



May 17, 2006

To All Interested Parties:

Please be advised that an independent review raised valid concerns about the Manufacturing Cost Updates. As a result, the "Weighted Average Manufacturing Costs for Butter, Nonfat Powder, Skim Whey Powder, and Cheddar cheese, 1989-2005, adjusted for September 2005 and adjusted for January-September 2005" (commonly referred to as the adjusted manufacturing cost data) that was issued in our February 9, 2006 mailing, has been withdrawn by the California Department of Food and Agriculture (Department).

The Department was requested to obtain more "current" labor and utility rates after the 2004 cost studies were published. Additionally, the Department was requested to perform an analysis to backwardly project what the manufacturing costs would have been during 2004, if the more "current" labor and utility rates were incorporated into the 2004 cost study.

Therefore, the Department is replacing the withdrawn report with the attached cost estimates. The cost estimates that are derived using this methodology are not reflective of actual cost data and should not be confused with the annual cost study information published by the Department. At best, the analysis generates cost estimates to address the hypothetical question of incorporating the "current" cost of just two variables, while assuming all other variables in the 2004 cost calculations remain constant.

Consequently, the data contained in the attached document is entirely separate and distinct from the annual manufacturing cost data, which was released in November 2005. It is important that the differences and similarities be understood and appreciated.

In providing the impact analysis and the derived estimates of manufacturing costs for 2004, the Department makes no claim that the estimates would actually occur beyond the year 2004. As a result, the Department makes no claim as to whether or not the derived estimated costs are reflective of the actual 2005 manufacturing costs.

The Department considers its annual publication of the manufacturing cost studies to be the best reflection of actual California processing cost. The annual manufacturing cost study for 2005 will not be published until sometime later in 2006, after the Department completes its compilation of all relevant aspects of the manufacturing process (i.e. volume, labor, packaging costs, etc.).

Should you have any questions, you may contact Venetta Reed, Manufacturing Cost Supervising Auditor, or Thomas Gossard, Senior Agricultural Economist, at (916) 341-5988.

Sincerely,

David K. Ikari, Chief
Dairy Marketing Branch



**Estimated Impact Analysis
of 2005 Utility and Labor Rates on
Butter Manufacturing Costs**

- The 2004 butter manufacturing cost study served as the model for preparing the estimated costs.
- All other variables/factors in the 2004 cost study were held constant.

ESTIMATE A

- The labor and utility rates that were incorporated in the 2004 cost study were replaced by September 2005 labor and utility rates.
- Thus, the impact of the September 2005 labor and utility rates on estimated manufacturing costs could be determined, and are listed below:

	<u>Number of Plants</u>	<u>Processing Labor</u>	<u>Processing Non-Labor</u>	<u>Package</u>	<u>Other Ingredient</u>	<u>General & Administrative</u>	<u>Return on Investment</u>	<u>Total Cost</u>
		<i>dollars per pound of butter</i>						
Utility & Labor Rates for September 2005	8	\$0.0512	\$0.0526	\$0.0100	\$0.0040	\$0.0152	\$0.0066	\$0.1396

ESTIMATE B

- The labor and utility rates that were incorporated in the 2004 cost study were replaced by the nine-month average (January-September 2005) labor and utility rates.
- Thus, the impact of the nine-month average (January-September 2005) labor and utility rates on estimated manufacturing costs could be determined, and are listed below:

	<u>Number of Plants</u>	<u>Processing Labor</u>	<u>Processing Non-Labor</u>	<u>Package</u>	<u>Other Ingredient</u>	<u>General & Administrative</u>	<u>Return on Investment</u>	<u>Total Cost</u>
		<i>dollars per pound of butter</i>						
Utility & Labor Rates for January-September 2005	8	\$0.0512	\$0.0514	\$0.0100	\$0.0040	\$0.0152	\$0.0066	\$0.1384

Note: The estimated cost data provided above set forth what would have occurred if the more current utility and labor rates were in effect during the 2004 time period. There is no basis to project with any degree of certainty that these costs would actually occur beyond 2004.

**Estimated Impact Analysis
of 2005 Utility and Labor Rates on
Nonfat Powder Manufacturing Costs**

- The 2004 nonfat powder manufacturing cost study served as the model for preparing the estimated costs.
- All other variables/factors in the 2004 cost study were held constant.

ESTIMATE A

- The labor and utility rates that were incorporated in the 2004 cost study were replaced by September 2005 labor and utility rates.
- Thus, the impact of the September 2005 labor and utility rates on estimated manufacturing costs could be determined, and are listed below:

	<u>Number of Plants</u>	<u>Processing Labor</u>	<u>Processing Non-Labor</u>	<u>Package</u>	<u>General & Administrative</u>	<u>Return on Investment</u>	<u>Total Cost</u>
		<i>dollars per pound of powder</i>					
Utility & Labor Rates for September 2005	10	\$0.0344	\$0.0993	\$0.0143	\$0.0106	\$0.0080	\$0.1666

ESTIMATE B

- The labor and utility rates that were incorporated in the 2004 cost study were replaced by the nine-month average (January-September 2005) labor and utility rates.
- Thus, the impact of the nine-month average (January-September 2005) labor and utility rates on estimated manufacturing costs could be determined, and are listed below:

	<u>Number of Plants</u>	<u>Processing Labor</u>	<u>Processing Non-Labor</u>	<u>Package</u>	<u>General & Administrative</u>	<u>Return on Investment</u>	<u>Total Cost</u>
		<i>dollars per pound of powder</i>					
Utility & Labor Rates for January-September 2005	10	\$0.0344	\$0.0918	\$0.0143	\$0.0106	\$0.0080	\$0.1591

Note: The estimated cost data provided above set forth what would have occurred if the more current utility and labor rates were in effect during the 2004 time period. There is no basis to project with any degree of certainty that these costs would actually occur beyond 2004.

**Estimated Impact Analysis
of 2005 Utility and Labor Rates on
Cheese Manufacturing Costs**

- The 2004 cheese manufacturing cost study served as the model for preparing the estimated costs.
- All other variables/factors in the 2004 cost study were held constant.

ESTIMATE A

- The labor and utility rates that were incorporated in the 2004 cost study were replaced by September 2005 labor and utility rates.
- Thus, the impact of the September 2005 labor and utility rates on estimated manufacturing costs could be determined, and are listed below:

	<u>Number of Plants</u>	<u>Processing Labor</u>	<u>Processing Non-Labor</u>	<u>Package</u>	<u>Other Ingredient</u>	<u>General & Administrative</u>	<u>Return on Investment</u>	<u>Total Cost</u>
		<i>dollars per pound of cheese</i>						
Utility & Labor Rates for September 2005	7	\$0.0477	\$0.0768	\$0.0186	\$0.0112	\$0.0203	\$0.0082	\$0.1828

ESTIMATE B

- The labor and utility rates that were incorporated in the 2004 cost study were replaced by the nine-month average (January-September 2005) labor and utility rates.
- Thus, the impact of the nine-month average (January-September 2005) labor and utility rates on estimated manufacturing costs could be determined, and are listed below:

	<u>Number of Plants</u>	<u>Processing Labor</u>	<u>Processing Non-Labor</u>	<u>Package</u>	<u>Other Ingredient</u>	<u>General & Administrative</u>	<u>Return on Investment</u>	<u>Total Cost</u>
		<i>dollars per pound of cheese</i>						
Utility & Labor Rates for January-September 2005	7	\$0.0477	\$0.0732	\$0.0186	\$0.0111	\$0.0203	\$0.0082	\$0.1791

Note: The estimated cost data provided above set forth what would have occurred if the more current utility and labor rates were in effect during the 2004 time period. There is no basis to project with any degree of certainty that these costs would actually occur beyond 2004.

**Estimated Impact Analysis
of 2005 Utility and Labor Rates on
Skim Whey Powder Manufacturing Costs**

- The 2004 skim whey powder manufacturing cost study served as the model for preparing the estimated costs.
- All other variables/factors in the 2004 cost study were held constant.

ESTIMATE A

- The labor and utility rates that were incorporated in the 2004 cost study were replaced by September 2005 labor and utility rates.
- Thus, the impact of the September 2005 labor and utility rates on estimated manufacturing costs could be determined, and are listed below:

	<u>Number of Plants</u>	<u>Processing Labor</u>	<u>Processing Non-Labor</u>	<u>Package</u>	<u>General & Administrative</u>	<u>Return on Investment</u>	<u>Total Cost</u>
		<i>dollars per pound of powder</i>					
Utility & Labor Rates for September 2005	3	\$0.0644	\$0.1739	\$0.0126	\$0.0026	\$0.0398	\$0.2933

ESTIMATE B

- The labor and utility rates that were incorporated in the 2004 cost study were replaced by the nine-month average (January-September 2005) labor and utility rates.
- Thus, the impact of the nine-month average (January-September 2005) labor and utility rates on estimated manufacturing costs could be determined, and are listed below:

	<u>Number of Plants</u>	<u>Processing Labor</u>	<u>Processing Non-Labor</u>	<u>Package</u>	<u>General & Administrative</u>	<u>Return on Investment</u>	<u>Total Cost</u>
		<i>dollars per pound of powder</i>					
Utility & Labor Rates for January-September 2005	3	\$0.0644	\$0.1548	\$0.0126	\$0.0026	\$0.0398	\$0.2742

Note: The estimated cost data provided above set forth what would have occurred if the more current utility and labor rates were in effect during the 2004 time period. There is no basis to project with any degree of certainty that these costs would actually occur beyond 2004.