USDA Testimony
January 2024

Introduction -

- My name is Steve Galbraith, I am the Vice President of Procurement and Commodity Risk Management at Saputo Cheese USA. I have held this position since April 2013.
- I work out of Saputo's Dallas office located at 2711 N Haskell, Suite 3700 Dallas Texas, 75204
- Saputo operates 29 plants in 13 states across the United States, manufacturing and packaging a variety of cheeses, cultured dairy products, whey ingredients, extended shelf-life and aseptic dairy products.
- Saputo is among the top 3 cheese manufacturers and one of the largest producers of extended shelf-life fluid products in the US.
- Saputo routinely sources milk, cream, and condensed dairy products from 10 of the 11 Federal Milk Marketing Orders as well as unregulated regions of the western US. We buy approximately 3,400 loads of milk and 250 loads of cream per week. The vast majority of the milk we buy is priced based on the Class II and Class III formulas.
- Saputo plants process milk that is pooled in seven of the Federal Milk Marketing Orders. Most of the milk Saputo buys is regulated by the Federal order system. Saputo pays for milk according to each of the Class I, Class II, Class III and Class IV formulas.
- Consequently, Saputo may be greatly impacted by the results of the hearing and any resulting changes to the milk pricing system.

I testified at a hearing on August 30th, 2023, where I provided my background and experience in the dairy industry. Unless requested to do so, I will not repeat my resume.

Position – Proposal #21

I testify today in opposition of Proposal #21 that seeks to increase the Class II Differential from +$.70/cwt. to +$1.56/cwt. over the Class IV price.

Saputo manufacturers products in several different states that utilize Class II milk, both skim solids and butterfat components and opposes Proposal #21 for the following reasons –

A. When I testified on August 30th in opposition to Proposals #1 & #2, I presented data demonstrating Saputo Plants in FMMO #6 & #7 were receiving milk that contained skim solids below the 9% level. Raising the calculation of costs above 9% (as proposed in #1/#2) would only cause Saputo to pay for solids not being received today. Increasing the premium from $.70/cwt. to $1.56/cwt. is simply asking to pay higher levels for solids that are not being received today. Placing manufacturing facilities in FMMO #6/#7 at a further competitive disadvantage.
B. The differential increase of $.86/cwt. is intended to increase revenue to dairy producers but will likely not have the intended effect.
C. Class II skim solids demand is likely to decrease as alternative milk solids have a greater substitution value.
D. Cream multiples will increase – further increasing costs to consumers.

A. The table below shows the following values for skim solids based on the published prices of various indexes over the past five years–
    1. Western States Non-Fat Dry Milk Powder $1.2557/lb.
    2. NDPSR Class II Skim Solids $1.1495/lb.
    3. AFBF Proposed Class II Skim Solids $1.2445/lb.

    Based on the last five years market value spreads, the following conclusions can be derived –

- Substitution of current NFDM values for Class II Skim Solids in raw milk does not seem to make economic sense given that NFDM carries a premium.
- When you add premiums for condensing skim milk – Class II condensed skim gets closer to NFDM values. However, the rehydration time and expense has prevented substitution to date for financial reasons.
- Consequently, if there is any substitution going on today or has gone on in the recent past it is not due to market values.
- Should the AFBF Proposal to increase the Class II Skim Solids by over $.095/lb. – it is possible we could see substitution of NFDM in a formula replacing Class II Skim Solids in certain months.
- This is likely to be done at various levels in the supply chain from the condensed skim manufacturing process to the mixing plant itself where the finished product is made.
- The net result would be the same amount of milk solids used – however there would be limited or no additional revenue anywhere in the supply chain for producers when this substitution occurs.

Commodity	NDPSR Class III Skim Solids	NDPSR Class II Skim Solids	Western States NFDM	NDPSR Sweet Whey	Central. St. Buttermilk
2019 Average $/lb.	$0.9417	$0.9157	$1.0586	$0.3799	$1.0504
2020 Average $/lb.	$1.4036	$0.9950	$1.0583	$0.3621	$1.0232
2021 Average $/lb.	$1.2151	$1.1280	$1.3039	$0.5744	$1.2255
2022 Average $/lb.	$1.2133	$1.5912	$1.6792	$0.6057	$1.7690
2023 Average $/lb.	$0.7667	$1.1178	$1.1787	$0.3618	$1.0586
Average	**$1.1081**	**$1.1495**	**$1.2557**	**$0.4568**	**$1.2253**

B. When making Ice Cream Mix (ICM), processors can create ICM formulas that incorporate milk solids other than Class II solids – These substitution alternatives include:
   - Sweet Whey – The substitution for skim solids is a one-for-one.
     - Sweet Whey substitution for the past 5 years would have benefited an average of just over $.69/lb.
     - Sweet Whey substitution under Proposal #21 would have benefited nearly $.79/lb.
   - Buttermilk – The substitution for skim solids includes removing some butterfat as well as skim solids.
     The table below shows the substitution cost benefit/cost increase over the past 5 years when compared to actual market and a market where Proposal #21 is enacted. There are a couple of take-aways from the data –
     - Buttermilk substitution would have been beneficial 2 of the last 5 years under the current market dynamics.
     - Buttermilk substitution under Proposal #21 would have been beneficial 4 of the past 5 years.

     The larger these substitution savings opportunities become – the more likely owners of their formulas (customers) will look closer at the opportunities and ultimately make the switch.

     The net result of implementing Proposal #21 would likely result in a decrease in use of Class II skim solids in current formulas.

Class III Skim Solids values are referenced below for the following reasons –

- There are a variety of reasons dairy companies acquire NFDM powder
  - Some reasons are intentional when block purchases are made to take advantage of a market price or distressed inventory.
  - Some reasons may be unintentional when milk must be diverted to a balancing plant for numerous reasons.

- When assessing the disposition of acquired NFDM – typically two options are reviewed.
  - Outright sale into the marketplace
  - Substitution of powder into Class III or Class II products. This option is often done when the NFDM inventory is valued at less than the Class III or Class II solids.
- The best option for any substitution is always to replace the highest priced skim solids – which is more likely to be Class II if the Differential is increased.

	Reference			ACTUAL MARKET						
Commodity	Class III Skim Solids	Class II Skim Solids	NDPSR Sweet Whey	Central. St. Buttermilk		SS - LBS	BMS	BF	Net Per Lb. Buttermilk	Net Per Lb. Sweet Whey
2019 Average $/lb.	$0.9417	$0.9157	$0.3799	$1.0504		1	1.0256	0.0256	$0.08	($0.5358)
2020 Average $/lb.	$1.4036	$0.9950	$0.3621	$1.0232		1	1.0256	0.0256	($0.03)	($0.6329)
2021 Average $/lb.	$1.2151	$1.1280	$0.5744	$1.2255		1	1.0256	0.0256	$0.05	($0.5536)
2022 Average $/lb.	$1.2133	$1.5912	$0.6057	$1.7690		1	1.0256	0.0256	$0.14	($0.9855)
2023 Average $/lb.	$0.7667	$1.1178	$0.3618	$1.0586		1	1.0256	0.0256	($0.12)	($0.7560)
Average	$1.1081	$1.1495	$0.4568	$1.2253		5 lbs. Skim solids in Case 5% ICM				

	Reference			PROPOSAL #21 MARKET						
Commodity	Class III Skim Solids	Class II Skim Solids	NDPSR Sweet Whey	Central. St. Buttermilk		SS - LBS	BMS	BF	Net Per Lb.	Net Per Lb. Sweet Whey
2019 Average $/lb.	$0.9417	$1.0107	$0.3799	$1.0504		1	1.0256	0.0256	($0.02)	($0.6308)
2020 Average $/lb.	$1.4036	$1.0900	$0.3621	$1.0232		1	1.0256	0.0256	($0.12)	($0.7279)
2021 Average $/lb.	$1.2151	$1.2230	$0.5744	$1.2255		1	1.0256	0.0256	($0.05)	($0.6486)
2022 Average $/lb.	$1.2133	$1.6862	$0.6057	$1.7690		1	1.0256	0.0256	$0.04	($1.0805)
2023 Average $/lb.	$0.7667	$1.2128	$0.3618	$1.0586		1	1.0256	0.0256	($0.21)	($0.8510)
Average	$1.1081	$1.2445	$0.4568	$1.2253		5 lbs. Skim solids in Case 5% ICM				

C. Another impact of increasing the Class II Differential would be the impact on cream pricing.
- Cream Premiums will increase by an average of ½ multiple point as Class II solids increase.
  - There are approximately 2,550 pounds of skim solids in a load of cream today.
  - Cream sellers will realize the increased value of skim solids by increasing the multiple charged for the fat
  - By increasing the cost $.09/lb. solids – that would increase multiples by .0045 at $2.50/lb. butter.
- Increasing butterfat pricing in an already high-value market may not always prompt additional usage and could have a negative impact on consumption.

Impact of Class II Differential –
- When the math is applied to the current increase in Class II versus Class IV solids –
  - Butterfat increases is .007/lb.
  - Skim solids increase is $.0778/lb. ($.70/9 lbs. solids)
  - Skim solids increase by a factor off 11 over butterfat.

The same factor of skim solids increase of 11x occurs when you increase Class II in Proposal #21
- Why would you increase the skim solids disproportionately to the fat solids?
- Particularly given that skim solids continue to experience demand struggles in the marketplace?