POST-HEARING BRIEF
Of **Kraft Foods**

Submitted by Barry Brokaw, Sacramento Advocates, on behalf of Kraft Foods

To address questions of the panel from the

Hearing to Consider Amendments to the Stabilization and Marketing Plans for Market Milk For the Northern and Southern California Marketing Areas

June 8, 2015

Mr. / Ms. Hearing Officer and Members of the Hearing Panel:

This post-hearing brief is to answer the questions of the hearing panel members as communicated. The answers were prepared by Renee Peets, former Senior Director of Procurement for the Kraft Cheese & Dairy Division.

Question: What source did you use to determine your four tiers?

- I determined the four tiers of whey processing in California based on my California dairy industry and marketplace knowledge, as well as my knowledge of the other California dairy manufacturers.

Question: What is the product mix at Kraft's nine plants?

- Campbell, NY: string cheese, mozzarella, condensed whey, dry whey
- Lowville, NY: cream cheese
- Walton, NY: sour cream and cottage cheese
- Beaver Dam, WI: cream cheese
- New Ulm, MN: processed cheese
- Albany, MN: processed cheese, cheese powders
- Tulare, CA: sour cream, cottage cheese, hard Italian cheeses, condensed whey, dry whey
- Springfield, MO: processed cheese, macaroni & cheese
- Champaign, IL: processed cheese, macaroni & cheese, salad dressings

Question: What is the cost of milk at Kraft's other plants?

- The cost of milk is confidential to Kraft's business, and contract prices cannot be disclosed. However, Kraft has six plants that receive raw milk, including Lowville NY, Walton NY, Campbell NY, Beaver Dam WI, Springfield MO, and Tulare CA. All plants have milk contracts which include premiums and volumes over life of the contract, as well as additional items such as additional premiums for rBST-free milk. The three plants in New York share a milk supply which is very

local to the plant locations. In the WI and MO locations, the milk sourcing locations are flexible, and therefore, so is the pricing. As Kraft periodically has excess capacity due to volume fluctuations, it is able to take advantage of less expensive spot milk when it is available. There is also more competition from milk sources in areas other than California. The Tulare plant has only 2-3 milk sources at any given time, and the lack of competition keeps prices stable and elevated. The larger number of milk sources around some of the other Kraft plants keeps milk premiums extremely competitive. Additionally, the Tulare plant is somewhat limited to manufacturing capacity by the amount of whey that can be processed downstream of the cheese making process.

- Finally, the proximity of the other plant locations to a large number of Kraft's customers make the total cost of manufacturing and distribution from the other Kraft plants less than from Tulare. The comparison of milk cost in other regions versus California needs to include the total cost of manufacturing and distribution to be a proper comparison; and the transportation component can be material. Routing product to alternative locations to be aged and/or processed before storage and distribution can add even further material costs.

Question: What is the volume covered by the two-thirds of plants that are in the 4th tier of whey processing plants?

- The estimated share of total cheese plant volume of those plants that do not process whey is 5.3%, as reported in the CDFA's Background Materials Table entitled "Pounds of Milk Processed into Cheese by Plant Size".

Question: Would you elaborate on the processing issues that lower human food grade to animal feed.

- The USDA AMS US Standards for Dry Whey issued in December 2000 list the specifications for U.S. Extra Grade dry whey, which include flavor, physical appearance, bacterial estimate, coliform count, milkfat content, moisture and scorched particle content. These standards say the dry whey must be: free from undesirable flavors, uniform in color, free from lumps except those that readily break up with slight pressure, and be practically free from visible dark particles. The whey must have no more than 30,000 per gram standard plate count, no more than 10 coliform per gram, milkfat content of no more than 1.5%, moisture content of no more than 5%, and scorched particle content of no more than 15.0 mg.
- There is no official standard for animal feed grade whey, other than to say that it is whey that is out of specification from the USDA Standards for dry (food grade) whey mentioned above. There are numerous processing issues that can cause the whey to be out of food grade specification, including mechanical or equipment issues, temperature issues, power outages, bacterial contamination, or building structural issues (i.e. roof leak). If any of these issues result in dry whey that does not meet the USDA Standard, the dry whey must be sold into animal feed, at a significant discount to the food grade whey market. The amount of the discount depends on the party buying the whey, whether they have a customer already or need to find an outlet, and the general marketplace availability of animal feed grade dry whey.

Question: Can you elaborate on the "enough correlation" statement made in your testimony?

- The 10-year (April 2005-March 2015) correlation coefficient on monthly AMS western dry whey and WPC-34 is 0.8804. The 5-year correlation coefficient is 0.8041, and the 3-year correlation coefficient is 0.6773.
- Over the long run, the two price series are fairly correlated, but when they do depart, the difference can be considerable for a long period of time. And it appears that they are becoming even less correlated than historically in more recent years. That is why, given that most plants in CA have pricing more closely tied to WPC-34, it will make sense for the greatest number of plants if the switch is made to a liquid whey value. The bigger goal is to get the valuation off of the full value of finished products, which few plants can attain, to a liquid whey value which is more achievable for a larger number of plants.

Thank you for the opportunity to submit this post-hearing brief.