HEARING BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE

September 2023

Testimony of Kimberly Greenbaum, Sr. Procurement Specialist for Dairy, Nestlé USA, Inc.

Thank you for providing Nestlé with the opportunity to testify on proposed changes to the United States Department of Agriculture (USDA) Federal Milk Marketing Order (FMMO) system.

My name is Kimberly Greenbaum, I am the Sr. Procurement Specialist for the dairy category at Nestlé USA (NUSA). In my role, I am responsible for our procurement relationships with individual dairy farms, cooperatives, proprietary handlers, and dairy ingredient manufacturers. Prior to my current position I served as a dairy buyer for Nestlé USA and Nestlé SA. In those roles I have bought Cheese, Class IV and Class I fluid milk, Processed Milks, and Powdered Dairy Ingredients.

Nestlé: Who We Are

Nestlé is committed to unlocking the power of food to enhance quality of life for everyone, today and for generations to come. With more than 30,000 employees across 28 states, Nestlé in the U.S. offers a wide portfolio of food and beverage products for people and their pets. We proudly contribute to enhancing communities and economies around the U.S. where we have a presence by creating jobs, supporting community programs, and doing our part to protect the planet and conserve resources. As Nestlé S.A.'s largest market, Nestlé in the U.S. consists of four main businesses: Nestlé USA, Nespresso, Nestlé Health Science, and Nestlé Purina PetCare Company.

Dairy as part of Nestlé's DNA

Since 1867, dairy has been central to Nestlé's product portfolio and our value chain. Dairy is Nestlé's largest raw ingredient purchase category worldwide, with many milk and milk-derived ingredients used in our products. We believe milk and dairy products can bring valuable nutrition to families throughout their lives, and we are looking for reassurance that U.S. dairy policy continues to ensure safe, reliable, and predictable supplies across the dairy supply chain.

As the world's largest food and beverage company, Nestlé has been the largest purchaser of dairy globally for many years. To service the U.S. market, we purchase over 90 percent of our dairy needs from domestic sources located within the United States. Beyond what is needed for our U.S. factories, we also make additional purchases of U.S. origin dairy and ship that product to Nestlé manufacturing facilities in other countries. This provides a crucial export market for U.S. dairy.

Nestlé's largest beverage facility is in Anderson, Indiana. The Anderson factory, which employs 880 people, utilizes U.S. dairy to produce well-known brands such as Nesquik Ready-to Drink milk, Coffee Mate Creamer, Starbucks Creamer, Natural Bliss Creamer, Boost Nutritional Drink, and Carnation Instant Breakfast. We hope this snapshot is useful as an introductory backdrop to our testimony today.

Support for "IDFA Floored Class I Mover Proposal"

Nestlé supports the International Dairy Foods Association's (IDFA) Proposal 14 also known as the *"IDFA Floored Class I Mover Proposal"*.

The IDFA proposal will strengthen the position of the entire dairy industry, from dairy farmers, to processors, to end consumers. Collectively this proposal will encourage increased sales of Class I milk products and promote a stable supply of wholesome milk at reasonable prices for industry participants and consumers. Maintaining the “average of Class III and IV skim milk price” structure will allow for the continued hedging by fluid milk bottlers. Adding a true-up mechanism and flooring the adjuster at $0.74/cwt will ensure that dairy producers receive the equivalent of “higher of” pricing over time. As such, flooring the adjuster at $0.74 will ultimately lead to dairy farmers receiving higher prices than simply adopting the higher of mover methodology. The industry needs solutions that collectively benefit all industry participants and that create a viable business environment in which the industry can flourish.

We believe the IDFA proposal will provide that holistic solution and that it will increase the price visibility and stability for dairy buyers and sellers. The proposal will also put more dollars into the pockets of dairy farmers when compared to current conditions and alternative proposals. Importantly, the proposal will reinforce consumer confidence in the ready availability of milk at a stable and consistent price point.

This testimony will explain the vital importance of the IDFA proposal to Nestlé as well as the collective dairy industry.

<u>Nestlé’s Class I Milk Procurement and Hedging</u>

Nestlé procures Class I fluid milk for its Nesquik Ready-to-Drink (RTD) business at our Anderson facility. This is done through contract agreements with dairy cooperatives that cumulatively purchase dairy from over 300 individual farms across the states of Wisconsin, Michigan, and of course, Indiana, where we are today. Nesquik RTD products remain a strong, sizeable, and growing brand, despite the decline in national fluid milk consumption.

To reduce price volatility, Nestlé utilizes hedging with commodities futures markets when procuring Class 1 milk. Through hedging, a contract risk mitigation tool, Nestlé can increase price visibility and decrease price volatility, by determining its price for Class I milk in advance. It also provides assurances to processors against losses due to market volatility. These factors lead to pricing stability for retailers and end consumers.

<u>Price Predictability and Hedging</u>

As you are no doubt aware, hedging is a strategy used to limit price risk exposures in financial assets, and to manage price fluctuations in commodities or raw materials used by businesses. The IDFA proposal will provide greater price stability and enable dairy farmers and processors to continue incorporating hedging with commodities futures markets into their customer contract negotiations. The IDFA proposal would see the FMMO maintain the “average of” price methodology, which is vitally important because this methodology is the key that enables processors to effectively engage in hedging.

Nestlé has extensive experience with hedging our contracts for Class I Milk dating back to 2019. This was the first year that implementation of the “average of” price methodology enabled hedging as a risk mitigation tool. Again, Nestlé utilizes hedging for two main purposes, first it provides price visibility, and second it protects against high price volatility.

Class I milk is typically the most volatile and most difficult to forecast dairy derivative in the United States because of its complex calculation methodology and its pricing linkages to four different derivatives, cheese, whey, nonfat dry milk, and butter. Each of these four commodity derivatives has its individual market fundamentals, which independently impact the price of Class I Milk.

Without the ability to effectively hedge, or with the introduction of the alternative “higher-of” price methodology, the cost of Class I milk is subject to drastic price swings. This creates substantial financial risk, which can only be mitigated by increasing prices with customers to ensure that a reasonable return on investment is achievable in the event of price volatility.

This can result in higher consumer prices and reduced consumption because a higher risk mitigation premium must be built into purchasing agreements, driving up the cost of doing business. Retailers seek out and tend to dedicate shelf space to products with flat and consistent pricing. If hedging cannot be used to secure flat pricing, it is likely that prices will increase to offset the margin risk of having a variable milk cost and a flat finished goods price.

These higher costs can reverberate throughout the supply and impact all industry players, including end consumers. Conversely, hedging is a well-established and proven strategy that is widely utilized today to mitigate pricing risk in a cost-effective manner. This is to the benefit of all industry participants, including consumers, but again, hedging does require the “average of” pricing methodology to be utilized effectively. Prior to 2019 when the alternative “higher of” price methodology was in place, effective hedging was not possible.

Refuting the “higher-of” Proposal

We are aware that USDA has received proposals which would see the FMMO utilize a “higher-of” Class III or Class IV price approach. This is simply not a viable solution and presents significant challenges along the dairy value chain, including challenges to processors, farmers, and end-consumers because it does not support the ability to effectively hedge.

In a “higher of “scenario, the utility of hedging with futures/options is severely limited, given that it is not known in advance which “higher of” mover (Class III or Class IV) will be in effect at the expiration of the right to exercise the futures/options. This creates unmanageable uncertainty, making it difficult to know which contract to use to hedge, and once the hedges are placed, if the higher of Class I mover switches from Class III to Class IV, or vice versa, the result is an unexpected loss.

Again, under the “average of” methodology to date and with the ability to hedge, Nestlé’s main Class I Milk product, Nesquik RTD, has been a stable and growing brand. As such, the brand continues to provide a reliable market into which dairy farmers can sell Class I Milk. Ultimately, the incorporation of a “higher of” price methodology would pose threats to Nesquik RTD business viability. The “higher of” approach would introduce new price volatility and undermine consistent product supply. This also carries the risk of eroding consumer confidence in the availability or accessibility of milk products that are an affordable daily staple for millions of households across the United States.

Hedging Protects Against Volatility, Maintains Pricing Stability

Price volatility can have impacts along the supply chain, down to the consumer. Take products like Nesquik for example that have a longer “shelf-life” than jug milk. It would be a challenge for retailers to set different prices due to volatile milk price fluctuations for two identical products sold at the same time just because they come from batches produced in different months. Moreover, consumers would understandably be confused should retailers find it necessary to set different prices for the same product on the same shelf based on different input costs at the time of production. This would likely raise questions in the minds of consumers. The impact of volatility under this scenario would likely be difficult to explain in a way that is readily comprehensible, which could lead to a loss of consumer trust.

Hedging is a solution that insulates against that volatility. Without hedging, Nestlé would need to consider other steps to protect itself from market volatility, which could include upwardly adjusting prices with retailers to help ensure a reasonable return on investment is reached. In turn, retailers would likely increase their own prices at which they sell to consumers. Ultimately this means a higher costs of doing businesses to protect against volatility and ensure flat and consistent retail prices for consumers. These are costs that would likely reverberate down the supply chain and impact retail sales. As a result, we believe there would be a significant negative impact on the growth potential for the liquid milk consumption around the nation.

Added Value for Dairy Farmers:

At Nestlé, we recognize that the vitality of the U.S. dairy industry is a key component of our success as a business. We depend on the dairy industry in the United States to provide a reliable and continuous supply of milk at a fair price, and we understand that the financial stability of our farming sector plays an important role in delivering those results. That is why we were pleased to see that the IDFA proposal would add a floor to the $0.74 adjuster to the minimum amount paid to dairy farmers each month. Meaning that under the proposal, dairy farmers would receive a higher minimum payment even if the true-up to the higher of Class I skim milk price results in a price that is lower than that set minimum amount.

The IDFA proposal also includes a "look back and make whole" process, which means that the Class I skim milk price paid overtime will not fall below the old "higher of Class I mover" price. Analysis by IDFA shows that over time dairy farmers would be paid more than under the alternative “higher of” proposals that the USDA has received. We therefore see the IDFA proposal as highly effective to not only support the business environment for dairy procurement, but also as a key assurance to ensure a strong financial foundation for dairy production. Subsequently, it serves to reinforce consumer confidence in a price-stable and continuous supply of milk.

Closing

Nestlé is proud to produce iconic products like Nesquik using high quality dairy ingredients from U.S. dairy farmers and cooperatives. We believe U.S. dairy policy should drive safe, reliable, and predictable supplies of dairy products across the supply chain – supporting farmers and processors alike. For this reason, Nestlé would like to see a consistent approach to Class I mover maintained through the *“IDFA Floored Class 1 Mover Proposal.”* Thank you for your time and consideration of this testimony.