Exhibit-NMPF-18

Make Allowance Testimony (Proposal Number 7)

Testimony Presented By:
Rob Vandenheuvel
Sr. Vice President, Member & Industry Relations
California Dairies, Inc.
2000 N. Plaza Drive
Visalia, CA 93291

This testimony is presented on behalf of California Dairies, Inc., hereafter CDI, and is submitted in support of Proposal Number 7.

My name is Rob Vandenheuvel, and I am Senior Vice President of Member and Industry Relations for CDI, headquartered at 2000 North Plaza Avenue, Visalia, CA 93291. CDI is a Capper-Volstead cooperative association qualified to market milk on Federal Milk Marketing Orders, hereafter "Federal Orders," is a member of National Milk Producers Federation, hereafter "National Milk," and fully supports Proposal Number 7. I serve on National Milk's Executive Committee, Economic Policy Committee, and Federal Order Task Force.

CDI is co-owned by 258 member-owners, operating 297 member farms, all within the state of California. Our member farms produced 17.1 billion pounds of milk in 2022, or 41 percent of California's total production. Of that total, 10.3 billion pounds, or 60.6 percent, was received and processed at one of six CDI-owned manufacturing facilities, while the other 6.7 billion pounds, or 39.4 percent, was sold as bulk raw milk to dairy product processors throughout the State. Among the products produced by CDI-owned manufacturing facilities, butter and powder are a vast majority, as four of our six facilities produce butter and all six facilities produce milk powders. CDI also produces a range of processed fluids that are marketed in bulk to customers primarily in the Western United States.

NEED FOR AN UPDATE IN MANUFACTURING COST ALLOWANCES

The issue of establishing appropriate manufacturing cost allowances, hereafter make allowances, in the Federal Order formulas is of critical importance to CDI, as we view this issue not only through the lens of a marketing cooperative co-owned by 258 member owners, but also as a partnership of those same member owners in making large-scale investments in dairy product manufacturing.

Unlike some of the other issues being considered by USDA in this hearing proceeding, there is overwhelming recognition across the industry, by both producer and processor representatives, that make allowances are in need of an update. Few businesses, regardless of industry, can say their fundamental economics are unchanged in the more than 15 years that have passed since the last update.

It is also important to keep the broader picture in mind, especially in a hearing like this where we will delve into the minutia of the Federal Order formulas. Federal Orders utilize end-product pricing formulas, which calculate a minimum price for milk purchased by pooled milk handlers based on the wholesale price of four end products, specifically butter, nonfat dry milk, cheddar cheese and dry whey. The make allowances that are part of those formulas are intended to generally represent the costs of converting raw milk into those end products. Simply put, the cost structure associated with converting raw milk into those four end products is different today than it was in the mid-2000s when the make allowances were last evaluated. An update is clearly warranted.

THE PROPOSED UPDATES

Specifically, Proposal Number 7 would adjust the make allowances used in all four classified milk pricing formulas to the following levels:

- Butter: $0.21 per pound *(currently $0.1715 per pound)*
- Nonfat Dry Milk: $0.21 per pound *(currently $0.1678 per pound)*
- Cheddar Cheese: $0.24 per pound *(currently $0.2003 per pound)*
- Dry Whey: $0.23 per pound *(currently $0.1991 per pound)*

While not the direct subject of this hearing proceeding, a critical element of National Milk's package of Federal Order updates is an effort on Capitol Hill to authorize the U.S. Department of Agriculture to require participation in an audited manufacturing cost survey for all manufacturers subject to mandatory price reporting to the National Dairy Product Sales Report. CDI is strongly supportive of an immediate adjustment to the make allowances coming out of this hearing process, for reasons that are spelled out in this testimony. However, we also strongly support the work by National Milk in facilitating the creation of an unbiased source of audited manufacturing cost data, which will greatly assist in future USDA and industry consideration of updated formulas.

RISK OF INACTION

While CDI joins National Milk in proposing long-term improvements to this process through better data, the immediate adjustments reflected in Proposal Number 7 in this hearing process are also a critical need for the industry. The risk of inaction or delayed action is simply too great to put the issue off any further.

Cooperatives Most Exposed to Financial Risk of Inaction

Market-wide balancing is primarily conducted by farmer-owned cooperatives that have built milk manufacturing plants that produce storable dairy products like butter and nonfat dry milk. While non-cooperative manufacturers that purchase their raw milk supplies from cooperatives as-needed can scale milk purchases to their profitable demand for various end products, cooperatives – in their role as milk balancers – receive the residual volumes of milk and turn it into storable products.

CDI, like many of our fellow cooperatives, is on the front lines of this market dynamic, experiencing significant swings in milk processing volumes as we balance the seasonal ebbs and flows of our member-owners' milk production, as well as the ebbs and flows of seasonal demand for raw milk. In 2022, the six CDI-owned manufacturing facilities processed as much as

31.8 million pounds per day in April and as little as 24.6 million pounds per day in October – a swing of 7.2 million pounds per day, or 23 percent from the peak to the valley.

Managing that level of volume volatility is challenging enough. Doing so with an artificially elevated Federal Order Class IV price due to outdated make allowances magnifies the difficulty and increases costs borne by our member owners.

Inaction Creates Winners and Losers

When the make allowance is set too low – a scenario that is playing out right now – the system creates winners and losers within the dairy farmer community. The losers are those producers who have made an investment in manufacturing infrastructure, either individually or through a cooperative, as their return on that investment is diminished – or completely eliminated – due to a milk price formula that essentially overvalues the raw milk being processed. The winners are those producers simply selling milk to a third-party processor that is pooling milk on a Federal Order. Those producers are guaranteed an artificially inflated Federal Order blend price, and yet are contributing nothing to the financial stress the system is placing on the producers who have made investments in processing.

In essence, failure to maintain a make allowance that fairly represents current manufacturing costs creates a disincentive to invest in processing infrastructure for use in balancing milk supply and demand, which will ultimately create significant disorderly conditions if or when producers are unwilling or unable to take on that cost.

RISK OF OVERCORRECTION

While an update to the make allowances is warranted, CDI recognizes that there is also a risk of overcorrection. There are certain unknowns due to limitations in the available manufacturing cost data sources, such as:

- Range of costs that may be seen if all plants making eligible products were required to report plant costs to USDA;
- Product yields using current technology;
- Benefits of automation; and
- Energy efficiencies or other improvements to plant efficiencies

While CDI supports mandatory cost reporting that could provide reliable data in these key issues areas, we believe that for the purposes of this hearing, the absence of available, reliable data provides a justification for a more tempered adjustment in the very near term, which is what Proposal Number 7 represents.

Furthermore, the impact on dairy farms and on the regulated monthly milk price must be considered when evaluating these adjustments. It is simple arithmetic that an increase in the make allowance will generate a lower resulting classified milk price. While a regulated milk price reduction due to higher manufacturing costs can be justified, the impact on dairy farms from a sudden and large milk check adjustment is a consideration that supports a more tempered approach.

THE BALANCED APPROACH

Proposal Number 7 takes a balanced approach, making incremental change to the current make allowances, while erring on the side of conservatism. The proposal garnered unanimous support from the National Milk Board of Directors, across cooperatives with and without significant ownership in processing assets. The following are considerations CDI made in supporting Proposal Number 7, particularly with respect to the adjustment in butter and nonfat dry milk make allowances.

CLEAR COST INFLATION

CDI has experienced significant cost inflation across our network of manufacturing facilities since 2007, when the manufacturing cost allowances were last updated.

California Statewide Data

While CDI supports mandatory plant cost reporting to USDA as previously referenced, CDI participated in a statewide and mandatory cost study for dairy manufacturing plants when California operated under a state milk marketing order prior to 2018. This mandatory, audited cost study was conducted by the California Department of Food and Agriculture, hereafter CDFA. The most recent publication of the results from that annual cost study reported results using 2016 data *(Attachment A)*. Also attached to this testimony are the results from CDFA's 2006 cost study *(Attachment B)*, which was used in part as a basis for establishing the current make allowances in 2008.

Table 1. BREAKDOWN OF BUTTER MANUFACTURING COSTS			
Survey Year	2006	2016	
Number of Plants Surveyed	7	7	
Processing Labor (per pound)	\$0.0498	\$0.0754	+\$0.0256 (+51.4%)
Processing Non-Labor (per pound)	\$0.0508	\$0.0724	+\$0.0216 (+42.5%)
Packaging (per pound)	\$0.0108	\$0.0128	+\$0.002 (+18.5%)
Other Ingredients (per pound)	\$0.0030	\$0.0038	+\$0.0008 (+26.7%)
General & Administrative (per pound)	\$0.0159	\$0.0193	+\$0.0034 (+21.4%)
Return on Investment (per pound)	\$0.0070	\$0.0101	+\$0.0031 (+44.3%)
Average Total Cost (per pound)	**\$0.1373**	**\$0.1938**	**+\$0.0565 (+41.2%)**

Table 2. BREAKDOWN OF NONFAT DRY MILK MANUFACTURING COSTS			
Survey Year	2006	2016	
Number of Plants Surveyed	8	8	
Processing Labor (per pound)	\$0.0362	\$0.0538	+\$0.0176 (+48.6%)
Processing Non-Labor (per pound)	\$0.0965	\$0.1129	+\$0.0164 (+17.0%)
Packaging (per pound)	\$0.0147	\$0.0152	+\$0.0005 (+3.4%)
General & Administrative (per pound)	\$0.0111	\$0.0140	+\$0.0029 (+26.1%)
Return on Investment (per pound)	\$0.0079	\$0.0123	+\$0.0044 (+55.7%)
Average Total Cost (per pound)	**\$0.1664**	**\$0.2082**	**+\$0.0418 (+25.1%)**

As evidenced by this data, the cost of producing butter and nonfat dry milk at California manufacturing plants surveyed by CDFA rose across all cost categories in that 11-year time frame. The category "Processing Labor" saw some of the most significant inflation – a rise of 51.4 percent for butter and 48.6 percent for nonfat dry milk – an interesting finding in a cost area that one would expect to see some benefit of automation during that 11-year window of time.

University of Wisconsin Report

In December 2021, Dr. Mark Stephenson, Director of Dairy Policy Analysis at the University of Wisconsin, Madison published a report entitled, "Cost of Processing in Cheese, Whey, Butter and Nonfat Dry Milk Plants." *(Attachment C)*. This report, requested and funded by USDA, was based on feedback from 57 dairy manufacturing plants making either butter, nonfat dry milk, cheddar cheese and/or dry whey. Included in the report was feedback from 12 butter and 27 nonfat dry milk plants that had fully completed the survey.

Specific to Dr. Stephenson's findings on the plant costs for butter and nonfat dry milk, the report found a weighted average processing cost for all respondents of:

- $0.1411 per pound for butter
- $0.2933 per pound for nonfat dry milk

Upon review of the report's findings, CDI grew concerned about the widely divergent findings for the cost of manufacturing butter and nonfat dry milk, especially when compared to other plant cost results published previously by Dr. Stephenson. We questioned the method used to allocate costs among the various products being produced in a single facility and whether those methods contributed to the significant divergence in the reported cost of manufacturing.

Unable to reconcile precisely what caused the difference, we evaluated the butter and nonfat dry milk results in total, rather than individually. Below are the results of that evaluation.

	U-W Report	**Pounds of Product Produced from 100 Pounds of Milk @ 3.5% Butterfat and 8.685% SNF**	**Total Cost per 100 Pounds of Milk @ 3.5% Butterfat and 8.685% SNF**
Reported Butter Processing Cost (weighted average)	$0.1411	4.2385 *(3.5 pounds of butterfat X yield of 1.211)*	$0.5980 per CWT
Reported Nonfat Dry Milk Processing Cost (weighted average)	$0.2933	8.5982 *(8.685 pounds of SNF X yield of 0.99)*	$2.5218 per CWT
			$3.1198 per CWT
		Weighted Average Cost Per Pound of Butter and NFDM	**$0.2430 per pound**

We then compared the weighted average cost of $0.243 per pound to the current make allowances of $0.1715 per pound for butter and $0.1678 per pound for nonfat dry milk. Under that comparison, the proposed updated make allowance of $0.21 per pound for both butter and nonfat dry milk included in Proposal Number 7 represents the capture of 50 percent of the difference between the current make allowances and the weighted average cost per pound of butter and nonfat dry milk as calculated above, rounded to the nearest $0.01 per pound.

Given the intent of Proposal Number 7 to err on the side of conservatism and be reviewed once again at a later date with the availability of data from a mandatory, audited reporting of plant costs and yields, it seemed very reasonable to propose an updated allowance equal to approximately 50 percent of the difference between the current make allowances and the updated weighted average manufacturing costs as calculated in Dr. Stephenson's USDA commissioned and funded cost study. This was further validated by the California-specific data from CDFA in 2016 that demonstrated even at that point seven years ago, the real cost of producing butter and nonfat dry milk in California was already around $0.20 per pound.

CONCLUSION

Weighing all the available information, and in the context of the broader goal to provide USDA with the authority to collect mandatory cost data in advance of the next make allowance adjustment, CDI joins National Milk in supporting Proposal Number 7, a balanced adjustment to make allowances that garnered the unanimous support of the National Milk's Board of Directors.