DATE: January 27, 2017  
TO: Directors & Members  
FROM: Kevin Abernathy, General Manager

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**MPC FRIDAY MARKET UPDATE**

**CHICAGO CHEDDAR CHEESE**

<table>
<thead>
<tr>
<th>Blocks</th>
<th>$0.0100</th>
<th>$1.6875</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barrels</td>
<td>$0.0875</td>
<td>$1.4475</td>
</tr>
</tbody>
</table>

Weekly Average, Cheddar Cheese

<table>
<thead>
<tr>
<th>Blocks</th>
<th>$0.0513</th>
<th>$1.6525</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barrels</td>
<td>$0.1199</td>
<td>$1.4670</td>
</tr>
</tbody>
</table>

**CHICAGO AA BUTTER**

<table>
<thead>
<tr>
<th>Weekly Change</th>
<th>$0.0300</th>
<th>$2.2200</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weekly Average</td>
<td>$0.0375</td>
<td>$2.2075</td>
</tr>
</tbody>
</table>

**NON-FAT DRY MILK**

Week Ending 1/20 & 1/21

| Calif. Plants | $1.0037 | 7,949,315 |
| Nat'l Plants  | $1.0285 | 18,513,110 |

Prior Week Ending 1/13 & 1/14

| Calif. Plants | $0.9990 | 6,009,744 |
| Nat'l Plants  | $1.0242 | 15,968,314 |

**DRY WHEY**

| Dairy Market News | w/e 01/27/17 | $.4688 |
| National Plants  | w/e 01/21/17 | $.4454 |

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**FRED DOUMA’S PRICE PROJECTIONS…**

Jan 27 Final:  
Quota cwt. $17.34  
Overbase cwt. $15.64  
Cls. 4a cwt. $15.69  
Cls. 4b cwt. $15.99

Last Week:  
Quota cwt. $17.36  
Overbase cwt. $15.66  
Cls. 4a cwt. $15.61  
Cls. 4b cwt. $16.07

**MARKET COMMENTARY: (By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)**

*Milk & Dairy Markets*

In his first week on the job, President Trump has made it clear that he is keeping his campaign promises, the ones you liked and the ones you didn’t. The prospect of fewer regulations, tax reform, and infrastructure spending has cheered the equity markets. The Dow topped 20,000 Wednesday for the first time ever. Meanwhile, Mr. Trump is also picking a fight with Mexico. He signed executive orders strengthening enforcement of immigration policy and directing federal officials to start work on the promised wall along the Mexican border. He got into a Twitter spat with Mexican President Peña-Nieto and cancelled a planned meeting with our largest trading partner. On Thursday, White House Press Secretary Sean Spicer floated the idea that the administration could pay for the border wall by taxing imports from Mexico at 20%. The commodity markets swooned. The Trump team walked back the comments a bit on Friday, saying the border tax was one of a “buffet of options” to pay for the wall, but the tone of the dialogue with Mexico has been set.

NAFTA eliminated tariffs on dairy products moving between the U.S. and Mexico. Renegotiating the massive trade pact will not improve the U.S. dairy industry’s trade prospects and could do considerable damage. Under the prospect of a trade war, nonfat dry milk (NDM) plunged. Several futures contracts tested contract lows this morning but regained a little ground this afternoon. CME spot NDM dropped to two-month lows Thursday and finished today at 94.75¢/lb., down 5.75¢.

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**CME Spot Prices**

- **Butter**
- **Cheddar Blocks**
- **Cheddar Barrels**
- **Nonfat Dry Milk**

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The butter market also took a step back. CME spot butter lost 3¢ and finished at $2.22. At the end of the year, there were 174.9 million pounds of butter in storage, 12.8% more than on December 31, 2015 and the highest end-of-year stocks in more than a decade. Inventories climbed 13.7 million pounds from November, an unexpectedly large build that puts the strong demand story into question. The cream market is sluggish and the futures are under pressure. But the Friday rebound suggests that butter prices may have fallen far enough for now. Class IV futures posted substantial losses this week. Most contracts were 50¢ to 80¢ in the red.

CME spot Cheddar block supplies are adequate, while barrels are plentiful. Blocks slipped a penny this week to $1.6875. Barrels fell 8.75¢ to $1.4475, the lowest price since October. Most Class III contracts lost 20 to 35¢, but losses were more pronounced later in the year. The October contract lost 92¢.

There were 1.21 billion pounds of cheese in storage on December 31, 5.3% more than the year before. Cheese stocks climbed 24 million pounds from November to December, the largest December increase since 2012. Furthermore, November cheese inventories were revised upward. The Cold Storage report was decidedly bearish for both cheese and butter.

Chinese imports of cheese, ultra-high temperature milk, and whey products were record large in 2016. China also revealed a healthy appetite for whole milk powder (WMP) in 2016. China imported 74.4 million pounds of WMP in December, up 98.6% from a year ago. For the year, Chinese WMP imports were up 21.3% compared to 2015 but well short of the unsustainable mountains of product China brought-in in 2013 and 2014. In contrast, Chinese skim milk powder (SMP) imports ebbed. In December they totaled 25.1 million pounds, down 26.8% from a year ago. For the year, Chinese SMP imports were 7.9% shy of 2015 volumes.

Continued growth in demand for dairy from China and elsewhere will necessitate commensurate growth among dairy exporters. For now, our competitors overseas are not growing to meet that demand. In New Zealand, December milk collections totaled 2.69 million metric tons, down 2.7% from a year ago. On a milk solids basis, output was 3.1% short of year-ago levels. This deficit is smaller than those reported at the peak in October and November. For the season-to-date, output is down 3% from the 2015-16 season.
U.S. dairy output more than makes up for New Zealand’s shortfall. U.S. milk production totaled 17.9 billion pounds in December, up 2.2% from December 2015, and in line with gains reported in recent months. California’s dairy producers stepped up production 0.5% from the year before. Growth continued at a modest pace in the Midwest and accelerated in the Southern Plains and mountain states. Production was up 11.7% in Texas, 9.5% in Kansas, 7.3% in Colorado, and 7.1% in New Mexico. The year-over-year gains in Texas and New Mexico were likely boosted a bit by comparisons to depressed output after winter storm Goliath the year before. However, the devastating storm arrived late in the month, and much of its impact on milk production hit in January.

USDA reported the dairy herd at 9.358 million head, a more than 20-year high. The agency revised upward its estimate of the November dairy herd by 8,000 head and reported that dairy producers added 11,000 head in December. Cows in much of the west are cold and muddy, which could stifle national milk output for a time, but given the size of the dairy herd, U.S. milk output is likely to continue to accelerate in the medium-term.

**Grain Markets**

After jumping to six-month highs last week, corn futures retreated. The March contract settled today at $3.625 per bushel, down more than 7ȼ from last week. March soybeans closed at $10.4925, down 18.25ȼ from last Friday.

Argentina’s Agricultural Ministry reports that 1.6 million acres of soybeans and 395,000 hectares of corn were affected by recent flooding. However, they don’t give any indication of how badly the heavy rains have damaged production potential. Even assuming a total loss of all crops on these acres, this would reduce the Argentine soybean crop by about 1.9 million metric tons, and crimp corn production by 1.2 million metric tons. These volumes represent a 3.3% decline in both the corn and soybean crops relative to USDA’s January production estimates.

But a total loss seems unlikely. Drier weather has returned to central Argentina, allowing flood waters to recede and planting to progress. The forecast looks favorable, with sunshine through the end of the month and scattered rains in early February. In southern Argentina, it’s too dry and double-cropped acreage is likely to suffer. Conditions are excellent in most of Brazil, with the exception of Bahia, a relatively low-production state. South American production appears sufficient to meet the impressive, sustained growth in global soybean demand. However, if the weather takes a turn for the worse, the soybean market is likely to surge.

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CDFA RELEASES ANNUAL COST OF PROCESSING STUDY: (By Geoff Vanden Heuvel, MPC Board Member and Economics Consultant.) The California Department of Food and Agriculture (CDFA) released its 2015 manufacturing cost study last week. Back in the old days when milk hearings in California were frequent, the release of a new study would inevitably prompt the processors to petition for a hearing to consider raising the make allowance in the California formulas. Currently, the whole state hearing processes seems to be on hold awaiting the release by USDA of a result of the California Federal Milk Marketing Order hearing, which is expected very soon. However, the studies do have some interesting information that I thought I would pass along. According to CDFA’s survey of California’s manufacturers, the 2015 average cost to make nonfat dry milk and cheese inched up by about a half cent per pound of product over the 2014 study averages. Their survey reports that the butter manufacturing cost was nearly unchanged from 2014.

The current class 4a formula make allowances were set in 2011. The allowance currently used for butter is 16.35 cents per pound. CDFA’s surveyed cost to make butter in the recent study was 18.42 cents per pound. The formula make allowance for nonfat dry milk is 17.63 cents per pound. CDFA’s surveyed cost to make nonfat in the study was 20.78 cents per pound. On the cheese side, the block cheddar cheese make allowance was last changed in 2007 and is 19.88 cents per pound. CDFA’s surveyed cost of manufacturing block cheddar cheese in 2015 was calculated at 23.94 cents per pound. So there are some pretty big gaps between the current formula make allowances and costs reported in CDFA’s study after surveying California’s manufacturers.

By the way, the FMMO make allowance for butter is 17.11 cents per pound, the nonfat dry milk make allowance is 16.78 cents per pound and the cheese make allowance is 20.03 per pound. Pretty similar.

This is not the whole story with regards to whether our current formulas are where they should be. The formulas are based on commodity dairy products (and for cheddar cheese and butter, those sales are for large lots sold at bulk prices on the Chicago Mercantile exchange). Profit opportunities for the plants lay in making and selling dairy products that bring higher sales prices than the basic commodity values that are embedded in the minimum pricing formulas. There are also other parts of the formula that are subject to debate. But clearly processors are interested in making changes to these formulas whenever conditions will allow it.

Two more items of interest. The CDFA cheese study estimated the cheese yield in the study’s participating plants to be 13.31 pounds of cheese for every 100 pounds of milk in the cheese vat. That milk had an average composition of 4.73% butterfat and 9.62% solids nonfat. That is certainly not average Holstein milk. The study also identified the average payroll cost per employee. For butter/powder plants it was $88,096 per employee in the plant. For cheese makers it was $67,855 per employee. That seems like a pretty big difference.

THANK YOU, ROB VANDENHEUVEL FOR YOUR DEDICATION AND SERVICE TO CALIFORNIA DAIRY FAMILIES: (By Kevin Abernathy, MPC General Manager) Milk Producers Council announced last week that the stellar leadership and tenure of Rob Vandenheuvel will come to end as he transitions to a new role with California Dairies, Inc.

As has long been the case, the MPC board is focused on the future and the best interests of California dairy families. With that in mind, they asked Rob and I to develop a vision for what MPC will achieve on behalf of producers going forward. It’s exciting – and humbling – to think about the future and how we can continue to make progress on your behalf.

Personally, it has been a pleasure over the past five years to work with Rob and an amazing board of directors. We've always felt that we are just the spokespersons for a dynamic board, working on it, and the membership’s, behalf.

At a time when one could be sad, I'm elated. The broader dairy industry is gaining Rob’s tremendous talents and
qualities, which we at MPC know quite well. He is certainly one of the dairy community’s next generation of leaders.

In referring to Rob and I, our former chairman coined the term “the dynamic duo” since we worked well together to solve issues on behalf of our members and the industry. As I reflect, any success we achieved was the result of the tremendous leadership provided by the MPC board because they kept their eye on the cutting-edge issues that mattered most to producers.

It’s been with humble appreciation watching Rob take the reins of MPC to develop working relationships and respect from his peers, which is not often seen in our line of work. He demonstrated an uncanny ability to bring differing opinions into the room to develop productive results that benefitted all California dairy families on relevant pricing and policy issues. Rob’s ability to explain the complexity of milk pricing in layman’s terms (thankfully the apple didn’t fall too far from the tree) is something I and others value.

Most people don’t like change, but in this case the change will benefit the industry we love and the families we admire and respect so much. I look forward to our continued friendship and working relationship as a new era of California dairy leadership begins. Good luck and best wishes, my friend!

Under the direction of the MPC board, it is my personal commitment to continue to bring value and leadership on issues that affect you, our producers. MPC is only here because of your support and we gladly work at your behest.

Never hesitate to contact me or any of the staff with issues or suggestions on how to make your organization better serve you.

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