

Presentation to  
DNR Commissioner Mike Menge  
And the  
Ad Hoc Committee on Alaska's Dairy Industry

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## **Introduction**

Matanuska Maid, the oldest and most successful multi-product dairy products manufacturer in Alaska, celebrates this year, seventy years of continuous operations.

The history of what is now Matanuska Maid can be traced back to the original Matanuska Valley Colonists, who came to Alaska to seek a new life and prosperity farming Alaska's great Matanuska Valley.

Founded in 1936 as an owner cooperative, Matanuska Maid's manufacturing arm was separated from the producer side when the co-op declared bankruptcy in 1983. The company's assets were exchanged for its debt by the State of Alaska in order to collect loans made by the Agriculture Revolving Loan Fund (ARLF) and attempt to keep Alaska's agriculture industry viable.

By 1989, the company had recovered from that bankruptcy and was incorporated as the Creamery Corporation dba Matanuska Maid Dairy. Investments totaling more than \$8 million dollars in physical plant renovations, upgrades, and product innovations have been made. Market share continues to be above 40% against larger competitor brands simply because of consumer loyalty and a commitment to quality.

At the same time Matanuska Maid has purchased all available local milk that meets its quality standards, at premium prices. Matanuska Maid has consistently paid more for local milk than Northern Lights Dairy, by more than \$1.00/cwt. This has provided south central Alaska producers with the second highest pay price for Grade A raw milk in the United States, second only to Hawaii.

During the period of State ownership Matanuska Maid has done its part to stabilize the industry and build a market for producer milk. In order to sustain corporate health and pursue new markets for Alaska brands, significant reinvestment is necessary including new facilities. Either the owner (the State of Alaska) must commit to the needed reinvestment or it must consider a sale or closure of its holdings in order to maximize its investment for the people of Alaska.

## **The Industry**

Developing and maintaining a dairy industry in Alaska requires implementation of steps that will reduce that cost of inputs to reduce the cost of production and reduce the costs of processing and marketing. Such steps will permit dairy products produced in Alaska to compete in the marketplace with dairy products shipped to Alaska from elsewhere.

A critical volume of products must be processed on each production day to amortize the cost of equipment and labor needed to meet economic requirements. Moreover a sufficient volume and diversity of dairy products must be available to consumers to capture and maintain a sustainable market share. Previous studies by the State of Alaska have shown that processing only milk currently produced in Alaska cannot support processing facilities necessary to maintain a viable market share. For this reason Matanuska Maid historically has processed milk it purchases from Outside as well.

Therefore, continuation of Matanuska Maid operations along the lines of the current business plan is a means of maintaining a viable volume of production and a sustainable market share of diversified products as well as providing a stable market for milk producers in Alaska. Although this method of operation has required no funding from the State of Alaska for many years, there is substantial need to improve and modernize the processing facility.

### **The issue of establishing the value for raw milk produced in Alaska**

Mr. Roy Ferguson II, a renowned agricultural consultant hired by the State of Alaska Attorney General's Office and experts from Washington State University, Small Business Development Center retained after Mat Maid filed for bankruptcy protection, were critical of the way producer milk pricing historically has been handled. Ferguson stated in his 1989 report, "the prior consulting report's authors stressed several times that most of the Cooperative's financial problems were directly attributable to unrealistically high prices being paid to local producers for milk."

Following are direct quotes from the WSU nine person consulting team:

"The historical approach to milk pricing taken by Matanuska Maid producers has been to base milk price, regardless of actual costs and market realities on FOB Seattle plus shipping costs, or, on maximization of producer revenue at the expense of Matanuska Maid's economic health."

"Prices paid to producers should be adjusted and modified based upon market conditions and the ability to compete effectively as the creamery is the marketing extension for the producers rather than a buyer of raw milk at producer directed prices." It is unsound and impractical to base the pay price on the Puget Sound Class I price plus the cost of transportation of either bulk or packaged milk from Seattle to Anchorage. That will simply price Matanuska Maid out of the market."

“Non-fluid milk product lines should be expanded to maximize cash flows.”

“The consulting team found no record of any other direct benefit beyond Matanuska Maid being a guaranteed buyer of milk at a producer dictated price.”

For more than twenty-years Matanuska Maid has provided a stable market for local milk production and at a value significantly higher than our competition, second only to Hawaii in price. Just during the period 1997-2005 Matanuska Maid has paid over \$2 million dollars more for local milk than the competitive value. It is estimated that between 1990-2005, this premium could actually total more than \$5 million dollars. We have risked our future by not having the availability of these funds for capital expansion and marketing activity.

### **Sales and Product Diversification**

Dairy and other food and beverage products manufactured by Matanuska Maid have a difficult time competing with products from Outside when Matanuska Maid's cost structure is out of line, its processing equipment is less efficient, outdated, or otherwise limits the ability to produce products that the consumer desires.

Matanuska Maid has diversified its products to include non dairy items including juices, bottled water, and the manufacture of plastic bottles.

Initially, Mat Maid manufactured yellow gallon bottles to satisfy its own needs. Then the company became the plastic container supplier for Delta Junction's Northern Lights Dairy, the only other Alaskan milk bottler in the State. Today, almost 30% of Mat Maid's one gallon bottle capacity is sold to other businesses-for milk, water and other beverages. In 2005, a new production line was added that allows Mat Maid to also produce ½ gallon plastic milk containers.

In 1997 the plastic manufacturing capability was further expanded to include containers for the bottled water industry. In 1998 the company began co-packing bottled water for custom orders.

These various expansions have resulted in a changed product mix. Today bottled milk represents about 70% of Matanuska Maid's total sales while the other dairy foods and beverages represent the balance.

### **Matanuska Maid 2005**

Matanuska Maid's approximately 50 employees work hard every day. In 2005, they processed and packaged over 37,000,000 million pounds of milk, dairy, and juice products; bottled almost 800,000 gallons of water; maintained a 7 day per week quality laboratory; maintain, repair and update complex physical plants in Anchorage and Palmer; maintain a 70 vehicle fleet to transport materials between our two locations and for delivering around 8 million individual units of product to retail and wholesale

establishments; manufactured 4.8 million plastic bottles; made sales calls to a multiple corporate offices spread across the country; produce and merchandise over 100 various sized products in more than 120 locations in “rail belt” Alaska and beyond; invoice and collect \$14-15 million in receivables; made both employee and producer payroll 24 times...on time!

The Corporation had a decline in sales and for first time in eight years, operated at a loss in 2005. The combination of increasing costs and decreased sales resulted in the 2005 loss of \$179,000 on revenues of \$14,600,000.

The major reasons for this:

- Competitive price pressure at the retail marketplace coupled with the overt manner in which retailers noticed WIC participants of program changes, negatively impacted sales.
- Escalating energy, transportation, and packaging material costs.
- Insurance costs: Workman’s Compensation and health care coverage costs are increasing at phenomenal rates.

2006 sales through August are flat as compared to 2005 and net at a loss.

### **Corporate governance under government ownership**

State ownership has been both a blessing and a curse as it pertains to governance. Matanuska Maid being an anomaly has received its share of attention and conflict. From 1984 to 2001 its operations have been the topic of multiple consultant reviews, at least three Legislative Audits, and OMB review, two Ombudsman reports, and in conflicts with Directors of Agriculture, DNR Commissioners and elected politicians. Constant conflict of this nature is counterproductive to leaning out the business for maximum output. This is because it draws attention and concentration away from day-to-day activities.

From 1996-2003 the Corporation experienced its longest sustained period of boardroom continuity, board and management harmony, and a business like relationship with the Director of Agriculture that combined resulted in relative calm. This translated into business growth and profitability.

Ferguson, in his 1989 report, made observations and recommendations concerning the business structure of Matanuska Maid. “Operating management should report to an independent board of directors whose primary function is to establish and monitor both policy guidelines and operating procedures that emphasize the Company’s financial welfare and competitive viability, while maintaining reasonable social and environmental responsibility.”

Further he states, “ The ARLF board’s unavoidably conflicting agenda, in addition to an apparent absence of understanding regarding food processing plant business strategy, prevent it from performing satisfactorily in an oversight capacity.”

Eight years after Ferguson made these comments, a report by the office of Legislative Audit made these comments that confirm his observations: “Since the State has not provided funding for Matanuska Maid in almost a decade, the premium paid to Anchorage farmers has become an “untouchable” subsidy that the dairy must pay from its own earnings. The primary public purpose for Matanuska Maid seems to have implicitly changed from protecting the public treasury (collecting ARLF loans) to protecting producers (preserving raw milk prices).” 1998 Leg. Audit Report pg. 16

“DOAg has thus placed Matanuska Maid management in the unenviable position of serving two conflicting missions. On one hand, management is charged with minimizing costs and perpetuating the existence of a once-bankrupt business which must compete in the private sector. On the other hand, management is directed to maximize its purchases of local milk, which is the highest priced milk available.” Leg. Audit Report pg. 16

In 2004, the conflicting agendas that Ferguson warned of in 1989 were manifested in three attempts by the Board of Agriculture and Conservation (BAC), a successor organization of the ARLF, to force the Corporation to increase the pay price for producer milk by \$2.00 cwt. which the Creamery board rejected as not financially prudent nor sustainable.

Seemingly in disregard of Ferguson’s advice, DNR Commissioner Tom Irwin, prompted by his Director of Agriculture, encouraged less autonomy at the Creamery Corporation board level by suggesting in a memo to the BAC that it “exert itself” into the corporate oversight role. The BAC took that suggestion and ceremoniously voted longstanding volunteers including the Chairman, off the Creamery Board in an attempt to get their way. This “test of wills” is still evident today.

### **Issues that are looming ahead**

The price of local dairy products on the shelf continues to collide with changing consumer trends. Recently, research commissioned by Matanuska Maid revealed that of all the purchase factors of local consumers, there has been a change from a long held sentiment of supporting Alaska brands, to that of preferring the lowest cost in the category. This mirrors the trends that the Lower 48 has been experiencing for years.

Increasing competition from national and multinational retailers whose marketing philosophy may not leave room on the shelf for local products.

Labor shortages that may develop due to the gas pipeline and other construction activity.

Decreasing amounts of local milk as local producers exit the business.

The cost of federal mandates which food handling operations like Matanuska Maid, Northern Lights Dairy, and Windsong Farm, must comply.

## **The future of Matanuska Maid - the future of the industry**

In the symbiotic relationship that is the Alaska dairy industry, Matanuska Maid plays the role of “host”. It is the largest piece of the puzzle supporting both producers and the State’s other milk processors, Northern Lights Dairy and Windsong Farm. The success of the whole is hugely influenced by the health of the “host”.

Following are critical success factors that, if managed and supported with the needed capital will help to insure that we are here for the next seventy years in Alaska.

1. The public and the business community must come forward and express an interest in seeing agriculture flourish and help us establish a “culture” for agricultural activities in Alaska.
2. We must maintain customer loyalty and trust.
  - Almost 1 of every 2 shoppers state they purchase Mat Maid products.
  - Northern Lights Dairy has a similar loyal following in the Interior.
  - Maintain shelf presence in face of increasing competition
3. We have to keep up with changing market conditions.
  - New products and diversification
  - Competitive in the market place
  - New processes for the ever changing desires of consumers
  - New distribution channels both in and outside of the State in order to increase sales
4. The industry needs capital for growth and expansion. Such financing would hasten the construction of a new processing and distribution facility at the outskirts of Anchorage for Matanuska Maid. Northern Lights Dairy also wishes to expand its operation and needs capital for growth. This will better position the Alaska dairy industry for expansion in a burgeoning food and beverage marketplace.
5. Should the competitive price offered by processors for local milk be less than necessary to keep producers in business, subsidy support may be necessary from government sources. It should not be expected from for-profit business entities.
6. Should the State elect to maintain ownership of Matanuska Maid, a governance model that is not in conflict with sound corporate objectives and consistent with business philosophy must be instituted.

The State’s dividend for twenty years of ownership of Matanuska Maid is the economic activity from dairy production and processing that has occurred. As Mark Twain so well stated, “Stay on the right track long enough – and, you’ll eventually get run over.” Just like any business, Matanuska Maid must grow and thrive, or die. Which ‘track’ is better

for Matanuska Maid in the long run? Seek an ongoing State and or federal subsidy that will prop up and support or dairy industry at the producer and processor level for the short term, or private sector ownership and that allows us to aggressively grow markets and sales?

Or, should the State simply walk away from the prospect of dairy agriculture on a commercial scale in Alaska?

After all, even with maintaining ownership in Matanuska Maid all these years, we have fewer producers and less milk production today then at any time in recent history. Maybe its time to recognize our limitations before any more capital is put at risk.