

General Manager's Report To the MMPA Delegates

In preparation for MMPA's annual meeting, we have had a combined total of 55 local meetings, district meetings, and Resolution's Committee meetings to inform our membership of MMPA activities of the past year. These meetings were also held to formulate MMPA policies for the future. I am pleased to provide a summary report to you today on MMPA's activities for this past year and an outlook for our industry for the future.

Everyone in the dairy industry will certainly conclude the past year was a welcomed relief to the dairy business of 2002 and 2003. In the past fiscal year, MMPA revenues were up \$118 million and the average producer pay price last year was up 33% from \$12.14 in 2003 to \$16.19 in 2004.

During the past year, I have indicated there are many reasons behind the price improvement story. Part of the improvement relates to the MMPA employee efforts that improved premium payments by almost \$3 million, for a record member premium payment of almost \$29 million.

I must acknowledge, however, that the vast majority of the pay price improvement last year came out of the marketplace. Dairy producers themselves, through promotion programs and a supply management program, were largely responsible for much of the price improvements in the market place.

Perfect Alignment of the Stars

How did this turn-around in milk prices happen? And what can we do to keep higher prices?

The fundamental answer lies in the supply and demand for milk and milk products. For any

product in a free market economy, when demand is strong and supply is weak, price improvement always takes place. I want to briefly discuss how dairy producers have significantly impacted both supply and demand in the last two years.

There are very few years when production and economic factors are generally all positive. Last year, we had what could be called a "perfect alignment of the stars" for favorable milk prices.

On the demand side, the economy continued to recover, the value of the U.S. dollar declined, research funded by the dairy check-off program produced great results on the benefits of dairy products in a person's diet.

In addition, cooperative efforts with the fast food industry produced terrific results for milk sales in plastic resealable bottles. There was strong buyin to the 3-A-Day program by the retail food industry. There was also positive news in the school lunch program and with the recent recommendation to increase dairy consumption on the USDA food guide pyramid.

On the supply side, there were large numbers of dairy farm sell-outs after the low prices of 2002 and 2003. Cow numbers last year were down substantially from 2003. Dairy replacements from Canada were banned, rBST production and use was limited and milk production per cow was off from expectations for various reasons.

And last, but not least, the National Milk Producers Federation's CWT program had completed its



first year and was approved for a second year.

CWT Investment Pays Off

Dairy producer investments in the CWT supply management program attempts

to balance milk supply with current dairy product demand. The bulk of the CWT money is spent on the herd buyout program. The herd buyout is designed to do the bulk of the supply balancing. The export assistance feature of the CWT program is designed to "fine tune" supply with current market conditions.

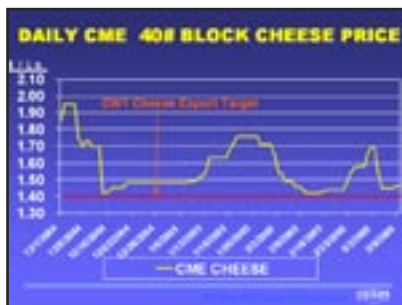
I have commented several times in my monthly General Manager letter about the significance of this export program feature. On three occasions last year, cheese prices dipped below the export assistance target level. Three times NMPF quickly responded with calls for cheese to be exported. These exports caused cheese prices to quickly rise above the \$1.40 level. The immediate intervention by the CWT program is a feature that has never been available through any government support program.

Cheese Price Changes

The first chart on the next page illustrates the daily changes in cheese prices over the last three months and the continuing impact this year of the CWT export assistance program. On three occasions in the last three months, cheese prices have gone into a free-fall, but the price bot-

tom has not broken through the \$1.40 target threshold. In effect, the CWT program has established a new support level or floor price for cheese pricing.

In prior years, when cheese went into a free-fall, it didn't usually stop until it reached the USDA support price of \$1.13, which is still the current USDA



support price for cheese. It was recently reported in one dairy industry newsletter that the buyers did not want to test the CWT program's ability to export cheese. With the world price of cheese at \$1.35, the CWT program could export a lot of cheese at minimal cost to correct any excess cheese inventory position.

As we have noted during the past year, when the market is in balance, small changes in either supply or demand, or even rumors of change in either, can have a significant short term impact on milk prices. The cheese market and the milk futures market over the last three months are excellent examples of a market in near balance, but with high uncertainty existing about the future.

The volatility the dairy market is currently experiencing has a lot to do with the uncertainty about whether there will be a shortage of milk or surplus of milk or dairy commodities in the near future. Are cheese inventories up? Are cow slaughter numbers down? Are there too many available heifers? Will the rains in California adversely impact the national milk supply? Each of these news

items has caused the market to head one way and something else causes a quick turn-around. It is important to avoid getting caught up in the emotions of the latest breaking news story. It is also important for dairy producers to support industry programs that can help balance supply with demand.

Market Projections

Now I want to update you on the current market outlook and provide a projection for the current year, even though projections in this volatile environment is risky at best. U.S. milk production continues to increase over the prior year, as it has since July of last year. However, milk production is still restrained, primarily due to lower cow numbers and a slower increase in milk production per cow. Milk production per cow in recent months has been increasing less than 1% over the prior year. February 2005 milk production was down 0.7% from 2004, but up 2.8% from last year after adjusting for the leap year. USDA continues to believe that the per cow increase will be in the area of 2.2%.

Cow numbers dropped by about 150,000 in 2003. The closing of the Canadian border in May 2003, helped keep cow numbers down. The other major reason for a decrease in cow numbers was the CWT program. Over 83,000 cows have been removed from milk production in the last two years by that program. As of January 2005, U.S. cow numbers totaled 8,993,000 head and are projected to decrease to 8,940,000 head by the end of this year.

Milk production forecasts for this year have both favorable and unfavorable factors coming into play. Given the recent BSE cases and the lawsuit in Montana, we expect the border closing for dairy replacements to continue for the rest of this year.

The production of rbST has recovered and producers are now allowed to purchase supplies in excess of their past history. A recent ban on the use of rbST for producers of an Oregon cooperative is the latest twist for the use of this product. It was hard to identify any decrease in milk production when product supplies were limited, so it may be difficult to determine what impact the new increased rbST supplies may have on U.S. milk production.

Another statistic that has often been used to reflect future trends in milk production is the milk-feed ratio. While the ratio has declined somewhat in recent months, it was still a respectable 3.47 for February and has been over 3.0 for the last 10 months. Milk-feed ratios over 3.0 have generally been considered positive for milk expansion.

Demand Strong

Dairy demand has continued to grow as the economy continues to recover. The very high spike in milk prices last spring did have an adverse impact on fluid milk sales and cheese sales during the high price period. For the year, fluid milk sales were down from the previous year, probably due to the significant drop in sales last spring.

Cheese sales recovered and have been able to absorb the increase in cheese production during the past year. The largest production increase came in the area of Italian cheeses, which has caused some inventory buildup. American cheese stocks are down due to lower production and very



strong sales in the last quarter of last year.

Given the current outlook for milk supply and cheese demand, the Class III futures currently projects a \$14.00 to \$15.00 milk price for the rest of this year. As you know, there has been a lot of volatility in the futures market for several years. But, given that cheese inventories are not in excess, and that the CWT program is now setting a new price floor, the Class III futures price for this year certainly looks favorable.

The Class IV milk price, which is based on butter and powder prices, is forecasted by the futures market to range between \$13.00 and \$14.00 for the balance of this year. Recently, butter production has been increasing, but butter stocks are still down 35% from last year. Powder production has been down while sales have been up substantially, in part due strong export demand

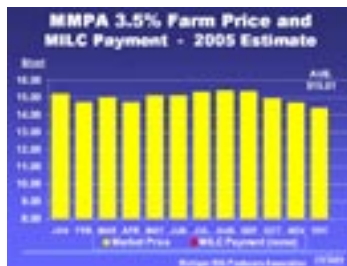
Based on these future price projections, our estimate for

MMPA 3.5% pay price for this year is down somewhat from last year, but still very respectable. As you can see from the chart, the prices look very similar to the Class III futures price trend. For most of the year, the 3.5% pay prices will hover around \$15.00 and average about the same \$15.00 for the year. Particularly encouraging in this picture is the lack of any significant milk price declines during the year. I believe you can credit the CWT program for maintaining a new floor on milk prices.

Federal Order Changes Sought

Depooling of milk from the Fed-

eral Order system has continued to cause disruptions in the marketing of milk in this region. During the past year, the various groups of producers have come together to request a Federal Order hearing in the Mideast order. A Federal Order hearing was held on March 7-10. Carl Rasch, our Federal Order expert, was present to enter MMPA's testimony regarding depooling, qualifying and diversion issues, transportation credits and several other minor issues. The issue of producer-handler exemption will be addressed at a later date.



Carl doesn't expect a decision before late this fall or early next year. We hope a decision on the depooling and pool riding issues will address some of the market abuse, so that the producer price differentials will be less depressed in the mid-east market. If a decision is positive, we could see some reductions in the neg-

ative producer price differentials, but not the complete elimination. We still have advanced pricing for Class I milk, which does allow the potential for negative ppd's in a rapidly rising market.

MMPA's mission statement for many years has been: "To market our member's milk to the greatest advantage possible." Milk marketing has been the core of our cooperative from the beginning and will continue to be so in the future. We have also recognized, however, that our members are facing many new challenges in production agriculture, particularly in the regulatory area.

MMPA Commitment Continues

To assist our members with these new challenges, our field staff has gone through significant training in recent years.

We have developed specialists within the field staff in a number of different areas that can provide assistance on farm management issues. Some of the areas of specialty include: assistance with CNMP and MAEAP programs, John's assessments, Internet access for quality and financial information, milker training schools, mastitis management and milking systems analysis and a wide variety of laboratory testing services. In addition, our member merchandise program continues to evaluate new products to provide the best possible products to our members at a competitive price.

I believe these programs and the staff that provides them can be given at least partial credit for the significant improvement we have seen in the somatic cell count in the last couple of years. The SCC last year averaged 278,000 for the year. This is an excellent commentary on the quality of milk produced by MMPA members. The quality improvement is also reflected in the much larger number of members qualifying for MMPA quality awards. You are to be commended for your efforts and success.

In conclusion, I want to publicly recognize and thank all MMPA employees and especially the senior management team, for their dedication and commitment to MMPA. I want to assure our members that these individuals are as committed to MMPA in good times as they are in hard times and continue to be dedicated to "Working to make a difference for you."