The Milkweed

Dairy's best information and insights

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

Straight Ahead: Global Surge in Human-Quality Protein Prices

by Pete Hardin

In the early 1970s, a series of complex weather and crop events combined to dramatically reduce global food supplies:

• Russia suffered a near complete failure of its wheat crop. Russian buyers – with the connivance of high-level USDA officials – bought heavily from U.S. grain supplies before our nation's farmers and grain marketers realized there was a global wheat shortage.

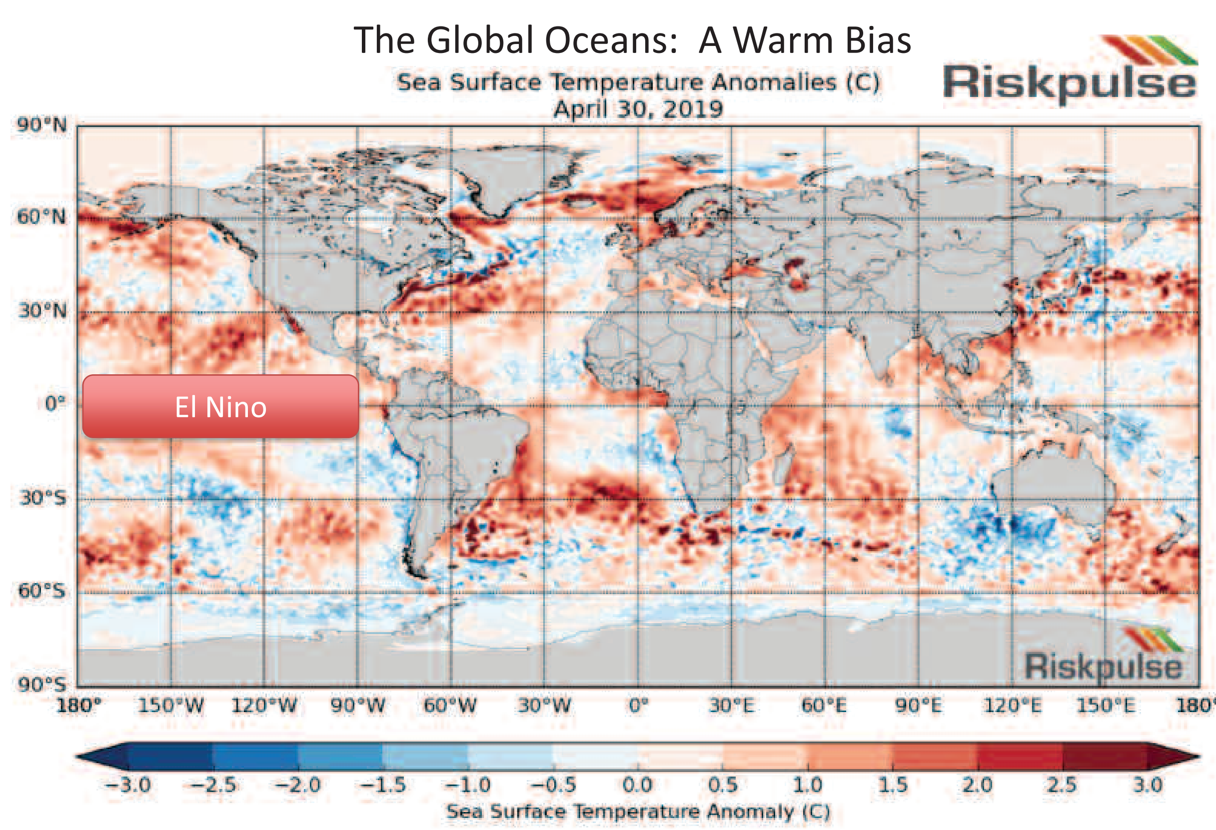
• One year, the Peruvian anchovy harvest was zero, due to aberrant temperatures in the Pacific Ocean off the South American coast. Back then, Peru's anchovy harvest made up 25% of crude protein fed to livestock and poultry ***globally.*** *Resulting shortages of protein for livestock/poultry feed drove up soybean prices to $14 per bushel in the United States.*

• A corn disease – Southern Corn Leaf Blight – wiped out 10% of the U.S. corn crop.

As a result of these events, prices for agricultural commodities and consumer food prices spiked dramatically. The human protein complex – beef, pork, poultry, fish and dairy – was particularly sensitive to higher grain costs. Livestock prices rose, consumers paid dearly for meat and dairy at the supermarket. The U.S. government invoked a ban on soybean exports – shutting off Japan (a key customer) from its raw materials used to make soy sauce and tofu.

Fortunately, weather events (and the Peruvian anchovy harvest) soon reverted to normal and world food reserves stabilized within two or three years. Japanese investors helped develop the Brazilian soybean industry – a slap at the United States for being an unreliable trading partner. Globally, soybean acreage has grown dramatically – reducing reliance upon protein sources such as Peru's anchovies.

In the analysis of The Milkweed, the current confluence of severe weather events and disease problems in China's swine industry are starting to approximate those thrilling days of the early 1970s' food shortages. As a nation and a world, we are one disruptive, major event away from a return to the early 1970s' scarcities of human protein supplies. What's different about modern times? First, there are a couple billion more citizens of the globe – particularly in Asia, where dramatically improved economic conditions have allowed those people to develop far greater tastes for western-style diets – beef, pork, poultry and dairy. China's population has increased by a half billion since 1970.



This map depicts April 30, 2019 global Sea Surface Temperature (SSTs) Anomalies (differences from the historic norms), in degrees Centigrade. SSTs are major influences on weather and climate. Global SSTs are currently warmer than historic norms. Warm Pacific Ocean water temperatures foreshadow an El Nino event, which generally means a wet spring/summer in the Upper Plains and Midwest. Global agricultural areas of peak concern for adverse weather in coming months are North America and Southeast Asia (including Australia and Oceania).

Source: Jon Davis, Chief Meteorologist – Riskpulse.

Current challenges to global food supplies

A series of weather disasters, along with China's African Swine Fever contagion, are combining to boost demand for global human protein supplies – particularly in the red meat sector. The severe weather events include:

• Australia has been devasted during the past year by intense heat and drought, as well as flooding in that country's northern regions in late January/early February. Dry conditions have spread to New Zealand in recent months.

• Field conditions and planting progress in the agricultural heartland of the United States have been

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Commodities to Springers: Dairy Prices Improving

by Pete Hardin

After 4-plus long years of depressed farm milk prices and eroded dairy livestock values, dairy prices are improving – boosted by increases for dairy commodities such as Cheddar cheese and nonfat dry milk. Butter prices have recently bumped up into the $2.30s ($/lb), after spending many months locked in the $2.20s.

The combined March-April 2019 uptick in USDA's Class III (cheese) milk has totaled $2.07/cwt. Those Class III price boosts do not reflect early May gains in Cheddar cheese prices at the Chicago Mercantile Exchange. Recent prices for both barrel and block Cheddar that pushed just above the $1.70/lb. level are a little high for current conditions. The market corrected downwards on May 12.)

Among the major dairy commodities, only whey prices are suffering. That's greatly due to eroding demand by China's swine industry, which is caught in a maelstrom of widespread deaths due to African Swine Fever.

Perceived improving milk prices are spurring buyers' interest in springing heifers. However, livestock brokers advise that buyers are looking for quality animals. Prices for open dairy heifers are bumping up. And prices for quality dairy culls are improving.

Nationally, farm milk production is slowing. March '19 milk production in the top 23 states was down 0.1% — the first monthly decline in some time. Milk cow numbers are declining. Poor crops harvested last year in the Upper Midwest, Northeast and Southeast are also depressing milk production.

Ahead? *The Milkweed* projects continued improvement in farm milk prices, driven by higher prices for dairy commodities (other than whey). Dairy marketers see serious cream shortages during 2019's second half. Difficult weather events in the world's three major (first world) dairy-producing regions: Oceania (New Zealand, Australia), Western Europe, and North America are highly likely to challenge farm milk production for at least the next year, if not beyond. Australia's dairy and livestock and industries were scorched by heat and drought in 2018. And early 2019 saw the Aussies hit with devastating flooding in the northern parts of that island continent. Precipitation has been scarce in New Zealand in recent months – contributing to a major, late-season slow-down in farm milk production. Adequate precipitation in coming months is needed to restore pasture conditions in New Zealand throughout the next several months

Here in mid-spring 2019, many agricultural areas of the United States feature saturated, cold soils – conditions that are delaying spring field work and planting. In northern dairy states, concerns about winterkill problems for alfalfa stands are front and center.

Ultimately, Mother Nature rules. And she's continuing to be rather difficult.

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Straight Ahead: Global Surge in Human-Quality Protein Prices, con't

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severely impaired by incredibly wet, cold weather this winter and spring. Iowa, for example, has experienced its rainiest spring in over 120 years. Spring planting across wide regions of the U.S. has been delayed. Some intended acreage will not adequately dry out in time for normal, intended plantings.

A series of weather disasters, along with China's African Swine Fever contagion, are combining to boost demand for global human protein supplies – particularly in the red meat sector.

What's the difference between present challenges and those of nearly 40 years ago? C-H-I-N-A. At the end of 1970, China was an insular country of some 829.9 million citizens living in Third World status. China was struggling to recover from Chairman Mao's fatally-flawed, "Great Leap Forward." As a result of forced collectivization of food in rural areas dictated by Chairman Mao, untold millions of Chinese died of starvation and related diseases in subsequent years. The "Great Leap Forward" went so far as to feature Communist functionaries seizing rural villagers' cooking pots – forcing their dependence on communal food systems. Then, the food supply withered.

Today, China is a nation of approximately 1.4 billion citizens, a large number of whom have enjoyed tremendous economic growth during the past three decades. As China's middle and upper economic classes have blossomed, they've widely adopted western-style diets, including greater amounts of meat and dairy.

Compared to the chilling days of the "Great Leap Forward' (details and memories of which China's government seeks to bury), China's citizens are generally well fed. However, adequacy of food supplies is just about THE most important pillar undergirding China's political stability. That fact explains China's reaching out to secure supplemental food supplies from many parts of the world, including the United States. Ownership by the Chinese military of Smithfield Foods – the United States' largest hog slaughterhouse operator – is one example of China's tentacles spreading to grip critical links in the global food supply … particularly red meat.

Pork is the single most consumed meat in China, on a per capita basis. Pork prices paid by Chinese consumers represent a key element in China's official inflation index. Consumers' pork prices in China have doubled in recent months. China's pork industry is in deep trouble, due to African Swine Fever.

Conservative estimates, such as reported recently by Rabobank, estimated that 150 to 200 million of China's swine population would either die from African Swine Fever or be killed in disease eradication efforts. Rabobank is the world's most prominent agricultural lender, based in The Netherlands. Other estimates project even bigger declines for China's hog population. Distrust reigns. Some Chinese pork producers have acknowledged not reporting suspicious deaths of their hogs to government authorities. When government inspectors are due for visits, other producers will play "hide and seek" — moving some or all of their animals off-premises.

Contaminated feed materials are believed to be a key vector introducing African Swine Fever into China's hog population. Eastern European sources are pointed to as the culprit for those rumored, contaminated feeds. African Swine Fever is present in Eastern European countries and Russia. Feed industry sources explained to *The Milkweed* that China is now buying rations for its hog population in distant parts of the world, testing those feeds, and then heat-treating the to kill pathogens, prior to feeding. Credit Chinese officials with trying to find solutions. Unfortunately, there is no vaccine available to ward off the ravages of African Swine Fever.

China scouring globe for red meat –

So, the world's most populous nation will lose a minimum of 25% (or so) of the single most important source of meat in its citizens' diets. And ravages to China's pork population could be far greater, some skeptics fear. In response, China is ramping up its global procurement of pork and beef. Anticipated greater export demand to China has already pushed U.S. hog futures to all-time peak levels – around $75 per 100 lbs. And sources indicate that even higher hog prices will likely follow.

U.S. hog producers are tempering their joy at prospects of record high prices. That's because they fear the United States will ultimately be infected with African Swine Fever. The International Pork Congress, scheduled for July in Des Moines, Iowa, was recently cancelled. Fears were that international attendees might import the dreaded African Swine Fever on their shoes or clothing.

China has started purchasing increased amounts of beef from the United States, to supplement dwindling available pork supplies. Two factors are furthering demand for added Chinese purchases of our nation's beef:

• Weather ravages (heat, drought and flooding) have caused Australia to lose over one million head of cattle – dairy and beef – during the past year. That massive loss leaves recent months' milk production down double-digits in Australia (compared to same-month, year-ago figures). Also, Australia's diminished beef cattle numbers leave far less beef available for export. Surviving animals often suffered severe stress from weather events.

• Some Chinese citizens fear that eating pork may not be safe. Thus, they are purchasing more beef. Declarations by the Chinese government that pork is "safe" ring hollow with some Chinese citizens. They've been skeptical of their government's food safety oversight for more than a decade, ever since the 2008 debacle with melamine contamination ruined confidence in the safety of local dairy products.

Thus, nations such as the United States, Brazil, Argentina, and maybe Canada may benefit from increased sales of beef exports to China. (Note: Canada is on China's "shit list" lately, because the Canadians cooperated with demand by the U.S. government to arrest a high-level executive of a Chinese electronics executive. Recently, China interrupted imports of Canadian canola due to that arrest.

U.S./China trade talks' fail

China's emerging serious food challenges are quickly worsening, just at a time when the U.S. government is trying to force China to kow-tow to our nation's demands regarding international trade rules and practices. The relationship between China and the United States is tenuous. If China's food needs weren't so great, those trade negotiations might have already collapsed into even sharper acrimony.

At press time, high-level Chinese officials are in the United States, trying to work out amended trade rules. President Donald Trump has been employing his usual "sweet and sour" strategy of alternating promises and threats. In the current negotiations, China's leaders must balance their nation's looming food needs, while not being perceived by its citizens as being subservient to the United States' dictates. Historic humiliations of the Chinese by western nations is a still sore scar in the psyche of the Chinese people.

Few historic positives from "food as a weapon"

The current trade war(s) between China and the United States were irrationally based from the git-go. The Trump administration imposed 25% tariffs on imported steel, and 10% tariffs on imported aluminum in 2018's second quarter. The alleged purpose of those import tariffs was to slap China for its trading practices. However, at that time, China was the source for only 2% of this nation's steel imports. Far more steel was entering the United States from solid trading partners such as Canada, Mexico and the European Union. Curiously, since those tariffs were imposed on steel imports, the U.S. government has honored 40% of requests by Chinese importers to forego those tariffs. (Far fewer such requests from Canada and Mexico have been honored.)

Thus, the steel and aluminum tariffs have failed to chastise China, while doing great harm to relations between the United States and Mexico, Canada, and the European Union.

China – along with Canada and Mexico – quickly responded to those import tariffs by placing countervailing, 25% tariffs on imports of many U.S. food products, including dairy. (Note: China did not impose a tariff on infant formula imports. Further, China has not collected import tariffs on a significant amount of pork imports through Smithfield Foods – no sense adding 25% to the costs of a business owned by China's military.)

China cognitively "weaponized" food imports from the United States. That move was predictable, since food products are this nation's major export category sold to China – one of the few areas against which China could counterstrike. But making food a weapon in times of national food emergencies is a dangerous strategy.

China's tariffs on U.S. soybeans have dramatically diminished our nation's exports by 74% during the past year – dropping current soybean cash markets to the lowest levels in several decades.

Ultimately, China's vulnerability in its trade war with the United States boils down to that nation's need to provide quality, human proteins to its citizens. Short-term, the growing global shortage of human proteins may force China's leaders to accede to some demands of the Trump administration. But longer term, it's likely that China will push back against pressures brought upon it during a period of food vulnerability.

River City Mayors, con't

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The ASA president said he hoped the administration could "resolve this situation and make sure the China market is viable going forward." The flooding and the trade war's effect on international marketing affects farmers throughout the basin, he added.

The market with China was established 40 years ago, and this trade war could have an impact on several generations to come, said Stephens, who was recently in China hoping to shore up trade relations.

"We are not seeing the assistance we've looked for from the White House," Klipsch added. "We need to have some moderation for soybean growers."

Mayor Phil Stang of Kimmswick, Missouri, elaborated further: "Ultimately, people's livelihoods are on the line. I suppose I would like the administration to hear from us that there is a nuance to these negotiations that has an exponential impact on the ground. If you're going to take a tough line with China for American interests, fine, we can get behind that, but there are impacts to real folks on the farm and on Main Street."

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608-455-2400

China's Hog Deaths Drop Demand for U.S. Whey/Lactose

by Pete Hardin

Every time a Chinese hog dies of African Swine Fever, on the way down it defecates on the price of U.S.-produced whey and lactose.

Facing the specter of at least 150 million deaths out of its population of 700 million hogs, China's needs for U.S.-produced whey and lactose materials is diminishing.

Industry sources report that warehouses in China's "Free Trade Zones" are chock full of de-proteinized whey (DPW), whey permeate, and lactose permeate. All of those dairy-derived materials have been important sources of nutrition for China's massive hog industry. The situation is much the same in South Korea, with warehouses brimming over with these dairy materials originally intended for China's hog industry.

Prices are plunging dramatically. Scuttlebutt around the busy bar at the American Dairy Products Institute's meeting in early May in Chicago told of offers for lactose permeate in the 10-11 cent per pound range. That's nearly a 50% decline in just the past week, when comparing prices cited by USDA's Dairy Market News during the prior week!

What's ahead? Overall returns from the whey complex have been trending lower, despite lower cheese production in the United States. Cheese plants may reach a least-loss strategy of land-spreading some whey and lactose materials, rather than processing them. For lactose permeate, it's generally estimated that $.20/lb. is a break-even figure for highly-efficient processors.

Whey prices are a key element in USDA's monthly pricing formula for Class III (cheese) milk. Each penny per pound movement in whey prices will move the Class III price by $.06/cwt. – up or down. Thus, we'll probably see sinking whey prices offset some of the upwards propulsion currently being seen for commodity Cheddar prices at the Chicago Mercantile Exchange.

DFA Studying Doubling of Members' Equity Requirements

by Pete Hardin

Details are nebulous, because the co-op's leaders are studying various proposals. But word emanating from the annual meeting of Dairy Farmers of America in late March is that the co-op is reviewing its member equity needs and seems likely to DOUBLE members' equity requirements – from the current $1.75/cwt. on a year's milk production up to $3.50/cwt. $3.50 per hundredweight on a year's production? That's a lot of moo-la.

Raising equity levels at DFA was reported in the April 19, 2019 issue of *Progressive Dairyman*. That publication reported:

"Despite the lengthy stretch of lower milk prices, Rick Smith, DFA president and chief executive officer, said the cooperative needed to invest in milk markets and be in the position to take advantage of other market opportunities. That will include adjustments in DFA capital retention and patronage earnings programs, asking members to invest a larger share of their milk check and patronage earnings back into the co-op.

"Under a timeline outlined during the meeting, the DFA board will provide details on capital restructuring to members by the middle of 2019, with implementation likely before January 1, 2020.

Within weeks of DFA's announcing pending higher equity requirements, many DFA members in Wisconsin were calling other milk marketers, seeking to leave DFA.

In *The Milkweed's* analysis, DFA's current equities are woefully inadequate, but not for reasons that the co-op's leaders would want to admit. According to DFA's 12/31/18 financial report:

*DFA's financial audit is full of "blue skies" assets, including "Goodwill" ($247.1 million) and "Intangible assets" ($344.965 million). Those two bookkeeping contrivances total $592 million.

*As an "Asset," DFA lists $375 million in "Preferred Equity Securities." That "asset" looks more like a liability. What? Why? "Preferred Equity Securities" funds from DFA members' equities that have been borrowed against by the co-op. ***The annual interest rates paid by DFA for three separate issuances of Preferred Equity Securities range from 7.125% to 7.875%.*** True "assets" don't require such stiff annual interest rate payments.

All told, these seemingly bogus "assets" total $967 million – roughly $150 million more than DFA's "Members' Capital" as of 12/31/18.

Other holes in DFA's "Swiss Cheese" finances …

Apparent bogus assets are not the only questionable items in DFA's 2018 financial report. Other curious items include:

"Accumulated deficit" — $49.666 million

"Accumulated other comprehensive loss" — $108.359 million

"Pension plan liabilities due after one year" — $94.768 million

Those three items total another $252.792 million.

Final concern: Exposure to Dean Foods

DFA's history has been to run with the big dogs, like Dean Foods. Going back 20+ years, DFA has evolved as Dean Foods' biggest single supplier of raw milk. How many tens … or hundreds … of millions of dollars will DFA face if Dean Foods dairy processing empire collapses? *The Milkweed* estimates that Dean Foods currently purchases about $275 million worth of milk and cream monthly – with DFA enjoying the lion's share of that business.

Unlisted on DFA's 2018 financial report is the early January 2019 purchase of the remaining stock of Stremick's Heritage Dairy for $947.9 million. (DFA already owned 47% of that food processing firm, which produces both aseptic, plant-based and dairy beverages.) Since Stremick's is an affiliated, non-member business, DFA's farmer/members will not share in the profits of that business.

Kansas Statute #17-1642: Ex-DFA Members May Object to Merger, Request Equity Pay Out

by Pete Hardin

Dairy Farmers of America – the nation's largest dairy cooperative (DFA) – is working towards merger with the St. Albans Co-op, which is based in Vermont.

With DFA in merger talks, former members of that co-op who still hold equities in DFA, have a legal option to seek payment of those equities by objecting in writing to the merger DFA/St. Albans. The enabling legal statute is Kansas Statute 17-1642. DFA is chartered as an agricultural cooperative in the State of Kansas.

Specifically, Kansas Statute 17-1642 states that **former members** may recover retained earnings and equities by objecting **in writing** before votes take place on the proposed merger involving a Kansas-based cooperative.

If the merger were to pass, Kansas law repayment of all equities and retained earnings within 60 days.

"Equities" and "retained earnings" at DFA are easily extracted by the co-op, but hard to recover for former members. DFA currently requires an equity investment of $1.75/cwt. on all milk produced in a year. That equity may be accumulated through regular deductions from members' milk checks, "retained earnings" (i.e., a members' share of the co-op's annual profits, if any), and by purchasing equities held either by non-members and members.

But extracting equities by former members is tough, unless the individual becomes deceased. Former members' equities are held by DFA without interest. Starting on the 11th year after a former member has departed the co-op, DFA will starting paying back 10% per year for the next 10 years (without interest). Thus, the co-op holds onto former members' equities for as long as 20 years (without interest). Such repayments are subject to the approval of DFA's board of directors (and creditors).

Put pen to paper …

Former DFA members interested in requesting their equities under Kansas Statute 17-1642 should write DFA directly at:

1405 N. 98th St.
Kansas City, KS 66111

It's strongly suggested that folks send their letters by Certified Mail and cover the costs of a Return Receipt. Note that you are a former member and that you specifically object to the pending merger between DFA and the St. Albans Co-op. (Cost for a one-ounce letter sent by Certified Mail and including a Return Receipt is $6.85. This is important to confirm that DFA personnel were obliged to sign for the letter.)

A full copy of Kansas Statute 17-1642 is posted on *The Milkweed's* website – www.themilkweed .com

Go to the red icon on the home page that reads, "Kansas Statute 17-1642."

Years ago, DFA lawyers lied/threatened …

In fall 1997, when DFA was being formed, a similar effort was started among some ex-members to solicit return of equities. Back then, the merger creating DFA was really a guise by CoBank (the national bank for cooperatives) to put three financially-troubled dairy cooperatives under the same roof with one healthy one.

In response to former members of Mid-American Dairymen, Inc. (DFA's predecessor co-op) objecting to the merger and asking for their money back, DFA's lawyers first lied … and then sued the claimants.

How did DFA's then attorney Michael Fayhee lie? He was quoted by *Dairy Profit Weekly* stating that the merger creating DFA was not a merger. That assertion was made, despite the fact that the word "merger" appeared **38 times** in an 8-page document, titled "Statement of Terms for the Merger," given to members of Milk Marketing, Inc. (one of the four merging co-ops).

Fayhee also stated that the 1997 merger was structured in a way to avoid repaying equities to ex-members.

When such factual fabrications didn't work, DFA sued the several hundred claimants. Those claimants were scattered across the nation and few, if any, had the resources to go against DFA in court.

Today? DFA's financial condition is still tenuous – marred by bogus assets, in the analysis of *The Milkweed*. Will DFA contest ex-members' claims for repayment of their equities? Maybe. But today, with modern communications and a significant number of lawyers who are wise to DFA's thievin' ways … maybe Kansas Statute 17-1642 will pay out as intended.

DFA & Vermont's Saint Albans Co-op Mulling Merger

by Pete Hardin

Dairy Farmers of America (DFA) is on the verge of picking off one of the few remaining dairy cooperatives in the Northeast – the St. Albans Cooperative, based in St. Albans, Vermont. St. Albans is the last remaining indigenous dairy cooperative in northern New England.

St. Albans operates an aging butter-powder plant in St. Albans. The cooperative faces significant costs to modernize its milk powder production facilities. Several years ago, the St. Albans co-op bit off a huge chunk of debt to buy the McDermott's milk transportation firm – a purchase that did not turn out rosy.

If those two cooperatives' respective boards and/or members approve the merger proposal (a likelihood), it will conclude an long-running chapter that pushed St. Albans Co-op into DFA's clutches. In the early 2000s, Dean Foods (at that time a partner with DFA in a fluid processing enterprise) paid $50 million to the major New England food retailer, Stop & Shop, to halt fluid milk processing at the Reedville, Massachusetts plant. Instead, Stop & Shop received its packaged milk from Dean Foods. Trouble was, St. Albans was the long-term supplier of farm milk to that Class I plant in Southern New England. And DFA was locking down access to many other fluid milk plants in New England. So the St. Albans co-op was left out in the cold, unable to meet Class I (fluid) milk sales obligations, under the rules of the Northeast federal milk order.

Enter Patrick Leahy, Vermont's long-serving United States Senator (and bosom buddy with the St. Albans co-op). Leahy then, as now (nearly 20 years later) served on both the Senate Judiciary Committee and Agriculture Committee. Leahy threatened to raise an antitrust stink about the Dean Foods' pay-off to Stop & Shop, and the St. Albans co-op's lost Class I sales. But ruffled feathers were smoothed and Leahy went back into his woodchuck hole. As a long-serving Senator on those respective committees, no politician merits more responsibility for the demised competition of the Northeast dairy industry than Senator Leahy, in the analysis of *The Milkweed*.

St. Albans ultimately affiliated with DFA, marketed its milk through DFA's Dairy Marketing Services affiliate (complete with excessive deductions swiped from members' milk checks), and ultimately has become so enmeshed in DFA's clutches that it's only logical that the two cooperatives merge. The combination of declining dairy farm numbers in St. Albans' area of operations – along with the co-op's outdated milk powder facilities – signals a change.

Another recent challenge: Ben & Jerry's – the famous, Vermont-based ice cream maker – is buying increased amounts of cream from out-of-state sources (New York and Michigan).

Sources report that at a recent meeting of St. Albans co-op members, the question was asked about what it would cost per member for that co-op to absorb costs of replacing the aged milk powder facilities. Co-op leaders could not answer that highly relevant question. St. Albans members should beware of DFA's financial condition and current proposal within DFA to dramatically increase the co-op's equity requirements for members. In the works, a rumored doubling of DFA's member equity requirements – from $1.75/cwt. to $3.50/cwt. on all milk produced within a year's time. Why does DFA need more "equity" from members? To expand its operations (like spending $950 million to buy a business that primarily makes plant-based "milk" beverages) and patch over bogus assets in its financial sheets.

Rather than be pushed into DFA and get hit with a $3.50/cwt. equity requirement, it's logical that St. Albans could replace its milk powder facilities (or some other variation of dairy manufacturing) for that amount or less.