

10-25-2012

2012 Chapter 29 Dealer Margin Study Statement of Carl Herbein, CPA

Carl D. Herbein CPA

Maine Milk Commission

Department of Agriculture, Conservation and Forestry

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Recommended Citation

Herbein, Carl D. CPA; Maine Milk Commission; and Department of Agriculture, Conservation and Forestry, "2012 Chapter 29 Dealer Margin Study Statement of Carl Herbein, CPA" (2012). *Milk Commission Documents*. Paper 1.
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STATEMENT OF CARL D. HERBEIN, CPA

Submitted to the Maine Milk Commission

Dealer Margin Adjustment

October 25, 2012

STATEMENT OF CARL D. HERBEIN, CPA

MAINE MILK COMMISSION

My name is Carl D. Herbein and I am a CPA in the State of Pennsylvania. My address is 2763 Century Boulevard, Reading, PA 19610. I am the President and CEO of Herbein + Company, Inc. a regional CPA firm that practices extensively and nationwide in the dairy processing industry. I attach my Curriculum Vitae, as Exhibit 1 which outlines my education, and experience in the dairy industry. I am familiar with the milk marketing conditions in Maine. Herbein + Company, Inc. has been engaged by the Maine Milk Commission to update the dealer margin (cost study). In this statement, I will present details as to the study conducted, will explain the attached exhibits which reflect our findings, and will provide other comments that I believe appropriate for the Maine Milk Commission's consideration in their task of adjusting dealer margins.

Background and Purpose of Study

The Maine Department of Agriculture, Food and Rural Resources – Maine Milk Commission – Chapter 29 – Dealer Margins states “the Maine Milk Commission is responsible for setting minimum wholesale and retail milk prices. Minimum wholesale prices paid to processors (dairies) are set to reflect the lowest price at which milk purchased from Maine producers can be received, processed, packaged, and distributed to retailers within the state at a just and reasonable return”. The Maine Milk Commission has engaged Herbein + Company, Inc. to study, review, and present costs which will satisfy the Commission's statutory requirement to conduct a cost study and to update dealer margins.

Study Conducted

The firm of Herbein + Company, Inc. reviewed the State of Maine statute, reviewed the prior cost studies, and visited and obtained financial information from all Maine processing dairies. We then determined that three (3) of the four (4) Maine processing dairies should be included in the study. The procedures performed by the staff of Herbein + Company, Inc. were developed by me and all work and analysis conducted has been reviewed by me. I visited the state of Maine as part of this project.

In our review of the prior cost studies which utilized “a model milk processing plant”, we decided that the utilization of theoretical information was not in the best interest of the milk industry in the State of Maine as it is our experience that modeled costing and projections many times vary significantly from actual costs incurred.

Herbein + Company, Inc. maintains a significant data base of actual processing fluid milk dealer costs. The study we conducted includes utilizing the actual costs for three (3) Maine dairies studied along with 15 other dairies which are comparable to those doing business in the State of Maine. Their comparability was determined by a review of products produced, delivery methods utilized, the size of the market served, the size of the plant itself, analysis of how plastic containers are utilized (either blow molded on site or purchased) and also the economic conditions of the actual location of the plants utilized from the Herbein data base that are outside of the State of Maine.

Herbein + Company, Inc. has developed a methodology for adjusting costs economically and geographically when producing benchmarking reports and this procedure was applied to the 15 comparable dairies so that their costs are stated in an economic condition similar to Portland, Maine. U.S. Department of Labor economic statistics are used for this adjustment.

The costs for the 18 company data base were combined using a weighted average (based on volume) to arrive at the benchmarked averages.

The costs utilized were extracted from the calendar year 2011. The container cost reflected in the attached exhibits has been based upon an average cost for calendar year 2011.

The data base of Herbein + Company, Inc. maintains plant costs on a per point (quart) basis. The Maine dairies included in this study were adjusted to be in conformity with the Herbein data base as to methodology of combining and calculating costs. The average plant cost has been adjusted, utilizing a small container adjustment so that actual processing costs per container are reflected in the study. The operation of a fluid milk processing facility where containers of various sizes are processed reflect different costs by container size. The most efficient container is an in-line blow molded plastic gallon and the least efficient containers would be bulk dispensers and small containers such as half pints, and 4 oz. containers. The “small container adjustment”

calculates and reflects a reduction from average for the larger containers and an increase of above average for the smaller containers.

This adjustment methodology has been utilized for many years in the State of Pennsylvania by the Pennsylvania Milk Marketing Board in its calculation of minimum wholesale prices.

The 15 out of state fluid milk plants included in our study include companies that blow mold on-site their containers and also those that purchase containers from outside vendors. The economic condition of the comparable companies is reflective of the condition within the Maine dairies. The delivery of milk products in an area such as comprised by the State of Maine includes many long haul deliveries, numerous small deliveries, as well as tractor trailer deliveries to supermarkets. The dairies included in the delivery analysis are comprised of 11 comparable dairies included in the 15 plants utilized in studying the plant costs. The four (4) dairies not utilized in the delivery studies did not have delivery characteristics that are comparable to the conditions that exist in the State of Maine. The 11 comparable dairies include companies whose distribution area is as large as the State of Maine as well as companies delivering to supermarkets, convenience stores, schools, hospitals, and other institutions. It is my opinion that the comparable dairies are very reflective of the actual activities in the State of Maine.

Exhibits

Exhibits 2, 3, 4, 5 and 6 reflect the results of our study. The column entitled Current ME Statute reflects the costs currently included in the minimum price announcements issued by the Maine Milk Commission and are reflective of milk costs for September 2012. The column entitled Benchmark Group is reflective of the actual costs incurred by the 18 company group. The last column reflects the adjustment necessary to adjust the current dealer margin to that which has been calculated using the 18 company group. It is important to note that there is no margin or profit included in these calculations.

Exhibits 7, 8, 9, 10 and 11 are adjusted to include a reasonable rate of return.

In the “Background and statutory framework” of Chapter 29 – Maine Milk Commission the following language appears “minimum wholesale prices to paid to processors (dairies) are set to reflect the lowest prices

which milk processed from Maine producers can be received, processed, package, and distributed to retailers within the state at a just and reasonable return”.

In order to maintain a healthy dairy industry, a rate of return (profits) is necessary so that industry participants can afford to modernize their facilities, maintain a safe and healthy processing environment, and also provide a reasonable rate of return to owners and operators. It is the finding of Herbein + Company, Inc. that a 3% rate of return is average (based upon our data base) and also reasonable when considering the needs of processors, and the effect on in-to-store pricing.

I believe that the Maine Milk Commission should consider this rate of return inclusion to be appropriate especially when combined with actual costs based on a substantial and representative group of processors. Historically, the utilization of theoretical costing, coupled with adjustments made to theoretical costs for Maine economic conditions has resulted in a “hidden profit”. I recommend that the Maine Milk Commission utilize actual costs and include a reasonable rate of return to processors.

Conclusion

Thank you for considering the actual cost information presented in the report exhibits and I believe that the utilization of these statistics will allow the Maine Milk Commission to establish minimum wholesale milk prices that will satisfy the statutory requirements while providing a healthy environment for Maine processors.

Carl D. Herbein, CPA

Curriculum Vitae

EDUCATION

Elizabethtown College – B.S. Degree in Accounting (1968)

Delta Mu Delta – National Honor Society – Co-captain Cross Country Team

EMPLOYMENT

Herbein + Company, Inc., Reading, PA

October, 2004 to present

President and CEO

July, 1985 to September, 2004

Managing Partner

1974 to June, 1985

Partner

Reading, PA

Carl D. Herbein, CPA – Reading, PA

1972 to 1974

Ernst & Young, Reading, PA

1967 to 1972

Staff/Senior Accountant

PROFESSIONAL AND CIVIC ASSOCIATIONS AND DESIGNATIONS

CPA – Commonwealth of Pennsylvania (1971)

Member – American Institute of CPAs – Council (1990 – 1991)

Member – Pennsylvania Institute of CPAs – President (1988 – 1989)

Firm Member – PKF North American Network – Board of Directors (1993 – 1994)

Chairman – Reading Redevelopment Authority (1992 – 1998) Board of Directors (1984 – 1998)

Board Member

- Greater Berks Development Fund (1995 – present)
- Berks County Convention Center Authority - Treasurer (1996 – present)
- Alvernia University (2012 – present)

Berks County Chamber of Commerce (1980 – present)

- Chairman of the Board (1994 – 1996)
- Treasurer (1992 – 1993)
- Treasurer (2007-2009)

C.H. Briggs Hardware, Reading, PA

- Member of Board of Directors
- 2008 to present

Carl D. Herbein, CPA

SPECIFIC DAIRY-RELATED EXPERIENCE

Grew up and worked on his parents' dairy farm

Partner-in-charge of services for all dairy clients currently serviced by the Firm

Performed the feasibility and accounting work for numerous successful dairy mergers

Currently leads firm's engagements in industry consolidation, including due diligence, valuation, and consolidation benefit analysis

Performed other special projects for dairies – Product cost analysis, route accounting and profitability analysis, by-product and excess butterfat cost analysis, buy-sell arrangements, labor contract negotiations, hauling cost analysis, plant shrink studies, delivery cost studies, market price analysis, cost benchmarking projects, business valuations, Federal Trade Commission analysis, and dairy financial reporting design

Has spent more than 14,300 hours of time in personally preparing for and testifying at over 139 Pennsylvania Milk Marketing Board price hearings between 1976 and 2012

Has visited and provided services to more than 155 dairy food companies

Has presented accounting and financial related topics at numerous Pennsylvania Association of Milk Dealers conventions, All Star Dairy national conventions, Quality Check Dairies national convention, Master Dairies national convention, New York State Dairy Foods, Inc. annual meeting, and International Association of Milk Control Agencies annual meetings

Has published an article, "Financing Agribusiness Growth," which appeared in the *Pennsylvania CPA Journal*

Has performed dairy cost accounting litigation support engagements for the state of New Jersey, Department of Agriculture

Has performed dairy cost accounting engagements for the state of Colorado

Developed and presents the annual "Dairy Cost Accounting Workshop" for International Dairy Foods Association

Has published an article, "Product Costing In A Volatile Environment," which appeared in the *National Ice Cream Mix Association, Inc.'s Newsletter*

Has published an article, "Milk Costing and Regulation – Is There a Conflict?" which appeared in the 2003 *International Association of Milk Control Agencies' Newsletter*.

Has published an article, "Benchmarking," which appeared in the August 2004, *422 Business Advisor*.

Has published an article "Processors Improve Profits With Benchmarking", which appeared in the October 2011, *Dairy Foods Magazine*.

Awarded the 2006 Eugene L. Shirk Community Builder Award.

2010 Corporate Honoree – March of Dimes

**Maine Milk Commission
Dealer Margin Hearings
Summary of Current and Proposed Dealer Margins - Plastic Quart**

	Current ME Cost	Proposed Cost	Increase (Decrease)
Processing		\$ 0.1294	
SG&A		0.0542	
Container		0.1388	
Dock Cost	\$ 0.3215	\$ 0.3224	\$ 0.0009
Delivery	0.0865	0.1044	0.0179
Commission Fee Adjustment	0.0005	0.0005	-
Dealer Margin	\$ 0.4085	\$ 0.4273	\$ 0.0188
Milk Cost (1) (2)	0.5315	0.5315	-
Into Store Cost	\$ 0.9400	\$ 0.9588	\$ 0.0188

(1) The milk and component prices utilized were from October 2012

(2) The milk cost was calculated assuming a 2% fat content

**Maine Milk Commission
Dealer Margin Hearings
Summary of Current and Proposed Dealer Margins - Plastic Half Gallon**

	Current ME Cost	Proposed Cost	Increase (Decrease)
Processing		\$ 0.1567	
SG&A		0.1048	
Container		0.1350	
Dock Cost	\$ 0.4253	\$ 0.3965	\$ (0.0288)
Delivery	0.1538	0.2084	0.0546
Commission Fee Adjustment	0.0011	0.0011	-
Dealer Margin	\$ 0.5802	\$ 0.6060	\$ 0.0258
Milk Cost (1) (2)	1.0698	1.0698	-
Into Store Cost	\$ 1.6500	\$ 1.6758	\$ 0.0258

(1) The milk and component prices utilized were from October 2012

(2) The milk cost was calculated assuming a 2% fat content

**Maine Milk Commission
Dealer Margin Hearings
Summary of Current and Proposed Dealer Margins - Plastic Gallon**

	Current ME Cost	Proposed Cost	Increase (Decrease)
Processing		\$ 0.3286	
SG&A		0.2170	
Container		0.1892	
Dock Cost	\$ 0.6907	\$ 0.7348	\$ 0.0441
Delivery	0.3460	0.4178	0.0718
Commission Fee Adjustment	0.0022	0.0022	-
Dealer Margin	\$ 1.0389	\$ 1.1548	\$ 0.1159
Milk Cost (1) (2)	2.1311	2.1311	-
Into Store Cost	\$ 3.1700	\$ 3.2859	\$ 0.1159

(1) The milk and component prices utilized were from October 2012

(2) The milk cost was calculated assuming a 2% fat content

**Maine Milk Commission
Dealer Margin Hearings
Summary of Current and Proposed Dealer Margins - 10 Quart Dispenser**

	Current ME Cost	Proposed Cost	Increase (Decrease)
Processing		\$ 1.8422	
SG&A		0.5424	
Container		0.8749	
Dock Cost	\$ 1.8855	\$ 3.2595	\$ 1.3740
Delivery	0.6921	1.0444	0.3523
Commission Fee Adjustment	0.0054	0.0054	-
Dealer Margin	\$ 2.5830	\$ 4.3093	\$ 1.7263
Milk Cost (1) (2)	5.3270	5.3270	-
Into Store Cost	<u>\$ 7.9100</u>	<u>\$ 9.6363</u>	<u>\$ 1.7263</u>

(1) The milk and component prices utilized were from October 2012

(2) The milk cost was calculated assuming a 2% fat content

**Maine Milk Commission
Dealer Margin Hearings
Summary of Current and Proposed Dealer Margins - 20 Quart Dispenser**

	Current ME Cost	Proposed Cost	Increase (Decrease)
Processing		\$ 3.6844	
SG&A		1.0848	
Container		0.8754	
Dock Cost	\$ 3.7709	\$ 5.6446	\$ 1.8737
Delivery	1.3842	2.0889	0.7047
Commission Fee Adjustment	0.0108	0.0108	-
Dealer Margin	\$ 5.1659	\$ 7.7443	\$ 2.5784
Milk Cost (1) (2)	10.6541	10.6541	-
Into Store Cost	<u>\$ 15.8200</u>	<u>\$ 18.3984</u>	<u>\$ 2.5784</u>

(1) The milk and component prices utilized were from October 2012

(2) The milk cost was calculated assuming a 2% fat content

**Maine Milk Commission
Dealer Margin Hearings
Summary of Current and Proposed Dealer Margins (including rate of return) - Plastic Quart**

	Current ME Cost	Proposed Cost	Increase (Decrease)
Processing		\$ 0.1294	
SG&A		0.0542	
Container		0.1388	
Dock Cost	\$ 0.3215	\$ 0.3224	\$ 0.0009
Delivery	0.0865	0.1044	0.0179
Commission Fee Adjustment	0.0005	0.0005	-
Dealer Margin (before rate of return)	\$ 0.4085	\$ 0.4273	\$ 0.0188
Rate of Return on operating costs (3)	-	0.0128	0.0128
Milk Cost (1) (2)	0.5315	0.5315	-
Rate of Return on milk costs (3)	-	0.0159	0.0159
Into Store Cost	<u>\$ 0.9400</u>	<u>\$ 0.9875</u>	<u>\$ 0.0475</u>

(1) The milk and component prices utilized were from October 2012

(2) The milk cost was calculated assuming a 2% fat content

(3) A 3% rate of return was applied to the dealer margin for the benchmark group

**Maine Milk Commission
Dealer Margin Hearings
Summary of Current and Proposed Dealer Margins (including rate of return) - Plastic Half Gallon**

	Current ME Cost	Proposed Cost	Increase (Decrease)
Processing		\$ 0.1567	
SG&A		0.1048	
Container		0.1350	
Dock Cost	\$ 0.4253	\$ 0.3965	\$ (0.0288)
Delivery	0.1538	0.2084	0.0546
Commission Fee Adjustment	0.0011	0.0011	-
Dealer Margin (before rate of return)	\$ 0.5802	\$ 0.6060	\$ 0.0258
Rate of Return on operating costs (3)	-	0.0182	0.0182
Milk Cost (1) (2)	1.0698	1.0698	-
Rate of Return on milk costs (3)		0.0321	0.0321
Into Store Cost	<u>\$ 1.6500</u>	<u>\$ 1.7261</u>	<u>\$ 0.0761</u>

(1) The milk and component prices utilized were from October 2012

(2) The milk cost was calculated assuming a 2% fat content

(3) A 3% rate of return was applied to the dealer margin for the benchmark group

**Maine Milk Commission
Dealer Margin Hearings
Summary of Current and Proposed Dealer Margins (including rate of return) - Plastic Gallon**

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Processing		\$ 0.3286	
SG&A		0.2170	
Container		0.1892	
Dock Cost	\$ 0.6907	\$ 0.7348	\$ 0.0441
Delivery	0.3460	0.4178	0.0718
Commission Fee Adjustment	0.0022	0.0022	-
Dealer Margin (before rate of return)	\$ 1.0389	\$ 1.1548	\$ 0.1159
Rate of Return on operating costs (3)	-	0.0346	0.0346
Milk Cost (1) (2)	2.1311	2.1311	-
Rate of Return on milk costs (3)		0.0639	0.0639
Into Store Cost	<u>\$ 3.1700</u>	<u>\$ 3.3844</u>	<u>\$ 0.2144</u>

(1) The milk and component prices utilized were from October 2012

(2) The milk cost was calculated assuming a 2% fat content

(3) A 3% rate of return was applied to the dealer margin for the benchmark group

**Maine Milk Commission
Dealer Margin Hearings**
Summary of Current and Proposed Dealer Margins (including rate of return) - 10 Quart Dispenser

	Current ME Cost	Proposed Cost	Increase (Decrease)
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SG&A		0.5424	
Container		0.8749	
Dock Cost	\$ 1.8855	\$ 3.2595	\$ 1.3740
Delivery	0.6921	1.0444	0.3523
Commission Fee Adjustment	0.0054	0.0054	-
Dealer Margin (before rate of return)	\$ 2.5830	\$ 4.3093	\$ 1.7263
Rate of Return on operating costs (3)	-	0.1293	0.1293
Milk Cost (1) (2)	5.3270	5.3270	-
Rate of Return on milk costs (3)		0.1598	0.1598
Into Store Cost	<u>\$ 7.9100</u>	<u>\$ 9.9254</u>	<u>\$ 2.0154</u>

(1) The milk and component prices utilized were from October 2012

(2) The milk cost was calculated assuming a 2% fat content

(3) A 3% rate of return was applied to the dealer margin for the benchmark group

**Maine Milk Commission
Dealer Margin Hearings**
Summary of Current and Proposed Dealer Margins (including rate of return) - 20 Quart Dispenser

	Current ME Cost	Proposed Cost	Increase (Decrease)
Processing		\$ 3.6844	
SG&A		1.0848	
Container		0.8754	
Dock Cost	\$ 3.7709	\$ 5.6446	\$ 1.8737
Delivery	1.3842	2.0889	0.7047
Commission Fee Adjustment	0.0108	0.0108	-
Dealer Margin (before rate of return)	\$ 5.1659	\$ 7.7443	\$ 2.5784
Rate of Return on operating costs (3)	-	0.2323	0.2323
Milk Cost (1) (2)	10.6541	10.6541	-
Rate of Return on milk costs (3)		0.3196	0.3196
Into Store Cost	<u>\$ 15.8200</u>	<u>\$ 18.9503</u>	<u>\$ 3.1303</u>

(1) The milk and component prices utilized were from October 2012

(2) The milk cost was calculated assuming a 2% fat content

(3) A 3% rate of return was applied to the dealer margin for the benchmark group