

PFB EXHIBIT 1

**Testimony Offered for
Pennsylvania Farm Bureau
Before the Pennsylvania Milk Marketing Board
Regarding the Level and Duration of
the Class I Over Order Premium**

September 7, 2016

**Presented by Michael Evanish
Manager, MSC Business Services
PFB Members' Service Corporation**

Introduction

This testimony is offered at the request of Pennsylvania Farm Bureau, which represents over 61,920 farm and rural family members in 63 counties. Dairy farmers comprise the largest segment of agricultural producers who are members of the Farm Bureau.

I am Michael Evanish. I currently serve as manager of MSC Business Services, a division of PFB Members' Service Corporation (an affiliate company of Pennsylvania Farm Bureau), and have served in this position since 1997. MSC Business Services provides an array of services to assist farmers economically manage their farm operations. The services provided include income tax planning and preparation, business and tax accounting, payroll services and recordkeeping, business analysis and benchmarking, and business consulting.

I am responsible for managing the division's approximately 4,400 contracts and the supervision of its 35 accountants, known as Account Supervisors, and 25 support staff. I have been employed by MSC Business Services since 1976. Until January 1989, I served as an Account Supervisor, working with members in Butler, Beaver and Lawrence Counties. From 1989 through 1997, I served as Director of Training. In this capacity, I was responsible for educating and training all staff, including Account Supervisors who work with MSC's clients.

Other features of my work experience and educational background are contained in Appendix 1.

In my capacity as Manager of MSC Business Services, it is imperative that I have a working knowledge and understanding of existing economic and financial conditions in Pennsylvania's dairy industry and the likely financial impacts these conditions will have on the current and future operation of the dairy farms. To maintain this working knowledge I am in daily contact with Account Supervisors who share the conditions their clients are experiencing, including prices received for their products.

Important services that MSC Business Services provide are business consulting and benchmarking. As part of these services, we provide historical cost of production figures and projections. I personally review and approve all reports produced by MSC Business Services.

To provide our clients with insights into their relative financial health, we prepare comparisons of their operations to all-client averages. One key measurement is how they compare with other MSC dairy clients of similar size and make-up. For the past several years, each dairy farm has received a *Dairy Profitability Comparison* that provides a side-by-side listing of their income and costs with the same from "comparably sized" dairy farms and the "top 10% farms" serviced by MSC. See Appendix 2 for a sample report.

In testimony I offered at last year's over-order premium hearing, I presented to the Board aggregate annual averages of income and costs experienced by our dairy farms for the years 2008 through 2014.

Table 1 is the same table I offered at the Board's hearing last September updated to include 2014 figures. It displays the annual average incomes, costs and net margins per hundredweight of milk sold by MSC-client dairy farms.

There is little doubt that the prices received by Pennsylvania dairy farmers in 2013 and 2014 have helped them recover significantly from the devastating financial effects of 2009 and 2010. But that two-year period of economic gloom was a serious financial setback, and can't be ignored. As shown in Table 1, MSC client dairy farms lost, on average, <\$2.53> for every hundredweight of milk produced in 2009. And losses continued, throughout 2010, averaging <\$0.12> per hundredweight. Such losses, for such a prolonged period of time, have a depressing impact on subsequent business decisions and enthusiasm about the future. Without enthusiasm for the future, owners are far less likely to take on the additional financial risk necessary to modernize their operations. They are also far less likely to promote dairy farming as a career to the next generation, placing the future of dairy farming in Pennsylvania in greater jeopardy.

As I indicated in my testimony last September and as shown in Table 1, MSC client dairy farms experienced, on average, modest profits of \$1.04 per hundredweight in 2011 and \$1.41 in 2013, and essentially broke even in 2012. These modest returns did little more than offset the financial losses incurred by MSC-client farms in 2009 and 2010.

For the six-year period of 2008 through 2013, the net margin realized on MSC-client dairy farms averaged a meager \$0.06 per hundredweight. To put it another way, our dairy farmers had little profit to show for these six years of operation. After a six year period of essentially breaking even, 2014 was certainly a welcome, if short lived, period of relief. The net margin for 2014 was \$3.58 and resulted in a 7 year average of \$0.56 net average margin.

To help demonstrate just how meager profits were during this seven period, even with a profitable 2014, I added the “Yearly Net Margin” dollar amounts for each year. The cumulative total of all seven years was only \$144,421 (the vast majority of which came in 2014) or a seven year average of \$20,632.

Table 2 provides the averages of incomes, expenses and net margins per hundredweight for MSC client dairy farms for the period 2008 through 2015. It essentially is a restatement of Table 1, with an additional column to include the 2015 numbers. The average figures in the last column in Table 2 have been updated from Table 1 to reflect the addition of 2015 information. Again, the

“Yearly Net Margin” dollar amounts have been added to the bottom of each column. The total of all eight years is \$114,100 or an average of \$14,263.

The average 2015’s loss wiped out 23% of 2014’s financial progress.

As many including myself expected, producer prices in 2015 were much lower than 2014’s record setting prices. And, given the degree to which milk prices have fallen in 2015 (29% drop), I expected the average loss to be greater than the \$0.82 per hundredweight net margin loss experienced.

This better than expected performance came because producers responded to the dramatic drop in milk price experienced from 2014 to 2015. They reduced overall costs by \$2.64 per hundredweight. In fact, the 2015 cost of production per hundredweight is down to levels not seen since before 2011.

But the issue at hand is the fact that 2016 average milk price, based on information provided to me by our Account Supervisors, could easily average between \$16.00 and \$17.00 per hundred. Yes, an additional \$1.00 to \$2.00 per hundredweight price reduction. Based on the 2015 cost reductions that were not enough to offset the 2015 milk price drop, how can the average Pennsylvania dairy farmer be reasonably expected to absorb even greater price reductions?

At past hearings, I have testified on the recent trend for dairy farmers to devote a greater portion of their milk income toward purchases of feed and for the production of feed crops. Table 3 shows the percentage of milk income that was utilized, on average, for purchased feed and for crop expenses (seed, fertilizer, chemicals and fuel). Keep in mind that these costs are out-of-pocket costs for MSC-client dairy farms.

My prior testimony highlighted for the Board the increased drain on farmers' income to meet expenses related to feed purchases and production of feed. From 2008 to 2013, that percentage of milk income needed to purchase feed and feed crop production inputs averaged over 44% and was well above the average of 30% that dairy farms had traditionally experienced prior to 2008. Even with 2014's average milk price of \$25.57, the percentage of milk income needed to purchase feed and crop production expenses was over 38%. Again, much higher than the traditional 30% level.

This brings me to 2015. Much has been written about the drop in commodity prices in 2015, and how this drop would help Pennsylvania dairy farmers absorb the milk price reduction. For 2015, purchased feed and crop expenses for MSC client farms averaged \$8.39, a substantial reduction from 2014's \$9.86. But when examined as a percentage of milk income a more startling reality is seen. For 2014, the \$9.86 cost represented 38% of the average milk price, while

the 2015 \$8.39 cost represents 46% of that year's average milk price. A dramatic 8% increase for the average MSC-client dairy farmer.

I have one final observation. While compiling this testimony, I was struck by the number of dairy farms included in our averages that were not profitable in 2015. To be sure there were farms that through outstanding foresight and management were profitable (35%), but the vast majority (65%) were not. And this displays in rather dramatic fashion for the Board the current state of the Pennsylvania dairy producer base. How long is it reasonable to expect this to continue?

Conclusion

2014 was a very positive financial year for Pennsylvania dairy farms, clearly 2015 was not. Prices dropped substantially from 2014 to 2015, and without a major run up in prices this fall, 2016 prices will not even average 2015 levels. As previously stated, reports from Account Supervisors indicate a 2016 milk price reduction that could be as much as \$2.00 per hundredweight. Only time will tell if this becomes the story line for 2016.

Looking to the future, the Board must consider the costs of production trend line and how that will interact with the current price depression. Is 2016 a replay of 2015 or worse? Or will Pennsylvania's dairy farmers experience relief in the second half of the year? No one can be sure. The only sure thing is that the

current price being received for milk does not support current reasonably expected costs of production.

On the basis of the testimony I offer today, I can make no other recommendation but that the over-order premium be increased.

I would like to thank the Pennsylvania Milk Marketing Board (PMMB) for the opportunity to offer testimony today.

Table 3

MSC Business Services

Key Dairy Benchmarks - Purchased Feed and Crop Expense to Milk Price

Year	Purchased Feed & Crop Expense (Per Cwt.)	Avg. Milk Price (Per Cwt)	Percent of Feed & Crop Expense to Milk Price
2008	\$7.98	\$19.84	40%
2009	\$7.02	\$13.91	50%
2010	\$7.69	\$18.05	43%
2011	\$9.50	\$21.87	43%
2012	\$9.45	\$19.77	48%
2013	\$8.94	\$21.40	42%
2014	\$9.86	\$25.57	39%
2015	\$8.39	\$18.14	46%

APPENDIX 1

Michael Evanish, Manager MSC Business Services

Michael Evanish is Manager of MSC Business Services, a division of PFB Members' Service Corporation (an affiliate company of Pennsylvania Farm Bureau). MSC Business Services employs approximately 60 professional and support staff providing services to members consisting of income tax planning and preparation, write-up and computerized records services, payroll preparation, business analysis and benchmarking, and consulting services. All services are provided under contracts numbering in excess of 4,400.

Michael has been with PFB Members' Service Corporation since 1976. He served clients in Butler, Beaver and Lawrence Counties in Western, PA until January 1989 when he became Director of Training. As Director of Training, Michael was team leader for the electronic recordkeeping program currently used by over 700 PA farms, and the rewrite in 1990 & 2006 of the Business Analysis program and meeting the training needs of all staff. In 1997, Michael became Manager of MSC Business Services.

Michael has degrees in accounting and marketing from Clarion University. He is an IRS Enrolled Agent and has passed the CPA exam. For three years he was a member of the IRS Commissioner's Advisory Committee where he chaired the Small Business/Self-Employed Sub-Committee. He also served on the PA Department of Agriculture's Dairy Task Force and was appointed to the Governor's PA Dairy Leadership Council where he co-chairs of the Economic Development, Finance and Infrastructure Sub-Committee. The publication of the annual *Dairy Profitability Comparison* is his responsibility.

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Dairy Profitability Comparison 2015

Specially Prepared For:

Management Study Comparison 2015

	My Farm			Comparable Size Farms			Top 10%		
	Avg # Cows		100.00	Avg # Cows		97.74	Avg # Cows		147.94
	Milk Sold /Cow		23,187	Milk Sold /Cow		20,336	Milk Sold /Cow		22,864
	Dollars	\$/Cow	\$/CWT	Dollars	\$/Cow	\$/CWT	Dollars	\$/Cow	\$/CWT
Revenue									
Milk, Sold	\$424,258	\$4,243	\$18.30	\$369,514	\$3,781	\$18.14	\$621,351	\$4,200	\$18.37
Livestock Income	62,824	628	2.71	46,106	472	2.26	108,513	733	3.21
Crop Income	0	0	0.00	11,910	122	0.58	20,751	140	0.61
Ag Program Payments	43,306	433	1.87	4,742	49	0.23	9,846	67	0.29
Miscellaneous	3,281	33	0.14	1,726	18	0.08	5,290	36	0.16
Patronage Refunds	5,001	50	0.22	2,409	25	0.12	4,790	32	0.14
Other Income	775	8	0.03	10,641	109	0.52	7,077	48	0.21
Total Revenue	\$539,445	\$5,395	\$23.27	\$447,048	\$4,576	\$21.93	\$777,618	\$5,256	\$22.99
Production Costs									
Feed Expenses	\$177,709	\$1,777	\$7.66	\$119,315	\$1,221	\$5.86	\$153,430	\$1,037	\$4.54
Labor Expenses	14,319	143	0.62	27,663	283	1.36	51,986	351	1.54
Rent - Lease of Real Estate	2,250	22	0.10	10,938	112	0.54	33,772	228	1.00
Machine Hire (Custom Work)	17,883	179	0.77	22,321	228	1.10	31,722	214	0.94
Supply Expenses	38,734	387	1.67	22,513	230	1.11	29,799	201	0.88
Repairs (Machinery)	14,626	146	0.63	21,052	215	1.03	26,536	179	0.78
Seeds & Plants	3,473	35	0.15	17,924	183	0.88	18,752	127	0.55
Utilities (Business)	13,579	136	0.59	13,210	135	0.65	15,802	107	0.47
Vet and Medicine	7,528	75	0.32	9,745	100	0.48	14,720	99	0.44
Gasoline, Fuel, Oil (Business)	11,322	113	0.49	12,729	130	0.63	14,047	95	0.42
Chemicals (Sprays or Pestic.)	1,867	19	0.08	8,185	84	0.40	10,728	73	0.32
Repairs (Real Estate)	2,476	25	0.11	4,066	42	0.20	9,715	66	0.29
Fertilizer	7,472	75	0.32	14,110	144	0.69	9,714	66	0.29
Other Production Costs	10,787	108	0.47	18,844	193	0.93	27,271	184	0.81
Total Production Costs	\$324,025	\$3,240	\$13.98	\$322,615	\$3,300	\$15.86	\$447,994	\$3,027	\$13.27
Administrative Costs									
Management Labor	\$56,183	\$562	\$2.42	\$54,370	\$556	\$2.67	\$62,082	\$420	\$1.84
Economic Depreciation	63,750	638	2.75	43,801	448	2.15	53,218	360	1.57
Marketing Expenses	27,118	271	1.17	26,329	269	1.29	38,838	263	1.15
Insurance (Business)	13,599	136	0.59	10,600	108	0.52	17,764	120	0.53
Other Administrative Costs	9,683	97	0.42	11,379	116	0.56	13,621	92	0.40
Total Administrative Costs	\$170,333	\$1,704	\$7.35	\$146,479	\$1,497	\$7.19	\$185,523	\$1,255	\$5.49
Interest Expense	\$27,378	\$274	\$1.18	\$13,119	\$134	\$0.64	\$16,807	\$114	\$0.50
Net Margin	\$17,709	\$177	\$0.76	(\$35,165)	(\$355)	(\$1.76)	\$127,294	\$860	\$3.73

Disclaimer:

Numerous factors, many beyond the scope of the data in this summary, influence individual results. All data reported reflects past performance and does not predict or forecast future results. The data reported is believed to be accurate, but Pennsylvania Farm Bureau, MSC Business Services makes no warranty or representation, expressed or implied, as to its suitability or fitness for any purpose. The user of this data is cautioned to utilize the data at their own risk, recognizing that Pennsylvania Farm Bureau, MSC Business Services disclaim all liability for any damages, however occurring, to any person or entity as a result of such use.

Analytical Study Comparison 2015

	My Farm	Comparable Size Farms	Top 10%
Dairy Productivity Factors			
Total # Milk Shipped (CWTs)	2,318,675	2,036,548	3,382,465
Somatic Cells (1,000s)	200	213	198
Cow Cull Rate	18%	32%	33%
Dairy Animal Inventory Change	\$28,200	(\$997)	\$11,152
Internal Herd Growth	25.00%	1.64%	4.85%
Replacements per Cow	1.01	0.84	0.89
Purchased Feed & Crop Exp / CWT	\$6.72	\$8.23	\$7.02
Net Milk Price / CWT	\$17.13	\$16.85	\$17.00
Total Cost Prod Milk / CWT	\$17.53	\$20.22	\$14.37
Pur Feed / Milk Income	34%	28%	25%
Milk Shipped / Man	2,107,886	946,030	1,136,625
Total Feed Fed / CWT	\$14.06	\$11.08	\$9.43
Milk Inc. over T. Feed / Cow	\$982	1,048	1,647
Return per \$100 Feed Fed	\$149	\$199	\$204
Ratios			
Return on Assets	2.65%	-1.59%	6.32%
Current Ratio	3.16:1	3.14:1	2.98:1
EBITD / Cow	\$1,650	\$884	\$1,884
Percent Net Worth	55%	57%	58%
Operating Expense %	92%	107%	84%
Interest Expense %	5%	3%	2%
Asset Turnover (years)	3.16	3.90	3.14
Total Business Prod / Man	\$458,854	\$219,239	\$292,894
Labor Productivity Ratio	7.16:1	6.08:1	7.97:1
Total Man Equivalents	1.10	2.48	3.36
Dairy Debt per Cow	\$4,648	\$3,761	\$4,082
Cows / Man	91	45	50
Other Cost Analysis			
Total Fixed Costs / CWT	\$8.12	\$9.03	\$8.91
Total Variable Costs / CWT	\$14.38	\$17.04	\$15.90
Direct Crop Expense / Acre	\$57	\$118	\$118
Crop Margin / Acre	\$191	\$45	\$112
Value Forage Harv / For Acre	\$658	\$467	\$540
Value Grain Harv / Grain Acre	\$640	\$419	\$479
Machine Op Cost / Acre	\$214	\$184	\$213
Total Mach Op Cost / Acre	\$408	\$279	\$297

* Comparable Size Farms

The data in the Comparable Size Farms column is designed to average, as closely as possible, farms with roughly the same number of cows milked as your farm. The data is not from all farms in the MSC Business Services database, but is only from those utilizing conventional feeding systems that have been designated as included in this summary by their Account Supervisor.

* Top 10%

The Top 10% Farms were chosen based on Net Margin per cwt within the MSC Business Services database. These farms utilize conventional feeding systems and have been designated as included in this summary by their Account Supervisor.


Dairy's Changing Landscape:

The past year has seen the entire landscape of dairy change. Prices paid for milk have dropped, profitability on even the most efficient farms is questionable, at least one cooperative has instituted a quota system, dairy farmers have lost their markets, and more.

So what happened that caused such a dramatic change?

Below is just a short list of some of what has affected milk prices:

- The EU discontinued quotas and production is up. This resulted in increased exports.
- The US has helped India establish their dairy industry, and India has become self-sufficient. Check off one major export market.
- The dollar is trading at a very high levels impeding exports. Latest figures show that exports are off by 2% - 3%.
- Cheap oil might seem like an odd reason for milk prices to drop. But if you think about it, this oil makes it less expensive to move a bulky product like milk around the nation or the world. This is adding to the downward pressure on milk prices.
- Finally, a relatively new major player – customer preferences – is becoming more important. While the average person has no idea what an artificial growth hormone is, or what a GMO is, or what organic or pasteurization is, they do know that "they are bad."

Even given the above, there are many factors that make the future of dairy farming bright. Population growth and worldwide income growth are projected to be substantial in the coming years. And it is important to note that as incomes rise, so does the intake of high value foods, like milk. But there is also no denying the issues faced today.

The key to your success is doing a detailed evaluation of where your farm stands, and how it compares to other dairy farms. This is the purpose of this publication.

