

10 DAIRY ISSUES TO WATCH

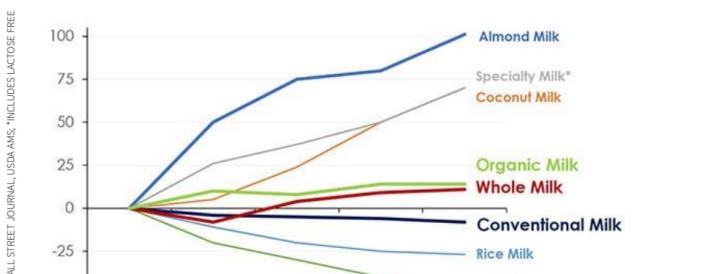
By Mike Opperman

Dairy producers face a myriad of challenges as they navigate low milk prices and shrinking margins. John Newton, director of market intelligence with the American Farm Bureau Federation, has compiled a list of the top 10 issues facing dairy producers based on his travels and conversations with producers from across the country. He presented this list at the recent Dairy Forum held by the International Dairy Foods Association.

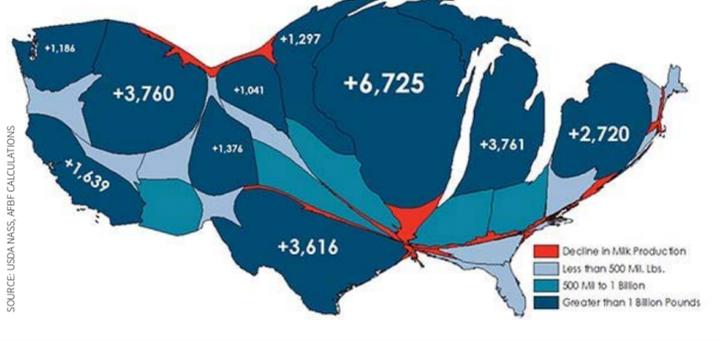
"These are long term challenges the dairy industry is facing that leaders in the dairy industry are going to need to think about moving forward," Newton says. "Some of these are questions and observations that don't have an answer but represent very complex issues that challenge our industry."

1 Weak Farm Economy. Since 2013, net farm income has declined by 46% or \$56 billion. "A lot of this comes from the decline in commodity prices," Newton says. On the dairy side, revenue from on-farm sale of milk has dropped about \$15 billion, or about \$300,000 per dairy farm. Related to this is farmer's ability to pay back loans. "We see debt to asset ratios increasing for a fourth consecutive year," Newton says. "Debt service ratios are at the highest levels they've been at for several years, which creates a challenging farm economy."

2 Changing consumer preferences. "Millennials spend the least amount on food at home than any other age demographic," Newton says. This is the most evident in the consumption of fluid milk products where we have seen changes since 2013. Sales of whole and organic milk have increased but conventional white milk sales have been declining in recent years while sales of non-dairy milk alternatives have skyrocketed. "This has had a major impact on the dairy industry as we continue to produce more milk," Newton says.



3 Shift in U.S. Milk Production. Producers have added about 31 billion pounds of milk over the last decade, with the largest amount coming from the upper Midwest where cheap feed and grain led to a resurgence in production. "With all of that milk coming online and decreased consumption that poses a challenge to the industry and puts a strain on processing capacity," Newton says.



4 More milk coming online. Production will continue to grow as the industry hits 250 billion pounds by 2027, or an additional 38 billion pounds of milk on top of what is already produced.

5 Access to processing. All of this extra milk will put a strain on an already at-capacity processing infrastructure. "We need to make additional investments and for plants to come online to be able to handle all of that extra milk," Newton says. "Producers are already concerned that there is a processing home for the milk they produce, and that there's a market for that milk."



6 Over order premiums. With all of this milk entering the market and lack of capacity, some milk has to travel longer distances to find a home, according to Newton. "We've seen over order premiums shrink dramatically in the upper Midwest and the Southeast," he says. "For example, producers in Michigan have some of the lowest milk prices due to these processing capacity issues." Over the last few years the basis in these areas has shrunk significantly, Newton says, causing producers to receive less money in their milk checks.

7 Fat demand vs burdensome NFDM stocks. The move of consumers to full-fat diets and the growth in demand toward butter, especially in the EU, has created a glut of a residual product, namely nonfat and skim milk powder. EU inventories of milk powder are burp full, causing the price of nonfat dry milk (NFDM) to drop around the globe, including in the U.S. That's had a direct impact on milk prices, Newton says, changing the milk price dynamic. From 2000 to 2014 the value of fat accounted for about 39% of a producer's milk check. Due to the increase demand for butter, that contribution has rose to about 53% since 2015. In addition, every 10-cent change in the butter price has a 47-cent change in farmer's milk price. But powder has a bigger impact. "For every 10 cent change in NFDM, we see almost a dollar impact in farmer's milk prices," Newton says.

8 Federal Milk Marketing Order (FMMO) pricing formulas. "The Federal Milk Marketing Order system is nearly 90 years old," Newton says. "And the make allowance program hasn't been revisited in more than a decade." The regulatory environment represented by the milk marketing order system influences processing plant investment decisions as well as where plants are located, Newton says, and that also affects our ability to compete on a global market. "There is an opportunity as we move forward to think about the role of federal orders, milk pricing and product pricing formulas."

9 Big dairies are getting bigger. Newton says this divide between small farms and big farms impacts policy discussions. Safety net programs have to meet the needs of smaller dairies that rely on more market-based programs and larger dairies that have completely different needs based on economies of scale. "Cost of production is significantly different on these operations and safety net programs need to be thought about differently," Newton says.

10 Enhanced risk management. It's been well documented that the current dairy Margin Protection Program (MPP) set in place through the last farm bill isn't working. AFBF has proposed a revamp to the MPP program. AFBF has analyzed the IDFA and National Milk Producers Federation Class I milk proposal and believe that could "go a long way toward switching the decline in fluid milk sales," Newton says. He says that if the proposal would have been in effect since 2000, an additional \$50 million would have been added FMMO's, or about a penny per cwt. "It makes a very small difference to the farm milk price but provides notable risk management tools within the fluid milk space," he adds.

Newton adds that many of these factors have a direct impact on the ability of the U.S. dairy industry to compete on a global basis.

"We need to take advantage of new market opportunities around the globe for our dairy products with all of the new milk coming online," Newton says. "That's the key to a successful dairy industry."