

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**

August 30, 2017

**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 62,000 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.

The purpose of my testimony today is to give the Board perspective of what MSC-client dairy farmers have experienced, on average, during these past several years. It is important for the Board to consider the financial health and stability commonly experienced by dairy farm operations in Pennsylvania in the Board's determination of the level of over-order premium required to be paid to farmers. I believe my testimony about cost and income generally experienced by MSC-client dairy farms will give you a proper perspective.

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.

Table 1 is an update of the table I offered at the Board’s over-order premium hearing last September (Table 3 of my prepared testimony to that hearing). This table shows the annual average incomes, costs and net margins per hundredweight of milk sold by MSC-client dairy farms for the period of 2009 through 2016. The eight-year time frame reflected in this table includes two periods in which Pennsylvania’s and our nation’s dairy farmers experienced serious drops in milk prices, including that most recently experienced in 2015 and 2016.

Table 1 should clearly show the Board how financially critical prices received by Pennsylvania dairy farmers in 2013 and 2014 were to getting through the periods of low milk prices. These years literally kept many dairy farms in business. MSC clients, on average, have experienced losses in 4 of the past 8 years. And average losses incurred by dairy farmers for 2009 (-\$2.53 per hundredweight) and 2016

(-\$1.68 per hundredweight) were higher – and significantly higher – than average gains in net income received in three of the “profit years” during this period.

During the three-year stretch of 2011 through 2013, MSC dairy farmers received important, but modest, average net returns of \$1.04, \$0.01 and \$1.41 per hundredweight. As I mentioned in my testimony last September, the financial “rebound” that MSC client dairy farms experienced in those years did little more than offset the financial losses incurred by MSC-client farms in 2009 and 2010.

The Board should not only be concerned with the level of loss being experienced by dairy farmers. The Board should also be concerned with the length of time that dairy farmers have operated at a financial loss. Losses for the average MSC-client dairy farm have continued for the 2-year period of 2015 and 2016. While economic indicators for the dairy industry for 2017 are modestly encouraging, they hardly suggest that Pennsylvania dairy farms will receive the level of financial recovery needed to recover from the losses incurred the past two years.

The “Net Margin” and “Yearly Net Margin” figures in Table 1 provide the most telling data of what dairy farming has meant financially for the average Pennsylvania dairy farm operator and the financial “reward” for operating a dairy farm during the past eight years. The “Net Margin” row shows the annual net returns received on average by MSC-client dairy farms per hundredweight of milk

produced. While the “Yearly Net Margin” shows in total dollars the annual net return that MSC-client dairy farms received on average.

The last column of Table 1 (under the heading of “Avg”) provides a broader picture of the “Net” of prices, costs, annual profits and losses that a MSC-client dairy farm operating throughout period of 2009 through 2016 has experienced. The “Net Margin” figure contained in the last column reflects the average of annual profits and losses per hundredweight of milk experienced by MSC-client dairy farms for the eight-year period. The two “Yearly Net Margin” figures contained in the last column show, in dollars, the total Income generated for the period and the average of Net Income.

As Table 1 indicates, the average MSC-client farm that operated a dairy farm throughout the past eight years netted a total of \$38,830 from the operation – an average annual return of \$4,854.

It shouldn’t take an accountant or business analyst to understand what these figures mean. These are dismal financial returns, and have a depressing impact on farmers’ subsequent business decisions and enthusiasm toward investing in their businesses. 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.

At last year's hearing, I stated that I expected average losses for dairy farms in 2016 would be greater than the -\$0.82 per hundredweight experienced in 2015. Table 1 affirms what I expected, as MSC-client dairy farms lost, on average -\$1.68 per hundredweight. Many of us were extremely happy when farmers were receiving record-setting prices and profits in 2014. Nearly 70 percent of those profits received in 2014 have been wiped out from the financial losses experienced in 2015 and 2016.

Dairy farmers in 2016 have continued, to respond as best they can, to the lower milk prices they are receiving. Table 1 shows that MSC-client farms reduced their average costs by an additional \$0.69 per hundredweight. This reduction put 2016's annual cost of MSC-client farms at nearly the same level as 2010. At first glance, this is a remarkable achievement; but I wonder how long it can be sustained.

At past hearings, I have testified on the recent trend for dairy farmers to devote a greater portion of their milk income for purchases of feed and the production of feed crops. Table 2 shows the percentage of milk income that was spent, 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.

Testimony offered at previous hearings highlighted for the Board the increased drain on farmers' income to meet expenses related to feed purchases and production of feed. In years prior to 2008, dairy farms traditionally needed to commit about 30% of their milk income to purchase feed and feed crop production inputs. Since then, the portion of milk income needed to purchase feed and feed crop production inputs has increased significantly. From 2009 through 2013, the portion of milk income committed for feed and for crop production purchases averaged over 44%. For 2015, this increased to 46%, despite a significant drop in feed commodity prices from the previous year and a reduction in average costs per hundredweight for the purchase of feed and feed crop inputs.

As shown in Table 2, MSC-client dairy farms in 2016 experienced another drop in average expense for feed and feed crop inputs per hundredweight of milk produced. 2016's average (\$7.97) was more than 40 cents below 2015's, and was well below the average annual expense per hundredweight incurred in years 2011 through 2014 (\$9.50 in 2011, \$9.45 in 2012, \$8.94 in 2013 and \$9.86 in 2014). Yet these farms needed to dedicate 47 percent of their milk income for feed and feed crop purchases. This is a higher percentage of their milk income than what was committed in five of the seven previous years. The necessity for Pennsylvania's dairy farmers to commit a high percentage of their milk income to purchase feed and inputs for feed crops remains a significant concern, and highlights why there is

a continuing need for efforts by the Board and the milk industry to sustain a high level of milk prices for dairy farmers.

I have one final observation. While compiling this testimony, just like in 2015, I was again struck by the number of dairy farms included in our averages that were not profitable in 2016. To be sure, there were farms that, through outstanding foresight and management, were profitable. But only 19% of the farms in our averages generated a profit in 2016. 81% did not. This is a dramatic drop from 2015's 35% profitable result. This drop 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 trend can continue?

Conclusion

Pennsylvania's dairy farmers continue to be directly and negatively impacted by serious reductions in producer milk prices that have occurred over the past two-plus years. Despite the efforts by dairy farmers to respond to this economic downturn, by managing costs and increasing cost efficiency, Pennsylvania's dairy farms continue to face imminent and real financial challenges.

My testimony should convince the Board that continuation of the base level of Class I over-order premium at \$1.60 per hundredweight is warranted. It is my recommendation that the Board adopt an Order to continue this premium at \$1.60 for the upcoming six months.

I would like to thank the Board for the opportunity to offer testimony today.

TABLE 2

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
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%
2016	\$7.97	\$16.97	47%

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 2016

Specially Prepared For:

Management Study Comparison 2016

	My Farm			Comparable Size Farms			Top 10%		
	Avg # Cows	175.00		Avg # Cows	168.87		Avg # Cows	187.09	
	Milk Sold /Cow	25,452		Milk Sold /Cow	22,720		Milk Sold /Cow	24,090	
	Dollars	\$/Cow	\$/CWT	Dollars	\$/Cow	\$/CWT	Dollars	\$/Cow	\$/CWT
Revenue									
Milk, Sold	\$777,895	\$4,445	\$17.46	\$654,331	\$3,875	\$17.05	\$781,907	\$4,179	\$17.35
Livestock Income	56,931	325	1.28	61,068	362	1.59	86,694	463	1.92
Crop Income	13,668	78	0.31	17,472	103	0.46	25,833	138	0.57
Crop Insurance	0	0	0.00	7,865	47	0.20	10,993	59	0.24
Patronage Refunds	21,990	126	0.49	8,343	49	0.22	8,775	47	0.19
Ag Program Payments	2,099	12	0.05	7,816	46	0.20	8,668	46	0.19
Other Income	3,485	20	0.08	13,056	77	0.34	15,391	82	0.34
Total Revenue	\$876,068	\$5,006	\$19.67	\$769,951	\$4,559	\$20.06	\$938,261	\$5,014	\$20.80
Production Costs									
Feed Expenses	\$288,763	\$1,650	\$6.48	\$234,375	\$1,388	\$6.11	\$229,187	\$1,225	\$5.09
Labor Expenses	31,486	180	0.71	64,890	384	1.69	68,058	364	1.51
Rent - Lease of Real Estate	11,397	65	0.26	32,983	195	0.86	40,074	214	0.89
Supply Expenses	47,013	269	1.06	34,620	205	0.90	34,618	185	0.77
Repairs (Machinery)	47,638	272	1.07	29,451	174	0.77	29,788	159	0.66
Machine Hire (Custom Work)	6,956	40	0.16	38,145	226	0.99	27,297	146	0.61
Seeds & Plants	15,687	90	0.35	25,636	152	0.67	26,187	140	0.58
Fertilizer	14,692	84	0.33	19,742	117	0.51	19,728	105	0.44
Utilities (Business)	17,736	101	0.40	18,450	109	0.48	16,183	86	0.36
Vet and Medicine	16,188	93	0.36	17,256	102	0.45	16,127	86	0.36
Chemicals (Sprays or Pestic.)	10,654	61	0.24	13,596	81	0.35	15,359	82	0.34
Gasoline, Fuel, Oil (Business)	11,500	66	0.26	16,286	96	0.42	14,755	79	0.33
Breeding Fees	10,479	60	0.24	9,292	55	0.24	11,847	63	0.26
Other Production Costs	14,630	84	0.33	37,200	220	0.97	39,558	211	0.88
Total Production Costs	\$544,819	\$3,115	\$12.25	\$591,922	\$3,504	\$15.41	\$588,766	\$3,145	\$13.08
Administrative Costs									
Management Labor	\$46,282	\$264	\$1.04	\$73,930	\$438	\$1.93	\$79,683	\$426	\$1.77
Economic Depreciation	116,000	663	2.60	64,330	381	1.68	63,155	338	1.40
Marketing Expenses	52,677	301	1.18	48,375	286	1.26	56,371	301	1.25
Insurance (Business)	6,416	37	0.14	16,819	100	0.44	14,655	78	0.33
Other Administrative Costs	18,428	105	0.41	17,787	105	0.46	14,347	77	0.32
Total Administrative Costs	\$239,803	\$1,370	\$5.37	\$221,241	\$1,310	\$5.77	\$228,211	\$1,220	\$5.07
Interest Expense	\$39,579	\$226	\$0.89	\$18,611	\$110	\$0.49	\$20,517	\$110	\$0.46
Net Margin	\$51,867	\$295	\$1.16	(\$61,823)	(\$365)	(\$1.61)	\$100,767	\$539	\$2.19

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 2016

	My Farm	Comparable Size Farms	Top 10%
Dairy Productivity Factors			
Total # Milk Shipped (CWTs)	4,454,165	3,836,694	4,507,006
Somatic Cells (1,000s)	131	223	284
Cow Cull Rate	40%	32%	32%
Dairy Animal Inventory Change	(\$17,300)	\$4,234	\$26,690
Internal Herd Growth	-1.67%	1.12%	4.23%
Replacements per Cow	0.70	0.88	0.93
Purchased Feed & Crop Exp / CWT	\$7.60	\$7.76	\$6.66
Net Milk Price / CWT	\$16.28	\$15.95	\$15.81
Total Cost Prod Milk / CWT	\$16.30	\$19.05	\$14.95
Pur Feed / Milk Income	38%	27%	25%
Milk Shipped / Man	1,781,666	1,253,651	1,263,532
Total Feed Fed / CWT	\$9.01	\$9.29	\$8.31
Milk Inc. over T. Feed / Cow	\$2,153	1,197	1,506
Return per \$100 Feed Fed	\$208	\$188	\$221
Ratios			
Return on Assets	3.20%	-2.12%	5.55%
Current Ratio	0.91:1	4.43:1	2.58:1
EBITD / Cow	\$1,450	\$642	\$1,464
Percent Net Worth	52%	57%	52%
Operating Expense %	90%	106%	89%
Interest Expense %	5%	2%	2%
Asset Turnover (years)	3.26	2.96	2.88
Total Business Prod / Man	\$353,883	\$257,069	\$272,145
Labor Productivity Ratio	11.38:1	6.12:1	6.84:1
Total Man Equivalents	2.50	3.71	3.57
Dairy Debt per Cow	\$4,623	\$3,113	\$3,340
Cows / Man	70	56	54
Other Cost Analysis			
Total Fixed Costs / CWT	\$6.57	\$7.31	\$6.88
Total Variable Costs / CWT	\$11.94	\$15.86	\$12.81
Direct Crop Expense / Acre	\$104	\$123	\$107
Crop Margin / Acre	(\$107)	\$56	\$87
Value Forage Harv / For Acre	\$368	\$448	\$419
Value Grain Harv / Grain Acre	\$294	\$349	\$326
Machine Op Cost / Acre	\$175	\$163	\$137
Total Mach Op Cost / Acre	\$314	\$252	\$215

* Comparable Size Farms

* Top 10%

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.

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.

Great Advice

There is advice that should be taken advantage of in good times, while some advice is only applicable in bad times. But every so often we all run across advice that is good all the time. And that is what I heard this week.

While at a speaking engagement and listening to the presenter on the agenda before me, something pretty profound was presented. The speaker was Dr. David Kohl, Professor Emeritus from Virginia Tech and a nationally recognized farm economist. He was speaking to the group of bankers about on-farm management practices. Ideas every farm manager should always keep in mind.

The advice was simple and to the point:

In Good Times:	Manage Conservatively
In Bad Times:	Manage Courageously
All the Time:	Manage Cautiously

Now what did he mean by these?

In good times (think 2014) it is easy to have all past due accounts cleaned up and look to improve the operation. For those who do not follow a conservative managerial mindset, it is easy to start believing the good times will last forever and “multiply the effectiveness” of any cash outlays by incurring debt. The belief is that the good cash flow will last a long time, so payments are not an issue.

In bad times (think 2015 or 2016) it is easy to lose heart, and make destructive managerial decisions. I have heard of dairy farmers who stopped feeding soybean meal, for example. This decision resulted in greater financial losses, due to reduced production, than the milk price drop would have generated. In this case, management of the operation was forgotten in favor of financial panic.

The bottom line is that at all times, (good, bad or whenever) the natural business cycle from good to bad and back again must be remembered and every management decision must contain an element of caution, where best management practices are not forgotten.

Think about it.