

National Milk Producers Federation's **“Foundation for the Future”**



A presentation by:

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* Much of the information included in this presentation is courtesy of National Milk Producers Federation (www.futurefordairy.com)

What is Foundation for the Future?

- Foundation for the Future, or FFTF, is a dairy policy reform plan that contains three main pieces:
 1. A **“Dairy Market Stabilization Program”** that is designed to temporarily send a signal for producers to cut back milk production when the industry experiences low margins.
 2. Replacing the Milk Income Loss Contract (MILC) and Dairy Price Support Program with a **“Dairy Producer Margin Protection Program.”**
 3. **Reforming the Federal Milk Marketing Orders.**

Margin Calculation

- Before going into the three pieces of FFTF, we need to understand what NMPF means when they talk about **“margin.”**
- Two of the three parts of FFTF heavily rely on a monthly **“margin”** calculation.
- Two components to the margin calculation
 - **U.S. All milk price** – A figure published by USDA each month
 - **National average feed cost** – based on a formula that includes corn, soybean meal and alfalfa values
- The difference each month between these two figures is the monthly **“margin.”**

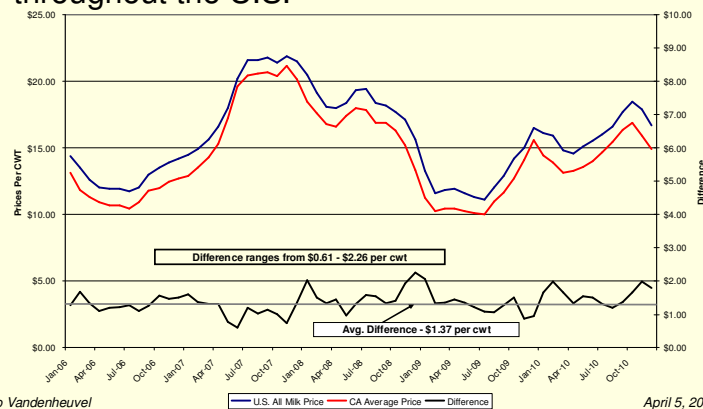
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All-Milk Price

- The **U.S. all-milk price** announced each month by USDA is the average price received by dairy farmers throughout the U.S.



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National Average Feed Cost

- NMPF has created a formula to determine the “national average feed cost,” using nationally-recognized values for corn, soybean meal and alfalfa as the price drivers.
- **The first step:** how much to feed a lactating cow

Daily Quantities of Feed Ingredients for a Lactating Cow

| Ingredient | Quantity of Dry Ingredient (lbs/day) | | Quantity of Commercial Ingredient (lbs/day) | Quantity in Commercial Units (units/day) |
|--------------|--------------------------------------|------------------|---|--|
| | | Moisture Content | | |
| Shelled Corn | 15.4 | 14% | 17.9 | 0.319803 bushels |
| Corn Silage | 16.0 | 65% | 45.7 | 0.02286 tons |
| Soybean Meal | 5.7 | 12% | 6.5 | 0.003238 tons |
| Alfalfa Hay | 10.0 | 15% | 11.8 | 0.00588 tons |

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National Average Feed Cost

- The next step: how to take that information and calculate the costs to feed the whole herd (milk cows, dry cows, and replacements)

Daily Quantities of Feed Ingredients for the Entire Herd

| Cow Type | Proportion of Herd | Dry Matter Consumed (lbs/day) | Quantity in Commercial Units (units/day) | | | |
|------------------------|--------------------|-------------------------------|--|------------------------|-------------------------|------------------------|
| | | | Shelled Corn (bu/day) | Corn Silage (tons/day) | Soybean Meal (tons/day) | Alfalfa Hay (tons/day) |
| Milking Cows | 52.49% | 47.1 | 0.3198 | 0.0229 | 0.0032 | 0.0059 |
| Hospital Cows | 1.05% | 47.1 | 0.3198 | 0.0229 | 0.0032 | 0.0059 |
| Dry Cows | 8.82% | 24.0 | 0.0249 | 0.0172 | 0.0020 | 0.0042 |
| Replacements Heifers | | | | | | |
| To calve within 1 year | 18.53% | 23.0 | 0.0239 | 0.0164 | 0.0020 | 0.0041 |
| 500 pounds and over | 9.55% | 15.0 | 0.0311 | 0.0107 | 0.0013 | 0.0022 |
| Less than 500 pounds | 9.55% | 7.0 | 0.0363 | 0.0045 | 0.0006 | 0.0006 |

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National Average Feed Cost

- The third step: determine price of corn silage using CBOT corn price.

$$\text{Price of corn silage, per ton} = 10.1 \times \text{Price of corn, per bushel}$$

- The final step: combine the data into a formula that takes three prices (corn, soybean meal and alfalfa) and determines a “national average feed cost.”

$$\text{Feed cost per cwt. of milk} = 1.192 \times \text{Price of corn, per bushel} + 0.00817 \times \text{Price of soybean meal, per ton} + 0.0152 \times \text{Price of alfalfa hay, per ton}$$

National Average Feed Cost

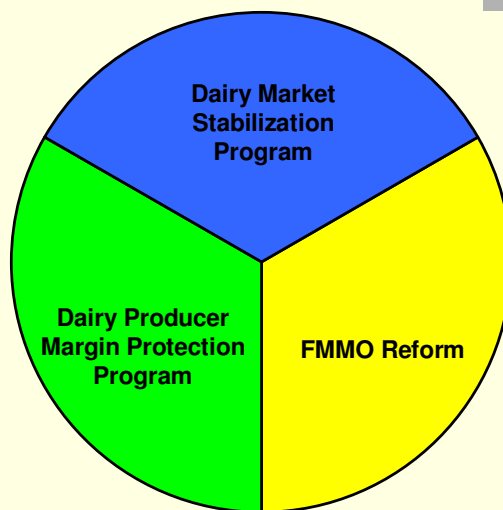
- The corn price is the average of the daily settlement prices during any month for the nearest month CBOT corn futures contract.
 - *Example: In February 2011, the average settlement price for the March 2011 contract was \$6.90 / bushel.*
- The soybean meal price is calculated the same way.
 - *Example: In February 2011, the average settlement price for the March 2011 contract was \$372.09 / ton.*
- The alfalfa price is taken from the monthly USDA report.
 - *Example: The announced February 2011 price received by alfalfa farmers in the U.S. was \$127 / ton.*

Margin Calculation

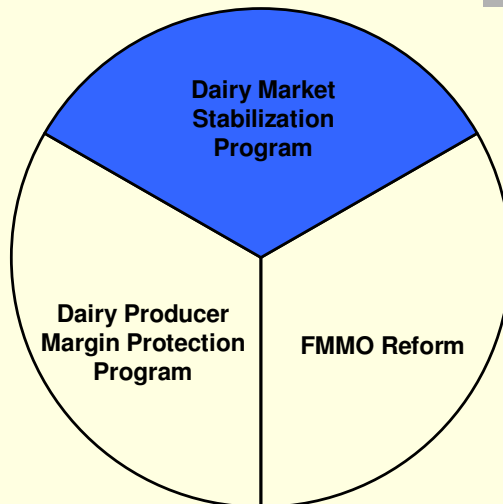
An example: February 2011

- All-milk price (announced by USDA): **\$18.40**
- National average feed cost (using NMPF formula): **\$13.20**
 - Corn price: \$6.90
 - Soybean meal price: \$372.09
 - Alfalfa: \$127
- Margin for February 2011: **\$5.20 per cwt**

Foundation for the Future



Dairy Market Stabilization Program



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Dairy Market Stabilization Program

- The Dairy Market Stabilization Program, or DMSP, is a temporary, stand-by program that activates if the “margin” falls below the trigger margin for 2 consecutive months
 - Once the DMSP is triggered, a temporary “base” is established for each dairy facility. That “base” is either:
 - A rolling 3-month average of the most recent milk marketing immediately prior to DMSP implementation
- OR
- The same month in the previous year

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The DMSP “Triggers”

- **<\$6 for 2 consecutive months**
 - Producers paid for 98% of their base milk marketings
 - Maximum reduction is 6% of current milk marketings
- **<\$5 for 2 consecutive months**
 - Producers paid for 97% of their base milk marketings
 - Maximum reduction is 7% of current milk marketings
- **<\$4 for 1 month**
 - Producers paid for 96% of their base milk marketings
 - Maximum reduction is 8% of current milk marketings

The DMSP “Triggers”

- The DMSP is in effect until the margins are above \$6.00 per cwt for **two consecutive months**. Then the program ends and the “base” is extinguished.
- Monies paid by handlers for milk produced in excess of these levels will go into a fund, to be managed by a producer board and used to “stimulate the consumption of dairy products.”
- If either of the U.S. prices for cheddar cheese or skim milk powder (SMP) is 20% - 30% higher than the world price for the applicable commodity for a period of two consecutive months after the DMSP has been implemented, DMSP will be discontinued unless the national average margin is below \$4.00.

An Example of the DMSP

- December 2010 margin: \$4.93 per cwt
- January 2011 margin: \$3.72 per cwt
 - *Because the margin was below \$4 for a single month, the program would be triggered.*
- A notice is sent to each dairy that the DMSP will begin in March 2011.
 - *Producers paid for 96% of their base milk marketings*
 - *Maximum reduction is 8% of current milk marketings*
- The DMSP would be in place until there are two consecutive months with margins >\$6.00 per cwt.

An Example of the DMSP

- Producer A:
 - Base monthly milk marketings 2,000,000 lbs.
 - Markets 2,000,000 lbs. in March 2011
 - Paid for 1,920,000 lbs. (2,000,000 lbs. times 96%)
 - DMSP deduction from his milk check for March:
 - 2,000,000 lbs. minus 1,920,000 lbs.) = 80,000 lbs.
 - 80,000 lbs. X \$17.21/cwt. = \$13,768 deducted from milk check.

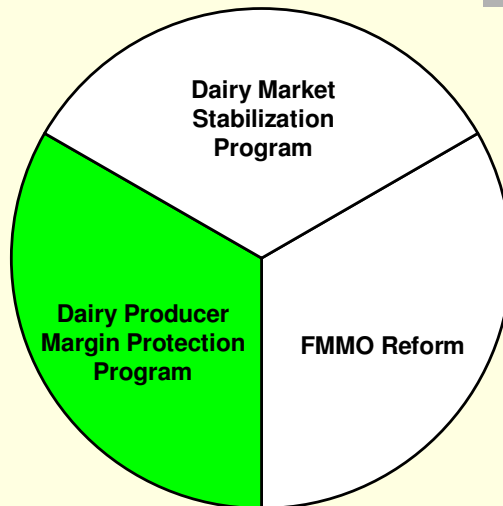
An Example of the DMSP

- Producer B:
 - Base monthly milk marketings 2,000,000 lbs.
 - Markets 1,920,000 lbs. in March 2011
 - Paid for 1,920,000 lbs. (2,000,000 lbs. times 96%)
 - No DMSP deduction from his milk check for March.

An Example of the DMSP

- Producer C (in the middle of expansion):
 - Base monthly milk marketings 1,000,000 lbs.
 - Markets 2,000,000 lbs. in March 2011
 - Paid for 1,840,000 lbs. (2,000,000 lbs. minus 8%)
 - DMSP deduction from his milk check for March:
 - 2,000,000 lbs. minus 1,840,000 lbs.) = 160,000 lbs.
 - 160,000 lbs. X \$17.21/cwt. = \$27,536 deducted from milk check.

Dairy Producer Margin Protection Program



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Dairy Producer Margin Protection Program

- The Dairy Producer Margin Protection Program, or DPMPP, replaces the current Milk Income Loss Contract (MILC) and Dairy Product Price Support Program (DPPSP).
- In their place, the DPPMP establishes a voluntary two-level system of “margin protection”: the Base Coverage and Supplemental Coverage

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Dairy Producer Margin Protection Program

- The DPPMP utilizes the same margin calculation as the DMSP: *National all milk price minus national average feed cost.*
- All producers have the option of signing up for either the base coverage or the base + supplemental coverage.
- The base coverage is free for the producer; the supplemental coverage has an annual premium.

Dairy Producer Margin Protection Program

- Each dairy's coverage is based on that dairy's production history.
 - A dairy can get coverage for up to 90% of their highest annual production in the three years prior to this program's implementation.
 - That volume is locked in for the next five years. The dairy cannot get coverage under the DPMPP for production above that level during the five-year life of the program.

The Base Coverage

- The base coverage is free for producers.
- It provides direct payments to dairy farmers when monthly margins drop below \$4 per cwt.
- In the past five years, the base coverage would have made payments in 8 of the 60 months (all in 2009).

The Supplemental Coverage

- The supplemental coverage is for dairies wishing to “protect margins” greater than \$4.00 per cwt.
- It provides direct payments to dairy farmers when monthly margins drop below their selected margin level.
- An annual premium is required for supplemental coverage.

Supplemental Premiums

| Coverage Level | Premium per Cwt. |
|----------------|------------------|
| \$4.50 | \$0.015 |
| \$5.00 | \$0.036 |
| \$5.50 | \$0.081 |
| \$6.00 | \$0.155 |
| \$6.50 | \$0.230 |
| \$7.00 | \$0.434 |
| \$7.50 | \$0.590 |
| \$8.00 | \$0.922 |

An Example – 1,000 cow dairy

- 1000 cow dairy
 - 22,000 lbs. / cow
 - 22 million lb. production history
- Dairy signs up for free base coverage of \$4.00 per cwt + \$2.00 in additional coverage on 90% of production history.
- Annual premium rate is \$0.155/cwt., \$30,690/year, payable by January 15th of each year.
- 2011 payout, to date (January/February):
 - Base coverage: \$0
 - Supplemental coverage: \$49,288, or \$1.54/cwt.

An Example – 150 cow dairy

- 150 cow dairy
 - 20,000 lbs. / cow
 - 3 million lb. production history
- Dairy signs up for free base coverage of \$4.00 per cwt + \$2.00 in additional coverage on 90% of production history.
- Annual premium rate is \$0.155/cwt., \$4,185/year, payable by January 15th of each year.
- 2011 payout, to date (January/February):
 - Base coverage: \$0
 - Supplemental coverage: \$6,721, or \$1.54/cwt.

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A Calculator For Your Dairy

<http://www.futurefordairy.com>

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Dairy Producer Margin Protection Calculator

Print | Calculator on paper | Download a printable Margin Protection Calculator spreadsheet.

Milk Production Base
Enter your expected annual milk production from the previous year's yield. This is your milk production base.

22,000,000 lbs.
Milk production (lb.)
Please enter in ounces.

Supplemental Coverage
Select the percentage of your base milk production you want to insure - up to 90%.

90%
Please enter in percent.

Select the additional coverage you want to buy - up to \$4.00 in \$0.25 increments.

\$2.00 per cwt.
Please enter in dollars.

Estimated Margin Protection Premium
Based on an actuarial analysis of the level of supplemental coverage sought:

| | |
|------------------------------------|------------|
| Total Annual Premiums per cwt. | \$0.155 |
| Estimated No. cows (based on 2009) | 150 |
| Annual Premiums | \$4,185.00 |
| Outlay | \$4,185.00 |

Print

The Dairy Producer Margin Protection Program
This program has been created by producers for non-commercial use. It is not a hedge program for producer margins, but price, and will cover all production, regardless of use and region. All producers are eligible for base margin protection and also have the option to purchase supplemental protection.

Basic Coverage
A producer may sign up for the base coverage. It guarantees margin protection up to \$4.00 per hundredweight (cwt) for production of milk in the production of all cows. The base coverage is available only to producers who signed contracts in 2009, and is available through 2010.

Supplemental Coverage
A producer may sign up for the base coverage. It guarantees margin protection up to \$4.00 per hundredweight (cwt) for production of milk in the production of all cows. The base coverage is available only to producers who signed contracts in 2009, and is available through 2010.

The Dairy Producer Margin Protection Calculator
This calculator is for producers who have base and supplemental coverage selected on their own dairy operations. It does not include production.

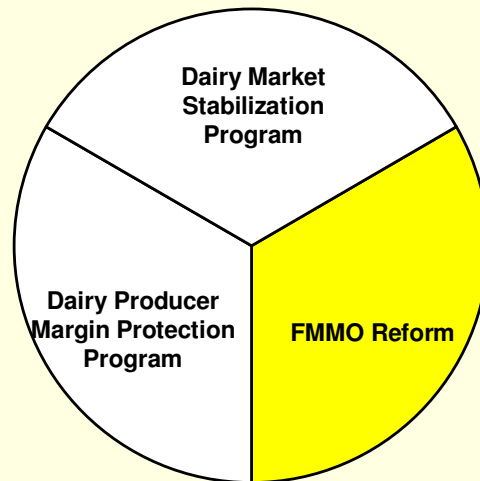
NOTE: Premiums are a fixed percentage of the supplemental coverage sought. The base is \$0.155 per cwt. The base is \$0.155 per cwt. The base is \$0.155 per cwt. The base is \$0.155 per cwt.

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Federal Milk Marketing Order Reform



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Federal Milk Marketing Order Reform

- In March 2011, the NMPF board of directors approved the Federal Milk Marketing Order (FMMO) reform package to be included in FFTF.
- These reforms would directly apply only to FMMO areas. Dairies in areas such as California (state order) or Idaho (unregulated) would not be directly under the new rules.

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Federal Milk Marketing Order Reform

- Replaces end product pricing formulas with a competitive milk pricing system.
- Incorporates two classes of milk – fluid (Class I) and manufacturing (formerly Class II, III, and IV product uses).
- Maintains the “higher-of” for establishing the fluid use (Class I) minimum base price.
- Maintains current Class I differentials.
- Maintains the number and basic structure and provisions of FMMOs.

Federal Milk Marketing Order Reform

- **Class I** (*milk sold to fluid bottlers*) – continues to operate with a minimum price and pooled revenues
- **Former Class II** (*milk sold to make soft manufactured products*) – price determined through direct contract; no minimum price; some pooled revenue
- **Former Class III** (*milk sold to cheese plants*) – price determined through direct contract; no minimum price, no pooled revenue
- **Former Class IV** (*milk sold to butter/powder plants*) – price determined through direct contract, no minimum price, some interaction with pooled revenues

Milk Sold to Cheese Plants (Formerly Class III)

- No minimum price regulations.
- Dairies/cooperatives would contract directly with the cheese plants at a price agreed upon by both parties.
- No pooling of revenues.
- Every cheese plant that processes 250,000 lbs. of raw milk per day (regardless of what style of cheese), would have to report what price they paid for their milk (including base prices, premiums, transportation subsidies, etc.)
- A weighted average of these reported prices will be announced for each region as their “competitive pay price” for milk sold to cheese plants. A national average “competitive pay price” will also be announced.

Milk Sold to Butter/Powder Plants (Formerly Class IV)

- No minimum price regulations.
- Dairies/cooperatives would contract directly with the butter/powder plants at a price agreed upon by both parties.
- Each month, USDA will still calculate what the former Class IV formula would have been (with an energy adjuster added to the formula).
 - When this former Class IV formula is *higher* than the Competitive Pay Price for milk sold to cheese plants in that region, the butter/powder plants would be required to pay the difference into that FMMO pool.
 - However, when this former Class IV formula is *lower* than the Competitive Pay Price for milk sold to cheese plants in that region, the butter/powder plants would be entitled to receive the difference from that FMMO pool (the payment would be limited to only the funds in the pool).

Class II – Milk Sold for Soft Manufactured Products

- No minimum price regulations.
- Dairies/cooperatives would contract directly with the cheese plants at a price agreed upon by both parties.
- These plants would be required to contribute \$0.30 per cwt into that FMMO pool for all the milk they purchase for this use.

Class I – Milk Sold to Fluid Bottlers

- Maintains a minimum price for Class I milk.
- The base value of Class I milk will be determined by the “higher of”:
 - The national weighted average Competitive Pay Price for milk sold to cheese plants*; or
 - The “advanced Class IV price,” as currently calculated.
- In addition, Class I plants will continue to pay an additional price differential based on their location.

** The Competitive Pay Price is adjusted for the change in NASS cheddar prices from the first two weeks in that month compared to the NASS cheddar price for the first two weeks in the previous month.*

Class I – Milk Sold to Fluid Bottlers

- Class I handlers must make two payments: one to the dairies/cooperatives that supply their milk, and one to the producer pool managed by the Market Administrator.
- The payment to Class I suppliers will be based on the lowest regional competitive pay price for milk sold to cheese plants, adjusted just like the formula on the previous slide.
- The rest of the Class I value is paid into their FMMO:
 - The difference between the lowest regional competitive pay price and the Class I mover (using the “higher of” calculation on the previous slide)
 - The location differentials.
 - The Market Administrator will directly pay this out to producers in that FMMO.

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Any Further Questions?

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