DATE: October 19, 2007
TO: DIRECTORS & MEMBERS
FROM: John Kaczor

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

<table>
<thead>
<tr>
<th></th>
<th>CHICAGO AA BUTTER</th>
<th>NON-FAT DRY MILK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blocks</td>
<td>Weekly Change</td>
<td>Week Ending 10/12 &amp; 13</td>
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<tr>
<td>NC</td>
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<td>$1.2900</td>
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<tr>
<td>Barrels</td>
<td>Weekly Average</td>
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<tr>
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Weekly Average

<table>
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<tr>
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<th>DRY WHEY</th>
<th>WEST MSTLY AVG</th>
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<td>WEST MSTLY AVG w/e 10/18/07</td>
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<tr>
<td>Barrels</td>
<td>NASS</td>
<td>WEST MSTLY AVG</td>
</tr>
<tr>
<td>+$.0055</td>
<td>$1.8735</td>
<td>$.4100</td>
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CHEESE MARKET COMMENTS: The inversion of prices between block and barrel prices on the CME continues, while USDA sees uncertainty and even speculation about the future direction of the market. Buyers appear to be more certain that prices will be lower fairly soon than being concerned about adequate supplies for the upcoming 3-month heavy sales season. They are cutting it thin in terms of the time needed to service their major retail accounts. The report that September milk production was 2.6% above a year-earlier did not phase the market. Next Monday's cold storage report should give all concerned a bit more direction. It still appears that the cheese market is being supported by fairly firm fundamentals, meaning the balance between supply and demand if fairly close. This is good.

BUTTER MARKET COMMENTS: Prices gained a half-cent this week, but that is not to be taken as a sign of strength. More like a sign of steadiness, or even stubbornness. $1.29 per lb is not as good as $1.40, but considering the slow-down in sales that started in late May while production increased, it’s not bad. The hoped-for surge in butter exports looks like it won’t be significant or long. So far, through August, exports of butter are 85% higher than a year earlier, but still represent an insignificant proportion of total sales. USDA reports that European butter manufacturers are expecting to be able to supply their regular customers by early next year. So the attention returns to the amount of butter in storage. When will it start to drop?

NONFAT DRY MILK: There is still no significant competition from other countries on the supply side, and none seems likely through next Spring. That should bode well for nfdm prices, and for future milk prices, although unsold inventories have recently been reported to be about 50% higher than last year. Last week the NASS and California plant average prices were around the $2.08 per lb level, up about 3 cents from the previous week. Export sales are reported to be slowing even though the average price for those sales are running about $.15 per lb below domestic prices. Something seems a little un-real about these prices. Validation of current export prices may be needed to support the current domestic prices.

WHEY MARKET COMMENTS: The word is spreading: dry whey prices appear to have found the bottom, and a wee bounce can even be seen. USDA reports higher prices and a firm market. Exports of dry whey through August accounted for more than one half of all production, and are more than 20% above last year. The cautionary comment is to not expect a recurrence of 80-cent whey any time soon. WPC prices continue to drift lower, but the volume that is exported continues to increase as more countries are looking to the U.S. for dairy proteins. The Western "mostly” price is up another one-half cent, at $.41 per lb. Lactose prices continue well-below where they should be.

FRED DOUMA’S PRICE PROJECTIONS...

OCT 19 EST: Quota cwt. $21.03 Overbase cwt. $19.33 Cls. 4a cwt. $21.30 Cls. 4b cwt. $17.59
Last Week: Quota cwt. $20.98 Overbase cwt. $19.28 Cls. 4a cwt. $21.19 Cls. 4b cwt. $17.58
SEPTEMBER MILK PRODUCTION REPORT:  (J. Kaczor) The good news is that there were no surprises in yesterday's report of September milk production. The nation-wide production increase was 2.6%, 373 million lbs above last September. With the possible exception of butter, that increase is not expected to result in increased product inventories. The month-to-month increase over 2006's milk output has now fallen two months in a row. The number of dairy cows in September is the highest it has been since 1999, and is not a surprising response to the recent record high milk prices.

USDA had reported that buyers of cheese and butter were anxiously awaiting September's report to get a sense of the availability of product supplies this Fall, and therefore prices. Judging by the lack of response on the CME today, they didn't get a clear enough direction, and will now look to Monday's report on September's inventories and the report on product manufacturing activity a week and a half later. The strength of dairy commodity prices this year can be attributed largely to the strength of the export market for nonfat dry milk and whey-based products, and the latest reports regarding price levels and supplies in Europe and New Zealand suggest that that demand should continue at least through this Winter.

Nine of the twenty-three largest milk producing States had 57,000 fewer cows this September, and the other fourteen added 114,000. California had 49,000 more cows, had a slightly larger output per cow, and produced 105 million more lbs of milk than a year earlier. In the West, Arizona lead the way with 9.9% more milk, and Texas (+6.5%), Idaho (+6.0%), California (+3.3%), and New Mexico (+1.9%) followed. However, these five States added only 11,000 cows from August, and their daily milk production increased only 1.1%. Worthy of special note is New Mexico which had 24,000 fewer cows than last September, but still produced 19 million more lbs of milk.

September production in California, on a daily basis, was lower than July and August levels and, if normal seasonal patterns continue, should be about the same or even lower this month. However, testimony in last week's hearing on price formulas for milk used to produce butter, powder, and cheese, included numerous reports by manufacturers and cooperatives about milk being left at ranches or shipped to plants in nearby States. The question is whether there is too much milk being produced in the West, or too few plants to handle the supply.

DECISION REACHED ON NONFAT DRY MILK PRICE REPORTING HEARING: (J. Kaczor) Just before noon today, CDFA posted on its website its response to proposals to correct a major deficiency in what weekly and monthly prices may be reported by California manufacturers for sales of nonfat dry milk. These sales reports are the major determinant of California's Class 2, 3, and 4a price formulas. The consequences of accepting prices that are as much as one year old was reported in this Update throughout this Spring and Summer -- namely, a loss of more than $190 million for California milk producers. The Department's response to the problem was essentially to do as little as possible and still call it a change.

The above documented loss was the result of a single difference between California's reporting rules and rules applying to the national price series used in federal order areas. The F.O. rule prohibits the reporting of a sale whose price was determined more than 30 days prior to shipment of the product. The California rule had no such time limitation. The new California rule continues to have no limitation on the length of time between establishment of a price and first shipment of the product, and then accepts reports of all sales within 5 months of the first shipment. It's hard to see how the hearing panel members could have done less.

The decision to do almost nothing was consistent with CDFA's response to this issue from the first time it was brought to their attention, in early February. Four months passed without a meaningful response from them, until they received formal petitions in mid-June. And then nine weeks passed before the hearing. CDFA principals were apparently privately assured that the problem would be corrected when nonfat dry milk prices fell back to 2006's levels.

There are a number of problems with the decision that was announced, not the least of which was that it does nothing to prevent a repeat of this summer's raid on California producers' income. The hearing panel, in explaining its decision, cited the same CDFA Code sections that were cited by those who proposed that California's rules for reporting product sales should be essentially identical, or at least very similar, to the rules that apply to
manufacturing plants in federal order areas. There was overwhelming support for that principle in the hearing. In reaching it’s decision, very specific standards that are established for determining California's milk prices were seemingly ignored by the hearing panel while other, very general, standards were used which supported a change that was not proposed by anyone in the hearing. By focusing in on how to make a distinction without causing a difference, the hearing panel apparently ignored (or set aside as unimportant) the critical fact that the major seller of nfdm in California has been setting its own raw product cost for such sales, at the expense of all California producers, and has been sharing the proceeds from those sales with other plants, and their producers, who are located outside of California. The decision also means that California will continue to be the U.S. dumping ground for distressed priced nfdm.

In effect, California producers have been told that the statutory standards mean whatever CDFA principals want them to mean, and nothing else. And that should give us all something to think about while waiting for the decision from the contentious hearing that was concluded just last Thursday.

CENTRAL VALLEY WDR WORKSHOPS GOING WELL (By Rob VandenHeuvel) Several workshops hosted by the California Dairy Quality Assurance Program (CDQAP) have been held over the past couple weeks. These workshops (which have been held in Glenn, Kern, Fresno and Merced Counties) are the best opportunity available for dairymen to hear more details about what is required in the new “waste discharge requirements” (WDR). The workshops are open to all dairymen, so if you missed the workshop in your county, you are welcome to attend a workshop in a neighboring county. Next week, three more counties will host workshops:

- Tulare County – Tuesday, October 23rd
- Madera County – Wednesday, October 24th
- San Joaquin County – Thursday, October 25th

Each of these counties will host two workshops, one from 9:30 am – 12:30 pm, and one from 1:30 – 4:30 pm. More details on times and locations of these and future workshops can be found at: http://www.milkproducerscouncil.org/cdqapdates.pdf or by calling Debi Clark at (909) 628-6018.

Important Date to Remember
While the WDR is a step-by-step process with due dates and requirements spread out over the next five years, there are several monitoring items that the dairies must begin immediately. The next important date for Central Valley dairies to remember is SATURDAY, NOVEMBER 3rd. By November 3rd, all Central Valley dairies under this WDR (which is most Central Valley dairies) must collect a water sample from your domestic and agricultural wells and have those samples analyzed at a lab for nitrate-nitrogen content. Any MPC members seeking assistance with this or any other WDR compliance are encouraged to call Betsy Hunter, MPC’s Central Valley Representative at (661) 205-6721.

NEW MANURE SAMPLING REQUIRED FOR SOUTHERN CALIFORNIA DAIRIES (By Rob VandenHeuvel) As part of the new General Permit approved by the Santa Ana Regional Water Quality Control Board in September, all dairy facilities in the Santa Ana region that have more than 700 mature cows (milking and dry) must sample and analyze their manure once per year and provide that analysis to anyone to receives your manure over the upcoming year. There are several labs in Southern California that provide this service, and any MPC members wanting assistance should call Rob VandenHeuvel at (909) 992-9529.

AS DAIRYMEN FILL OUT THE DISASTER RELIEF FORMS… (By Rob VandenHeuvel) Many of you have already started filling out the paperwork to apply for the Livestock Indemnity Program, which compensates farmers across the U.S. for livestock losses due to natural disasters. This week, FSA staff recommended that any dairyman filing out an FSA-900 form send it in UNSIGNED. This will allow FSA staff to take the data from the form sent in and enter it electronically into their system. They will then send the computer-printed form back to the dairies to be signed by the owner. If you have any questions, please call the MPC office at (909) 628-6018.