FINANCIAL STATEMENTS

Dairy Management Inc.
Years Ended December 31, 2017 and 2016
With Reports of Independent Auditors

Ernst & Young LLP

Building a better working world

Dairy Management Inc.

Financial Statements

Years Ended December 31, 2017 and 2016

Contents

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Report of Independent Auditors

The Board of Directors
Dairy Management Inc.

We have audited the accompanying financial statements of Dairy Management Inc., which comprise the statements of financial position as of December 31, 2017 and 2016, and the related statements of activities and changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Dairy Management Inc. as of December 31, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our report dated May 2, 2018, on our consideration of Dairy Management Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Dairy Management Inc.'s internal control over financial reporting and compliance.

Ernst + Young LLP

May 2, 2018

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Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance With *Government Auditing Standards*

The Management and the Board of Directors
Dairy Management Inc.

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Dairy Management Inc., which comprise the statements of financial position as of December 31, 2017 and 2016, and the related statements of activities and changes in net assets and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated May 2, 2018.

Internal Control Over Financial Reporting

In planning and performing our audits of the financial statements, we considered Dairy Management Inc.'s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Dairy Management Inc.'s internal control. Accordingly, we do not express an opinion on the effectiveness of Dairy Management Inc.'s internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Dairy Management Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst & Young LLP

May 2, 2018

Dairy Management Inc.

Statements of Financial Position

	December 31 2017	December 31 2016
Assets		
Current assets:		
Cash and cash equivalents	**$ 341,177**	$ 4,555,640
Accounts receivable, net of allowance for doubtful accounts of $25,000 in 2017 and $26,352 in 2016	**967,860**	1,358,429
Amounts due from related parties:		
National Dairy Promotion and Research Board, current portion	**16,214,547**	16,594,851
United Dairy Industry Association	**3,156,572**	1,618,111
GENYOUth Foundation	**66,720**	54,474
Dairy Research Institute	**75,247**	82,500
Notes receivable, current portion	**1,363,997**	1,490,725
Prepaid expenses and other assets	**961,400**	742,877
Total current assets	**23,147,520**	26,497,607
Amount due from National Dairy Promotion and Research Board, less current portion	**–**	7,328,132
Notes receivable, less current portion	**3,750,990**	5,590,220
Fixed assets, net of accumulated depreciation of $2,305,554 in 2017 and $4,094,064 in 2016	**1,056,958**	1,107,619
Total assets	**$ 27,955,468**	$ 40,523,578
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 14,510,937**	$ 10,002,770
Interest payable	**36,323**	73,112
Deferred revenue	**42,165**	169,876
Amounts due to related party:		
U.S. Dairy Export Council	**1,662,347**	1,961,032
Loan payable, current portion	**1,704,996**	8,095,629
Accrued expenses and other liabilities	**6,247,710**	7,416,788
Total current liabilities	**24,204,478**	27,719,207
Loan payable, less current portion	**3,750,990**	12,804,371
Net assets	**–**	–
Total liabilities and net assets	**$ 27,955,468**	$ 40,523,578

See accompanying notes.

Dairy Management Inc.

Statements of Activities and Changes in Net Assets

	Year Ended December 31	
	2017	**2016**
Revenues		
Program	**$ 110,004,531**	$ 102,712,024
Core	**39,451,999**	48,890,938
Contract services	**5,559,562**	6,068,945
Total revenues	**155,016,092**	157,671,907
Expenses		
Programs:		
Domestic marketing	**127,878,595**	118,153,561
Export	**17,095,000**	19,544,629
Contract services	**5,559,562**	6,068,945
Total program expenses	**150,533,157**	143,767,135
General and administrative	**4,138,356**	3,688,436
Additional pension termination contributions and administrative fees	**344,579**	10,216,336
Total expenses	**155,016,092**	157,671,907
Change in net assets	**–**	–
Net assets, beginning of year	**–**	–
Net assets, end of year	**$ –**	$ –

See accompanying notes.

Dairy Management Inc.

Statements of Cash Flows

	Year Ended December 31 2017	2016
Operating activities		
Change in net assets	**$ –**	$ –
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Bad debt provision	**(1,352)**	–
Depreciation	**315,257**	328,638
Changes in assets and liabilities:		
Accounts receivable	**391,921**	(202,676)
Amounts due from related parties	**6,164,982**	(8,487,461)
Prepaid expenses and other assets	**(218,523)**	295,617
Accounts payable	**4,508,167**	(4,376,316)
Interest payable	**(36,789)**	73,112
Deferred revenue	**(127,711)**	43,515
Amounts due to related parties	**(298,685)**	1,961,032
Accrued expenses and other liabilities	**(1,169,078)**	117,588
Net cash provided by (used in) operating activities	**9,528,189**	(10,246,951)
Investing activities		
Notes receivable	**1,965,958**	(7,080,945)
Purchases of fixed assets	**(264,725)**	(37,291)
Cash proceeds from sale of fixed asset	**129**	–
Net cash provided by (used in) investing activities	**1,701,362**	(7,118,236)
Financing activities		
Proceeds from loan	**–**	22,000,000
Loan principal payments	**(15,444,014)**	(1,100,000)
Net cash (used in) provided by financing activities	**(15,444,014)**	20,900,000
Net (decrease) increase in cash and cash equivalents	**(4,214,463)**	3,534,813
Cash and cash equivalents, beginning of year	**4,555,640**	1,020,827
Cash and cash equivalents, end of year	**$ 341,177**	$ 4,555,640

See accompanying notes.

1. Organization

Dairy Management Inc. (DMI) was incorporated on January 1, 1995, as a joint venture between National Dairy Promotion and Research Board (NDB) and United Dairy Industry Association (UDIA). The purpose of DMI is to promote greater coordination, efficiency, and effectiveness and avoid incompatibility and duplication in the marketing programs and projects undertaken by NDB and UDIA. NDB and UDIA jointly plan, develop, and implement their various marketing programs and activities through DMI, subject to the oversight guidelines of the Agricultural Marketing Service of United States Department of Agriculture (USDA). The collective programs and activities are called the Unified Marketing Plan (UMP).

2. Summary of Significant Accounting Principles

Basis of Presentation

The financial statements are prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles. These principles require management to make estimates and judgments that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses in the reporting period. Actual results could differ from those estimates.

Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, amounts due from/to related parties, prepaid expenses and other assets, accounts payable, interest payable, deferred revenue, and accrued expenses and other liabilities are reasonable estimates of fair value due to the short-term nature of these financial instruments. In addition, the carrying values of the notes receivable and the bank loan payable approximate fair value.

DMI has cash balances at a financial institution that exceed federal depository insurance limits. Pursuant to guidelines published by USDA's Agricultural Marketing Service, DMI's cash balances are reviewed daily by the financial institution in which the balances are held and are fully collateralized by U.S. Treasury securities.

2. Summary of Significant Accounting Principles (continued)

Accounts Receivable

Accounts receivable, which consist of amounts due from UDIA state and regional members for expenses incurred in connection with qualified program activities and from entities to which DMI provides management services, totaled $967,860 and $1,358,429 as of December 31, 2017 and 2016, respectively.

Notes Receivable

Notes receivable are stated at their unpaid principal balances. Management considers a loan impaired when based on current information (such as payment history, value of collateral, and assessment of the borrower's creditworthiness), it is probable that the principal and interest payments will not be collected according to the loan agreement.

Fixed Assets

Fixed assets consist of computer equipment, software, furniture, equipment, and leasehold improvements and are recorded at historical cost. Depreciation and amortization are provided in amounts sufficient to charge the cost of the depreciable assets to operations over the assets' estimated service lives of 3 to 15 years using the straight-line method.

Revenue Recognition

Program and core revenues are recognized as DMI is reimbursed on a cost basis for expenses incurred in connection with its programs and services. Contract services revenue and the corresponding expense are recognized when the accounting and management services are provided under various contracts.

Income Taxes

DMI has received a determination letter from the Internal Revenue Service indicating that it is exempt from federal and state income taxes on related income under Section 501(c)(6) of the Internal Revenue Code. However, DMI is subject to taxes on unrelated business income. DMI had no unrelated business income for 2017 or 2016.

3. Related-Party Transactions

DMI is funded by NDB and UDIA on a cost reimbursement basis. Core costs, which include staff salaries and benefits, travel, Board of Directors' expenses, and office operating expenses, are primarily funded by NDB, with UDIA funding one-half of the Office of CEO and Board of Directors costs. Marketing program costs, which include expenses associated with developing, implementing, and evaluating the marketing programs, are funded by NDB and UDIA based on the annual UMP budget.

NDB has funded DMI program and core costs as follows:

	2017	2016
Program costs	**$ 76,868,916**	$ 69,138,196
Core costs	**38,003,214**	47,440,117
	$ 114,872,130	$ 116,578,313

UDIA has funded DMI program and core costs as follows:

	2017	2016
Program costs	**$ 33,135,615**	$ 33,573,828
Core costs	**1,448,785**	1,450,821
	$ 34,584,400	$ 35,024,649

At December 31, 2017 and 2016, amounts due from NDB were $16,214,547 and $23,922,983, respectively, and amounts due from UDIA were $3,156,572 and $1,618,111, respectively.

Dairy Research Institute (DRI) was incorporated in 2010 for dairy scientific research and sustainability advancement purposes and operates under the oversight and control of DMI. For 2017 and 2016, DMI provided funding of $115,000 and $130,000, respectively, to DRI for program and operational expenses.

3. Related-Party Transactions (continued)

The U.S. Dairy Export Council (USDEC) was incorporated in 1996 to improve the marketing conditions for the U.S. dairy industry with respect to the export of U.S. dairy products by promoting their acceptability, consumption, and purchase in international markets. DMI is the primary source of USDEC's funding. For 2017 and 2016, DMI provided funding of $17,095,000 and $19,544,629, respectively, to USDEC, of which $8,136,378 and $8,654,601, respectively, was for marketing programs; $8,958,622 and $8,434,204, respectively, was for USDEC core costs; and $0 and $2,455,824, respectively, was for the additional pension contribution expense.

Youth Improved, Inc. was incorporated on May 8, 2009 and obtained a certificate of registration on January 24, 2001 to operate under the trade name GENYOUth Foundation (GENYOUth). GENYOUth was formed for the purpose of encouraging, monitoring, and assisting organizations in implementing youth-oriented health programs in schools and promoting healthy diet and exercise programs. DMI is the primary source of GENYOUth's unrestricted contributions which are used to fund its operating costs. For 2017 and 2016, DMI provided cash and in-kind contributions of $2,632,298 and $2,759,307, respectively, to GENYOUth in support of program implementation and operational expenses.

4. Transactions with Other Industry Organizations

DMI provides various marketing, financial, computer, and administrative support services at cost under contract to National Milk Producers Federation (NMPF), Dairy MAX, Western Dairy Association (WDA), California Dairy Research Foundation (CDRF), New England Dairy and Promotion Board (NEDPB), New England Dairy Food Council (NEDFC), Global Dairy Platform Inc. (GDP), and Newtrient L.L.C.

4. Transactions with Other Industry Organizations (continued)

The amounts charged by DMI for such services were as follows:

	2017	2016
Organization		
Dairy MAX	**$ 3,123,761**	$ 3,750,397
Newtrient L.L.C.	**1,444,752**	1,092,472
GDP	**717,089**	802,211
NMPF	**135,696**	289,365
WDA	**82,236**	80,000
NEDPB and NEDFC	**51,396**	50,000
CDRF	**4,632**	4,500
Total contract services	**$ 5,559,562**	$ 6,068,945

DMI obtains economic research, communications support, and environmental sustainability services from NMPF under annual contracts. Amounts paid by DMI to NMPF were $1,598,157 and $1,504,041 for 2017 and 2016, respectively.

5. Fixed Assets

Property and equipment at December 31 consisted of the following:

	2017	2016
Computer equipment and software	**$ 1,210,849**	$ 2,160,044
Furniture, equipment, and leasehold improvements	**2,151,663**	3,041,639
	3,362,512	5,201,683
Accumulated depreciation	**(2,305,554)**	(4,094,064)
	$ 1,056,958	$ 1,107,619

6. Employee Retirement Plans

UDIA sponsored a defined benefit multiemployer plan (the Plan) until May 31, 2016 (termination date), in which participating employers were members of UDIA and/or shared a common goal and mission of managing the production and consumption of milk and milk-related products in the United States and globally.

While the Plan was in existence, each employer's board of directors appointed the Plan's trustees, who were selected from the 12 employers that participated in the Plan. In response to the increasing cost and the higher level of employer contributions required to maintain the Plan, UDIA's pension trustees approved a resolution on December 18, 2015, as did the UDIA and DMI boards of directors in February 2016, to cease the accrual of benefits in the Plan for all participants effective March 31, 2016, and to terminate the Plan effective May 31, 2016. A favorable determination letter for the Plan's termination was received from the Internal Revenue Service, dated August 8, 2016. Subsequent to the decision to terminate the Plan, the Plan's assets were liquidated in December 2016.

Until termination of the Plan, assets contributed by one participating employer could be used to provide benefits to employees of other participating employers, since assets contributed by an employer were not segregated in a separate account or restricted to provide benefits only to employees of that employer. Participating employers made their contribution directly to the Plan. By law, those funds may only be used to pay plan benefits and other obligations of the Plan. Each participating employer was jointly and severally liable for the Plan's obligations, which were not recorded on any of the participating employers' individual financial statements.

During December 2016, the Plan made payouts totaling $70.7 million, of which $41.7 million was paid to participants who elected a lump-sum option, $28.9 million was transferred to Massachusetts Mutual Life Insurance Company in order to fund annuity payments for those plan participants who elected to have annuity payments, and $0.1 million was paid in monthly annuities.

The market value of the Plan's assets and employer contributions totaled $49.8 million, resulting in a deficiency in plan assets upon termination of $21.2 million. Each participating employer's contribution into the Plan to fund its share of the $21.2 million deficiency in plan assets, which was determined based on an analysis prepared by an external actuarial consulting firm, was recorded as an operating expense in 2016 by the participating employers.

6. Employee Retirement Plans (continued)

In 2016, DMI's additional contribution into the Plan to fund its share of the deficiency in plan assets was $9,913,800, excluding administrative costs of $302,536. The additional contribution was funded from the proceeds of a five-year loan that DMI obtained from CoBank on behalf of DMI and certain participating employers. The CoBank loan of $22.0 million was obtained on October 18, 2016, has a 3.93% annual interest rate, and has a maturity date of September 20, 2021. DMI expensed its normal contributions to the Plan totaling $796,998 during 2016. During 2017, DMI recognized an additional $344,579 in net costs associated with the termination of the Plan resulting from administrative fees and incremental costs incurred to final settle pension obligations.

The original loan amount of $22.0 million was based on a preliminary estimate of the pension liability from the external actuarial consulting firm. After the pension liability allocated to each employer was finalized in February 2017, DMI was able to repay $4,434,755 of the loan to CoBank on April 11, 2017. On October 10, 2017, DMI was able to repay $8,202,009 of the loan to CoBank to satisfy the portion of the debt attributable to DMI's pension obligation. The loan balance was $5,455,986 and $20,900,000 at December 31, 2017 and 2016, respectively.

The following is a schedule of future expected loan principal payments under the CoBank note as of December 31, 2017:

2018	$ 1,704,996
2019	1,363,997
2020	1,363,997
2021	1,022,996
	$ 5,455,986

DMI entered into separate loan agreements with a number of these participating employers under the same terms as its loan with CoBank. The notes receivable balance related to the loan agreements totaled $5,114,987 and $7,080,945 at December 31, 2017 and 2016, respectively.

6. Employee Retirement Plans (continued)

Effective April 1, 2016, employees who participated in the Plan were transferred to an existing UDIA-sponsored defined contribution plan, which already covers all eligible DMI employees and employees of other UDIA members and industry organizations sponsored by UDIA, who had been hired on or after January 1, 2009. Under the terms of the defined contribution plan, DMI contributes an amount equal to its employees' contributions, up to a maximum of 3% of eligible compensation for all employees. DMI also contributes an additional 7% of eligible compensation, representing an unmatched contribution. DMI's contributions to the savings plan were $2,046,358 and $1,646,400 for 2017 and 2016, respectively.

Effective January 1, 2009, DMI revised the retirement benefits offered under its existing supplemental executive retirement plan (SERP) to a select group of employees. The SERP is intended to be an unfunded plan. At December 31, 2016, DMI recorded a plan liability of $1,824,339 as estimated by an actuarial firm. Coinciding with the termination of the Plan, the SERP obligation was satisfied by DMI with a payout of all benefits due to participants in February 2017.

7. Office Leases

DMI leases its offices in Rosemont, Illinois, under the terms of a noncancelable lease agreement that requires DMI to make minimum lease payments plus pay a pro rata share of certain operating costs. Rent expense under operating leases aggregated $1,583,207 and $1,726,245 for 2017 and 2016, respectively.

The following is a schedule of future minimum lease payments under the Rosemont office lease as of December 31, 2017:

2018	$ 1,052,446
2019	1,081,749
2020	1,111,052
2021	1,140,355
2022	1,169,658
2023 and thereafter	3,684,793
	$ 9,240,053

7. Office Leases (continued)

DMI subleased its entire office space in Arlington, Virginia, to USDEC, NMPF, and an unrelated party under operating lease agreements until June 1, 2016, at which point it canceled these agreements. Rent expense under the previous agreement was a total of $436,927 in 2016, with USDEC and NMPF each reimbursing DMI $199,457 and $191,635, respectively, and the unrelated party reimbursing DMI $45,835.

8. Line of Credit

DMI had an agreement for a $10 million revolving bank line of credit, which expired on June 30, 2017 and was not renewed. Borrowings made, if any, under the line of credit accrued interest, payable monthly, at the equivalent prevailing prime interest rate and were guaranteed by NDB. No amounts were borrowed from the bank line of credit in 2017 or 2016.

9. Subsequent Events

DMI evaluated events occurring between January 1, 2018 and May 2, 2018, which is the date the accompanying financial statements were available to be issued. No events subsequent to December 31, 2017 have been identified that require recognition or disclosure in the financial statements.

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