DATE: March 31, 2017
TO: Directors & Members
FROM: Kevin Abernathy, General Manager

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MPC Friday Market Update

<table>
<thead>
<tr>
<th>CHICAGO CHEDDAR CHEESE</th>
<th>CHICAGO AA BUTTER</th>
<th>NON-FAT DRY MILK</th>
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<tr>
<td>Blocks + $.0800 $1.5200</td>
<td>Weekly Change + $.0100 $2.1075</td>
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<tr>
<td>Barrels + $.0800 $1.4700</td>
<td>Weekly Average - $.0120 $2.1015</td>
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<td>Weekly Average, Cheddar Cheese</td>
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<td>Blocks + $.0405 $1.4730</td>
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<td>Barrels + $.0140 $1.4060</td>
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DRY WHEY

| Dairy Market News w/e 03/31/17 $0.5000 |
| National Plants w/e 03/25/17 $0.5312 |

Fred Douma’s Price Projections…

March 31 Est: Quota cwt. $15.79 Overbase cwt. $14.09 Cls. 4a cwt. $13.64 Cls. 4b cwt. $14.50
Mar ’17 Final: Quota cwt. $15.90 Overbase cwt. $14.20 Cls. 4a cwt. $14.02 Cls. 4b cwt. $13.76

Market Commentary

By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com

Milk & Dairy Markets

Two weeks ago, the spot Cheddar market plunged to 10-month lows at $1.36/lb. That was far enough, apparently. Since then, CME spot Cheddar blocks have rallied 16ȼ to $1.52, including an 8ȼ climb since last Friday. Barrels matched them step-for-step, rising 8ȼ this week to $1.47. Cheap cheese reportedly helped entice buyers back to the market, and end users became less anxious to sell and more willing to put product into storage. Still, concerns linger as cheese demand is still well short of output.

Both the cheese and whey markets strengthened this week, boosting Class III futures. Most Class III contracts settled 20ȼ to 35ȼ higher than last week. The May contract gained 49ȼ

In contrast, the Class IV markets were quiet. Class IV futures settled steady to as much as 14ȼ lower. CME spot butter mostly sat idle, but it livened up a bit on Friday, finishing at $2.1075, a penny higher than last week. Dairy Market News reports, “The United States is heavy with cream supplies clearing to butter manufacturers who are busy churning.” It seems likely that butter inventories will expand by larger than typical volumes in March, just as they did in February.

CME spot nonfat dry milk (NDM) slipped 1ȼ this week, falling to 81ȼ. U.S. milk powder is competitively priced and the dollar dropped to four-month lows on Monday. This is helping to attract some demand from end users both at home and abroad. But competition will remain stiff. New Zealand reported February milk collections at

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1.9 million liters. That is up 0.6% from a year ago after adjusting for Leap Day, and milk solids output was up 3.3%. This brings season-to-date production down just 2.3% from a year ago in fluid terms, with milk solids output down 2.1%. Volumes have been much larger than expected just a few months ago, and New Zealand is stepping up the size of its milk powder offerings for next week’s Global Dairy Trade auction.

Chinese demand for milk powder improved in February relative to last year. The import giant brought in 119 million pounds of whole milk powder (WMP) and 44.7 million pounds of skim milk powder (SMP) last month. Combined milk powder imports were up 45% from a year ago, putting January and February imports up 5%.

“Following January’s slightly slower start compared to a year earlier, these trading volumes are likely reassuring to a market burdened with abundant milk powder,” according to the Daily Dairy Report.

Chinese imports of cheese, whey products, and ultra-high temperature (UHT) fresh milk were noticeably greater than year-ago levels in February. China imported 21 million pounds of cheese, up 41.3% from last February. China brought in 89.2 million pounds of whey products in February, nearly 70% more than a year ago. The United States accounted for 52.3% of China’s whey imports in February, a slightly lower share than in the preceding months. China imported 67 million pounds of UHT milk in February, some 42% more than last year. Still, the country’s UHT milk imports for the first two months of the year were down 4.9% from a year ago, and January and February shipments were decidedly lower than the impressive import volumes posted from March to December 2016.

Dairy cow slaughter volumes declined in the week ending March 18, totaling 54,944 head, down 5.2% from the same week a year ago. This brings year-to-date slaughter down 0.8% compared to the 2016 pace.

**Grain Markets**

Today USDA published Prospective Plantings, one of its most anticipated reports of the year. After surveying farmers during the first two weeks of March, the agency called for an even greater shift to soybean acres than the trade had anticipated. Farmers intend to plant 89.5 million acres to the
oilseed, up 6.1 million acres from last year’s already record-breaking area. Cotton seedings are expected to climb to 12.2 million acres, a five-year high.

Cheap and abundant grains are clearly losing ground to other crops. With lower projected returns, corn acreage is expected to decline 4 million acres to just shy of 90 million acres. USDA expects winter wheat area to decline to the second lowest figure on record, and spring wheat plantings will likely be the lowest since 1972. With that, both corn and wheat futures finished in the green today. May corn settled at $3.6425, up 9¢ this week.

Despite the expected decline in acreage – which is, of course, subject to the weather in coming months – grain prices are likely to remain under pressure. In its quarterly Grain Stocks report, USDA showed larger than expected inventories of corn, wheat, and soybeans. Meanwhile, estimates of the South American harvest for both corn and soybeans continue to grow. With large inventories, record-breaking acreage, and a colossal crop in South America, the soybean market suffered further losses. Although the acreage figure grabbed the headlines, the stockpiles weighed heaviest, as evidenced by the steeper losses on the front of the board. May soybean futures finished at $9.46, down nearly 30¢ this week.

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The Journey to a California FMMO. Are We There Yet?
By Geoff Vanden Heuvel, MPC Board Member and Economic Consultant.

The short answer is no, but we are making progress. On February 14, USDA published a proposed California Federal Milk Marketing Order (CA FMMO). Since that time, great effort has gone into understanding its mechanics and the potential implications of the proposed order.

Does this proposal protect quota? This is the first threshold question that has to be answered.

The USDA proposed order does allow for quota, but it stipulates that it is the California Department of Food and Agriculture’s (CDFA) responsibility to administer and enforce the quota program in the state. MPC, along with California Dairy Campaign and Western United Dairymen, as well as the cooperatives, California Dairies, Inc., Dairy Farmers of America and Land O’ Lakes, have been in very productive discussions with CDFA about how they would administer the quota program in the context of a CA FMMO. The cooperatives’ legal team has researched California law and laid out, in detail, the case that current law would permit CDFA to operate a Pooling Plan that would only collect and distribute the monies necessary to fund the quota payment, with the rest of the pooling and pricing responsibility being handled by the federal order.

The key to making this a viable option is CDFA determining that all Grade A milk in California is subject to being assessed to fund the quota program. It has become very clear that if all grade A milk is not subject to a quota assessment, then a California FMMO that protects quota value is not viable.

Why should all Grade A milk be subject to a quota assessment? There are three main reasons:

- First, that is basically what currently happens. In the state order, the money to fund the quota payment comes out of the pool before the overbase price is calculated, so you do not explicitly see it, but it is there.
- Secondly, since all Grade A milk in California can theoretically be covered by quota, then all that milk needs to contribute to funding the system.
• And thirdly, remember that the benefit of having a California FMMO is that it provides higher milk prices for all milk than what the current state order provides. In order to get those higher prices, the cooperatives and producer trade associations have committed that quota values must be protected.

Tuesday, April 4, 2017 is an important date on this journey. CDFA has scheduled an open meeting in Modesto at the Stanislaus County Ag Center, 3800 Cornucopia Way, starting at 9:00 a.m. to hear from folks their thoughts on this issue. They suggest that they would like direction on three questions:

1. Should all Grade A milk be subject to a quota assessment or only pooled milk?
2. What is the best mechanism to gather the requisite data from handlers to calculate the necessary deduction as this will not be provided for under the FMMO?
3. What is the process by which CDFA shall collect, distribute and enforce quota payments?

Our answer to the first question is the most important message producers can give to CDFA at this meeting. All Grade A milk needs to be subject to the quota assessment. If CDFA adopts this approach then we have a path forward on our journey. Under this scenario, the issue of whether milk is pooled or not in the FMMO is moot with regards to quota, because all milk, whether pooled or not, will be subject to the quota assessment. This should relieve a lot of the concern among producers about the looser pooling rules that exist in the proposed FMMO.

As for the other two questions, CDFA has all the legal authority they need to require handlers to report data and collect money. These are technicalities that can be worked out as we move forward.

Hopefully we can soon get a positive answer to the first threshold question about the protection of quota and move on to assessing the magnitude of the financial impact on milk prices that the proposed order will provide. More information on that should be forthcoming in the weeks ahead.

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New Dairy Cattle Official Identification Requirements

By Kevin Abernathy, MPC General Manager

We were recently informed by Dr. Annette Jones, State Veterinarian and Director of the CDFA Animal Health and Food Safety Services, that new official identification requirements will take effect tomorrow. Please review the information below, which was provided by Dr. Jones and CDFA.

Effective April 1, 2017, changes to animal disease traceability regulations, including requirements for movement of cattle, identification, documentation, and specific livestock diseases, go into effect. These regulation changes can be found in Chapters 2 and 7, Division 2 of Title 3 of the California Code of Regulations. These include the requirement that:

1. All dairy cattle born after January 1, 2017 must be officially identified prior to leaving their birth premises, unless moving directly to an approved tagging site.

2. All dairy cattle changing ownership also require official identification unless moving directly to:
   - An approved tagging site.
   - A recognized slaughtering establishment with a USDA approved backtag.
• No more than one approved livestock marketing facility (that is an approved tagging site), and then to a recognized slaughtering establishment with a USDA approved backtag.

For more information on these new regulations, please visit: www.cdfa.ca.gov/ahfss/animal_health

For a list of approved tagging sites: https://www.cdfa.ca.gov/ahfss/animal_health/pdfs/ApprovedTaggingSites.pdf

Summary of Regulation Changes – Animal Disease Traceability | Trichomonosis

Animal Health and Food Safety Services is willing to answer any questions regarding these new regulations. Dairy operators are encouraged to call the main office at 916-900-5000, or their closest Animal Health District Office (Redding: 530-225-2140; Modesto: 209-491-9350; Tulare: 559-685-3500; Ontario: 909-947-4462).

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$19 Million in Funding Made Available for California Farmers to Lower Emissions

By Kevin Abernathy, MPC General Manager

The USDA Natural Resources Conservation Service (NRCS) announced that it has created an option for farmers interested in improving their operation’s conservation efforts. Through the Environmental Quality Incentive Program (EQIP), $19 million has been made available to fund projects focused on improving air quality and reducing on-farm emissions.

These funds are available for projects to:
• Replace old diesel-powered farm equipment with similar new equipment powered with the cleanest Tier emissions-certified diesel engines;
• Repower irrigation engines with new electric motors or new Tier 4 emissions certified diesel engines;
• Adopt no-till or reduced-till conservation tillage practices;
• Utilize combined-tillage implements that perform multiple tasks in a single pass;
• Stabilize unpaved roads and traffic areas to limit dust;
• Establish windbreaks and shelterbelts at Confined Animal Feeding Operations;
• Chip debris from orchard or vineyard removals;
• Apply the safe handling and disposal of chemically-treated wooden stakes;
• Use “low-dust” nut harvesters instead of the conventional harvesters (New in 2016).

NRCS accepts EQIP applications year-round with established cut-off dates for funding selections. Eligible applications for EQIP funds must be submitted by May 26, 2017. Applications sent after the cut-off date will be accepted but not considered for the next project selections.

For more information on the Environmental Quality Incentive Program and examples of past projects, please visit https://goo.gl/AkE9hT

Please contact the MPC staff with any questions at office@milkproducers.org.