DATE: September 5, 2014
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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<td>Dairy Market News</td>
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**FRED DOUMA’S PRICE PROJECTIONS...**
Sept 5 Est: Quota cwt. $24.77 Overbase cwt. $23.08 Cls. 4a cwt. $24.85 Cls. 4b cwt. $22.23
Aug ’14 Final: Quota cwt. $23.42 Overbase cwt. $21.72 Cls. 4a cwt. $23.83 Cls. 4b cwt. $19.96

**MARKET COMMENTARY:** (By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)

Milk & Dairy Markets

After a brief respite, CME spot butter is once again sitting at record highs. This week it climbed to $2.845/lb., up 9¢ from last Friday. Fresh barrel supplies have been hard to come by and for weeks barrels have been the driving force behind the Cheddar market’s march to multi-month highs. But this week they slipped, dropping 2¢ to $2.325. Fresh cheese is reportedly becoming a little easier to find, although it is far from abundant. Blocks closed at $2.35, up 2¢. Grade A nonfat dry milk (NDM) rallied 0.75¢ on Tuesday and then paused, settling at $1.3325.

September Class III futures gained 37¢ this week, but all other contracts moved lower as traders believe that the cheese market must eventually acknowledge overseas pressures. Class IV futures put in a mixed performance.

Milk checks are big and getting bigger. USDA announced the August Class III price at $22.25/cwt., up $0.65 from July and $4.34 higher than last year. Futures project that the September Class III price could be as much as $2 higher. At $23.89, the August Class IV price was $0.11 higher than July and $4.82 above the previous year. California’s dairy producers will enjoy an even larger month-to-month jump in their mailbox milk price. The California 4a price is $23.83 for August, up $0.25 from July and $5.13 higher than August 2013. The 4b price is $1.27 higher than last month, at $19.96.

Margins are excellent and U.S. dairy producers are likely doing all they can to increase production. Meanwhile, producers overseas are bracing themselves for leaner times. A number of cooperatives in the United Kingdom and Europe have cut their pay-price forecasts. Fonterra and Westland have already lowered their forecast for New
Zealand’s dairy producers, but they may have to do so again. The Global Dairy Trade (GDT) index plunged 6% to two-year lows on Tuesday. The drop was unexpectedly large and no product was spared. The 9.5% decline in skim milk powder (SMP) prices was particularly noteworthy.

Dairy product output usually wilts in July as milkflows succumb to high temperatures. But this year producers in the Midwest and Northeast enjoyed a mild summer and greater cow numbers helped to offset heat losses in the rest of the country. While daily average cheese, butter and milk powder production was lower in July than in June, the month-to-month deficit was smaller than in a typical year. At 956 million pounds, July cheese output was the highest ever for the month, up 7% from last year. Butter production exceeded the prior year by 2.6% and also recorded a new high for July. Combined production of NDM and SMP was 14.1% greater than July 2013.

Manufacturers switched drier capacity from SMP to NDM in July. SMP output has not been this low, nor NDM production this high, since June 2012. While slumping SMP prices certainly warranted the shift, there was no great demand for the sudden boom in NDM supplies. Manufacturers’ stocks of NDM soared to all-time highs at 250.4 million pounds. Stocks are 21% higher than at this time last year. Milk powder inventories typically decline from June to July, but this year they grew by 21.5 million pounds. Increased supplies are only partly to blame for rising stocks. NDM exports fell 17% from June levels, and domestic users have been in no rush to buy. They are waiting for the U.S. milk powder market to match the declines seen overseas, and those markets are still eroding.

Butter exports slumped to 11.9 million pounds in July, down 7% from June and 39% lower than the previous year. Imports rose to the highest level since December 2012. Cheese exports also slipped when compared to June, but they were still 18% greater than in July 2013. Cheese imports are climbing, and in the coming months the disparity between U.S. and global cheese and butter prices is likely to attract even larger volumes of those products to our shores. European exporters are particularly motivated to find new markets in the wake of the Russian import ban, and this week they got a little help from Mario Draghi. The European Central Bank unexpectedly lowered interest rates and seems inclined to enact asset purchase measures similar to the Fed’s soon-to-be-retired quantitative easing program. The already gaping chasm between U.S. and European cheese and butter prices widened further as the euro fell to 14-month lows against the dollar.

For the week ending August 23, dairy cow slaughter totaled 54,474 head, down 7.2% last year. After 34 weeks, dairy slaughter is 10.4% lower than at the same
time a year ago. Lean beef prices stand at record highs and are fast approaching $3.00/lb. But the under-supplied beef market has been wholly unable to entice dairy producers to ignore their excellent margins and increase cull rates.

Grain Markets
The corn and soybean crops are flourishing and harvest looms. Silage chopping is getting underway in the Midwest just in time for the latest drop in the corn market. December corn futures fell to four-year lows this week, touching $3.4375/bushel. On Friday they bounced back to $3.56, but remained almost a dime lower than last week.

Soybean and soybean meal prices once again whipsawed as the market struggles to balance its empty cupboards and burgeoning fields. All told, soybean prices retreated a few cents. There is a possibility of frost in a couple weeks, but it is too soon to have much confidence in that forecast. A hard frost could incrementally reduce yields. Still, record corn and soybean crops are all but assured.

MORE ON THE NEW MARGIN PROTECTION PROGRAM FROM NATIONAL MILK PRODUCERS FEDERATION: (By Rob Vandenheuvel) Last week, we mentioned that the final details of the new Margin Protection Program (MPP) had been announced by the U.S. Department of Agriculture and that signups are now available. As I mentioned, the signup period is open through November of this year, so producers have some time to evaluate the program and how it fits within your dairy’s risk management toolbox. To that end, MPC is in the process of scheduling member meetings throughout the state, to be held in the coming weeks, to go over the details of the program and the process of signing up. The specific dates/locations of those meetings will be announced in next week’s newsletter.

In the meantime, below is a great article on the MPP published this week by Jim Mulhern, President and CEO of National Milk Producers Federation (NMPF). The article can also be found on NMPF’s website at: http://www.nmpf.org/print/1975.

The Margin Protection Program: Dairy’s Foundation for the Future
By Jim Mulhern, NMPF President & CEO

What a change 2014 has brought for the nation’s dairy farmers. Milk prices have reached record levels, and feed prices have plunged to the lowest level in nearly a decade, thanks to ideal growing conditions in the Corn Belt.

It’s a long way, indeed, from the dark days of 2009, when farmers lost money on every hundredweight of milk they produced, month after month. That prolonged period of non-existent operating margins between 2007 and 2009 robbed farmers of a collective $20 billion in equity.

As dark as 2009 was, the present moment, at least, stands in bright contrast. But high prices have a history of curing high prices, and we all know that commodity production is a cyclical business. Just as stormy weather never persists, neither do the sunniest days. That’s why we have rainy-day plans, for the challenging times that inevitably follow the good ones.

Thus, in the midst of our present good fortune, 2014 has also brought the dairy producer community a new way to prepare for those rainy days, in the form of the Margin Protection Program contained in the Farm Bill passed by Congress earlier this year and just implemented by the U.S. Department of Agriculture.
This month, dairy farmers will have the opportunity to learn about and eventually enroll in the new MPP. It’s a risk management program for the 21st century, one that recognizes that past federal programs to help farmers – those that targeted the milk price alone – are no longer adequate in an era when feed costs are much more volatile than in the past (2014’s anticipated bumper crop notwithstanding…we can’t count on perfect weather ever year).

The program that is debuting this month represents NMPF’s vision for how farmers can protect against the types of catastrophic conditions we experienced in 2009, and again as recently as 2012. It will protect against the most critical gap on a dairy farm: the difference between a farmer’s milk price, and the cost of corn, soybean meal and alfalfa hay that farms typically use to produce that milk.

Producers will be able to insure their margins on a sliding scale, deciding both how much of their milk production to protect, and the level of margin they wish to cover. Basic margin coverage, at $4 per hundredweight, is at essentially no cost to the farmer, aside from a $100 annual registration fee. Above the $4 level, coverage is available for an escalating scale of premiums.

Let’s look at an example of how MPP might have worked in 2012, when margins dropped below $4. Consider a 500-cow dairy with 90 percent of its production covered and its margin insured at $6.50 per hundredweight. Had MPP been in effect, that farm would have paid a premium of $21,500 in 2012. But it would have received benefits of more than $140,000, for a net gain of at least $120,000.

A 100-cow dairy with similar coverage would have paid a premium of approximately $1,600 and come out $23,600 ahead, while a 1,000-cow dairy would have paid a $56,000 premium and come out $260,000 ahead.

Most importantly, the safety net would have gone a long way toward keeping these farms from financial ruin, as margins dipped below $4 per hundredweight.

The ability to use a voluntary, flexible government program to insure margins had its genesis at the grassroots level, through an NMPF effort we called “Foundation for the Future.” Dairy producers and their co-ops were instrumental in coming together through NMPF, and convincing Congress to include the concept in the 2014 farm bill.

Over the last six months, NMPF has worked closely with the Agriculture Department on the details of how to implement MPP. On balance, we’re pleased with the way things turned out. Looking ahead, in the coming months we’ll be putting a lot of effort into explaining why it’s critically important for farmers to sign up for MPP. To help producers make coverage decisions, we have multiple tools on our websites, including a downloadable calculator allowing them to gauge the program’s potential impact on their farms.

Above all, producers shouldn’t let today’s healthy margins lull them into inaction. MPP’s insurance protections aren’t likely to be triggered the remainder of 2014. But U.S. milk production was up nearly four percent in July, suggesting that a surge in milk production could be coming down the pike. If supply begins to outstrip demand (and eventually there is always a day of reckoning that arrives), farmers need to protect themselves when the time comes.

Fortunately, producers can sign up between now and Nov. 28th for minimal cost, and will be able to adjust their coverage for future years on an annual basis. However, they need to be in the program to make those adjustments.

If current conditions continue 2014 will be remembered, fondly, as one for the record books. But it will also be remembered as the time when we established a new foundation that will help greatly in those years when strong milk prices are nowhere to be found.