

Milk Producers Council

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MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks +\$.0675 \$1.7175

Barrels +\$.0575 \$1.6950

CHICAGO AA BUTTER

Weekly Change N.C \$1.6350

Weekly Average -\$0.0130 \$1.6350

NON-FAT DRY MILK

Week Ending 11/07 & 11/08

Calif. Plants \$.8411 21,995,165

NASS Plants \$.8565 30,837,689

Weekly Average

Blocks +\$.0905 \$1.7080

Barrels +\$.0315 \$1.6780

DRY WHEY

NASS w/e 11/08/08 \$1.863 WEST MSTLY AVG w/e 11/13/08 \$1.1650

CHEESE MARKET COMMENTS: The steadiness shown on the CME last week turned into a solid performance this week as prices for both blocks and barrels rose to the \$1.70 per lb area. There was nothing in the news to spark this upward move – just more of the same price cycling that has characterized cheese prices for the past 18 months. It could be that buyer sentiment switched to a “buy now” mode once prices fell to levels not seen since April 2007. The future for sales still does not look good. It’s the economy, people – but maybe, just maybe, milk production increases will continue to ease a bit more, and then even dip to last year’s level if CWT doesn’t go cheap on its current herd retirement program.

BUTTER MARKET COMMENTS: The word describing the butter market this week is “steady”. Prices were unchanged on the CME the entire week, with few sales. Domestic sales are reported to be about where they were last year, but the experts (or, at least, the informed) see much lower prices just a few months from now (referring to the futures market). Those traders read the tea leaves and sense the changes that are just over the horizon, and they are mostly right, but not always. Last week, **the negative news** about butter was that production in September was 7.4% higher than a year earlier. This week, **the bad news** was that September exports of butter and anhydrous milkfat were sharply lower than in August, **and were lower than last September**. **The mixed news** is that butterfat products in cold storage at the end of September was less than last September, but about equal to September 2006. **On the positive side**, CWT continues to approve below-market sales of butterfat products for export, which should help to clear products out of cold storage.

NONFAT POWDER COMMENTS: The national average price for current sales of nfdm and the California plant average are each closing in on the support price level of \$.80 per lb. *Dairy Market News* reports the obvious: buyers are not willing to pay much more than what manufacturers (that’s California manufacturers, by the way) have been charging the Commodity Credit Corporation. All the sales at support price levels so far appear to have been made by California plants. Know why Dairy America does that? Supposedly, because they can. The costly burden on California producers continues. **Production of nfdm in September was 4.0% lower than last September, while production of skim milk powder was 161% higher.**

WHEY MARKET COMMENTS: The average of the “mostly” price range this week for the western region was a half-cent per lb lower than recent weeks. Prices are reported by DMN to be generally weak. Prices for whey protein concentrate are reported to be somewhat firmer than they have been. DMN also hears that some plants may be cutting back of production on wpc in favor of producing dry whey. Won’t that do nice things to prices for dry whey; more product being sold into a very un-accepting market? DMN also calculated the relative prices per lb of protein for the 4 major competing dairy products containing high quality protein; dry whey prices are now at the bottom of the list, slightly higher than wpc.

FRED DOUMA'S PRICE PROJECTIONS...

Nov 14 Est:	Quota cwt. \$16.05	Overbase cwt. \$14.35	Cls. 4a cwt. \$12.21	Cls. 4b cwt. \$14.99
Last week:	Quota cwt. \$15.89	Overbase cwt. \$14.19	Cls. 4a cwt. \$12.32	Cls. 4b cwt. \$14.64

BRIEF SUMMARY OF SEPTEMBER'S DAIRY PRODUCT EXPORTS: (By J. Kaczor) USDA's Foreign Agricultural Service reported September's exports yesterday. It's not great news. On the good side, exports of nonfat dry milk and skim milk powder increased a bit over last September's levels, but the average price was about \$.30 per higher than the prices reported for current sales and by California plants for all sales. The reason given for that difference is that skim milk powder that was shipped in September was pre-sold about a year ago at a price close \$2.00 per lb, even though smp is virtually identical to nfdm. It would seem that it's either a matter of smart sellers, dumb buyers, or not what really happened in the first place. On the bad side, exports of butterfat products (butter and anhydrous milkfat) fell below last September's level. Butterfat product exports had been averaging about 21 million lbs per month for the previous 6 months, but fell to about 15 million lbs, and appears to be trending lower. Also in the negative column, exports of dry whey continued to be weak; lower by about 11 million lbs, with an average price about \$.16 per lb above the price for current sales in the U.S. for the month. We are still seeking an explanation from the Agricultural Marketing Service for the upside-down prices for nfdm and dry whey (exports vs. domestic sales). Cheese exports in September were higher by 6 million lbs, but continue to have insignificant effect on market prices.

Last week, MPC President Sybrand Vander Dussen published part one of a two-part article looking at the California dairy industry and explaining how many of our problems as an industry can be tied to our chronic over-production of milk. If you missed last week's segment, you can find it on our website at: <http://www.milkproducerscouncil.org/updates/110708.pdf>.

MORE THOUGHTS ON OVER-PRODUCTION OF MILK: (By Sybrand Vander Dussen) Last week, I wrote that the dairy industry in California continues with its "addiction" to over-produce milk, explained why I thought that was so, pointed out the problems it causes, and made a case for all of us **to expect more of the same unless something is done**. This week, I'll show examples of some successful programs, and suggest some steps that could start us towards a solution.

A few comments about powder plants. We need them. We need them to balance our production to meet daily, weekly, and seasonal demands of our customers. A problem arises, though, when investments in multi-hundred million dollar plants are made. The coops making those investments want to keep them running full tilt, of course, to return profits or "dividends" to their members. So indirectly, those investments encourage even more production. In a more perfect world, coops would not build those super-sized plants, and would run the ones they have only when a true profit can be made, or when there is a need to clear the market of the normal short-term and seasonal surpluses, and leave them idle otherwise.

That's essentially what United Dairymen of Arizona is doing. They have a base program which pays about a dollar more than overbase milk, and when supply exceeds what UDA can process, a "history base" is put into effect which limits the amount of milk a producer may deliver. By controlling the milk flow to the market with that plan, that plant, when it is idle, may be UDA's biggest contributor to the net profits they have. I can hear the howls of derision and condescending laughter at the possibility of something like that happening in California. But think about it – coops have hundreds of millions of our retain dollars **interest free**, they are given ample make allowances for processed products, they charge their customers for **every** service given – they even dip into our money bucket when fuel costs go up. You'd think that keeping a powder plant for back-up purposes is a no-brainer.

So why isn't it? To use a metaphor, a glove will shape itself exactly to the hand that goes into it. That is to say, coop management will do exactly as their boards direct. The boards are made up of dairymen who largely share

the “*produce more milk!*” *entitlement mentality*, maybe because that’s all we’ve known since our pooling/quota program began 40 years ago. (Those of you who were around back then will remember the projections that were made to help “sell” the pooling legislation: **all existing producers would be equalized, meaning all the milk they were producing during the period just prior to pooling, plus normal growth, would receive the quota price within about 14 years**, and everyone would live happily ever after.)

Land-O-Lakes and Dairy Farmers of America are nationwide coops. Their corporate planning and board decisions will of course show that influence. A “California solution” will not likely be at the top of their agendas and any positions they take affecting California will be watered down accordingly. California Dairies, Inc. is different. CDI controls 50% of the milk in California. CDI has only California producers as members. By taking a courageous leadership role, CDI could bring L-O-L and DFA to the table. Their combined volume would represent 85% of California’s milk, and the right management of that volume could help resolve some of our problems immediately. The total production of all other milk is 15%! Can the tail wag the dog? It shouldn’t.

In 1922, the Capper-Volstead Act became law which exempted agriculture from anti-trust restrictions. Stated simply, our coops can legally collude, price fix, develop common marketing plans, and make economic decisions that in any other industry would violate anti-trust laws. Are we doing this? Of course not. Why not? Because we have that “*produce more milk*” *entitlement mentality*, and the moment words or statements like “production cuts,” “production discipline,” or “growth management” are spoken in a group setting, **all forward thinking shuts down**. The recently instituted base programs in California do little to cap production, and their main effect was to isolate producers who recently expanded or who were in the process of doing so. The problem of our coops not being in a position to achieve milk prices above the state minimums remains.

Look at what Hilmar Cheese has done. All their producer/members are on a production **contract**. This sets a limit on the amount of milk each member ships to Hilmar. Do Hilmar members expand production? Of course. But in an orderly, as-market-dictates basis, which shields that increase from the vagaries of an over-supplied market. The total volume of all the member contracts is less than what Hilmar’s normal needs are and accomplishes the following:

1. Hilmar’s members focus on managing what they have, rather than expend energies to see into which cubbyhole they can stuff a few more cows.
2. Hilmar buys milk outside their membership group when needed, **in the exact amount it is needed**, which in almost all cases is distressed milk, begging for a home.
3. Those who supply Hilmar with their reserve needs receive the minimum price if purchased from producers, and possibly less than minimums if purchased from other plants. With this program, Hilmar **never** has market-clearing costs. That translates into an extra source of profits for its members.

This results in our production-assaulted coops balancing Hilmar’s needs, at no charge and sometimes at a loss. Does that mean that Hilmar management knows more about what is happening than do our coop boards? Or is Hilmar simply using common sense to take advantage of what is going on in the industry?

In the mid-west, Continental Dairy Products, Inc, a producer coop operating in Ohio, Indiana, and Michigan, has strict production control on their producers. They are seldom, if ever, in a position of having to beg a buyer to take more milk. The result is one to two dollars premium, at all times, just because they do not let overproduction overwhelm their ability to market the milk.

The overarching theme here is that overproduction is the single culprit keeping us from operating an orderly, intelligent industry. State minimum prices are exactly that, minimums. Nothing in policy or law keeps coops from setting a higher price. Only the neutering effect of overproduction. To underscore the point, after the government instituted the national buyout about 25 years ago, prices increased. When financial hemorrhaging

runs its course and targeted culling removes those 50 pound producers, prices increase. When CWT removes enough cows, prices increase. Hilmar doesn't have disposal or balancing costs; Continental garners a premium because overproduction is not an issue; UDA doesn't flood the market. What is it about these facts we don't comprehend?

So often we hear from fellow producers "let the market control production." Well, it has, and look at what has been happening over and over. It's brutal. It bleeds the strong and kills the weak. When prices return to an acceptable level, the survivors, who are now less strong, recover just in time to face that insane cycle again.

If you own a hardware store across town from mine, and you go broke, I gain sales. That's healthy capitalism. But when my neighbor dairyman goes broke, it has no positive affect on me. Why? Because our heavily regulated industry is joined at the hip by virtue of pooling and a myriad of regulations. We swim or sink together!

There is a truism in the industry: all heifer calves born, are raised. All fresh heifers are milked – either in your barn or mine. Large dairies that have been built do not produce milk, cows produce the milk. If those large dairies add a thousand heifers, that's simply a thousand heifers not being milked at your place or mine.

So what's at the core of the California problem? There are 1,800 dairymen in the state, all working at increasing or maintaining production. Collectively, that creates the unwieldy, seemingly unsolvable overproduction problem we have. If each one of those 1,800 would do a little bit of production control, the problem disappears. How do you eat an elephant? One bite at a time. If only a few producers reduce or control production, and not the rest, those people hurt themselves and only temporarily make it better for the others. **We need to do it in concert, and our common point of connection is our coops.**

Last year, MPC sponsored a Cornell University study that showed establishing an incentive to manage production increases by producers would likely solve the bust-to-boom-to-bust problem. The study showed that, if individual self-interest could be activated in the right way at the national level, producers would respond. Our goal was to have this "Growth Management Plan" included in the Farm Bill. MPC hit the road and spoke with many dairy groups, in California and elsewhere. The response from producers was total approval and acceptance of the idea, but the industry "leaders," our coops and trade associations, were not interested. And so the problem remains.

So, what would happen if production discipline for California were to be instituted? A whole, brand new world would be open to us. A complete paradigm shift for our coops would be required, which would probably not be welcome, at least initially. Here are some of the things that probably would need to be done to get it started.

1. The first step would be to have California's three major coops jointly look into ways to establish and manage a production discipline program for their members.
2. The committee should consider if production controls only would be sufficient – or if pricing authority would be needed – in effect, a California Marketing Agency In Common.
3. A review should be made of possible changes needed to be made to California's milk statutes to provide maximum operational flexibility for the "CalMac."
4. A study and plan is needed on how to equitably correct or control the current inter-state milk pricing and usage problems that have caused immense losses to California producers and processors.

Getting three major coops together to share costs, prices, problems, and opportunities certainly will not be easy. **It wasn't easy for the three coops who now make up CDI to arrive at a solution**, but it happened, partly because they each could see real benefits from the result. CDI's leadership at this time in exploring the road to the point where higher milk prices would result in profits, not problems, is an exciting thing to consider. Think

about our coops being able to finally market our milk instead of just finding outlets for it. That's the difference between being price makers instead of price takers.

Few have experience with such a scenario (UDA, Hilmar, and Continental, excepted of course). So, a lot must be learned. The suggested steps and studies listed above are the least that is needed to be done. But I'm convinced that **we do** understand that the core problem is overproduction, and **we should** understand that it won't be corrected unless there is a consensus to do so. I'm also convinced that our coops (that is, the dairymen on their boards) have the authority and the responsibility to lay plans to improve what is now a virtually unacceptable situation. All we need is for them to agree to do it.

Years ago, California producers voted to "tax" themselves about \$.05 cwt on all milk (which has since risen to about \$.20 cwt) to reimburse our manufacturing plants for the costs of transporting their products to the mid-western and eastern parts of the country, to compete head-on with local sellers. With the emigration of California producers and west coast style of dairying to states lying to the east of us, plants in those areas are in an increasingly stronger position to supply those markets than we are.

Our future growth market lies to the west – the Pacific Rim countries. We need to develop those markets, because we are closer geographically and have the shipping ports and certainly the milk supply. The growth of the dairy industry to the east has increasingly compromised us on the west coast, and it will take a concerted effort to develop these "new" markets. This requires cooperation between coops, time to develop products wanted by those countries, and production control. **That is one of the fundamental responsibilities of coops – to foresee what is needed to match current and future supply with current and future needs.** Alternatively, we can choose to do nothing, allow the anti-business, anti-agriculture forces in California to continue to push us to obscurity. Or we can unite to "re-invent" our west coast dairy industry.

We don't need Sacramento. We don't need minimum prices. We don't need the support price program. What we do need is for our coops to function in a manner they are supposed to – but that can't be done without effective and acceptable production controls as a starting point.

We need a call to action. Our coops will do what their members want. Every producer who agrees with some or all of the points in this article should – and must – contact their board member representative and tell him or her what should be done. Here's the key problem that stands in the way of progress: **it's when a group or committee is confronted with a new idea, and everybody looks to why it can't, or shouldn't, happen.** Challenge your board to address themselves only to how it can be done. If our coops know that we as producers are more than willing to take that small "bite" of production discipline, nothing should stop them from accomplishing a sane, profitable industry. But that will take guts; it will take a willingness to make mistakes and to learn from them. It will take a concerted, united effort – something which is sadly missing in California – to accomplish this. New brooms sweep cleaner than old ones. If the job isn't being done properly, perhaps it's time for a change. But it can be done, it should be done, and it must be done. Status quo is no longer acceptable.

Your views on my views will be greatly appreciated. We would like to hear from you. Please address your comments to mpc@milkproducers.org, and reference this article. Or give MPC a call at (909) 628-6018.

ATTENTION SOUTHERN CALIFORNIA DAIRIES – SALEM LIVESTOCK AUCTION NEXT WEEK: (By Rob VandenHeuvel) For those who are interested, Salem Christian Homes is hosting their 2008 Annual Livestock Auction next Thursday, November 20th. The auction begins at 12:30 p.m. at the Euclid Stockyards. For more info, you can see their flyer at <http://www.milkproducerscouncil.org/salemauction.pdf>.

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