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     +$0.0175 $1.5500</td>
<td>Weekly Change  - $0.0475 $1.8500</td>
<td>Week Ending 9/30 &amp; 10/1</td>
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<td>Barrels    N/C $1.5100</td>
<td>Weekly Average  - $0.0720 $1.8565</td>
<td>Calif. Plants $0.8924 11,535,112</td>
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<td>Nat’l Plants $0.9076 18,111,857</td>
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<td>Weekly Average, Cheddar Cheese</td>
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<td>Blocks     - $0.0005 $1.5360</td>
<td>Dairy Market News w/e 10/07/16 $3.350</td>
<td>Calif. Plants $0.8743 9,088,116</td>
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<td>Barrels    N/C $1.4810</td>
<td>National Plants w/e 10/11/16 $3.135</td>
<td>Nat’l Plants $0.9022 13,481,957</td>
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DRY WHEY

Dairy Market News w/e 10/07/16 $3.350
National Plants w/e 10/11/16 $3.135

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FRED DOUMA’S PRICE PROJECTIONS...

Oct 7 Est: Quota cwt. $15.67 Overbase cwt. $13.98 Cls. 4a cwt. $13.11 Cls. 4b cwt. $14.16
Last Week: Quota cwt. $15.57 Overbase cwt. $13.87 Cls. 4a cwt. $13.14 Cls. 4b cwt. $13.93

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

Milk & Dairy Markets

For months, overseas dairy product markets have climbed energetically upward. Fueled by expectations for lower milk output in Europe and Oceania, they never seemed to tire. But this week, they looked a little less sprightly. In Europe, most products continued to ascend but at a much slower pace; several markets paused to take in the landscape. In Oceania, they went a little ways back down the trail. All products expect buttermilk lost ground at the Global Dairy Trade (GDT) auction; the GDT index fell 3% from the previous event, its first retreat since early July. Whole milk powder (WMP) prices slumped 3.8%, and the average winning price for skim milk powder was 3.9% lower. Cheddar prices slipped 2.3% and butter finished a little behind.

With inertia abroad and abundance at home, the Class IV markets faltered. CME spot butter dropped to a nearly 18-month low at $1.85/lb., down 4.75ȼ from last Friday. Nonfat dry milk (NDM) ended at 91.5ȼ, down 3ȼ, the first weekly decline in spot milk powder since August. Class IV futures settled 20 to 60ȼ lower.

Held fast by either indecision or contentment, CME spot Cheddar blocks went nowhere for most of the week, but today they perked up and closed at $1.55, up 1.75ȼ from last Friday. Cheddar barrels also strengthened late in the week, which brought them back to even at $1.51. Nearby Class III futures were 20ȼ lower, but deferred contracts moved a little higher.
Domestic milk powder prices remain at a sizeable discount to product overseas. After adjusting for protein, SMP for nearby delivery averaged $1.07 at the GDT auction this week, down from $1.11 at the September 20th event. It’s been a year since spot NDM at the CME topped a dollar. That has helped buoy U.S. NDM exports, which climbed to a 15-month high of 116 million pounds in August, up 22.7% from the previous year. Shipments to Mexico were particularly impressive, up 42% from last August.

Processors have shifted milk from NDM to SMP. In August, NDM production fell 5.8% short of year-ago volumes, while SMP output jumped 17.2%. Manufacturers’ stocks of NDM fell by 22 million pounds from July to August, but they stand 1.5% higher than the year before.

U.S. cheese and butter prices stood at a substantial premium to product from overseas for nearly a year and a half. That disparity is still rippling through trade flows, but it will soon shift. Domestic cheese and butter is now some of the least expensive available, and export volumes are likely to climb. But in August, cheese and butter exports suffered and imports thrived. The U.S. imported 4.3 million pounds more butter than it sent abroad. Net cheese exports dropped to 14.2 million pounds, the smallest monthly volume since February.

At 129 million pounds, butter production was 0.7% greater than last August. In light of the small drawdown in butter stockpiles, this tepid growth in butter output implies softening demand for butter. Inventories are plentiful heading into the holiday baking season. Fortunately, domestic churns will not have to compete with as much imported butterfat in the months to come.

U.S. cheese output in August was 990 million pounds, up 1.2% from a year ago. Cheese makers continue to favor Italian style cheeses; output of those varieties was up 5% from a year ago. Production of American style cheese was down 1.4% from last year and Cheddar output was steady.

Despite continued growth in cheese output, whey production waned. As they Daily Dairy Report noted, “Processors did not shift whey streams from one product to another; they simply used less whey than a year ago.” With the help of robust exports, whey stocks are falling. At 59.5 million pounds, inventories of dry whey for human consumption are smaller than in any month since November 2015. The whey market is slowly but steadily climbing. National Dairy Product Sales Report whey prices are up 33.3% so far this year.
For the week ending September 24, dairy cow slaughter reached 58,209 head, the highest for any week since March but still down 1.5% from last year. For the year-to-date, dairy cow slaughter is 1.5% behind last year’s pace.

Grain Markets
Rocked by the waves of the currency and energy markets, grain and oilseed futures moved violently back and forth this week. Both December corn and November soybean futures finished roughly a nickel higher, at $3.3975 and $9.5675 per bushel, respectively.

Harvesters are rolling in the Corn Belt and yields continue to impress. But harvest pressure is notably absent. Farmers are storing their corn and praying for higher prices. If their prayers are answered, corn will move from the bin to the elevator. Thus, significant rallies will likely be short-lived.

China continues to browbeat the grain and oilseed trade. It is clear that China’s central planners want to see domestic prices recover so that they can whittle away their colossal inventories, and to encourage Chinese farmers to step up production. China cannot be self-sufficient in grain and oilseed output, but for now they see cheap imports as an invasive species. DDGs are the major culprit, and U.S. DDG export volumes have languished even as prices fall. China continues to buy soybeans en masse, but officials are speaking out against the practice. This is probably pure politics, meant to convey sympathy to the plight of domestic farmers without requiring much action. But even a slight slowdown in Chinese soybean purchases could have a big impact.

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WHAT’S THE LATEST ON THE CALIFORNIA DISCOUNT?: (By Rob Vandenheuvel) Our very active California Legislature kept us pretty focused on their shenanigans over the summer, so it’s been a while since we’ve published an update on the California Discount. So how has our Class 4b price been tracking with the Federal Order Class III price? In short: better than the past few years, but still a significant discount in the regulated price that California’s cheese manufacturers must pay for the milk that they need.

You can see the price differentials in the table here (an average discount of $0.74/cwt, and $1.15 in September), but what has that meant in real dollars for California’s dairy families? In 2016 alone (January – August only, which we have utilization data for), the California Discount has resulted in $89 million less revenue to the California pool. For an average 1,000 cow dairy, producing 65 lbs/cow/day, this equates to almost $54,000 through the first eight months of the year. Granted, the California Discount in the first eight months of 2015 was nearly $200 million; but while we recognize the improvement, our dairy families cannot afford any kind of long-term discount in the price we receive for our milk. And frankly, with the labor and environmental regulations now set to be implemented in the near future, our manufacturers are going to have to find a way to pay MORE than their out-of-state colleagues if they want to have a sustainable local supply of milk.

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IN CASE YOU MISSED IT: INTERVIEW WITH LOS ANGELES RADIO SHOW ON CALIFORNIA’S RECENT METHANE REDUCTION LEGISLATION: (By Rob Vandenheuvel) This past week, the John & Ken Show on KFI 640 AM in Los Angeles, took on the issue of California’s Climate Change Legislation – specifically the Legislature’s move to regulate methane produced on California’s dairy and livestock operations. The John & Ken Show – which boasts more than a million weekly listeners – invited me to participate in the discussion, which you can listen to here: https://goo.gl/GPHYex. This was certainly one of the more unique radio interviews I’ve had, and I am very much appreciative of John and Ken’s interest in the ridiculous job-killing regulations being constantly churned out in Sacramento.