

STAFF TESTIMONY BEFORE THE PENNSYLVANIA MILK BOARD
COST REPLACEMENT HEARING – MILK MARKETING AREA 1
December 4, 2024

Good morning. My name is Gary Gojsovich. I am employed by the Pennsylvania Milk Board as an Audit Supervisor. This morning I will be testifying to Staff Exhibits 1, 2, 3, 5 and 7 through 10 and also Staff Surrebuttal Exhibits 4, 6, 11 and 12.

Staff Exhibit 1

A group of 19 dealers has agreed to be part of an expanded monthly data collection by Board staff; we refer to these dealers as cross-section dealers and they are a sub-population of all dealers. For each PMB Area, a smaller group of cross-section dealers is chosen from the 19 cross-section dealers; the data of each smaller group of cross-section dealers is used to enable calculations for cost replacement hearings for the respective PMB Area.

The chosen sampling technique for this analysis was purposeful or judgmental sampling based on the needs of the study. The volunteer nature of the population limits us to analyses based on the representativeness of the sampling by judgment. This technique, along with establishment of one or more specific desired criteria for selection before the actual sampling process takes place, ensures that the sample will provide the most accurate and representative data for cost replacement calculations since a random sample is not possible.

We used a benchmark criterion of a minimum percentage of sales into an Area for selection of cross-section dealers for that Area. The total sales of the selected CRH cross-section were also set at a desired level of 62.00 percent.

12 of the 19 larger cross-section dealers sell into Area 1 with DFA Dairy Brands – Lansdale, Wawa Beverage Company and Milk Industry Management Corporation (dba Balford Farms) having the greatest percentages of sales into the area. Five dealers out of the 12 who sell into Area 1 meet the predetermined criterion of a minimum sales percentage into the area and were selected as the cross-section for cost replacement purposes. Overall sales percent for the CRH cross-section was 64.06 percent, higher than the predetermined desired percent.

Staff Exhibit 1 shows that the sales by product data for the Area 1 CRH cross-section dealers are close to the same as that of all dealers selling into Area 1 considering the top 5 selling products. The CRH cross-section for Area 1 is fully representative of all dealers selling into the area.

Staff Exhibit 2

This exhibit provides information about the average weighted cost for processing, packaging and delivering milk for the Area 1 cross-section milk dealers. For each of the major cost centers we have matched the expenses associated with the cost center with the volume of milk or other products that flowed through that cost center. The volumes are stated in points (where a point equals a quart or quart equivalent). All costs and points are weighted using the sales weighting method. For example, if a dealer has 25% of their sales in Area 1 then we include 25% of their costs and 25% of their points in the Area 1 cost centers.

Staff recommends that the Board replace the costs in the current Order with those costs in this exhibit.

Staff Exhibit 3

This exhibit provides information on the cost of containers for the cross-section dealers. We initially use the costs of the cross-section dealers for plastic containers, paper containers and resin as of April 2024 to calculate weighted cost per units. As has been done in previous hearings, we are using controlled container sales volumes for the previous year. We are therefore pairing current costs with the weighted units sold in the previous year to arrive at the most current weighted cost per unit available. Where the market has both paper and plastic containers, like the quart container, we have provided a combined paper/plastic price. After we established a cost for each container type in Column E, we are updating those April 2024 costs to the costs observed in our most current container surveys in Column F (October 2024). In Column G we are applying factors for container shrinkage. Column H adds the shrinkage factor to the updated container cost in Column F.

Staff recommends that the Board replace the base container costs with those found in Column C and the base weighted units with those in Column D and continue to update these costs using the audited surveys submitted by the cross-section dealers. Staff also recommends that the Board continue the practice of providing separate plastic and paper half-pint prices through a plastic add-on.

Staff further recommends that the Board replace the current container costs with the costs found in column E.

Staff SURREBUTTAL Exhibit 4

This exhibit provides information on the cost of ingredients added to the various milk products like chocolate powder and sugar used in chocolate milk. This exhibit pairs Year 2023 sales activity with April 2024 costs to get current weighted costs.

This exhibit has changed from the time of initial submission as some missing input ingredient data has now been included.

Staff recommends replacing the current ingredient costs with those in this exhibit. Staff further recommends the continuance of updating chocolate and sweetener costs quarterly.

Staff Exhibit 5

Dealers typically sell off excess bulk milk and cream they are unable to use in their own plants and they will recognize either a profit or a loss on these sales. Dealers also lose small amounts of milk as it moves through the plant; this loss is called shrinkage.

Row 1 shows the calculation for shrinkage cost. Column G shows the weighted costs using the sales weighting method.

Rows 2, 3 and 5 show calculations for determining profits and/or losses on diverted or transferred sales of bulk milk and cream. Dealers incur additional costs to process and sell transferred milk and cream (Column E). We add these additional processing costs to the producer costs in Column D to determine if the dealers made a profit or loss on the transactions.

The costs in the top panel are summarized in Column H. We divide these costs by the number of pounds of product sold or manufactured by the dealers (net of purchased packaged products) in Column I. By dividing the costs in Column H by the pounds in Column I we arrive at a weighted cost per pound in Column J.

Staff recommends that the Board use the costs and profits in this exhibit to replace those in the existing Order.

Staff SURREBUTTAL Exhibit 6

This exhibit summarizes the costs of the milk components. We are using the most current announced milk prices available prior to the submission date for the Initial Exhibits. The current fat and skim prices for Class I products are in the top panel. In the lower panel we show the actual pounds of the Class I products (Columns A and B) sold by the cross-section dealers in this Area. We have labeled the columns A through K and show how we arrive at the cost per pound for each of the products in the table.

This exhibit was affected due to the change in Staff Exhibit 4 (Ingredients); therefore, the results of this exhibit have been updated as well. No other changes were necessary for this exhibit.

Staff recommends that the Board continue to use this method for establishing the before-bottling costs.

Staff Exhibit 7

In this exhibit we compare the costs and related plant volumes for three significant categories (labor, utilities, and insurance) for the 1st half of Year 2024 with the 1st half of 2023 to update the cost per point from Staff Exhibit 2. We use bottling points as the denominator as they are a good measure of the plants' overall volume or activity. In columns A and B, we list the first half-year costs for 2024 and 2023 for each of the cost categories. In the next two columns, we list the bottling points for 2024 and 2023 for the first half-year. By dividing the costs by the points in columns E and F, we can compare the cost increase or decrease per point in column G.

Staff recommends replacing the first half cost adjustment in the current Order with the adjustment in this exhibit.

Staff Exhibit 8

In this exhibit we update diesel fuel costs from the previous year (Year 2023) by indexing to diesel prices for the most current month (August 2024). Line 1 shows the weighted cost for diesel fuel for the cross-section dealers for Year 2023. Line 2 is the Year 2023 average On-Highway diesel price per gallon as posted by the Energy Information Administration (EIA). Line 3 is the current EIA On-Highway diesel price. Line 4 shows the percentage of change in the diesel price from Year 2023 to the current price. Line 5 shows the current presumed diesel cost. By subtracting line 1 from line 5 we find the changed diesel cost on line 6. And by dividing the changed diesel cost on line 6 by the weighted delivery points of the cross-section dealers, we find the changed cost per point on line 8.

Staff recommends that the Board continue to include this adjustment in the cost replacement process. Staff also recommends that the Board replace the Year 2022 points and costs with the Year 2023 points and costs found in this exhibit.

Staff Exhibit 9

Staff has calculated the current heating fuel add-on using the same methodology as in Staff Exhibit 8 except here we are using Standardization and Pasteurization points and the Pennsylvania Natural Gas Industrial price as posted by the EIA. Staff recommends that the Board continue to include this adjustment in the cost replacement process. Staff also recommends that the Board replace the 2022 points and costs with the 2023 points and costs found in this exhibit.

Staff Exhibit 10

The container efficiency adjustments are made to account for the cost efficiencies of bottling and handling milk in larger size containers than in smaller size containers. Board Staff updated these adjustments by replacing Year 2022 container sales with Year 2023 container sales (Column B) and by also replacing the Year 2022 processing costs per points for the Bottling, Cold Room and Delivery cost centers with those for Year 2023.

Staff recommends that the Board replace the container efficiency adjustments per the existing Order with those found in column E of this exhibit.

Staff ~~SURREBUTTAL~~ Exhibit 11

This exhibit summarizes the information from the previous exhibits to arrive at proposed wholesale prices which are shown in Column K.

This exhibit was affected due to the change in Staff Exhibit 4 (Ingredients); therefore, the results of this exhibit have been updated as well. No other changes were necessary for this exhibit.

Staff SURREBUTTAL Exhibit 12

This exhibit calculates our proposed retail prices which are shown in Column G.

This exhibit was affected due to the change in Staff Exhibit 4 (Ingredients); therefore, the results of this exhibit have been updated as well. No other changes were necessary for this exhibit.

The effect of this cost replacement analysis is that the retail price of a gallon of 2% milk will increase by \$0.05 from the current retail price in Area 1. The majority of this increase is attributable to the increase in the 'processing costs per point' (Staff Exhibit 2) from Year 2022 to Year 2023.

Thank you. I'd be happy to answer any questions pertaining to my exhibits.