

Farm and Food File for the week beginning Sunday, May 22, 2005

Got debt? Milk giant DFA downgraded by Moody's

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According to a May 9 report from Moody's Investors Service, the finances of Dairy Farmers of America, the giant, farmer-owned dairy cooperative that marketed 33 percent of the nation's fluid milk last year, are souring faster than cream in a July sun.

Worse--at least for its 22,000 dairy farmer members--the best strategy to clean up the mess, says Moody's, is for DFA "to restrict payments to members in order to conserve cash for debt service."

Great, another Kansas City-based ag cooperative--recall Farmland Industries?--whose farmer-members now face the likelihood of paying the big debts of their big-dreaming, big-spending hired hands.

It's a familiar hymn, an all-too-familiar, sad hymn, these days.

Farmers form a cooperative to gain marketing power. Success brings size; size brings "professional" managers and, before long, the pros convince members to move into areas where members have no ability or interest--usually processing.

Then come mergers, bond offerings, maybe a legal tangle, more debt, a market reversal or two and pretty soon you have Moody's issuing a report warning the world that there is "a decreased likelihood that investors will receive their principle and interest in full and on time."

In a nutshell, that's DFA's short story. Its birth in early 1998 (as noted at the time in this space) had few merits other than scale. Three of its four merging members, Milk Marketing, Inc., Western, and a large portion of AMPI, brought more debt into the deal than dollars.

Its fourth and biggest player, MidAm, and MidAm's charismatic leader, Gary Hanman, predicted DFA would be a dairy superstar. With control over one-fifth of the nation's fluid milk, Hanman envisioned DFA as a national and international powerhouse in milk marketing, processing and exporting.

Hanman's dream became a reality because Hanman became DFA's boss. Since 1998, DFA has used joint ventures, vertical integration, buyouts and, says the U.S. Dept. of Justice, a tangle of questionable tactics to become the dominant U.S. milk seller and a major player in the cheese market.

The maneuvering, however, never brought the promised profits.

According to Peter Hardin, the editor and publisher of The Milkweed, a monthly dairy marketing report in Brooklyn, WS, and a long-time MidAm, Hanman and DFA watcher, the big coop was “built on a cracked foundation.”

“When times are good for its dairy farmers,” as in the past two years with record or near-record milk prices, explains Hardin, “DFA’s processing subsidiaries can’t make money. To make money, DFA needs low milk prices because DFA is really a processor.

“Low milk prices, though, are exactly what the farmers don’t want,” says Hardin. “In essence, DFA is competing against DFA.”

Moody’s May 9 report concurs. “(A)s DFA’s investments in bottling affiliates have increased and its branded dairy foods business has grown, its earnings have become... negatively impacted... hence lower core earnings...”

Recent market moves by DFA only added to the coop’s woes. In 2004 DFA bought hundreds of tons of cheese on the open market to hedge against what it believed would be higher milk prices, the key cost to its cheese plants.

Trouble was, notes Moody’s, “When prices for those materials fell, DFA incurred large inventory losses. This event not only highlighted the increased price risk that DFA’s business now faces, but also the cooperative’s poor risk management and hedging ability.”

The blunder puts editor Hardin in mind of Hollywood. “You’ve heard of the movie ‘The Gang that Couldn’t Shoot Straight.’ DFA is ‘The Gang that Can’t Milk a Cow Straight.’ ”

Straight or otherwise, DFA’s troubles may compound before they climax.

According to published reports, the U.S. Dept. of Justice’s Antitrust Division is investigating allegations that DFA used its market clout to influence raw milk prices--push prices lower, claim affected farmers--in regions around the nation.

Should DFA’s financial cheese thicken, its members may take the biggest hit, notes Moody’s, because DFA’s “bylaws dictate that payments to third party creditors, including debt service, have seniority over payments to members for milk.”

That ending also sounds familiar. Just ask Farmland members.