DATE: February 15, 2013  FROM: Rob Vandenheuvel, General Manager

TO: Directors & Members

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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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<td><strong>Blocks</strong></td>
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<td>+$.0700</td>
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<tr>
<td><strong>Barrels</strong></td>
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<td><strong>Weekly Average, Cheddar Cheese</strong></td>
<td><strong>DRY WHEY</strong></td>
<td><strong>Prior Week Ending 2/1 &amp; 2/2</strong></td>
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<td>Dairy Market News w/e 02/15/13</td>
<td>Calif. Plants $1.5514 10,203,467</td>
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MARKET COMMENTARY: (By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)

**Milk & Dairy Markets**

CME spot butter and Cheddar prices posted impressive gains this week. Butter added a nickel, settling at $1.605/lb., an eleven-week high. Cheddar blocks climbed 2 ½¢ and barrels moved 7¢ higher. The spread between blocks and barrels was inordinately wide last week, and this week’s price action helped narrow the gap to more normal levels. But while block prices were expected to gain on barrels, the simultaneous increase in block Cheddar prices came as somewhat of a surprise. The Daily Dairy Report noted Thursday that strength in the spot markets is likely due to a combination of slowing milk production growth and filling inventories ahead of Easter and Passover demand. Nonetheless, Class III futures struggled. Nearby contracts logged double digit losses from Friday to Friday, and contracts in the second half of the year were slightly lower. Class III futures appear comfortable within the $17 to $18/cwt. range in the first half of the year and at slightly higher prices in July through December.

Spot Grade A nonfat dry milk (NDM) fell 0.75¢ on Tuesday and lost another 0.75¢ on Thursday, ending the week at $1.505/lb. Milk powder prices have been the weak leg in the dairy complex of late. Dairy Market News dry product prices were also softer. In the West, the NDM mostly range narrowed and the average price fell 0.25¢. Whole milk powder, dry whey and milk protein concentrate prices all reported similar, fractional declines.

Cream is widely available in the Central and Western regions and churning activity is heavy, according to Dairy Market News. Manufacturers are building inventories as supply is currently outpacing demand. Cream supplies are also ample in the Northeast in the wake of winter storm Nemo.

Dairy Market News noted weaker dairy product prices in Western Europe, contrasted with higher prices in Oceania. Adverse conditions in both Australia and New Zealand are restricting milk production as the season winds down. Near drought on New Zealand’s North Island is prompting dairy producers to dry cows earlier than normal. This notably lower production has reduced supplies and supported prices. European milk production is plodding along at volumes lower than last year, but this is nothing new. Production has been below prior year levels since July and is expected to remain so at least through the end of the month. The declines are steady, but not enough to support prices for now. Tightening global dairy supplies are expected to buoy dairy product prices later this year.
Weeks of nearly ideal weather in California have led to strong milk production in the Golden State and output is expected to top year ago levels for the first time in months. Recent declines in feed prices may be encouraging higher per cow production across the nation.

For the week ending February 2, dairy cow slaughter totaled 63,179 head. This is lower than the very high levels seen for much of January, but still high enough to suggest contraction in the herd. Year to date slaughter is 5.3% higher than 2012. Dairy cow slaughter in Region 9, which includes California, Arizona, Nevada and Hawaii, totaled 17,300 head, slightly lower than the same week a year ago. Year to date slaughter in Region 9 is up 6.6% from 2012.

**Grain and Hay Markets**

Feed prices moved lower this week; corn lost a dime and soybeans fell more than 20¢. The markets came under pressure as weather in South America turned more favorable. Rains fell in Argentina, and while more would be welcomed, the moisture came as a relief to farmers and feed buyers alike. More rain is expected Sunday through Tuesday, but there is not a lot of moisture in the 6-10 day forecast.

The Buenos Aires Cereals Exchange (BACE) estimates the Argentine corn crop at 25 million metric tons (MMT), below the USDA’s latest 27 MMT projection. The BACE expects soybean production to total 50 MMT, which puts it in line with private estimates but below the USDA’s 53 MMT forecast.

Skies are mostly clear in northern Brazil, which will help farmers catch up on the harvest. The faster the current crop is harvested, the higher the acreage farmers can plant with second crop corn. Currently about 20% of the second corn crop is in the ground, sharply lower than the 42% planted at this time last year. Expectations for strong corn production in Brazil depend heavily on expanded second crop acreage, and if the harvest and subsequent planting remain slow, estimates of Brazilian corn production will have to move lower.

U.S. ethanol production remains much slower than prior years, but margins are improving and production is increasing from its low levels. Ethanol stocks have fallen notably in the past few weeks. Ethanol companies that have idled ethanol plants are reportedly considering reopening several of them. If ethanol stocks continue to decline, this would signal room in the market for a return of some of the idled capacity.

In general, feed prices remain range-bound, but there are good reasons to expect a rebound. Uncertainties about the size of South American grain and soybean crops linger. The amount of corn used for ethanol appears to be on the rise. Most importantly, feed demand remains stronger than this tight market can afford.

Dairy and grain markets will be closed on Monday in honor of President’s Day.
FRED DOUMA’S PRICE PROJECTIONS…
Feb 15 Est: Quota cwt. $18.32 Overbase cwt. $16.62 Cls. 4a cwt. $17.91 Cls. 4b cwt. $15.51
Last Week: Quota cwt. $18.23 Overbase cwt. $16.53 Cls. 4a cwt. $17.80 Cls. 4b cwt. $15.40
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BIG CROWD AT FEDERAL ORDER DISCUSSION; SO WHAT DID WE LEARN?: (By Rob Vandenheuvel) This past Wednesday, the three major California cooperatives hosted a panel discussion on Federal Milk Marketing Orders (FMMOs) and the recent interest in exploring a Federal Order for California. The panel was made up of the Dairy Economists from the three major cooperatives: Tom Wegner (Land O’Lakes), Elvin Hollon (Dairy Farmers of America) and Eric Erba (California Dairies, Inc.). The event was very well attended; I would estimate that more than 300 people in the audience, a vast majority of whom were dairy farmers.

Tom Wegner opened up the discussion with a 30-minute powerpoint presentation providing those in attendance with a basic understanding of how FMMOs operate compared to the current California State Order operated by the California Department of Food and Agriculture (CDFA).

So what did we learn from this week’s panel discussion? Quite a bit, actually. It’s fair to say that this was probably the first time many dairy farmers in the room had been exposed to a clear, concise explanation of how FMMOs operate and how California’s industry could fit within this national structure. Further, the three panelists made it clear from the onset of the discussion that none of their organizations were interested in pursuing a California Federal Order unless guarantees were received by Congress that California’s quota system could be maintained as part of a California Federal Order. The presentation also included a rough estimate that the blended pay price for California dairy families could have been more than $1 per hundredweight higher in 2012 under a California Federal Order when compared to the blend prices announced under the current State Order.

But beyond those things – all of which are critically important – one particular item was especially enlightening. During the Question & Answer session, Tulare dairyman Cornell Kasbergen asked the panel to clarify the issue of “de-pooling” with respect to FMMOs. De-pooling has been a common argument raised by critics of a California Federal Order. At face value, the argument is quite simple. De-pooling is occasionally done in both FMMOs and California when one of the manufacturing classes has a minimum price above the blend or Overbase price. When it occurs, de-pooling can result in some of the higher value usage of milk being removed from the pool, which in turn can reduce the overall blend prices paid for the milk remaining in the pool. In other words, if the California Class 4b price is higher than the California Overbase price, a de-pooled plant will pay its producers the announced Class 4b price (or more, depending on premiums), rather than the lower Overbase price. By removing some of the higher-value Class 4b milk from the pool, the Overbase price, which is paid to the dairies remaining in the pool, will be slightly lower than it otherwise would have been if that Class 4b milk had remained in the pool. Both California and FMMOs allow for this de-pooling, but the rules for each program are different:

- In California, the decision of whether to pool or de-pool milk is a 12-month decision. In other words, if a manufacturing plant wants to purchase its milk supply without associating with the California pooling plan, that decision is made for a 12-month period.
- In many FMMOs, a decision on whether or not to associate with the Federal Order pool is made by milk handlers on a monthly basis (it’s important to note the use of the term “many FMMOs,” as each of the 10 FMMOs determines its own regulations with respect to those pooling decisions). The various FMMOs differ on how de-pooled milk can be re-associated with the pool in subsequent months.

The question by Kasbergen was aimed at the definition of a “handler,” who is the party ultimately responsible for deciding whether the sale of specific milk is pooled or not. What was revealed in the panel’s response to Kasbergen’s question was that when a dairyman-owned cooperative is involved in marketing the milk, that cooperative is able to serve as the “handler,” even though the milk may ultimately be sold to a proprietary manufacturing plant.

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So why was this an important distinction made during the discussion? For the dairy farmers in the room, there is a big difference between having a proprietary cheese manufacturer making decisions about how the milk they purchase is associated with the pool versus having their own producer-run cooperatives making that decision. About 80 percent of California’s milk production is marketed by one of the State’s cooperatives, meaning that the decision about whether or not milk is pooled or de-pooled largely falls in the hands of producer-run organizations.

As our industry moves forward with this discussion, there will undoubtedly be additional questions and concerns that come up. But one key point that was brought up by multiple individuals in the audience is that we’d be cheating ourselves if we didn’t at least begin this process of drafting a California Federal Order to be submitted to the U.S. Department of Agriculture (USDA, who oversees the FMMO programs around the country) in the very near term. Once a proposal is submitted to USDA, a process taking up to 14 months begins, including the solicitation of possible alternative proposals, a hearing process open to any interested party and a final decision from USDA. After the conclusion of that process, dairy farmers in California would be given the opportunity to vote (either individually or through their cooperative) on whether to accept the USDA-approved California Federal Order, with a 2/3 majority needed for producer approval. So the bottom line is that there will be plenty of opportunities to examine the pros and cons of a California Federal Order, with dairy farmers holding the power to ultimately decide whether or not to implement the new Order, but the roughly 14-month process won’t even begin until a joint proposal with the support of the three major cooperatives is submitted to USDA. The members of the audience who spoke out during the discussion made their thoughts very clear: Get this process started as soon as possible.

LESS THAN TWO WEEKS LEFT IN “RELIEF PERIOD” FOR MILC PROGRAM: (By Rob Vandenheuvel) As we have reported in recent weeks, dairies that are enrolled in the Milk Income Loss Contract (MILC) program have the ability to select any month (October 2012 – September 2013) as their “start month.” However, the flexibility to consider previous or current months as a start month is only available until February 28th. Since nearly all California dairies will exceed the 2.985 million pounds of milk covered by the MILC program, the selection of a “start month” can have an impact on the possible payout under the program.

While no one knows what the future holds, there are several projections that are published and updated regularly (one such projection is included on the next page). Those projections rely on best estimates for what the outlook is for not only dairy products, but also feed products (since feed costs can also impact MILC payments). While the projections can differ in their actual projected payouts, there seems to be general agreement that using the current dairy market levels, March 2013 will generate the highest monthly payout, with April 2013 projected to generate the next highest payout. However, these projections can change on a weekly or even daily basis, so dairies can use the flexibility provided in this year’s MILC program and wait a little longer before making final decisions. Dairies just need to make sure that if they ultimately want to choose February or March as their start month, that paperwork will need to be filed with the Farm Service Agency by no later than February 28, 2013.

Any MPC members with questions about this can contact the office at (909) 628-6018.