DISCUSSION DRAFT WHITE PAPER

New market dynamics, new FMMO pricing rules…
How did we get here and what's it all mean?

By Sherry Bunting, Independent Ag Journalist, Prepared for American Dairy Coalition (ADC)

On July 15th, the USDA published its five-part recommended decision for Federal Milk Marketing Order (FMMO) price formula changes. Most notable are: 1) Restoration of the higher-of formula for the Class I base skim milk price (mover), except on extended shelf life (ESL) products; and 2) Proposed increases in processor make allowances, equating to a 75 cents to $1.00 per hundredweight milk check deduction embedded in end-product pricing formulas. The updated make allowances would hit hardest the already beleaguered Class III markets, like the Upper Midwest.

Cheese markets have turned higher, finally, and feed costs have moderated after Jan.-April milk checks left Upper Midwest dairy farms facing margins well below the DMC trigger, with no payments in the mailbox. Their All Milk and Mailbox Milk prices have been running more than $1 to nearly $2 below the U.S. average, contrary to historical averages.

This Discussion Draft White Paper, prepared for the American Dairy Coalition (ADC), highlights the Order 30 region as most vulnerable in the upcoming producer referendum. Order 30 market dynamics illustrate impacts we may expect to see elsewhere in the future as significant Class III processing expansion occurs in other milk marketing areas as well.

**Please provide feedback to the author -- at agrite2011@gmail.com or 717.587.3706 (mobile) -- regarding the four points below that you and/or your organization may want to sign onto in a joint public comment on the USDA recommended decision and see the accompanying invitation to join ADC for a timely FMMO webinar, featuring American Farm Bureau Federation economist Danny Munch, on Thursday, August 29 at 2:00 p.m. EDT, entitled "Those who don't learn from history are doomed to repeat it."*

Four positions ADC has identified:

1) **Oppose the proposed make allowance increases until mandatory audited surveys are conducted by USDA, and develop policy that ties future make allowance updates to improvements in milk check transparency and price discovery.**

   The industry is changing. According to American Farm Bureau Federation data, the USDA weekly price survey (National Dairy Product Sales Report, NDPSR) **covers less than 15%** of the butter, powder, cheese and whey products that are sold today. End-product pricing captures only the value of salted butter, nonfat dry milk, 40-lb block cheddar cheese (USDA proposes discontinuing the 500-lb barrels), and dry whey. The value of the many other products made from milk, representing over 85% of sales today, is not captured in the FMMO class and component pricing formulas. At the same time, the voluntary cost of processing surveys had participation by less than half of the price-reporting plants.

Comprehensive, accurate, audited cost data are necessary to ensure that only the basic costs to make the four base commodities used in end-product pricing are considered by USDA when setting make allowance levels, even when other products are made in the same plant.

Make allowance updates by USDA in the future should also be tied to improvements in milk check transparency and expanded price discovery for information purposes. Dairy producers should be able to see what milk is made into and what a hundredweight of milk is worth, similar to the way that beef producers see a carcass cutout value reported by USDA (daily or weekly) on the composite value of all cuts. For example, more mozzarella is produced today than cheddar, but bulk mozzarella prices are not reported by USDA for information purposes. With USDA proposing to end the 500-lb barrel cheese price series, some proposals sought to add 640-pound block cheddar or bulk mozzarella, as well as unsalted butter, but these proposals were rejected by USDA in terms of inclusion in end-product pricing. However, from package size to product type, there are so many other products today that could be mandatorily reported for informational purposes to improve market transparency.

Future make allowances updates could also be tied to milk check transparency by having FMMO Market Administrators enforce payment of FMMO minimum prices at the component level, not just the gross-check level, and increasing accountability of cooperative milk buyers to their members on how these minimum values were or were not applied.

2) **USDA's proposed dry whey make allowance increase is excessive and needs a 'snubber' to floor the deduction at zero, whenever the dry whey price falls below an updated make allowance level.**

USDA proposes raising the dry whey make allowance from $0.1991/lb to $0.2653/lb. That is a nearly 7-cents-per-pound increase and represents a 33.2% expansion of the farm milk check deduction to cover processor costs for drying whey. How does this happen? How do processors end up in this proposal receiving so much more money out of dairy farmers' milk checks as they make a broad array of higher value whey products that are not included in the end-product pricing formula? Furthermore, as cheese prices have increased, the USDA price survey has failed to capture the concurrent dry whey price increases on the 'market clearing' CME daily spot call. The weekly USDA National Dairy Product Sales Report (NDPSR) is the reported price that is used in the FMMO formulas, and it is running 10 to 14 cents per pound behind the market-clearing spot CME price on dry whey through July and August 2024. Let's slow down the make allowance train, especially on whey. It was just a year ago that the NDPSR price for dry whey was at or below the new proposed make allowance level in July-August 2023. The last time the whey make allowance was raised, farmers paid processors to take the 'other solids' for seven straight months from Oct. 2008 through Apr. 2009. Processors today make and sell many higher value whey products at additional revenue that create no value to the farm milk check because those prices are not captured in the end-product pricing formulas. When processors dry less whey and make more of the higher value products, as they are now, the NDPSR loses its ability to capture the resulting increase in the 'market-clearing' dry whey price when demand exceeds supply.

DRAFT

3) **We fully support USDA's recommended decision to restore orderly marketing with the higher-of formula for the Class I skim milk price. However, the introduction of an average-of adjuster for extended shelf life (ESL) fluid milk products could produce unintended consequences. We ask USDA to reconsider this addition of a 5th class of milk, at minimum putting up guard rails to abuse by restricting the implementation to only shelf-stable aseptically packaged milk and build-in a formal review process to examine this bifurcation of Class I after two to three years of implementation.**

In 2018, dairy farmers were told the average-of method for Class I would be revenue neutral, but then they experienced disorderly marketing and Class I revenue losses totaling $1.3 billion from May 2019 through July 2024. This did not include amplified depooling losses or disrupted risk management.

USDA's 'compromise' in the recommended decision to price fresh fluid milk by the higher-of while pricing ESL products using an average-of adjuster observes the differing characteristics and markets of ESL fluid milk products, but the hearing did not examine the potential for unintended consequences around a two-mover system that essentially adds a 5th Class of milk.

The USDA hearing did not allow for evidence on the long-term impacts of bifurcating Class I under two different price movers, nor did it hear evidence on the range of products that fall under the ESL heading.

In light of these deficits in the evidentiary proceeding, we believe further analysis is needed. At a minimum, it should be narrowly implemented to include only shelf-stable aseptically packaged milk with long-term non-refrigerated storage, and require processors to register products for designated approval to be priced under the second mover and be prevented from modifications that would allow such beverages to move back and forth between mover options. These factors make a formal review process necessary after implementation.

USDA has not defined what an ESL product is. The proposed rule references "over 60 days shelf-life." This is a broad definition. Provisions to prevent abuse are needed. One example is if the conventional mover is lower than the ESL mover for a given month, could processors label the product as 59 days to pay the lower price?

Another observation is that two different movers, calculated differently, will result in different Class I raw milk product costs between processors at the same location. Could this lead to an expanded definition of "different" fluid milk markets for "different" movers?

DRAFT

4) **If USDA moves forward with proposed make allowance increases in 2025, then the updated milk composition standards should be implemented at the same time. Both pieces impact risk management, so why is USDA proposing to stagger them?**

Dairy farmers face price risk heading into 2025. These are uncertain times for markets and policy. There is little to no activity occurring on the CME board for milk futures contracts (or DRP) beyond February 2025, due to traders sitting on the sidelines as they expect USDA may implement make allowance updates that would cause Class III and IV milk prices to drop by 75 cents to $1.00. Farmers once again find themselves with fewer risk management options at a time they may need it most.

At the same time, USDA proposes delaying the benefit to farmers in the milk composition updates? There should be no implementation of the proposed make allowance updates without concurrent implementation of the proposed milk composition updates.

Comments due Sept. 13, 2024 on USDA's 5-part recommended decision

On July 15, the USDA published its 5-part recommended decision in the *Federal Register* after 49 days of hearing proceedings on 21 proposals, yielding 12,000 pages of transcripts, 500 exhibits and more than 30 post-hearing documents.

The 60-day public comment period ends at 11:59 p.m. on September 13, 2024 at https://www.regulations.gov/commenton/AMS-DA-23-0031-0002

A 60-day review will follow, and then the producer referendum will be conducted among eligible voters in each Federal Milk Marketing Order (FMMO).

Producers vote early in 2025

Dairy farmers who are pooled in the representative month selected by each FMMO Market Administrator (MA) will be eligible to vote. The vote is expected to take place in early 2025. Eligible producers will receive a ballot, or their cooperatives will receive notice of the number of pooled members their bloc vote will represent, according to USDA.

The two-thirds threshold for either producers or volume will be determined based on the number of eligible producers who actually participate in the vote. According to USDA AMS: *"Eligible producers who do not return their ballots will not be counted against the denominator or enumerator."*

What are producers voting on?

The vote is conducted separately within each of the 11 FMMOs. If two-thirds of eligible participating producers vote 'yes' in an FMMO, it means that USDA's final rule is accepted and the FMMO will continue to operate with the changes.

A 'no' vote is a vote to end the FMMO in which the producer is voting.

DRAFT

A two-thirds 'yes' vote of participating eligible producers is required in each FMMO for that FMMO to continue. If the two-thirds 'yes' threshold (by number or volume) among participating eligible producers is not met in any FMMO, then the final decision is rejected, and that FMMO is terminated.

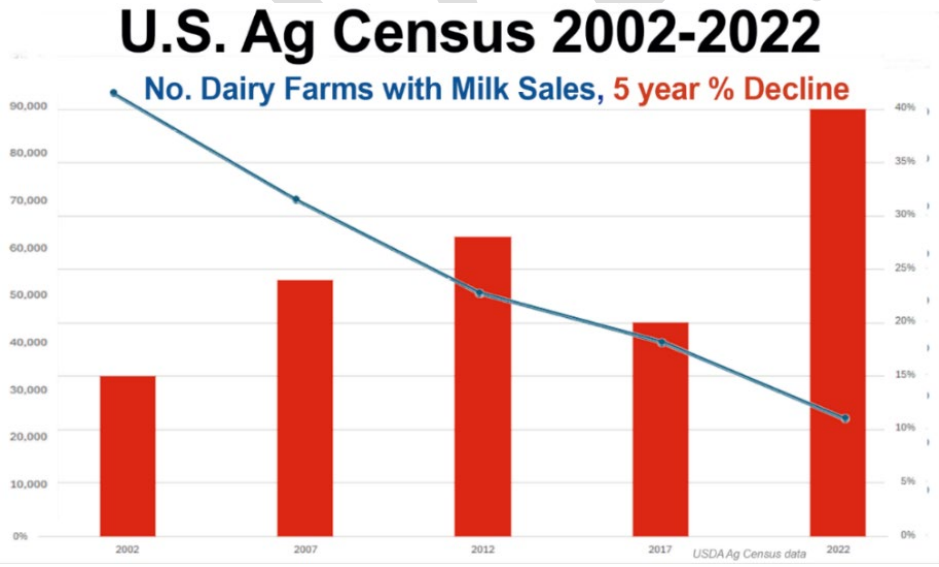
Each Market Administrator will choose a representative month for their FMMO that is both recent and includes a representative number of pooled producers.

What's at stake?

In various surveys and during the Milk Pricing Stakeholders Forum hosted by American Farm Bureau Federation (AFBF) in Kansas City in October of 2022, producers from across the nation indicated they want the FMMO system to continue. Reduced competition, and increased consolidation, along with lack of confidence and transparency in milk checks leave most dairy farmers in a position of wanting a 'referee.' They also rely on the FMMO system for market data, benchmark minimum pricing, twice-monthly payment, and auditing.

USDA recommended decision highlights: Return to 'higher-of'

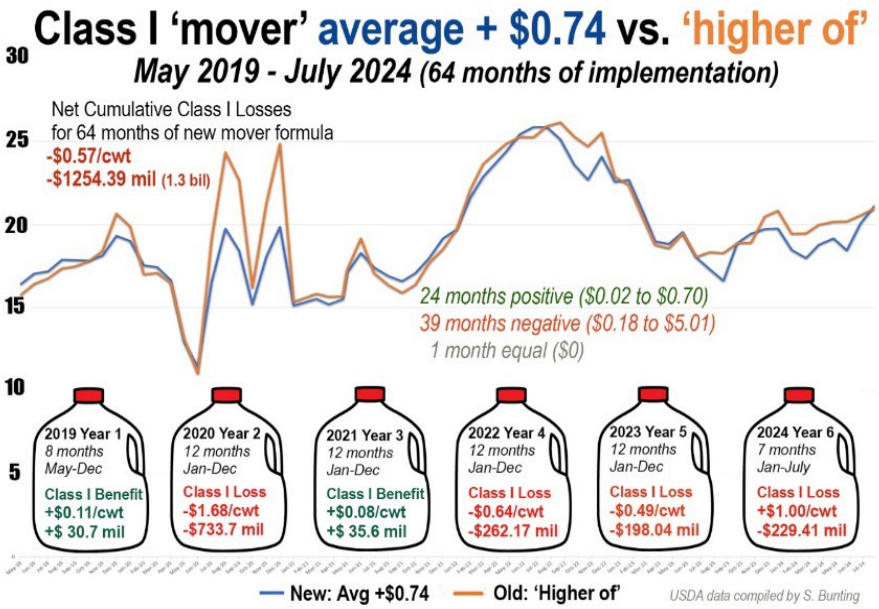
The USDA intends to (partially) undo the average-of method for Class I fluid milk. The July recommended decision proposes the restoration of the previous higher-of method for pricing the base skim milk price mover – except for extended shelf life (ESL) fluid milk products.



How did dairy farmers fare under the 2018 farm bill change from higher-of to average-of?

The U.S. lost 40% of its dairy farms with milk sales in the five years between the 2017 and 2022 Ag Censuses -- the largest loss of dairy farms in any five-year Census period, reflecting in part the disorderly marketing and milk price value losses over most of the 65 months in which the average-of experiment was (and still is) in-play. The graph at left shows the decline in U.S. dairy farm numbers over the past 20 years from over 90,000 in 2002 to just over 20,000 in 2022. The red bars are the percentage loss in each 5-year Census of Ag from 2002 through 2022.

In the 2018 farm bill, the change was made in the method for calculating the Class I skim base price 'mover' by averaging Class III and IV advance skim pricing factors and adding 74 cents instead of using the prior method, in effect for the previous 19 years, which calculated the Class I mover using the higher-of the two advanced skim pricing factors. Over the 64 months of the average-of method to-date, (May 2019 through July 2024), dairy farmers lost an estimated $1.3 billion in Class I revenue, along with unquantified losses from the exacerbation of record wide spreads between Class III and IV milk prices and disruptions to orderly marketing, resulting in opportunistic depooling of higher value manufacturing milk, which reduced FMMO pool dollars, and in some cases created negative producer price differentials (PPD) that undermined producer risk management plans, creating -- for some -- a "double whammy."



In USDA's economic impact analysis of the five-part decision, the past five years of pool composition were used -- as it existed 2019-23 in the 11 FMMOs under the average-of method. However, this change back to the higher-of for Class I fluid milk would have created more orderly marketing conditions, which would have changed pooling behavior, so that pool composition would have looked different. The benefits of this change back to the higher-of were not factored into the USDA impact analysis.

Class I pricing will differ for fresh fluid milk vs. ESL

USDA's recommended decision returns the Class I mover to the higher-of but uses an averaging method with a backward-looking adjuster on ESL fluid milk products. While this variation of the average-of method was part of the hearing record, there was no evidence or cross examination on the concept of adding a fifth class of milk by splitting Class I into two different pricing methods.

Other Class I pricing changes

The USDA recommended decision also keeps the Class I base differential at $1.60 per hundredweight, and raises location differentials, although by less than was proposed by National Milk Producers Federation (NMPF).

The recommended decision also updates standard milk composition levels to reflect increases in today's protein, other solids, and solids nonfat in the skim portion of a hundredweight of Class I milk. Butterfat, of course, is priced separately and paid by the pound in FMMO price minimums. The USDA decision will increase the butterfat recovery in cheesemaking from 90% to 91%, which necessitates a yield factor change from 1.572 to 1.589 per pound in the butterfat value in cheese.

Proposed make allowance updates equate to a new $0.75 to $1.00/cwt deduction

The USDA recommended decision makes a substantial update to the processor make allowances, landing in between NMPF's smaller proposed update and the larger one proposed by IDFA and Wisconsin Cheesemakers. These credits have not been updated since 2008; however, the dairy market, and processing plants, look much different today than in 2008.

USDA's proposed make allowance updates will collectively result in an immediate estimated 75 cents to $1.00 per hundredweight reduction in milk prices paid to farmers, depending on product mix. These credits are embedded in the class and component pricing formulas, including the Class I mover.

These make allowances are processor credits deducted from the bulk product prices that are surveyed weekly by USDA via the NDPSR. They reflect the cost to make the four basic commodities used in end product pricing:

On the Class IV side, salted butter (current make allowance $0.1715/lb, proposed at $0.2257/lb) and nonfat dry milk (current $0.1678/lb, proposed at $0.2268/lb);

On the Class III side 40-pound cheddar blocks (current $0.2003/lb, proposed at $0.2504/lb) and dry whey the biggie (current $0.1991/lb, proposed at $0.2653/lb).

If raised by the proposed amount, the collective make allowance credits for processors -- that are embedded in the pricing formulas -- will go from the current range of $2.80 to $3.60 per hundredweight to a new range of $3.60 to $4.60 per hundredweight -- depending on each FMMO's class utilization mix.

USDA used data from two methodologies presented in testimony. American Bureau Federation, supported by American Dairy Coalition, National Farmers Union, and other organizations has requested no make allowance update until mandatory audited cost of processing surveys are implemented. Language in both the House and Senate versions of the new farm bill would authorize USDA to do these mandatory surveys.

In testifying on the voluntary surveys, Dr. Mark Stephenson noted it is more challenging today to separate out the costs to make products that are not price-surveyed as today's milk processing plants are more complex than in 2006, with many different products made alongside the four base commodities.

DRAFT

In its post-hearing brief, NMPF noted that make allowances have never before been raised by more than a collective 35 cents per hundredweight. The NMPF proposal would have raised them by a collective 50 cents. USDA chose to use the two methodologies provided by IDFA and Wisconsin Cheesemakers to arrive at make allowance raises that collectively deduct an estimated 75 cents to $1.00 from producer pay prices.

One argument against updating make allowances is the robust expansion in processing capacity. This was referenced by AFBF and others during the hearing. Processors can pass higher costs downstream on the vast majority of dairy products that are not price-surveyed by USDA and whose value is not captured by the end-product pricing formulas.

The USDA rejected proposals to modestly expand the products surveyed and accepted the proposal to end the 500-pound barrel cheese pricing survey to limit Class III protein calculations to 40-pound block Cheddar, alone. While barrel cheese was historically lower than blocks, the 500-lb barrels are currently contributing more positive value than the 40-lb blocks to the Class III protein price.

The hearing record reflects testimony that more block-cheddar capacity is being built than 500-lb barrel capacity. How will this impact future pricing or the ability to make more 40-lb blocks with a make-allowance guarantee and use inventory to suppress raw milk prices for all of the other cheeses that are not price-surveyed?

The 33.3% increase in dry whey make allowance is too big, without a 'snubber'

We have seen this movie before. The size of the dry whey make allowance increase for processors could be a real liability for dairy farmers -- without a 'snubber' to floor the losses when the whey price slips below the make allowance level.

USDA proposes raising the dry whey credit from the current level of $0.1991/lb to a new level of $0.2653/lb. That's a 33.3% increase, and the largest monetary increase of the four product make allowances at nearly 7 cents per pound. Without a 'snubber' to stop losses at zero when the dry whey price falls below the new make allowance level, farmers could end up paying processors to take these 'other solids' in their milk, as they did for seven months in 2008-09.

In fact, if the new make allowances were in place a year ago, farmers would have been sending the 'other solids' virtually free to processors in July 2023, when the dry whey price was barely above the proposed $0.2653/lb make allowance. In August 2023, the dry whey price fell below the proposed make allowance, meaning dairy farmers would have seen a negative value for 'other solids' on their milk checks – essentially paying processors $0.01/lb to take them as though worthless.

This is what happened in 2008-09, after the make allowances were last raised. The futures board immediately dropped as the formula change was implemented.

DRAFT

Farmers were left unprotected when the dairy crisis hit in 2009. They also paid processors $0.01 to $0.04 for every pound of other solids in their milk from November of 2008 through March 2009, and paid a fraction of a penny per pound in October 2008 and April 2009 -- as the dry whey price dipped below the then-new make allowance of $0.1991/lb for those seven consecutive months.

Furthermore, the current 'market clearing' spot CME price for dry whey is running fully 10 to 14 cents per pound higher than the USDA's weekly National Dairy Product Sales Report (NDPSR) from mid-June through mid-August 2024 (to-date). It is the NDPSR price, not the CME spot price, that is plugged into the FMMO formulas, and the rallying 'market clearing' price for dry whey on the CME is simply not translating. The formula is already deficit on the value side.

Timing is everything

In its recommended decision, USDA delays the milk composition changes that would help soften this blow to producer milk checks, due to the impact on risk management contracts. However, the make allowances are to be implemented immediately, according to the USDA recommended decision, even though these processor credits also affect the exchange-traded instruments that underlie risk management programs like LGM and DRP as well as hedging.

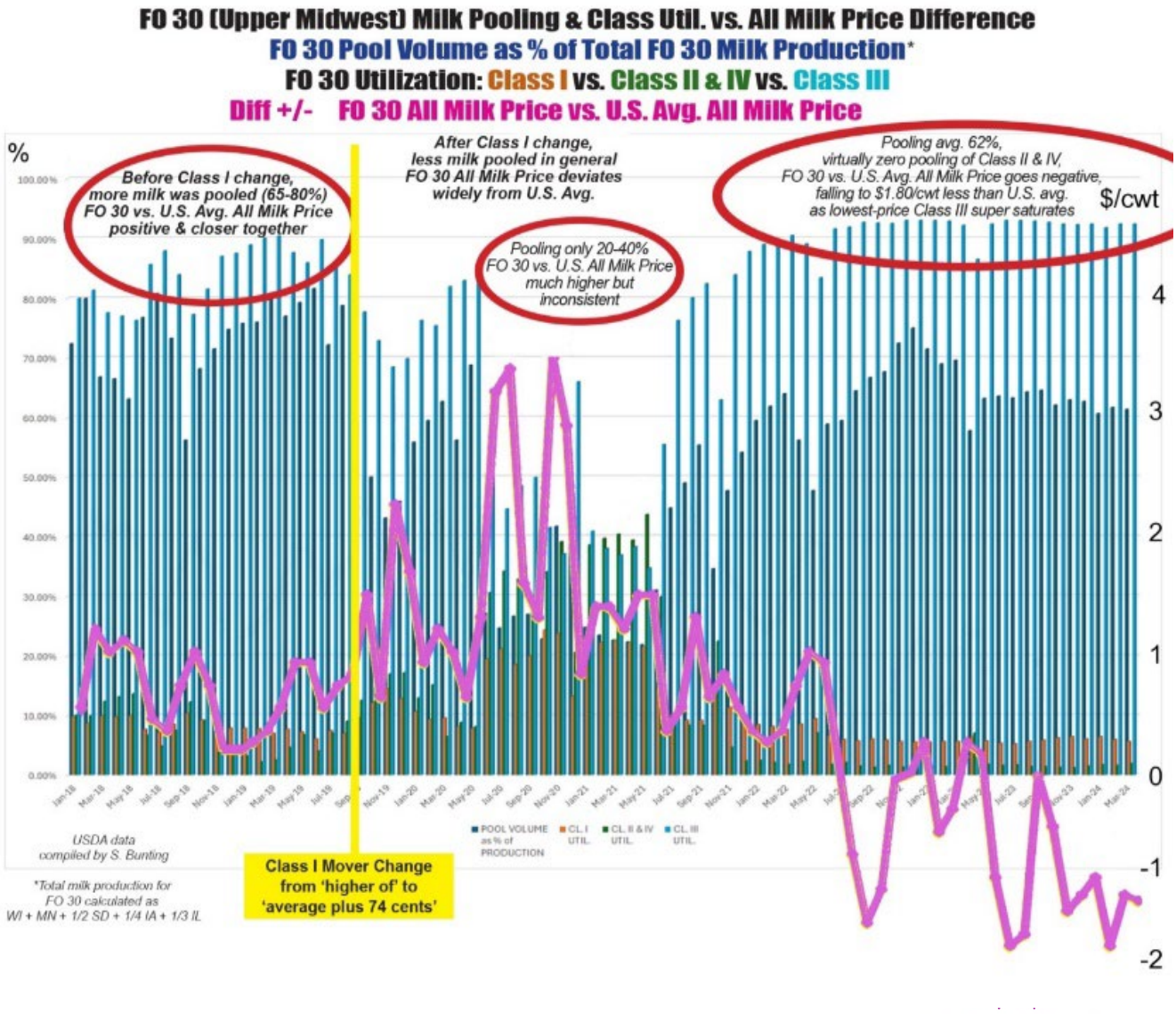
It's no surprise that these reductions are baked into the 2025 futures board as lower Class III and IV milk price contracts show little to no activity after March. Why? Because formula changes via updated make allowances substantially change those contracts and few are taking the buy side of those bets.

The Upper Midwest (FMMO 30) All Milk price underperforms national average

The Dairy Margin Coverage (DMC) program is limited in its ability to help dairy farmers manage price and margin risk. In fact, producers in Class III markets were scratching their heads wondering why their below breakeven margins had not triggered DMC payments in March and April, even May of 2024, and small to zero payments since September 2023.

Class III has been a major market underdog, and dairy producers in the Upper Midwest have been feeling it, struggling under the brunt of the region's FMMO blend prices built almost exclusively on Class III, along with some creative internal pricing formulas. Virtually all of the milk used for Class II and IV products in the Upper Midwest (and California) has been depooled over the past two years. Much of it was also depooled in other Orders.

DRAFT



-2

The graphs above and below show pooling and utilization changes in Order 30 when the Class I mover was changed to the average-of, and the impact this has had on the volatility of the All Milk price in the Upper Midwest vs. the U.S. average, which used to track more consistently.

Opportunistic depooling, especially in Order 30, has dropped to near-zero of the already smaller volumes of milk used to make Class II and IV products in the Upper Midwest. This can go unnoticed when the producer price differentials (PPD) increase as the pool becomes saturated with the lowest priced Class III -- dragging down the minimum benchmark prices, All-Milk prices and Mailbox Milk prices in the Upper Midwest vs. the national average.

It has been the story for more than two years as the Class IV price has been above Class III by a wide margin. The monthly All Milk price in the Upper Midwest reflects this, running 30 cents to $1.90 per hundredweight below the U.S. average All Milk price for 21 of the past 25 months (June2022-June2024). Mailbox Milk prices in Order 30 have run 30 cents to $3 per hundredweight below the U.S. average for 20 of the past 23 months reported (June2022-April2024).

Pooled producer milk volume as a percentage of total production has declined in general over the past 5 years since the Class I formula change to average-of, even when Class III has been the lowest priced class. For example, pooled volume was estimated at 67% for May, of which 92.5% was Class III milk (lowest priced class), 5.2% Class I, 1% Class II and 0.7% Class IV.

The pool looked similar to April, when the Market Administrator estimated 1.5 billion pounds of milk was depooled, saturating the blend price built primarily on Class III, which has been much lower than Classes II and IV, dragging Class I down too.

Conversely, in 19 of the 24 months from Sept. 2019 through Aug. 2021, the Order 30 region's All Milk price tracked $0.30 to $3.00 higher than the U.S. average All Milk price. During this time, the Class III milk price was much higher than Class IV. This milk was selectively depooled. During this time, pooled producer milk volume dropped to 20 to 40% of total production, with scattered months at 60 to 70%, as processors jumped in and out of the pool.

The results were mixed. Some processors passed the revenue windfall they kept out of the pool to their shippers. Others did not.

Negative PPD (defined as the Uniform Price minus the Class III price) disrupted the expected performance of purchased risk management tools for many producers who did not receive the coverage, nor the higher Class III market price for their milk.

This brings us to today's milk check realities, the farm bill 'safety net' and risk management

The April Dairy Margin Coverage (DMC) margin was $9.60 -- 10 cents above the highest DMC coverage level, but this was based on a U.S. average All Milk price of $20.50 with a 4.24 U.S. average Butterfat. USDA NASS calculates a monthly All Milk price for all 24 major milk producing states and a national average. The U.S. average All Milk price is used in the Dairy Margin Coverage (DMC) program.

DRAFT

Prices Received for All Milk – States and United States: April 2024 with Comparisons

[Before deduction for hauling. Includes quality, quantity, and other premiums. Excludes hauling subsidies]

State	April 2023		March 2024		April 2024	
	Price	Fat test	Price	Fat test	Price	Fat test
	(dollars per cwt)	(percent)	(dollars per cwt)	(percent)	(dollars per cwt)	(percent)
Arizona	19.70	3.74	21.30	4.06	21.10	4.01
California	20.00	4.05	20.20	4.23	19.80	4.22
Colorado	21.00	3.90	21.30	4.11	20.60	4.05
Florida	24.10	3.77	25.10	3.93	25.40	3.91
Georgia	23.40	3.81	25.50	4.04	25.80	3.99
Idaho	20.70	4.24	20.50	4.45	20.50	4.30
Illinois	20.80	4.12	20.70	4.28	20.10	4.25
Indiana	21.40	4.04	22.20	4.16	22.00	4.11
Iowa	19.50	4.30	19.10	4.51	19.00	4.48
Kansas	19.10	4.14	20.00	4.35	19.70	4.29
Michigan	20.40	4.06	21.30	4.22	20.80	4.19
Minnesota	20.10	4.41	19.50	4.55	19.40	4.51
New Mexico	18.40	3.86	19.50	4.07	19.40	4.01
New York	21.40	4.17	22.40	4.28	22.20	4.26
Ohio	21.70	4.01	21.70	4.12	21.30	4.09
Oregon	23.70	4.20	23.40	4.44	22.30	4.35
Pennsylvania	21.20	4.04	21.70	4.19	21.80	4.15
South Dakota	21.70	4.63	20.20	4.76	19.40	4.72
Texas	20.60	4.17	21.20	4.35	21.20	4.31
Utah	20.50	4.02	20.80	4.22	20.30	4.17
Vermont	21.70	4.17	22.80	4.35	22.60	4.33
Virginia	23.40	3.92	25.10	4.12	25.20	4.06
Washington	21.30	4.21	22.10	4.32	21.90	4.26
Wisconsin	20.60	4.12	19.10	4.24	18.60	4.23
United States	20.60	4.11	20.70	4.28	20.50	4.24

In stark contrast (above), Wisconsin stood at the bottom -- $1.90 lower with an April All Milk price of $18.60, even though butterfat was nearly equal to the U.S. average at 4.23. Minnesota and Iowa were $1.10 and $1.50 lower than the U.S. average at $19.40 and $19.00, respectively, with considerably higher butterfat averages of 4.51 and 4.48, respectively.

Historically, the Upper Midwest All Milk price pattern tracked more closely with the U.S. average, and the percentage of production pooled ran 60 to over 85%. Then, USDA implemented the average-of method for calculating the Class I base price mover, per the 2018 farm bill. This created incentives for wider spreads between manufacturing classes and reduced pooled producer milk volume as a percentage of total production in the Order 30 milk marketing area.

Wide manufacturing class divergences have suppressed Class I prices and contributed to disorderly marketing through selective depooling that further changed the utilization ratios in favor of whichever is the lowest manufacturing class price. The result has been more volatility in the Upper Midwest All Milk price compared with the U.S. average All Milk price.

The NASS All Milk price is published two weeks after the FMMOs announce Statistical Uniform Prices, and the AMS Mailbox Milk price is published nearly three months after the All Milk price.

According to the NASS office in Wisconsin, the All Milk price is simply the collection of data from representative cooperatives and proprietary processors, including a small portion of organic sales, that have historically responded to the survey. Regional NASS offices collect and aggregate the total volume of milk purchased and the total amount of money paid during the month to calculate the per-hundredweight monthly All Milk price.

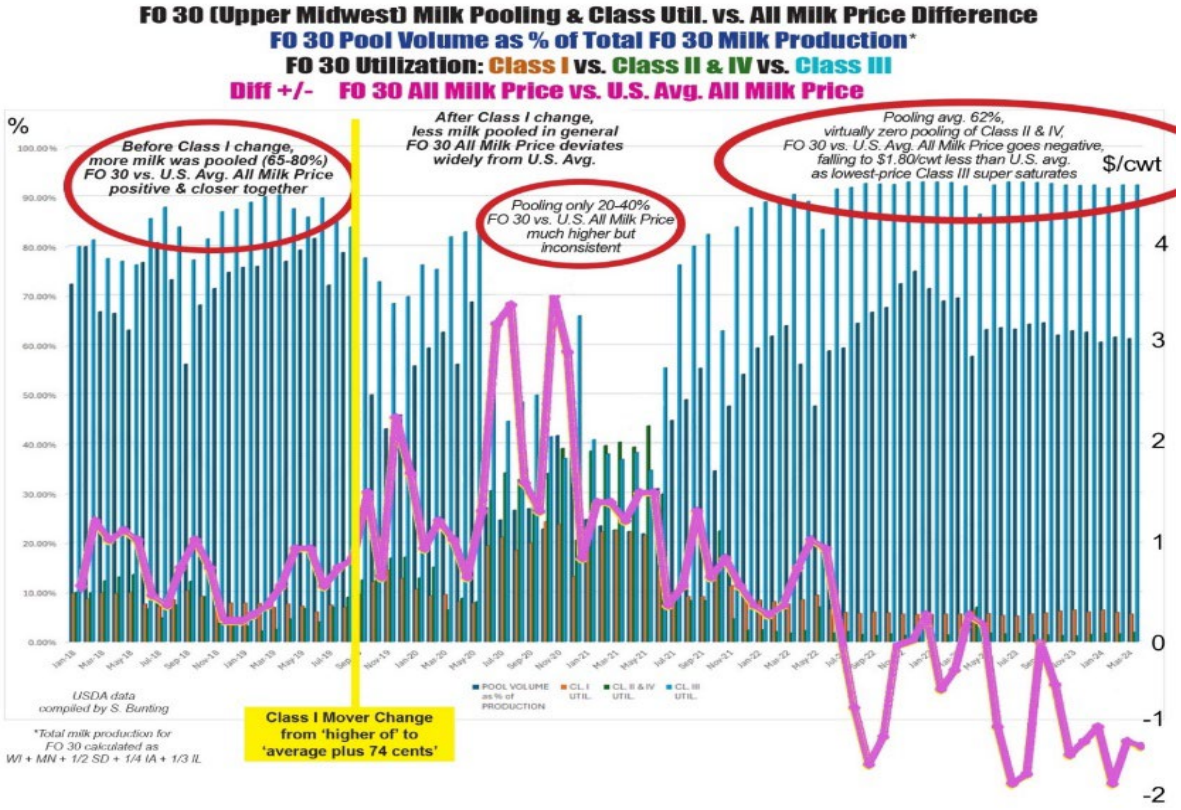
This is how it is done for Wisconsin and Minnesota. A monthly All Milk price is also calculated for South Dakota, Iowa, and Illinois, of which portions are included in the Order 30 milk marketing area.

April 2024 FO statistical uniform (blend) prices at 3.5% BF

FMMO	UNIFORM PRICE	CHANGE	PPD	CHANGE
Florida (6)	$23.94	+0.19	N/A	N/A
Southeast (7)	$22.27	+0.20	N/A	N/A
Appalachian (5)	$21.80	+0.20	N/A	N/A
Northeast (1)	$20.18	−0.09	+4.59	+0.75
Arizona (131)	$19.44	−0.19	N/A	N/A
Mideast (33)	$18.27	−0.37	+2.77	+0.47
Southwest (126)	$18.22	−0.26	+2.72	+0.58
Pac. NW (124)	$18.26	−0.15	+2.76	+0.69
Central (32)	$17.70	−0.32	+2.20	+0.52
California (51)	$17.34	−0.43	+1.84	+0.41
Upper MW (30)	$15.95	−0.45	+0.45	+0.09

A closer look at Order 30: The Statistical Uniform Price (SUP) was $15.95 for April 2024 – significantly lower than any other Order, even $1.39 below the next lowest Order 51 (California), and $1.75 per hundredweight lower than neighboring Order 32. With a 45-cent average PPD, this put the SUP right around $16 as a starting point.

Again, observe the difference between Order 30 All Milk price vs. U.S. average All Milk price as represented by the pink line in the graph below, repeated from page 9 (plus/minus) against the backdrop of pooling changes since May 2019 when average-of replaced higher-of in the Class I mover formula.



What did dairy farmers actually receive as a Mailbox Milk price in April? That data was published on July 27th, when USDA AMS calculated Mailbox Milk prices, including premiums, deductions, and hauling, and the Order 30 Market Administrator published a Mailbox Milk price for the Order 30 region at $18.47 – that was $1.24 per cwt. below than the U.S. average for April 2024.

Mailbox prices are calculated differently by AMS three months after the All Milk price is calculated by NASS. Mailbox prices are calculated for Wisconsin, Minnesota, Iowa and Illinois, but not for South Dakota. The Order 30 Market Administrator calculates an 'Order 30 Mailbox Milk price' that is updated monthly at the FMMO 30 website.

When asked how the All Milk prices are calculated, which are different from the Mailbox Milk prices, the initial response by NASS statisticians was to observe that they look back to compare to the Mailbox series and noticed**:** *"The Upper Midwest producers received $2 above the Order 30 minimum price,"* suggesting that the basis is pretty healthy.

But the Order 30 'minimum price' they are referring to is the published Statistical Uniform Price, announced monthly by the Market Administrator, based on standard 3.5% BF, not a producer's actual minimum price based on pounds of BF.

In fact, this "$2 over published minimum" is often pointed out to farmers as their 'basis.' Even those questioning some of the underpayment of 'other solids', or use of protein premium to make up for underpaying 'other solids,' or the loss of premiums in recent years, are often shown that their Mailbox price ends up being around $2 per cwt. above the published minimum.

<u>Knowing your basis starts with understanding YOUR unique FMMO minimum price</u>

In reality, as dairy farmers improve butterfat and overall components, this changes their individual minimum. Market Administrators explain that each pooled producer has their own individual and unique FMMO minimum price that is based on the actual pounds of components they delivered each month as well as the location differential in the PPD on the Class I side.

The announced monthly Statistical Uniform Price (SUP) in each FMMO is a contrived calculation based on the standard 3.5% butterfat. This published price, in fact, may represent not a single dairy farmer in that Order -- if they are all shipping milk over 3.5 butterfat!

Producers in Order 30 have been averaging 4.1 to 4.3 butterfat. This means a chunk of that $2 'basis' over the 'published minimum' is reflective of butterfat pounds that the dairy has earned. It's not a market basis at all. It is part of each producer's own respective minimum price that they controlled and created by making more butterfat. (In the case of making more protein, we've seen where protein premium is used by some buyers to fill the void left by underpaying 'other solids'.)

DRAFT

If producers are cooperative members, the minimum price requirement does not apply at all, but the FMMO announced SUP helps ensure some measure of accountability. Cooperatives are considered the producer, so the auditing stops there.

More volatility

Under the 5-part USDA recommended decision, producers in Class III markets will take the brunt of higher make allowances. Cheese make allowances are already the largest at $0.2003/lb and they will be increased by the largest number of cents per pound to $0.2805/lb.

Class III also uses the whey make allowance, which is already quite large as a percentage of the price value at $0.1991/lb, proposed to go up by 33.3% to $0.2653/lb.

It's hard to imagine how a market for everything from pizza cheese (re-curded whey) to bakery use, to food ingredients, and popular high protein snacks and beverages can be growing while farmers are at risk for seeing 'other solids' become a milk check liability.

All things considered in the evolving milk market dynamics, several organizations have been on record from the outset, including American Dairy Coalition, American Farm Bureau and others opposing a raise in make allowances without mandatory, audited cost surveys. Accurate and complete data are important, and so is the auditing function to make sure processing costs reflect only the cost to make the four base commodities that are captured in the NDPSR for the end-product pricing formulas in the first place.

Once accurate and complete data are available, future hearings could look at how to use the data to avoid overreach. Care must be taken not to incentivize processing investments for a guaranteed 'make allowance margin' instead of the demand signals of the market for all of these other products. Today, the weekly USDA NDPSR covers less than 15% of all the butter, powder, cheese, and whey products sold.

Are these additional make allowance deductions necessary at the level proposed, given the $7 billion in new processing capacity that has the industry buzzing about making more milk to fill? Processors need to be profitable, but farmers need to be profitable also. It's important to also ensure the rest of the supply chain is not unduly insulated from the rising energy, labor and other non-milk input costs that affect all businesses today. It would be detrimental to see consumers pay higher prices at stores and restaurants, based on inflationary trends, while farmers receive less in their milk checks to pay higher processor make allowance credits – leaving money in the middle that may not reflect supply and demand factors.

****

DRAFT