

Dean Foods Pocketed Big First Quarter Raw Milk Price Drop

by Pete Hardin

Cut through the syrupy mumbo-jumbo from Dean Foods' executives about outstanding first-quarter 2009 net income of \$76.2 million.

Profits for Dean Foods' sector that includes fluid milk operations were spectacular in the first quarter. Dean Foods now calls that subsidiary, "Fresh Dairy Direct." Operating income for Fresh Dairy Direct for January-March 2009 was \$182 million - a 39% gain over 2008's first quarter.

Dean Foods' massive indebtedness is coming back to haunt the nation's largest fluid milk processor. A trove of information released in early May 2009 shows Dean Foods' first-quarter in a different light. That information includes: the company's 10-Q report filed with the federal Securities and Exchange Commission, comments by Dean Foods' senior executives to a teleconference of financial analysts on May 1, and January-March 2009 data gleaned from supermarket checkout scanners. Here's the quick analysis:

* A big chunk of Dean Foods' Q1/2009 moo-la was squeezing the difference between steeply declining farmers' milk prices and consumers' retail costs that declined modestly during January-March 2009.

* Dean Foods has been unable to attract loans from banks to meet a \$122.8 million obligation coming due on May 15, 2009. Dean Foods' management cast a pall on its big first quarter earnings report with an announcement that the company would offer 22.5 million shares of new company stock to try to cover the \$122.8 million repayment obligation that comes due May 15. Company stock plunged \$1.77 per share, or 8.6%, on the day of these announcements.

* Dean Foods has another obligation of \$56.25 million coming due on June 30, 2009.

Specious debt, "Goodwill" & Intangibles cast shadow

Upon examination, Dean Foods is a bundle of debt and assets that would not bring much at a "fire sale."

Borrowed nearly \$2 billion for stock bonuses in 2007. In early 2007, the company used \$1.94 BILLION of borrowed funds to pay out a one-time, \$15 per share "bonus" to stockholders. At the head of that receiving line stood Gregg Engles, Dean Foods' CEO and Board Chairman, who received more than \$39 million from that \$15/share bonus payout. Borrowing nearly two billion dollars for a non-performing use - paying out a stockholder bonus - added mightily to the company's debt. Payback time is less joyous. In a conference call with investment analysts on May 1, Engles admitted that banks will not cover the company's maturing debts with more loans: "And the reality of the markets today are (sic) such that we do not have confidence we could refinance the full amount the full amount of bank financing revolver and term loans that we have today into the bank market of the future. Bank capacity has simply diminished greatly."

Company Chief Financial Officer Jack Callahan told that same financial analysts' teleconference that, "We've already made great progress here reducing our debt levels by nearly a \$1 billion since the third quarter of 2007 ..." No mention of the how Dean Foods' borrowing were so ill-used.

Pocketing some of the "difference"

During the first quarter of 2009, USDA's "Class I mover" (the base price for fluid milk prices in the federal milk order pricing system) dropped to \$11.96 per cwt. That figure was a full \$7.16 per cwt. (or -37.4%) lower than the "Class I mover" for January-March 2008.

Do the math:

* According to Dean Foods' 10-Q filing with the SEC, the company's fluid milk volumes increased about 1.4% during the first quarter of 2009.

* Total sales volume of fluid milk was relatively flat in the first quarter of 2009 versus 2008.

* But the company's net sales decreased 14.6%, "primarily due to significantly lower commodity costs being passed through to customers."

Surely, if Dean Foods - with its massive market power in numerous metropolitan areas around the United States - had passed through to consumers fluid milk price cuts more in keeping with the company's reduced raw milk costs, Dean Foods wouldn't have made so much profit in the first quarter of 2009.

(Data from Information Resources Inc. indicates that U.S. consumers paid about 12.5% less for fluid milk purchased at supermarkets during the first three months of 2009).

Failure to pass through such lower costs is a clear sign of a non-competitive fluid milk marketing picture across the country. And Dean Foods - including recent acquisitions - now controls about 40% of all the fluid milk sold in the U.S.

Massive amount of "Goodwill" and Intangibles

Unaudited financial results for 3/31/09 show Dean Foods had assets totaling \$6.916 BILLION dollars. But 52% of those "assets" are listed as "Goodwill" (\$3.075 BILLION) and "Intangible Assets" (\$578.3 MILLION).

Added together, those two "assets" total \$3.653 BILLION dollars. "Goodwill" is the difference between the value of a business acquisition and the actual purchase price. Thus, with all the acquisitions Dean Foods has made over the

past dozen-plus years ... overpaying for businesses has been the company's *modus operandi*. Over \$3 BILLION of overpayments. (Here's *The Milkweed's* explanation of goodwill, in farmer terminology: A farmer pays \$2,000 for a milk cow. The cow is worth \$1,000. The farmer has \$1,000 worth of a live asset and \$1,000 worth of goodwill.)

Intangible assets defy specific value. Dean Foods only counts a mere \$578 MILLION of intangibles.

In tandem, however, "Goodwill" and intangible assets form just over half of Dean Foods' "assets" ... for what they're worth. And Dean Foods' management wonders why the financial community won't come up with borrowings to roll over borrowings!

Bankers studying more than quarterly profits

In these times, the financial community is studying far more than short-term earnings statements in evaluating the creditworthiness of potential borrowers. Despite those big profits snagged by Dean Foods during the first quarter of 2009, the company did not gain confidence of lenders to roll over the \$122.8 million obligation coming due on May 15, 2009.

So Dean Foods resorted to a "quickie" fix - a stock offering that put 22.5 million more shares of company stock on the market. And the company's stock plunged that day.

The bankers remember how Enron was declaring profits, right up to the end.

All that debt ... all that "Goodwill" and intangible assets ... add up to good reasons why Dean Foods just can't seem to get enough access to capital, either by hook or by crook.