Dairy Situation and Outlook

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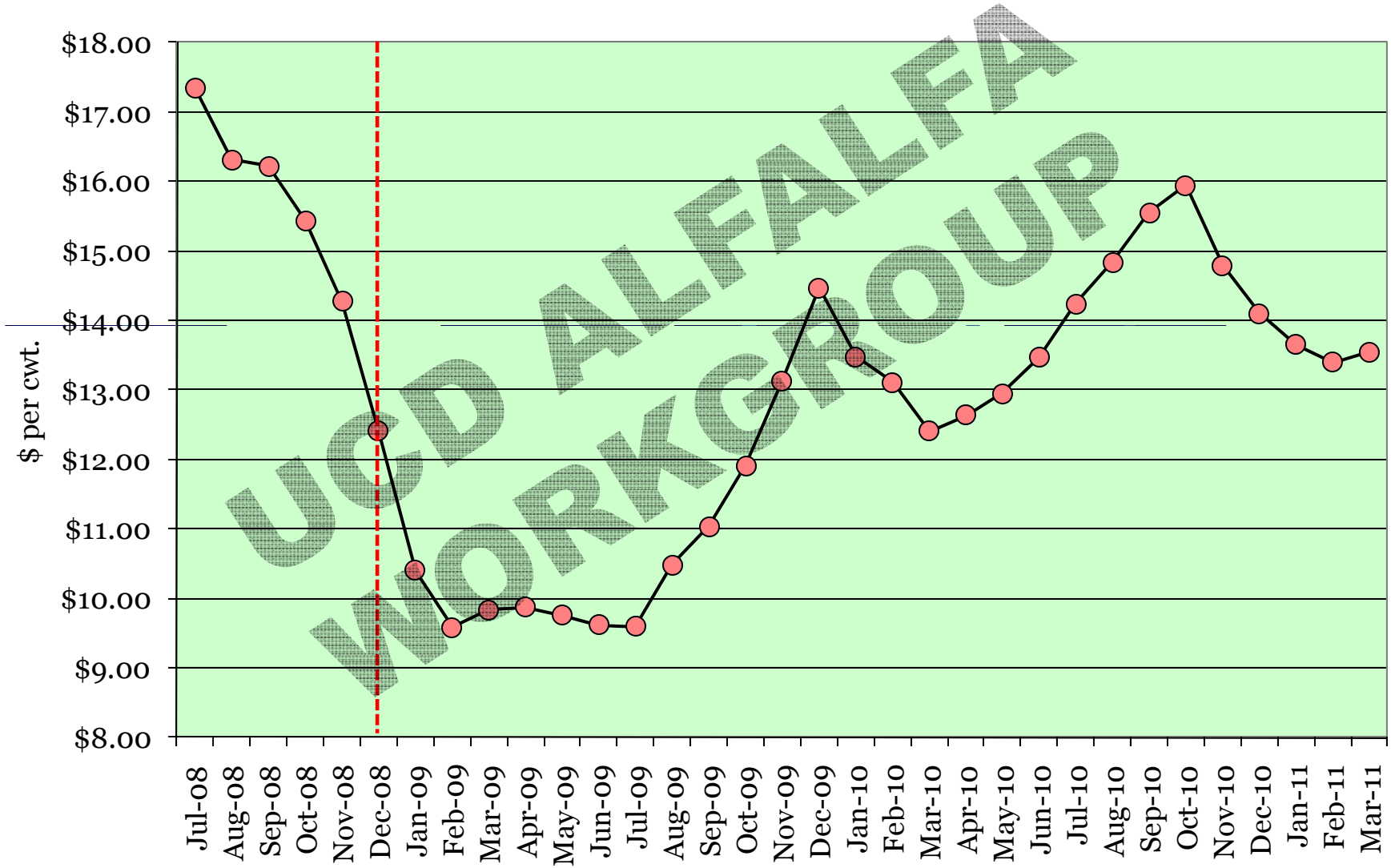
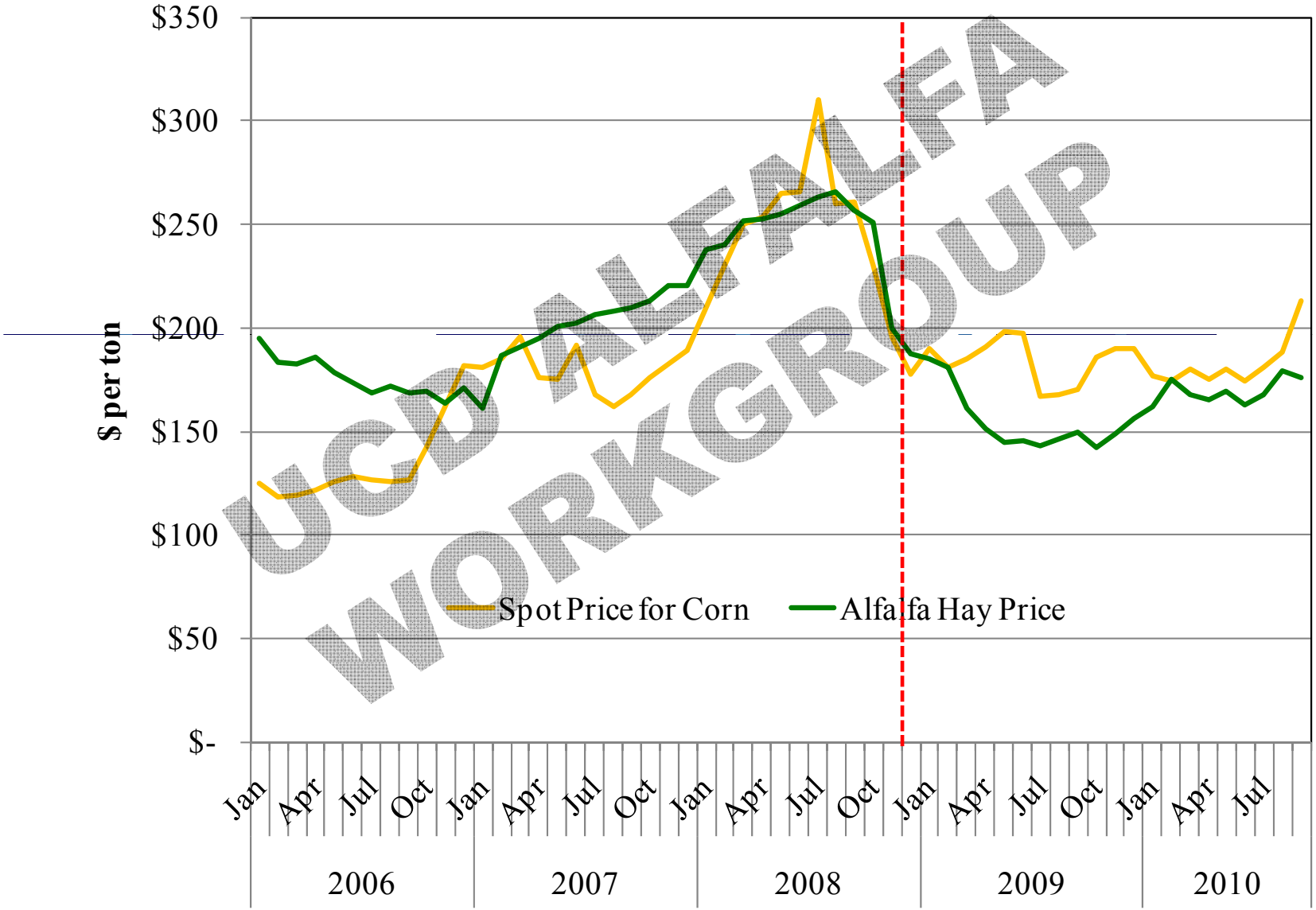
Dairy Situation and Outlook

- Thoughts from 2008 – "Dairy industry at a crossroads"
  - Level of government involvement
  - Modifications of decades-old national policies
  - Dominance of domestic market
- California's Golden Age of Dairying 1970 – 2008
  - Growth rates averaged 3 to 4% annually (US averaged 1.2%)
  - 1993 – Took top-ranking dairy state title from Wisconsin
  - Era Mega-Dairies – lowest cost per cwt in the U.S.
- So what happened after 2008???

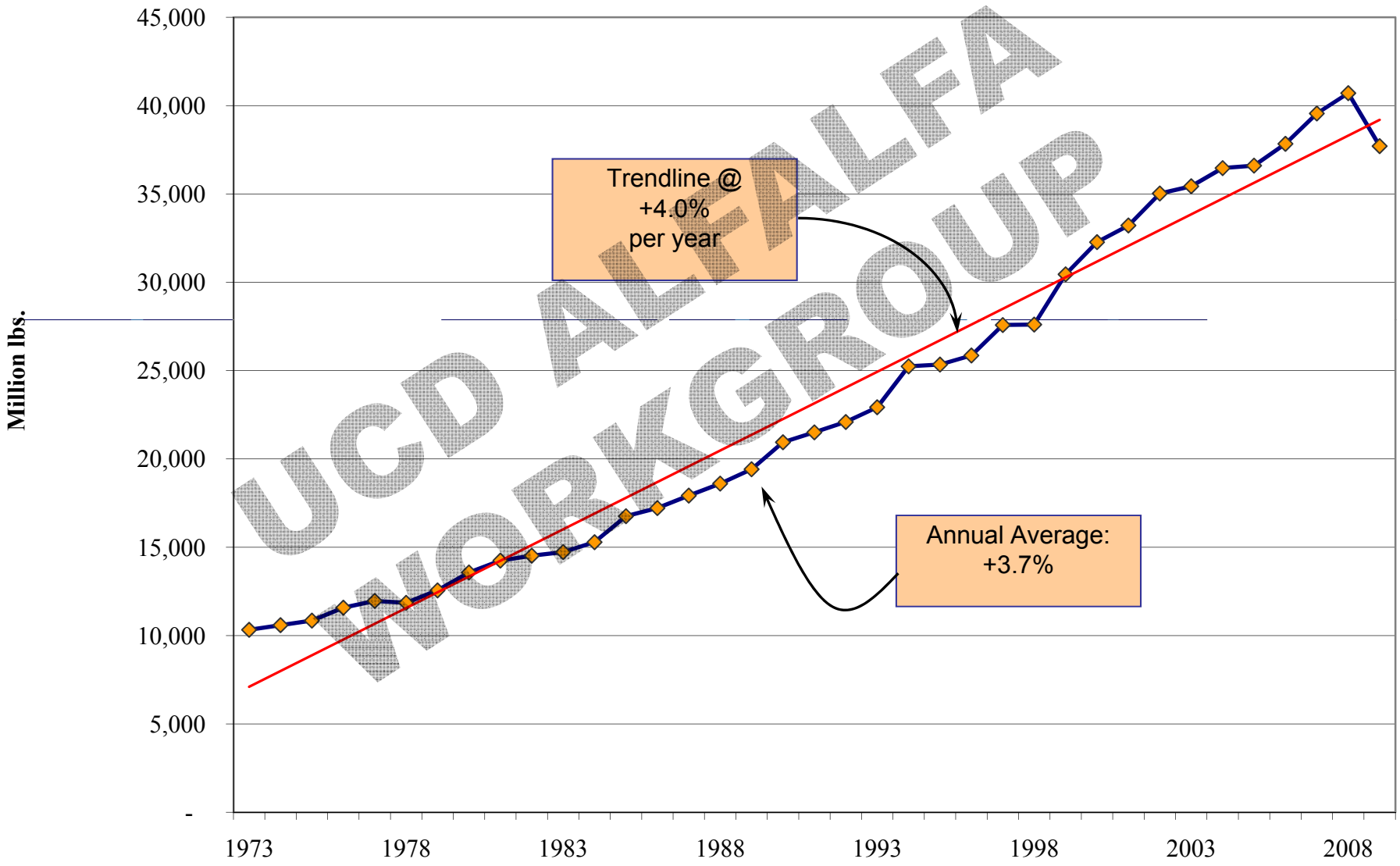
O/B Price, July 2008 to March 2011 (projected)



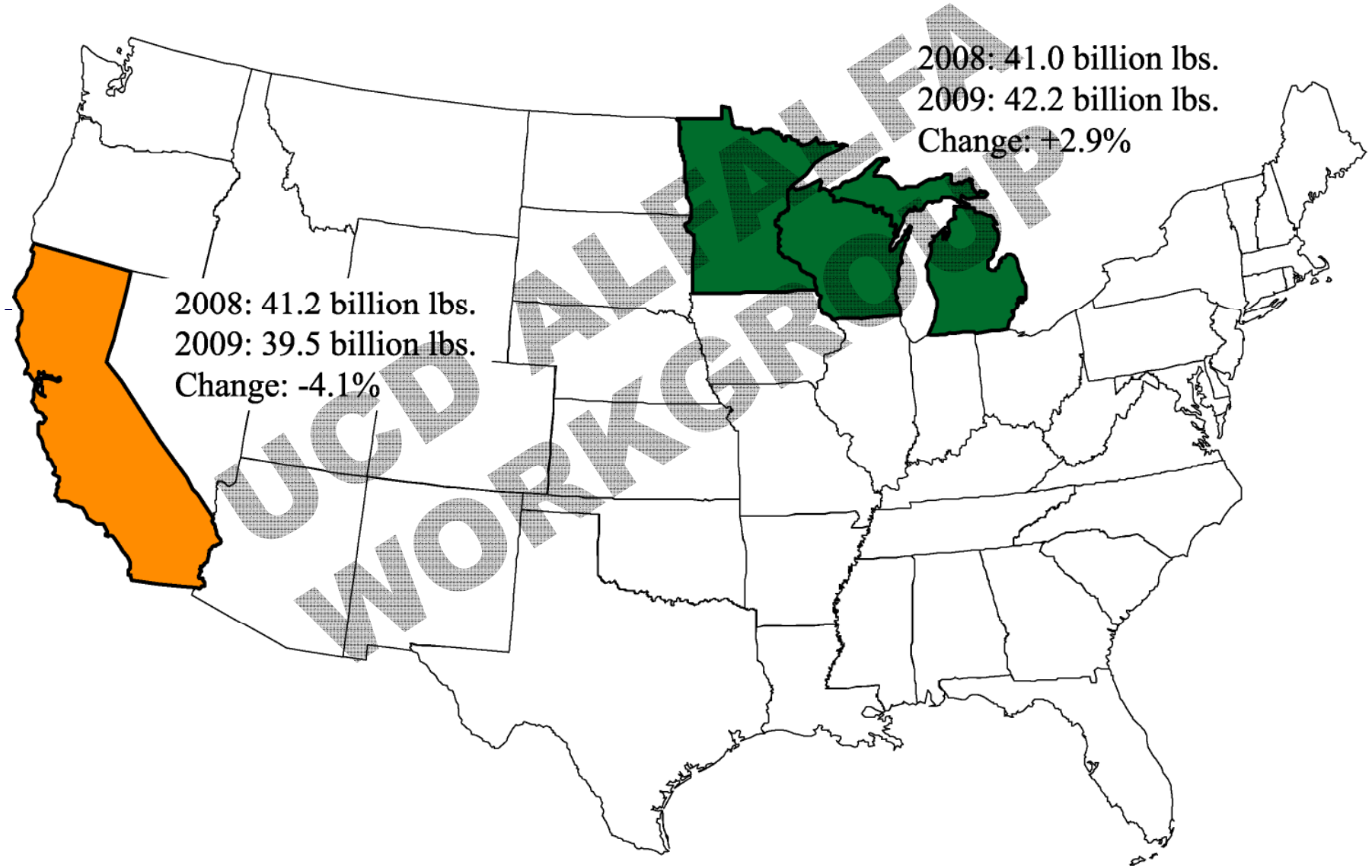
Corn and Alfalfa Hay Prices Paid by California Dairy Producers.



California Milk Production, 1973 to 2010



Milk Production Comparison: CA vs. Upper Midwest



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2008 - 2009 Dairy Financial Crisis

- Sustained negative producer margins due to low milk prices and high feed costs
- Unprecedented loss of producer equity
- Number of dairies declined from >2,000 in 2004 to ~1,600 in 2010
  - Almost 100 California dairy farms exited in 2009 through the CWT (herd retirement program)
- Major disruption in dairy families and dairies that had existed for generations

Has The Sun Set On The Golden State?

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Issues "in the Shadows"

- Processing Plant Capacity
  - Very little change since 2008
  - Not enough capacity to have CA continue at 4% milk production growth per year
- National Supply Management
  - Proliferation of ideas in 2010
  - Only one has been introduced into Congress
  - Not widespread support for government-run supply management
  - California cooperatives and large proprietary plants have maintained their own individual supply management programs

Issues "in the Shadows"

- Exporting Dairy Products
  - If the industry can commit long-term, great upside potential in international markets in the long run
  - What does it take to be a better supplier for international customers?
    - Capability to supply consistent, high quality, spec-ready product in correct volumes with correct documentation
    - Competitive pricing relative to world (not the lowest)
    - Innovation – what can be provided to assist in applications of product

Spotlight: Dairy Farm Profitability

- How will dairy producers survive after 2009?
  - Will take years of good returns to earn back the equity lost
- Growth by dairy producers has been an essential ingredient to profitability
  - Projected annual growth rates of 1% to 2%, not the extraordinary growth rates of the past (3% to 4%)
- If continued growth is not the answer, what will be the key to "survivability"?

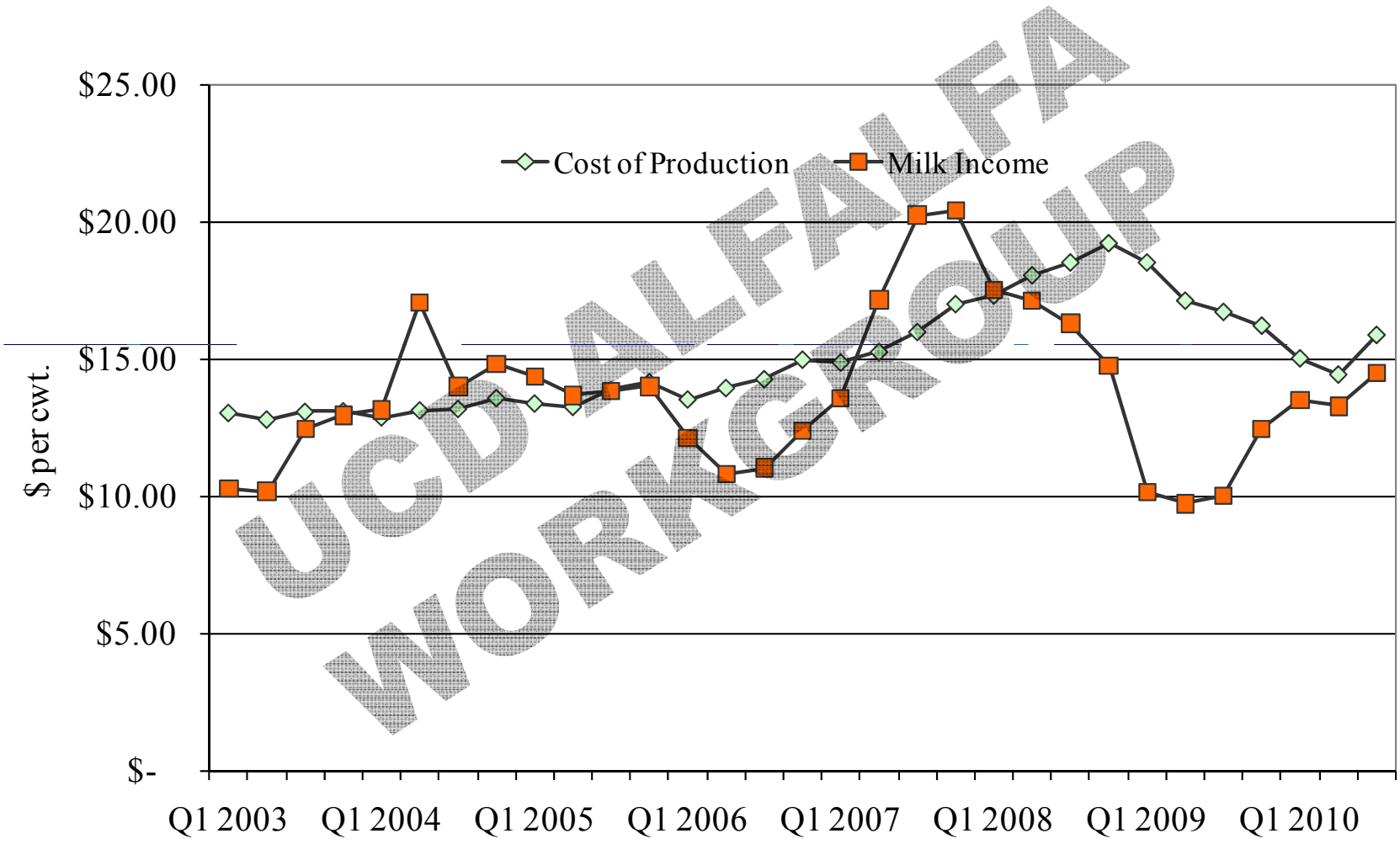
Spotlight: Dairy Farm Profitability

- Commercial banks and farm credit are the major source of operating capital
- The game has changed – banks are demanding the re-establishment of farm equity
- Some banks have announced scaling back or exiting from dairy lending
  - Portfolios were too heavily invested in dairies when the economy collapsed
- Interest expense is a larger line item on financials

Spotlight: Dairy Farm Profitability

- Must adapt to a new way of doing business – no room for mistakes
- Must seek refinancing on different terms than in the past
- Must protect against falling milk prices and rising feed prices with hedging tools
  - Milk futures, options, and swaps
- Must involve lender by education, communication, more frequent contact regarding long term

Cost of Production Relative to Milk Income for California Dairy Farms



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What is the Future of Dairying in California?

- Fewer facilities being operated, more cows and more production per cow (i.e., increased efficiencies)
- New larger dairies will be built at a much slower rate
  - Look for increased number of remodels to existing facilities
- Dairy producers must seek out more education on financing practices and commodity trading
  - Milk price and feed price volatility are not going away
- Dairymen will spend less time with cows and more in the office where critical business decisions must be made

What is the Future of Dairying in California?

- New/expanded plants will be built primarily by cooperatives with emphasis on specialty products
- Plants producing commodity products (butter, powder and cheddar cheese) must develop an operating plan in the absence of a relevant price support program
- Industry must decide whether or not to support National Supply Management

Concluding Remarks

- The California dairy industry has matured, but it is not dying off
- "Dairy industry at a crossroads" has morphed into a question of dairy farm survivability
- Long-term factors that will shape the dairy industry continue to persist
  - Limitations on milk processing capacity
  - National milk supply management
  - Effect of federal policies on feed costs
  - Commitment to dairy product exports
- The "new dairy world" continues to evolve…