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DATE: November 6, 2015
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 +$.0800</td>
<td>Weekly Change +$.1150</td>
<td>Week Ending 10/30 &amp; 10/31</td>
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<tr>
<td>$1.7000</td>
<td>Weekly Average +$.2220</td>
<td>Calif. Plants $0.8416 8,933,046</td>
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<tr>
<td>Barrels +$.0550</td>
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<td>Nat’l Plants $0.8666 17,162,596</td>
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<td>Weekly Average, Cheddar Cheese</td>
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<tr>
<td>Blocks +$.0380</td>
<td>Dairy Market News w/e 11/06/15 $2.250</td>
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<tr>
<td>$1.6465</td>
<td>National Plants w/e 10/31/15 $2.2305</td>
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<td>Barrels +$.0445</td>
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<td>$1.6035</td>
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DRY WHEY

Dairy Market News w/e 11/06/15 $2.250
National Plants w/e 10/31/15 $2.2305

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FRED DOUMA’S PRICE PROJECTIONS...
Nov 6 Est: Quota cwt. $17.14 Overbase cwt. $15.45 Cls. 4a cwt. $17.01 Cls. 4b cwt. $14.94
Last Week: Quota cwt. $16.80 Overbase cwt. $15.11 Cls. 4a cwt. $16.73 Cls. 4b cwt. $14.42

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

Milk & Dairy Markets
Like Lewis Carroll’s famous Wonderland, the butter market grows curiouser and curiouser. Cream is becoming more available, imports are growing and prices are falling overseas. It matters not. This week the CME spot butter market gained another 11.5ȼ and climbed to $2.885/lb. Perhaps after the holidays the market will evoke a very different Alice in Wonderland quote, such as, “Down, down, down. Would the fall NEVER come to an end!” But for today, the spot butter market continues to ascend.

The other spot markets also moved higher this week. Cheddar blocks rose 8ȼ to $1.70. Barrels closed Friday at $1.65, up 5.5ȼ. Spot nonfat dry milk (NDM) gained 0.5ȼ and reached 81ȼ. The trade is not convinced that the strength will last. For both Class III and Class IV milk, 2015 futures contracts moved higher, but 2016 contracts retreated from last Friday’s settlements.

Whey futures continued to slip this week, but there are finally signs that the bears may be ready to hibernate for the winter. Dairy Market News reports, “Manufacturers in several regions indicate they either have no inventories to offer to the spot market, or they are holding inventories with confidence.” Whey inventories declined incrementally from August to September, but they remain 43.4% above 2014 levels.

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USDA announced the October Class III price at $15.46, down 36ȼ from September and $8.36 below October 2014. The California 4b milk price was $14.75, down 19ȼ from September and $6.19 lower than a year ago. USDA announced the October Class IV price at $15.08, up $2.18 from the previous month but down $4.92 from a year ago. California 4a milk was $15.10, up $2.32 from September.

Without exception, every contract traded lower at the Global Dairy Trade (GDT) event on Tuesday. The GDT index dropped 7.4% from the previous auction. Both skim and whole milk powder (SMP and WMP) fell 8%. Butter and Cheddar were not far behind, with losses of 5.6% and 4.6%, respectively.

On a protein equivalent basis, GDT SMP is priced at 98ȼ, much higher than CME spot NDM, at 81ȼ. Dairy Market News reports that average SMP prices in Oceania and Western Europe exceed the GDT benchmark. As the Daily Dairy Report noted earlier this week, “U.S. milk powder is clearly priced at a low enough level to attract international demand, such as it is.” The GDT wrapped up quickly on Tuesday, largely because of a lack of bids. The milk powder market is weighed down by unwanted powder that is growing stale. This prompted Fonterra to announce specifications for “enhanced age” milk powder, guaranteed to be manufactured recently.

After a slow summer, U.S. exporters did manage to step up shipments of milk powder in September. Combined exports of NDM and SMP totaled 104.7 million pounds, up 4.8% from a year ago. This helped manufacturers to trim stocks to 211.5 million pounds, down 8.5% from August. Still, inventories are 24.6% greater than a year ago.

It should come as no surprise that U.S. cheese and butter exports remained lackluster. Shipments of cheese and curd in September totaled 48.9 million pounds, up slightly from August but 20.3% lower than a year ago. September butter and milkfat exports dropped to just 1.6 million pounds, the lowest monthly volume since July 2009. Butter imports totaled 4.96 million pounds. While this is 14.1% lower than the very high volumes seen in August, it is still more than double year-ago levels.

Without a recovery in exports or another surge in domestic demand, U.S. cheese and butter inventories are likely to grow, as output remains
strong. U.S. cheese production totaled nearly 956 million pounds in September, up 2.4% from a year ago. Cheddar production was 3.8% greater than in September 2014. At 134 million pounds, butter production was 0.9% greater than a year ago and 7.8% higher than August on a daily average basis.

For the week ending October 24, dairy cow slaughter totaled 56,080 head, steady with a year ago. For the year-to-date the cull rate is 3.9% ahead of the 2014 pace.

**Grain Markets**

For weeks, the corn market has traded quietly between $3.75 and $3.85 per bushel. This week it slipped just below that range, settling at $3.73, nearly a dime lower than last Friday. The trade expects that USDA will raise its corn production estimate slightly in next week’s World Agricultural Supply and Demand Estimates report. But this year’s large crop is only slowly making its way to buyers. Farmers are putting corn in storage because they are reticent to sell it for less than $4.00, and the basis is moving higher.

However, a significant rally seems unlikely. U.S. corn exports have been disappointing small, while Brazil is shipping massive volumes. Farmers in Brazil and Argentina are expected to plant more corn and soybeans this year. The strong dollar has boosted potential crop revenue in Brazil, while the winds of political change could do the same in Argentina. Presidential candidate Maricio Macri recently told farmers, “Plant corn. Be enthusiastic. By harvest you will be in a different country, without export taxes for corn.”

Soybean futures dropped 12.5ȼ this week to $8.7125. Since harvest, soybeans have been leaving U.S. ports at a heady pace, allaying concerns that merchants had committed to export very few soybeans later this year. But this week’s export sales report was surprisingly small, and the market deflated. Anxiety about the lack of deferred export contracts rushed to the fore.

There are reports that China took advantage of the break in the futures market and purchased several cargoes of soybeans. If this continues, the market could bounce back quickly from these post-harvest lows. But it is clear that soybeans and soybean meal are vulnerable to decline without the constant evidence of robust demand from around the globe.

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**AN UPDATE ON THIS WEEK’S CA-FMMO HEARING PROCEEDINGS:** *(By Rob Vandenheuvel)* We are now 32 days into the U.S. Department of Agriculture’s (USDA) hearing on a California-Federal Milk Marketing Order (CA-FMMO). At the risk of sounding like a broken record, this week was a continuation of the Dairy Institute of California’s case on behalf of the dairy processors they represent. Their witnesses this week testified on a number of the major areas where their proposal differs from the proposal put forth by California Dairies, Inc., Dairy Farmers of America and Land O’Lakes (and supported by California Dairy Campaign, MPC and Western United Dairymen).

The following witnesses spoke either on behalf of the Dairy Institute or in support of their proposal:

- **Michael Anthony,** *Unified Grocers*
- **Rob Blaufuss,** *Dean Foods*
- **Mkulima Britt,** *Clover Stornetta*
- **Jim Dolan,** *Driftwood Dairy*
- **Patrick Fish,** *Saputo Cheese*
- **Steven Kluesner,** *Nestle*
In addition, two cheese manufacturers from Wisconsin made the trip to Clovis, California to testify on their desire to change the Federal Order Class III calculation, specifically with regard to the whey-driven portion of the formula. Cheese makers outside of California are understandably jealous of the cheap-milk policies that our California cheese makers have been and continue to be benefitting from. Those witnesses included:

- **Steve Buholzer**, Klondike Cheese Company (Wisconsin)
- **Steve Stettler**, Decatur Dairy, Inc. (Wisconsin)

On Wednesday, USDA heard testimony from Dr. Mark Stephenson, who flew in from the University of Wisconsin-Madison. Dr. Stephenson made it clear that he did not come to support one proposal over another, but rather to share information he has observed as an industry economist who has worked on milk pricing issues over the years. Much of Dr. Stephenson’s testimony related to what he termed the “spatial value of milk,” which is to say that he believes the value of milk to a manufacturer can vary based on factors such as the location of that plant, its relation to the available milk supply, and its relation to available market demand. The data presented by Dr. Stephenson indicated that milk produced and sold to cheese manufacturers is more valuable in the Eastern and Midwest United States, and becomes less valuable in the Western U.S.

This is a phenomenon that California producers have readily acknowledged in the past and even in testimony during this hearing. It is a well-known fact that cheese manufacturers in the Upper Midwest regularly pay significant premiums above the minimum Class III price for the milk they buy. Those premiums – which in previous hearing evidence has been estimated in excess of $1.00 or even $1.50 per hundredweight – are well above the typical premiums paid in California, even with our severely discounted Class 4b milk price.

Of course, as we would unfortunately expect, our processor colleagues have ignored this significant difference in over-order premiums, and have instead advocated that this is all evidence supporting a California Federal Order that would have a lower regulated Class III price than the uniform Class III price used in all of the ten current Federal Orders. After years and years of enjoying the California Discount on the backs of our State’s dairy farmers, they are willing to grasp at any dataset that they believe justifies a continuation of that discount. *(They’ve even attempted on a couple occasions to paint it as a “Federal Order Premium,” rather than a “California Discount.” Cute trick.)*

Late in the week, USDA was able to hear from three more California dairy farmers. All three dairymen did a fantastic job of presenting the reasons they support the CA-FMMO proposal put forth by the California cooperatives. Those producers who testified this week were:

- **Rien Doornenbaal**, Dairyman in Escalon, CA
- **Geoffrey Vanden Heuvel**, Dairyman in Chino, CA
- **Jacob Verburg**, Dairyman in Modesto, CA

Week 8 of the hearing will convene on Monday at 9 am at the Piccadilly Inn – Airport, located at 5115 E McKinley Ave, Fresno, CA 93727. **For those of you planning to attend, PLEASE NOTE THE LOCATION CHANGE.** Those folks who cannot attend but are interested in listening to the hearing live can tune into the audio feed at: [https://www.ams.usda.gov/live](https://www.ams.usda.gov/live). USDA also continues to post the available transcripts to their website at: [http://www.ams.usda.gov/rules-regulations/moa/dairy/ca/transcripts](http://www.ams.usda.gov/rules-regulations/moa/dairy/ca/transcripts). Remember that there is a two-week lag in getting these transcripts finalized and posted.
**A NEW TWIST TO CDFA’S TEMPORARY CLASS 4B ADJUSTMENT:** (By Rob Vandenheuvel) When CDFA announced a one-year change to the Class 4b calculation in July (which began August 1st), it was heralded as an upward adjustment to the Class 4b price. In fact, in announcing the results of that hearing, CDFA included commentary that, “Had these changes been in effect from April 2010 to March 2015, the effect of these changes would have resulted in a five-year monthly average increase of $1.01/cwt. in the Class 4b price and $0.46/cwt. in Quota and Overbase prices.”

I received one email from a producer who had read that statement in the announcement and lamented that it really added insult to injury, pointing out the significant market-based dollars that CDFA was now acknowledging that producers should be entitled to but that we would never get back. While that recognition was painful, the producer was at least pleased that for the next year, it appeared that some proportional relief would be in place (emphasis on “proportional,” as we still expect to be at a more than $0.50/cwt discount to the Federal Order Class III price over the next year).

So what was the twist this past month? The October Class 4b price was actually $0.25/cwt LOWER under the new temporary adjustment than it would have been had the Department not acted at all. Why? Under the previous calculation, there was a ceiling and a floor in the dry whey portion of the Class 4b price. In other words, the calculation made sure that dry whey market prices never impacted the Class 4b final price by: (1) more than $0.75/cwt or; (2) less than $0.25/cwt.

The new temporary calculation of the Class 4b price still contains a ceiling and a floor in the dry whey portion of the Class 4b price. In other words, the calculation made sure that dry whey market prices never impacted the Class 4b final price by: (1) more than $0.75/cwt or; (2) less than $0.25/cwt.

Looking out at the futures market for dry whey, it appears that this drop below the previous floor of $0.25/cwt may be short-lived (to the extent that the futures market is an indicator of future market movement). But it certainly is an unwelcomed twist in this saga. For years producers have been forced to live under a price “ceiling” that prevents our Class 4b price from maintaining a reasonable relationship with the Federal Order Class III price, and just as markets turn south, the previous “floor” (which producers were given to help compensate for the lower “ceiling”), is lowered to the detriment of producers and to the benefit of cheese manufacturers.

Of course, California producers have advocated that no ceiling or floor is needed if we simply are put on a level playing field with the Federal Order prices, but our State’s cheese manufacturers have to be smiling over the fact that they seem to win on both ends of the market spectrum – a low price-ceiling during the past several years of high market prices, and a timely reduction in the price-floor during the current period of low market prices.

Seems like a good idea to continue our laser-like focus on a California Federal Milk Marketing Order that puts our producers on par with our fellow producers around the country.

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<tr>
<th>CDFA’s Temporary Class 4b Adjustment*</th>
<th>Oct ‘15</th>
<th>What it would have been without CDFA’s Adjustment</th>
<th>Aug ‘15 – Present</th>
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<tr>
<td>California Class 4b Price</td>
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<td>$15.00**</td>
<td>$15.14</td>
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<tr>
<td>FMMO Class III Price</td>
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<td>$15.46</td>
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<tr>
<td>Discount</td>
<td>($0.71)</td>
<td>($0.46)</td>
<td>($0.71)</td>
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* CDFA’s temporary changes to the Class 4b pricing formula are set for August 2015 – July 2016
** California’s Class 4b price in October was actually LOWER than it would have been prior to CDFA’s temporary adjustment announced in July 2015.