DATE: September 20, 2013
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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<tr>
<td>Blocks</td>
<td>Weekly Change</td>
<td>Week Ending 9/13 &amp; 9/14</td>
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<tr>
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<td>Calif. Plants</td>
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<tr>
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<td>Barrels</td>
<td>Weekly Average</td>
<td>Nat’l Plants</td>
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<td>Weekly Average, Cheddar Cheese</td>
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<td>$1.8010</td>
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<td>$1.7720</td>
<td>$1.5794</td>
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</tbody>
</table>

DRY WHEY

| Dairy Market News | National Plants |
| w/e 09/20/13      | w/e 09/14/13    |
| $.5638            | $.5794          |

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FRED DOUMA’S PRICE PROJECTIONS...

Sept 20 Est: Quota cwt. $19.42 Overbase cwt. $17.72 Cls. 4a cwt. $19.36 Cls. 4b cwt. $16.68
Last Week: Quota cwt. $19.46 Overbase cwt. $17.76 Cls. 4a cwt. $19.26 Cls. 4b cwt. $16.83

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

_Milk & Dairy Markets_

The holidays are looming and the butter market is booming. Manufacturers are struggling to keep up with firm demand from all buyers, whether foreign or domestic. CME spot butter settled at $1.60/lb., up 7¢ from last week to its highest level since May. A record-large 36 loads traded on Friday, and an impressive 67 loads changed hands this week. Both October and November butter futures added a nickel Friday, settling limit up. Milk powder demand remains strong, and Grade A nonfat dry milk (NDM) futures rose 1.5¢ this week. Class IV futures rallied Friday but ended the week slightly below where they began it.

The buoyant Class IV market helped Class III futures to rally from their lows on Friday, and the Class III market was mixed on the week. September through November contracts settled 4¢ to 10¢ lower, while deferred contracts managed moderate gains. CME spot Cheddar blocks and barrels continued to fade from the highs posted last week. They each lost 4.5¢. Not a single load traded this week. If the cheese market continues to follow the same pattern of highs and lows that has been in place since May, it is likely to deflate for another few weeks before turning higher again.
Across the nation, dairy processors of all types are complaining of tight milk supplies. Cheese and milk powder manufacturers have reduced output. Butter makers must choose whether to modify their products to capture the premium offered by the export market or meet the needs of domestic buyers. Domestic dairy product inventories are likely falling.

But for all the talk of “tight milk supplies,” the seasonal lull in milk production has been muted. Supplies are tight because demand is firm. According to USDA’s Milk Production report, August milk production totaled 16.835 billion lbs., up 2.6% from August 2012. This was the steepest year-over-year increase in monthly milk output since April 2012. Only two states – New Mexico and Idaho – reported lower production than last year.

California milk production totaled 3.393 billion lbs., which was 2.7% higher than August 2012. This is the Golden State’s first year-over-year increase in milk production in thirteen months. USDA did not provide an estimate of milk cow numbers due to the sequester, but given the high cull rates in California and throughout the West, it seems that regional gains in milk production were driven by stronger output per cow. Milk production growth in the Midwest was not as spectacular as it has been in recent months. This suggests that per-cow production in the cheese-producing states suffered during last month’s hot spell.

Prices moved incrementally higher at the 100th Global Dairy Trade (GDT) event. The GDT Price Index was up 0.3% from the previous event. Skim milk powder prices dropped 1.7% while whole milk powder prices added 1.1%. Cheddar increased 1%. Butter was undoubtedly the stand-out product. The average winning price for butter was up 5.2%. California-based Dairy America sold butter for October delivery at $1.653/lb. after equating to 80% butterfat. On the same day, Dairy America’s competitors sold 20 loads of butter at the CME spot market for $1.52.

The California Weighted Average Price for NDM rose to $1.7847/lb. the index’s highest level since December 2007. Sales volume ticked upward.

For the week ending September 7, which included Labor Day, dairy cow slaughter totaled 56,478 head. This was up 1.1% from the same week last year. Year to date slaughter remains 2.5% higher than 2012.

According to USDA’s Cattle on Feed report, September 1 cattle inventory totaled 9.1 million head. This is 7% lower than the prior year and was slightly lower than pre-report expectations. Finished cattle supplies will likely tighten later this year and the cattle industry will not be able to expand the herd for years. Beef prices will be well supported into 2014 and beyond.

Grain and Hay Markets

December corn futures settled at $4.51 per bushel, down 8¢ from last week. The basis is also beginning to fall, so dairy producers are finally able to enjoy lower cash grain prices. Corn futures spiked higher Tuesday after the Farm Services Agency (FSA) released its acreage data, but the rally was short-lived. FSA data is notoriously hard to interpret. Analysts agree that the data points to lower planted acreage than on the most recent USDA Crop
Production report. However, this does not imply a one-to-one decline in harvested acreage, and the overall impact of the FSA data seems minimal. Anecdotal harvest reports continue to suggest better than expected yields, and the bears rule the corn market.

Soybean and soybean meal futures were anemic this week. November soybeans lost nearly 70¢ and December soybean meal dropped more than $40/ton. Soybean prices have not been able to sustain rallies alongside the clearly bearish corn market, and early reports from the field suggest yields are no worse than anticipated. Rains across the Corn Belt are helping the crop to finish well, and there is no threat of frost in the forecast.

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“DON’T MODEL CHEESE PRICING” – HOARD’S DAIRYMAN LETTER TO THE EDITOR: (By Rob Vandenheuvel)  The current issue of *Hoard’s Dairyman* includes a Letter-to-the-Editor from MPC’s Vice-President Geoffrey Vanden Heuvel. The letter responds to an editorial from a previous issue of the magazine stating the need for a robust price discovery method for nonfat dry milk (nfdm) and using the price discovery methods for cheese as a good example. Below is Geoffrey’s response to that idea:

**Don’t model cheese pricing**  
*From September 10, 2013 Issue of Hoard’s Dairyman (Page 566)*

*Hoard’s Dairyman* really missed the boat in the August 10, 2013, editorial “Nonfat dry milk is mired in price discovery limbo” on page 500. The editorial started with a commonsense observation, asking why U.S. powdered milk prices are reported to be so much lower than international prices. However, *Hoard’s Dairyman* took this to an inappropriate conclusion when you endorsed the “price discovery mechanisms for cheese” as being a more “robust” alternative.

Let’s examine the primary price discovery mechanism used in valuing cheese in the U.S.: the daily activity in the Chicago Mercantile Exchange (CME). The results of those few daily trades of block and barrel Cheddar cheese have a direct (in California) and indirect (in Federal Orders) impact on the price paid for milk sold to cheese plants.

So, who is involved in these important transactions each morning in Chicago? On the one side you have sellers, who are often just looking to move product they weren’t able to sell through other channels. They also know that if they lower the price in order to sell their product, it will ultimately contribute to lower milk prices and lower input costs in the weeks to come.

On the other side you have buyers, who obviously prefer to keep the price of cheese as low as possible. To be honest, I’m almost surprised anytime I see the price of cheese actually go up on the CME! As I write this letter, I see that block cheese dropped 2.75 cents per pound today in the CME on zero trades. Is that really a “robust” mechanism that should be driving our producers’ milk checks around the country?

In addition, it’s important to note that those who participate in the daily cash market can also stake out positions in the futures markets for cheese and Class III milk. So, let’s think about this…the sellers of cheese in the daily cash market have a clear knowledge of what they plan to do the next day, week or month, knowing exactly how much cheese they plan to sell in the thinly-traded daily market. They also have the ability to take positions in the highly-liquid futures markets, which are largely impacted by the events that occur in the daily cash market. It’s like having tomorrow’s newspaper today! Are we really going to pretend that there’s no opportunity for manipulation in that situation?

Now to be fair, while these comments may sound critical of the Chicago Mercantile Exchange, they are not meant to be. The CME was never intended to be a price discovery mechanism used to dictate the value of cheese milk sold throughout the country. We, as an industry, have allowed that to happen, and shame on us for that. But let’s not compound our mistake by hoisting this system up as a model for other dairy commodities.
The Innovation Center for U.S. Dairy is absolutely right to be having discussions on developing robust price discovery solutions for all dairy products including cheese. One interesting model that is worth exploring is the Global Dairy Trade biweekly auction.

Some of the intriguing features of that auction structure include:
1. Short, medium and long-term product availability and pricing.
2. Strong participation, perhaps due to the biweekly nature of the auction.
3. Transparency in what the products are being sold for (although there is probably room for improvement in this area).

The bottom line is that given the end-product pricing system we have around the country, our dairy farming industry is greatly reliant on determining a fair and transparent value for our dairy products. If we are intent on keeping that end-product pricing structure, let’s not sell ourselves short and accept the deeply flawed cheese model as our hope for the future.

GEOFFREY VANDEN HEUVEL
Dairyman, Chino, CA

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WATCH MAILBOX FOR MONITORING PROGRAM NOMINATION FORMS: (By James Garner, Dairy Cares) The Central Valley Dairy Representative Monitoring Program (CVDRMP) is seeking nominations for candidates for election to the CVDRMP Board of Directors. All CVDRMP members in good standing will soon receive a nomination form and instructions by U.S. mail; nomination materials will be mailed to CVDRMP members during the week beginning September 23.

A total of six seats are open for election or re-election, one for each of the five CVDRMP Districts and one at-large seat. A CVDRMP member may nominate himself/herself or any other CVDRMP member as a candidate within any given district. All nominations must be received at the CVDRMP office no later than October 18, 2013.

Following the close of nominations, the election for CVDRMP Board members will be held by mail-in ballot in November and/or December 2013.

CVDRMP is a not-for-profit association of dairy owners and operators, organized for the sole purpose of conducting a cost-effective groundwater monitoring program on behalf of its members. CVDRMP is governed by 12 elected directors serving two-year staggered terms, with half the seats up for election or re-election each year. Directors elected this year will serve from January 2014 through January 2016.

More information about CVDRMP as well as a downloadable nomination form is available at www.DairyCares.com/CVDRMP.