DATE: April 22, 2016
TO: Directors & Members
FROM: Rob Vandenheuvel, 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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</thead>
<tbody>
<tr>
<td>Blocks: - $0.0050</td>
<td>Weekly Change: - $0.0400</td>
<td>Week Ending 4/15 &amp; 4/16</td>
</tr>
<tr>
<td>Barrels: +$0.0150</td>
<td>Weekly Average: - $0.0380</td>
<td>Calif. Plants: $0.7328</td>
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</tbody>
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<table>
<thead>
<tr>
<th></th>
<th>DRY WHEY</th>
<th>Nat’l Plants: 23,772.112</th>
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<tbody>
<tr>
<td>Blocks: +$0.0030</td>
<td>Dairy Market News</td>
<td>Prior Week Ending 4/8 &amp; 4/9</td>
</tr>
<tr>
<td>Barrels: +$0.0060</td>
<td>w/e 04/22/16</td>
<td>Calif. Plants: $0.7404</td>
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<table>
<thead>
<tr>
<th></th>
<th>National Plants</th>
<th>Nat’l Plants: 20,153,163</th>
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<tbody>
<tr>
<td></td>
<td>w/e 04/16/16</td>
<td>$0.7359</td>
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FRED DOUMA’S PRICE PROJECTIONS...

<table>
<thead>
<tr>
<th>Est.</th>
<th>Quota cwt.</th>
<th>Overbase cwt.</th>
<th>Cls. 4a cwt.</th>
<th>Cls. 4b cwt.</th>
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<tbody>
<tr>
<td>Apr 22</td>
<td>$14.31</td>
<td>$12.61</td>
<td>$12.56</td>
<td>$12.71</td>
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MARKET COMMENTARY: (By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)

Milk & Dairy Markets

Early in the week the dairy markets were riding high, swept upward in the powerful winds of the broader markets. But by mid-week they came crashing back down to earth. The fundamental story remains largely unchanged; demand is strong, but supplies are overwhelming. For the week, 2016 Class III futures were steady to 52ȼ lower. Class IV futures were a little higher to 31ȼ lower.

The spot market trade was more ambivalent. CME spot butter dropped 4ȼ to $2.03/lb. and Cheddar blocks slipped 0.5ȼ to $1.4225. In contrast, Cheddar barrels bounced 1.5ȼ to $1.425 and nonfat dry milk (NDM) climbed 2.5ȼ to 75ȼ.

The milk powder markets got a boost Tuesday from a strong performance at the Global Dairy Trade (GDT) auction. The GDT index jumped 3.8%, its largest gain since early December. Butter was up 2% from the previous auction, and Cheddar reported a disappointing 3.9% loss. Skim milk powder (SMP) prices posted a modest 0.3% gain. Whole milk powder (WMP) prices were particularly buoyant, climbing 7.5%.

WMP prices at the GDT were likely supported by improving export demand. In March, China imported 103.8 million pounds of WMP, most of it from New Zealand. China’s combined imports of WMP and SMP totaled 151 million pounds in March, well below the volumes of March 2013, but 21% greater than the prior year and 32% more than February on a daily average basis. China also continued to step up its imports of cheese, whey, and...
ultra-high temperature (UHT) fluid milk. China’s UHT milk imports fell just short of the record-breaking volumes of December.

It will take more than a modest uptick in China’s appetite to shake the dairy market from its doldrums. Global milk production will have to fall short of demand for long enough to allow dairy product inventories to return to less burdensome levels. But milk output continues apace. Assuming steady production in Spain and Cyprus and adjusting for Leap Year, milk collections in the 28 nations of the Eurozone were 5.5% greater in February than they were a year ago. Output was up 32.3% year-over-year in Ireland, 20% in Belgium, and 17.5% in the Netherlands. In the first two months of the year (excluding Leap Day), Europe has increased milk production by 3.4 billion pounds from 2015, a volume that is not much shy of California’s milk output in March.

U.S. milk production totaled 18.41 billion pounds in March, up 1.8% from a year ago. Year-over-year growth in milk output was surprisingly robust, driven by a 1.6% increase in production per cow relative to March 2015. California milk production fell for the 15th consecutive month, dropping 2.4% from a year ago. Output also slipped in Florida (-5.7%), New Mexico (-2.9%), Utah (-1.6%), and Virginia (-0.6%). Dairy producers in Texas managed to produce 2% more milk than a year ago with 6,000 fewer cows, and dairy producers in the Midwest and Northeast continued to post impressive growth relative to last year.

USDA revised upward its estimate of the February milking herd by 3,000 head and reported the March herd at 9,325 million head. The U.S. dairy herd is now larger than it has been in any month since December 2008. It grew by 10,000 head from February to March and is 14,000 head greater than it was in March 2015. As the Daily Dairy Report noted earlier this week, “Declining dairy cow slaughter volumes since mid-March have hinted – and the Milk Production report confirms – that U.S. dairy producers are not heeding market signals to lower output. Like their counterparts in Europe, they are instead trying to weather the downturn by spreading their fixed costs over greater volumes of milk.” Dairy producers culled just 53,894 head in the week ending April 9, 4.1% fewer than the same week a year ago. For the year-to-date, dairy cow slaughter is 1.6% behind last year’s pace.
Dairy product inventories grew in March at a modest pace, implying strong demand. On March 31 there were 1.19 billion pounds of cheese in cold storage. Although this record-breaking volume is 11.4% greater than last year, it was up just 0.7% from February. Similarly, butter inventories are much larger than they were a year ago, but month-to-month growth lagged the historic average as is typical in years when Easter falls in March. Butter stocks reached 243.6 million pounds, up 3.4% from February and up 32.1% from March 2015.

Grain Markets
Two weeks ago, the crop markets were rudely awakened from their winter slumber by reports that once perfect growing conditions in South America had deteriorated. Large investment funds, anxious to find the next bull market in a world with few such opportunities, piled in, pushing both old and new crop corn futures above the $4 mark on Wednesday. May corn futures settled today at $3.7175 per bushel, down 6.75ȼ on the week, but much higher than they were a couple weeks ago.

May soybean futures settled at $9.87, up 31ȼ from last Friday. The bulls were likely a little overexuberant early this week, but there has been a clear and sudden shift in the psychology and fundamentals of the crop markets.

Hot, dry weather in northern Brazil has harmed the second – or safrinha – corn crop, and estimates of production and exports are falling quickly. In fact, Brazil has waived its import tariff on up to one million metric tons of corn outside of the Mercosur trading bloc, which can already send tariff-free corn to Brazil. Just like that, the U.S. became the grain export market of choice at a time when that title typically shifts to South America.

Wet conditions in northern Argentina have damaged the soybean crop. Private production estimates have dropped to around 56 or 57 million metric tons, compared to 59 or 60 mmt a month ago. The forecast is starting to improve, with clear skies in northern Argentina and rains pushing into part of Brazil’s safrinha corn region. Weather in the U.S. has been nearly ideal for corn planting, and the world still has plenty of grain and soybeans. However, the once complacent trade has had to adjust its outlook for 2015-16 global crop production lower and its prices forecasts higher.

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SOME CHANGES ANNOUNCED IN THE MARGIN PROTECTION PROGRAM: (By Rob Vandenheuvel) Last week, the U.S. Department of Food and Agriculture (USDA) announced a couple modifications to the Margin Protection Program (MPP). As you know, the MPP is the federal program operated by USDA that replaced the “Milk Income Loss Contract” (MILC) program in the last Farm Bill. While USDA cannot change the underlying law that was passed by Congress in the Farm Bill, they do have the ability to adjust their implementation of that law within limits.

The biggest change for those participating in the program is the option starting next year to enroll in the “basic
catastrophic protection” at the $4 margin level on 90% of your “production history,” and have the option to enroll in an enhanced level ($4.50 margin level and above) at a different percentage of your production history. This is different from the way the program has operated thus far, when you had to choose one percentage of your production history to enroll in both the $4 basic level and any enhanced level.

Will this impact how participating dairies use the MPP in 2017 and beyond? Perhaps. It certainly makes for better policy. Every participating dairy should get the same basic catastrophic protection regardless of whether or not that dairy chooses to also “buy up” additional coverage on some percentage of their production. With this change, that is now the case.

USDA also made some changes that would allow a dairy to update their “production history” when an eligible family member joins the operation. I have not seen specific details on this new addition, which USDA is calling an “intergenerational transfer,” but the press release indicates that dairies will be allowed to do it once during the remaining years of the program (2018). As more information on this new feature in the MPP becomes available, we’ll certainly update you through this newsletter.

One additional note (and a bit of editorializing). In the press release put out by USDA announcing these changes to the MPP, they also included the following statement:

“Assuming current participation, had the Margin Protection Program existed from 2009 to 2014, premiums and fees would have totaled $500 million while providing producers with $2.5 billion in financial assistance, nearly $1 billion more than provided by the old Milk income Loss Contract program during the same period.”

It’s clear that USDA has heard the critiques over the past year or more by some folks about the structure and performance of the MPP. Most of those comments center around the fact that the MPP has made virtually no payments in 2015 and the first two months of 2016 (other than some limited payments to the 261 dairies that enrolled in the $8 margin level last year).

I have found this criticism interesting. We all knew (or should have known) at the start of the MPP what the program is and what is isn’t. It isn’t designed to replace the futures/options hedging opportunities that some dairies participate in. It also isn’t designed to trigger payments frequently or guarantee profitability. Instead, it was designed to provide meaningful indemnity payments during catastrophic periods of significant margin collapses such as 2009 and 2012 (which is when virtually all of the “$2.5 billion in financial assistance” mentioned above would have been paid out). As you are all painfully aware, 2009 saw U.S. All-Milk Prices below $12/cwt for six straight months (and California overbase prices averaging $9.71/cwt during those same months). And 2012 saw corn prices rocket up above $7/bushel, with hay and other feed commodities shooting to historic highs as well.

Not to discount the significant challenges currently being felt by dairy farmers (particularly in California…see last week’s article on the CDFA hearing for more on that), but do these critics of the MPP really want our producers to experience 2009-era milk prices or 2012-era feed costs just so that the MPP can be called a “success” because it paid out indemnities? If our dairies were receiving the milk prices that Fonterra is projecting their producers will receive over the 2015/16 production season (about $9/cwt equivalent), the MPP would be paying out hundreds of millions of dollars, if not billions. Would our producers be better off? Of course not.

Now for those who argue the inequity of a Farm Bill that is estimated to spend $200 billion over ten years on all ag programs, but less than $1 billion on programs aimed to help our valuable U.S. dairy industry, you’ll get no argument from me. But within the strict budget limitations that Congress has put on the crafting of this program, it was designed to provide the most assistance for producers of all sizes (a stark difference from the previous MILC program) at the times those dairies needed it the most – years like 2009 and 2012. There are other tools that will cost you more but may result in more frequent payments; that’s just not what this program was designed to be.