DATE: September 4, 2015
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>
</tr>
</thead>
<tbody>
<tr>
<td>Blocks - $0.0050</td>
<td>Weekly Change +$1.125</td>
<td>Week Ending 8/28 &amp; 8/29</td>
</tr>
<tr>
<td>Barrels +$0.0700</td>
<td>Weekly Average +$0.0855</td>
<td>Calif. Plants $0.7698 18,405,021</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Nat’l Plants $0.7445 31,481,713</td>
</tr>
</tbody>
</table>

Dairy Market News w/e 09/04/15 $2.400
National Plants w/e 08/29/15 $2.748
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DRY WHEY

Weekly Average, Cheddar Cheese

| Blocks +$0.0335 | $1.7150 |
| Barrels +$0.0480 | $1.6500 |

Milk Producers Council
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FRED DOUMA’S PRICE PROJECTIONS...

Sept 4 Est: Quota cwt. $16.57 Overbase cwt. $14.88 Cls. 4a cwt. $14.53 Cls. 4b cwt. $15.34
Aug ’15 Final: Quota cwt. $16.27 Overbase cwt. $14.57 Cls. 4a cwt. $13.08 Cls. 4b cwt. $15.74
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MARKET COMMENTARY: (By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)

Milk & Dairy Markets

The butter market remains ascendant. This week spot butter prices jumped 11.25ȼ to $2.4525/lb. The milk powder market also perked up. Nonfat dry milk reached 90ȼ on Friday, up an impressive 13ȼ from last week. Boosted by strength in both underlying markets, Class IV futures rallied. The October contract soared $1.06 from last Friday. Most contracts gained between 15 and 35ȼ.

The Class III markets were more ambivalent. Cheddar blocks slipped 0.5ȼ to $1.695. Barrels climbed 7ȼ to $1.67. The dry whey market continued to deteriorate. The National Dairy Product Sales Report average slipped to just 27.5ȼ and futures languished. Most Class III contracts settled a little higher than last Friday, but the nearby September and October contracts dropped 3ȼ. The spread between the Class III and IV markets continues to narrow.

USDA announced the August Class III price at $16.27, down 6ȼ from July and down $5.98 from a year ago. The California 4b price gained 76ȼ, at $15.74. August Class IV milk was $12.90, down 25ȼ from July and an astounding $10.99 below August 2014. At $13.08, California 4a milk is a nickel higher than last month.

All products except lactose moved upward once again at the Global Dairy Trade (GDT) auction on Tuesday. The milkfat markets performed especially well. Buttermilk rose 30%, anhydrous milkfat gained 11.7% and butter climbed 8.1%. At the equivalent of $1.22/lb., GDT butter is wholly detached from the U.S. market. Strength in GDT milk powder prices did offer support to the U.S. markets. Skim milk powder (SMP) rose 11.7% to an NDM-equivalent price of 82ȼ. Whole milk powder gained 12.1%. Cheddar moved up 4.7% from the previous auction.

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This is the GDT’s second winning auction, but it’s too soon to declare that the bear market is dead. Demand remains in question. China’s economy seems adrift in troubled waters, and end users have inventories and patience to spare. Furthermore, as the Daily Dairy Report noted, “This event represented just 63% of the volume traded at the GDT a year ago, providing ammunition to skeptics who believe that the auction results do not reflect an imminent recovery in dairy product prices… New Zealand’s milk production is seasonally on the rise and expected to rival last year’s early season pace, suggesting there is still a considerable amount of dairy products to be marketed off GDT.”

European milk production is also strong. Output in June rose 3.6%. This is especially impressive given that European dairy producers had already expanded aggressively by mid-2014, and it is important because European milk production dwarfs that of the U.S. and New Zealand. Dairy producers in Europe are lamenting loudly over painfully low prices. The complaints are likely to continue, but production is unlikely to slow meaningfully. They have invested heavily to expand production and processing capacity, and most producers will tough it out.

Heavy milk production in the U.S. cheese states has predictably resulted in formidable cheese output. July cheese production totaled 988.4 million pounds, the highest ever for the month and 3.1% more than the previous record set in July 2014. Butter output remained limited as competing products lapped up cream. At 133.3 million pounds, July butter production was 3.2% lower than the year before.

The latest rally in the butter price has further widened the chasm between the U.S. and global butter markets. The domestic market now stands more than a dollar higher than both Europe and Oceania. This gap cannot persist forever. Indeed, the groundwork to erode the premium has already been laid. The U.S. has been a net butter importer since May. January through July butter imports are nearly twice as large as 2014 volumes and exports are down 76% from a year ago.

Still, the butter market may not succumb to overseas pressure just yet. The holiday demand season looms, and U.S. output has underwhelmed. End users have not forgotten the sting of $3 butter last fall, and they may be less reticent to buy ahead this year. They will also face some new competition. McDonald’s is switching from liquid margarine to butter. The fast food giant will toast its iconic Egg McMuffins and other breakfast breads in real butter, and they’ll serve them all day. Preliminary estimates suggest that this could mean an additional 25 million pounds of butter demand in the first year.

U.S. cheese exports have also suffered due to the domestic premium. U.S. cheese imports are up 26% so far this year, and imports are off 13%. U.S. exports of NDM slipped 22% in July from a year ago.

Combined output of NDM and SMP dropped to 190.2 million pounds in July, down 2.5% from a year ago and down 7.9% from June on a daily average basis. Milk intakes slipped in late August as the temperature rose, so output likely declined further last month. However, demand is shrinking faster than supply. Manufacturers’ inventories of NDM reached a new record of 269.7 million pounds in July, up 8.5% from a year ago.
For the week ending August 22, dairy cow slaughter totaled 55,022 head, up 0.9% from the same week a year ago. So far this year, the cull rate is 3.9% ahead of the 2014 pace.

**Grain Markets**

December corn futures dropped 12¢, settling at $3.63 per bushel ahead of the long weekend. Soybean futures continued to slide. The November contract closed at $8.665, down nearly 20¢. Crop prices are likely to remain under pressure through harvest.

Concerns about China have clouded the demand outlook, and the U.S. is becoming less competitive in what may be a shrinking market. The Brazilian economy is struggling and the real has plunged to multi-year lows against the dollar. It dropped 7.5% against the greenback in the just the past week. Amidst crippling uncertainty, Brazilian lenders are holding tight to their cash, and Brazilian farmers have been forced to sell more of their harvest to finance inputs for the upcoming season. South American supplies are finally flooding the market, and U.S. corn and soybean exports are likely to suffer.

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**AN UPDATE ON THE “CALIFORNIA DISCOUNT”:** *(By Rob Vandenheuvel)  For the last couple years, we’ve been regularly reporting on the gap between California’s Class 4b price and the Federal Order Class III price. We’ve also maintained a running count of the real-dollar impact of this California Discount for the past couple years, totaling a mind-blowing $1.88 Billion from January 2010-July 2015. That works out to more than $28 Million per month over those 5-plus years. It also works out to more than $1.1 Million over those five years for an average 1,000-cow dairy producing 65 lbs. of milk/cow/day.

Those numbers are real, and tell the story of a past that can never be made up for. And producers should never forget the financial wreckage those numbers represent. However, being the eternal optimists that farmers have historically been, we do need to recognize progress when it is made, and August represents the first small step in that progress.

As our regular readers know, CDFA Secretary Karen Ross made some significant adjustments to the Class 4b calculation, and those adjustments are in place for the next twelve months. As a result, the August Class 4b price was $0.53/cwt below the Federal Order Class III price – the smallest gap we’ve seen since July 2010.

Those who watch our California pricing formulas closely will note that much of that shrinking of the gap was due to collapsing whey market prices *(the “California Discount” is at its highest when whey prices are higher). Had Secretary Ross not acted, the actual discount would have been $0.81/cwt, rather than the $0.53/cwt gap we actually saw.

Going forward, we obviously continue to desperately need a long-term policy that puts California’s producers on a level playing field with producers around the country. That’s why the California Federal Order hearing that begins later this month is so critical. But in the meantime, it’s good to know that the California Discount we experience each month will be significantly smaller than the painful figures we’ve reported the past several years.

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The MPC board and staff would like to wish all of you a happy and healthy Labor Day Weekend!