The Milkweed

Dairy's best marketing info and insight

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DFA 2004 Audit Lacquered & Perfumed, But ...

by Pete Hardin

The management of Dairy Farmers of America (DFA) slapped a lot of polyurethane and perfume on the co-ops 2004 financial audit. But beyond the chirping about how DFA "achieved record revenues" and "payments to members reached a record $5.8 billion for their milk," DFA's 2004 audit stinks, revealing:

- Burgeoning debt levels.
- Deteriorated performance by co-op's joint ventures and "affiliates."
- A bigger hole ($158 million) in woefully underfunded pension programs
- "Intangible assets" that equal just under 60 percent of DFA's "member equities."

"…respect of the financial community"???

A quick "truth test" for DFA's 2004 financial audit can be found in a simple paragraph on page 2, in which President/CEO Gary Hanman and Board Chairman Tom Camerlo report:

"DFA's commitment to a solid fiscal strategy has earned the respect of the financial community. We ended 2004 with desirable investment grade credit ratings from Standard & Poor's and Moody's Investor Service, assuring our access to operating capital at competitive interest rates."

That claim completely ignores two announcements from Moody's Investors Service, issued in December 2004, that Moody's was reviewing DFA's financial condition for a likely downgrade. Moody's blasted DFA's management for poor performance from its affiliates (through the first nine months of 2004) and chastised management for not deducting money from DFA members' milk checks to boost liquidity to protect the DFA's creditors. On December 21, 2004, Moody's started a 90-day review of DFA's finances. That review remains incomplete, as of April 11, 2005, almost four months later.

Thus, the claim by Hanman and Camerlo that "we ended 2004 with desirable investment grade credit ratings" completely ignores the fact that Moody's is in the midst of a credit review with a pre-announced, likely downgrade. (DFA secretary/treasurer Tom Croner suffered an attack of honesty at the annual meeting, initially reporting that Moody's intended to downgrade DFA's credit ratings. Croner was forced to later correct that statement, noting that DFA's management had no idea of what Moody's would do.)

(Media reports indicated Hanman took a "see no evil" approach to the ongoing Antitrust investigation against DFA. Hanman claimed not to know what Antitrust investigators are digging for Ho! Ho!)

This year's analysis of DFA's audit by *The Milkweed* will focus on several key areas, depicting DFA's financial flim-flams in key aspects, rather than trying to show the whole, muddy nine yards.

#1: Disappearing Class III-Pay Price Spread

From DFA's 2004 audit, the following information is gleaned on the narrowing "spread" between federal milk order Class III (cheese) milk prices and average prices paid per cwt. on members' milk in 2004:

	2004	2003	2002
Class III avg.	$15.39	$11.42	$10.42
Avg. Member Price Paid	$16.15	$12.62	$12.36
Difference	$.76	$1.20	$1.84

Yes, Class III prices in federal milk orders rose. But DFA pirated significant amounts of those increases. Outside the Upper Midwest, DFA swiped the higher values of Class III milk (compared to statistical uniform prices) for months when cheese milk prices rose above Class I (fluid prices).

Those months were April, May and December 2004. In early 2004, DFA suckered numerous members in the Southwest and California into signing "fixed-price" contracts in the $11.75-12.00/cwt. range — far below what subsequent months' prices achieved. DFA kept the difference—averaging several dollars per cwt. difference for all of 2004.

Thus, the "spread" between Class III prices and actual member prices received shows, in part, a measure of the larceny DFA committed against its members pay prices in 2004.

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Antitrust Subpoenas Many DFA Directors

by Pete Hardin

The sunlight is starting to shine on the "mushroom directors" of Dairy Farmers of America (DFA). (Editor's note: According to *The Milkweed's* unabridged dairy dictionary, a "mushroom director" is kept in the dark and is top-dressed with substantial quantities of manure.)

Just a few days before the cooperative's annual meeting in late March, about two dozen corporate directors of Dairy Farmers of America received subpoenas from the Antitrust Division of the United States Department of Justice (DOJ). These subpoenas are part of the massive Antitrust investigation underway against the nation's largest dairy cooperative.

Details of the subpoenas are not known to *The Milkweed*. Nor is it known why only about half of DFA's corporate board received subpoenas. (Some "mushrooms" must be bigger than others.) DFA is deeply enmeshed in a fast-moving Antitrust probe involving DOJ in tandem with about a dozen and a half state attorneys general offices.

Receipt of the DOJ subpoenas no doubt put a damper on DFA's annual meeting for the higher-ups on the corporate board. Various tidbits picked up by *The Milkweed* in recent months indicate that numerous corporate directors really didn't understand why DFA is in hot water with Antitrust. Some directors talk of a "big force" in Washington, D.C. that wants to put under the nation's largest dairy cooperative. The impression is given that DFA's corporate directors have not been kept up to date very well on the details of the probe.

If anything can start sobering up DFA's well-remunerated corporate board, "greetings" from DOJ ought to. In recent months, a wave of lawsuits (both public and private) has been thrown at directors of wayward corporations. It's a fact: corporate directors' personal assets stand behind their responsibilities to adequately oversee the cooperative's business and assets.

At DFA's annual meeting, when asked in public about costs of the Antitrust investigation, management only replied that more than a million dollars has been allocated. That's an understatement!

Word is that DFA's senior leaders are running scared on the Antitrust issue. President/CEO Gary Hanman is nervously trying to "smoke a peace pipe" with certain parties DFA has most competitively abused. But those belated efforts can't put out the fires of the Antitrust investigation that has progressed with surprising speed. *The Milkweed* projects that "big news" will emerge this spring from the federal/state Antitrust investigation into DFA. Stay tuned.

March Class III $14.08; Who Knows What's Next?

USDA announced the March federal order Class III (cheese milk) price at $14.08/cwt., down 62 cents from February.

This latest Class III price move continues athe confusing and nonsensical cycle for cheese and cheese-milk pricing that has ruled in recent months. Class III values at the Chicago Mercantile Exchange have been a yo-yo since last fall, as CME traders keep sending cash prices skyward at the end of each month, and then send them plummeting when the calendar changes. While USDA's Class III price is not directly tied to CME, the market does greatly affect values.

The true story remains, however: Milk and cheese supplies are tight enough to merit continued good prices, no matter how much CME traders try to manipulate the market.

USDA said the March federal order Class IV (butter-powder) price had been placed at $12.66/cwt., down 8 cents from the February Class IV.

DFA's '04 Audit: Smoke, Mirrors, Baling Twine ...

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#2: Affiliates' return on investment posts severe declines

As criticized by Moody's, DFA's earnings from "affiliates" have dramatically declined. Here's a presentation of DFA's investments in affiliates, reported earnings of affiliates, and *The Milkweed's* calculation of percentile annual returns on investment for 2004, 2003 and 2002:

	2004	2003	2002
Investments in Equity affiliates	$1,056,993,000	$867,275,000	$720,704,000
Earnings of Equity affiliates	$54,538,000	$69,118,000	$85,925,000
Percent return On Investment	5.16%	7.97%	11.9%

Curiously, Moody's criticisms of DFA's financial performance during the first nine months of 2004 noted only about $5 million in returns from affiliates at the three-quarters mark of 2004. Are DFA's stated equity affiliates' earnings accurate?

#3: DFA's core operations consistently lose about $30 million annually

By subtracting affiliates' earnings and profits from sale of assets, *The Milkweed* calculates that DFA's core businesses—raw milk sales and manufacturing plant operations—consistently lose about $30 million annually. This information is calculated from data contained in DFA's 2004 audit:

	2004	2003	2002
(A)Equity Affiliates' Earnings	$54,538,000	$69,118,000	$85,925,000
(B)Net gain on sale Of affiliates	$39.600,000	$13,900,000	-0-
(C)Net Savings	$65,101,000	$55,623,000	$50,163,000
C – (A+B)	-$29,037,000	-$27,395,000	-34,762,000

DFA has used affiliates' earnings and net sales of affiliate businesses to offset its horrid core performance of core businesses. Hanman talks a good game, but can't run the day-to-day businesses at DFA.

#4: $158 million gap in pension plans' assets vs. projected pay-outs

Footnote 9 of DFA's audit shows the co-op's huge pension problems further deteriorated during 2004. The "hole" between pension plans' assets and "projected benefits obligations" grew to $158 million—up $9 million since 2003's audit.

Amid the audit's mumbo-jumbo, *The Milkweed's* review gleaned the following details:

• $51,500,000 of DFA "members' equity" has been set aside to offset pension liabilities. That amount increased by $11.5 million in 2004. Plugging "equity" as an asset into the pension program is a joke. DFA's equity is specious, at best.

• DFA low-balled employer contributions to the pension plans in 2004. DFA paid in only $14 million during 2004, despite the fact that pay-outs to retirees totaled more than $27 million. Don't worry, the piper will be paid. DFA's audit estimates 2005's payments to the corporate pension plans will total $41.9 million—a boost of $27.7 million.

DFA's many mergers and acquisitions have added obligations for thousands of retirees, employees of predecessor dairy co-ops from an era when the industry counted many more dairy producers and service personnel. DFA retirees and employees had better not count on getting retirement checks from the financially troubled co-op *ad infinitum*. Fine print at the back of the DFA employees pension program specifies the co-op can change any aspect of the program at any time!

#5: "Goodwill" and Intangible Assets total $400,000,000

DFA's 2004 audit lists "Goodwill" and intangible assets totaling right around $400 million. These "intangibles" are bogus "assets." The technical definition for "Goodwill" is the amount paid above fair-market value for acquired assets. For example: if a dairy farmer paid $2000 for a cow worth $1000, the farmer would have a cow worth $1,000, plus "Goodwill" of $1000 (at least until his wife found out about it). "Intangible assets" are generally theoretical values, which won't bring much at a forced auction.

$400,000,000 in assets that are basically bookkeeping contrivances is a joke. DFA's audit lists "member equities" totaling $691 million as of 12/31/04. Sad to analyze that 58% of the value of DFA's member equities are just paper fit for lining the outhouse walls.

#6: "Members Equity" a weak joke

Let's analyze DFA's members' equity—alleged at $691 million last year. Besides "paper" assets of $400 million, DFA entered into so-called "Preferred Equity Securities" totaling $150 million in October 2003 and April 2004. Those borrowings pay 7.875% interest rates (mainly to insurance companies), with those purchasers taking a preferred position to DFA members on the pay-backs of members' equities.

Throw in another $51.5 million of member equities in the pension program "black hole," and it becomes obvious that DFA's equities are not very solid. Equities are returned to members and retired producers only at the discretion of DFA's board of directors.

#7: DFA's debts and borrowings grow

For an outside observer to try to unravel DFA's tangle of borrowings is a difficult, if not impossible task. Debt and borrowings are disguised under a variety of labels. And no accounting is made of actual obligations that DFA covers for the borrowings of its "equity affiliates," joint ventures and subsidiaries.

DFA's 2004 audit lists the following borrowings:

Long-term debt:	**$304,611,000**	**(+11.3%)**
Preferred equity Securities:	**$150,000,000**	**(+50%)**
Trust-originated Preferred Securities:	**$375,000,000**	**(no change)**

By whatever name, DFA's insatiable thirst for borrowed money grows, despite widespread measures of financial deterioration, in the analysis of *The Milkweed*.

Liquidity? DFA's monthly member milk sales averaged $484,000,000 in 2004. Moody's Investors Service has repeatedly stated that DFA's creditors have first claim to the co-op's members' milk checks.

Etc., Etc. Pass the Grape Kool-Aid

Footnote 10 of DFA's 2004 audit claims that the co-op is a defendant in various legal matters "in the normal course of business." Management's opinion is that resolution of such matters will "not have a material effect on our consolidated financial position." Analysis: If DFA's "normal course of business" includes coercion of members and non-members, then the present federal/state Antitust investigation must seem like more of the same-old, same-old.

Disappeared from the 2004 audit is a $105 million "accumulated deficit"—an unposted operating loss from affiliates from fiscal 2001. Presumption is that $105 million unreconciled loss remains deep in the bowels of DFA's books.

A few hundred millions here, a few hundred millions there … of debts and bogus assets, and DFA resembles an Enron-like financial mess. *The Milkweed's* final analysis: DFA is a financially bereft cult. Gary Hanman was last seen leaving a supermarket with a shopping cart full of grape-flavored Kool-Aid.

DFA's 2004 Audit Available

Copies of DFA's 2004 financial report are available from *The Milkweed* at a cost of $10 apiece. Interested persons should send a check for $10 to: *The Milkweed*, P. O. Box 10, Brooklyn, WI 53521.

DMS Duns Northeast Processors for Long-Ago Back Billing Mistakes

Strange. In the Northeast, Dairy Marketing Services (DMS) is billing fluid milk processors for years-ago milk sales in an attempt to clean up DMS' prior invoicing mistakes.

Questions arise:

• Why, if DMS incorrectly invoiced for raw milk sales back in 2001, 2002 and 2003, should fluid milk processors open up their checkbooks in late 2004 and early 2005 to pay these suspicious invoices? Businesses have seemingly closed their books on those long ago fiscal years.

• If DMS made billing mistakes years ago, what, if any, legal compulsion exists for fluid processors receiving these bills to pay them? There would appear to be no obligations involving the Northeast federal milk order, since Class I (fluid) sales were reported as Class I sales, whether or not DMS invoiced processors accurately.

• Is DMS so hard up for money that it must revert to long-ago invoicing mistakes, in order to grub for money? DMS was two weeks late paying for November 2004 milk diverted to Dean Foods by Wisconsin cheese plants. (See article, page 2, February 2005 issue of *The Milkweed*.)

• If revealed, is the "embarrassment factor" from invoicing years-ago billing mistakes worth the money for DMS?

• Is DMS competent? (Quick answer: Absolutely not.)

In early 2003, DMS evolved from a regional screw-up in the Northeast to a coast-to-coast milk mis-marketing agency. That's when Dean Foods turned over its raw milk supply to DMS, with very little notice. DMS got the raw milk supply responsibilities for Dean Foods' 2500+ dairy farms, because those producers would have revolted if their milk marketing had been turned over to Dairy Farmers of America (DFA). (DMS is a joint venture basically controlled by DFA.)

DMS made many, many mistakes. But that doesn't mean that customers must honor these ancient invoices.