Testimony of Darin Hanson

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My name is Darin Hanson. This testimony is presented in support of Proposal 7: Increase manufacturing make allowance for butterfat, nonfat solids, protein, and other solids as proposed by National Milk Producers Federation (NMPF). This testimony is presented on behalf of Foremost Farms USA (Foremost), a long-time member of NMPF. I am Senior Vice President of Supply Chain and Risk Management at Foremost. I have been employed in the dairy industry for 20 years in various dairy supply chain roles; including, dairy product procurement/sales, member relations management, and risk management. Former employers include Land O' Lakes and General Mills. During my career, I've accumulated significant knowledge and expertise related to raw material procurement, contracting for milk and finished products with customers/suppliers, and managing milk premium programs with dairy producers.

Foremost is a large dairy cooperative headquartered in Middleton, Wisconsin. Our 850 members, located in Wisconsin, Michigan, Iowa, Minnesota, Indiana, Ohio, and Illinois, produce 6.2 billion pounds of milk annually. The cooperative has members spanning the full range of dairy farming operation sizes, ranging from less than 50 cows to more than 10,000 cows. Foremost is a large manufacturer of cheese, producing 500 million pounds annually. Of that volume, 350 million pounds is soft Italian styles of cheese, making Foremost one of the top manufacturers of soft Italian style of cheese in the US. Foremost has eight plants in its dairy manufacturing network, including three Italian cheese manufacturing plants, two cheddar type manufacturing plants, and one butter manufacturing plant. All these plants are located in Wisconsin. In addition, there are two milk separation facilities in Michigan and Wisconsin. Foremost utilizes two-thirds of its member milk in its products and markets the remaining one-third of its milk to raw milk processors. We sell cheese in various bulk sizes to converters, foodservice, and retail customers where our cheese is incorporated in their finished products.

Foremost supports the proposal to increase the make allowances in the butterfat, nonfat solids, protein, and other solids component formulas as recommended below by NPMF.

- Butterfat: From $0.1715 to $0.2100 per pound of butter,
- Nonfat Solids: From $0.1678 to $0.2100 per pound of nonfat dry milk,
- Protein: From $0.2003 to $0.2400 per pound of cheddar cheese,
- Other Solids: From $0.1991 to $0.2300 per pound of dry whey.

As other NMPF members have stated, these amounts are a stretch for dairy producers to absorb with their thin margins, even though these proposed make allowance increases may not fully compensate for the cost increases realized by dairy processors in manufacturing of dairy products. Instead, these make allowance increases strike a fair balance between the reduction in producer pay price and the reduction in processor milk cost resulting from increasing make allowances. Foremost plants have experienced higher operating costs due to inflation since 2008, but especially over the past two years. Labor, energy, packaging, capital, and other non-dairy costs have risen significantly during this time. It is fair to note that some of these costs have decreased in 2023. For example, natural gas prices have fallen back to pre-pandemic levels, and diesel fuel costs, a large driver of hauling costs, have trended downward. Allowing these proposed make allowance increases increases while we work toward a mandatory audited survey of cost data will balance the need for the increase while not devastating our producer market.

An important note is that manufacturing class FMMO prices are not mandatory prices that are required to be paid by milk buyers to dairy producers. Payments to dairy producers can also include other pluses and minuses, such as volume premiums, quality incentives, hauling cost allocations, and market adjustments. Also, milk customers can be charged a basis that is added to the milk price to account for increased costs as well. This basis can be positive or negative. The level of the basis is determined by regional supply and demand factors, and various other market factors. If a processor is buying milk from a cooperative at an agreed upon basis and their operating costs rise unexpectedly, the basis can be negotiated lower to offset some of the processor's higher costs. This in turn may force the cooperative/processor to pay their members less for the milk produced by reducing member premiums. If the cooperative is also a processor, they may be required to pay less premiums to their members to ensure that earning targets are met in the face of these higher operating costs. With make allowances changing infrequently, customer basis and member milk premium programs allow parties to adapt to higher manufacturing costs over time in a natural market way. Since 2015, in the Midwest and in the Mideast, customer basis has been declining, which has pressured member premiums for milk procurement to also go lower. This is partially in response to higher processor operating costs. Ideally, when make allowances are changed, customer basis and dairy producer premiums would adjust at the same time. However, changes to these premiums tend to change gradually over time, i.e., they are "sticky" and do not change quickly. This may be due to contractual agreements between parties that lock in milk and finished product basis and overages. When these longer-term, e.g., annual agreements are in place, it is difficult to adjust dairy producer premiums without impacting earnings because only one side of the equation is fixed.

In addition, milk supply may be slow to rebalance due to an abrupt change to producer pay prices as it takes time to ramp down or back up when pricing recovers. Large increases to make allowances would be a good example of an abrupt change to producer pay prices, and such a change would likely force changes to farm operations. Due to financial pressures of lower milk prices, resulting from a large make allowance increase, dairy producers may decide to reduce cow numbers or exit the dairy industry, at a time when processors are incentivized to ramp up production. This would disrupt supply and pressure milk premiums and customer basis levels to move higher as processors compete for milk, partially or totally offsetting the impact of the make allowance change. If make allowance changes are implemented, the full impact to the milk price will be felt by dairy producers immediately, but milk premiums to dairy producers and basis to customers could be much slower to adjust. This is an important reason to limit the magnitude of the make allowance changes to ensure that markets remain orderly and not disruptive to dairy producers.

Foremost also supports the recommendation for mandatory USDA plant cost surveys to ensure that make allowance calculations are as accurate as possible. Costs will change over time with inflation consistently causing some cost to go higher. For other costs, such as energy, costs can increase and decrease from year to year. A consistent and robust survey process that refreshes the manufacturing cost data on a timely basis is critical to the validity of the make allowance values.

In summary, Foremost supports the NMPF proposal to increase make allowances. The proposed change directionally accounts for changes in higher operational costs experienced by processors while minimizing the immediate financial disruption to dairy producer pay prices. The reality is that there are other mechanisms to account for higher operating costs for processors, including milk customer basis and milk premiums programs for dairy producers. These likely have been adjusted lower over the years to reduce the impact of higher processor operating costs. The key is to adjust make allowances to better represent reality but ensure an orderly marketplace for dairy producers.