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Statement

of

Patricia D. Stroup

on behalf of

Nestlé USA

and Dreyer's Grand Ice Cream Holdings, Inc.

at the

United States Department of Agriculture Emergency Hearing
on Class I and II Price Formulas in all Federal Milk Marketing Orders
at Pittsburgh, Pennsylvania, commencing on December 11, 2006
Docket No. AO-14-A76, et al.; DA-07-01

My name is Patricia Stroup. I am the Group Manager for Dairy for Nestlé Business Services (NBS) and today I am representing Nestlé USA and Dreyer's Grand Ice Cream. In my role with NBS, I am responsible for milk and dairy ingredients procurement for Dreyer's and Nestlé brands in the United States and Canada. This includes procurement relationships with individual dairy farms, cooperatives and proprietary handlers and manufacturers. Prior to my position with Nestlé, I held positions with Hilmar Cheese Company in Hilmar, California; Maryland and Virginia Milk Producers Cooperative in Reston, Virginia; and Eastern Milk Producers/Milk Marketing, Inc., in Syracuse, New York, and Strongsville, Ohio. I hold an M.B.A. from Purdue University and an undergraduate degree with a cognate in Dairy Science from Virginia Tech. I developed today's testimony in cooperation with Nestlé and Dreyer's staff and present it today with authorization from Nestlé beverage division and Dreyer's Grand Ice Cream executive staff.

Nestlé in the United States includes Nestlé USA, Nestlé Nutrition, Nestlé Purina PetCare Company, Nestlé Waters North America, Dreyer's Grand Ice Cream, Inc and Alcon Laboratories, Inc. and is part of Nestlé S.A., the world's largest food company, in Vevey, Switzerland. Nestlé USA's 15,500 employees operate 20 manufacturing facilities and five distribution centers focused on making branded food and beverages.

Dreyer's Grand Ice Cream Holdings, Inc., and its subsidiaries manufacture and distribute a full spectrum of ice cream and frozen dessert products. The company's premium products are marketed under the Dreyer's brand name throughout the Western states and Texas, and under the Edy's® brand name throughout the remainder of the United States. Internationally, the Dreyer's brand extends to select markets in the Far East and the Edy's brand extends to the Caribbean and South America. Dreyer's has 7,000 employees and operates six manufacturing facilities in Texas, Indiana, Maryland, Utah and California.

I testify today in opposition to the National Milk Producers Federation's proposal to sever the pricing relationship between Class I and II and the manufacturing classes and to increase Class I and II prices. Our opposition is based on two main factors. First, increases in prices of Class I and II dairy products risk losing significant share of the consumer's stomach to non-dairy products. Secondly, from the milk procurement perspective, Nestlé and Dreyer's are not experiencing milk shortages or increased premiums resulting from costs associated with "servicing" our Class I and II markets plants.

It is no secret that, as milk production in the United States continues to climb, the utilization of milk in Class I and II products has been declining and stagnant, respectively. But, what is more distressing is that the consumption of Class I milk, in particular, is not only declining in terms of percent utilization, but also per capita and, most alarming, in terms of absolute pounds of usage. According to population numbers and fluid sales data from USDA, Economic Research Service, from 1990 to 2005, per capita consumption of whole, reduced, lowfat and nonfat milks declined, in total, by 21 percent. More recently, from 2000 to 2005, consumption of those products dropped by an average of 1.8 percent per year. In terms of absolute demand volume, "white" milk volume has decreased by 5.5 percent since 1990 and averaged over a 0.75 percent drop each year since 2000. This means that the industry cannot simply rely on increases in population to stabilize or grow Class I and II markets. It will need to rely on innovative product development, unique marketing and attractive price points.

It is short-sighted to look at milk as an isolated category. While NMPF's analysis looks strictly at the supply side and USDA's elasticities consider only the reactions to price of Class I milk as a whole, mainly "commodity" white milk, Class I milks truly include a wide array of beverages that reach beyond gallon jugs of milk. Flavored milks have potential to lead growth in Class I sales. In the same periods I mentioned for white milk, from 1990 to 2005, per capita consumption of flavored milks increased by 55 percent while total volume increased 83.5 percent. More recently, from 2000 to 2005, per capita consumption has been increasing even faster, averaging over four percent improvement per year. One would like to think that flavored milks have cannibalized the white milk loss so that users are staying within the milk category, but independent and proprietary attitude and usage research commissioned by Nestlé and reported in June 2006 indicates that consumer movement in and out of the flavored milk category does not generally come from white milk, but rather from other beverages. To be truly competitive, as a company and as an industry, we must look at milk's positioning against other beverages and not just other dairy products. We cannot increase prices on milk beverages without losing demand, not just from the category, but from the use of dairy products in general.

Nestlé's Nesquik® Ready to Drink beverages include single-serve, quart and half-gallon offerings in such varieties as chocolate, banana, cookies and milk, strawberry and a host of other flavors. Nestlé's recent attitude and usage study indicates that the main competition for Nesquik® are not dairy-based beverages. The top competition for flavored milks are, in this order, soft drinks, bottled water and refrigerated pre-mixed orange juice. Only after those products did respondents list other milks. In fact, even non-beverages compete with flavored milks. Over half of the respondents indicated that they replaced flavored milks with fruit or vegetable snacks, salty snacks, chocolate candy and snack bars.

One of the principles of price elasticity is that products with few substitutes generally have low price sensitivity. Unfortunately, we have found that flavored milks have many substitutes. Price becomes a major factor for consumers in deciding how to satisfy their snack cravings. One of the critical results of our research indicated that price point affects elasticity of flavored milk more than price gap among flavored milk brands does. This means that consumers are using price as a determinant of whether to purchase a beverage in the category of flavored milks or another beverage more than they are using differences in price to choose among brands within the flavored milk category. In other words, the consumer question is "chocolate milk or soda," not "Nesquik® or store brand milk."

Our elasticity studies, using two years of scanner data ending in 2005, found that flavored milks exhibit above-average price elasticities to price changes compared to other refrigerated items. Results indicate that single-serve flavored milk exhibits a negative 1.35 elasticity and 64-oz. flavored milk exhibits a negative 1.54 elasticity. Coupled with what we know about consumer food and beverage choices, we expect the majority of those lost sales will not go to other dairy products, but to non-dairy beverages and foods.

At Nestlé, where our business is characterized by the phrase "Good Food. Good Life." and three-quarters of all research projects focus on health and wellness, we are particularly concerned about what an increase in milk price will do to the consumption of milk in the school market. This is a venue where we have exciting opportunities to encourage more milk consumption by children, but also face daunting challenges from entrenched competitive beverages. Several studies have shown that children choose milk more often, and consume more of what they do choose, when they are offered new flavors and attractive packaging. The studies show consumption can be increased not only on the school meal line, but also through dairy sales in a la carte and vending.

Flavored milk has been identified by a number of experts as a positive way to encourage more milk consumption. The Dietary Guidelines for Americans, 2005, cite flavored milk favorably as a product whose palatability is increased by modest amounts of added sugars, thereby encouraging people to consume the nine important nutrients found in milk. But, price is a factor in the school market. If students can buy a soda but milk in the adjacent vending machine costs more, the soda has a competitive advantage. If milk sellers hold vending prices down to ensure competitiveness, their vending operation is less likely to be financially attractive and milk vending machines will be placed in fewer schools. Similar considerations apply to a la carte sales. This means that every increase in Class I prices poses risk to emerging sales opportunities like a la carte and vending in schools. Equally troublesome is the fact that, even if placed, less profitable items earn less attractive placement in schools and stores, again limiting consumption. Since these marketing opportunities not only can increase today's consumption, but also help build life-long consumption habits, we should not lightly dismiss this risk.

While I have focused on price increase impacts on milk beverage demand, much the same can also be said of the effect of price increases in the ice cream category. Dreyer's Grand Ice Cream products include brands of frozen dessert products such as Grand, Slow Churned®, Dibs®, Häagen-Dazs®, Nestlé® Drumstick®, Nestlé Crunch®, Nestlé® Butterfinger®, Nestlé® Toll House®, Nestlé® Carnation®, The Skinny Cow® and others.

Dreyer's independently commissioned research on price and demand issues performed and reported in late fall 2005 indicates that increases in premium packaged ice cream prices of eight percent per 56-oz. package across the category result in up to a 9.8 percent decrease in sales volume. According to Dreyer's research, when consumers are not buying ice cream, 75 percent of the time they are spending those potential dairy dollars on non-dairy dessert items like cookies and cake with the remaining 25 percent devoted to snack foods.

In summary, National Milk's assertion in its proposal that "processors of Class I and Class II products are able to pass on increased costs to the market" may be technically correct in that there is not a circularity issue with NASS survey pricing as there is with Class III and IV, but is entirely incorrect in its assumption that there is not an impact on usage and, therefore, cost…measured in cost per unit, cost in the net price impact to dairy farmers and cost in competitiveness of the industry on the store shelf.

Secondly, the petitioner asserts that premiums are increasing as a result of increased costs in servicing the Class I and II markets and that Class I and II milk supplies are at risk because of inadequate regulated pricing. It has not been our experience, at any of the Nestlé divisions or at Dreyer's, that Class I or II milk is in short supply. In fact, in preliminary work on our new Class I and II facility in Anderson, Indiana, we have had discussions with five different milk suppliers interested in servicing that plant. Four of those contacts were unsolicited by us. On the same note, at all of our Dreyer's plants, milk and milk ingredients were all readily available this year and, in net, we are paying the same premiums for those products for 2007 that we did last year. We, in fact, had more proposals from suppliers for the Dreyer's business than we had the volume to accept. The assertion that higher costs of servicing the Class I and II markets are being reflected in higher over-order premiums and/or lack of milk availability has not been our experience nationwide and illustrates to us that no emergency situation exists in that regard.

We urge USDA to consider carefully whether there is actual evidence that Class I and II supplies are at risk. The overriding function of federal milk marketing orders is to balance milk supplies by efficient allocation of supplies within the various utilization categories for milk and other dairy products. The hallmark of program administration should be efficient supply allocation, not aggregate price enhancement or depression.

For these reasons – because a price increase will result in decreased demand and because we are not experiencing milk shortages or increased premiums associated with servicing Class I and II milk - we oppose any increase in the Class I or Class II federal order pricing formulas. Thank you for this opportunity to share Nestlé's and Dreyer's position in this matter.

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