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Operator: This is Conference # DeanFoodsMP3.

Alexia Howard: OK. Good afternoon, everybody. My name is Alexia Howard and I cover the U.S. package food group here for Bernstein and it's my very great pleasure to welcome Gregg Tanner, the CEO of the Dean Foods Company to the podium here and then we're going to follow up with the Fireside chat.

Now, Gregg has been CEO of the company since the fall of 2012 and with the company since 2007. Prior to that, he was the SVP of global operations at the Hershey Company and before that the SVP of the retail supply chain at ConAgra Foods. We also have Chris Bellairs, the chief financial officer of Dean Foods, who joined the company in 2008 and became CFO in early 2013. And before joining Dean Foods, Chris held financial positions at both PepsiCo and P&G.

Now, Dean Foods has recovered from the challenges of high milk prices a couple of years ago and with some very strong profit performance in recent quarters driven by cost-cutting and the launch of a national milk brand, DairyPure. Although investors worry somewhat about the implications of Walmart building a plant in Indiana, the company is picking up new contract to offset that volume loss and the fluid milk category volumes dynamic – volume dynamics seem to be improving.

So, here to tell us a little bit more about the outlook for the company before we go into the Q&A, I'll now hand it over to Gregg. Thank you.

Gregg Tanner: Great. Thank you, Alexia, and thank you for the invite. What we thought we do is just walk you through a brief overview for some of those who may not be familiar with Dean Foods and kind of give you an idea of who we are. We are the largest U.S. dairy processor and not by a little bit. We have about a 36-share of the U.S. market and we have a relatively broad portfolio of dairy products. So, you can see from the chart – maybe you can see the chart from where you're at – but it's about 70 – 71 percent fluid dairy products and you will notice that about 32 percent of that is in private label, about 25 percent is in branded white milk, and about 7 percent was in where our TruMoo brand or our flavored milk brand.

Other than that, we also are in the ice cream category. We have about a 12 percent share of the ice cream category or 12 percent of our volume is ice cream. We have about 7 percent in creams and creamers and then we also have cultured products, so cottage cheese, sour cream and another cultured products. And then we also do teas, water, juices, that type of stuff. So, it's a fairly diverse portfolio, at least within the dairy universe. We also have the largest DSD refrigerated distribution system out there. So, the majority of our products today go DSD or Direct Store Delivery to the groceries.

And we also – if you look across that map on the bottom, there are – not all of them are up there, but we have about 52 regional brands and those 52 regional brands are basically a rollup of the number of regional brands that we bought over the last 15 to 20 years and are bringing all those together to form Dean Foods. We also have our two national brands, like you mentioned, DairyPure and TruMoo. Those are our two national brands, both of them performed extremely well in the marketplace and we're very pleased with their performance.

And outside of that, we're about 2.5 billion gallons of milk. We handle about 2.5 billion gallons of milk, about 1.7 billion (cap), and about 17,000 employees scattered across the U.S. So, that's a real brief overview of Dean and what makes us up. So, with that, I will turn it over to you.

Alexia Howard: Sounds great. OK. So, we got some questions here that we can kick off with. Also, if you have questions that you'd want to write down in the cards, feel free to do so. We will vacuum them up and bring them up here in a little bit.

So, in terms of the volume outlook, there's a lot of different angles on this. What will you say with regard to the industry volumes in the fluid milk category at the moment? What are the key drivers here? Are things getting a little bit better now, the pricing is more modest on the volume side? And if not, what are some of the headwinds?

Gregg Tanner: Sure. I think what we're seeing over the last three quarters is that the categories actually has gotten considerably better. I think most people would be aware that the fluid milk consumption per capita has been declining for a number of years. The misconception of that is that volume has been declining. Population growth basically offset the consumption drop up until about 2007- 2008 to the recession here and then we started seeing the volume start to decline.

It hit its peak in about 2014 when we had extremely high milk prices and we saw a decline during that period of about 3 to 3.5 percent in the category. In the third quarter, we were down to single digits or about 1 percent. And through the first quarter of this year, it was down 0.6. But at the same time, you have to take into account leap year and all the things that go with that. So, it's – but it's as healthy a category today as what I've seen in the time that I've been at Dean.

Really the – I think there's a number of contributing factors. One is the lower milk prices has obviously helped that. And the other two major drivers behind that were birth rates – so birth rates dropped. We have seen that. It is starting to turn. Birth rates are now picking back up and multi-children families are starting back up. And the cereal consumption – and so, cereal consumption drops obviously milk consumption drops with that. And we've actually seen the major cereal (guys) start to see better volumes as well. We get some benefit from that as well. So, those have been the two major trends.

And then you obviously have the alternative beverages along with, you know – so whether it's almond milk or soy milk or cashew milk or whatever the latest nut milk is. And those have had some impact but, you know, a lot of times I think those get played out in a way that it says it is significant. It is about 5 percent. Alternative beverages would translate to about 5 percent of the total category.

And organic on the other hand is about 5 percent as well. So, those are the other two what I would call credible trends that were emerging over the last few years. Organic currently is about flat. So, the growth on organic has come down some. And then I – on the alternative beverages, you've seen soy dropped fairly dramatically. Almond milk is still growing, but it is more in the low to mid single digits. And you're seeing cashew now become the latest craze.

Alexia Howard: OK. So, if we look at more of the most recent news today, you talked about the DairyPure national brand earlier. That was launched in, I think, around about May of last year and has obviously done very well over the past year. But in the recent (days), it starts to look at that the promotional activity is pulling back a little bit. I'm not – might be weighing on the sales growth of the branded milk and measure channels. How do you see the development of the overall DairyPure brand from here?

Gregg Tanner: Oh, I'm extremely pleased with DairyPure on multiple fronts, but I think it starts with – I think DairyPure has provided us the opportunity to really start to drive the brand premium. We know that our message is getting across. Our brand awareness continues to go up. Our ACV continues to go up. Our velocity per point-of-sale continues to go up.

So, we feel like the message is getting out there. The consumers appreciate the five-point purity promise. So, they really seem to resonate with at least two of the five points and that is, one, being that there is no artificial growth hormones and there is no antibiotics. And it used to be the consumers, I think, believe that to do that they had to drink organic and finding out that they don't have to drink organic to get growth hormone free and antibiotic free. So that's – that's helped us.

What it's really provided us from a P&L perspective is it has put us in a position where we've been able to up our premium to private label. So, under our regional brand scenario, we had about a 20 percent premium to private label. We have seen that grow over the last year to about 27 percent. And we think there is still room for that to expand.

Alexia Howard: So, the biggest question I'm getting from investors at the moment is this question of Walmart and the (backcourt) integration question and I'm sure you're getting that all the time as well. The big concern is that Walmart may announce further plans to build new production plants around the countries – the country now that they've announced this one plant that's opening up in Indiana in the middle of next year. On the last earnings call, you mentioned that if this were to happen, it wouldn't impact your financial results, although it probably would have an impact on your employee numbers and base.

Can you just elaborate a little bit further on that? How much of the hit is it likely to be to your volume that one plant next summer? Why do you think Walmart is doing this? When better on the and how much of a hated it likely to be teal volume 1 plot next summer. I want anything lots doing this when might they make a decision on whether or not to go bigger and why wouldn't they buy up existing plants or buy even buy you guys out while they've putting new greenfield sites down in the ground?

Gregg Tanner: Well, I wish I could answer those questions. That's …

Alexia Howard: Sure. Do your best.

Gregg Tanner: Yes. It is – you know, I think from our perspective I would look at it and say that the reason that we say that there is going to be minimal to no impact to our – to our financials, the Walmart private label is basically a breakeven business. It helped cover overhead, but outside of that, there really was no margin that we were getting from that business. And so, from a financial perspective, we don't expect this plant to have material impact to our financials, assuming that we can take the overhead costs out and we are very confident in our ability to do that.

The question may be, so why are we confident that we can do that? Well, we have done it multiple times over the last few years. There was an RFP that we did was Walmart back in 2013, the end of 2012 or early 2013, and they took 180 million gallons away from us at that point in time. In that process, we had about two months notice and we executed against that to minimize the impact. And I think we've seen our or P&L actually get stronger through that period of time. So, I'm confident that we can – you know, we can get through that part of it.

The harder part is just the impact that it has to our employees. You know, they're talking about adding 200 people to their facility in Northern Indiana. That means we're going to take 200 people or more out of our system to be able to do that. So, there are 200 plus families who will be impacted by that occurring and that's never easy as a CEO to walk up and tell families that we're going to take away their employments. So, that's been the hard part.

As far as what they're thinking, you know, we have hypothesized over and over again about what we believe why they are doing this and it is really difficult from a financial perspective to understand that we have not been able to come up with any hypothesis that says, "Well, this is why they're doing that financially and it makes financial sense on a number of fronts."

One is they have provided public information as to how they're gonna staff that facility, and through that process, we can translate that into what their cost will be from a conversion or a manufacturing perspective. Our belief is that we are a low cost producer in the dairy industry. We don't think they're going to be able – and at those staffing levels, we know that they're not going to be able to be the cost that we had from a manufacturing perspective.

From a distribution perspective, we were going to their stores through four or five different facilities that we're much closer to those stores that where their Fort Wayne, Indiana facility is going to be. So, we got – we got to believe that they're gonna to see some kind of distribution penalty to get back to the same number of stores. They're talking about a 250-mile radius around that facility.

So, when you take the two major cost markets and you don't see where the advantage comes from, if you look at it from a milk procurement perspective – milk procurement is basically determined by the U.S. government. So, the U.S. government sets milk pricing and where they – where they would get benefit would be is if they can convince the cooperatives to somehow give them milk at a lower premium than what we would pay for. The downside to that is on almost all raw materials including milk we buy 20 times more than they do. So, I'm not sure where the scale comes in that's going to allow them to improve their pricing.

So, we're struggling a bit. I'll turn it over to our CFO and see if he can come up with a hypothesis that makes sense, but I can tell you from my chair, we have struggled to do that. So, Chris, you want to …

Chris Bellairs: No. We've all (knew the little) numbers kind of the same way Gregg described and it's not obvious to us what that (payback) proposition looks like. I'm sure it got great (math for it), but let me spend less time on that. That really isn't as relevant to us as how we respond to what they're doing.

Alexia Howard: And from the conversations with them, do you have any view as to when they might make a decision or a known decision to go bigger on that in the future?

Chris Bellairs: No. They really haven't said.

Alexia Howard: OK.

Chris Bellairs: At least they haven't told us. I think there's – you know, we have to assume in our contingency planning as if they will – they will go further. So, you know, we obviously have internal workings going on, coming up with contingency plans that, you know, how we would address that if and when. And you know, I think we'll deal with that when that time comes, but I – what they have told us is this is – this is the only one, but I think if it is effective and it works for them they may go further.

Greg Tanner: We think those contingency plans are important because it will probably some amount of extended learning curve for them to figure out how to run a milk plant. So, if they want to get a good read on, number one, before going to 2, 3, 4 and x that may not happen in short order.

Alexia Howard: Sure.

Gregg Tanner: And the nice part about that from our perspective is we are in a position where we've, you know – we've got 12 months notice. So, 12 months is a long time with their business.

Alexia Howard: And can I sneak in that final question about why on Earth wouldn't they buy up existing plants or even a company rather than putting a new …

Gregg Tanner: You know, I wish I could answer that as well. I really don't know. I mean they're going to spend $165 million to $180 million to build this facility. I assume – and you would assume that they believe that there is a technology advantage to new versus existing. But we haven't seen a lot of technology advances that would change the cost dynamic within manufacturing, so unless it's more driven by the state incentives that the state of Indiana may be providing that.

Alexia Howard: Moving on to more positive news. The – on the 40 million gallon contract that stars I think this month, is that mostly branded or private label milk and how does the margin on that new business compared to the margins or the average, I guess …

(Multiple Speakers)

Gregg Tanner: Yes. It is private label, but it does provide us the opportunity to put our brands in those – in those stores. So, that's incremental to the 40 million and we believe it provides us a great opportunity for some margin enhancement. As far as what the margins are on that private-label business, it's definitely in line. We've said we're going to continue to reduce our cost and drive productivity in our private-label business at margins that are acceptable us. And it definitely is in line with the margin of expectations that we've identified and we believe it's going to be a really good business for us.

Chris Bellair: You've certainly seen a shift on our strategic focus toward brands. That shouldn't be read as we're walking away from private labor business. In instances like this where we can land a substantial new chunk of business 40 million gallons at what we would define as acceptable margins for that kind of business that does remain a priority for us.

Alexia Howard: Moving into the competitive dynamics in the milk category. Are there any smaller players or how would they behave in these days? I think at times they've been irrational. At times, they've been more rational. How were they shaking out …

Gregg Tanner: You know, it seems to be that everybody is acting very rational right now. I think 2014 was a bit of an awakening for many. Just when we $24 a hundredweight milk, and I think that still relatively emblazed in many people's minds. So, I think there – everybody seems to be reacting and acting very, very appropriate right now.

Alexia Howard: Then one very specific (one) in the competition, Coca-Cola's Fairlife, it's somewhat different product in a different subcategory and a different price point, but it does seem to have had some success in that area. What do you make of that and how do you respond to that?

Gregg Tanner: Well, you know, it's a form of flattery when the largest beverage company in the world decides they wanted to get in to the dairy category. So, I get pretty excited about Coke bringing news to the dairy category. So, I think it's great. I think it's good for the category. I think it's good for the consumer that, you know, anytime you bring in new news to a category that's had little to no news for a long time, I think, that's a real positive.

I think they have – you know, they've re-energized in many cases the milk industry and the dairy industry. So, I'm very excited about Coke coming in with Fairlife. And you know, they're coming out with a very premium product. So, it does help us and kind of provides an umbrella that gives us some margin capabilities that may be beyond what we could have gotten before. So, I'm very pleased with it. And the nice part about it is if and when we decide to do that we have the capability to do something very similar.

Alexia Howard: A couple of additional questions from the audience here. Do you think the gap between branded and private label milk has widened too much and is that one reason why Walmart might have decided to pursue it (backward) integration strategy?

Gregg Tanner: No. I don't think that would have played into those strategies because the price that they get is always at the private label price point. So, I don't think it would change their pricing and I – you know, they have the ability today to drive that pricing within their private label. So, I don't think that was what's driving it. I don't believe that the branded to private label gap has widened too much, especially when you look at the higher umbrella of that. So, if you look at the top of the pyramid today, you've got Fairlife just below that. You have organic, and then you have branded and then you have private label.

So, like I said earlier, you know, DairyPure has allowed us to expand to expand our margins from the regional brands of about 20 percent premium to private label to about 27 percent. Our belief is that there are still some room without starting to impact volume or share significantly in pushing that onto to a 30-type margin.

Chris Bellairs: Within large-format grocery, our brand-private-label mix is probably 15-85 – 15 percent branded, 85 percent private label. Maybe in some accounts, it's even as high as 20 percent branded. Walmart is down in the high single digits. So, Walmart's focus hasn't really – in the dairy space hasn't been branded anywhere. Their focus has been on their private label business. So, I'm with Gregg. I don't think that our pricing dynamics there would drive around their decision to build a plant.

Alexia Howard: Just another few follow ups to the comments that we've had already on the volume side before we get in to the cost cutting or the margin side of things. Could one of the motivations from Walmart get them in be that it allowed – it allowed them to make more money on the yogurt and other dairy based products that grow faster with that?

Gregg Tanner: Well, I guess if they decided to start doing that it could help them. But right now, they've said this is only going to be a (jogging) facility. So, it's only going to be gallons and half gallons of white and flavored milk. So, unless they put the capability in to start doing yogurt and other things, I mean they may use it as a learning curve to try to – to try to get into some of the other categories. I think that would be a fairly big stretch though.

Alexia Howard: And then another real quick followup. Does your private-label milk have antibiotics or growth hormones and does any milk across the industry still have those problems?

Gregg Tanner: I'll answer the second one first. Yes, there's still quite a milk out there with RBST or growth hormones in it and there are products out there – the way we operate, we go back to the farms we signed after they've been from the farm that they commit to not using any type of growth hormones. So, outside of ours, I can't guarantee anybody else.

As far as the private label that we produce for our customers, it would not have growth hormones nor would it be or would be antibody free. But again, most people when they walk into a grocery store, they don't know who made that private-label. So, there's no guarantee that it would be …

(Multiple Speakers)

Alexia Howard: So, it's hard to label basically?

Gregg Tanner: Yes.

Alexia Howard: Can we discuss the barriers to other players going antibiotic and hormone free?

Gregg Tanner: You know, it's minimal from a barrier perspective other than they've got to convince the cooperatives and they have to convince the local producers to do that. And many producers will see a reduction in their throughput when they get away from hormones. So, what RBST does, it allows the cow to produce more milk, somewhere in the 15 percent range. And so, a farmer has to commit to the fact that he is going to – he is going to produce less and assume that he is going to get more money for his milk. And depending on where that milk is going, because it most of their milk is going to cheese, they don't – they don't worry about whether it is hormone free or not.

Chris Bellairs: And then once the farmer makes that change, the processor – in this case, you have to be able to communicate it to consumers or extract any value, you can put it on the label but trying to teach people that at the shelf is hard, which is the beauty of our DairyPure initiative. We can now communicate RBST free, hormone free and antibiotic free through national advertising. We can advertise it scale and the regional players in industry will have an extremely hard time communicating that same message or (later) even try in an efficient way.

Gregg Tanner: Yes. One of the benefits that we've seen that we have in the national brand, obviously, is being able to advertise and speak to the consumer on a national front. And what we've seen is that we can do that – we can talk to the consumer twice as much for the same price nationally we could regionally.

Alexia Howard: One last question on volumes and it's actually related to the cereal category. You made the comment that the cereal category does seem to be pulling itself around after several years of decline. Do you believe that that's a secular improvement now rather than just a temporary one or was it really just the efforts of activist investors pushing the cereal economy to pull out all the stops?

Gregg Tanner: Yes. I really can't tell, you know, when you talk to Ken at the General Mills and some of the other folks. You know, they've committed publicly as well as privately that they're going to do absolutely everything they can to continue to focus on the cereal category. I think they've also listened to the consumer and you see a lot of the new products that are coming out with a much more consumer relevant than some of the sugar-laden stuff they had before.

So, I think they've made some nice changes that have allowed them to grow and I think you'll see that continued, whether or not they'll get back to growth rates. That we'll have to wait and see because I think the dynamic has really changed in the family environment, you know. Very few people sit down in the morning, have breakfast as a family or sit down at a table and eat. It seems to be the growing trend is grab a bar on the way out the door, stop by somewhere and grab something on the way to work from. So, you see a lot of the dynamics secular wise that have changed that would change that. But I also see people in our office who now bring a box of cereal in and they'll do it in the office.

Alexia Howard: So, let's move on to the margin side. How was the – you've been – you've been pursuing the cost-cutting program really since it began back in 2008 or so. What was the low hanging fruit in terms of the cost opportunities to begin with and how has that evolved over time? Are you in, you know, more innings that you're in with that opportunity and can you keep the dollar savings at this so there are $80 million to $100 million a year?

Gregg Tanner: Yes. So, if I go back to 2008, it was really when we had decided instead of operating, you know, these 52 regional brands all independently to start to bring those together and take advantage of that opportunity that we had to get the synergies out of the system and we really started with procurement.

So back in 2008, we started centralizing certain parts of the procurement organization. We started bringing in a lot of the stuff that was being bought independently out in the field and we got the synergies out of procurement early on and as we started the process. We kind of moved from there into operations. And the real low hanging fruit there was how do you take this network and consolidate this network in a way that optimizes it.

And we had a number of facilities. An example would be in Dallas. We had two facilities within 7 miles of each other. It didn't make sense to have two facilities within 7 miles. You would stop by the local convenience store. You would see two of our trucks from two different dairies setting at the same stop, dropping off milk. It's like this. This is crazy. This ought to be on one truck and ought to be consolidated from a manufacturing perspective. So, that was really where a lot of that came from over. And over a three- to five-year period we've probably shut down 25 facilities.

And as we – as we started getting towards – and I say towards the end of that, so we're probably in the middle innings to, you know, we're about ready for the seventh-inning stretch from an operations perspective. There are still opportunities there because as we continue to get more efficient and effective in our operations, it creates capacity that allows us then to go further from an optimization standpoint.

And then you know, kind of during that period of time, we did the spinoff of the IPO of WhiteWave. And when we did that, we went through a fairly significant G&A adjustment and we right size the company to what we believed was the right G&A to support our business going forward.

And then from there, we kind of moved into logistics back. And I guess we’re coming up on a year and a half, almost two years ago, maybe a little over two years ago now where we centralize logistics. Logistics within our company was always underneath the sales organization. So, it was very service focused and not very cost focused. And we’ve really started putting pressure on the logistics organization to now start taking their cost out.

And it’s really coming on three fronts. It’s coming on what I’ll call frequency, how many times do you deliver to a customer in a given week. It comes on route optimization, so can you optimize the routes more effectively. And then it comes on box utilization or utilization of your assets. And as you bring those three together, it starts taking miles off the road.

And you can see at the end of the first quarter we took about 6 percent of the miles out of our logistics network. When you take 6 percent of the miles out, you’ve got to take miles out faster than your volume decline and we did that at about twice the rate during the first quarter. So, we’re starting to see the benefits of that, but I would tell you we’re in the early innings of the logistic cost structure. And I think will continue to be somewhere between our $80 million and $100 million.

The thing I missed in there that I probably shouldn’t have missed was we also started buying some more milk direct. So, we put in place four or five years ago, six years ago maybe, what's called Dairy Direct. So, we buy direct from the farmers and during that process we were able to save a significant amount of money and we’ll continue to expand that as we go forward.

Alexia Howard: Yes. I really (missed one and lost). Why cannot it be a lot higher than $80 million to $100 million? Is there something that slows it down that sort of means that you just …

(Multiple Speakers)

Gregg Tanner: It is – it is a lot of blocking and tackling. It's a lot of very low level grind without – I mean when you go to a customer and after you get an agreement with the customer that they don't need to be serviced five days a week, they should be serviced three days a week, it is very difficult to convince that customer when they're used to having five days. And a lot of this was with very local customers. I mean it's not like I can go to Bentonville and get agreement at the top and it kind of happens. This is a lot of up and down the street optimization that takes time and takes a lot of energy and effort.

Chis Bellairs: If you thank of the degree of difficulty and distribution versus operations, distribution is our focus today. When you're optimizing the operations network, you've got 60 to 70 plants, supply manager can roll out an initiative pretty quickly. So, if want to allow warehouse management software, you can do that across a critical mass of facilities over a very short period time. When you're managing 6,500 delivery assets, some of them who don't see their supervisor but maybe once a week, once every other week, trying to rule out a similar initiative across a very fragmented distribution network, we believe the opportunity is every bit as big as what we expensed in operations, but it's a slower burn.

Alexia Howard: Sure. OK. Thank you for that.

(Multiple Speakers)

Alexia Howard: Yes, certainly. So, input cost inflation, obviously, it's been very volatile I guess since everything changed in the late 90s and it seems as though the (patents) of input cost volatility has accelerated in the last, I guess, 8 to 10 years or so. What's the biggest factor to keep an eye on so that we don't get caught up as investors on a spike in the input cost? And I just got, I guess, a similar question from the audience about can you discuss the prospect of going to inputs cost inflation and how quickly the government adjust its pricing to account the rising cost.

Gregg Tanner: Yes. Well, I think, you know, the biggest impact that we saw back in 2014 – 2013 coming into 2014 was the China impact.

Alexia Howard: Yes.

Gregg Tanner: And the China impact was really China started buying up all the powder milk that they could – they can buy. They had gone through a period where they had (hoof) and mouth disease issue within their (herd) in China. So, their supply was dramatically impacted. They immediately started buying all the milk they could. Since that time that has kind of gone away. They're now – you know, their herd has grown. They're back to where they can support themselves and they still have a fairly significant stockpile of powder available. So, we don't think that's going to happen again.

The biggest factor, at least my belief, is the biggest factor today is the European Union and the European Union went off of quotas in April 2015. And since that time, they had been growing at phenomenal rates. So, they've been growing their milk supply 5 plus percent since that time. You had to keep in mind that the EU is the largest milk producer in the world. So, when they start to grow, it is substantial. That – that's like the U.S. seen an 8 to 10 percent growth in our milk supply, so that – that's been the biggest driver. So if there was a thing to watch for, I think as you see the international market start to come more in line and you see the U.S., the gaps between the U.S. prices and the international prices start to come together, then – then you will see I think – you will see it start to come back up a bit.

I don't see it going back to, you know, yes, Chris always refers to it as the 100-year flood of 2014. We don't see anything like that at least in our horizons. We do see it starting to come back up a little bit back in the back half of this year, all well within the parameters that we believe we can – we can manage within fairly easily.

The U.S. government, I guess my desire would be that we – we get rid of the federal market order and go to a free market system but that's probably the one thing that as you look to the future, if we could ever get away from the federal market orders, it would – it would be very beneficial to us, and I think very beneficial to most of the farmers. Now most of them see the current federal market order system as a bit of a protection of – of pricing and kind of that barrier between the processor and the retailer, not being able to come in and buy milk at a cheaper rate, so.

Alexia Howard: What are the barriers to that, is it purely political?

(Multiple Speakers)

Gregg Tanner: It is – it is …

(Multiple Speakers)

Alexia Howard: Because if you tied the price of milk to the price of feed, then the dairy farmer's profits would be much more stable.

(Multiple Speakers)

Gregg Tanner: It is the – it is a very political issue. I think you know one of the best lobbying groups in Washington are farmers and – and I think most people do not want to upset their constituency, whether it is one or two farmers in their – in their home market. And I think, like I said, I think the farmers today see that very much as a protection and so they kind of held on to that as a – as a way to do that, particularly the smaller farmers, yes.

Alexia Howard: Okay, just fear of change I guess. Moving on to something different, the profit differential per gallon on private label milk versus branded milk, is there anything you can tell us about that, I'm presuming it's pretty wide but the …

(Multiple Speakers)

Gregg Tanner: It is.

Alexia Howard: … a lot of things makes a lot more money.

Gregg Tanner: Well, it's also very regionally focus, so it will depend upon the competition. So you know, when you look at upper Midwest and the upper – upper Midwest today is kind of a flush with milk. I mean they had been growing at 4 and 5 percent, so the competition in that upper Midwest market is a little bit more.

So you know, that gap between private label and branded is a little bit less. When you go to other parts of the market, you will see it expand. So, somewhere between 50 and 75 percent would be our margin difference between private label and – and branded. Some people have heard us talked about we're working to shift the mix from private label to brand, they have interpreted that to mean that you need to get a 5 or even a 10-point mix shift from private label to brand in order for it to be material for our P&L.

Given that the outsize difference in the margin profiles, it actually is a much lower number (that) even, so we'll sell 2 billion gallons of milk this year. So if you move a point of mix, move 20 million gallons out of private label and into brand, that 20 million gallons, that's the kind of margin differentials that we're talking about, will have a very substantial impact.

(Multiple Speakers)

Alexia Howard: OK.

Gregg Tanner: Even a one point shift.

Alexia Howard: Okay. Moving on to non-margin stuff, let's move on to acquisitions. You've obviously pursued the Friendly's deal recently. How do you expect to create value from that – that deal going forward, particularly in light of shedding WhiteWave, shedding Morningstar back in the day it feels as though the pendulum is swinging in the other direction?

Gregg Tanner: Well, I think it's – it's as we continue to look at building and buying brands that it – I think that you know the exciting thing for us is it was a perfect strategic fit. And when I say a perfect strategic fit is, it – it was a geography that we were void in, so we have no ice cream brands in the – in the

Northeast. So, this really fit well into our brand strategy of trying to buy and build brands.

We believe we got it at a good value. We were – and we think there are significant synergies that we can bring to that market. We're going to create value through the synergies, we'll create value through continuing to grow that business. The business had been growing in low double digit rates for the last two or three years and that was – and now I had the question asked of well is that because of Blue Bell.

Well Blue Bell wasn't in the Northeast, so it had nothing to do with Blue Bell. They were just – they were finding ways to grow that business and our expectation is they will continue to grow that business. There's – there are parts of that portfolio that we believe we can take nationally and continue to grow.

You know, they do cakes which we do not have the capability to do ice cream cakes today. They do cakes, they do rolls, ice cream rolls which we did not have the ability to do and they do a sundae cup which is a smaller portion. And we think those concepts have legs to move well beyond the Northeast.

Alexia Howard: So as you think about future potential deals, how do you think about the criteria for that and how is it different from you know as you try to build a branded business, how is it different from reversing the logic and getting rid of WhiteWave and I guess to a lesser extent Morningstar was in a different category?

(Multiple Speakers)

Gregg Tanner: Yes, so – so I think as we – as we look at that strategically what we're trying to accomplish, you know we're trying to – we're always doing a kind of a make versus buy scenario. So around capabilities, we look for capabilities that allow us around extended shelf life. You know, we may look at balancing assets that allow us to balance more direct, very direct milk and – and warehouse capabilities. How do we get warehouse capabilities to break into – to some of the verticals that today we don't go to through our DSD system?

So, building out those capabilities is critical for us, so we will look at – at any opportunities that have come our way to say, can – can we buy this versus trying to build it ourselves and that will get us there much quicker and it may or may not be more cost effective. Other than that, we'll look at brands, brands that may be regional brands that we can then take and put through our system that are going to utilize our existing capabilities, whether it be manufacturing or DSD system and how can we expand that out.

We'll also look at licensing agreements. We signed a licensing agreement with Caribou Coffee, so we're doing a nice coffee now that we're rolling out nationally through our system. It's also we manufacture it, we also distribute it, so we'll utilize that as well. So, those are the types of things that we're looking at as we – as we look at (inquisitive) things that are interesting to us.

Alexia Howard: Moving on to some of the financial questions. Free cash flow yield so pretty good at the moment I think.

(Multiple Speakers)

Gregg Tanner: I like it.

Alexia Howard: Yes, exactly and you've introduced and recently raised the dividend as well. What are the priorities for uses of cash from here and would the company ever be in a position to take itself private?

Gregg Tanner: I'll turn that over to the financial guy.

Chris Bellairs: So yes, we've been very pleased with both our ability to generate free cash flow, the rebounds that we have enjoyed since the challenges of 2014. And then kind of a – the various uses that we put cash to work since we (instituted them) a couple years ago, did our first increase to the dividend here in the prior quarter.

We've been in the market opportunistically buy back our own shares twice over the last couple of years. So that's – when we first declared the dividend, I think some people said, well the 2 percent yield that you're starting at, feels a little anemic and our – our pushback, our thought was we want be able to keep some flexibility to deploy against – against opportunistic share repurchase as well.

And we think, if you look at the prices we bought out over the last two times we've been in the market, we think that's working out pretty well for us. So – so beyond the dividend and repo, continuing to invest in the business. So our base CapEx, we've guided to $160 million of CapEx this year.

We actually kind of parse that down a little bit more finally into about $140 million on the base and $20 million on some strategic initiatives that we're focused on. So we're glad they were able to keep putting downward pressure on our base CapEx which then creates the opportunity for – for more free cash flow as well.

And then finally, deploying cash to go out and do things like we do at Friendly's if there are willing sellers at good price points that have businesses that – that we think Dean Foods can bring value to as you described Alexia, you know, that's obviously something that is – remains a very interesting place for us to continue to look.

Gregg Tanner: You know, I would add too that I think that, you know, we restructured our balance sheet a year – a year and half ago …

(Multiple Speakers)

Chris Bellairs: Yes, our first quarter.

Gregg Tanner: Yes, our first quarter of last year and I'm extremely pleased with where the balance sheet is. Our balance sheet is in the best condition it's been in since I have been with the company and our intent is to keep it that way.

Alexia Howard: So any commentary on the possibility of buying yourselves out?

Gregg Tanner: You know, not really. I think it's one where that – that's really a board decision and you know, it's not one that we – we spent a lot of time on.

Alexia Howard: So just as wrap-up and then let the final few minutes here just some broader questions, what do you see is the biggest risks from here on out?

Gregg Tanner: You know, I think the – the big risk is – is what happens internationally that could – that could put a shock into the – into the market. That could be China, that could be the EU, all of a sudden deciding they're not going to – they're going to do away with the purchase back and farmers decide to start calling quickly or some type of disease that comes across the system. So, I think that's probably one of the biggest risks. I think the regulatory environment, seeing a change in the regulatory environment if – if it was to get more restrictive as it has over the last eight years, going forward, that – that would put more pressure on the – on the system.

And if you know – because one of the things that we continue to get – to get driven on is, you know, sustainability and some of things that we – that we're making good improvements on. And I think we have an advantage over most of our competitive set but it's still a significant play in the marketplace. So, I think those are the big risks.

I think they also played to some degree as an opportunity, so we talked a little bit earlier about the federal market order. If we were to find a way to change that, I think it would – it would change the dynamics of – of the industry and give us some additional advantage. I also think that if – if we were to be able to change the standard of identity for milk.

I think most – most of you may not understand but if I take a stevia and I put stevia into TruMoo, our chocolate milk, I can no longer call it milk. I have to call a chocolate drink or I have to call it something other than milk. And so trying to change that center of identity that opens up that window for innovation, I think would be a game changer as well. So, I think there's – there's risk but I think there's opportunities that lie in that same arena.

Alexia Howard: I guess along those lines. What prevents the industry from investing in UHT processing capabilities to extend the shelf life of milk and eliminate the need for chilled DSD distribution?

Gregg Tanner: You know, I think the biggest one is just the cost. Yes, it's – it's a significant increase in the cost to go to aseptic. You know, the one thing that I think consumers get a bit confused on is there are really three types of processes.

You have, what I will characterize as fresh or HTST, you know high-temperature short-time and then you have UHT which is the ultra-high temperature which – which could be then characterized as extended shelf life, which is about 60 days of shelf life and that's just a much higher temperature, you cook the product a little bit more. And then there's aseptic which aseptic you have to have aseptic packaging. You have to have aseptic materials, you have to have a totally enclosed environment and that gets really expensive.

And I think consumers in the U.S. have not embraced putting milk in their pantry for future use. I think they feel like if they have milk it has to be in their refrigerator and it has to be cold, that you can't put milk in a pantry.

Alexia Howard: Just as a final wrap-up then, one of the biggest changes that you – you think we could be surprised about over the next five years and what are the main items on your personal agenda for the company I supposed over the next two or three years?

Gregg Tanner: Yes, well I think it – to me it's relatively clear. We're going to continue to stay focus on being a low-cost provider. We're going to continue to drive our cost reduction program. We're going to continue to transform our go-to-market capabilities and that is one of the – one of the big items that will continue to be a focus area. We're going to continue to focus on – on building capabilities. So, we have capabilities that we need to build in ESL and warehouse capabilities and other capabilities that open up the innovation window for us.

And thirdly, we're going to continue to buy and build brands, so we're going to stay focus on our brands, we're going to stay focus on how do we continue to drive that mix. And as Chris said it only takes a 1 or 2 percent mix shift to significantly impact the P&L. So, those are the three things that I'll stay focus on and when I say capabilities that mean people capabilities as well.

Alexia Howard: Perfect. Thank you so much for your time today.

(Multiple Speakers)

Gregg Tanner: Thank you very much. We appreciate the opportunity …

Alexia Howard: We really appreciate it, that's very enlightening and thank you all for coming along as well. Cheers.

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