



DAVISCO

DAVISCO FOODS INTERNATIONAL, INC. ■ QUARTERLY NEWSLETTER

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27 years with Davisco

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Producer Update

Cows from one Idaho dairy produce income in more ways than one.

Dairy Economics

A dynamically changing marketplace affected increasingly by world markets and new technologies is rapidly altering the dairy industry in the United States. Decision makers involved in every aspect of dairying feel the crunch; new realities demand fresh ways of thinking and a look to the marketplace for solutions to serious financial challenges.

On the Farm

On the farm, competition is forcing change in milk production methods. Dairies find it increasingly necessary to seek specialty markets or to adopt more efficient production practices to remain profitable.

In the Processing Plant

In the traditionally strong dairy states of the Midwest, processors are short on milk as the number of dairy farms continues to decrease. These companies persist in the effort to procure enough raw product to keep plants operating profitably and at capacity. In the West, milk production steadily increases, luring processing plants and skilled workers to the opportunities presented there. In all regions, processors find it necessary to increase production efficiencies and adapt to the demands of changing consumer tastes.

Marketplace Dynamics

A growing percentage of US dairy products are sold internationally. This trend demands attention to pricing, international standards of quality and changing consumer tastes in other areas of the world. Broader thinking by processors is required, as well as a willingness to take risks and increase investments.

The Role of Government

Government price supports for milk will cease to exist in the year 2000. The Federal Milk Order System is currently in the process of comprehensive revision and could potentially be abolished within the next decade. As the role of government in the dairy industry decreases, the need for attention to the marketplace and managerial adjustments in every part of the dairy industry will increase.

Survival Strategies

Acknowledgement of industry trends is a necessary first step in the process of developing strategies. Positive change is possible but requires an openness to new paradigms for the industry.

Independence vs. Interdependence

Processors, milk producers, and suppliers are now turning their attention to the potential of alliances that will strengthen the efforts of individuals and the industry as a whole. This move toward a new interdependence has the potential to boost profits, improve quality of life, and energize the dairy industry for the accomplishment of common goals.

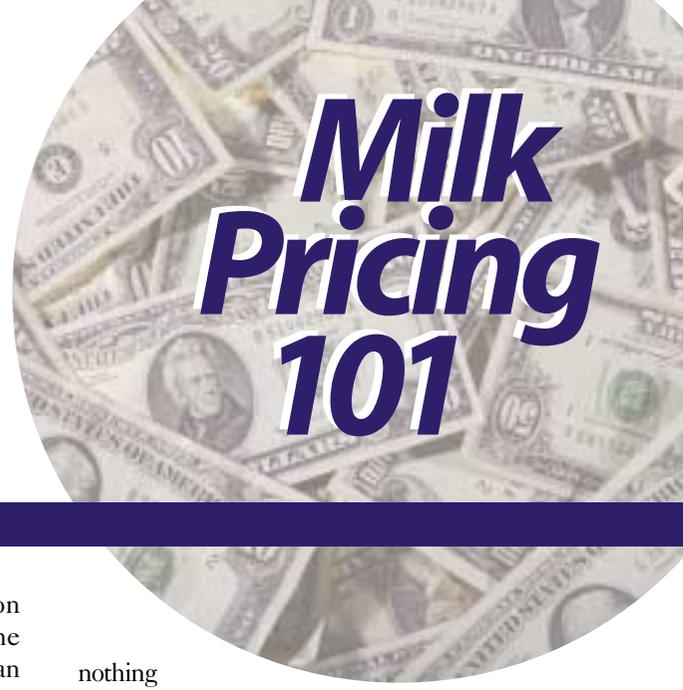


Market Dynamics & New Technologies Transform the Industry

Confusion is the norm when milk pricing is the topic. Decades of change and regulation have created a system that can stump even the experienced financier. Government regulation, advancements in technology, changing tastes and priorities in other parts of the world, the evolution of transportation and refrigeration techniques, the influence of varied climates on United States dairies, management choices made on the farm, and the power of the free market all play heavily into the price paid for raw milk.

Within a few years, as conditions in the United States changed, adjustments were made to the Market Order system and a process of ongoing revision began. Price formulation became increasingly complicated and changes in society altered market forces.

How are regulated prices formulated?



What is the Federal Market Order system?

In 1937 the United States government created a system to encourage milk production in every county of the United States. Transportation and refrigeration techniques were limited at the time, and federal agencies wanted to ensure a healthy diet for the public — especially for children.

In 1937 most U.S. dairies were located in the midwest. The Federal Market Order system named Eau Claire, Wisconsin the center of the dairy industry. Farmers near Eau Claire needed no economic encouragement to produce an adequate supply of milk for the region, and so they received the lowest price enhancement. As the distance from Eau Claire increased, enhanced milk prices increased also. The vehicle for this price enhancement became known as the Class 1 differential. This in effect increased the value of milk used for fluid consumption above the value of milk used for all other purposes (mainly cheese). The system created an economic incentive to produce milk in areas where there was not an abundance, essentially making it economically viable to produce milk where the conditions were not ideal. Geographical regions established at this time were called FMMO's or Federal Milk Marketing Orders.

The price paid for raw milk depends on the final use of the milk. The value of the milk sold to a cheese plant is different than the value of milk that is used as fluid, or drinking, milk. The total combined values of all the regulated milk in the Milk Marketing Order is combined and divided into the total regulated milk in the Milk Marketing Order. This then becomes the blend price, and is theoretically the price that all the dairymen in the Order area receive for their regulated milk. These values are broken down into four categories.

Class 1	fluid milk
Class 2	soft dairy products such as cottage cheese & yogurt
Class 3	hard dairy products such as cheese
Class 4	butter and milk powder

Prices for every class are formulated using the Basic Formula Price (BFP) as the starting point. The bulk of the value of the BFP is formulated based on the Chicago Mercantile Exchange forty block cheese price.

Milk pricing west of the Rocky Mountains is handled differently than in regions east of the Rockies. In western Federal Orders the price enhancement (differential) has

nothing to do with the distance from Eau Claire, Wisconsin. It is a number that was developed by milk producers in the specific orders as the orders were being formulated.

Milk pricing in the largest dairy state, California, is regulated in a completely different way than the various Federal Orders throughout the country. Since the 1960's California has been regulated by a state order. The state order rules, though in principal similar to Federal Orders, are actually much different in the way they economically encourage milk production. The discrepancy between the regulation of milk pricing in the largest milk shed in the country (California) and the rest of the country is one of the most important issues facing the industry today.

This summary of regulated milk pricing details the minimum price that a milk producer will be paid throughout the country. Local supply and demand conditions could conceivably cause actual prices to be higher than those regulated by the Federal Order System.



In Focus
Mark Davis

This issue of Daviscope briefly describes the multitude of related circumstances that the dairy industry farmer and processor must digest in order to operate their businesses.

All of agriculture and with it, farm dairy production, must be able to evolve in response to the same economic pressures that have caused all other industries to react to their individual circumstances. We would not try to break up successful retailers;

we cannot expect production agriculture to exist in a vacuum.

Farmers must not be prevented from making any economic choice that allows them to prosper. They must be able to make any adjustment, that they individually choose, which will allow their business and their family to continue to farm.





Producer Update

Idaho Dairy Turns Manure into Compost for Regional Crops

On the dairies owned by John Reitsma, Jerome, ID, manure may someday be an asset, not a liability. Manure from 7,000 cows on Reitsma's dairies is processed and marketed to crop producers and other customers. Reitsma's compost company, Compost West, is four years old and its product, Nu Earth, is gaining widespread acceptance as a soil enhancer, explains Sean Mallet, Reitsma's son.

"Our product is generally used on land for row-crop production. Up to a 25% yield improvement is possible; on average ten to fifteen percent," he says. Annual application of compost reduces the cost of commercial fertilizer and tillage. Weed seeds, odor, and fly larvae found in raw manure are virtually eliminated. Nu Earth contributes organic matter to the soil, reducing irrigation needs on crop land.

"We began composting because local, state and federal regulators were coming down hard on manure management in this area," says Mallett. "John teamed up with a composter in Nampa, Idaho who showed us how to compost and to develop markets here," says Mallett. The venture reduced the volume and cost of hauling manure; 60,000 tons of manure generated annually on the dairies is reduced to 30,000 tons.

Composting methodology is influenced by climate and season. A proper carbon to nitrogen ratio is essential to the process. In Idaho, where annual rainfall totals

eight to nine inches, manure is hauled out of drylot corrals twice a year. Manure and straw from winter bedding are hauled together in the spring. Straight manure is hauled in the fall and bulking agents such as moldy hay or straw and used feed from bunks are added.

Once manure is hauled out of corrals it is placed in windrows on a firm surface.

A Frontier self-propelled compost turner handles 1,500-2,000 yards per hour, or the equivalent of 100 manure trucks per hour with each truck holding fifteen yards.

The turner, a \$250,000 piece of equipment measuring sixteen feet wide by six feet high, aerates the material as it blends and turns the windrows. The compost is turned six to eight times, with a finished product available for marketing in three months.

Compost West composts for four other dairies and has about one hundred compost customers who haul the finished product off-site themselves or have it delivered and custom spread.

Compost West markets its products in two ways: making cold calls to potential customers, and working with agencies and organizations to get the word out. The company is involved in a four-year crop rotation study with the University of Idaho to show the benefits of compost to crop yields, quality and soil condition improvements," says Mallett. "It's definitely a hard-sell, but there's interest and acceptance."



Two self-propelled turners aerate the compost.



Windrows of finished compost (left) and the raw product (right)

Compost is loaded into a spreader truck for field application.



Compost is spread on an Idaho field.

Crops such as organic Idaho potatoes thrive in compost-enriched soil.



Evaluate Your Dairy's Insurance Coverage

Damage caused by the tornado that swept through southern Minnesota on March 29, 1998 has caused regional residents to evaluate the extent of their personal insurance coverage. Dairy owners, among others, have come face to face with the need for coverage that will adequately replace damaged facilities, repair equipment, and meet expenses that continue when loss of income occurs.

Tom Rekstein of Reidman Insurance in Mankato, Minnesota believes that dairy owners should ask three basic questions when purchasing insurance:

1. What are the operation's most valuable assets?
2. What expenses continue if production comes to a standstill?
3. What is the potential environmental liability of this business?

Rekstein advises milk producers to work with an insurance agent who evaluates the policy annually, asks questions that prioritize needs, and clearly outlines coverage options (such as the difference between actual cost and replacement value insurance).

During the annual review, ideally done in person, the agent should ask:

1. How has your operation changed during the past year?
2. Have you taken on more debt?
3. Have you added employees to the operation?
4. Has environmental liability insurance become a necessity?

It's important to have in hand current facility reconstruction costs at the time of the annual review. When making decisions, Rekstein advises that the most valuable assets be insured for replacement cost and smaller assets at actual cost if economy is important. Larger deductibles can also be considered. It is also important to remember that the rate for actual cost and replacement value insurance is the same per hundred dollars. The total coverage amount is increased to obtain replacement cost coverage.

Do you manage for optimum profits?

Look around for low feed prices. Ask questions. Evaluate costs per cow, per day/feed cost/cwt.

Minnesota	Spot Load	JFM
Cottonseed	\$194	\$199
Hay	\$90-100	(RFV 150-160)
Distillers	\$85	
Corn Gluten	\$75	
Corn	\$1.80/bushel	
Soy Meal 44%	\$133	\$135
Soy Meal HP	\$142	\$142

Feed for milk component value, not volume.

Work creatively with your nutritionist to match feed price and nutrient content with component value results.

Le Sueur Cheese Company, November 1997

Butterfat (Value on Surplus Fat)	\$0.273/point/cwt
Protein	\$0.21/point/cwt
Somatic Cell Count	\$0.08/cwt per 100,000 below standard of 350,000

Jerome Cheese Company, November 1997

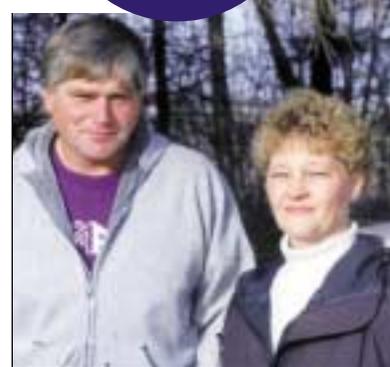
Butterfat (Value on Surplus Fat)	\$0.2489/point/cwt
Protein	\$0.191/point/cwt
Somatic Cell Count	Bonuses ranging from \$.04 to \$.45/cwt are given for counts 0-500,000. \$.04-\$.45 is deducted for counts 501,000-1,000,000

Point= 1/10 of % (For example: 3.2-3.1=1 point)

Note: Each dairy is individually evaluated. This is a simple overview of point value.

Bank on Success

Producer Profile



Lyle & Val Thompson

Nicollet, Minnesota

When Lyle and Val Thompson look at their 26 years as dairy farmers they see two goals as driving forces. The first: to raise their family in the country and successfully put three children to school. The second: to build a high-producing, profitable herd. The Thompsons have achieved both.

Except for the first seven months of their marriage the Thompsons have produced milk and farmed the land where Lyle grew up in Nicollet County. They moved back to the Thompson farm in 1972. Lyle, Harley and brother, Larry, farmed together for 12 years and were one of the first in the area to switch from a tie-stall barn to a free-stall and parlor set-up. They eventually built the herd to 80 cows. In 1989 the herd was split between Lyle and Larry, and Lyle and Val have since built their herd from 40 to 80 cows.

The farm is operated by Lyle, Val, and a high school senior, Louis Krohn. Krohn works weekdays after school and on weekends. "Louis is a big part of this operation. I remind him of that often," says Val. By employing Krohn and finding extra help the Thompsons find it possible to get away occasionally.

Lyle produces forage, cash beans and corn on the land; he started collaborating this year with a neighbor to complete crop production tasks.

Lyle and Val were recognized by the DHIA for having the herd which produced the highest dollar value of milk in Nicollet County during 1997. They were thrilled with the honor, but do not consider it their most important achievement; that place is reserved for the family they raised. "When we think back now to all we did from 1980-1996 — all the football, basketball, wrestling, volleyball, softball, baseball and 4-H — we sometimes wonder how we kept our dairy farm going," says Val. "We couldn't have done it without our children. They learned a very important lesson — by working hard together as a family and completing the necessary daily tasks, we were able to have fun together as a family. We sacrificed very little, which goes to prove that you can run a dairy farm and have a social life." The three Thompson children, Chris (26), Shawn (23) and Nikki (20) all went on to college and now reside in Minnesota.

Working the Numbers

We believe the success of dairying depends on an awareness of the forces at work in the marketplace and our ability to take control together.

A Look at the Potential of Partnering

QUICK FACTS

The dynamics of market economies change, and so can people. Throughout the United States individuals involved in many aspects of agriculture are rising to meet current challenges by reshaping the traditional structures of the industry. As these people reach out to neighbors, family, and business partners they form working alliances that help to create personal and collective success.

Such collaboration, and a willingness to “think outside the box,” is creating new opportunity in Veblen, South Dakota. Located in the northeastern part of the state, Veblen has suffered economically in recent years due to the shutdown of a local cheese plant and the closing of the town’s grain elevator.

When approached by two area farmers with a proposal to establish a large dairy in 1997, community members responded. Karen Hornseth, a shareholder in the dairy who has been involved with the project since its onset, says regional residents were hungry enough to take a risk. Seventy-seven shares of \$20,000 each were purchased. The \$1,600,000 helped the group secure additional money and put the business on its feet.

The MCC Dairy’s ten-member board of directors met weekly for more than a year to put the project together. A core executive group of three handled many tasks, and the at-large membership met less frequently. Facility construction did not meet projected deadlines and heifers, pre-purchased for October delivery, had to be shifted between temporary facilities until project completion. But in spite of these challenges the group remains upbeat.

“We believe this dairy will have a significant impact on our community,” says Hornseth. “Already there are new families connected with us who have purchased homes and have children in our schools. The schools alone will receive \$50,000 in taxes annually from this business.

“Jobs are being created, and perhaps even more importantly, the income from subcontracted work may enable families to keep their farm enterprises alive. With the addition of steady work such as trucking, raising heifers, housing dry cows not permitted by law on our dairy premises, and local sale of crops, enough additional income can be provided to make a real difference for people.”

Hornseth’s personal story exemplifies the reasons people are driven to change,

“I grew up on a farm in this area and loved it; I was behind the wheel almost before I could see over it. My husband and I were able to rent my dad’s land a few years ago. We knew we needed a minimum of two thousand acres to make cropping work for us, and if anyone had the dream and the drive to make a go of it, we did.

“But the truth was that we couldn’t make it. Looking back, we probably should have partnered with other families to buy machinery, but it was a

difficult time and it didn’t happen. What all of us in agriculture need to do is figure out how to cooperate, and how to cooperate in time.”

Harold Stanislawski, Livestock Development Specialist with the Minnesota Department of Agriculture, concurs,

“Positive change is going to happen through partnering in a variety of ways — sharing the wealth and sharing the risk. While there is nothing wrong with independence, it’s not much fun when you’re losing your profitability. People can do more than survive, they can thrive. But they have to look to the market for solutions.”

Such solutions can be formal or informal; they can be large or small investments. Some are as simple as neighbor helping neighbor, a practice that’s taken place for as long as people can remember. Brothers Bruce and Russell Nelson and Randy and Greg Green of Ottertail County, Minnesota, have taken cooperation between neighbors a step further.

“We milk 95 head and farm our own land,” explains Russell Nelson. “We don’t have the acreage to keep all the modern equipment we need, so for the last fifteen years or so we’ve shared equipment and labor with Randy and Greg. It trims costs, we get more work done, and we have a bit more time.”

One processor in Ohio has created opportunities for milk producers who want to start from the ground up. Jon Mast, of Masted Farms in Millersburg, Ohio runs a dairy operation on his farm. He owns the facility; Holmes Dairy owns the cows and the stainless steel system.

Darrel Luthens of Hutchinson, Minnesota expanded his dairy operation to include family members,

“We’ve found that working together as a family in a larger dairy is far more efficient, flexible and profitable than sending our sons off to start on their own with thirty to forty cows.”

Larger dairies are creating opportunities for contracted sale of feed and forage. These dairies are often owned by neighbors who work together to add value to their crops through the dairy enterprise. They may also be independent operations that do not raise their own feed. The success of these joint ventures is largely linked to the quality of the written contract; contracts must be fair to both parties and allow for reduced market volatility.

While the primary goal of partnering is usually financial stability, cooperative ventures offer other benefits as well. They can relieve business owners of the need to handle every responsibility alone, and frequently, they facilitate further innovation. Collaborative efforts also create opportunities for individuals to focus their attention on a particular area and to do what they most enjoy. ■

In 1950 there were 3,648,000 dairy farms in the United States, with a total of 22,000,000 milk cows. By 1997 those totals fell to 117,000 dairy farms and 9,309,000 cows.

Between 1978 and 1997 the number of farms with fewer than 30 cows shrank from 65% to 29% of total. The percentage of farms with more than 100 cows rose from 4% to 13%.

Attention to diet has significantly influenced the amount of milk a cow produces in the United States.

The average California cow makes 31% more milk than a Wisconsin cow, primarily because of experimentation with high-quality feed. Arizona ranks highest for pounds of milk produced per cow, with an annual average of 20,976 pounds. California and Washington follow closely with averages over 20,000. Idaho’s average is 19,092; Minnesota’s, 15,798; Wisconsin, 16,957.

World markets play an increasingly significant role in management decisions made by milk producers and processors everywhere. Statistics show why. In 1983, fewer than 500 million pounds of total milk produced in the US was exported; in 1997 that number rose to more than 3,500 million pounds.

Looking to the Future after 27 Years

Employee Profile

"There's a family atmosphere at Davisco and we're working together for the betterment of the group. That's why I've enjoyed working with the Davis company all of these years," says Frank Burg. Burg appreciates the small, friendly gestures and phone calls he's received from Mark, Mitch and Marty Davis, acknowledging work well done. "It makes you want to do the job and gives you a good feeling," says Burg, who emulates this philosophy with a ready smile and a genuine appreciation for those around him.



Frank Burg

As office manager Burg handles all payables for the Le Sueur Cheese Company and oversees the producer payroll. He supervises Sheila Culbert, receptionist and employee payroll clerk, Colleen O'Neill, patron payroll coordinator, and Kim Leonhardt, director of sales.

"I was hired in 1972 and have always been treated as a part of the family. I grew up with the Le Sueur Cheese Company," says Burg. When he started, the cheese plant processed about 700,000 pounds of milk per day. Now, 1.6 million pounds of milk runs through the Le Sueur plant daily and a new plant addition will soon allow block cheese production in addition to barrels.

Burg embraces new technology and works to avoid stagnation — business styles he has learned

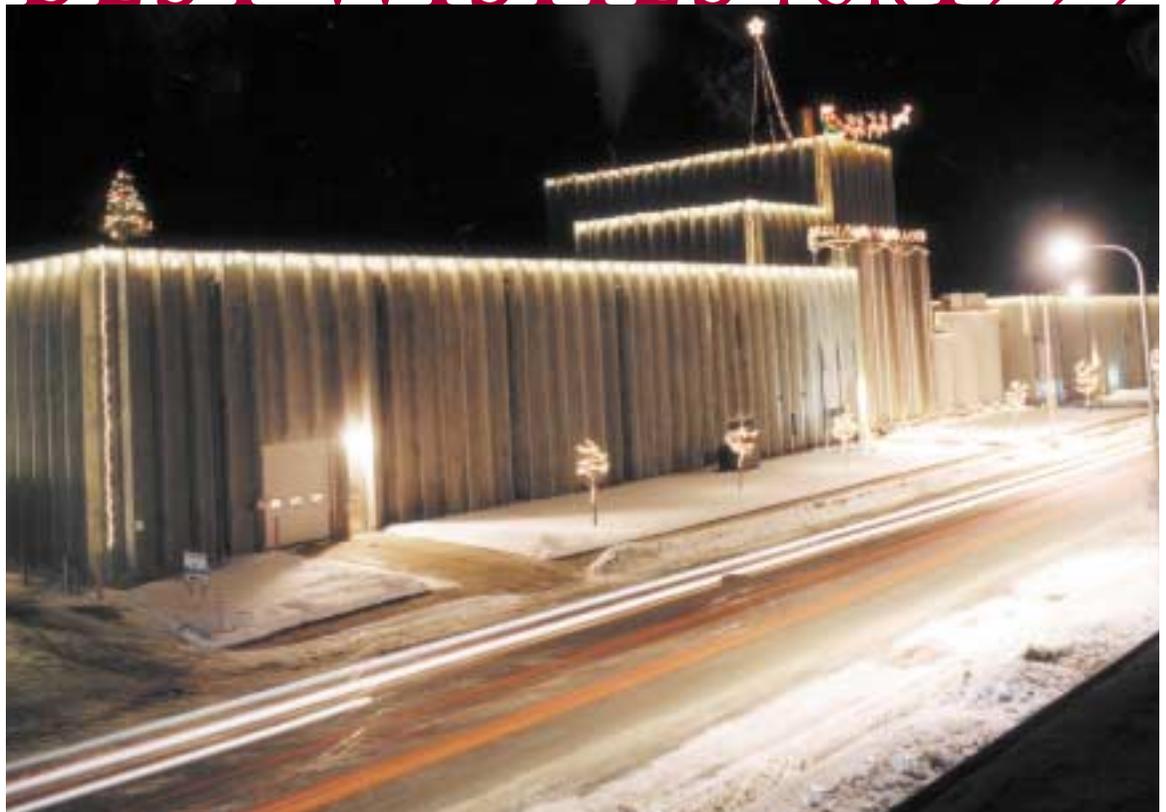
from Davisco's leadership. Changing times in cheese processing, milk acquisition and accounting practices have converged to make his job challenging and rewarding through the years.

Davisco aggressively seeks out new things, Burg explains. "I don't think you ever stagnate at Davisco. It's a fast-paced company," he says. To smooth transitions into using new technology in his job, Burg finds training classes useful. "When I started, everything was written down by hand. Now it's all on computers. I have learned to adjust to new things and grow. Mark has always looked to the future and is a forerunner in using new technology in the food ingredient and cheese sides of the business," he says.

Burg, an avid outdoorsman, met Mark Davis during the formation of baseball teams in Saint Peter, Minnesota, where Burg grew up and now lives. Having just completed commercial college, Burg was seeking an accounting position and Davis needed an accountant. "I interviewed and didn't leave!" says Burg.

Paying producers competitively is key to retaining and adding milk supply, in Burg's opinion. "We've got to have milk and produce a good product to keep costs down and sales up. It's imperative that we fully utilize the milk we're getting to improve products on both the food ingredient side and the cheese side, so we can pay our farmers well." After all, it is Burg's signature that appears on the checks! ■

BEST WISHES FOR 1999



Davisco Foods International, Le Sueur, Minnesota

December, 1998