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IRAQ PRIVATE SECTOR GROWTH AND EMPLOYMENT GENERATION

July 9, 2006

The Dairy Market in Iraq



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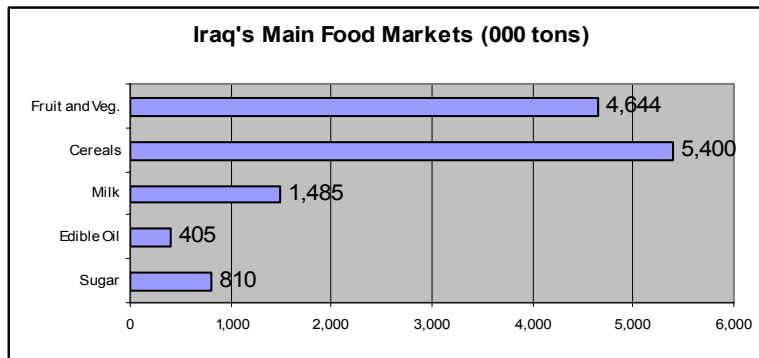
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INTRODUCTION

Dairy probably represents the best chance of establishing a food processing sector in Iraq. As outlined in “*The Potential for Food Processing in Iraq*,” at the present time in Iraq only a few products have sufficient critical mass and volumes that are attractive for investors:

1. Cereals (bread and milled rice)
2. Edible oil
3. Sugar
4. Dairy
5. Bakery (biscuits and snacks)

Table 2.1 Iraq: Main Food Markets.



In the reality, all four of the biggest processed food markets in Iraq - sugar, cereals, edible oil, and dairy - are currently covered by the PDS distribution system, but dairy - based on government's new policy - is likely to be excluded from the scheme soon. Therefore, developing a modern dairy sector is fundamental to the establishment of a food processing industry in Iraq for various reasons:

1. It is potentially attractive to foreign companies able to transfer state-of-the-art food processing technology to Iraq. Dairy could pave the way for such a process and act as a catalyst for the dissemination of new technologies and best practices creating a wave of modernization in the food processing in Iraq.
2. If excluded from the PDS system, dairy has the high volumes and high margins wholesalers seek. Dairy could well become a strategic category in the portfolios of Iraqi distributors and wholesalers, thereby enhancing and accelerating the process of modernization, and inducing efficiency in the entire distribution system.
3. The dairy sector is traditionally a powerful engine and catalyst for the development of the packaging industry (tetrapack, glass, PET, PVC) and the cold chain supply facilities, both fundamental to creating a modern diversified food processing sector in Iraq or anywhere else.

For all these reasons, winning over foreign investors with state-of-the-art technology, financial resources and a marketing oriented approach in dairy is an essential strategic step in developing a food processing sector in Iraq. Success in this sector could accelerate the development process in a dramatic way and ignite a self-sustaining virtuous cycle of new investments leading to better distribution system, resulting in lower margins and prices, followed by higher consumption an additional new investment.

To develop the dairy sector Iraq should target Turkish investors. The processed food markets are well developed in Turkey but saturated, and now in the process of intense consolidation and showing dwindling profitability. In addition, Turkish investors have valuable regional experience and more likely to accept the challenge of investing in Iraq. They also have the advantage of proximity to the stable and secure northern part of Iraq, in addition to cultural affinity with all of Iraq, once part of their Empire, and until 1991 an extremely important market for Turkish goods and services.

No project, no matter how great the potential, can come into being without investors, and no investors can invest in the absence of reliable data and figures. The IIPA task in this regard is not only to help potential investors, but also to make available the best possible information and to guide the newly elected Iraqi government toward creating a friendly business environment. Foreign investors are never short of options: Tailor made incentives and a friendly business environment often play a very important role in influencing their choices.

1. DAIRY SECTOR ATTRACTIVENESS

The real potential demand for dairy is somewhat difficult to evaluate in Iraq, since current consumption is heavily influenced by the PDS and hampered by constraints such as the absence of an efficient cold chain and electricity shortages. In order to have a more realistic picture, the potential demand should be evaluated in a scenario where dairy is excluded from the PDS system and in a country gradually improving the cold chain facilities and the electricity supply.¹ Under this perspective, dairy is possibly the most attractive sector for investment in processed food in Iraq taking into consideration demand and supply factors:

Dairy Market Size



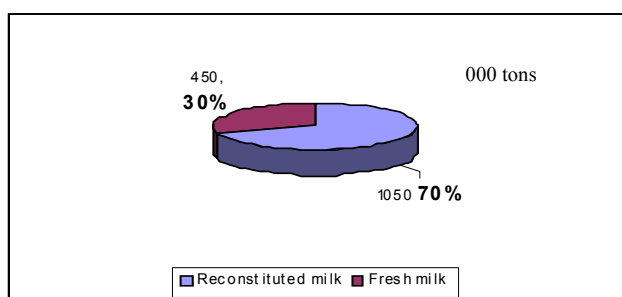
In low-income and low-purchasing power Iraq, few markets have the critical mass and attractive volumes to justify investing in manufacturing facilities, marketing and distribution: Dairy, edible oil, poultry, cereals (bread and milled rice) in addition to sugar and fresh vegetables and fruit and possibly bakery (biscuits and snacks). The dairy market, even defined narrowly – considering only milk – already has a remarkable size, with an annual turnover estimated 1.5 billion liters (excluding 0.5 billion liters of self consumed milk in rural areas) and a value of approximately \$700-800 million at the wholesaler level.

DAIRY: A BIG MARKET NOW IN IRAQ, NOT ONLY IN PERSPECTIVE



The average per capita consumption of traded milk is estimated to be 55 liters lower than in the pre-embargo period - 60 liters - and lower than in the GCC Countries - 96 liters. Liquid “ready to drink” milk - mainly from goats and sheep in rural area or imported - should account for only 1/3 of the consumption while the other 2/3 are from reconstituted powdered milk. Another 500 million liters are estimated to be produced and directly consumed by farmers in their communities without reaching the market.

Iraq: The Demand for Milk



Conservatively estimated, Iraq consumes a minimum of 120,000 tons of powdered milk/year and possibly as much as 200,000 tons/ per year. Realistically, no more than 0.5 billion liters per year of fresh milk are traded, a figure consistent with the estimated number of goats in Iraq (1.5 million), and the limited number of cows and their poor lactation (5-10 liters/day).

Iraq has no facility to produce UHT milk and the milk market is dominated by powdered products, although imported liquid UHT TetraPack is available but expensive - with an average a retail price between ID1,500-1,800/liter (\$1.0 - \$1.2).

¹ Milk removal from the PDS basket has been already anticipated by the government.



Total liquid packaged milk imports into Iraq are around 3,000 – 5,000 tons/year, mainly from the Gulf States but also from Turkey and Iran. No consumer tests measuring Iraqi consumer preferences among fresh, reconstituted and UHT milk are available, but such a test was conducted in the neighboring Gulf states by Al Safi in 2002, and showed the following:

GCC: Consumer Test Fresh vs Reconstituted vs. UHT Milk Round Robin, 550 Cases Each

MILK CONSUMER PREFERENCE	FRESH vs. UHT		RECONSTITUTED vs. FRESH		UHT vs. RECONSTITUTED	
	Fresh milk	UHT milk	Reconstituted milk	Fresh milk	UHT milk	Reconstituted milk
Overall preference	88%	8%	6%	92%	52%	48%
Score	9.2	7.9	7.2	9.5	7.8	8.0

The results would suggest that consumers clearly show a preference for fresh milk over reconstituted or UHT, while there is no clear preference for UHT milk over reconstituted product.

This consumer pattern looks remarkably similar all over the world and there is no good reason to assume that Iraq should be an exception.² These results - if confirmed in Iraq - would suggest only fresh milk (not UHT treated) and powdered milk would make sense in the country. In particular, liquid milk reconstituted from powder (produced industrially) would add little value to cheaper “homemade reconstituted”. On the other hand, the option of UHT from fresh milk it is also questionable, since expensive, but not clearly preferred by consumers over cheaper reconstituted product.

A demand for expensive fresh milk could exist realistically, but because of the much higher cost, the market share of fresh milk would probably limited to 10-15%, since the market looks to be extremely price sensitive. Also - and more importantly - a fresh milk market cannot thrive until an efficient cold distribution chain is developed in Iraq and household refrigerators are properly powered continuously.³

In addition to milk, at least three other dairy products probably have significant volumes in today’s Iraq, although no definitive numbers are available: Curd-white cheese, laban, and processed cheese.

MILK IS TODAY IRAQ’S DAIRY BASELINE MARKET

FRESH MILK VS RECONSTITUTED FROM POWDERED MILK

LABAN – CURD WHITE CHEESE AND TRIANGLE CHEESE ARE ALSO IMPORTANT DAIRY SEGMENTS WITH SIGNIFICANT CONSUMPTION



Iraq currently imports some 10,000 and possibly 20,000 tons of processed cheese, mainly from Iran, Egypt, Turkey and the Gulf states. Processed cheese (e.g La Vache qui Rit) enjoys high acceptance, especially among young consumers and because of its good value for money (a box of eight triangle units of 120g is sold for \$1.10 at retail price in supermarket in

² Based on leading dairy company consumer test conducted in 17 countries in 4 continents.

³ In most of the country electricity is available now on average only 8 hours/day.



Baghdad).

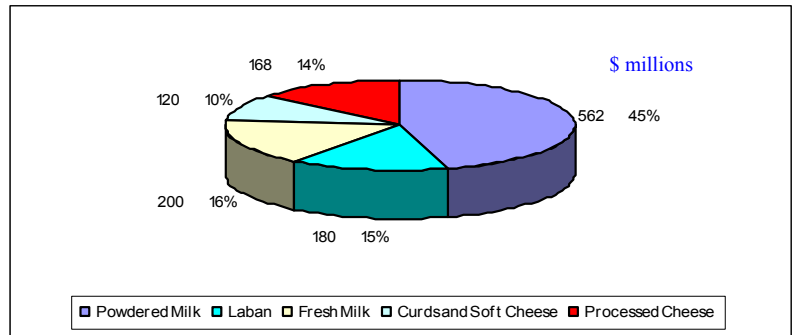
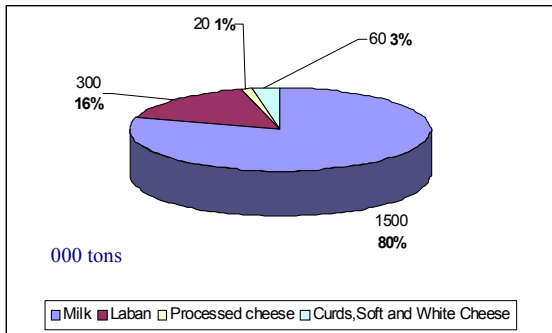
Laban consumption is estimated in 300,000 tons/year but, no industrial product is currently available and supply all comes either from reconstituted milk (from powder) or from small artisan processors lacking standardization and quality control.



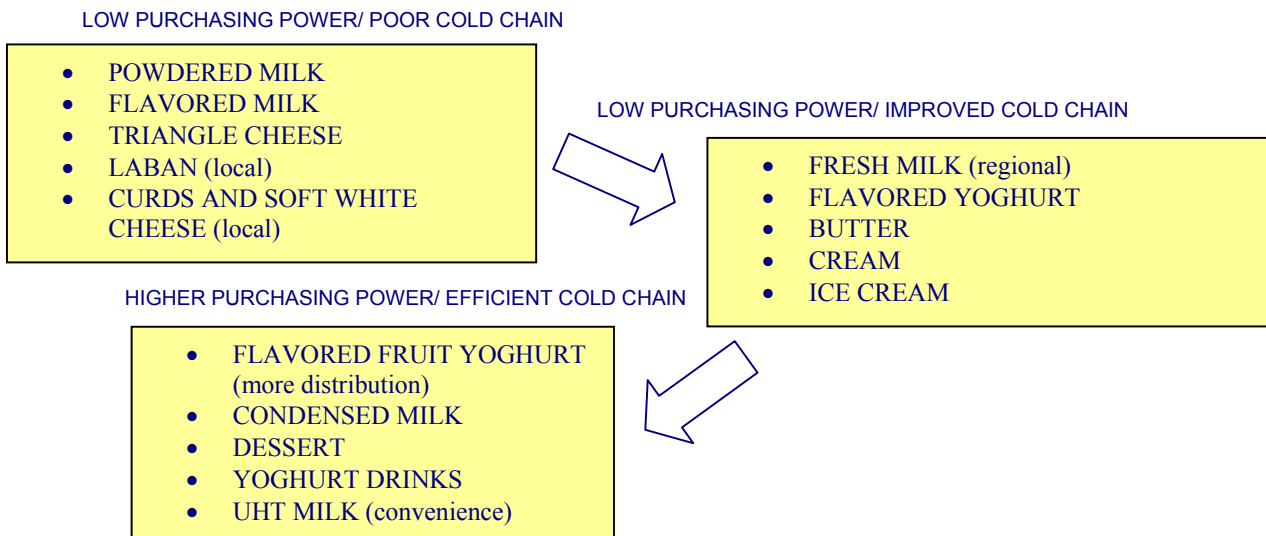
Curds and soft and white cheese are also widely available, although on a regional/local basis, and often marketed with no branding and few standardized specifications. The market for curds, white cheese, and soft cheese is estimated at 60,000 - 80,000 tons.

IRAQ: Actual Dairy Market, 2005 in Value Retail Prices

IRAQ: Actual Dairy Market, 2005 in Volumes



DAIRY PRODUCTS GROWTH DEPENDS ON INCREASING PURCHASING POWER AND COLD CHAIN



Dairy Estimated Market Growth

The potential growth of the dairy market in Iraq is spectacular, driven by:

1. Booming population and - more importantly - a growing young population, heavy consumers of dairy products;
2. Diet richer in protein;
3. Increasingly sophisticated demand for dairy products.

Iraq’s population is set to reach 40 million in 2025 and surpass 56 million in the year 2050.

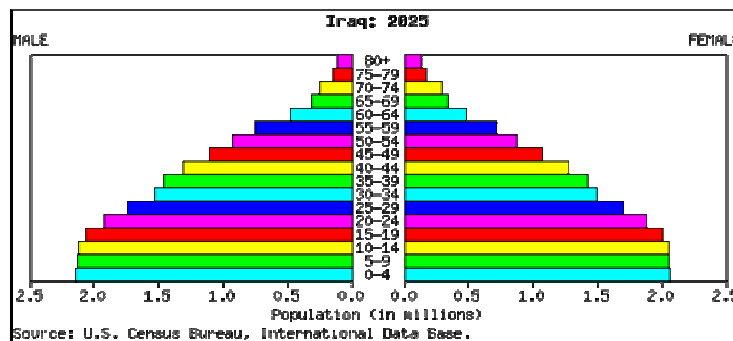
Iraq and Middle East: Population Indicators

Population Indicators	Iraq	Iran	UAE	Turkey	Syria	Jordan	Saudi Arabia	Egypt
Population – millions	26	68	2.5	69.6	18.4	5.7	26.4	77.5
Population growth/year.	2.7%	0.9%	1.5%	1.1%	2.3%	2.6%	2.3%	1.8%
Fertility rate	4.2	1.8	2.9	1.9	3.5	2.7	4.0	2.8
Population 2025 millions	40.4	83.2	3.2	82.2	26.5	8.6	35.7	103.3
Population 2050 millions	56.4	89.7	3.7	86.5	34.4	11.8	49.7	126.9

A GROWING YOUNG POPULATION TRADITIONALLY HEAVY DAIRY CONSUMERS

In addition to a fast growing population, Iraq will have a growing percentage of young people. This factor could have a dramatic influence on the demand for products such as milk (plain and flavored), yoghurt, processed cheese, and possibly condensed milk, products of which young people are generally heavy users.

Iraq: Population by Age



A CLEAR CONSUMER NEED FOR MORE PROTEIN AND A POTENTIAL FOR LINE EXTENSIONS

In light of the significant decline in the quality of the Iraqi diet, there will probably be a rebound in protein consumption as conditions improve: Milk and yoghurt, respectively, should recover to pre-embargo consumption levels and then increase rapidly, driven by growing concern about the nutritional value of children’s diets. Yoghurt consumption should also benefit from the likely launch of new varieties that are flavored or contain fruit, and are specifically targeted at children or teen-agers.

The universal experience is that in all developed countries dairy demand (and consequently the supply) becomes increasingly sophisticated in tandem with increased per capita income. This trend includes market segmentation with new, attractive product categories entering the market: Flavored milk (chocolate, vanilla, strawberry, and banana), possibly condensed milk, and certainly flavored yoghurt and yoghurt based drinks.



Flavored milk (cacao), and condensed milk, are all products with great potential in Iraq, and that do not require the cold chain (a clear constraint to the development of yoghurt for example). In South America - even in countries relatively as poor as Brazil, Peru and Bolivia - condensed milk and flavored milk have a penetration above 40%, reaching 55% in Brazil.⁴ On the other hand, flavored and fruit yoghurt show less acceptance, despite a growing market penetration, partly because of limited shelf life and price factors.

⁴ Nestlé market and consumer data.

2. DAIRY THE SUPPLY SIDE ANALYSIS

The availability of quality dairy products in Iraq is limited not only by low consumer purchasing power, but also by the lack of marketing-oriented manufacturers, the lack of efficient cold chain distribution, by faulty electricity supply, and by the limited production of quality raw material (fresh milk).

Milk

The supply of cow's milk is currently small in Iraq. Iraq has, in fact, no more than 700,000 cows, but probably less than 60,000 milking cows, with an average lactation of only 5-6 liters/day and 220 days/year. Modern, integrated dairy farms in Saudi Arabia such as Danone-Al Safi and Al Marai have all high yielding Friesian and Holstein breeds, providing an average of 35 liters/day at 300 days/year.



The shortage of quality forage and animal feed is also a constraint in Iraq, where the cultivated area of alfalfa is only 3,000 ha, and where the cost of quality forage is high (an average of \$100/ton for hay at 90% DM) and it is in short supply. Powdered milk has played an important role in Iraq also because it is included in the free public food basket distributed by the PDS (currently 250g/month of powdered milk per capita).

The development of a new, efficient, modern dairy industry requires a dramatic expansion of the milk supply in quantity and improvements in quality, traceability, standardization. In principle, only two strategies are viable: Integrated dairy farms such as Al Safi in Saudi Arabia, or using reconstituted milk made from powdered product.

Integrated dairy farms are unquestionably viable in Saudi Arabia, where they provide an abundant fresh milk supply, but the model requires an efficient cold chain and a regular electricity supply. Detractors of integrated farms - and there are many - argue such a model is expensive, and only viable in presence of heavy governmental subsidies. Unquestionably, integrated dairy farms require large investments: Al Safi-Danone reportedly invested \$200,000,000 for a capacity of 600,000 liters/day with 30,000 milking cows and a farm of 7,000 ha. It is true that the Saudi government subsidized the effort, but only at the beginning, with a one-time intervention, contributing to the irrigation systems and the transportation of the animals, and providing credit at preferential rates. Today Al Safi-Danone holds 30% of the Saudi dairy market, successfully competing with Al Marai and Sadafco without subsidies.

The absence of a cold chain in Iraq, along with the current shortage of quality milking cows, forage, and animal feed, discourages the early adoption of the integrated dairy model in the country, especially under the current circumstances of high country risk and insecurity in many regions. In particular, the absence of refrigerators in retail outlets or in households, and the faulty supply of electricity (only few hours a day in Baghdad), look to be severe constraints on the distribution of fresh milk and fresh derivatives - products with

LOW SUPPLY OF FRESH MILK, SHORT OF FEED ANIMAL AND FORAGE

POWDERED OR RECONSTITUTED MILK MAY BE THE SOLUTION FOR A QUICK INDUSTRY START

limited shelf life – in the area with the largest population. Fresh milk needs working refrigerators. On the other hand, UHT milk, with longer shelf life, tastes the same as reconstituted milk to many consumers, and therefore suffers by comparison with fresh product.



The relatively high cost of fresh milk, compared to reconstituted milk, might also turn out to be a powerful demand inhibitor. In fact, reconstituted milk has a much lower cost than fresh milk in today’s Iraq:

Fresh and Reconstituted Milk: Variable Cost Estimate

Milk cost estimate: variable costs fresh vs. reconstituted milk	Daily TMR/lbs	Daily TMR kg/fresh	Daily TMRkg/DM	Daily TMRCost kg/DM	TMR daily cost \$
Alfalfa hay	12	5.44	4.89	0.11	0.538
Corn Silage	44	19.93	6.98	0.08	0.558
Corn	10	4.53	4.53	0.12	0.544
Soybean	5	2.27	2.27	0.33	0.747
Total	71	32.16	18.66		2.39
Estimated variable cost per liter of fresh milk					0.077
Estimated variable cost per liter of reconstituted milk					0.04



COST OF FRESH MILK LIKELY TO BE DOUBLE THAN RECONSTITUTED

The variable cost of reconstituted milk from powdered products – 0.04/liter - would probably be 40% lower that that of fresh milk – 0.077/liter.⁵ A lower cost for fresh milk is viable in principle, were there more efficient production of feed ingredients as in Saudi Arabia (25% lower than in Iraq based on Al Safi-Danone integrated farm data). The cost factor is relevant in Iraq, where the average family has four children, and where household milk consumption averages well above 2 liters/day.

Packaging

NO MAJOR PACKAGING CONSTRAINTS



Packaging should not represent any significant constraint in Iraq: TetraPack is widely accepted for liquid milk and for flavored milk (imported). For powdered milk, cheap flow pack pouches are common and are distributed in the PDS, while the leading Nestle brand is only available in expensive cartons. Plastic bottles (PET or PVC) are for the most part not available in Iraq, and yoghurt (laban) is currently sold in plastic bags or cups. Therefore, for any product

⁵ Reconstituted milk variable costs are calculated assuming imported CIF powder milk in Iraq for \$260/ton and assuming powdered milk makes up for 80% of the total cost (20% is for the reconstitution: water, energy etc). Fresh milk cost is calculated assuming TMR (Total Mix Ration) based on Al Safi formulations and current Iraqi cost. Cows have 300 lactation days/year and produce 35 liters of milk/day.

requiring plastic bottles (such as liquid laban) a molding and blowing operation should be considered.

3. DAIRY: COMPETITION: The State PDS System

The PDS - Iraqi Public Distribution System - is the largest public food program operating in the world today and, at the moment, is the main player and competitor in the Iraqi dairy sector. It is perhaps the most visible program of the Iraqi government, consuming more than 20 percent of government revenue.

The monthly basket of rationed goods currently includes 9 kg of wheat flour, 3 kg of rice, 2 kg of sugar, 0.2 kg of tea, 1.5 liters of vegetable oil, 1 kg of powder milk, 1.5 kg of dried beans, 0.15 kg of iodized salt, 0.25 kg of soap, and 0.5 kg of detergent. Infants less than a year old get baby care products and formula. Consumers pay ID 250 per ration (ID 50 for flour and ID 200 for the remaining products). The ration's resale value is estimated at about ID 6,000.

The PDS is managed by the Ministry of Trade and implemented by a combination of state-owned enterprises and private-sector companies. While importing, rice processing, and warehousing functions are largely performed by state-owned enterprises, wheat processing, transportation, and retailing activities are predominately contracted out to the Iraqi private sector. The financial cost of the PDS is extremely high - approximately \$4 billion in 2005 - implying a transfer from the government of \$150 per person per year to a population of 27 million.

The relevant data for potential investors stem from the fact the Ministry of Trade has announced that milk will be taken out of the PDS due to budget reductions for the current fiscal year. (The PDS distributed 0.25 kg/month of imported powder milk). According to officials at the trade ministry, which is largely responsible for food distribution, the national budget for the PDS will be reduced from \$4 billion to \$3 billion for the current fiscal year: In the new scheme, scheduled to take effect in August 2006, only four essential items will be supplied – sugar, rice, flour and possibly cooking oil.

As it stands currently, the PDS system is highly distorting: Distortions occur in any market in which government actions impact prices, and occur on the supply side of the food markets, *i.e.*, the incentives of private-sector food producers are affected.

- *Producer Incentives.* The dominant role played by the PDS in food markets has created a massive distortion in the incentives faced by Iraqi farmers and private enterprises. Because the PDS is a government transfer of food in kind, the distortions are even greater than they would be in the case of input subsidies paid to farmers, and they occur throughout the supply chain. One of the largest distortions created by the PDS is not because of rationing itself, but because the food supplied through the system is imported. This large injection

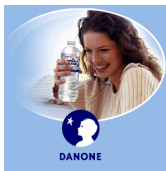
of imported food pushes domestic food prices below international prices, thereby reducing the incentive for domestic businesses. In reality, the PDS has been a powerful entry barrier to the Iraq dairy market where, at the moment, only Nestlé's powdered milk Nido has any visible distribution (but probably limited volumes). No other brand is strongly established - neither in the retail market nor in the consumer mind.



European Dairy Companies Focused on the Middle East

DAIRY GROUP DANONE
HIGHLY ACTIVE IN
ACQUISITIONS AND JOINT
VENTURES IN MIDDLE EAST.

The French Groupe Danone is the company most active in the Middle East dairy sector. Danone's sales in Northern Africa and the Middle East (MENA) come to over € 1 billion through stakes in companies that enjoy strong leadership positions in local markets.



- In Saudi Arabia it is the number one supplier of fresh dairy products through its partnership with Al Safi;
- In Turkey it is number one in both fresh dairy and bottled water;
- In Morocco it is number one in fresh dairy and biscuits and number two in bottled water;
- In Tunisia it is number one in fresh dairy products and biscuits;
- In Israel (in partnership with Strauss) it is number one in fresh dairy products;
- In Egypt it has recently established a presence in dairy (2005);
- In Algeria it has increased its interest in Danone Diurdjura from 51 to 95 percent in 2006.

Groupe Danone's growing interest in the region underlines the importance of MENA area in milk processing; the region offers significant growth potential, with an average annual growth rate of 20% over the last three years. Another example is provided by Arla.



Algeria has become one of the world's largest importers of milk powder, and Arla Foods has recently signed an agreement with a local importer for the sale of its Dano brand. Arla indicated recently that it wants to increase its annual Middle East turnover from DKK 9bn (€389) to DKK 4.1bn (€550) over the next five years, a moving which will probably require the doubling of its workforce in the region.

Groupe Lactalis (France) has also shown interest in the MENA region where sales of triangle cheese are presently \$1.1bn. Lactalis has become a leader in Europe, alongside Danone, and recently opened a new factory in Egypt.

Domestic Competition (Iraqi Private or State Owned Companies)

Finally, there are state owned enterprises (SOEs) for dairy products in Iraq, but they are nor real competitors, since at the moment they lie idle, with practically no production, due to a lack of functioning machinery, working capital, and

inputs (especially milk).

The State Company for Dairy Products is a holding company with three factories:

STATE OWNED ENTERPRISES
ARE CURRENTLY NOT
OPERATING FOR LACK OF
MACHINERY, CAPITAL, AND
INPUTS

- Abu-Ghraib, located approximately 20km west of Baghdad, with a processing capacity 25,000 tons/year;
- Al Diwaniya factory, with a limited capacity of 550 tons/year in the governorate of Qadissiya, 180 km south east of Baghdad;
- Al Mosul factory, with a capacity of 6,000 tons/year.

The company also controls a huge dairy cattle facility in Al Dujayla, of which the Iraqi government owns 75%, a Jordanian government body has 12.5%, and the remaining shares are in the hands of the private investors. The farm has a facility of 90 km² about 30 km south of Al-Kut, midway between Baghdad and Basra, and is capable of supporting 9,000 cows, but today it is operating at less than one-tenth of capacity.

4. MARKETING MIX and Distribution



Apart from the PDS, wholesalers dominate the distribution system in Iraq, where there are an estimated 15,000 outlets for packaging food. Based on a pool of leading multinationals, FMCG companies actively trading in Iraq support some 50 - 60 qualified, solvent wholesalers but none operates on a national basis, and only nine have operational - although basic - cold chain facilities.

Powdered milk, for its volume and market penetration, probably would be one of the most attractive products for wholesalers, should the PDS stop distribution. This seems likely to happen in the short term, based on the recent Ministry of Trade announcements.

A strong player in the powdered milk market would not only enter a high volume market, but control the best wholesalers in Iraq, creating thereby a strong entry barrier to competitors and laying the groundwork for possible new product launches in the country, including for categories with lower volumes that are otherwise unattractive to distributors.

Price

Wholesaler prices for UHT liquid milk in 1 liter Tetrapacks are around ID 1,300, and often as high as ID 1,500. Fresh, plain milk with no guarantees of pasteurization or sterilization is sometimes available in the market or at the farm gate, selling for approximately 600-700 ID/liter. Powdered milk (NIDO by Nestle - by far the most widely distributed brand in Iraq) is sold at retail for an average ID 9,000 (\$6.00/kg). Retail prices for processed triangle cheese are around ID 1,500-1,700 (\$1.10/\$1.20)/ box, with 8 units of 15g each. The reference price

for laban is more difficult to determine, since the products available in the market have different densities. In Baghdad, prices range from ID 900 to ID 2,000/liter, the mode being ID 900 /liter.

Branding



Branding in Iraq is almost non-existent. If, in the western world, an average consumer could easily mention some 6-7 brands in each FMCG category, in Iraq few brands achieve any consumer awareness and probably few are firmly established in consumer consciousness.⁶ However, in the last two years a variety of food products from Turkey and elsewhere are becoming known to Iraqi consumers, so the trend has begun.

For its high penetration, dairy - especially milk - is in an ideal position to create a strong brand in Iraq, a brand on which to capitalize, and a platform from which to launch lucrative line extensions. As demonstrated elsewhere by leading FMCG producers such as Danone and Nestle, a strong dairy brand is particularly powerful in creating an umbrella identity due to its association with positive nutritional values, quality, and dynamic, healthy lifestyle. Both Danone and Nestle built their wide portfolios of brands by adopting as an umbrella brand the name of the original dairy product.

A strong dairy brand is also desirable and valuable because it usually drives consumers into the franchise at an early stage by its presence among young population – normally heavy consumers of dairy products. For example, both Nestle and Danone attached their umbrella names to categories such as biscuits, mineral water, and ice cream, thereby capitalizing on brand awareness among young consumers.

Last but not least the cost of TV media in Iraq is still negligible, when compared to other countries. The cost of a thirty second spot in prime time during a program with an average audience of 60% is only about \$2,000.⁷

⁶ Unido consumer research on packaged food, 2004.

⁷ TV media space purchases would range within \$15,000 to \$40,000 in countries such as Italy, France, Spain or Brazil. The estimated cost for a TV campaign 800 GRP's (Gross Rating Points) is approximately \$2 million in the EU25 for a coverage of 60% and OTS (opportunity to see) of 12-13.

5. ENTERING IRAQ



To fully exploit the dairy opportunity in Iraq, a potential investor should contemplate at least three factories supplying the north, the greater Baghdad, and the south (Basrah) respectively. The Iraqi market represents a once in a lifetime opportunity for a dairy company willing to invest in the country. The potential advantages by far outweigh the risks:

1. Iraq is a large market of 27,000,000 people with a huge, booming young population - traditionally dairy's heaviest consumers;
2. The announced elimination of free powdered milk from the PDS system creates an immediate market for \pm 150,000 tons of powdered milk possibly as much as 200,000 tons/year. Alternative food security schemes under scrutiny by the government may also create additional opportunities. For instance, the Iraqi Ministry of Education anticipated a public tender to provide flavored milk in Tetrapack cartons to 1.5 million school children daily. No company in Iraq today has the manufacturing resources to supply this quantity.
3. The demand for dairy is likely to experience double digit increases, not only in the short to medium term but over the long term;
4. Competition is limited, and no brand or multinational company is firmly established in the country;
5. A brand can be established easily and cheaply, creating strong consumer and trade awareness, preference, and loyalty;
6. Distribution via wholesalers is viable with little investment. The retail system is still fragmented, lacking the bargaining power of big supermarket chains such as Carrefour or Wal Mart in advanced consumer markets;
7. Advertising, including TV advertising, is cheap;
8. A large number of dairy related line extensions seem viable, starting from a milk product baseline: Yoghurt; flavored milk; condensed milk; processed cheese; ice cream;
9. Once established, a brand with distribution through leading wholesalers could develop line extensions such as biscuits and snacks, juices, mineral water, powdered drinks and soft drinks, just to name a few.
10. Last but not least, margins – based on the current price structure – are attractive, and probably well above those of most advanced FMCG countries, where competition is fierce and distribution expensive.

CONCLUSION

10 GOOD REASONS
FOR ENTERING
THE IRAQI DAIRY
MARKET NOW

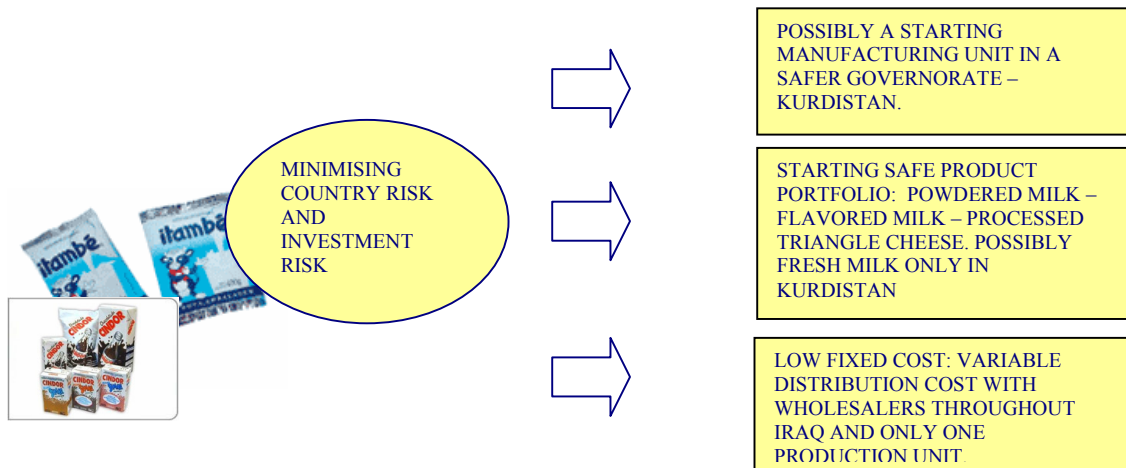
To fully exploit the dairy opportunity in Iraq, a potential investor’s business plan should include:

- A portfolio of both dry products (powdered milk, flavored milk from reconstituted milk, processed cheese) and fresh products (fresh pasteurised milk, yoghurt, white soft cheese);⁸
- Probably at least three production units: One in Kurdistan, a second close to Baghdad covering central Iraq, and one in Basrah or elsewhere for southern Iraq;
- Refrigerated storage and transportation facilities compatible with the characteristics of the fresh products.

The minimum capital investment required for such an ambitious plan would easily exceed \$25 million plus the necessary working capital (a minimum of \$5 million).



Perceived country risk - due to security and poor legal and institutional framework - is currently mentioned as the main constraint for foreign direct investment in Iraq. Under the current circumstances, some potential investors – or the less powerful - may well favor a more gradual approach with a lower investment in order to minimize risks. In the case of dairy in Iraq a “low risk entry” (a plan B) seems equally viable and attractive:



⁸ A mix of products with high current penetration (dry category) with products of high potential growth and lower penetration requiring higher investment.