



DAIRY

TARIFF ALERT

CURRENT TRENDS

- The COVID-19 pandemic continues to negatively impact the industry; market demand and pricing have been volatile since March creating difficulties for dairy farmers across the U.S. and requiring many to dump milk stocks.
- U.S. dairy prices began trending downward in March due to a reduction in demand, as restaurants and other institutional users decreased their purchasing volumes.
- After a rebound in June, Class III milk prices fell again in September and remain approximately 10% below last year.
- U.S. exports of dairy products to China and Southeast Asia increased 412% and 76%, respectively, year-to-date through August 2020.

PROJECTED VALUES (12-MONTH OUTLOOK)



APPROXIMATE NET RECOVERY ON COST

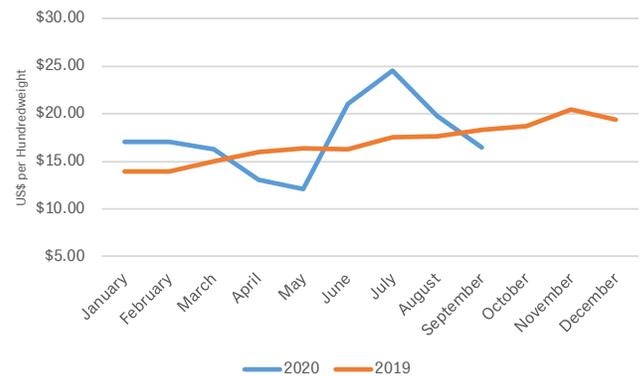
80-90%
commodity cheese

80-90%
butter

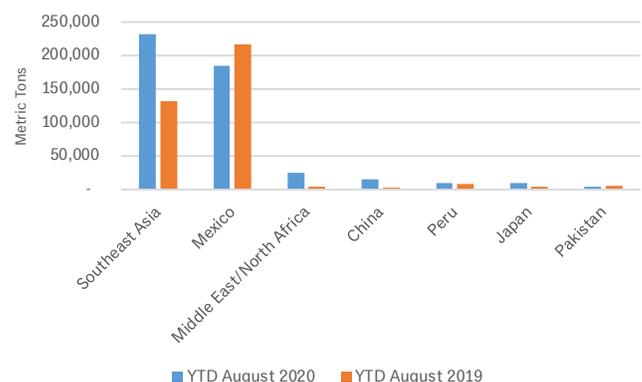
70-80%
milk powder

85-95%
milk

USDA - CLASS III MILK PRICE TRENDS



U.S. EXPORTS BY VOLUME - NDM/SMP



NOTE: THIS PUBLICATION IS PROVIDED FOR INFORMATIONAL MARKETING PURPOSES ONLY. THE MATERIAL CONTAINED HEREIN SHOULD NOT BE REGARDED AS ADVICE, NOR RELIED UPON TO MAKE FINANCIAL, OPERATIONAL OR OTHER DECISIONS; NOR SHOULD IT BE USED AS A SUBSTITUTE FOR AN ASSET APPRAISAL. ACTUAL RECOVERY VALUES MAY VARY FROM TRANSACTION TO TRANSACTION AND THE RECOVERY VALUES REFERENCED HEREIN ARE FOR REPRESENTATIVE TRANSACTIONS WITHOUT REGARD TO SPECIFIC KEY FACTORS. THIS MATERIAL MAY BE REDISTRIBUTED ONLY IN ITS ENTIRETY, INCLUDING NOTICE OF COPYRIGHT. ALL RIGHTS RESERVED. ©2020 GORDON BROTHERS, LLC. REFERENCE SOURCES: U.S. DEPARTMENT OF AGRICULTURE, U.S. FEDERAL RESERVE, SPECTRUM NEWS WISCONSIN, THE DETROIT NEWS, INTERNATIONAL DAIRY FOODS ASSOCIATION, FEDERAL RESERVE ECONOMIC DATA, IBISWORLD, U.S. DAIRY EXPORT COUNCIL



Gordon Brothers

GORDONBROTHERS.COM
+1.617.426.3233

COVID-19 IMPACTS INDUSTRY: The COVID-19 pandemic has hindered the entire dairy industry as customers have been forced to follow state and federal health orders that have limited operations. As COVID-19 began to impact the U.S. in early 2020, individual customers were able to visit local grocery stores, but hotels, schools, restaurants and other food service establishments were closing. This incited panic buying and stocking up on all grocery items, which slightly offset the negative impact of schools and food service closures in the short term.

Consistent with all food producers, the dairy industry was considered essential critical infrastructure at the onset of the pandemic. Nevertheless, dairy farmers have seen milk prices decline due to reduced institutional and food service demand. The U.S. Department of Agriculture's Class III milk price was \$16.43 per hundredweight (cwt) for the month of September, representing a decrease of \$3.34 per cwt from the previous month. While September pricing was below the February price of \$17 per cwt, it was a significant improvement from the May trough of \$12.14 per cwt, which was the lowest price seen in 2020 and lower than it had been in a decade. Market demand and pricing have been volatile since March creating difficulties for dairy farmers across the U.S. and required some to dump milk stocks and sell off older cows. According to Mark Stephenson, Director of Dairy Policy Analysis at the University of Wisconsin-Madison, the price volatility puts a tremendous strain on dairy farmers' business.

While many food companies have seen significant demand for their products, agriculture executives note that the surge has not represented a fundamental shift in consumers' overall food purchasing but rather an increase in consumption at home due to forced school and restaurant closures. Supermarkets and grocery stores have historically been the largest market segment for dairy products, and they have seen a decrease in demand. As demand for dairy has dropped since the onset of the COVID-19 pandemic, the industry has lowered prices to manage per capita dairy consumption. Going forward, industry performance and profit are likely to be hindered, as the active pandemic period extends and many downstream markets including hotels, schools and other food service outlets are forced to adjust to a lower level of operation for a longer term than initially expected. Rising infection rates across the U.S. have sparked fears of another full or partial shutdown of schools and businesses this winter.

SURGE IN U.S. DAIRY EXPORTS: In July, the International Dairy Foods Association released the following statement: "U.S. dairy exports continue to post strong gains in value and volume to destinations around the world, with surging demand from Asian nations accounting for most of the growth. In 2020, we're beginning to see demand pick up from countries including Vietnam, the Philippines, Indonesia and, of course, China, causing a shift in the top-10 destinations for U.S. dairy

exports."

Year over year through August, U.S. exports to Southeast Asia of skimmed milk powder (SMP) and nonfat dry milk (NDM) increased 76 percent over the same period in 2019 according to figures supplied by the U.S. Dairy Export Council. China, which previously had imported lower levels of U.S. dairy products due to tariffs imposed in 2018, increased 412 percent for the same period. Similarly, exports to the Middle East and North Africa increased 429 percent year to date through August.

In speaking to the importance of U.S. trade agreements, the International Dairy Foods Association noted the following: "As U.S. dairy production continues to increase over the next decade, new trade agreements will become even more vital to the industry and the American economy. The implementation of the U.S.-Mexico-Canada Agreement, as well as the Phase One China and Japan deals have been instrumental in keeping U.S. dairy export growth on track. However, the United States government must continue to aggressively advocate for the interests of the U.S. dairy industry with trading partners, relying on a market-principled approach to trade that demands the removal of unfair barriers so that U.S. dairy companies can compete on a level playing field."

STIMULUS ACTIONS: On May 11, the U.S. Secretary of Agriculture announced a plan for \$470 million in Section 32 food purchases to occur in the third quarter of 2020, in addition to purchases previously announced. Of this total spend, the agency plans to buy \$120 million in dairy products. Purchases are determined by industry requests, market analysis and food bank needs. Similarly, on May 12, Canadian Prime Minister Justin Trudeau announced several measures and an investment of more than \$252 million to support farmers, food businesses and food processors in Canada.

INVENTORY VALUATION OUTLOOK: In the short term for processors of dairy products, lower prices will make raw milk cheaper and should allow some opportunity for additional gross margin to be captured in value-added products. In the longer term, lower prices will reduce overall gross margin dollars and put pressure on the industry. For cheese processors, the market drop may impact any existing on-hand inventory. However, on a mark-to-market basis, inventory values are expected to hold firm.

BUTTER MAY WARRANT SPECIAL ANALYSIS: Butter is a seasonal product. Prices almost always go up in the fall and winter, related to holiday cooking and baking. While sales volumes may be moderately impacted, rising market prices for butter can more greatly impact sales dollars. A lot of creameries will start building supply in anticipation of fall demand. Lenders should discuss with appraisers whether a high-low analysis to account for seasonality makes sense for companies in this sector.

PRIVATE-LABEL PRODUCTS MAY REQUIRE MODIFICATIONS TO EXIT

STRATEGIES: Many dairy products are manufactured under a private label. Lenders should be aware that manufacturers may not be permitted to sell private-label products unless they are repackaged. While in certain instances repackaging may be possible, it will incur extra time and expense in a liquidation.

The Expert: Erick Beaudoin



Erick Beaudoin is a director in Gordon Brothers' Industrial Inventory Valuation practice. His industry specialties include agricultural food products, automotive, building materials, dairy products, fabricated metal products, frac sand, paper products, plastics, sporting goods, and recreational vehicles. Read his full bio [here](#).



**Gordon
Brothers**

GORDONBROTHERS.COM
+1.617.426.3233