

I want to briefly comment and pay tribute to Elwood Kirkpatrick, as he steps down as MMPA's fifth president. I think it is truly amazing that an organization of 91 years has had only five presidents, the last two presidents having served our cooperative for a total of 52 years! Elwood has served as president for 26 of his 28 years on the MMPA board of directors.

I also want to recognize Elwood's strong understanding of finance, a subject which has always been near and dear to my heart. Elwood was a former controller with Federal Mogul before going back home to the dairy farm in Kinde, Michigan. MMPA has benefited greatly from the financial background Elwood brought to the board room. While there have been many occasions when we all wished we could put more money in the monthly milk checks, Elwood always understood that the preservation of a strong cooperative was essential and key to maintaining a strong dairy industry in this state. It is certainly fitting as Elwood retires, that he is leaving MMPA in its strongest financial position in our 91 year history.

Last but not least, as a reflection of his character and integrity, Elwood was always very conscientious in making decisions that were in the best interest of **all dairy farmers**. He avoided personal conflicts of interest and personal preferences

more than any other dairy leader I have worked with and I highly respect him for that effort.

Throughout last year I had reported to you on some of the financial struggles we were experiencing with MMPA operations. High natural gas prices, higher transportation costs and volatile commodity markets kept operating margins far below budget for the first nine months of the year. We had a rapid recovery in the last quarter of the fiscal year, fortunately, as you may have observed from our Annual Report in the February *Messenger*.

I want to focus on the changes that are taking place in the dairy industry and all of agriculture. The high cost of energy and U.S. dependency on foreign oil have caused a dramatic increase in political interest and industry efforts to produce energy from renewable resources. We are seeing a fundamental and structural change in agriculture with the production and use of significant quantities of agricultural products for energy purposes. This "overnight" boom industry is challenging the food, fiber and animal feedstock industry for the use of corn in today's market.

I think we all appreciate the resurgence of a market oriented agricultural economy, but it will take a little time for milk and animal products to adjust to the much higher cost of feed for the animal industry. The milk futures market appears to be anticipating these higher costs and reduced milk supplies with higher futures prices in response to those expectations.

I want to review changes in our milk supply and plant renovations during this past year to accommodate our members' milk. One of the challenges we faced during the past couple of years has



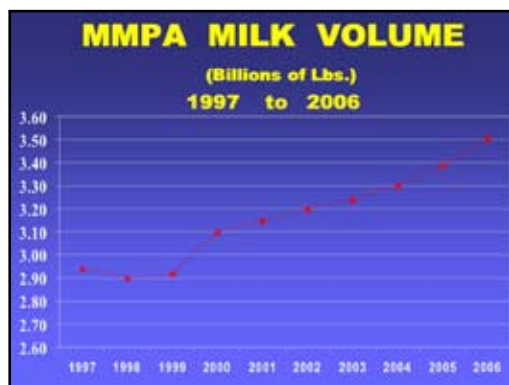
been our increasing member milk supply. All of us like to see an expanding and growing industry, but it can be challenging and sometimes expensive to develop a market with a profitable return. The chart on this page shows the growth in our milk supply over the last 10 years.

Member milk volume has grown from 2.9 billion pounds in 1997 to over 3.5 billion pounds in 2006, an increase of over 20 percent in the 10 year period or an increase of about 2 percent per year.

We have good diversification for the sale or use of our member milk supply. Approximately 38 percent of our milk goes to the fluid milk market, 29 percent is sold to Leprino and other manufacturing customers and the balance of 33 percent is processed through our own plants.

Over the last eight years, milk processed at our plants is up 45 percent or nearly 400 million pounds more milk than in 1999. This increase has put our manufacturing system at capacity during the holidays and flush periods in the last two years.

We decided early last year to expand both plants to increase our processing capacity. Last spring the Constantine expansion project was completed which increased that plant capacity by 30 percent. The Ovid project was just recently completed at a cost of \$4.8 million. Based on our assumptions last year, the increase in plant processing capacity would accommodate the increase in milk volume through





2010. The projection for the next three to four years was based on the past growth trend of 2 percent per year increase, the same as what we experienced in the last 10 years.

However, milk production in Michigan for the last six months has been increasing at a rate of 5-7 percent over the same months in the previous year. So our plants are quickly filling once again. We hit plant capacity before completing the Ovid renovation this winter and expect to be near the recently increased capacity at both plants this spring. As this year moves forward, we will attempt to forecast capacity requirements beyond 2007 and will be reviewing those projections with our board of directors to consider options that might be available to us.

I want to recognize the extra-ordinary efforts of our plant personnel in completing these expansion projects during this past year, on time and within budget. It is not an easy task to conduct an expansion program while operating the plant at or near capacity. Tom Carpenter and his management team and employees at Constantine and Dave Wittkop and his management team and employees at Ovid have done an outstanding job during this past year and I thank them for their extra-ordinary efforts.

Our plant expansions were certainly timely in meeting the latest milk production surge from our member dairy farms. Where we go from here is a major issue that needs to be addressed this year.

The CWT program recently announced the number of herds that will be removed from production in Michigan and throughout the U.S.. The Michigan herd retirement volumes will not have a significant impact on our overall milk volume. A larger unknown is the number of producers who may leave dairying to join the corn producing world for ethanol production.

I have put together a chart from information provided by the Michigan Agri-Business Association that identifies the ethanol plants in operation, under construction, in the process of permitting and those that are proposed for Michigan. The capacity of the plants is noted in millions of gallons of ethanol production per year, which determines the amount of corn needed to feed each plant.

If all these plants are built, there will be capacity to produce 902 million gallons of ethanol per year. This capacity would require about 374 million bushels of corn. Last year, there were 288 million bushels of corn produced in Michigan. Projections for 2007 reflect a possible corn crop of 370 million bushel. Fortunately, all the proposed plants will not be completed this year.

The corn requirement for those plants that are operating or under construction is 160 million bushels.

If the plants under permitting and those that are proposed are constructed, there will be a need for an additional 214 million bushels of corn production in 2008 and 2009 just for ethanol requirements. When the requirements for animal feed are combined with the re-

quirements for ethanol production, 448 million bushels of corn will be needed. That demand is about 78 million bushels greater than the projected corn crop **for this year**. Michigan could very well become a corn deficit state.

Many are beginning to question whether the ethanol industry is going to over-expand. The construction costs of a plant are rising rapidly and it may be difficult to secure financing for those that are only on the drawing board.

At the recent Michigan Agri-Energy Conference, Michael Schaal from the Energy Information Administration of the U.S. Department of Energy, predicted crude oil prices will decline slightly through 2015 because of recent additional domes-

ETHANOL INDUSTRY

Michigan Plants – Operating as of March 2007

Michigan Ethanol – Caro	40 mil gal per year
Andersons – Albion	50 mgpy
U.S. BioEnergy – Woodbury	40 mgpy
Global Ethanol – Riga Township	50 mgpy

Under Construction

Global Ethanol – Riga Expansion	50 mgpy
Liberty Renewable – Ithaca	116 mgpy
Marysville Ethanol – Marysville	50 mgpy

Plants Applying for Permits

E85, Inc. - Corunna - permit process	116 mgpy
McBain - permit process	50 mgpy
Watervleit- permit process	50 mgpy
Marysville Expansion - permit process	50 mgpy

Proposed Plants

Morrice - proposed	40 mgpy
Manistee – proposed	50 mgpy
Alma - proposed	50 mgpy
Miscellaneous Ontario Plants	100 mgpy
Total Capacity	902 MGPY = 374 M bu Corn

**2006 Total Michigan Corn Production:
288 million bushels**

**2007 Projected Michigan Corn Production:
370 million bu.**

tic oil drilling and discovery. He also indicated that due to the costs associated with the low energy density of cellulose, ethanol produced from cellulose will be relatively minimal, even in the distant future.

The February milk production report came out March 16 and indicated U.S. milk production is continuing to moderate. Part of the lower increase was probably weather related. February milk production per cow was unchanged from February 2006. This unchanged position is a rare occurrence. It did not happen even in August 2006 when much of the country had some very hot weather.

Cow numbers in February 2007 declined 5,000 head from January 2007, to 9,123,000 head. The decrease occurred even with the announcement of a new CWT buyout program at the beginning of February, so few producers were holding back on sending out cull cows. The CWT program will take out another 54,000 head within the next two months.

Michigan production also moderated in February, but was still up 4.6 percent from February 2006. Based on our milk receipts during the first 10 days of March, milk production has not recovered from the February cold weather to the level of production that existed in early January.

During the first two and a half months of this year there has been a lot of volatility in the daily block and barrel cheese prices. The NASS cheese price has ranged \$1.30 to \$1.40 per pound.

The most significant dairy price change has occurred in the whey market. The whey product price has typically fluctuated between 20-25 cents per pound in recent years.

Whey prices have almost doubled since the end of last year and are currently around 70 cents per pound.

Current whey prices are more than 3 times the whey price average for the period of 2002 through 2006. Export demand is currently driving the price increase. Over 63 percent of all whey production in January went to the export market. More than one half of the exports are going to Asia. Most analysts are expecting the export market to continue to remain strong for this year.

Since July 2006, whey prices have increased 42 cents per pound. The Class III price formula provides an increase of 6 cents in the Class III price for each one cent increase in the whey price. Since last July, the Class III price has increased by \$2.52 per CWT as a result of higher whey prices. If whey prices had not increased from last July, the Class III price today would be around \$12.50 per CWT.

The 2007 Class III futures price reflects a much needed recovery from the very low prices in 2006. The futures market has seen a significant increase in the last few days due to the CWT buyout news and the February production numbers. Currently, the Class III futures price for 2007 averages \$15.38 per cwt. This is an increase of \$3.49 from the average Class III price in 2006.

Nonfat dry milk prices have been very strong since late last summer and have contributed significantly to our profits last year and this year as well. The NASS nonfat price has increased 16 cents since the first of the year to \$1.16 per pound, but by many accounts the NASS price is still very slow in catching up with the current cash spot market.

The nonfat prices have accounted for much of the turn-around in the Class IV price. Class IV prices are projected to average \$13.65 for



this year which is up \$2.60 from the low prices in 2006.

When you combine the Class price projections, we see a much improved picture from 2006. Current projections reflect an all milk price for this calendar year of \$15.75 per cwt. This is an increase of \$2.50 per cwt from the all milk price of 2006. Feed costs are going to be a significant variable for the individual producer and could still be a major influence in milk production going forward. The picture should begin to become more clear as crop planting intentions become known this spring.

I want to thank the MMPA management team and all employees for their efforts in achieving another successful year for MMPA. The accomplishments of this past year, during some very trying times, illustrate the ability of the management and employee team to adapt to adversity and to react to new opportunities as quickly as they occur. I am truly grateful for our stable, experienced staff and for the high level of initiative they exhibit every day. The dedication, experience and responsiveness of our employees create our success.

As we face the uncertainties of the future, I want to assure you that the employees and the board of directors at MMPA continue to be committed to maximizing your return from your cooperative. We pledge to continue "Working to making a difference from your farm to the market."