

The Milkweed



“Float like a butterfly,
sting like a bee.”

— Muhammad Ali

Dairy's best information and insights

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Lost Export Markets Boost U.S. Cheese Inventories & Erode Prices

by Jan Shepel

Cheese inventories in warehouses across the United States were being lowered in the early part of 2018, but after retaliatory tariffs were imposed by trading partners late in 2018's second quarter, those inventories jumped to levels significantly above year-earlier levels.

The critical data for cheese inventories must

Table 1
Cheese Inventories Versus Exports After Tariffs

	2017 (Mill. lbs)	2018 (Mill. lbs)
Jan.	752	740
Feb.	745	761
Mar.	805	768
Apr.	835	780
May	838	803
June	810	800
July	810	821
Aug.	800	788
Sept.	780	802
Oct.	740	810
Nov.	732	802
Dec.	747	NA

(Source: USDA – NASS – AMS)

focus on American-style cheeses, which include Cheddar – dairy's price-setting benchmark variety.

American cheese inventories started last year below 2017 levels – a perceived good indicator for rising milk prices in the country. American cheese inventories climbed less dramatically than in the previous year, up to a July peak. American cheese inventories then dipped in August, before rising significantly above 2017 levels through November, which is the last month for which data was available.

Inventory numbers for 2014, 2015 and 2016 were well below both 2017 and 2018 for the entire year.

In terms of total U.S. cheese production, 2018 data shows the numbers to be higher throughout the year than all of those preceding years. But that's not necessarily a problem – due to solid, demand-driven output gains posted by Mozzarella and pizza cheese during 2018. Comparing total January production in each of the recent years, 2014 began with 970 million pounds produced; 2015 began with over 990 million pounds produced. In January 2017 there were 1,062 million pounds produced and in January 2018 the total was nearly 1,100 million pounds of total U.S. cheese production.

Each year the trend lines followed each other pretty closely until Oct. 2018. That's when cheese production hit a high of 1,130 million pounds produced, according to the USDA, National Agricultural Statistical Service (NASS) and the AMS.

According to those same USDA sources, total stocks of natural cheese in all U.S. warehouses stood at 1,267,950,000 pounds on October 31, 2017 and had risen to 1,372,517,000 by October 31, 2018.

According to the U.S. Dairy Export Council, the aggregate volume of dairy exports was 2,006,533 metric tons in 2017 and 2,034,820 metric tons in 2018. A report prepared for USDEC noted that the United State exports well over ten times the number



Roundup® herbicide's active ingredient is Glyphosate. Glyphosate-based herbicides are the world's most heavily applied agricultural chemical. Later in 2019, China will impose Glyphosate residue limits on imported foods and agricultural commodities – including dairy.

In this issue, we publish two lengthy articles exploring Glyphosate issues. The first story (pages 7-8) explores Glyphosate toxicity for dairy cows and livestock. The second story (pages 9-10) details a Utah business' products that remediate Glyphosate residues from soils. These stories are not quick reads. Understanding the downsides of Glyphosate for soils, livestock, water quality and human health are critical.

of dairy products to Mexico and China than it imports from those countries. Mexico is the larger importer due to the North American Free Trade Agreement and its geography – closer to U.S. markets.

That report by Informa Consulting noted that in 2017 total U.S. dairy exports to the world were worth \$5.4 billion. Of that \$5.4 billion, China and Mexico combined to account for \$1.9 billion – 35% of U.S. dairy product exports.

Mexico is the world's fifth largest importer of dairy products in terms of quantity and eighth largest

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Dean Foods on Financial Tightrope: March 1, 2019 Deadline Looms

by Pete Hardin

The clock is ticking at Dean Foods – the nation's largest fluid milk processor. Dean Foods processes about 30% of all fluid milk sold in the United States.

The Milkweed estimates that Dean Foods purchases about \$300 million of farm milk per month.

Dean Foods is out of compliance with a critical agreement with lenders, according to documents filed with the federal Securities and Exchange Commission (SEC) on January 24, 2019. That covenant with which Dean Foods is failing to adhere involves the firm's pledging up to \$450 million of the company's accounts receivables to wholly owned subsidiaries that are allegedly “bankruptcy remote” (according to the company's late 2018 10-Q filing with the SEC). The technical name for the accounts receivable-based notes is the “Receivables Purchase Plan.”

The SEC filing states that on January 19, 2019, Dean Foods and certain subsidiaries (virtually all dairy operations) agreed to Amendment No. 2 to the Seventh Amended and Restated Receivables Purchase Agreement. That's because for the period ending December 31, 2018, Dean Foods was in “... non-compliance with the Financial Covenant under the Revolving Credit Facility.”

Exactly how Dean Foods is in default of the covenant(s) is not clear from the filings.

The 8-K filing further noted:

“The Company is actively engaged in negotiations to amend or replace the Receivables Purchase Agreement and the Revolving Credit Facility to provide liquidity and financial flexibility. We expect the new capital structure to include a revolving credit facility secured by our real estate and fixed assets as well as a securitization facility similar to our existing Receivables Purchase Agreement. The Company currently believes that it will complete this recapitalization no later than March 1, 2019, **although it can offer no assurances that it will be able to complete such recapitalization on acceptable terms or at all.**” (Bold emphasis added.)

Simply stated, Dean Foods' accounts receivable are the funds payable to the company from companies selling branded and private-label dairy products processed and distributed by the firm – i.e., packaged fluid milk, ice cream, whipping cream, etc. From the recent SEC filing, it appears that virtually all Dean Foods' dairy processing enterprises are included in pledging their accounts receivable to those “bankruptcy remote” subsidiaries.

Dean Foods must return to compliance with covenants of the Receivables Purchase Agreement by March 1, 2019. The SEC filing lists the “Waiver Termination Date” (i.e., the date by which the accounts receivable-based notes may be cut off) as:

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Dean Foods on Financial Tightrope: 3/1/19 Deadline Looms, con't

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“... the earliest of (a) March 1, 2019, (b) the date, if any, on which any Seller Party breaches its obligations under this Amendment and (c) the date, if any, on which the Collateral Agent shall enter into a forbearance agreement with Dean Foods Company relating to (x) the Dean Credit Agreement and (y) the exercises of remedies with respect thereto.”

(Note: Dean Foods is the “Seller Party” under the Receivables Purchase Plan. The Dean Credit Agreement refers to a separate package of borrowings. In its late 2018 10-Q filing with the federal government, Dean Foods listed a total of 17 financial institutions as lenders, including seven separate units within the Farm Credit System.)

The 8-K filing’s Amendment No. 2 specifies that during late January and through February 2019, Dean Foods must submit weekly financial reports, each Wednesday, to its financial overseers.

Dean Foods’ financial quagmire is complicated by the fact recent company forecasts have projected that 2018’s fourth quarter numbers, by inference, again generated red ink. The covenant by which Dean Foods pledged its receivables specified that the company would restore and maintain profitable operations. That wasn’t the case during 2018’s second half. During that period, Dean Foods struggled to close seven fluid milk processing plants. Parceling out delivery of products from remaining Dean Foods plants resulted in logistical failures. Examples:

- In late 2018, the Atlanta, Georgia school system kicked out Dean Foods as its contracted supplier of school milk, due to failure to perform contracted obligations. Earlier that fall, Dean Foods had closed its Braselton, Georgia fluid milk plant, located in an Atlanta suburb.

- Last September, the *Boston Globe* reported that the Springfield, Massachusetts school district had to send its own truck(s) to Dean Foods milk plants to obtain half-pints of milk needed for school meals.

The January 24, 2019 8-K filing with the SEC lists the New York City-based branch of Rabobank as the “agent” involved in issuing the accounts receivables-based papers. Rabobank – based in The Netherlands – is the world’s largest agricultural lender, heavily exposed to the U.S. and global dairy industries ... from farm to dairy processing firms. The PNC Bank, National Association is listed as the “LC Bank.”

Other financial institutions listed as signatories on the “Amendment No. 2” to the Receivables Purchase Agreement filed with the late January 2019 8-K report include: Nieuw Amsterdam Receivables, Suntrust Bank, and Fifth Third Bank.

Dean Foods’ dairy receivables obligated

The two wholly-owned, “bankruptcy remote” subsidiaries to which Dean Foods has shifted its accounts receivable are revealed in the 8-K’s Amendment No. 2: Dairy Group Receivables, L.P., and Dairy Group Receivables II, L.P. – both limited partnerships incorporated in the State of Delaware.

Here’s a list of the Dean Foods’ subsidiaries reported on “Amendment No. 2” as “Servicers” for the “Receivables Purchase Agreement.”

Dean Dairy Holdings, LLC
Suiza Dairy Group, LLC
Alta-Dena Certified Dairy, LLC
Berkeley Farms, LLC
Country Fresh, LLC
Dean East, LLC
Dean East II, LLC
Dean Foods North Central, LLC
Dean Foods of Wisconsin, LLC
Dean West, LLC
Dean West II, LLC
Friendly’s Ice Cream Holdings Corp
Friendly’s Manufacturing and Retail, LLC
Garelick Farms, LLC
Land-O-Sun Dairies, LLC
Mayfield Dairy Farms, LLC
Model Dairy, LLC
Reiter Dairy, LLC
Shenandoah’s Pride, LLC
Southern Foods Group, LLC
Tuscan/Lehigh Dairies, Inc.
Verifine Dairy Products of Sheboygan, LLC

That long list of Dean Foods’ subsidiaries comprises virtually Dean Foods’ entire dairy processing empire.

Tremendous impact if Dean Foods fails ...

For 2018, analysts projected Dean Foods’ gross revenue around \$7 billion. *The Milkweed* estimates that Dean Foods currently processes and distributes about 30% of all fluid milk in the United States – about 1.15 billion lbs. of farm milk per month. That equals 11 million cwt. of farm milk per month – worth about \$190 million (at an estimated value of \$17.50/cwt.) Logically, it’s fair to project that Dean Foods’ monthly purchases of milk for processing into Class II products such as ice cream and yogurt would probably equal about \$110-120 million. **IF** Dean Foods is unable maintain existing relationships with lenders or secure new financing, the U.S. dairy producer sector would suffer a red ink bath to the tune of approximately \$300 million.

If Dean Foods suffers a financial collapse, the impact on the extended dairy industry – from raw milk sellers (cooperatives and some independent dairy producers) to suppliers (fuel, chemicals, packaging materials, etc.) – would be devastating.

Some states have milk producer security programs that cover milk income losses for sellers of raw milk in cases of dairy processor failure. Such states include: California, Wisconsin, New York and Pennsylvania. However, those programs legally cover only in-state milk production sold to in-state dairy plants. Federal Commerce Clause rules prohibit extending such programs to interstate commerce. Local sources report that California’s producer security program is adequately stocked to handle a major processor’s financial failure. Other aforementioned states would likely have to dig deep into public coffers to cover efforts to make whole dairy producers and cooperatives caught in a major processor financial failure.

Dairy Farmers of America, Inc. (DFA) – the nation’s largest fluid milk processor – is Dean Foods’ pre-

dominant supplier of farm milk, nationwide. The two big dogs in dairy – the biggest cooperative and the biggest fluid milk processor – chose to run in tandem long ago. More than 20 years ago, management of DFA’s and Dean Foods’ predecessor corporations hitched their horses tight in exclusive, or near-exclusive milk supply arrangements. DFA’s management promised to lower Dean Foods’ raw milk costs by charging Dean Foods less than the costs for maintaining the company’s own supply of producers. In early 2003, Dean Foods dumped over 2,000 independent producers from their markets and pushed most of those producers into the grubby mitts of a DFA subsidiary – Dairy Marketing Services, LLC. DFA and Dean Foods absorbed about \$200 million in settlement costs and legal expenses related to a pair of civil antitrust lawsuits filed in the Southeast and Northeast. Allegations included restricting producers’ access to milk plants and underpaying producers for their milk sales.

As noted in the January 2019 issue of *The Milkweed*, seven of the 17 financial institutions lending funds to Dean Foods are units of the extended Farm Credit System. Thus, the extended Farm Credit System has triply concentrated its risk to dairy – lending to dairy farmers, lending to dairy cooperatives, and lending to Dean Foods. Unfortunately, the “reverse flow” of cash from the processor (like Dean Foods) back to the cooperative and/or dairy producers finds, in many instances, all three tiers pledging their accounts receivable as collateral as loans ... to various units of the Farm Credit System. If Dean Foods takes a financial plunge, cash flows all the way back to the farm will be seriously disrupted, at least temporarily. Other suppliers do not enjoy anything similar to “milk check security programs” upon which to fall back.

Some suppliers to Dean Foods – including at least one dairy producer – have taken out “credit insurance.” If that option is not available, *The Milkweed* advises suppliers to consider old-fashioned C.O.D. – cash on delivery.

How may assets be “remote” bankruptcy ?

Obviously, highly paid legal minds crafted strategies at Dean Foods that supposedly protect the dairy accounts’ receivables squirreled away in “wholly owned subsidiaries” (i.e., Dairy Group and Dairy Group II). However, if the worst comes, it’s predictable that legal challenges to hiding away Dean Foods’ dairy processing subsidiaries’ accounts receivables would ensue in bankruptcy court. Some aggrieved supplier or creditor would obviously want to garner more of owed obligations than a bankruptcy process in which hiding away several hundred million dollars of receivables were sanctioned by the court(s).

As of December 31, 2017, Dean Foods’ “Receivables Purchase Agreement” totaled approximately **\$314 million**, according to Moody’s Investors Service. Subsequent data is not yet available. Timetables by which individual accounts pay dairy processors for products supplied may vary.

If Dean Foods hits the financial rocks, it’ll take years for lawyers and bankruptcy courts to sort out the mess. A Dean Foods financial collapse would lead to investigations, academic papers and debate among antitrust experts about the dangers of undue concentration. Welcome to the modern world of dairy, brought to you by failed federal antitrust enforcement and corporate crooks.

DFA Heavily Exposed to Collateral Damage at Dean Foods

by Pete Hardin

Dean Foods’ tenuous financial position is compounded by the fact that the company claims to have squirreled away virtually all of its dairy businesses’ accounts receivables into wholly-owned, “bankruptcy remote” subsidiaries.

Elsewhere in this issue, *The Milkweed* lists the long array of Dean Foods dairy processing units, the receivables from which are packaged as “bankruptcy remote.” This publication estimates that Dean Foods is buying about \$300 million worth of farm milk per month.

By far and away, Dairy Farmers of America, Inc. (DFA) is the single largest supplier of farm milk to Dean Foods. In some locales, DFA’s subsidiary – Dairy Marketing Services, LLC (DMS) – markets farm milk to Dean Foods.

For more than 20 years, DFA and Dean Foods have cultivated a sleazy relationship that has seen Dean Foods turn over virtually all its independent producers to the control of DFA/DMS.

Some firms selling farm milk or dairy ingredients to Dean Foods have taken out credit insurance. Details regarding the mechanics of that “protection” are not well known to *The Milkweed*.

Some states have programs that secure payments for milk to suppliers, in the event of a dairy processor’s financial failure. However, those laws apply only to in-state milk sold to in-state processors.

Another dairy cooperative exposed to Dean Foods is Organic Valley. Organic Valley entered in to a deal with Dean Foods about two years ago, whereby Dean Foods now processes and distributes virtually all of Organic Valley’s branded fluid milk. The particulars of that arrangement are not commonly known, outside the two firms. In the event of a financial default by Dean Foods, it’s logical to assume

that virtually all firms conducting business with Dean Foods would be impacted to some degree.

DFA Bleeding Members’ Checks

In many areas of the country, members of Dairy Farmers of America (DFA) are gripping marketing costs draining down milk checks.

In Southern California, for example, local sources report that DFA is about \$.50/cwt. behind California Dairies, Inc. in recent monthly pay-outs. In New York State, to add insult to injury, sources report a recent letter from DFA to members informing them of a significant hike per cwt. in milk hauling costs.

DFA spokespersons are making a big deal about all the plants the co-op owns. But DFA has never explained the report by Moody’s Investors Service in early November that DFA had effectively doubled its debt by adding \$1.1 billion to buy Stremick’s Heritage Dairy in California and another at that time unidentified fluid milk processor.