DATE: June 8, 2018
TO: Directors & Members
FROM: Kevin Abernathy, General Manager

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</td>
<td>Weekly Change</td>
<td>Calif. Plants</td>
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<tr>
<td>$0.0375</td>
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<td>Barrels</td>
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<td>Weekly Average, Cheddar Cheese</td>
<td>Dairy Market News</td>
<td>Prior Week Ending 5/25 &amp; 5/26</td>
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<td>Blocks</td>
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<td>Calif. Plants</td>
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Fred Douma’s price projections...

Last Week: Quota cwt. $16.05 Overbase cwt. $14.36 Cls. 4a cwt. $14.32 Cls. 4b cwt. $14.62

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

Milk & Dairy Markets

Amidst a broad selloff in commodities and rising trade tensions, the dairy product markets hunkered down to start the week. CME spot Cheddar blocks sunk to a two-month low on Tuesday, a casualty of the U.S.-Mexico trade spat. But by Friday the bulls had largely reasserted themselves. Blocks closed at $1.635 per pound, up 3.75ȼ this week. At $1.565, barrels were 4.5ȼ higher than last Friday. CME spot dry whey gained ground every day this week, closing today at a new high of 41.25ȼ, up 2.75ȼ from last Friday and up 15.25ȼ, or nearly 60%, since its debut at the spot market in mid-March. Nonetheless, nearby Class III futures finished in the red, while deferred contracts moved a little higher.

Spot butter closed today at $2.39, up 1.25ȼ for the week. Nonfat dry milk (NDM) slipped 2ȼ to 80.5ȼ per pound. Powders were mixed at the Global Dairy Trade auction. Skim milk powder (SMP) eked out a 0.3% gain, while whole milk powder fell 1.1% from the previous auction. Class IV futures retreated this week.

The churns were running hard in April. U.S. butter production reached 82.6 million pounds, up 8.3% from a year ago. Butter output was higher in all regions, but particularly in the West, thanks to an 11.3% year-over-year jump in California butter production. Growth in cheese output was modest. At 1.07 billion pounds, U.S. cheese production was just 0.9% greater than in April 2017. Cheddar output fell 3.5% from a year ago.
The protein markets remain well-supported, as demand is outpacing tepid growth in supplies. Combined production of NDM and SMP totaled 215.6 million pounds, down 3.3% from a year ago. The slow start to the spring flush clearly diminished the flow of milk to driers in April. Bucking seasonal trends, manufacturers’ stocks of NDM declined nearly 24 million pounds from March to April, dropping to just shy of 274 million pounds. Inventories are 2.5% greater than they were at the end of April 2017, the smallest year-over-year increase since January 2017.

The once-brimming whey product market has tightened considerably. Inventories of dry whey for human consumption stood at 66.8 million pounds in late April, down 20% from a year ago. Production totaled 84.1 million pounds, up 1.3% from a year ago. USDA’s Dairy Market News suggests that the bullish trends in the whey market have intensified. “Dry whey is moving well in both the international and domestic markets. Production is active, but so far has been unable to overcome the recent demand. Inventories are tight to highly committed.”

Exports are sopping up the excess in the ingredients market. April shipments of milk powders and whey products reached the second-highest volume on record. That helped to drive U.S. dairy product exports to their greatest total ever, surpassing the record set in March. Exports accounted for 18.8% of U.S. milk solids production in April, according to the U.S. Dairy Export Council. Compared to a year ago, the U.S. boosted dairy product exports of all varieties, including butterfat (+190%), milk powders (+37%), whey products (+24%), lactose (23%), and cheese (+22%).

Dairy producers are still milking more cows than they have at almost any point in the past two decades, although cow numbers are down slightly from the February peak. Domestic demand for dairy has improved, but exports are crucial for balancing U.S. milk supplies, which remain formidable. Regrettably, the U.S. dairy industry is losing some of its edge in the export markets. Since mid-April, the dollar has rallied more than 5% compared to a basket of currencies, eroding foreigners’ purchasing power for U.S. goods. Over the same period, the Mexican peso has fallen nearly 12% against the dollar.

In April, Mexico accounted for 46% of U.S. butterfat exports, more than 40% of the NDM/SMP trade, and 25% of U.S. cheese exports. But this important trade

![U.S. Cheese Production (Adj. to 30 Days)](image)

![U.S. Manufacturers' Stocks of Nonfat Dry Milk](image)

![Dry Whey Stocks](image)
relationship is souring amidst floundering NAFTA negotiations and growing U.S. protectionism. On Tuesday, Mexico officially retaliated against U.S. steel and aluminum tariffs, hitting back with levies on politically sensitive products, including some varieties of cheese. The four cheese tariff codes encompass the bulk of U.S. cheese exports, although U.S. cheesemakers and Mexican buyers can shift to products that fall outside of the tariffs’ reach, much as they did in a similar situation in 2010 and 2011. Most foreign suppliers face cheese tariffs at similar rates, suggesting that while Mexican importers may have to spend more pesos to buy less cheese, they probably won’t rush to other vendors. Still, the tariffs erode the U.S.’s historic advantage to a key market while our competitors seek to encroach. Mexico and the EU have reached an agreement in principal to reform their free trade pact. The new agreement, which could take effect as soon as next year, lowers tariffs on a variety of European cheese exports and creates non-tariff quotas for some cheeses. If we don’t patch things up by then, the dairy industry’s trade advantage with Mexico could become purely geographic.

Grain Markets
The feed markets took another step back this week. July corn futures settled at $3.778 per bushel, down 13.7¢ from last Friday. At $9.69 July soybean futures slumped 52¢. July soybean meal dropped to nearly four-month lows at $358.20 per ton, down $16.00 this week. U.S. row crops are off to an excellent start, and the weather risk premium has completely evaporated. This confidence seems premature. There are months of unpredictable weather between now and harvest, and the recent setback offers dairy producers and other end users an excellent opportunity to purchase feed at reasonable prices.

On the other hand, there is reason to suspect that U.S. soybean exports could continue to lag. The Brazilian real has plummeted, putting the price of soybeans priced in reals to attractive levels. Brazilian farmers have rushed to sell, putting U.S. soybean exports at a disadvantage. Eventually, Brazil will empty its stores and importers will turn to the U.S. But perhaps the trade has overestimated global soybean demand. China has been aggressively buying Brazilian soybeans, but they have not been crushing soybeans with equal fervor. Chinese soybean stocks are rising, which could lower their appetite for imports in the months to come unless crushers pick up the pace.

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It’s official; USDA announces the formation of the California Federal Milk Marketing Order
By Geoff Vanden Heuvel, Director of Regulatory and Economic Affairs

Yesterday, the United States Department of Agriculture made an official announcement that the producer referendum held in April passed. As they had told us when they came out to California to conduct meetings about the proposed order, they did not say by what margin the vote passed, or what the voting participation was. The
three major cooperatives operating in California had issued a press release in May after the voting period closed announcing that all three of them had voted yes on behalf of their membership. So, it is likely that the vote in favor was significant.

As a practical matter, there is a lot of transition work that needs to be done between now and late October when USDA will be publishing for the 1st time advanced pricing and pricing factors that will apply to pooled milk processed in California starting on November 1, 2018. First, USDA needs to get their office up and running in the state. Cary Hunter, the current Market Administrator for the Southwest Order based in Dallas, will be the acting market administrator for the California FMMO. He was one of the team members from USDA that came out in April and conducted producer meetings around the state. He is a very skilled administrator and a very approachable guy and will lead the effort to get the FMMO apparatus up and running in California.

On the processor side, the cooperatives will have quite a task evaluating milk movement logistics. Since the early 1980s, the California state order has had in place a producer funded transportation subsidy program to help pay for the hauling of milk to the urban class 1, 2 and 3 handlers. That system expires with the state order and who pays the extra costs of hauling farm milk to the urban plants will be the topic of conversation between our cooperatives and those urban buyers. Furthermore, because the FMMO calculates the pool prices for milk based on where it is received, cooperatives in particular will have some decisions to make about how to equitably pay their members for their milk. The experience in other FMMO’s is that if producers stick together with their cooperatives, very positive terms can be negotiated to extract the needed extra money to cover the transportation costs out of the market. So, sticking together with our cooperatives is pretty important to get a favorable outcome to this transition.

Also, on the processor side, the FMMO will announce prices for class III (milk for cheese) and class IV (milk used to make butter and powder) that will be higher than the comparable state order prices. But as we have often discussed, the requirement to pay those prices depends on whether or not that milk is pooled and the pooling decision is up to the handler. Here again it is very important for producers to stick together with their cooperatives to have the best opportunity to get the buyers to pay at least those regulated minimums.

When Dr. Novakovic and Dr. Stephenson came out to California in April to share their knowledge with us about the FMMO system, they explained the history of the program. One thing they said that struck me is that the FMMO program is primarily designed to assist the cooperatives in helping producers. You can see that this is true in the primary role that cooperatives must play in giving producers leverage in the marketplace to get a favorable outcome. Having the cooperatives work together has always been important, but it is now critical in making the most of the opportunity the FMMO presents for us.

On a personal note, you may have noticed that my title has changed. After nearly 39 years in the dairy business my wife and I sold the cows in May and retired from dairying. I have always dairied in the Chino Valley and urbanization has taken its toll. The dairy I leased was located next to the Chino Airport and owned by the County of San Bernardino. They sold it back in 2014 for a large truck distribution center. The project has been working its way through the planning process and I was informed a year ago that I would have to get off the property this year. We have four children who are all married and happily engaged in their own chosen careers, none of whom want to be dairy farmers. So, with no next generation to take over the dairy and facing the prospect of a significant cost in both time, energy and money to relocate the dairy out of the Chino Valley, my wife and I decided to sell the cows and relocate to Tulare to live where we have two children and a number of grandchildren. Fortunately for me, the Board of Milk Producers Council has agreed to hire me to assist Kevin and our members by continuing to provide consulting services on milk pricing and economic issues along with helping our members cope with the myriad water related regulatory challenges facing the industry, hence my new title and responsibility.

The dairy industry has been very good to me and my family. I was a city kid who had a chance to be a dairy farmer and I always considered it a great privilege to be able to make a living in such a wonderful way. I learned
a lot; it’s a tough business but involves some of the best people you will ever meet. I hope that I can continue to add value to Milk Producers Council and our members and our community in the years to come.

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**MPC welcomes aboard Geoff Vanden Heuvel as Director of Regulatory and Economic Affairs**

*By Kevin Abernathy, MPC General Manager*

As you just read above, we are pleased to announce that Geoff Vanden Heuvel will be expanding his role with the MPC family as director of regulatory and economic affairs. Geoff’s decades-long experience as a dairy producer and his deep understanding of water and economic issues will be a valuable addition to the MPC team. He will be an important asset for producers navigating the various regulatory compliance and water and market issues we continue to face as an industry.

We look forward to sharing more information about Geoff and his expanded role in the future. Welcome aboard, Geoff!