The Milkweed

Dairy's best information and insights

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

U.S. Agriculture Faces Surplus, Price and Credit Crises in 2018

by Pete Hardin

Several years of ears-flat-back output for numerous agricultural commodities have resulted in U.S. agricultural producers and their assorted lenders looking at some very sobering prospects for 2018. And dairy is right near the head of the pack in this sorry state of affairs.

U.S. agriculture is on the verge of some very tough decisions, for farmers, agricultural cooperatives, and their lenders and suppliers. Long-term price droughts in key sectors promise a brutal re-appraisal of agricultural assets and creditworthiness. Farmland values in many areas of the Midwest and Plains have been softening for a couple years. Used equipment values are generally soft, and will further soften once 2017's crop harvest is complete and early 2018 expenses loom.

Take your pick … corn, dairy and pork are deep into multi-year price depressions. Looking ahead, soybeans look like they have some solid legs underneath them, price-wise. Beef prices, which tanked in mid 2015, seem oblivious to any semblance of competition among processors. The poultry industry expanded (building new barns), in response to the avian flu epidemic of a couple years ago that de-populated many flocks. But both the old and new barns seem to be producing more broilers and eggs than the market bears.

Looking at 2018, legitimate questions must emerge about what farm-gate prices will be and what prospects farmers face for obtaining necessary operating loans next spring. The storage bins are overflowing unsold grain. Dairy commodities are piling up – particularly dairy protein powders like nonfat dry milk and whey.

Farm lenders have no choice but to closely scrutinize many borrowers' financial portfolios. Lenders generally have government-mandated standards for the worthiness of assets in their lending portfolios. The period for forbearance with problematic borrowers has just about expired.

Dairy's curse: Same asset collateralized twice

Nobody ought to be more nervous than the bigwigs at the Farm Credit System. And, regardless of any other commodities' problems, dairy has to be at or near the top of the pile of worries at the Farm Credit System. That's because the Farm Credit System, top-to-bottom, has sanctioned for decades the use of the same asset as collateral by two different borrowers under its extended roof – dairy co-ops that borrow from CoBank, and their dairy-farmer members who borrow from local Farm Credit offices.

So how does the same asset get used as collateral twice? Simply stated: many dairy cooperatives' pledge their receivables as collateral for loans – i.e., funds from milk sales that have not yet been paid out to members. At the farm level, however, dairy farmers themselves with significant borrowings have also pledged their milk checks as collateral. Thus, the same basic, or dollar asset – payments due the farmer through the co-op – is doubly pledged. Until something goes wrong, everybody is either happy or blissfully ignorant of this situation.

But when it comes to dairy cooperatives, things can and do go wrong. Historically, when dairy co-ops fail, the farmer may watch some or all of his/her outstanding milk income evaporate. Historically, the Farm Credit System has sought to merge troubled dairy co-ops into larger entities, to avert the specter of abysmal failure.

Historically, the way CoBank deals with problematic dairy co-op borrowers is to dictate equity requirements and compel that the co-op "bleed" members' milk checks. That "bleeding" serves two purposes. First, to cover current operating losses, erasing them as they occur (through members' milk check deducts). And second, to shore up dairy co-ops; depleted equities … through milk check deducts.

The scenario of CoBank dictating that dairy co-ops deduct funds from members' milk checks operates on the "logic" those that the co-op's financial stability supercedes of individual farmers'. That's the way things work, like it or not. Sounds like Communism, which "thrived" on treating farmers like serfs, but could not feed the USSR.

Ultimately, in the analysis of *The Milkweed*, CoBank's master plan maybe to shove many of its financially-troubled dairy cooperatives into a single structure – using DFA as the basis. Come to think about it, that's exactly how DFA was formed 20 year ago, when DFA was formed by consolidation of four dairy co-ops, three of which were financially challenged. It's the same old story, 20 years later … with no good answer to how modern dairy cooperatives should be responsibly financed and managed.

We profile Salemville Cheese Co-op near Cambria, Wisconsin. Salemville's 62 Amish members' faith requires them to milk their cows by hand. Milk is delivered to the plant in milk cans The plant makes top-quality Blue and Gorgonzola cheeses. (See pages 8-9.)

DFA's Debt Up $313.5 Mil. During 2017's First Half

On October 9, 2017, Moody's Investors Service updated its credit opinion for Dairy Farmers of America, Inc. – this nation's largest dairy producers' cooperative. One eye-popping statistic jumped off those pages – a huge increase of $313.5 million in DFA's "As reported debt" at mid-2017 (June).

For the fiscal year ending December 31, 2016, Moody's Investors Service found DFA's "As reported debt" totaled $841.5 million dollars. But as of June 2017, DFA's "As reported debt" had skyrocketed to $1.155 BILLION. That increase represents a 37.4% increase. Wow!

In New York State, rumors are swirling that **some**, but not all, DFA members recently received a letter warning of a steep milk check deduct coming soon. See *The Milkweed's* analysis of DFA's finances on page 6 of this issue.

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Block-Barrel "Split" Dramatically Inverted

by Pete Hardin

Cheddar cash market trading at the Chicago Mercantile Exchange (CME) on Friday, December 8, may have set some sort of record for "inversion.' That day, barrel Cheddar finished trading at $1.67 per pound, while 40-lb. Cheddar blocks closed at $1.4750 – a gaping 19.5 cents per pound inverted spread.

Under "normal circumstances" (whatever they may have been), 500-lb. Cheddar blocks range about three to four cents per pound below the 40-lb. block Cheddar price. That presumption is so deep-set in dairy's pricing mentality that USDA adds three cents to the barrel Cheddar monthly average of the weekly survey prices. (Barrel Cheddar contains slightly more moisture than blocks.)

The block-barrel "split" during 2017 has seen some wild gyrations. Earlier in the year, Cheddar blocks were more than $.30/lb. higher than blocks. But for some strange reason, block Cheddar prices have tumbled below barrel Cheddar in recent weeks. The December 8 "spread" was the biggest of its kind so far.

According to weekly commodity price survey data issued by USDA's Agricultural Marketing Service, volumes of block and barrel Cheddar sold by manufacturers are pretty much equal … maybe a slight volume advantage to blocks. Much cheese is sold by manufacturers using various CME quotes, such as "Day of Make," "Weekly Average," or "Date of Shipment." But cheese plants whose milk is pooled on federal milk orders have their costs defined by the monthly average of AMS' weekly surveys.

In fact, there appear to be evolving TWO significant price spreads for Cheddar. The first spread is the block-barrel spread, which now threatens the cash-flow of plants producing block Cheddar. The higher values of barrel Cheddar are averaged with block prices, in USDA's calculations for monthly Cheddar prices that go into the Class III (cheese) milk formulae. Adding three cents per pound to barrel Cheddar prices, when barrels are already far higher than block Cheddar, merely adds insult to injury.

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