MIG-Hood Exh. 11

UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

AGRICULTURAL MARKETING SERVICE

In re: Milk in the Northeast and Other Marketing Areas	7 CFR Parts 1000 *et seq.* Docket No. 23-J-0067; AMS-DA-23-0031

CARMEL, INDIANA
AUGUST 2023

TESTIMONY OF HP HOOD, LLC, PART 2 REGARDING NATIONAL HEARING ON FEDERAL MILK MARKETING ORDER PROPOSALS

September 8, 2023

I. BACKGROUND

A. PERSONAL BACKGROUND

My name is Michael Newell and I am a Sales Director for HP Hood LLC ("Hood"). I am also responsible for industry relations in California and serve on the Board of the Dairy Institute of California, the California Milk Processor Board, and the Dairy Council of California. In my role as Sales Director I am responsible for the sale of Hood brands and licensed brands in Northern California and the Pacific Northwest. From 2011- 2015 I was also responsible for international sales and was Hood's representative of the U.S. Dairy Export Council Board. I came to Hood when they acquired Crystal Cream & Butter Company in 2007. At Crystal I served in various positions between 1987-2007 including Operations Trainee, Sales Analyst, V.P. of Sales & Marketing, and President. As V.P. of Sales & Marketing at Crystal, I oversaw pricing policy and participated in a number of California Department of Food and Agriculture milk price hearings. I graduated from U.C. Berkeley in 1987 with BA in Economics and received an MBA from the Wharton School of the University of Pennsylvania in 1991.

B. COMPANY BACKGROUND

HP Hood was founded in 1846 and is one of the largest family-owned fluid milk bottling companies in the United Sates, with annual sales in excess of $3 Billion in 2022. Hood currently operates five ESL plants and four HTST plants, all of which process Class I milk. Hood's ESL plants are located in Philadelphia, PA (FMMO 1); Winchester, VA (FMMO 1); Oneida, NY (FMMO 1); Batavia, NY (FMMO 1); and Sacramento, CA (FMMO 51). Hood has a sale agreement in place for the Philadelphia facility which should close in the second half of 2023. Hood's HTST/DSD Plants are located in Agawam, MA (FMMO 1); Barre, VT (FMMO 1); Concord, NH (FMMO 1), and Portland, ME (FMMO 1). In addition to Class I Products, Hood produces cream, half & half, and a variety of cultured products, ice cream, and several non-dairy ESL beverages, including Almond Breeze and Planet Oat brands. Hood operates culture plants in

Vernon, NY, Lafargeville, NY and Arkport, NY and an ice cream plant in Suffield, CT. For 2022, Hood had Class I utilization rate of over 87% for both its ESL and HTST bottling plants.

Hood's ESL business is the largest segment of our business, and we distribute major ESL brands nationally. Hood markets its national brands as consumer products. Annual marketing and trade plans are rigorously developed and wholesale price changes take place infrequently (over the past 10 years the average is less than annually). Hood's largest brand is Lactaid Lactose Free Milk which is produced under a license from McNeil Nutritionals. According to market analytics firm Circana, Lactaid's Class I lactose free milk's Total U.S. Multi Outlet sales exceeded 108 million gallons for the 52 weeks ending July 30, 2023, making it the largest Specialty Milk brand in the U.S. Hood also exports a significant amount of Class I ESL milk to Asia from its Sacramento, CA Plant.

HP Hood's Class I HTST business is regionally confined to the New England Market. Hood's Class I sales occur under several brands including HP Hood, Crowley Foods, Booth Brothers, and assorted private labels. Hood's Class I products are primarily delivered directly to stores, food service accounts, and schools. Wholesale prices of Class I products typically change monthly in alignment with the FMMO Class I changes. According to Circana (based on public data), the HP Hood brand is the largest brand in the New England market with a 12.5 volume share. Private label has the largest share of the New England markets with a 74.7 volume share.

II. SUPPORT FOR MIG PROPOSALS

Hood is a member of the Milk Innovation Group ("MIG") and supports its proposals at this hearing. I am here today to testify on MIG's Proposal 15.

A. Proposal 15: MIG's Base Class I Skim Milk Price

Hedging has always been a critically needed tool for Class I. I understand that it may not be a familiar concept to most, and so want to walk everyone through what that looks like for

processors. First, what is hedging? Hedging is the use of risk management tools to achieve a predictable price and reduce the upside price risk.

Second, how do Class I processors hedge?

Under the current system, Class I processors can hedge in two ways:

1) A processor can purchase a futures contract for the solids (powder or cheese) and the fat (butterfat) on the CME.
2) Several commodity brokers will also "create" a Class I contract for a fee which will allow a Class I processor to hedge their Class I milk cost.

Third, what is the purpose of hedging? The key thing to understand about hedging is that it is not about making a higher return. It is about making an investment in insurance to reduce price risk and achieve a more predictable input price. This insurance removes some input price volatility and increases margin certainty for end product sales.

Fourth, is it possible for producers and processors to hedge? Yes, under the current system both producers and processors can hedge. Currently, Class I hedging is primarily used by more sophisticated operators to reduce their pricing risk. As Class I hedging becomes more accepted, the market should become more liquid and more processors will likely use this risk management tool.

Fifth, are any Class I processors currently hedging? Yes, Hood currently hedges. Specifically, it has utilized futures contracts to fix the cost of a portion of the milk it utilizes for Lactaid to create a level of predictability on the cost of the milk ingredients. This helps remove some volatility from the cost of goods and allows the company to execute its annual marketing and trade promotional plan and reduce the need for frequent product price changes. The option to hedge has only been in place a short while since Congress included the "average of" alternative to the old higher-of skim milk price standard in the 2018 Farm Bill and the USDA implemented this change in May 2019. The pandemic created a proliferation of supply chain challenges for manufacturers, and I suspect that it likely slowed the adoption of the risk management opportunity offered by the "average of." Hood is still exploring ways in which it can best use risk management

tools, and I suspect that other processors are interested in hedging even if they have not begun doing so yet.

Additionally, Hood sees an opportunity to utilize Class I hedging to be more competitive in overseas markets. Hood has sold ESL milk in overseas markets with the understanding that prices will move with the U.S. market. In one particular case in 2013 we had a distributor that guaranteed an annual price to several coffee chains at a solid margin. U.S. dairy prices then unexpectedly increased substantially over the next 12 months resulting in significant financial loss for the distributor. As a result of this price volatility, Hood and the distributor ended the business relationship which equated to about 750,000 gallons per year. With an active hedging program, Hood could have worked with this distributor to reduce their price risk and possibly preserve the business.

Finally, and most importantly, what is the impact of changing the formula from its current form to the "higher of," as advocated by NMPF? Such a change would hurt Class I processors, it would hurt our customers, and it would hurt consumers of fluid milk. Class I processors cannot effectively utilize one of the two hedging options under the "higher of" standard:

1) *A processor can purchase a futures contract for the solids (powder or cheese) and the fat (butterfat) on the CME.* – Under the "higher of," Class I processors have to guess which solids to buy.
2) *Several commodity brokers will also "create" a Class I contract for a fee which will allow Class I processor to hedge their Class I milk cost.* – For the same reason, it is immensely difficult for brokers to create these contracts when the price bounces between the "higher of" Class III and IV.

Additionally, the entire industry risks losing market share if Class I returns to a base skim milk price formula like the "higher of" because of the price instability it creates, particularly in regard to beverages competing with fluid milk. I noted above our use of hedging to help execute annual marketing and trade promotional plans for Lactaid. This is the same go-to-market approach that Hood uses for plant-based products and our competitors use for Value Added Milk and plant-based products. Relatedly, retailers require 60 to 90 days' notice of price changes for products

distributed through their warehouses. Retailers often will "margin up" on manufacturers' price changes due to favoring specific retail price points like $3.99, $4.49, $4.99. Thus, the less predictable the price, the higher the likelihood of more frequent price changes, the more opportunities retailers will have to build added margin into their retail prices. That harms the market as a whole – including, and especially, the consumer. The point here is that price changes can't be avoided, but with consumer products the frequency should be limited as much as possible. Hedging allows for this to occur.

Our ESL customers who buy through grocery warehouses would like stable and predictable prices with minimal price changes, dependable trade plans, and minimal supply disruptions. More Food Service customers may be interested in hedging to be able to keep menu prices steady and also to promote dairy based products for an extended period. For DSD operations there is a well-developed system to handle monthly price changes, so hedging capabilities may be less necessary. But all customers would like to have a pricing system that is less volatile and more predictable. As Proposal 15 delivers both the ability to use risk management tools and a more stable pricing system, all customers would be supportive.

In our view the MIG base Class I skim milk price proposal benefits both the processors and producers. Based on an analysis from MIG's expert Sally Keefe, MIG's Proposal 15 fulfills our goal of a base Class I skim milk price formula that allows for hedging, but ensures a comparable price to the "higher of" in NMPF's Proposal 13. The predictability inherent in MIG's proposed formula allows for more Class I product innovation and certainty in end product pricing both domestically and abroad. This should stimulate Class I growth and stability.

III. CONCLUSION

In summary, HP Hood respectfully requests that the USDA give its utmost consideration to the MIG's Proposal 15 in order to create a more stable, predictable price mover that continues to allow for Class I hedging. This proposal positions the Class I market better for future growth,

which would benefit both producers and processors. Hood also favors IDFA's Proposal 14 if USDA finds that to be a better alternative.

DATED this 7th day of September, 2023.

By */s/ Michael Newell*
MICHAEL NEWELL