DATE: September 21, 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 + $.0300 $1.6350</td>
<td>Weekly Change $0.000 $2.2350</td>
<td>Week Ending 9/14 &amp; 9/15</td>
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<tr>
<td>Barrels - $.0600 $1.3600</td>
<td>Weekly Average + $.0460 $2.2760</td>
<td>Calif. Plants $0.8293 10,200,033</td>
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<td>Block Average, Cheddar Cheese</td>
<td>Dairy Market News w/e 09/21/18 $0.4350</td>
<td>Nat’l Plants $0.8622 18,674,893</td>
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<td>National Plants w/e 09/15/18 $0.4185</td>
<td>Calif. Plants $0.8037 13,120,805</td>
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<td>Barrels - $.0765 $1.3935</td>
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<td>Nat’l Plants $0.8447 18,251,181</td>
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<td>DRY WHEY</td>
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Fred Douma’s price projections...

This Week: No prices this week. Will resume next week.
Last Week: Quota cwt. $16.45 Overbase cwt. $14.75 Cls. 4a cwt. $13.90 Cls. 4b cwt. $15.57

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Market commentary

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

Milk & Dairy Markets

Distress on the dairy drags on. The futures are a little better, but the present remains painful. August milk checks were clearly inadequate. Dairy producers sent 279,700 cows to slaughter last month, the second-highest volume for the month after 1986, when the industry undertook a whole-herd buyout and cow kill program. Slaughter volumes in August 2012, when dairy producers were similarly struggling, represent a distant third, some 1.6% lower than the August 2018 pace. Aggressive culling in 2012 prompted a 5,000-head decline in the dairy herd in August and a sharp 22,000-head contraction in September. But this time, apparently, is different. According to USDA’s latest Milk Production report, dairy producers collectively added 5,000 cows last month, bringing the national milk cow herd back up to 9.4 million head. That’s 4,000 head lower than August 2017 and 8,000 head lower than the recent high, but it’s still a lot of cows, especially after three years of discouraging prices. And, according to USDA’s assessment, we’re moving in the wrong direction.
U.S. milk output was surprisingly strong in August, reaching 18.3 billion pounds. That is 1.4% higher than August 2017, a much-larger-than-anticipated gain, especially in the face of excessive heat and humidity in the eastern half of the nation. Many states contributed to the increase, but none more so than Texas. Milk output in the Lone Star State jumped 0.6% from a year ago, an increase of 95 million pounds. Kansas and Colorado both boosted milk output by 8.6%. Milk production climbed 1.2% in California and 1.4% in Wisconsin, with the top two dairy states adding 38 million and 36 million pounds, respectively. Strong production per cow drove the big year-over-year gains.

Dairy producers have been selling out in the eastern half of the country but adding cows in much of the West. There were 20,000 more cows in Texas in August than there were a year ago. Over the same period, Colorado added 14,000 cows and the dairy herd grew by 8,000 head in Kansas, 4,000 in Idaho, 3,000 in Utah, and 2,000 head each in Arizona and Washington. In contrast, milk cow numbers dropped 12,000 head in California – a notable exception to the East-West divide – 7,000 head in Ohio, 6,000 head in Minnesota and Pennsylvania, 5,000 head in Florida and Michigan, and 4,000 head in Virginia and Wisconsin.

The Milk Production report was a setback to dairy producers hoping that industry contraction would lead to higher prices, but the markets greeted the data with a shrug. Perhaps that’s because the report was perplexing and nigh on implausible. Furthermore, physical milk markets are tight, undercutting the bearishness of the August numbers. Most Class III contracts finished about a dime higher than last Friday.

Cheese demand has been good but there are barrels aplenty. CME spot Cheddar blocks added 3¢ this week and reached $1.635 per pound. With key buyers on the sidelines, barrels continued to drop, falling 6¢ to $1.36. Still, the block-barrel spread is becoming untenuous. According to Dairy Market News, “Even with the uncertainty of recent cheese market tones, Midwestern cheese contacts expect a propitious return to positivity near term. They suggest increased sales, new/growing customer bases and more balanced cheese supplies are all favorable.” It seems the gap is more likely to close via a recovery in barrels prices than a steep decline in the block market.

Spot whey prices seem to be losing traction. CME spot dry whey slipped 0.75¢ this week to 51.5¢ per pound. The futures, however, continued to climb. Slowing exports to China in the wake of new punitive tariffs will pressure this market. However, production has slowed as less milk flows to cheese vats.
Like whey powder, nonfat dry milk (NDM) is running out of steam as prices rise. Domestic buyers are simply less anxious to secure milk powder above 90ȼ than they were when the market was a nickel or so lower. But export demand remains strong, especially from Mexico, where milk output has slipped. And inventories are likely tightening as there is less milk moving to balancing plants. CME spot NDM dropped just 0.25ȼ to 87.25ȼ per pound this week. Milk powder prices moved lower at the Global Dairy Trade (GDT) auction. The average winning price for skim milk powder (SMP) fell 1.1% from the previous event, while whole milk powder (WMP) lost 1.8%. The European Commission continues to sell skim milk powder (SMP) out of its Intervention storage program, but volumes were unimpressive this month.

Butter was incrementally lower at the GDT and the European butter market softened. But CME spot butter held steady at $2.235 per pound. Spot butter might have finished considerably higher but it sold off today, fresh on the heels of news that the CME would tighten standards for spot butter. The Daily Dairy Report explains, “This summer, buyers at the CME began to notice that some sellers tendered non-kosher butter. While permitted by CME spot butter trading rules… most U.S. butter sold is kosher-certified. That created a concern that CME butter may not be viable outside the spot market and that it could disrupt trade if buyers believed they might become the owner of butter that has no commercial use.” In the long run, the tighter standards will improve the utility of the spot butter market. But today, they may have pressured prices. Non-kosher butter cannot be traded at the CME after October 15. Until then, butter merchants with non-kosher product may try to offload it in Chicago.

**Grain Markets**

December corn and November soybean futures both forged new life-of-contract lows on Tuesday. Expectations for big crops continue to weigh on the market. But prices seem to have gone low enough for now. The corn market has rallied every day since forging new lows. December corn settled today at $3.5725 per bushel, up 5.5ȼ from last Friday. November soybeans closed at $8.4725, up 16.5ȼ.

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Dairy Revenue Protection program goes live in October
By Geoff Vanden Heuvel, Director of Regulatory and Economic Affairs

Dairy Revenue Protection (Dairy RP) is a program that will allow dairy producers to purchase crop insurance protection on milk income. The program will allow you to lock in a guaranteed revenue based on futures prices for class III and/or class IV milk. There is also the option of basing your revenue guarantee on your butterfat and protein components if that makes more sense for you.

The program structures the policies to cover quarterly volumes of milk at prices based on the closing futures prices each day. When the program goes live starting October 9, policies will be for sale that cover the 1st quarter of 2019 and also the next four quarters, going all the way through the 1st quarter of 2020. The revenue guarantee of the policy will be that day’s closing price for whatever combination of class III and IV you choose for the three months of the quarter averaged together, multiplied by the amount of hundredweights you decide to cover for that quarter, multiplied by a coverage level that can range from 95% down to 70%.

You can buy as little or as much coverage as you want. You can buy for whatever periods you want. You can buy differing amounts on different days and you can buy component-based coverage along with the class price coverage. There is great flexibility to this plan, but you do have to ultimately produce at least 85% of the milk you insure for a quarter, or there is a penalty. This is a disincentive to over insure. Here is what makes this program different than simply purchasing puts – the government will pay at least 44% of the premium.

So, what are the premiums? We do not have numbers on that yet and we will not have those numbers until October 9 when the program goes live. Then of course the premium amounts will vary depending on the underlying futures prices. We know that the premiums for the close quarters will be less than the further out quarters. And the range that has been indicated by the creators of the program are that they expect premiums to be in the $0.10 - $0.40 range per cwt. of covered milk. Premium payments for purchased policies are not due until after the end of the covered quarter, so no money is due up front.

This program is a crop insurance program approved and regulated by the Risk Management Agency of USDA. It is only sold through crop insurance agents, who market it through private crop insurance companies. Milk Producers Council wanted to make sure that California producers would be in a position to take advantage of this program.

To that end, I took the training and became licensed to actually sell Dairy RP policies to interested producers and would happy and honored to have the opportunity to tell you more about the details of the program to see if it is a fit for your operation. Feel free to give me a call at 909-730-1240 or email me at Geoff@milkproducers.org. In addition, Dr. John Newton, the senior economist at the American Farm Bureau who was one of the creators of Dairy RP is giving a webinar on this topic on Friday, September 28, 2018 at 11:30 a.m. Pacific time, which you can sign-up to participate by clicking here.

Like any agriculture program that involves government money, producers who purchase Dairy RP insurance policies have to comply with the USDA conservation requirements outlined in Form AD-1026. If you are signed up for the Margin Protection Program then you already in compliance with this requirement. Even though you cannot buy a Dairy RP policy until after October 9, you can register to be eligible to buy Dairy RP by submitting a no-cost application with a crop insurance agent who is authorized to sell Dairy RP. Once an application has been submitted and accepted by the insurance company, you are locked into that company for the insurance year, so you want to keep that in mind as you evaluate the value of this program for you.

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State Water Board increases 2018-19 dairy water quality fees
By Kevin Abernathy, MPC General Manager

The State Water Resources Control Board on Thursday voted unanimously, 4-0, to increase water quality permit fees for Confined Animal Facilities (CAFs), including dairies, by 6.2 percent.

That translates to an annual increase of $821 for the state’s largest dairies (over 3,000 mature cattle), from $13,248 annually to $14,069. For the smallest class of dairies that pay fees, those with between 50 and 149 mature cattle, fees are increased from $497 to $528 annually. Dairies that are environmentally certified by the California Dairy Quality Assurance Program will continue to receive a 50 percent discount on the annual fees.

Water board staff described the fee proposal as a compromise, noting that CAF fees had not been increased for several years, and that the proposed fee increase was only about half of what is needed to balance the program’s budget.

Milk Producers Council joined with the Dairy Cares coalition in opposing the fee increase. The coalition submitted formal written comments before the hearing and testimony during the hearing, arguing that the fee increases were not justified.

Coalition representatives pointed to a provision of the state Water Code that requires the Water Board to consider “the pricing mechanism of the commodity produced” when setting fees. They pointed out that the average cost of producing milk has remained below the priced paid since 2014.

They also argued that regulators have a smaller job to do than in the past, because of significantly fewer dairies in the state and refocusing of dairy regulatory staff to other activities.

“Given the reduced number of dairies to regulate, the expected increase in revenue from other CAFs and the proposal to increase all categories of CAF fees, it is very difficult to conclude that (the) Water Code … was adequately considered,” the coalition stated in its formal comments.

Milk Producers Council remains involved in litigation against the water board regarding previous fee increases. We will keep our members apprised as the situation develops.

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Proposition 3 information session scheduled for September 28 in Bakersfield

This November, Californians have a major decision regarding the future of our state’s water. Proposition 3, the Water Infrastructure and Watershed Conservation Bond Initiative, would allow $8.77 billion in general obligation bonds for water infrastructure, groundwater storage, dam repairs, watershed improvements, and more.

This measure, whether passed or failed, will affect various industries and communities throughout the state. Because of the importance of this ballot measure, the Water Association of Kern County, Kern County Farm Bureau, and other groups are hosting an information overview for Prop 3.

The event is scheduled for September 28 from 10 a.m. to 11 a.m. at the Bakersfield City Council Chambers, 1501 Truxtun Avenue, Bakersfield. Anyone interested in learning more about the impacts this measure can have on the future of California water is encouraged to attend.
IMPORTANT INFORMATION FOR CENTRAL CALIFORNIA

September 28, 2018, 10 a.m.

Proposition 3 Overview
Water Infrastructure and Watershed Conservation Bond Initiative

What every public official, real estate professional, farmer, oil company official, water manager, conservationist, business owner and homeowner should know.

Learn how this ballot measure will impact your community, business, farm and county.

with Gerald Meral
Director of the California Water Program at the Natural Heritage Institute
Location: Bakersfield City Council Chambers, 1501 Truxtun Ave., Bakersfield

Partial list of the ballot’s provisions
- Repair of Friant-Kern Canal: $750,000,000
- Oroville Dam Repairs: $200,000,000
- Water/energy conservation in State Water Project system, and by contractors: Up to $50,000,000 per year beginning in 2020.
- Safe drinking water and wastewater treatment for disadvantaged communities: $750,000,000
- Sustainable Groundwater Management Act (grants to local groundwater management agencies): $640,000,000
- Water Conservation: $300,000,000
Dairy Cares Member Update: AMMP Recipients and Dairy Sustainability Summit Information

Milk Producers Council has been a longstanding member of Dairy Cares, a coalition of dairy trade groups, cooperatives, processors, and allied industry members working together on industry sustainability issues.

The September edition of the Dairy Cares member update provides information on the upcoming California Dairy Sustainability Summit along with an overview of 2018 Alternative Manure Management Project (AAMP) recipients.

The update also details keynote speakers who will be attending the first annual California Dairy Sustainability Summit. Dairy farmers and employees interested in attending can sign up for early bird registration now through October 19.

Read the full article here.

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