U.S. Positioned as Only Global Source for Residual Butter & Cream

by Pete Hardin

Presently, and probably for at least the next six to nine months, the United States looks like the only source of discretionary cream and butter among major dairy nations in the world. We’ve seen these trends evolving during the second half of 2016. Domestic demand is strong for butter and high-fat content dairy products, such as whole milk, cheese and sour cream.

During the second half of 2016, U.S. butter inventories have been whittled down dramatically. But the U.S. butter situation is only part of a larger global pattern. Butter is quite scarce in Europe and dairy farmers to reduce milk output. That subsidy through March 2017. EU butter prices have climbed nearly $1.00/lb. since early June 2016, according to

Meanwhile “down under,” milk production is lagging dramatically in both New Zealand and Australia. Weather and economic events are pulling down farm milk flow in those countries. Butter is so scarce in Australia that Dairy Market News recently reported that small-scale food firms using butter in their product mix has been reduced to buying butter off the shelves at their local supermarkets.

And now Canada’s dairy and food processors are coming to the United States for large quantities of cream supplies. Reports indicate that during

October and November 2016, five to six million liters of cream were exported from the United States to Canada each month. Sources tell The Milkweed that Canada is caught in an increasingly tight cream supply/demand squeeze. That source related that virtually all cream in Canada is being produced into “prints” (i.e. table-grade butter). Residual cream users, such as baking and confectionary, are using cream shipped in from the United States. This same source notes that all cream sold to Canada must be “rBGH/rbST-free” and “GMO-free.” (Good luck!)

These 11 million liters of cream shipped to Canada during October-November would equal about 6.7 million pounds of butter, by our best “guesstimates.” Butter production in the United States fell a about 15 million lbs., compared to the same two-month period.

Those record exports of cream to Canada took place as USDA data noted a sharp drop-off in this nation’s butter production and shrinking inventories of butter in U.S. warehouses.

In summary: our domestic demand for butter and other high-fat dairy products is growing nicely. And both milk production and butter reserves in Europe and Oceania are low.

Butter marketing and price trends are all positive at the end of 2016. In the analysis of The Milkweed, 2017 is poised for an extremely strong demand for butter and cream – a factor that will propel farm milk prices and demand for high-fat dairy cows and heifers.

Tighter butter inventories and scarce global supplies are having a contra-seasonal impact in dairy’s cash markets. Normally, about the time that the Thanksgiving turkey is being thawed, domestic butter needs have been filled to meet holiday demand and cash prices for Grade AA start sliding backwards. But not in late 2016. Cash prices for Grade AA butter in trading at the Chicago Mercantile Exchange (CME) generally strengthened as December progressed. Grade AA butter peaked at $2.3475/lb. on December 26 at CME, before edging backwards to hit $2.2775/lb. on Wednesday, January 11.

The fundamentals of butter and cream demand appear extremely solid at the beginning of 2017. Consumer butter demand is strong. Butter inventories are nose-diving at year’s end. Seasonal cream demand for holiday Class II products such as eggnog was strong. Sour cream sales are demonstrating very strong growth during 2016’s second half. And consumer purchases of whole milk are growing nicely – moving more milk fat to consumers in beverage form.

During November, USDA’s Cold Storage report noted a huge drop in butter inventories. At 160.9 million lbs. on November 30, that means U.S. marketers held 67.3 million lbs. less butter than the October 31, 2016 Cold Storage total – a 29.8% decline. Here are the corresponding numbers for 2014’s and 2015’s October 31-to-November 30 U.S. butter inventory declines (and percent change): were 34.7 and 46.2 million lbs., respectively.)

From the data presented above, it’s clear that during November 2016, a higher percentage of butter moved out of inventories than during the previous two years. Also, the starting inventory figure for October 2016 was significantly higher than the two prior years.

Somewhat curiously, U.S. butter production has fallen off the table during October and November 2016. October’s total butter output was 141.6 million lbs. (~4.6% below Oct. 2015). November’s Butter Inventory Declines (# & %)

<table>
<thead>
<tr>
<th>Year</th>
<th>Oct. 31 Total</th>
<th>Decline (mil. lbs.)</th>
<th>Decline (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>147.956</td>
<td>34.7</td>
<td>-23.5</td>
</tr>
<tr>
<td>2015</td>
<td>78.834</td>
<td>46.2</td>
<td>-25.8</td>
</tr>
<tr>
<td>2016</td>
<td>228.157</td>
<td>67.3</td>
<td>-29.5</td>
</tr>
</tbody>
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Source: USDA-ERS Cold Storage Report, November 30, 2016

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Two medium-sized Midwest dairy cooperatives will have a hastily-announced, proposed merger vote before their members in late January 2017. Financially troubled Swiss Valley Farms (SVF – based in Davenport, Iowa) will be absorbed by Prairie Farms Dairy (Carlinville, Illinois) … if members of both co-ops vote to approve the merger.

The merger was announced in mid-December. Co-op members had about one month to sift through reams of confidential merger details, before they’ll vote in the second half of January. SVF members must vote by January 19. Prairie Farms’ primary focus is in fluid milk and cultured products. Prairie Farms counts about 600 dairy producer members, 5,700 employees, 100 distribution facilities, and 53 manufacturing plants. Prairie Farms holdings stretch from Maine to Ohio and 75% go to Iowa and down to Mississippi. In days of old, Prairie Farms was the “gold standard” of dairy co-op profits – often churning profits of close to $2.00/cwt. on all milk processed. Prairie Farms’ primary focus is in fluid milk and cultured products.

In early 2016, Prairie Farms was hit by a “White Elephant” in this deal, is the troubled SVF cheese plant at Luana, Iowa. Quality problems have dented SVF cheese production at Luana for time plant manager for the problem, but the same at Luana were sold as substandard, at commensurate. SVF is in the middle of an expensive upgrade at 12% of 2016 sales. The “White Elephant” in this deal, is the troubled SVF cheese plant at Luana, Iowa. Quality problems have dented SVF cheese production at Luana for time plant manager for the problem, but the same at Luana were sold as substandard, at commensurate.

Merger deal promises to repay SVF equities As proposed, the Prairie Farms/SVF merger proposes to repay SVF’s outstanding debts to be repaid by SFV members. That’s a sore subject for many present and former SVF dairy farmers, who have been appalled at recent years’ puny drubbing back of their moneys held by the co-op. In a couple recent years, SVF members were paid out 10% of their outstanding funds from 2001. A couple years ago, an angry Wisconsin dairy farm woman was threatened with legal action if she didn’t quit asking questions about her outstanding SVF equities.

The merger agreement promises to annually pay out 10% of outstanding SVF equities per year, for 10 years, starting in 2018. That means, by 2028, former SVF members will be finally made whole for funds that will have been held without interest for as long as 27 years.

SVF has also stalled repayment of its members’ equity in recent years. Those retained earnings – funds on which members actually incurred income tax liabilities during the years for which the earnings accrued – have dribbled out (at best in recent years). SVF’s unaudited Sept. 30, 2016 financial reports show $47.6 million of “Members’ Equity”– interest-free moo-la on which SVF operates.

In early December, SVF held to its custom of distributing financial statistical information for the fiscal year that ended the previous September 30. (Note: Competent directors and management would either have audited financial results within two or three weeks after the close of a given fiscal year, or else wait until the audits were complete, before holding district meetings for members.)

For whatever an “unaudited” financial statement may be worth, the numbers SVF handed out in December 2016 meetings for the fiscal year that closed on Sept. 30, 2016 showed some ugly sores, including:

- An 8% decline in member milk production (at a time when the Upper Midwest saw expanding milk production).
- Accounts payable rose $4.4 million (+52%), but receivables were down by 7.9%. (Note: A 59.9% “spread” between growing accounts payable and receivables is a very, very bad sign.)
- “Pensions/Deferred Liabilities” were $10 million of Sept. 30, 2016 – an increase of $3.7 million (+58.7%). Those “Pension/Deferred Liabilities” equaled 37% of SVF’s average monthly sales for the 9/30/2016 fiscal year.
- “Net Sales” for SVF’s fiscal year ending Sept. 30, 2016 were $321.9 million – a decline of $31.3 million (-13.7%). Despite that significant decline in “Net Sales,” SVF reported operating expenses of $315 million (+4.2%).

From the unaudited 9/30/16 financial information, it’s impossible to know how SVF accounts for the huge PPD deductions taken from members’ milk checks. In calendar 2015, for example, a disgruntled member calculated that the Illinois division of SVF’s PPDs from February 2015 through October 2015 had averaged $1.11/cwt. worse than the prevailing federal order PPDs. (That disgruntled producer has been appalled at recent years’ puny drubbing back of their moneys held by the co-op. In a couple recent years, SVF members were paid out 10% of their outstanding funds from 2001. A couple years ago, an angry Wisconsin dairy farm woman was threatened with legal action if she didn’t quit asking questions about her outstanding SVF equities. SVF is in the middle of an expensive upgrade at 12% of 2016 sales. The “White Elephant” in this deal, is the troubled SVF cheese plant at Luana, Iowa. Quality problems have dented SVF cheese production at Luana for time plant manager for the problem, but the same at Luana were sold as substandard, at commensurate.)

From the unaudited 9/30/16 financial information, it is clear that major portions of the estimated $44 million upgrades at the Luana, Iowa cheese plant have yet to plop on SVF’s books – at least on the unaudited financial results released in early December. Projects under construction generally do not appear on the books until the project, or at least various stages of the project, are completed.

SVF numbers look bad. SVF is trying to be the “weak sister” in this proposed merger between dairy cooperatives. The “White Elephant” – the Luana cheese plant – may just be the biggest financial problem facing Prairie Farms. In all likelihood the merger will be approved and Prairie Farms’ members will then determine the consistency, texture and aroma of albinno elephant dung.