

# General Manager's Report

Presented at the 92nd MMPA Annual Delegate Meeting, March 18, 2008



MMPA's annual report reflected an exceptional year for the cooperative and its members in 2007. Record milk prices were paid to our members last year. These monthly milk prices included record premiums. In addition, record earnings were realized by your cooperative in fiscal year 2007. As we know, however, good times in the dairy industry often end far too soon, and the current fiscal year is giving us a new reality check.

Over the last couple of months, we have reported extensively on MMPA's operations, activities and events of the past year to our members and delegates at our local and district meetings. For our *Messenger* annual meeting report, I want to primarily review the current market situation and discuss what we are doing to accommodate the strong increase in milk production in our region.

At our annual meeting Governor Granholm spoke about the importance of agriculture to the state of Michigan and also recognized the value of the proposed expansion of the Ovid plant.

Our first step in planning for the expansion at Ovid was to work with the rails-to-trails group to acquire the property needed to expand our Ovid plant. Officials from the village of Ovid, from Clinton County, from the Michigan Department of Agriculture, from the Michigan Department of Transportation and from the Michigan Department of Natural

Resources have all helped in acquiring the former railroad property next to our plant that allows for the expansion of the Ovid facility.

In addition, the application process with the Michigan Economic Development Corporation for the Agricultural Processing Renaissance Zone has also required and we have received the strong support from the village of Ovid, from Clinton County, from the Michigan Department of Agriculture and from the Michigan Commission of Agriculture. We still need approval from two more state boards for the Ag Ren Zone application before the process is complete. We are optimistic that approval will be gained in the next couple of months. Our thanks go out to all the individuals in these governmental organizations for assisting us with this project.

Obviously, we have had many of our plant and headquarters staff personnel deeply involved in planning, designing, engineering, application preparation, and evaluation of financing alternatives for the project. We have attended many meetings with various parties to justify and encourage their support

of the project. I want to thank all of our management team for their efforts on a job well done.

It has been exciting to be a part of this project and to promote a growing industry for the state of Michigan. The design, the engineering and the incentives for an efficient facility are critical to achieving a business plan that will allow us to compete in a national commodity market.

I want to briefly review the background for this expansion requirement and comment on the growth of milk production in this region because our delegates were asked to re-establish the equity retain program to help finance the project. Since current manufacturing facilities are at or near capacity during much of the year, future milk production in Michigan will be constrained without new manufacturing capacity because the cost of transporting milk out of state for processing can be very expensive. In just the last two months diesel fuel costs have risen by more than 60 cents per gallon.

During the past year MMPA marketed 3.8 billion pounds of milk. Fluid milk sales comprised 37% of the milk marketed with another 28% being marketed to various manufacturing plants including Leprino Foods. The balance of the milk volume, equaling 35%, was processed through our plants at Constantine and Ovid. Total milk marketed in 2007 was up by 240 million pounds with 70% of that increase going through our two plants.

Since 1999 the added volume processed at our plants total almost 500 million pounds. Monthly increases in member milk production

of 5% to 6% during this past year quickly used up the additional plant capacity added at both plants in 2006.

During the past year a survey conducted by our member reps indicated we had at least 30 member farms that were planning expansions of their dairy herds. The added milk volume from those expansions and the historical annual trend increase of 2 to 2-1/2% could result in 70% more milk by 2025.

Where will the new milk volume be marketed? Chart 1 reflects three distinct markets. While fluid milk sales are significant, there has been very little growth in this category, so we are projecting fairly flat sales for the future. We expect other manufacturing sales to be relatively flat also, largely because our milk supply contract with Leprino puts their Michigan plants at capacity for over the next 20 years. Therefore, all the growth in member milk production must be primarily marketed through our manufacturing facilities at Constantine and Ovid. The projected milk volume to our plants could more than double by 2025.

The proposed Phase II Ovid project would begin with a commitment of \$35 million for a plant expansion that would provide 2 million pounds per day of additional milk processing capacity. The tax incentives we have applied for are a

critical piece to our decision making process. Every day we compete with processors that are much larger than MMPA and with processors that have plants out west where the cost of milk is less than in our federal order system. All U.S. dairy manufacturing operations sell similar dairy commodity products, so we must be a low cost producer to be competitive.

One part of the Ovid Phase II project that is still being considered is whether or not we should add another dryer at the Ovid location versus some other site, possibly in the Thumb area. As we have reported to you in the past, we have been in discussions with DFA on a possible joint venture manufacturing plant in the Thumb. One of the factors influencing our decision is the tax abatement incentives that could be available to help make us more competitive with the western dairy manufacturers.

Chart 2 indicates we expect the Phase II project to be completed by late 2009 or early 2010, (shown here by the yellow line indicating manufacturing capacity of both plants increasing to 190 million pounds per month).

As you can see from the red line on the chart reflecting milk volume, there are a number of months where we expect to see milk supply to our plants greater than our manufactur-

ing capacity. If these milk projections are correct, we will have some periods where we will have to move milk out of state to find a market for the surplus production.

The loss of rBST as a management tool for dairy farmers has had a significant impact on milk production for many of our members. Milk production per cow has been declining in Michigan since last fall and has been negative for the last three months, compared to a year ago. As much as we would like not to be in the position of requiring an rBST-free supply from all our members, the reality of the market place is that our fluid milk customers have requested full rBST-free milk supplies, so if we want to maintain the Class I sales, we need to provide them with the milk they are requesting. This change-over has been accomplished and seems to be working smoothly. We know this has been a difficult decision for many of our members. We thank you for your understanding and cooperation in achieving nearly a 100% rBST-free member milk supply.

Milk production in Michigan has increased over last year's level, in spite of the loss of rBST, because there are more cows in Michigan this year than last year. The USDA Milk Production report for February came out March 17 and it reflects 16,000 more milk cows in Michi-

Chart 1

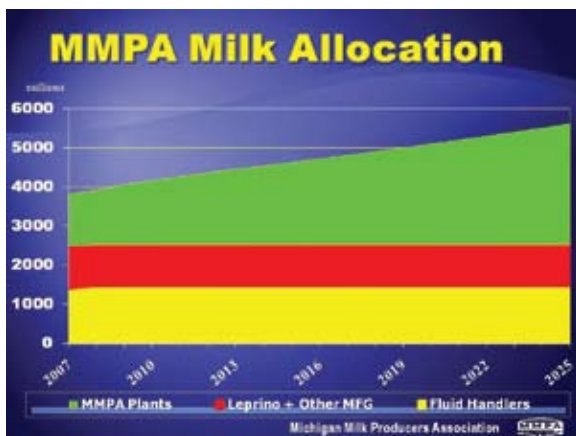


Chart 2

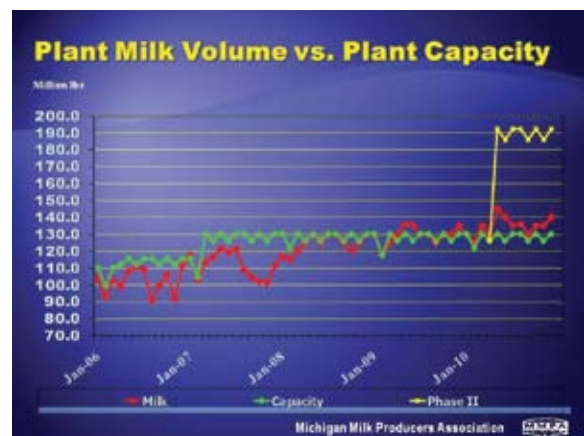


Chart 3



gan this year compared to one year ago. Once again this represents the significant dairy expansion that is going on in this state and the need for additional processing facilities.

MMPA members have seen a chart in my General Manager's letter for the past couple of months illustrating the volatility in the cheese market and that trend has continued for another month. By March 14th the CME block cheese price had dropped once again to \$1.80 per pound while the reported NASS sales price for block cheese was still rising to \$2.05 per pound for the week ending March 8th. As you know, within a couple of weeks the NASS price will be down again, which will impact the Class III milk prices. It is hard to find a reasonable explanation for this volatility. In spite of this volatility, the Class III futures price is relatively flat for the entire coming year, with trading taking place in a narrow range of \$16.86 to \$17.52 per cwt.

Chart 3 illustrates one of the reasons for the decline in producer pay prices this year. Since mid November last year, the price of nonfat dry milk has been declining virtually every week until this past week when it actually increased by a couple of cents. This 80 cent decline in the nonfat price has required MMPA to write down the value of its powder inventories in our current fiscal year. In addition, it has had a

huge impact on the expected price of Class IV milk and the overall producer price for this current year.

As recent as last December the market expected the Class IV price for 2008 to be consistently higher than the Class III price for this year. Class IV was expected to average \$18.30 for the 2008 year while Class III was expected to average \$16.43, almost two dollars less than the Class IV price.

The futures price as of March 14 shows a complete reversal of the Class III and Class IV price expectations. The Class III price is now projected to average \$17.43 for 2008, or \$2.30 more than the projected Class IV price of \$15.13. With such a reversal of prices in only three months it difficult to project a producer pay price for this year with any level of confidence.

USDA's latest all milk price projection for 2008 came out on March 11. Their estimate for the all milk price of 2008 has a range of \$17.30 to \$17.90 with a mid point of \$17.60 per cwt. as shown on Chart 4. MMPA's all milk price has averaged about 40 cents more than USDA's all milk price in the last few years, so if you assume that extra value continuing for this year, we would expect to see an all milk price for MMPA of about \$18.00 per cwt.

This price may seem attractive by historical standards, but the rap-

Chart 4



idly rising costs of production will make margins very tight for those that are buying all their inputs.

It is a very uncertain world we live in today, but I think there are still many reasons for being optimistic. It looks like the butter and powder markets have bottomed out. Global demand is starting to recover as witnessed by a recent MMPA sale of 1.8 million pounds of powder by our sales department to Chile. Butter prices have gone up nearly 20 cents in the past few weeks, so our butter inventories are also moving out. We also have established initial agreements for the sale of milk to southern markets for this year, which is occurring much earlier than in prior years.

While the challenges seem greater and the risks are higher in today's markets, you can be assured your MMPA employees and the management team will continue to be dedicated to making a difference for our industry and committed to accomplishing our mission of marketing our member's milk to the greatest advantage possible.