

# DFA's White Elephant—NDH—Lost \$134,200,000 Last Year

by Pete Hardin

The 2007 audit of Dairy Farmers of America (DFA) reveals absolutely HORRID financial performance for DFA's biggest subsidiary—National Dairy Holdings (NDH). Future prospects seem dim. NDH lost \$134.2 million in 2007. The fourth quarter was the worst: NDH lost \$63.5 million in the fourth quarter, or \$21 million per month!

NDH was dumped into DFA's financial books on October 1, 2007, after defaulting on a \$25 million payment to a creditor. That default forced a series of events:

1) DFA had to buy an additional 37.5% of NDH's stock, as a co-investor decided to throw in the towel. (DFA now owns a whopping 87.5% of NDH's stock.)

2) DFA had to lend NDH an additional \$25 million to cover the repayment default.

3) DFA was compelled to merge NDH's finances into DFA's own corporate books ... so that details of NDH's astoundingly terrible financial losses became public (when the DFA audit leaked out).

Funny thing: DFA officials who crafted the language for the 2007 audit couldn't bring themselves to use the word "losses." NDH's January-September 2007 negative net is referred to as "impairment charges." And NDH's \$63.5 million negative result for October-December 2007 was characterized as "delivery" costs. For DFA members, whose milk checks and equities are being cannibalized to absorb such losses, "delivery" is in the rear.

NDH is DFA's problem now ... DFA's biggest problem! And the bleeding hasn't stopped. According to information contained in DFA's 2007 audit, NDH lost \$134 million last year! NDH's needs for additional capital continue. In early 2008, DFA loaned NDH an *additional* \$40 million – enough to keep NDH afloat for another couple months?

Unless dramatically reversed, NDH's operating losses threaten DFA's already shaky financial stability. In 2007, DFA wrote off nearly \$150 million in losses from subsidiaries and joint ventures (like NDH). NDH's bad financial condition looms over DFA's financials as another potential \$100-200 million write-down, in the analysis of *The Milkweed*.

According to DFA's audit, NDH currently operates 19 fluid milk plants in the U.S. Many of those facilities are in the Southeast.

## What is NDH?

National Dairy Holdings was formed in early 2001, when DFA acquired dairy processing assets of Crowley Foods (a firm based in Binghamton, New York). NDH was in business less than one year when a great growth opportunity presented itself: acquiring milk plants "spun off" by the merger of the nation's two largest fluid processors: Suiza Foods and Dean Foods. In late December 2001, NDH added a dozen fluid milk plants that the Antitrust Division of the U.S. Department of Justice ordered stripped from the Suiza/Dean merged holdings. (To gain these additional plants, DFA relinquished its one-third interest in Southern Foods Group—a joint venture with Suiza Foods.)

In 2001, two former high-level Suiza Foods executives – "Tex" Beshears and Tracy Noll—joined DFA as investors in NDH. At Christmas 2001, NDH suddenly emerged from virtually nowhere to become the second-largest U.S. fluid milk processor. The merger of #1 (Suiza) and #2 (Dean Foods) left NDH – with the dozen plants spun off from the big merger – as the newly-crowned, second-largest fluid milk processor. Like DFA, size has been no guarantee of success for NDH.

Another NDH investor is—or was—Alan Meyers, who'd regularly fronted as "competition" in a series of earlier DFA business dealings involving milk plants. In one separate deal with DFA, Meyers personally **NETTED \$90 MILLION DOLLARS**, according to documents filed by the DOJ's Antitrust Division in a court action in Kentucky. (\$90 million is more money than DFA has ever netted in any business year.) Alan Meyer's monstrous profits in dealings with Dairy Farmers of America (and its predecessor co-op—Mid-America Dairy-men) raise questions about for whose benefit man-

agement was running the co-op.

(In 2007, Meyer was stripped of his NDH corporate jet by DFA CEO Rick Smith. That change put Meyer in a snit, sources say.)

## NDH: According to the DFA audit ...

Here's a breakdown of the various bits of "bad news" for NDH, according to the DFA 2007 financial audit:

\* **For January-September 2007, NDH lost \$70.7 million.**

\* **For October-September 2007, DFA wrote off \$63.5 million in NDH "delivery" expenses.**

\* **For October-December 2007, NDH's \$63.5 million in losses equaled 14.2% of total revenues for that quarter!!!**

\* **NDH defaulted on a \$25 million loan in 2007's third quarter. DFA had to loan NDH \$25 million in 2007.**

## Closer look at NDH's "assets" and liabilities

DFA's 2007 audit lumps NDH's "assets" and liabilities into a single column -- a ruse designed to inhibit analysis. *The Milkweed* will further separate and qualify these "assets" and liabilities. (We use quote marks when referring to NDH's "assets" for reasons that will become obvious.)

### "Assets"

Cash and cash equivalents .....	\$3,528,000
Accounts receivable.....	133,735,000
Inventories .....	39,813,000
Other current assets .....	6,535,000
Property, plant & equip.....	273,258,000
Goodwill* .....	10,096,000
Other intangible assets*.....	132,656,000
Other assets .....	2,735,000
<b>Total: .....</b>	<b>602,356,000</b>

\* Questionable assets, in *The Milkweed's* analysis

A large percentage of NDH's "assets" consist of "Goodwill" and "Other intangible assets." These categories of "assets" are bookkeeping contrivances, not solid assets. Combined, "Goodwill" and "Other intangible assets" listed as NDH's "assets" total \$142,752,000.

### Liabilities

Accounts payable	
and accrued expenses .....	128,420,000
Debt .....	182,584,000
Other liabilities .....	4,385,000
<b>Total: .....</b>	<b>315,389,000</b>

At first glance, NDH's "assets" total \$602,356,000, in contrast to \$315,389,000 of liabilities ... BUT!

Let's subtract "Goodwill" and "Other intangible assets" from NDH's total assets. Result: \$459,604,000. That figure is closer to NDH's liabilities listed as \$316,852,000.

Another suspicious NDH "asset" could be its single biggest asset – "Property, plant and equipment" – listed at a value of \$273,258,000. Valuing old dairy plants is a tough job, especially these days with much U.S. real estate values nose-diving.

The bottom line question arises: if NDH is so well endowed with "assets," why is the firm failing wildly in its operations? Further: why hasn't NDH sold off real estate to cover its losses???

## Bleeding continues! DFA had to lend NDH \$40 million in January 2008

"In January 2008, NDH borrowed \$120 million under the ABR. Additionally, we advanced NDH \$40 million drawn under our commercial paper program. The combined \$160 million was used by NDH to extinguish amounts under their previous credit agreement." (DFA 2007 audit, page 10.)

Analysis: NDH is now DFA's bleeding, Jumbo-sized white elephant. Unless DFA can reverse NDH's dramatic financial losses, NDH

promises to become the next big write-down listed in a future DFA audit ... maybe sooner than DFA's leadership would like to admit. Hard to imagine a fluid milk processor losing revenue roughly equal to 10% of its gross revenue!

Want a copy of the DFA 2007 audit?

See page 15 for details.

## NDH: Losses Without Precedent in U.S. Fluid Milk Sector

Talk about a sick white elephant! The more one studies National Dairy Holdings' (NDH) financial numbers, the worse it looks.

Let's rework three facts about NDH's 2007 financial performance that were presented in DFA's recent financial audit:

\* **Fact #1: NDH lost \$63,549,000 in the fourth quarter of 2007.**

\* **Fact #2: NDH reported sales revenue of \$446.8 million for 2007's fourth quarter.**

\* **Fact #3: NDH has 4,900 employees.**

\* **Fact #4: During the 2007 fourth quarter, after DFA acquired an 87.5% ownership of NDH and transferred NDH's financials to DFA's books, monthly losses climbed to \$21.5 million. For the first three quarters of 2007, NDH's reported losses were \$70.7 million, or \$7.855 million per month.**

### Ugly Analyses & Extrapolations:

A) **NDH's losses totaled 14.2% of sales for 2007's fourth quarter.** Simply divide losses by sales revenue.

B) **NDH averaged \$30,395 in monthly sales per employee.** Divide quarterly sales by number of employees and then divide that result by three.

C) **NDH averaged losses of \$4,323 per employee per month in 2007's fourth quarter.** Divide the fourth quarter loss figure by the number of employees. Further, divide that quarterly loss per employee figure by three to determine monthly losses. Go one step further. Conclusion: NDH lost roughly \$1000 per week per company employee in last year's fourth quarter.

D) **Based on an estimated value of \$28-30 per cwt. for finished dairy product sales, in the fourth quarter of 2007, NDH's huge losses translate roughly into \$4.00 per cwt. Stated another way, NDH lost roughly \$.35 for every gallon of milk it processed in the fourth quarter of 2007.** Ouch!

E) **Under DFA's ownership, NDH's monthly losses TRIPLED during 2007's fourth quarter, compared to NDH's losses during the first nine months of 2007.**

### Conclusion:

With very few historic exceptions (such as Prairie Farms), it's common wisdom in the U.S. dairy industry that dairy cooperatives simply cannot successfully operate fluid milk businesses. DFA's adventure with NDH appears to be the grossest example of that wisdom. NEVER in the history of *The Milkweed's* 29 years of reporting on dairy events have we seen such losses!

In January 2008, DFA pumped an additional \$40 million in loans into NDH. That ought to keep NDH going for another couple months!

How much longer can DFA afford this huge monthly flow of red ink? At what price is DFA selling raw milk to NDH?

DFA members should prepare for a write down of \$100-200 million in their cooperative's net worth, when (not if) DFA is forced to pull the plug on this white elephant.

Independent producers (and smaller co-ops) selling milk to NDH should seek other, more financially viable markets. No sense getting caught in the mess when this white elephant goes down.