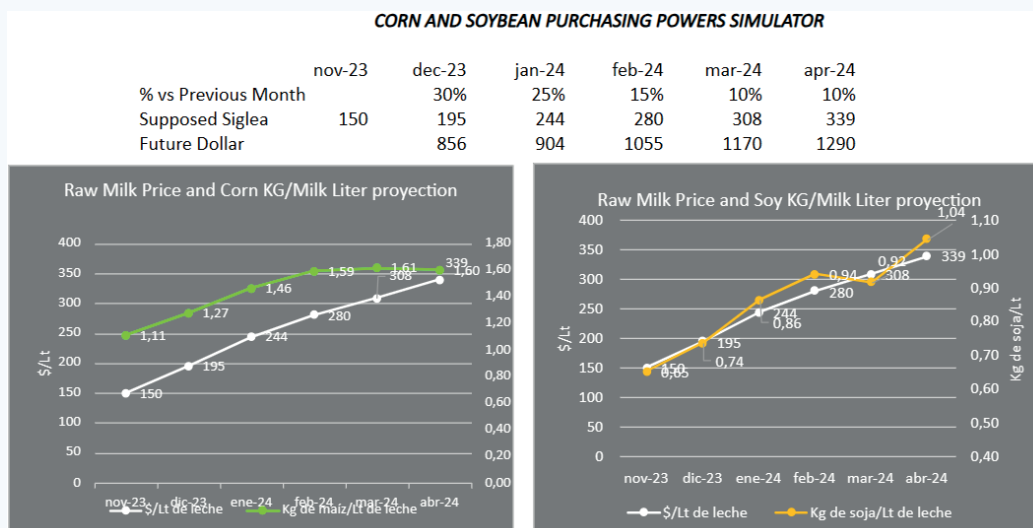
By that time of the year, convergence would be expected. March or April are the months with the lowest seasonal production, and the milk migration or change in processing mix would have occurred.

Concentrate Purchase Power

Among all milk production costs, concentrates are the most relevant. Therefore, the relationships between their prices and milk are crucial indicators for projecting pro-



duction costs, defining on-farm strategies, and speculating production projections.



Corn Milk

Using future corn and dollar values, we estimate the potential corn value and purchasing power if the milk price projection were to occur. Whenever there are strong devaluations, the immediate drop in purchasing power is significant. Even with a 30% rise in milk prices in December, the corn purchasing power would be at 1.27 Kg/Lt, far from historical levels of around 1.8 - 2 Kg/Lt. If all assumptions hold, purchasing power would reach 1.6 Kg/Lt by April. These figures highlight that if convergence doesn't happen relatively quickly, this indicator, the major variable cost for dairy farms, will remain in a critical state, raising doubts about potential production volume recovery.

Soy Milk

In the case of soy, the situation is similar but the recovery would be faster and more significant by April when soy prices drop due to the new harvest. While in December, the purchasing power would be 0.74 Kg/Lt, it would rise to 1.04 Kg/Lt by April, aligning with historical levels of 0.9-1.0 Kg of soy/Lt of milk. The relationship with soy is crucial not just because soybean meal is the main protein concentrate for dairy farms but primarily because it sets the reference for updating leasing values, with 50% of dairy farm land being leased.

For at least 7 months, we've been saying, "This dairy year will bring the adjustment."

The crisis might not be as acute as previously thought since international prices



shifted after months of decline.

Price-cost relationships will be unfavorable for a period of 3 to 5 months, depending on the speed of internal-external price convergence.

Dairy companies without export capacity will face a challenging period, likely losing dairy farms or at least needing to sell milk to exporters.

Once past the critical phase, it's expected that from the second half of the year, the business will improve for the entire chain.

The sales mix will shift towards greater export participation, likely lasting until internal demand grows as the economy begins its recovery.

All of this, as mentioned at the outset, is based on the current situation, knowing that we'll have to adjust scenarios dynamically as changes continue.

