

# Milk Producers Council

13545 S. EUCLID AVENUE, UNIT B – ONTARIO, CA 91762 - (909) 628-6018 - Fax (909) 591-7328

801 S. MOUNT VERNON AVENUE – BAKERSFIELD, CA 93306 – (661) 833-2549

E-mail: [mpc@milkproducers.org](mailto:mpc@milkproducers.org)

Website: [www.MilkProducers.org](http://www.MilkProducers.org)

DATE: February 26, 2010

TO: DIRECTORS & MEMBERS

PAGES: 5

FROM: John Kaczor

## MPC FRIDAY MARKET UPDATE

### CHICAGO MERCANTILE EXCHANGE

Blocks  $-.0725$  \$1.3400  
Barrels  $-.0875$  \$1.2900

### Weekly Average

Blocks  $-.0723$  \$1.3690  
Barrels  $-.0723$  \$1.3290

### CHICAGO AA BUTTER

Weekly Change  $+.0450$  \$1.4050  
Weekly Average  $+.0477$  \$1.3990

### DRY WHEY

WEST MSTLY AVG w/e 2/19/10 \$.4050  
NASS w/e 2/20/10 \$.3946

### NON-FAT DRY MILK

#### Week Ending 2/19 & 2/20

Calif. Plants \$1.0247 11,015,655  
NASS Plants \$1.0697 16,906,986

**CHEESE MARKET COMMENTS:** Another week of losses for blocks and barrels, involving heavy trading. Barrels have now fallen four straight weeks, \$.225 per lb, from the year's high of \$1.515 per lb reached just one month ago. Blocks fell \$.175 per lb over that same time. Interesting note: all (29 truck loads) of the sales of block cheese from Monday through Thursday were made by a single plant. The reason for what's happening is simply that there is more cheese being made than is readily sold, and there has been for some time. Production of cheese in 2009 was above 2008's output nine of the last ten months of the year, before stalling in December, and exports were lower for the year. Where does it stop? Maybe soon, as cheese production typically falls in January and February, and *Dairy Market News (DMN)* reported this week that some plants, particularly in the Eastern part of the country, have been cutting back this month because they have too much cheese in storage. That's a good start. Last year, U.S. cheese production rose by 170 million lbs and exports fell by 50 million lbs. For the year, cheese stocks increased by 115 million lbs, so domestic sales have been strong even with our dismal economic crisis. As the recession winds down, domestic cheese usage is expected to remain strong and exports could recover at least some of what was lost last year. There's a lot of "coulds," "maybes," and "ifs" involved – but one thing is almost a certainty: cheese production must be better aligned with current demand in order to support higher prices that are sustainable. If that doesn't happen, expect more of the same; speculation, fear, questionable decision-making, and lots of price volatility. Presently, the CME futures market doesn't show the confidence it had last October, when the number of dairy cows in the U.S. was moving lower. Class III futures prices are now almost \$3.00 per cwt lower for the first half of the year than they were for the same months last fall.

**BUTTER MARKET COMMENTS:** The market news for butter continues to give sellers and buyers reason to look ahead with optimism and some confidence. The situation is almost the exact opposite of what is happening with the cheese market. U.S. production of butter in 2009 was 76 million lbs below 2008's output, and domestic sales remained strong even with weaker restaurant demand. Exports collapsed: down by 72% from the previous year's peak, a loss of about 127 million lbs of sales. Imports in January were up by 59%, but the actual volume is negligible. The amount of butterfat products in cold storage in the early part of the year was below the previous year's levels then rose above and stayed there until January's report showed a slight drop. Butter prices on the CME for the past seven weeks, although swinging about, are higher than they have been at this time of year in the last five years; CME futures prices for the next ten months are averaging about \$.14 per lb higher than the current spot levels. Butter production is expected to increase seasonally through April before moving lower, but heavy usage of cream for Easter and Passover, and for ice cream production, along with continuing strong domestic butter usage, is expected to keep butter inventories from getting too high. Unless, of course, milk production changes course and begins to climb back above last year's levels.

**POWDER MARKET COMMENTS:** The market for nonfat dry milk is an unsettled mess. Manufacturers continue to slough off as much product as they can – more than can be readily used – and prices continue to fall. There seems to be little optimism, confidence, or trust among manufacturers and buyers. DMN reports that some sales in the West continue to go for as little as \$1.00 per lb. Some buyers are said to jump at the low prices,

while others are waiting until things settle down. On the CME, grade A powder has been steady at \$1.12 per lb and extra grade at \$1.24 per lb. Futures prices, which had been selling at a discount before the January price drop, are now at about the levels of recent weekly average NASS prices. Some light should be shed on true international values next week when Fonterra's internet auction takes offers for the first time on its skim milk powder. Because of recent prices for NFDM in the U.S. and the huge amount of SMP in government storage in Europe, internet buyers are not expected to accept prices much different from what DMN has been reporting as their reading on prices f.o.b. ports in New Zealand.

**WHEY PRODUCTS MARKET COMMENTS:** Although the market is unsettled, according to DMN, current prices for dry whey and whey protein concentrate have been holding up surprisingly well in the face of the drop in NFDM prices. However, CME futures prices for dry whey did react almost immediately in late January when the NFDM prices collapsed, and have continued to move downward since. May's dry whey futures price is now more than \$.12 per lb lower than the price recorded by NASS for sales made last week. Estimated prices per lb of protein are currently as follows: whey protein concentrate (34% protein), \$2.57 per lb; dry whey, \$3.29 per lb; NFDM, \$2.97 per lb. Strong exports are helping to hold prices for the whey-based products where they are. Considering its apparent value, it's not surprising that exports of WPC increased by 29% last year.

\*\*\*

### **FRED DOUMA'S PRICE PROJECTIONS...**

<b>Feb 2010 Est:</b>	<b>Quota cwt. \$ 14.85</b>	<b>Overbase cwt. \$13.15</b>	<b>Cls. 4a cwt. \$12.81</b>	<b>Cls. 4b cwt. \$12.92</b>
<b>Last week:</b>	<b>Quota cwt. \$ 14.87</b>	<b>Overbase cwt. \$13.18</b>	<b>Cls. 4a cwt. \$12.82</b>	<b>Cls. 4b cwt. \$12.98</b>

\*\*\*

**GOOD READING SUGGESTIONS:** (By J. Kaczor) The U.S. dairy industry is supported by many excellent periodic publications that cover a wide variety of subjects and include interesting and provocative editorial comments. Among the one's without editorial comments I look forward to reading are some under USDA's Economic Research Service (ERS) and Foreign Agricultural Service (FAS) banners which update their latest understanding of U.S. and international milk supply and demand changes, and possible affects on prices. They are easily found on the internet. Among the publications that include editorial comments are the *Cheese Reporter*, *Hoard's Dairyman*, and *The Milkweed*. Among the latter three you will find an amazing variety and range of factual reporting, viewpoints on a wide variety of industry matters, and editorial comments that are thoughtful and thought-provoking.

For example, in the February 10, 2010, edition of *Hoard's*, you will find a concise report on the geographic pattern of milk cows, by county, throughout the U.S., an article on what lies behind California's big milk drop (by Bill Van Dam), a forecast and discussion of what may happen to milk prices and margins in 2010 (Peter Vitaliano), another article on 2010 prospects with a little more detail (Andy Novakovic), and an editorial comment which disagrees with a recent USDA analysis that apparently implied that the CWT herd removal programs weren't very effective and which suggested the drop in cow numbers in 2009 would have happened even without CWT's help. "*The numbers speak for themselves. We don't know how anyone could conclude [otherwise],*" says the response. Well, in defense of USDA, numbers for other years also speak for themselves. For example, over a four month period in 2006, when CWT did not have the money to sponsor a herd removal program and milk prices were downright miserable, milk producers shed 38,000 cows; from January 2003 to January 2004 milk producers reduced herds by 156,000 cows (please, do not credit CWT's after the fact HRP, hastily formed in late 2003, with any of this reduction because cows were eliminated for four more months after that program came and went); and in the twelve months ending with September 2001, producers, acting on their own, removed 139,000 cows from production. In all likelihood, CWT's five herd removal programs in 2009 probably did help somewhat; let's say a net reduction of 25,000 because other producers, including members of CWT, with the knowledge of what CWT was doing or going to do, were aggressively expanding.

**AN INTERESTING LOOK INTO THE CALIFORNIA DAIRY INDUSTRY:** (By Rob Vandenheuvel) The January 29<sup>th</sup> issue of *Cheese Reporter* included an interesting article based on a recent speech by Paul Mulder, CPA, partner in Genske Mulder & Co., LLP. Paul's speech focused on the effect 2009 had on the California dairy industry. For those of you who weren't able to read the article already, I've put most of the article below. The full article can be found on our website at: <http://www.milkproducerscouncil.org/Mulder.pdf>.

*Courtesy of “Cheese Reporter” ([www.cheesereporter.com](http://www.cheesereporter.com)), January 29, 2010*

## **Banks Have Kept California Dairies Going, But May Soon Pull Trigger On Unpaid Loans**

**Cleveland, WI**—A great majority of California’s nearly 2,000 dairies are still engaged in full-scale milk production after suffering staggering losses during late 2008 and throughout 2009, certified public accountant Paul Mulder told his audience at the 2010 Lakeshore Technical College progressive operators seminar here earlier this month.

Mulder, who is a joint owner of Genske, Mulder and Co. LLP at Ontario, CA, and one of eight partners in two western dairies, said “it’s the bankers who kept them going” during periods of many months when the dairies in California and a few other states couldn’t even cover their feed costs with the income from their milk sales.

“They’ve run up against a wall. They don’t know what to do,” he said. “They’re happy if they were able to operate at close to breakeven.”

“It’s just amazing,” Mulder says of some of the dairies which continue to hang on despite their all but hopeless financial situations. He knows of one which has taken on the additional burden of \$20,000 per month in attorney’s fees, is aware of only a few herd liquidations so far, and points out that in some cases “the banks are in worse shape than their dairy clients.”

As to what’s ahead, Mulder’s theory is that “the banks will pull the trigger” on the unpaid loans “when the value of cows starts to come back. Then there will be blood out there.” He surmises that this will begin to happen in about six months.

In his capacity as business advisor and tax planning specialist for dozens of dairy farm clients who are in that predicament, Mulder had a front row seat for observing the financial disaster which has hit since late 2008. Many of the Western dairies “have gotten this far because the banks kept funding them,” in large part because the alternatives for the banks were even worse, he suggested.

Unlike some other observers, Mulder doesn’t view the nation’s dairy sector challenges from an “East versus West” perspective. He describes them instead as “each dairy operation looking out for itself, states also looking out for themselves, and countries doing the same with imports and exports. There is more conflict out there.”

“This is not about geography,” Mulder declared. “A good dairy manager can be profitable anywhere. But all areas were losing money in 2009. So this is not about area.”

While California was caught in the national phenomenon of a major downturn in milk prices after the record high prices of 2007 and 2008, Mulder cited several factors which exacerbated the economic crunch in the state. A great expansion of milk production has lowered the fluid market utilization from 70 percent in the 1960s to 14 percent today.

During times of a bad dairy economy in the past, a popular way to cope was to add cows, increase milk production, and thereby reduce the per hundredweight cost of milk production, Mulder observed. But this changed in 2008 when the milk powder export market greatly evaporated and the largest California dairy cooperatives imposed production controls and levied penalties on shippers who overproduced.

As a result, there was a “not in the news” silent dumping of excess milk into lagoons, dairies sold their lower-producing cows, cutbacks were made in dairy rations to limit milk production, and some bull calves were raised as steers because they had virtually no market value if sold as calves, Mulder reported. But this didn’t solve the problems as milk prices fell, dairies fell behind on payments for feed and to vendors, and real estate was refinanced in order to survive in business.

Mulder listed the 2009 operating losses for more than a dozen of his clients in California, Idaho, Texas, Colorado, Minnesota, and Ohio. Some of the cow numbers and operating losses were 2,600 and \$1.684 million, 466 and \$644,000, 5,071 and \$4.105 million, 7,164 and \$3.616 million, 3,060 and \$1.994 million, 1,939 and

\$1.832 million, 1,150 and \$1.158 million, and 644 and \$792,000.

At the 2,000-cow Shawnee Dairy, in which Mulder and his partners invested \$1.34 million in 1991, the equity had risen to \$7.126 million from operating profits before the equity eroded by \$4.45 million from August of 2008 through November of 2009, he disclosed. At the Queso Grande near Roswell, NM, in which the partners invested \$1.925 million in 2000, the value grew to \$6.078 million by early 2008 before the August 2008 to November 2009 losses were \$5 million, he added.

“Dairymen are a unique breed. They are farmers,” Mulder observed. “They will stay in business until they run out of money.”

As an extreme example, Mulder mentioned a client who received huge loans from and eventually ran up a \$50 million debt with a Greeley, CO, bank that has since been taken over by the Federal Deposit Insurance Corporation (FDIC). When no other bank would assume that bank’s existing loans, the FDIC sold the \$50 million portion of the portfolio for \$14 million to an investment group which hopes to resell at \$20 million, setting up the theoretical possibility that the original debtor could reduce his debt from \$50 million to \$20 million if he is able to procure a loan from another source, he explained.

In most other situations, taxes would be owed on the write-down of debt but farmers can obtain an exemption on such a tax obligation, Mulder disclosed. He added, however, that a \$12 per hundred price in that dairy’s milk market would not serve to discharge any of the debt because the cost of milk production is close to \$16 per hundred.

Despite the economic travail for a great majority of dairy operations in the West, Mulder pointed out that there are immigrants from Holland and Belgium who are anxious to get into the dairy business. “They have lots of money. These are aggressive people with high goals,” he stated. “They want cows.”

Among the many three generation dairy families in California, the economic downturn has prompted some members to diversify to the production of fruits, the establishment of vineyards, cheese processing, and the purchase of land likely to appreciate in value, Mulder reported. “They’re not adding more cows.”

But that’s quite different from the burgeoning of California’s dairy sector which leapt into first place for milk production and which still produces nearly 50 percent more milk than second place Wisconsin despite California’s cutback in milk production during the past year, Mulder continued. What has also happened and is continuing somewhat even today is that California’s dairymen, or members of their families, are expanding in several other states rather than within California and are “chasing a better milk price” as they do so.

Through his contact with clients since 1981, Mulder has documented many of the family histories, their movements within California, the expansions within the family, and the later relocation of members of those families to Idaho, New Mexico, Arizona, Texas, and most recently to Illinois, Indiana, and South Dakota. Genske-Mulder’s business grew in tandem with those movements and expansions because the family members who set up the new dairy operations sought services from the company if the family had already been a client.

California had about 3,400 dairy herds in 1975 but this has dropped to under 2,000 today with an average herd size of 850 cows, Mulder noted. Most of today’s larger operations originated in the outskirts of Los Angeles in the 1940s but many of the families have moved two to three times since then.

One of Mulder’s clients today started in 1945 as a single family dairy with 300 cows, had 4,200 when four sons were involved by 1965, and the extended family owns 33,000 cows in three states today. Another family which started with 400 cows has 12,600 today, including a 4,200-head herd in Minnesota, while an immigrant from Holland compiled equity of \$30 million in owning herds in California and Stephenville, TX.

A client family which had 300 cows in Chino Valley in 1970 survived some tough times and has a total of 4,500 cows at two New Mexico sites today and had amassed a net worth of \$15.7 million but another family which started with 400 cows at Artesia near Disneyland and gradually expanded to 9,000 head has three members who

are in various stages of “being broke” today, Mulder disclosed. In another case, he noted that the former owner of a 1,200 cow herd that went into the Cooperatives Working Together (CWT) bid buyout in 2009 still owes \$1 million.

After citing several other successful expansions within families and relocations first to the area about 40 miles east of Los Angeles, then north to the Central Valley and Visalia and outward to Idaho, New Mexico, South Dakota, and Texas, Mulder suggested that these were examples of how owners and managers “had learned to use debt as a tool – up until last year.”

The rapid expansion in California was fueled on several fronts, Mulder stated. He listed a very easy bankers’ lending policy with interest-only payments being required on many of the operating loans, the continuing increase in dairy cow values, the federal Section 1031 reinvestment of tax-free capital gains from sale of real estate on earlier dairy properties as residential development took over near Los Angeles and then in the Chino Valley, the obtaining of California milk pool quotas at no cost, and the farmer’s habit of spending for new investment rather than paying income taxes.

Regarding the current economic travails of many of those families, Mulder doesn’t have a solution other than to have milk prices rise above the costs of production – still \$2 to \$4 per hundred short of that goal in many cases today. He emphasized, however, that “management is often the difference between financial success and failure. Management is a whole realm of knowing where you’re at.”

One practice that Mulder doesn’t recommend and that few California dairy operators engage in is futures pricing for milk. He noted that this contrasts with their long-standing contract pricing for feed.

Mulder hesitates to push for futures pricing in part because there is no history of reliable trends for the timing and pricing of such contracts and says “I’m scared of a locked-in contract” because of how it could limit profits and advises clients who “have the equity to survive a turndown” not to consider contracting. He notes that any number of external factors can arise quickly to drive milk prices in either direction.

The experiences of some clients who contracted at \$12 per hundred in 2007 only to have the cash price jump to \$17, to have a 4,300-cow Kansas herd lose \$2.667 million on its way to a \$29 million debt that its banker is still backing, and to have the owner of a 6,700-cow Idaho herd leave \$3.1 million on the table also make Mulder wary of futures contracts.

What Mulder wonders, however, is whether dairy sector lenders are going to follow the practice for the beef industry and require a locked-in milk price in order to approve operating loans. By keeping some in business with loans when they would otherwise be bankrupt serves to keep milk production up and to lower the milk price for everyone, he observed.

To read the full article, you can find it at: <http://www.milkproducerscouncil.org/Mulder.pdf>.

**FEBRUARY CARES COLUMN NOW ON OUR WEBSITE:** *(By Rob Vandenheuvel)* The latest Dairy Cares column is now available on our website: <http://www.milkproducerscouncil.org/cares.htm>. This month’s column focuses on the barrage of attacks our industry has sustained over the past couple years in the area of animal welfare. We have become a target for not only animal rights extremists, but also the mainstream media (i.e., ABC’s World News Tonight). While a vast majority of our dairy farmers are deeply committed to the welfare of their cows, our industry needs to do better at sending that message to the most important group – our consumers. If we don’t send that message, we will continue to be defined by extremist groups like the Humane Society of the United States. Dairy Cares is involved in these efforts, and I encourage everyone to take a minute and read this month’s column.