DATE: September 12, 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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<tbody>
<tr>
<td>Blocks N/C $2.3500</td>
<td>Weekly Change $+.1550 $3.0000</td>
<td>Week Ending 9/5 &amp; 9/6</td>
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<tr>
<td>Barrels $+.0100 $2.3350</td>
<td>Weekly Average $+.1685 $2.9860</td>
<td>Calif. Plants $1.4594 20,798,317</td>
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<td>Nat’l Plants $1.4825 37,008,975</td>
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Weekly Average, Cheddar Cheese

| Blocks N/C $2.3500 | Dairy Market News w/e 09/12/14 $2.3500 | National Plants w/e 09/06/14 $2.3300 |
| Barrels $+.0069 $2.3300 |                                  |                                  |

DRY WHEY

<table>
<thead>
<tr>
<th>Dairy Market News</th>
<th>National Plants</th>
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<tr>
<td>w/e 09/12/14 $1.4594</td>
<td>9,066,096</td>
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<tr>
<td>w/e 09/06/14 $1.4825</td>
<td>20,663,836</td>
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FRED DOUMA’S PRICE PROJECTIONS...

Sept 12 Est: Quota cwt. $24.28 Overbase cwt. $22.58 Cls. 4a cwt. $23.12 Cls. 4b cwt. $22.24
Last Week: Quota cwt. $24.77 Overbase cwt. $23.08 Cls. 4a cwt. $24.85 Cls. 4b cwt. $22.23

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

Milk & Dairy Markets

The dairy markets got off to a strong start this week. October Class III futures sprinted to new all-time highs on Tuesday and the other markets also raced upward. But then fatigue set in. Dairy product prices collapsed Wednesday and deflated further Thursday. The losses were widespread, with limit down trades in a number of Class III, cheese, nonfat dry milk (NDM) and butter contracts. On Thursday, several butter contracts lost a dime as the market traded under expanded limits.

The most curious aspect of this week’s crash is that it lacked an obvious catalyst and was unaccompanied by a similar decline in the spot market. Indeed, traders in the dairy pit cheered Friday as butter changed hands at an astounding $3.00/lb., up 15.5¢ on the week. Although the other products posted less dramatic gains, their steady to higher performance was still quite a feat given the pervading bearishness. Cheddar blocks held at $2.35 and barrels added a penny, closing at $2.335. Grade A NDM climbed 0.75¢ to $1.34.

It seems that the trade remains concerned about near-term cheese and butter stocks but has finally – and suddenly – concluded that lower prices are warranted next year due to the outlook for abundant global supplies. While September through November Class III futures moved higher, later contracts posted losses around 35¢. The Class IV market suffered steep declines, with the December, February and April contracts all dropping a dollar or more. Based on today’s prices, dairy producers in Class III (or Class I) orders face much better returns than those whose milk checks rely more heavily on the Class IV market.
The milk powder market remains feeble, but manufacturers in the U.S. have found a way to sell larger volumes: lower prices. According to the National Dairy Product Sales Report (NDPSR), NDM prices averaged $1.4825 for the thirty days ending September 6, down 28.99¢ or 17% from the previous week. Similarly, the California Weighted Average Price for NDM plunged to $1.4594. The 27.53¢ decline from the previous week was the largest in the history of the index. Sales volumes for both surveys soared.

For now, the other dairy products remain strong. Dry whey prices slipped a little from the previous NDPSR survey, but butter prices gained 8.3¢ and Cheddar prices climbed almost 7¢. Domestic demand remains firm even at today’s prices, but the tide is shifting in the export markets. Exports accounted for 7.7% of January to July cheese production and 11.2% of butterfat output. But the U.S. may become a net importer of both products later this year. USDA’s Dairy Market News reports that butter cargoes from New Zealand and Australia “are in the process of coming to the U.S.”

It is not unusual for the U.S. to import butter or anhydrous milkfat (AMF) from New Zealand when the U.S. butter market stands at a premium. However, imports from Europe are rare. European butter prices are typically higher than U.S. prices, and over-quota tariffs of 70¢/lb. serve as a further barrier to entry. But this year the chasm between U.S. and global butter prices is so wide, it easily overwhelms the tariff. The Daily Dairy Report noted this week that the U.S. can import just over 15 million pounds of butter this year under its quota allocation, but there is no reason to stop there. At $3/lb., U.S. butter holds a $1.34 premium to the Dutch market and it is $1.495 higher than butter in New Zealand. Under the North American Free Trade Agreement, the U.S. can also import AMF duty-free from Mexico. Our neighbor to the south is likely to import AMF from New Zealand in order to free up domestic supplies that can enter the U.S. without paying the tariff.

The incentive for the U.S. to import dairy products will be further bolstered by the currency markets. The U.S. dollar index has rallied for nine consecutive weeks, its longest such run in 17 years. The dollar index measures the greenback’s performance against a basket of currencies that is heavily weighted toward the euro. The U.S. dollar now stands at seven-month highs against the New Zealand dollar.

For the week ending August 30, dairy cow slaughter totaled 55,820 head, down 10.9% from the same week last year. For the year to date, slaughter is 10.4% below the same period in 2013.

**Grain Markets**
Corn and soybean prices fell to four-year lows after USDA confirmed that both crops will be record-large. December corn futures dropped 17.5¢ and closed at $3.385 per bushel. USDA is often cautious about raising its yield forecast dramatically in the September Crop Production report, but on Thursday the agency forecast a national average corn yield of 171.7 bushels per acre. This is 4.3 bushels greater than its August forecast and was larger than the average guess ahead of the report. The corn crop is expected to total a bin-busting 14.4 billion bushels.
Plenty of last year’s corn is still in storage, and there is simply not enough room for all of this year’s harvest. USDA officials told the Senate Commerce Committee that this year’s crop will be around 694 million bushels larger than domestic storage capacity. Rail backlogs have slowed the flow of old crop corn out of the Corn Belt and exacerbated storage issues. Farmers in some areas face low corn prices, a falling basis and added storage charges at their local elevators.

November soybean futures dropped 36.25¢ this week to $9.8525. The September contract remains volatile as it tries to reconcile tight inventories and the looming harvest. USDA expects the soybean crop to total 3.9 billion bushels with an average yield of 46.6 bushels per acre. The yield is 1.2 bushels higher than USDA’s August forecast and fell in line with pre-report expectations. South American production is also expected to be record large. There will be no shortage of feed this year, and dairy producers should enjoy much lower feed costs for at least the next year.

**LOTS OF TALK ABOUT “FIXES,” BUT THE CALIFORNIA DISCOUNT CONTINUES:** (By Rob Vandenheuvel) A couple weeks ago, we wrote an article about the busy month of August with talks about California legislation that would start to shrink the gap between the California Class 4b and Federal Order Class III prices. The latest information on that discount for August is yet another reminder that this problem is not going away on its own. As shown below, California’s Class 4b price (for milk sold to CA cheese manufacturers) was $2.29 per hundredweight below the Federal Order Class III price (benchmark price for milk sold to cheese manufacturers around the country) last month. Since 2010, the gap represents more than $1.46 Billion in forgone revenue that never made it into the California pool. What does that mean for the average CA dairy? If you’re a 1,000-cow dairy producing 65 lbs of milk/cow/day, this $1.46 Billion represents about $858,000 since 2010 to your dairy alone!

The status quo is unacceptable, and only you as dairy producers pay the price of inaction. While reforms to the state system are no longer a near-term option, the three cooperatives have been developing a proposed California Federal Milk Marketing Order that could put California producers on an even playing field with their out-of-state colleagues. While we understand that is a lengthy process, producers need that effort to come to fruition so they can have that as a real option. So challenge your cooperative leadership to keep moving that effort forward. California producers can’t afford to be the cheap milk state forever.

**NOTE:** (By Rob Vandenheuvel) Last week, we mentioned MPC area meetings would be held in the coming weeks to go over the details of the new Margin Protection Program that was created by the 2014 Farm Bill. We were unable to finalize all the details of those meetings prior to publication of this newsletter, but once they are set, information will be sent out to members immediately. They will also be included in next week’s newsletter. We look forward to seeing you there!