



Gallagher's Topics of Interest - March 2024

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THIS MARK MATTERS. 

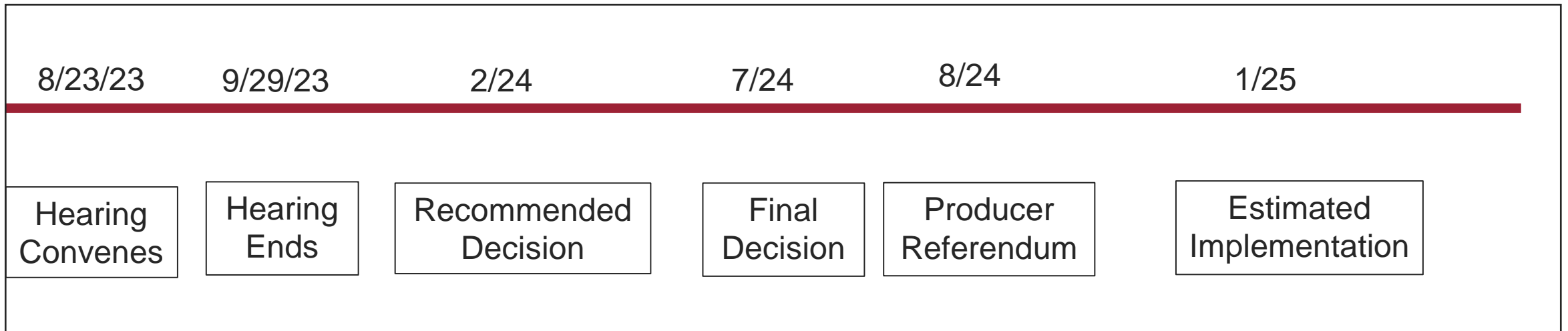
Today's topics

- **Federal order hearing perspectives**
- **Top three milk price influencers**
 - Milk plant investments
 - Beef prices
 - Consumer price inflation
- **2024 state of dairy farm profitability**

The hearing lasted far longer than USDA planned

- Hearing ended on January 30, 2024
 - After a record 49 days of hearing time and a hearing record of almost 12,000 pages
 - And dodging two potential government shut-downs
- Hearing originally scheduled to be completed at end of September and a recommended decision out in February 2024

Original Timeline



Three topics garnered the most attention



375 hours of testimony and cross examination

<u>Topic</u>	<u>% of Hours</u>	<u>Topic</u>	<u>% of Hours</u>
Class I Mover	14%	Milk Components	9%
Make Allowance	21%	Barrel Cheese and other	7%
Class I Differentials	35%	Misc other and legal wrangling	<u>9%</u>
Dairy Farmer Testimony	<u>5%</u>	Sub Total	25%
Sub Total	75%		

Make allowances issue impacts more than Class III and IV prices and has biggest potential impact on producer profitability

Make allowance proposals
milk check impacts on Day 1

Large Western Dairies'
Profitability

DFA's Estimated All-Milk Price Impact of Various Make Allowance Increases

<u>Proposal</u>	<u>Class III</u>	<u>Class IV</u>	<u>All-Milk Price</u>
	\$/cwt of milk		
NMPF	(\$0.58)	(\$0.52)	(\$0.56)
	Cumulative by Year		
IDFA Yr 1	(\$0.76)	(\$0.66)	(\$0.73)
IDFA Yr 2	(\$1.01)	(\$0.89)	(\$0.97)
IDFA Yr 3	(\$1.27)	(\$1.11)	(\$1.21)
IDFA Yr 4	(\$1.52)	(\$1.33)	(\$1.45)

Frazer LP Average Net Income, by Time Period, by Region

	<u>2012-2022</u>	<u>2015-2022</u>
Southern California	\$0.91	\$0.74
San Joaquin Valley California	\$1.05	\$0.66
Kern County California	\$1.45	\$0.99
Arizona	\$0.44	(\$0.22)
New Mexico	\$0.02	(\$0.64)
Texas Panhandle	\$1.71	\$1.40
Northwestern US	\$1.80	\$1.50

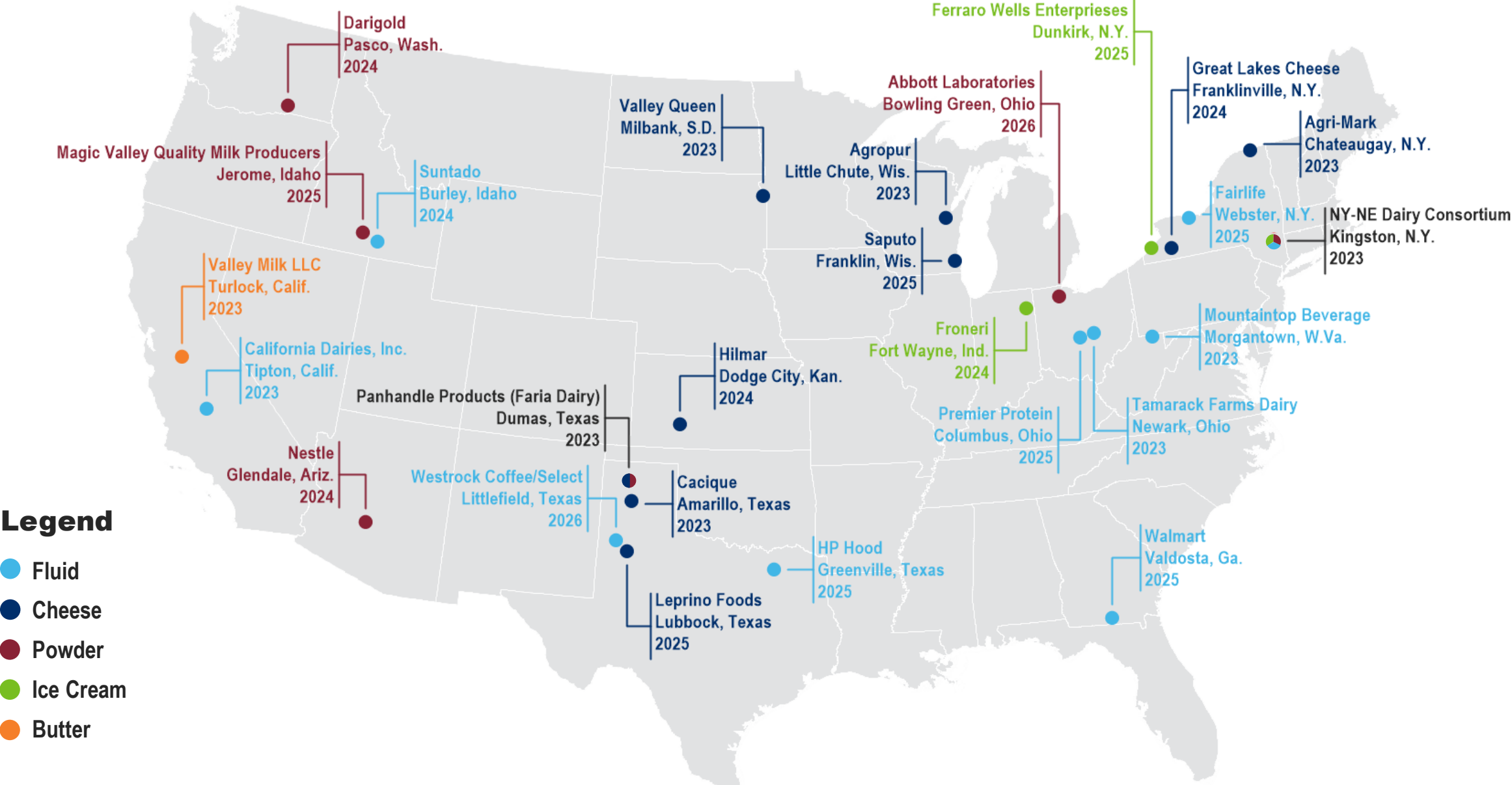
My expectations

- Dairy risk management an important consideration in FMMO decisions
- Make allowances will increase
- The Class I mover will change
- Class I differentials will likely increase
- A process to more regularly address make allowances and Class I differentials will be developed



Three leading factors influencing milk prices

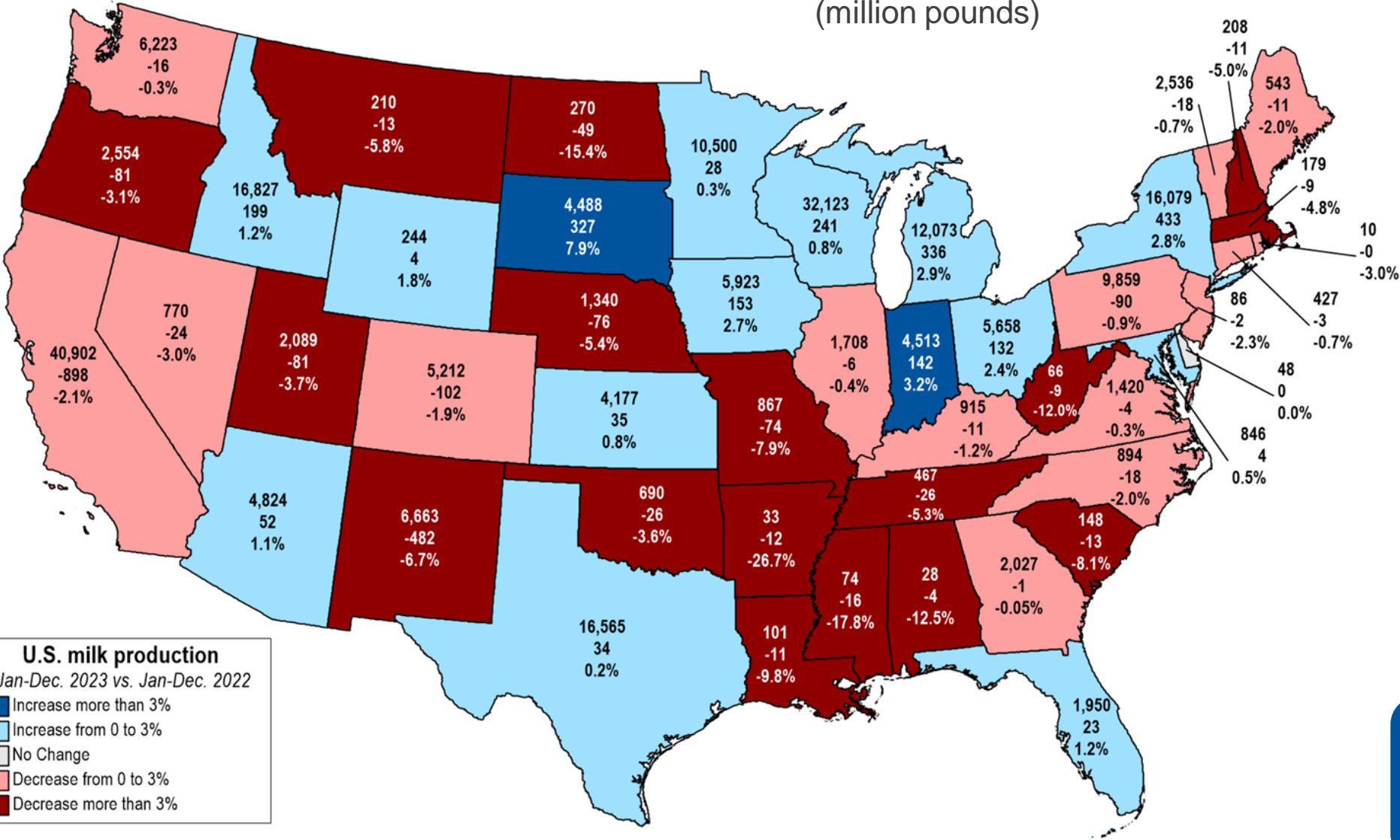
New dairy processing capacity coming online



U.S. milk production

Jan-Dec. 2023 vs. Jan-Dec. 2022

(million pounds)



U.S. milk production
 Jan-Dec. 2023 vs. Jan-Dec. 2022

- Dark Blue: Increase more than 3%
- Light Blue: Increase from 0 to 3%
- White: No Change
- Light Red: Decrease from 0 to 3%
- Dark Red: Decrease more than 3%

Insights

- Total U.S. milk production in 2023 decreased 52 million pounds (0.02%) from the prior year
- Decreases were driven by lower production in California, New Mexico and Colorado

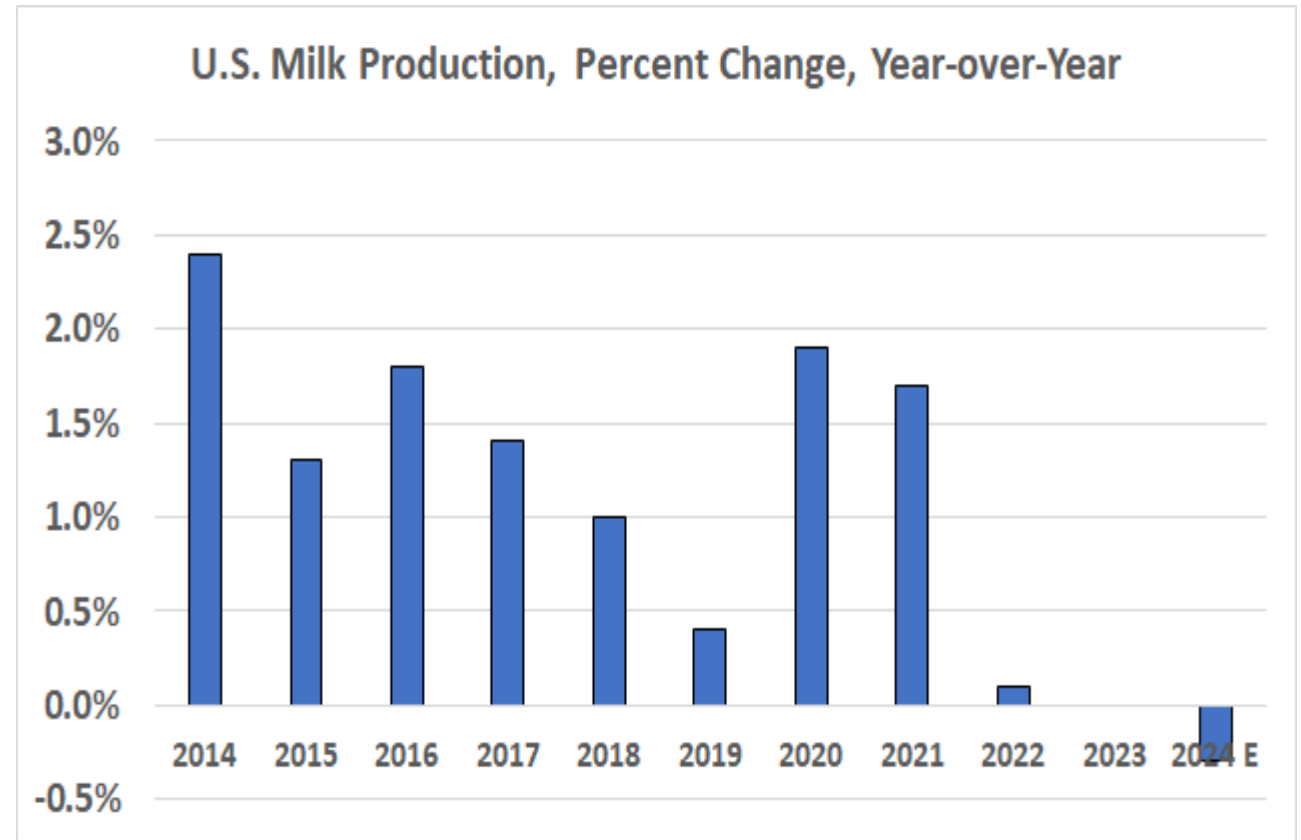
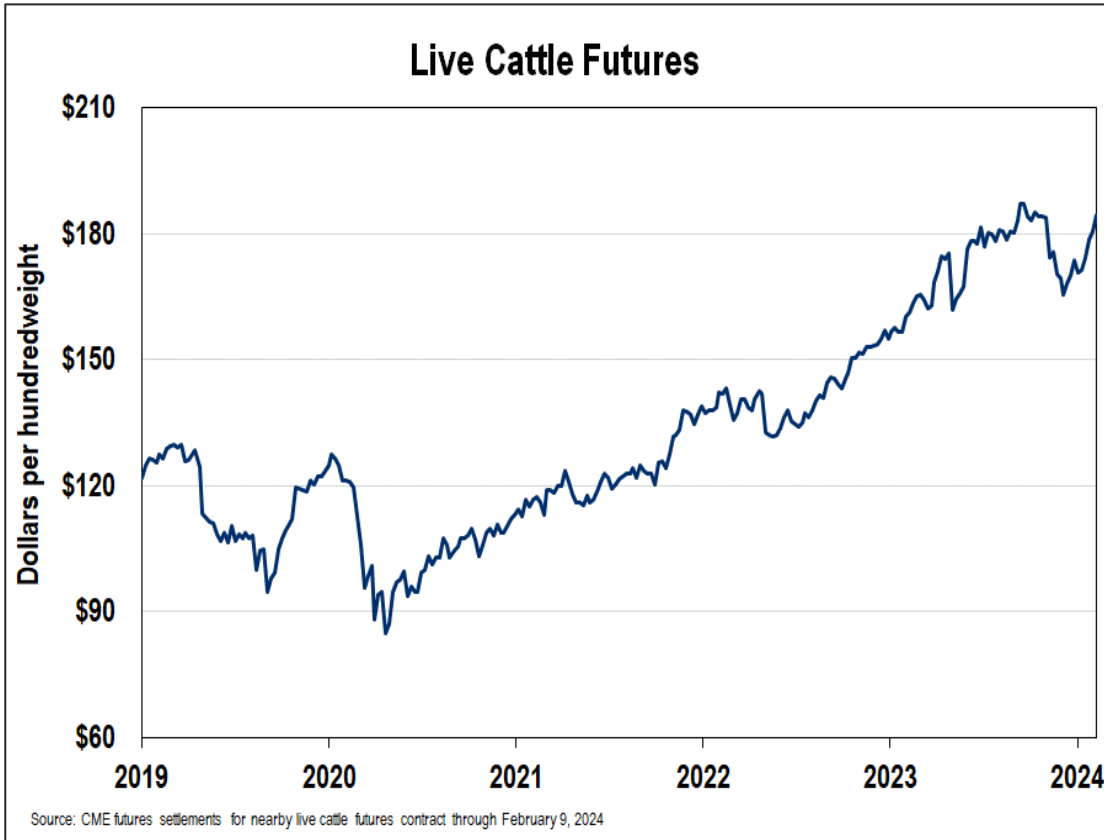
Key

Current milk production
 Qty. change from prior year
 % change from prior year

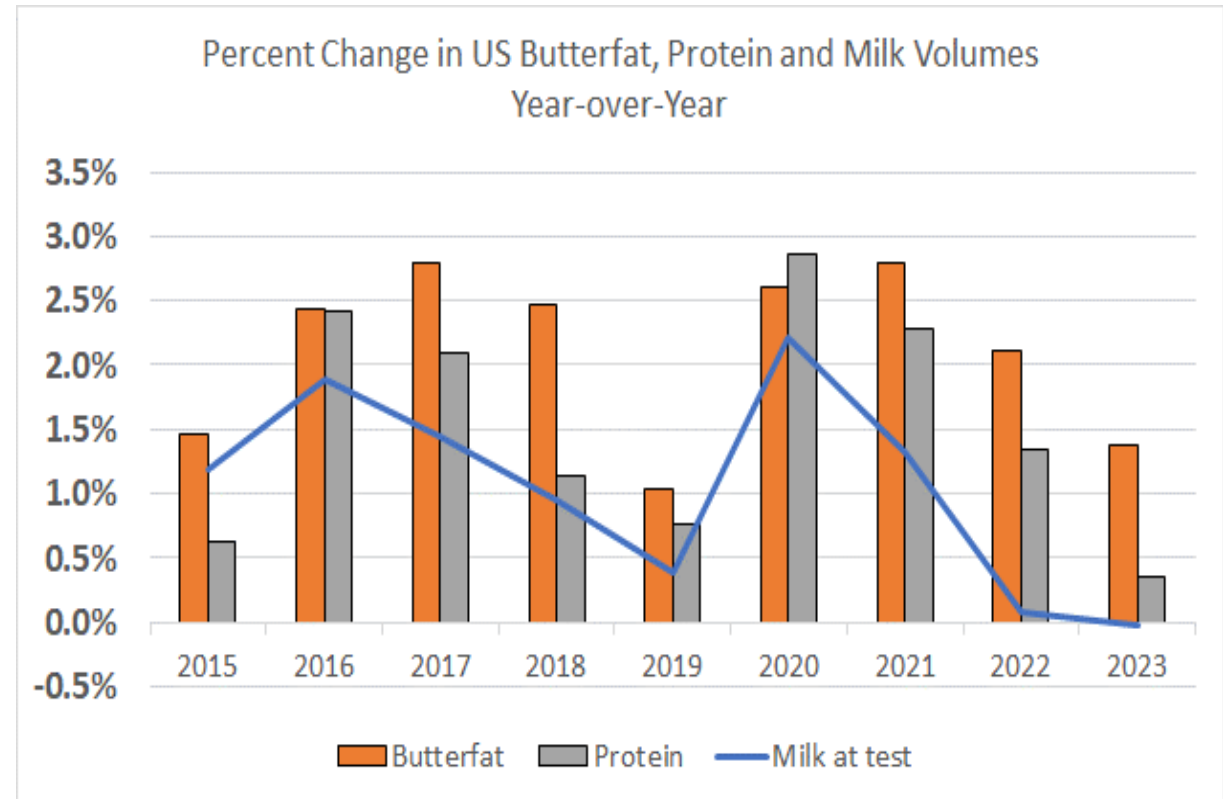
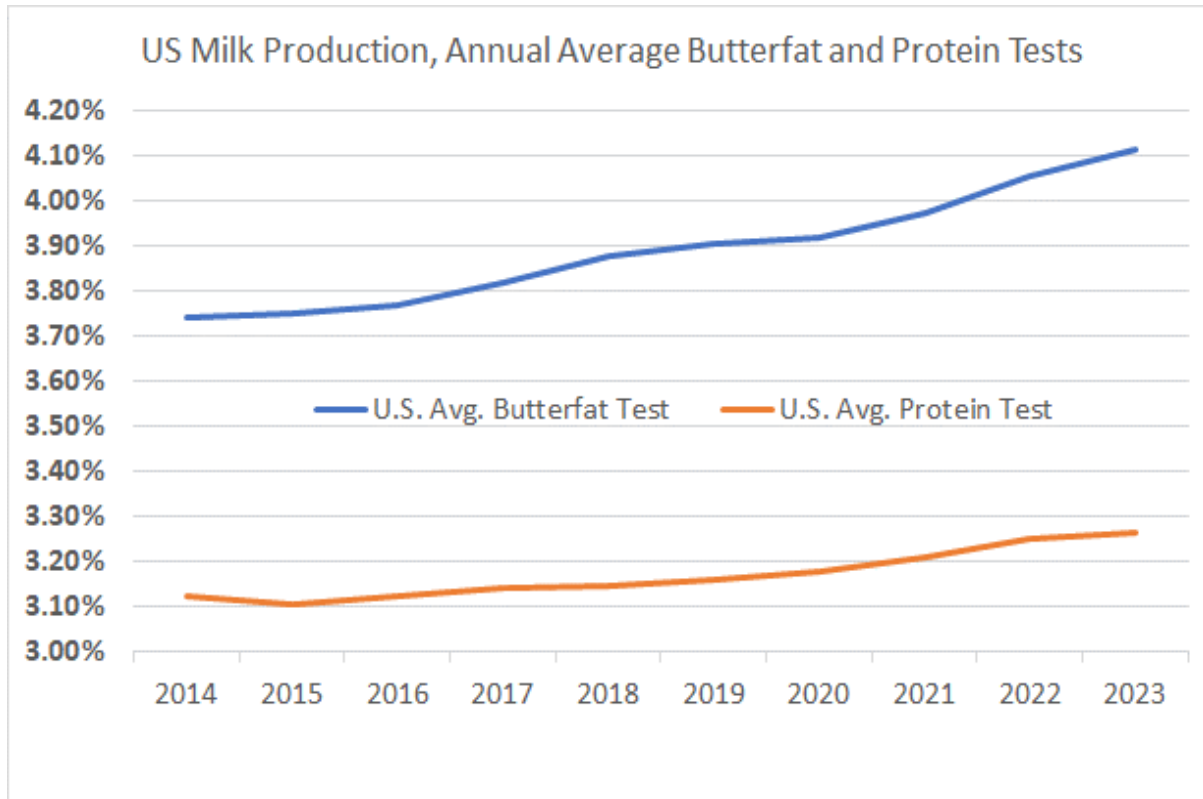
Report date: February 21, 2024

Source: USDA National Agricultural Statistics Service

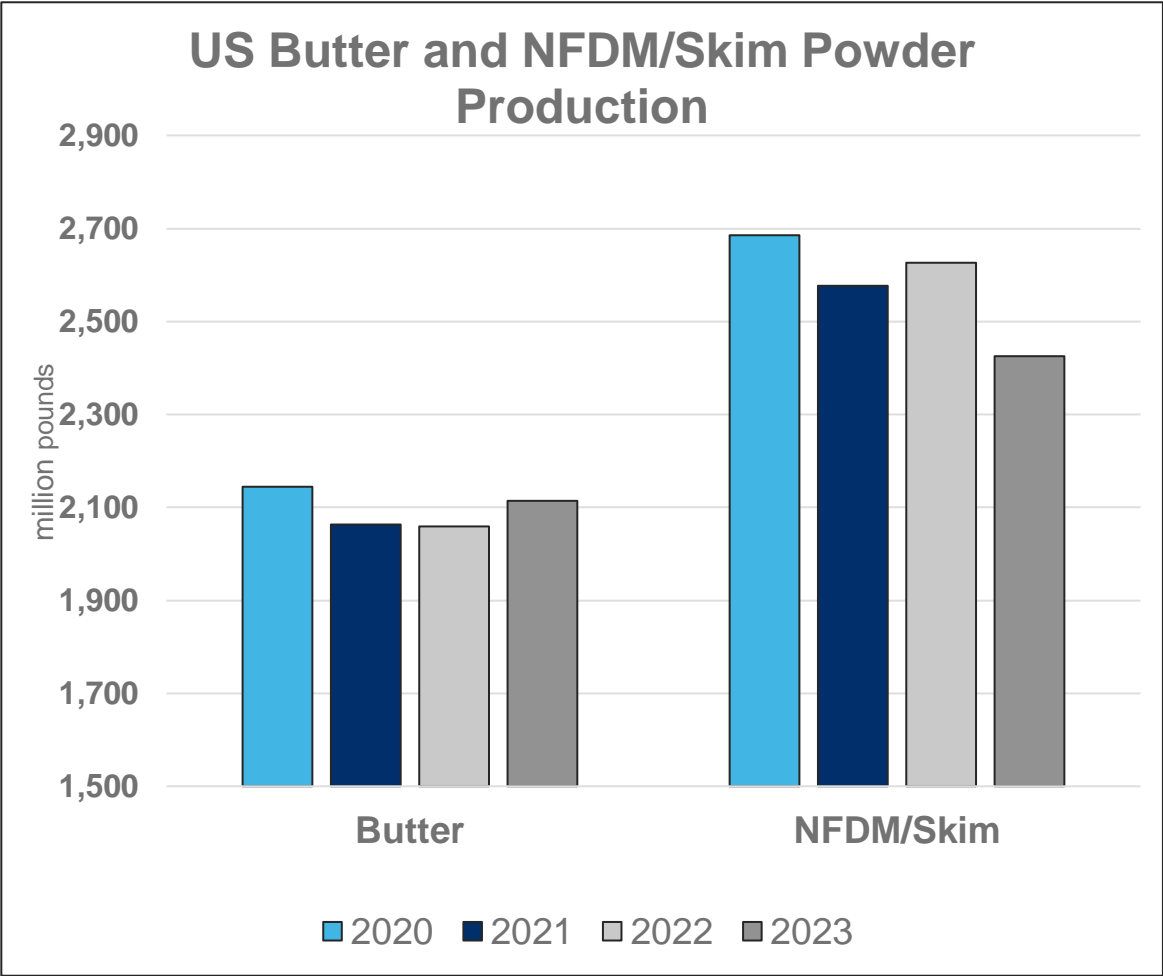
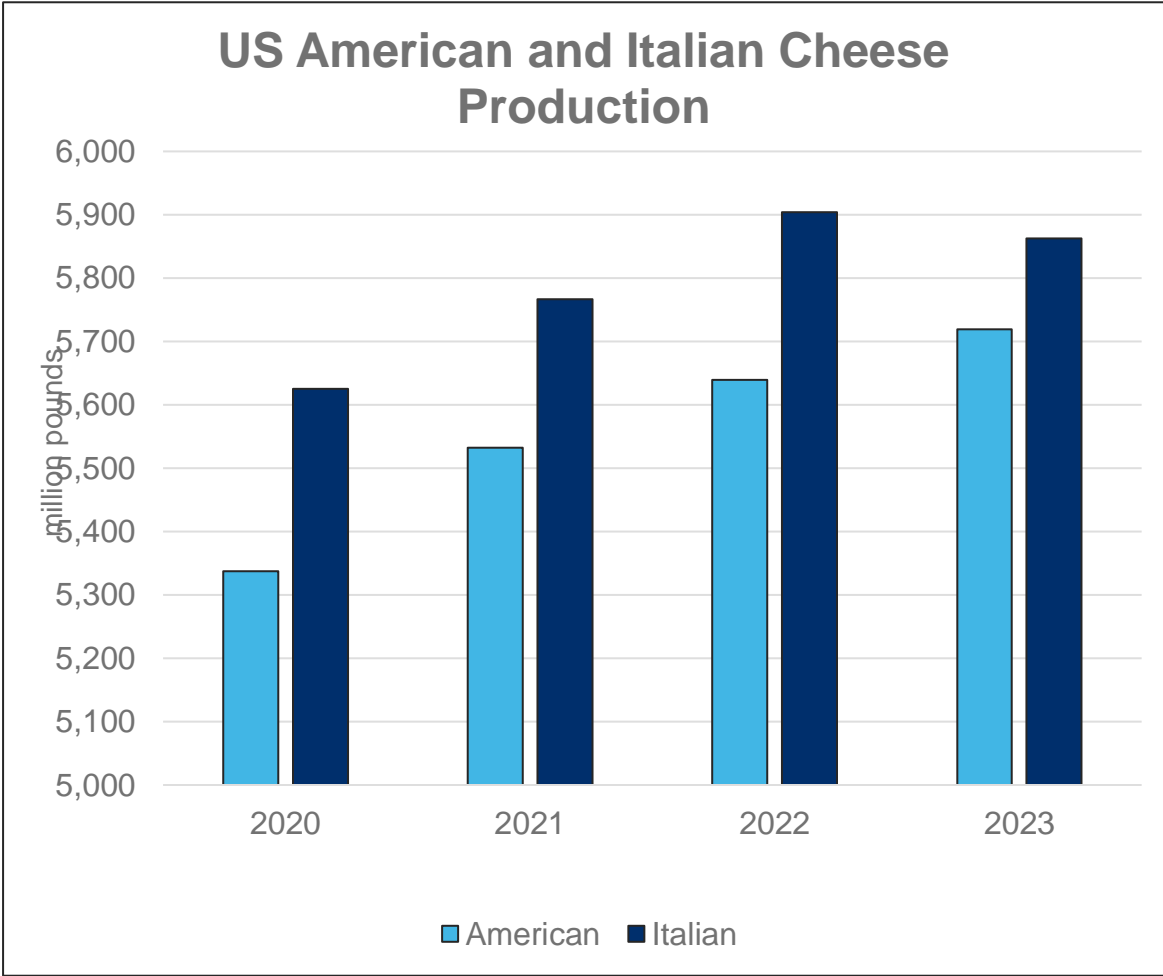
Beef prices influencing flat US milk production



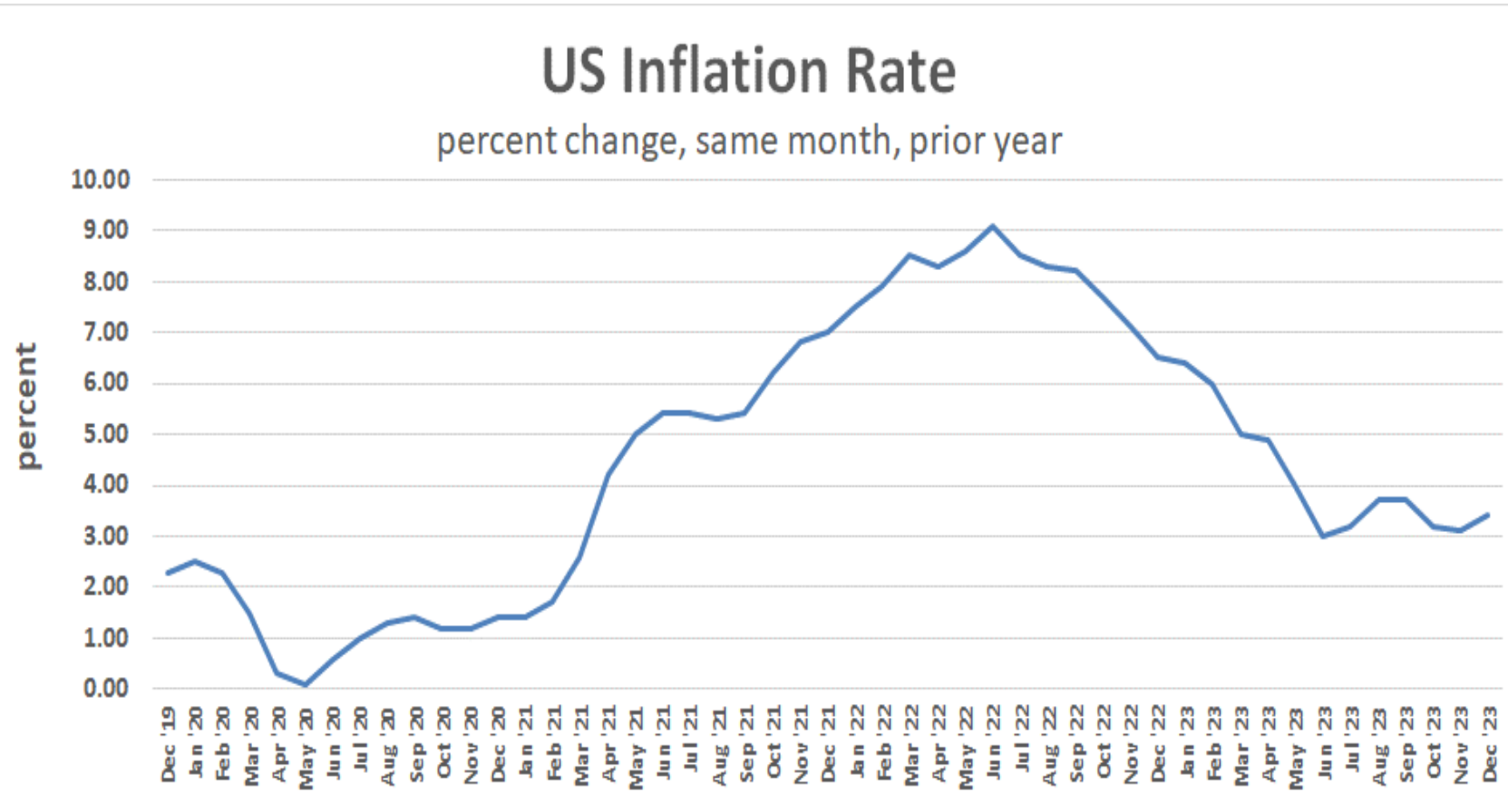
Is it only raw milk volume though?



Impacts on cheese, butter and powder



Consumer inflation is impacting milk prices



- The rate of increase is slowing
- Inflation is additive
- An item that cost \$1 in December 2019 would cost \$1.20 today
- Shrinkflation

Consumers pushing back...

- **Kroger (Nov 2023)**

- “As consumer spending tightens..”

- **Kraft (Feb 2024)**

- “industry faced headwinds that were driven by on going consumer pressure..”

- **Wendy’s (Feb 2024)**

- “The decrease in US company-oriented restaurant margins was primarily the result of higher commodity costs, customer count declines, and higher labor costs...”

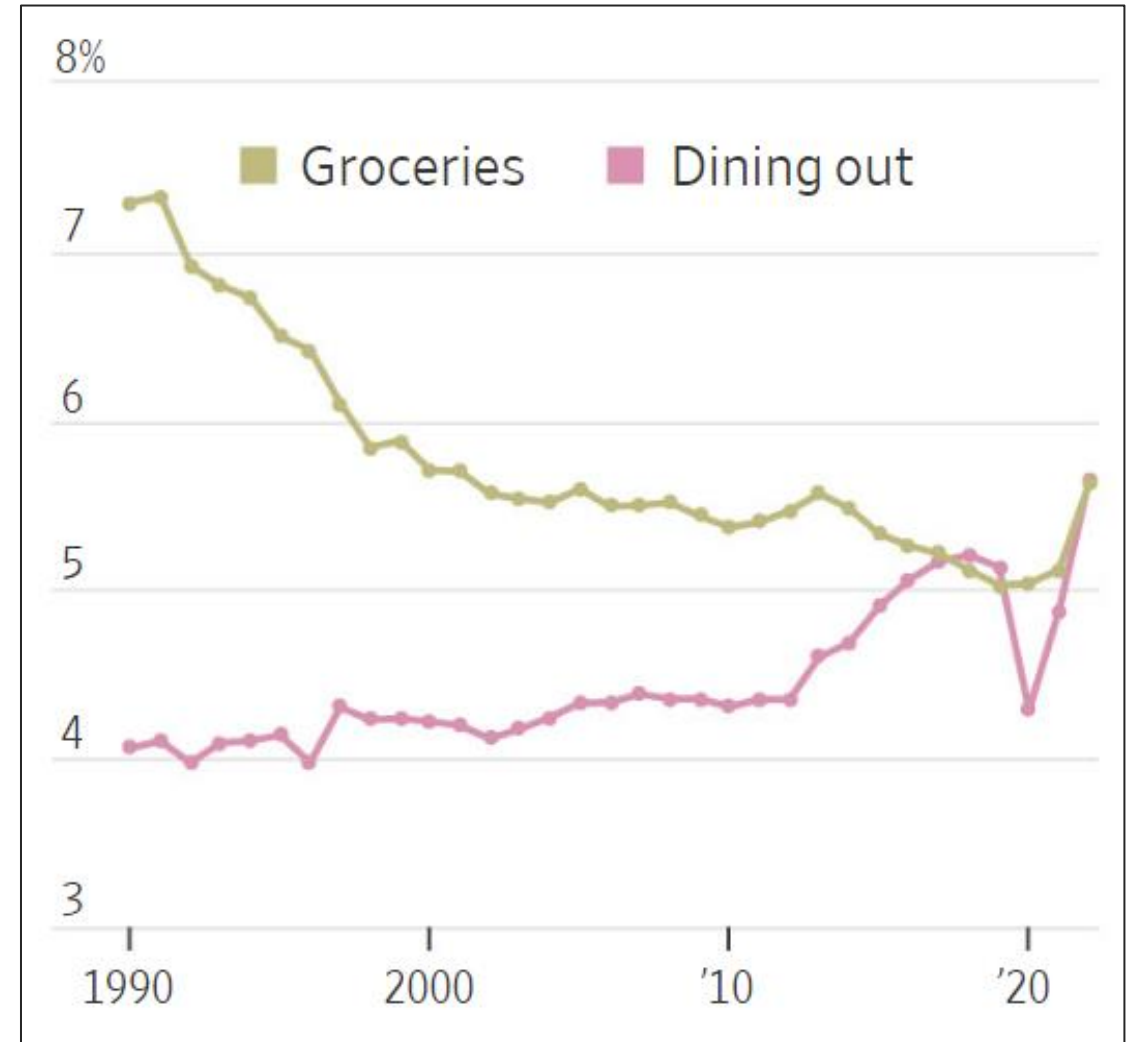
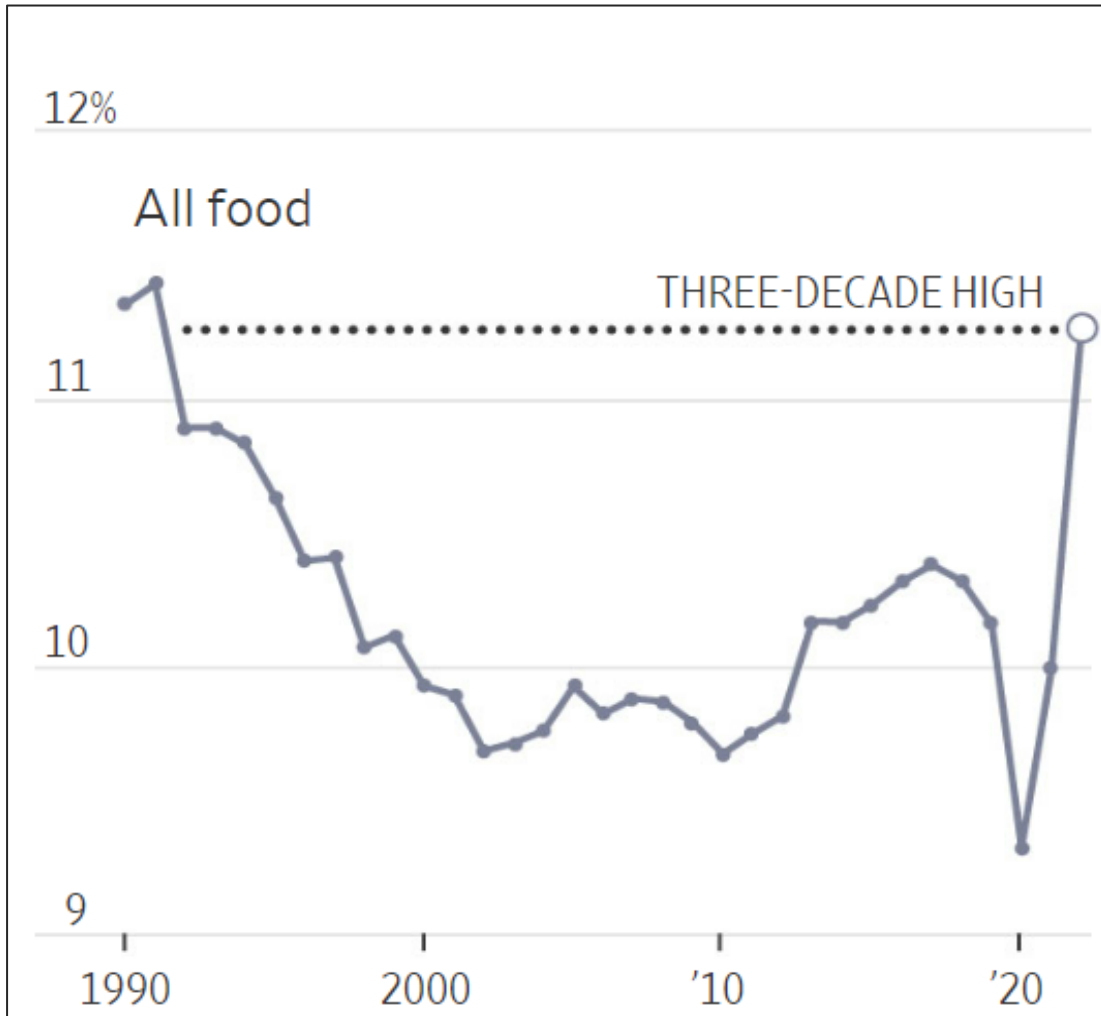
- **McKinsey and Company Grocery survey (Dec 2023) asked question:**

- Mr/Mrs Consumer, why have you reduced your purchases?

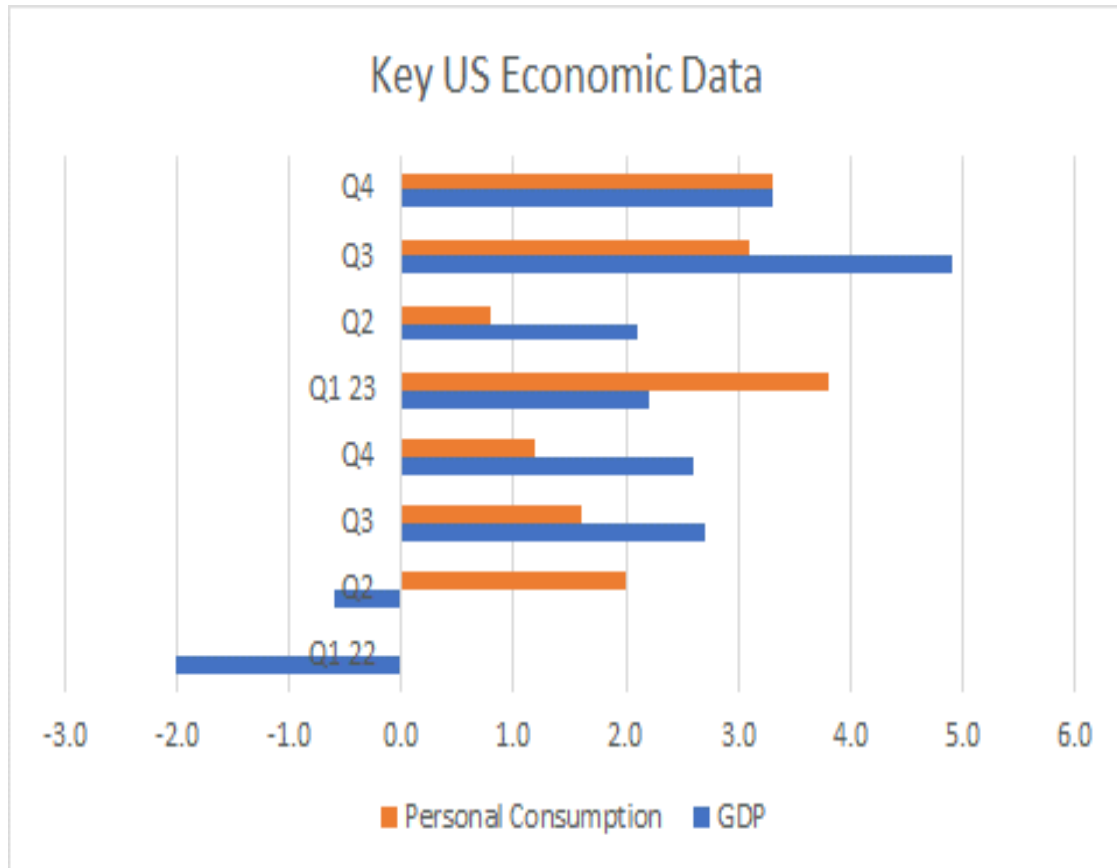
- Responses:

- 78%: prices have increased
 - 50%: waiting for a sale
 - 41%: can’t afford due to economic reasons
 - 19%: can’t afford as much due to personal reasons
 - 18%: I need less than I used due to personal reasons

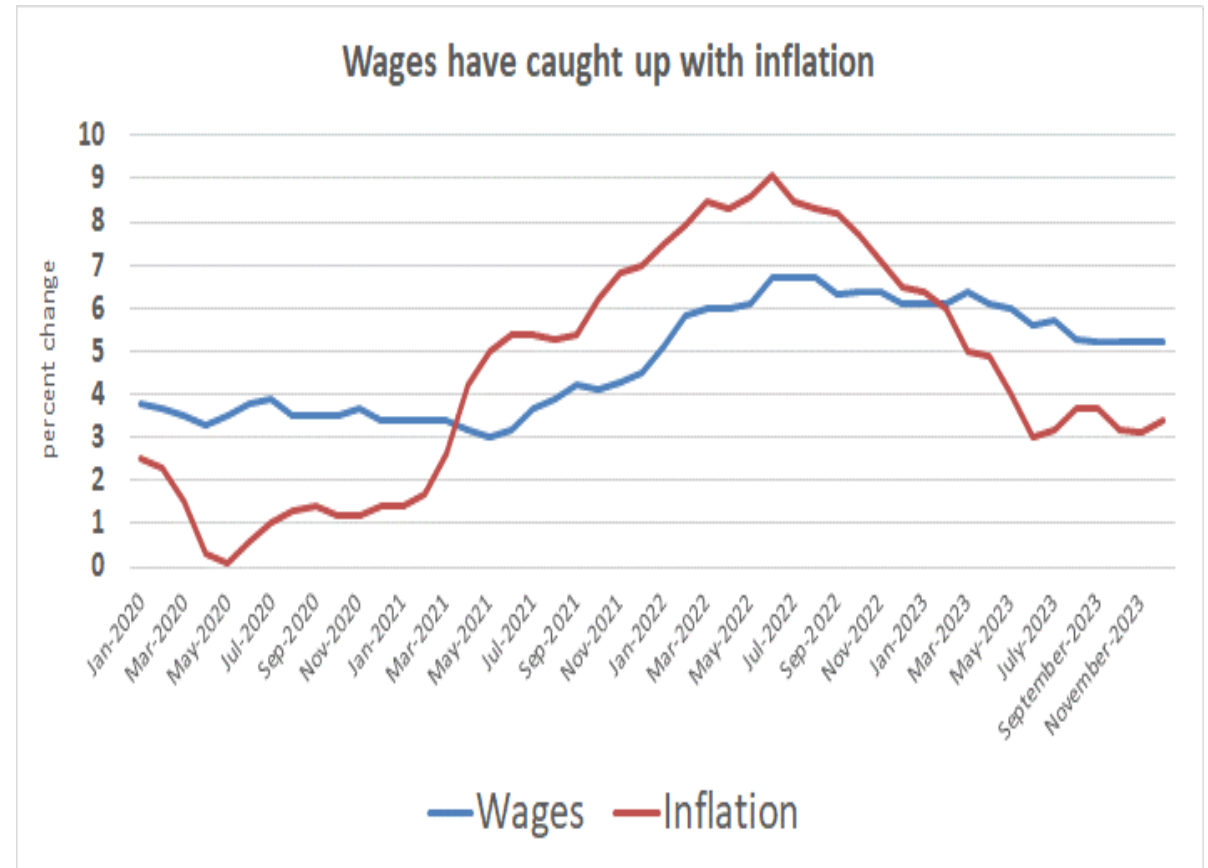
Food's spending share of disposable income



US economy is doing well and the consumer will eventually feel financially better...



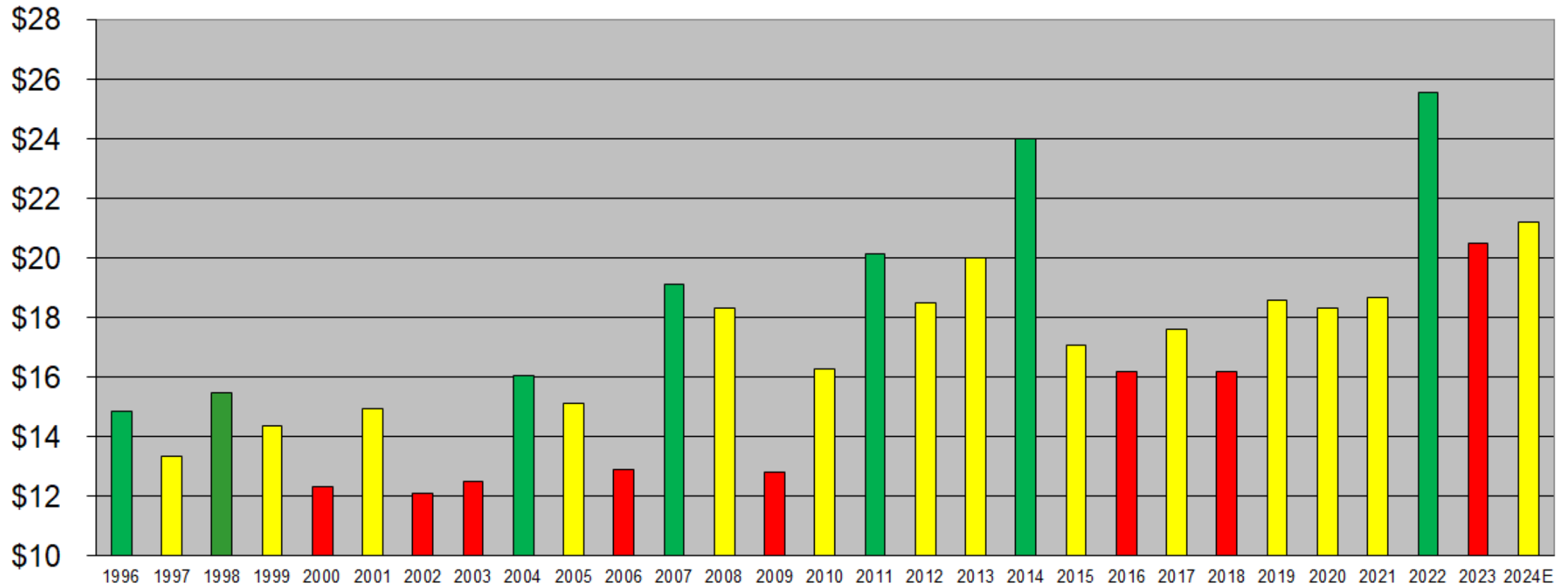
Data source: Bureau of Labor Statistics



Data source: Statista

At least a near green bar may appear soon

US All-Milk Price
Annual Average, 1996 - 2024E





2024 State of Dairy Farmer Profitability

US exports lagged in 2023

USDA expecting modest demand growth in 2024

Dairy Exports Jan - Nov 2023

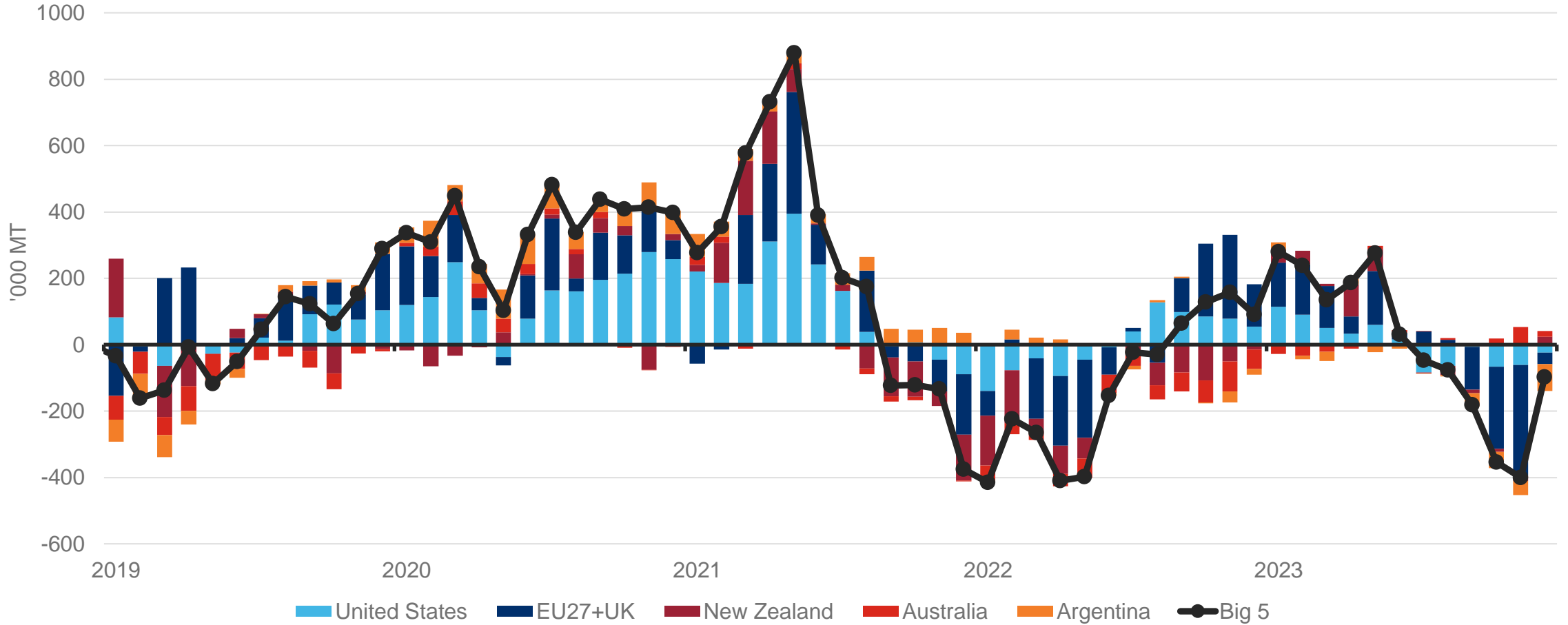
	<u>US</u>	<u>All Countries</u>
	<u>change from year earlier</u>	
All Exports	-7.2%	0.2%
NFDM/SMP	-3.3%	5.0%
Cheese	-3.7%	2.3%
Whey	-20.8%	7.4%

Data sources: USDEC and NMPF

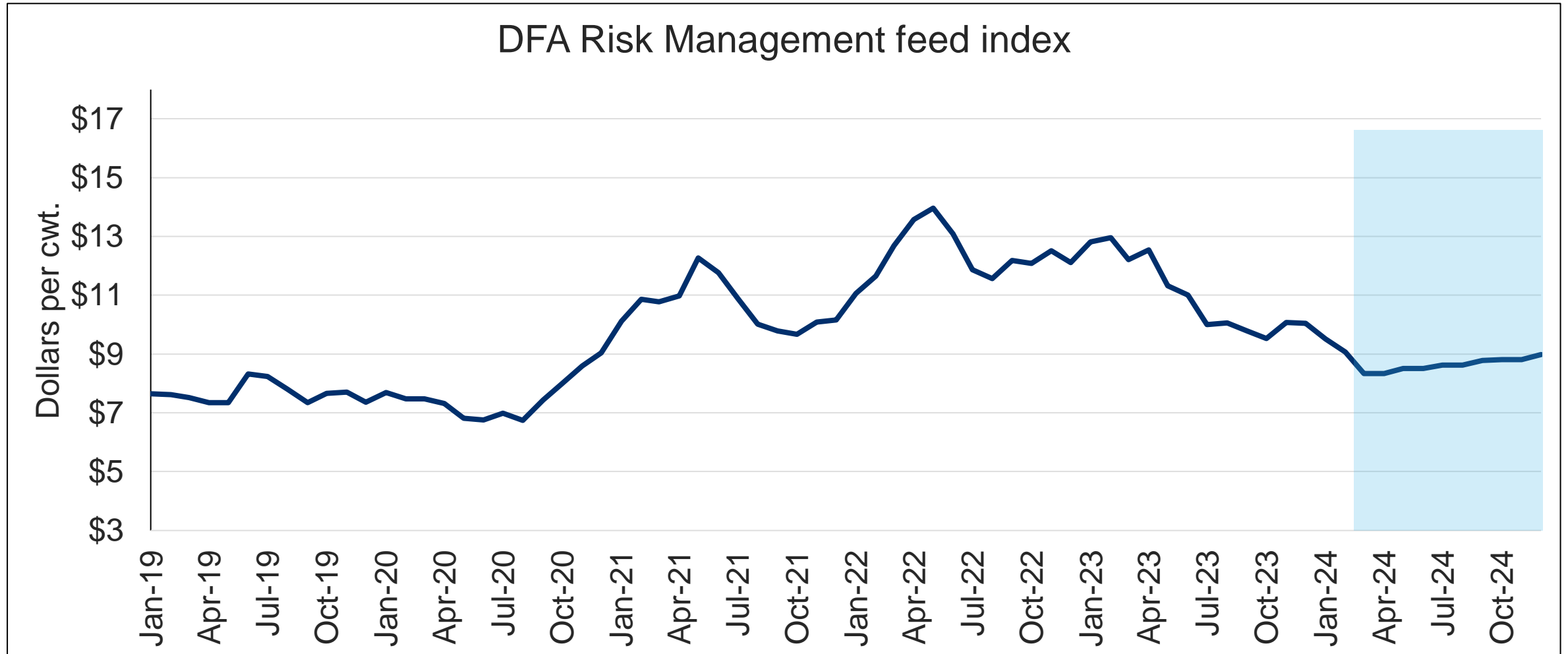
- 2024 USDA dairy demand forecasts:
 - Domestic demand: flat
 - Export demand: +7%
 - Total demand: +1%

Milk Production by Major Exporters

YOY Change in Milk Production by Major Suppliers

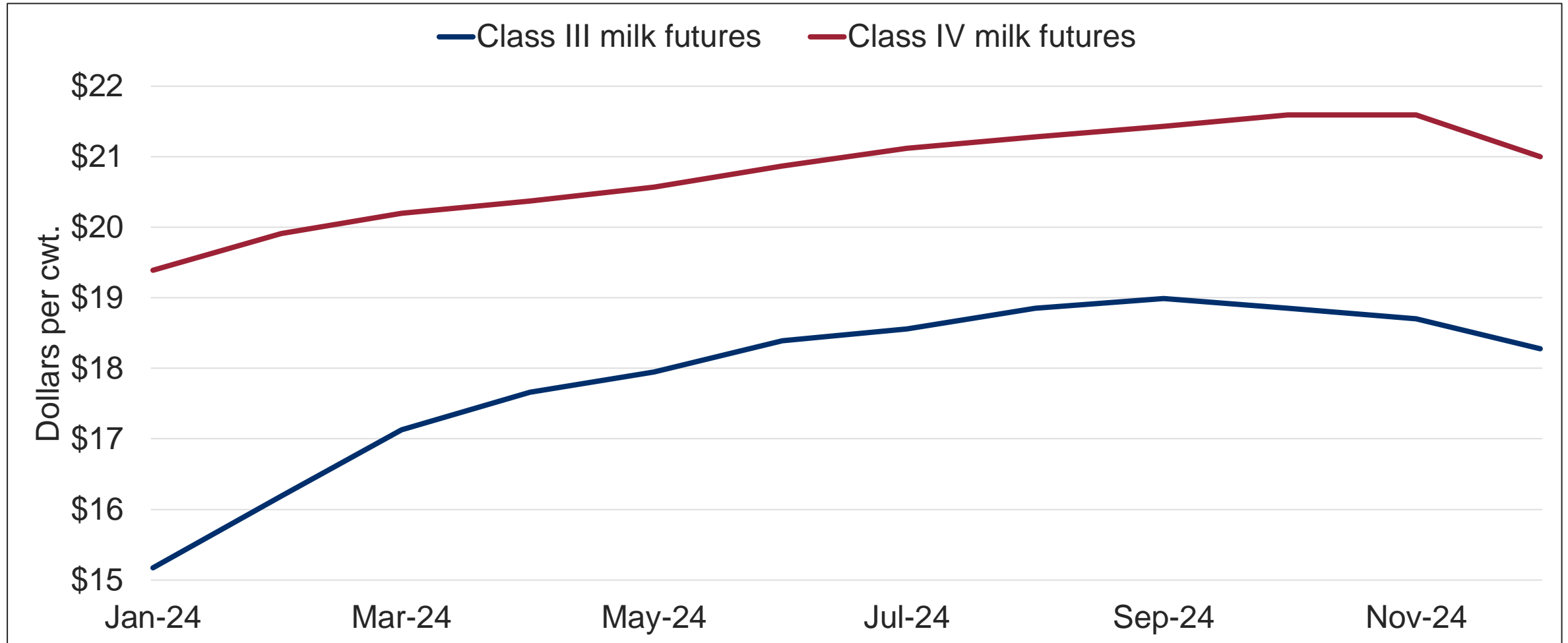


Livestock feed prices have moderated



Source: DFA Risk Management proprietary feed index calculation based on CME futures as of 2/22/2024.

CME Group futures reflective of price expectations



Source: USDA announced prices, CME Class III and Class IV milk futures settlements as of 2/22/2024.

Margins look better in 2024 with higher milk prices and less expensive feed

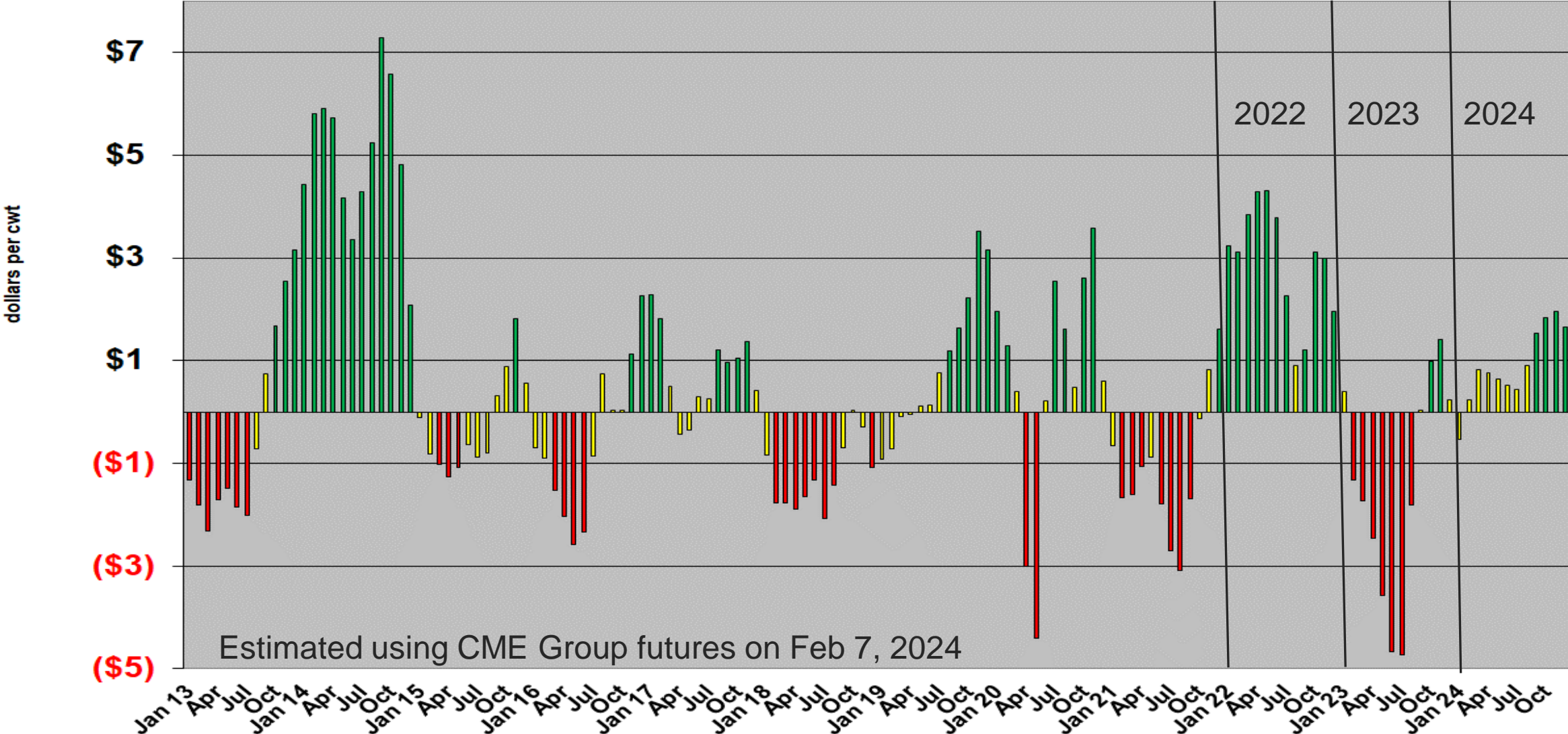
	US All <u>Milk Price</u>	DFA RM <u>Feed Index</u>	Milk Feed <u>Margin</u>
	<u>\$/cwt of milk production</u>		
2023	\$20.47	\$11.03	\$9.44
2024E	<u>\$21.21</u>	<u>\$9.27</u>	<u>\$11.94</u>
Change	\$0.74	-\$1.76	\$2.50
2019	\$18.60	\$7.66	\$10.94

- US All-milk price a good gauge for DFA-wide average pay prices
- Interest rates expected to be higher for longer....
- Compared to 2019
 - Non-feed input costs are higher
 - Profitability likely about the same

Estimated using CME Group futures on Feb 7, 2024

US Dairy Farm Average Net Margins

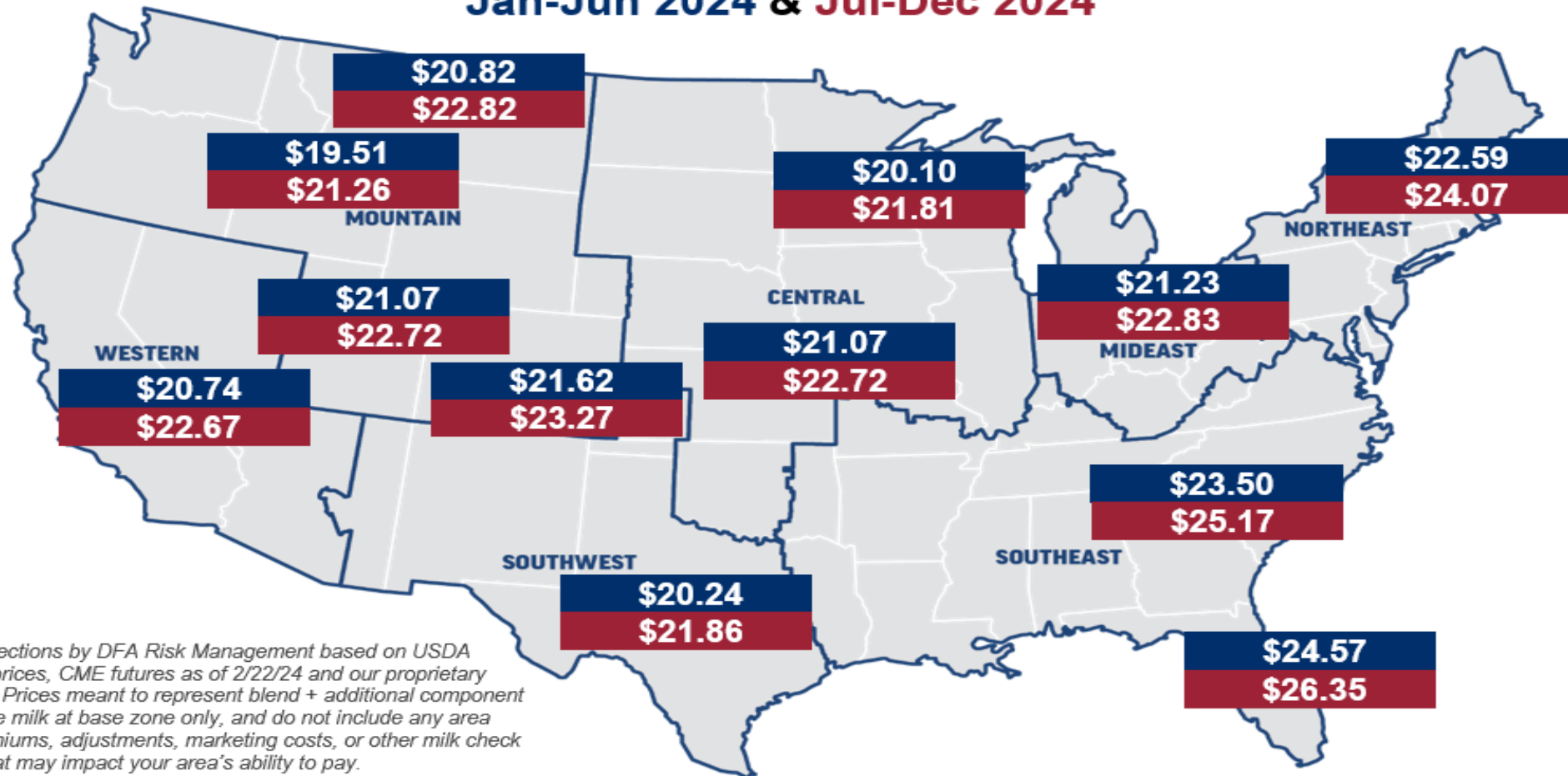
Estimated, Jan 2013 - Dec 2024



Estimated using CME Group futures on Feb 7, 2024

Eastern US outlook more positive than out west

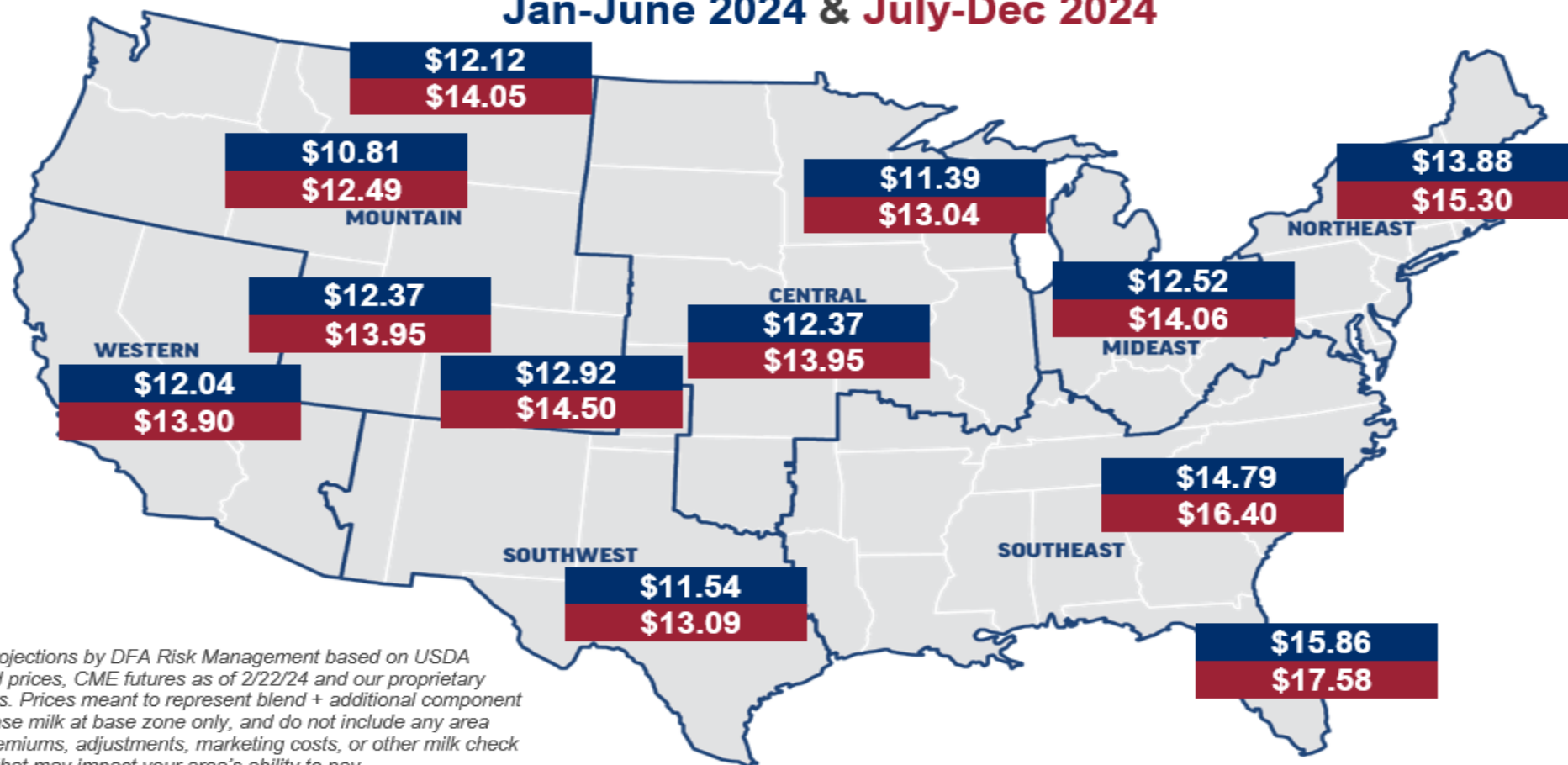
**Estimated gross milk price
(blend plus additional components)
Jan-Jun 2024 & Jul-Dec 2024**



Source: Projections by DFA Risk Management based on USDA announced prices, CME futures as of 2/22/24 and our proprietary calculations. Prices meant to represent blend + additional component tests on base milk at base zone only, and do not include any area specific premiums, adjustments, marketing costs, or other milk check line items that may impact your area's ability to pay.

Better 2nd half margins will support stronger milk production

Estimated gross milk price minus
DFA Risk Management feed index
Jan-June 2024 & July-Dec 2024



Source: Projections by DFA Risk Management based on USDA announced prices, CME futures as of 2/22/24 and our proprietary calculations. Prices meant to represent blend + additional component tests on base milk at base zone only, and do not include any area specific premiums, adjustments, marketing costs, or other milk check line items that may impact your area's ability to pay.

Nothing is static and everything in the future is unknown

- Potential concerns include
 - More milk and components than the market is expecting
 - Growing Middle East conflict stoking inflation again
 - Consumer debt growth reduces spending
 - China's economy continues to unravel
 - US exports continue to decline
- Factors that could generate upside
 - Milk production declines by greater than 1 percent for an extended time
 - China's economy stabilizes and shows signs of growth
 - US dairy exports surge
- And there are many others.....

Questions?

Contact us:

DFA Risk Management team

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