The Milkweed

Dairy's best information and insights

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"Float like a butterfly, sting like a bee."
— Muhammad Ali

Uncertainty: U.S. Dairy Industry Facing Confusing Market Signals

by Pete Hardin

As the snows start to spit in early November, the nation's dairy industry faces plenty of critical questions. Many in the industry – from producers to cheese marketers – are searching for signals about coming months' supplies, dairy demand … and prices.

Dairy's landscape is chockfull of market signals – some positive, some negative. Let's review some of these measures, and try to make sense of them.

• Countervailing duties against U.S. dairy and agricultural products disrupting export sales and demand. In response to unilaterally imposed U.S. steel import tariffs earlier this year, some of our biggest foreign buyers of dairy products have imposed tariffs against U.S. dairy exports. Those dairy tariffs are generally in the 25% range. Mexico and China are major recipients of U.S. dairy exports and their demand for our products is diminishing due to the tariffs. Until the U.S. steel import tariffs are lifted, dairy is but one major agricultural commodity that is seeing inventories start to pile up.

• Farm milk supplies tighter in Upper Midwest, Northeast and Southeast. Milk supplies are visibly tighter in these regions – due in great part to poor quality crops in 2018 and four long years of red ink on dairy farms. *The Milkweed* is hearing of Class III (cheese) spot milk prices in Wisconsin as high as $1.85/cwt. Meanwhile, in the Northeast, Class I (fluid) spot prices are generally bringing $1.00 over Class plus trucking costs. And Class III prices are selectively peaking at well over $2.00/cwt.

• Cheese orders very slow. In early November, cheese traders report little interest among buyers, who are taking a "wait and see" attitude as Cheddar prices at the Chicago Mercantile Exchange drop even lower.

• Mozzarella production/demand very strong. School openings in late August and early September amped up already-solid Mozzarella demand for use on pizzas. September 2018 saw a 7.5% increase in U.S. Mozzarella output, compared to September 2017's total.

• Yogurt output drops in September. USDA data listed September 2019 showing a huge decline in the nation's yogurt production – down 5.6% when compared to September 2017's total. What's driving consumers away from buying yogurt – a healthy and nutritious dairy product?

• Serious crop problems in many key dairy areas. In the Northeast, the Southeast, and the Upper Midwest, weather events of many sorts have created problems for 2018 crops intended for feeding dairy cattle. Both quality and quantity of forages and corn crops (for grain and silage) are being verified by laboratory analyses. In the above-mentioned regions, a surprising amount of 2018's corn and forage samples are filled with molds and toxins.

• Red-ink economics on dairy farms forcing tough decisions. After four years of low milk prices, many dairy farm families are worn out financially and emotionally. Same for their lenders and suppliers. Besides depressed milk income cash-flows, the value of dairy livestock had dropped by at least 50% in the past three-plus years. Ability to see a better future is difficult. But the losses associated with selling the milking herds are tear-inducing.

What's ahead???

Looking ahead, *The Milkweed* foresees a fast-coming slowdown in farm milk production in this nation. That slowdown will be caused by producers exiting the business, by additional milk cows going to slaughter, and by poor-quality crops impairing efficient milk production and dairy cows' health.

There's an old saying about a wise parasite not killing the host organism. All value in dairy starts with the cows and their milk in the bulk tank. The industry is now about to see a crisis of milk supply, occasioned in great part by failure to achieve milk pricing policies that return a fair share of the consumers' dollar spent for dairy to the farmer. The money ***IS*** in the market place.

What's controversial about a quart of skim milk? South Mountain Creamery is battling the FDA over naming skim milk lacking artificial Vitamin D. See page 9.

House Power Shift May Affect Farm Bill

by Jan Shepel

With Tuesday's election shifting the balance of power in the House of Representatives to Democrats, it could have an effect on the stalled farm legislation that has been languishing in a conference committee. House and Senate conferees, who can't agree on requirements for recipients of food stamps may now bolt into action during the lame duck session between now and the end of the year.

Collin Peterson, (D-Minn.) who was chair of the House Agriculture Committee during the creation of the last farm bill, is expected to once again take the helm of the Ag Committee. But that doesn't happen until the new Congress is seated January 20, 2019. Peterson is a fiscally conservative "blue dog" Democrat from Minnesota's seventh Congressional district.

Farms.com reported the day after the election that the shift in power may push conferees to wrap

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This issue mailed on November 9, 2018

DFA Doubles Debt; Adding $1.1 Billion for 2 Acquisitions

by Pete Hardin

On November 2, 2018, Moody's Investors Services downgraded both the senior unsecured debt rating and preferred stock rating of Dairy Farmers of America, Inc. (DFA). Moody's downgrade came following announcement that DFA will effectively double its indebtedness – adding on an additional $1.1 billion in new financial obligations to fund two acquisitions of dairy processing businesses.

Moody's revealed one of those acquisitions: the remaining 53% of Stremick's Heritage Foods that DFA did not control. Stremick's is based in the Los Angeles area and processes aseptic and ultra-high temperature dairy and non-dairy beverages at two locations in California.

The Moody's release also mentioned that DFA has "… entered into an agreement to purchase an undisclosed smaller company that produces value-added fluid milk and other beverages." *The Milkweed* reported in its September 2018 issue that DFA was angling to acquire Clover Farms, a well-regarded dairy processor in eastern Pennsylvania. Is Clover Farms that "smaller company?" Wait and see.

To fund these acquisitions, Moody's reports that DFA will issue $955 million of senior unsecured debt instruments and $125 million of perpetual preferred equity.

In October 2017, when Moody's Investors Service previously revised its DFA analysis, Moody's noted that as of June 2017 DFA's borrowings totaled $1.115 Billion. DFA's 12/31/17 audit finessed the actual debt figures – listing it in a line item as debts minus cash on hand.

With DFA's recently enhanced borrowings, DFA's direct debts equal approximately $2 billion and the Preferred Equity Securities load another half a billion on top of that.

Massive new debt sparks many questions

Doubling indebtedness to acquire fluid milk processing businesses is a brazen leap for DFA. For starters, that addition plugs our estimates of DFA indebtedness to around $2,000,000. When spread over approximately 8,000 member/farms (*The Milkweed's* estimate, as of 12/31/17) an estimated $2 billion would equal about $250,000 of co-op debt for each member farm of DFA. And throw in another $500 million of Preferred Equalty Securities and the debt load per DFA member farm would approach $300,000. At current farm milk prices, *The Milkweed* estimates that DFA's total load of obligations ($2 billion in debt + $500 million in Preferred

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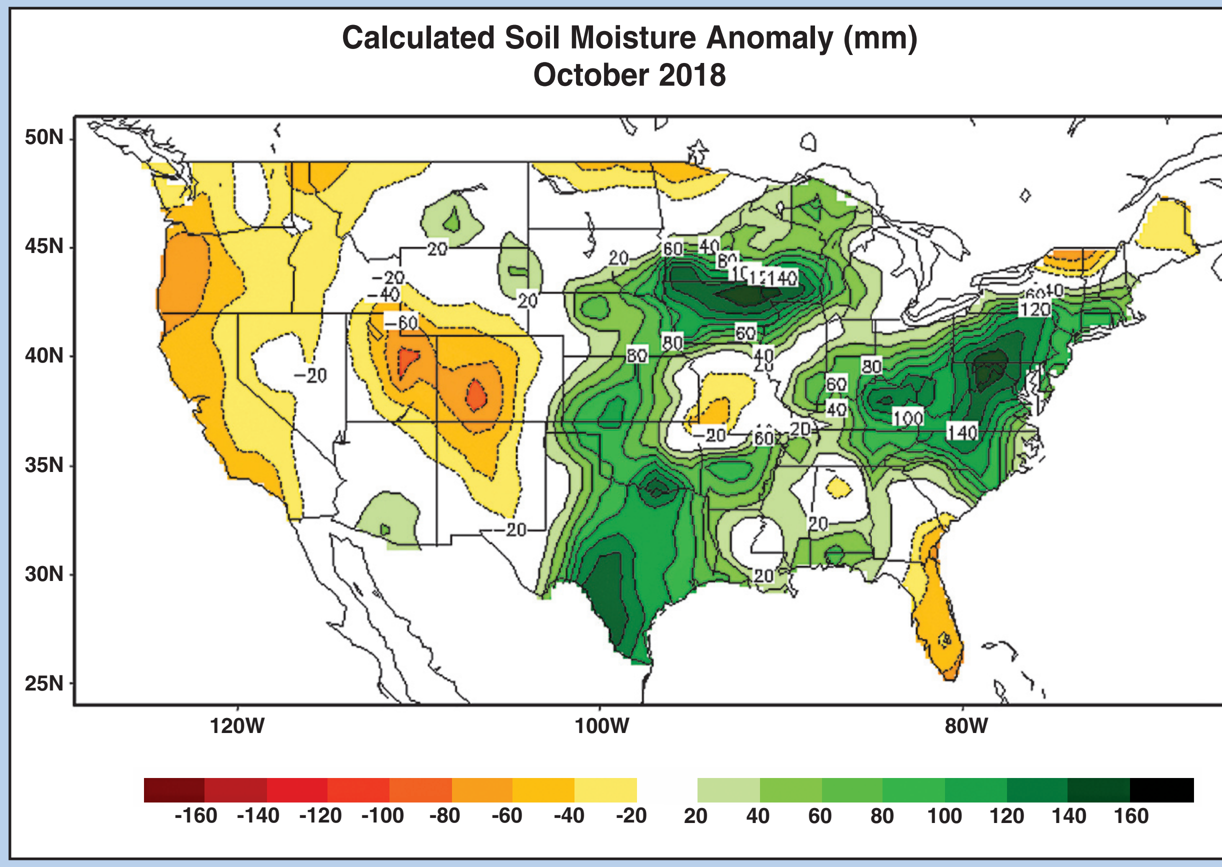
Soils in Eastern Half of U.S. Completely Saturated

by Pete Hardin

How wet is it? The accompanying map of Soil Moisture Anomalies offers a dramatic depiction of early November soil moisture levels in the United States. The dark green colors show overwhelmingly wet soil conditions throughout major areas of the Upper Midwest, Northeast, and Atlantic Coast states.

How wet has it been? Areas of North Carolina were 20 inches of precipitation ahead of normal, BEFORE being hit by late summer hurricane/tropical storm that dumped 25 inches (or more) of rainfall on that state.

This summer and fall, farmers in these regions have been tormented with incessant rain. That moisture has caused problems with maturing crops – leaving many crops super-loaded with toxins and mold. Efforts to harvest those crops have been delayed by wet soil conditions in fields.



Calculated Soil Moisture Anomaly (mm)
October 2018

This recent soil moisture map may be interpreted to explain that farmers in these extremely wet regions will face poor crops for the coming year's feeding of their livestock. Ultimately, Mother Nature rules agriculture.

DFA's Recent Deductions in Northeast

by Pete Hardin

A DFA member in New York State has forwarded to *The Milkweed* a summary of marketing fees assessed against his milk income for a recent month. Those deducts are listed below:

Location adjustment ....$.40/cwt.
Market adjustment....................$.37/cwt.
Hauling ....$.50/cwt.
Fuel surcharge ....$.1499/cwt.
Stop charge ....$.316/cwt.
CWT fee ....$.04/cwt.

Added up, these fees total about $1.75 per hundredweight. An additional $.15/cwt is deducted for the national dairy promotion check-off. Thus, marketing fees consume about $1.90/cwt. from this producers' milk check. No DFA deductions for equity are taken from his milk check. If they were, that'd put the total marketing cost deducts at right around $2.00/cwt. – about 15% of the value of his net monthly milk payments.

DFA's local officials and directors have offered little explanation for these deductions. Will coming tight milk supplies lower ... or increase DFA's need to drain members' milk checks?

House Power Shift May Affect Farm Bill, con't

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up the farm bill before the end of the year prompted by the shift to Democratic control of the House in January. Currently both houses of Congress are controlled by Republicans. Some observers said the current Congress may opt to simply extend the old farm legislation. But they could agree to pass a conference version that's acceptable to both houses or pass a completely new bill.

The farm bill was sent to a conference committee because there were glaring differences between the House and Senate versions.

In the House, the party had heeded President Donald Trump's request to push for stricter work requirements for food stamp (now known as SNAP or Supplemental Nutrition Assistance Program) recipients – but that was met with strong opposition from Democrats in the House and in the Senate.

Chuck Abbott in Successful Farming noted Wednesday that the midterm election "effectively terminated the welfare reform in the farm bill" provision. Analysts said the Democratic win in the House could be the thing that breaks the stalemate in the farm bill conference committee.

DFA Doubles Debt; Adding $1.1 Billion for 2 Acquisitions, con't

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Equalty Securities) would equal a hair less than ***four months worth of member milk marketings.***

DFA's creditors are comforted by Moody's Investors Service statement that payments to DFA members for their milk and equities are subordinated to the indebtedness of the co-op. Of course, DFA only carries about 30 days' of members' milk payments at any one time.

The matter of adding $125 million of "Preferred Equity Securities" makes up a separate bookkeeping flim-flam at DFA. As of 12/31/17, DFA's financial audit showed the co-op was carrying $375 million of "Preferred Equity Securities" (Preferred Equalty Securities). That's the amount of members' equities that DFA has borrowed against. According to DFA's 12/31/17 audit, the co-op was paying annual interest rates of around 7.75% to borrow against members' equities. Piling on another $125 million boosts DFA's total of Preferred Equalty Securities to $500 million.

Here's how DFA's Preferred Equalty Securities flim-flam works. The co-op borrows against members' equities. Strangely, DFA lists both members' equity and Preferred Equalty Securities as "assets" on its financial report. That practice seems, to the naked eye, to be listing the same "asset" twice … if in fact, Preferred Equalty Securities may even be an "asset" rather than a borrowed liability for which DFA is paying sky-high interest rates.

Moody's Investors Service has historically scorned DFA's Preferred Equalty Securities as an asset. In 2005, Moody's stated that the Preferred Equalty Securities were a debt-like instrument, not an asset, and credited them at zero value. Subsequently, Moody's has moved halfway towards center, valuing DFA's Preferred Equalty Securities at half of the co-op's claimed worth.

Presuming DFA continues its historic practice of listing both members' equity and Preferred Equalty Securities as assets on the 12/31/18 audit, that means DFA will either be:

1) listing a $500 million asset *twice* or,

2) counting as a $500 million "asset" what ought to be a liability.

If #1 is the case, then DFA's total assets are overvalued by $500 million.

And if #2 is actually the case, then DFA's total assets are overstated by $1 BILLION. (Think of a number line – shifting from +500 to -500 – a net change of 1,000. Then add a dollar sign and six zeroes.)

DFA's bogus "assets" on its financial audits also include hundreds of millions of dollars worth of "intangibles" and "goodwill" – accounting artifices. And throw in $100,000,000-plus in deficits for DFA's various pension programs.

Etc., etc.

Unrecovered Class 1 costs in California, effective Nov. 1. Moody's announcement that DFA would be acquiring the remaining 53% of Stremick's came on November 2 – one day after the start up of federal milk regulation for California. The new federal milk order for the Golden State is causing fluid milk processors to be unable to recover certain costs (transportation credits, supplemental nonfat solids) that were previously subsidized by California's state milk pricing program. Those unrecovered costs may total as much as 5 to 10 cents per gallon. Perhaps the owners of Stremick's – seeing rising costs with the new federal milk order – invoked "China shop rules" and simply said to DFA, "Here. You broke it. You own it."

Direct competition with Class I firms buying raw milk from DFA. Presuming that Clover Farms (Reading, PA) is the smaller of DFA's two pending fluid milk purchases, both Stremick's and Clover Farms are direct competitors with firms already being supplied with fluid milk by DFA and its subsidiary, Dairy Marketing Services. HP Hood is of particular interest in this scenario, because of Hood's longstanding relationship with DFA as a milk buyer. Example: DFA sold Hood the Batavia, New York plant that Hood is converting to an Ultra-High Temperature (UHT) fluid milk facility.

How long will HP Hood – management of which a savvy bunch – be willing to both buy raw product from DMS and compete for UHT milk sales with DFA-owned processing businesses? In that situation, the co-op has an advantage over the proprietary processor (like HP Hood), because the co-op can bleed its members' milk checks to make up for its operating losses.

In the cheese marketplace, we are seeing industry giant Kraft-Heinz edging away from DFA/DMS as a milk supplier. Kraft-Heinz has shifted to receiving about half of its raw milk supply at its Springfield, Missouri cheese plant from an alternate competitor. And in northern New York, at Lowville, Kraft-Heinz is shifting suppliers outside the grubby mitts of DFA/DMS. Could DFA's burgeoning relationship with Arla Foods – a European cheese giant – be viewed as "sleeping with the enemy" by Kraft-Heinz?