DATE: December 14, 2012
TO: Directors & Members
FROM: Rob Vandenheuvel, General Manager

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE

<table>
<thead>
<tr>
<th>Block</th>
<th>$1.7250</th>
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<tbody>
<tr>
<td>Barrel</td>
<td>$1.6250</td>
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Weekly Average, Cheddar Cheese

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<tr>
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<tbody>
<tr>
<td>Barrel</td>
<td>$1.6440</td>
<td>$1.6440</td>
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</table>

CHICAGO AA BUTTER

| Weekly Change | $1.5950 |
| Weekly Average | $1.5940 |

NON-FAT DRY MILK

<table>
<thead>
<tr>
<th>Week Ending 12/7 &amp; 12/8</th>
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<tbody>
<tr>
<td>Calif. Plants</td>
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<tr>
<td>Nat’t Plants</td>
</tr>
</tbody>
</table>

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

Milk & Dairy Markets

Butter markets stabilized this week, but cheese prices weakened and nearby Class III futures collapsed. Cheese is readily available, and sales between the holidays have been soft. Cheddar blocks and barrels each lost 3½ȼ at the spot market over the course of the week. Cheese buyers appear patient but not absent; they are willing bidders at lower prices.

Given lower cheese prices and generally steady conditions in the butter and powder markets, Class IV prices are now the “higher of.” January Class III futures are now 50¢ below Class IV. While January Class III futures fell to five month lows below $18, February and later contracts ended this week higher than they ended the last one.

The National Dairy Product Sales Price Report showed notable declines in butter and Cheddar prices, while whey and powder prices were slightly higher. For the week ending December 7, the California Weighted Average Price for nonfat dry milk powder was $1.5162, up 0.92¢/lb. Dairy Market News dry product prices for the West were steady or slightly higher.

U.S. dairy exports have slowed considerably from the heady pace earlier this summer as Oceania is actively competing for – and winning – market share. Nonfat dry milk (NDM) exports in October totaled 33,107.36 metric tons (MT), down 4.6% from October 2011. This followed a 13.4% decline in September NDM exports, the first back-to-back decline in monthly NDM exports since August and September 2009. Exports to Mexico, the U.S.’s largest NDM buyer, were record large and 18% higher than last year. However, the next four largest importers of U.S. NDM are Asian nations who have shifted much of their business to Australia and New Zealand. U.S. NDM exports will likely remain depressed for the next several months, until the region is no longer flush with kiwi dairy products.

October cheese and curd exports totaled 19,149.4 MT, up 12.9% from October 2011. Cheese exports have been higher than the prior year for 13 consecutive months and are 20% higher than last year. However, the pace of exports is well below summer highs.
October butter exports increased 124% from September and 48% from October 2011 as lower prices attracted buyers. Export values fell to two year lows, averaging $1.45/lb.

Weekly dairy cow slaughter was an impressive 65,120 head, among the highest weekly slaughter totals this year. This is partly due to a backlog of culling after the Thanksgiving holiday, but it also reveals a consistent increase in slaughter rates in the Midwest, an important change in trend. California dairy producers have struggled with high feed costs all year. Hay prices here reached record highs in February, well before drought in the Midwest increased feed prices there. Now Midwest hay prices, while still generally below California costs, have moved to record highs as well. Dairy producers in the Midwest have responded; dairy cow slaughter in the Midwest in the first half of 2012 was 10.4% below last year. Since July it has averaged 2.3% higher than a year ago. As margin pain is more widespread, the slaughter pace will likely remain elevated, and the dairy cow herd will contract more quickly. This will eventually allow a return to profitable milk prices although it also presages a loss in export volumes.

**Grain Markets**

Corn prices moved back to the low end of the $7.10 to $7.60/bushel range. U.S. corn exports have underwhelmed, and the corn basis is soft. However, the break in prices has created a flurry of export market activity. South Korean feed companies have been particularly active, and the U.S. may be able to sell a couple corn cargoes, although most of the business will go to South America. The USDA made no changes to its corn balance sheet Tuesday, but it did increase estimates for both domestic and foreign wheat production. This pressured wheat prices, and if USDA’s production estimates are correct, it will increase global grain supplies and encourage some wheat to replace corn in feed rations.

USDA increased its estimate of domestic soybean crush by 10 million bushels, lowering ending stocks by an equal amount. Crushing activity has been very strong both here and abroad as Chinese processing margins have improved. Chinese demand for both soybeans and soymeal remains strong, and processors in the U.S. and China are competing for soybeans that U.S. farmers have been largely unwilling to sell. The National Oil Processors Association reported November soymeal exports at a November record of 1,039,965 tons. All indications of demand are firm, and the market remains well supported. The market cannot afford a small crop in South America, but for now conditions in the southern hemisphere are favorable.

**FRED DOUMA’S PRICE PROJECTIONS…**

<table>
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<tr>
<th></th>
<th>Quota cwt.</th>
<th>Overbase cwt.</th>
<th>Cls. 4a cwt.</th>
<th>Cls. 4b cwt.</th>
<th>Cls. 4b cwt.</th>
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<tr>
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<tr>
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<td>$17.33</td>
<td>$17.36</td>
<td>$16.41</td>
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**CDFA HEARING ONE WEEK FROM TODAY:** (By Rob Vandenheuvel) Next Friday, December 21st, the California Department of Food and Agriculture (CDFA) will be holding a hearing to, “consider whether market conditions support short term price adjustments to all classes of milk” (December 6, 2012 letter from CDFA). The hearing will begin at 7 a.m. in CDFA’s auditorium, located at 1220 N Street in Sacramento, CA. Dairy farmers are encouraged to attend the hearing.

While the pricing formulas for all five classes of milk are open to debate at next week’s hearing, California’s Class 4b formula (which determines the minimum price to be paid for milk purchased by cheese manufacturers) has certainly been
the focus of the debate in recent months/years. Just last week, we were reminded once again of how steeply discounted our California Class 4b price is compared to the Federal Order Class III price that serves as a benchmark for pricing milk sold to cheese plants in most of the rest of the country (see table above).

We look forward to presenting the ample evidence to CDFA that justifies a meaningful upward adjustment to the pay price for California’s milk supply.

WHAT IF THE FARM BILL WERE ALREADY IN LAW?: (By Rob Vandenheuvel) In recent weeks, we’ve been urging our readers to contact their Congressmen in support of approving the five-year Farm Bill prior to the end of the year. This week, I was asked by one of our members, “What would 2012 have looked like if the Farm Bill were already in place for the dairy industry?” That’s a difficult question, because as our readers know very well by now, the Dairy Market Stabilization Program (DMSP), which is included in the 2012 Farm Bill, would empower our industry with a new voluntary tool to quickly respond to market imbalances with temporary adjustments to our milk production. We really don’t know how effective that tool will be in shortening these “downturns” (to put it lightly) in our industry.

However, for the sake of this article, let’s ignore the positive impact of the DMSP, and focus on what the other part of the dairy provisions would have done in 2012. As a reminder, the Dairy Producer Margin Protection Program (DPMPP), also known as the “margin insurance” portion of the dairy provisions, is designed to provide direct payments to dairies enrolled in the program when national average milk-price-over-feed-cost margins drop below certain thresholds. Dairies can receive those payments on up to 90% of their milk production (which is a much more attractive program for California dairymen than the volume-limited MILC program).

There are two options under this program: (1) a basic option that is available with no premiums paid by the dairymen, or (2) a supplemental option that includes a premium paid by the dairymen, but provides payments at a higher threshold (in other words, it provides potentially more frequent payments).

So what kind of payments would have been paid out in 2012 (ignoring the possible impacts of the DMSP)? Let’s look at a 1,000 cow dairy, producing 65 lbs of milk per cow per day (about the average operation in California).

**MILC – Current Law**

Of course, for a dairy of this size, the Milk Income Loss Contract (MILC) program is a mixture of forecasting and gambling. Due to the program only making payments on 2,985 million lbs of milk per dairy per year, the “start month” selected by each dairy made a huge difference in payments. For our sample 1,000 cow dairy, if they were fortunate enough to select July 2012 as their start month, they would have received approximately $47,000 in payments. If they had not been so fortunate, and had just begun collecting payments the first month they were available (February 2012), they would have received approximately $16,400 in payments.

**Farm Bill’s “Margin Insurance” – The Basic Option**

Now what if the Farm Bill had been in place in 2012 and the dairy had chosen to enroll in the “margin insurance” program’s “basic option,” which includes zero premiums. Over the course of 2012, that 1,000 cow dairy producing 65 lbs of milk/cow/day would have collected an estimated $57,000 in payments. Not only is this more than the MILC program was able to pay, but it comes without the “guessing game” of trying to pick the optimal start month.

**Farm Bill’s “Margin Insurance” – The Supplemental Option**

Now what about if the Farm Bill had been in place and the dairy had selected the “supplemental option,” which includes a premium to be paid by the dairymen, but triggers in more quickly? There are various “margin levels” that a dairymen can select under this program, but for this example, let’s look at the possibility that the dairy entered at the $6.00 per hundredweight milk-price-over-feed-cost level. Under that level of protection, the dairy would have had to pay a premium of about $28,000-$30,000 (there are slightly different figures in the House and Senate bills) for the year, and in total, the dairy would have received almost $258,000 in payments.
Of course, as we’ve discussed at length in previous issues of this newsletter, those who decide to participate in any part of this program would be automatically enrolled in the Dairy Market Stabilization Program, which triggers in when national average margins drop below pre-defined levels. When the program triggers in, enrolled dairies would be incentivized to temporarily cut back their facility’s milk production by 2-4%. Obviously, the hope with the DMSP is that through quick and temporary reductions in the national milk production, dairy markets will regain equilibrium, and a profitable price from the marketplace will be available more quickly.

So with that information available, the question is quite simple. **What is better for our California dairy families?** The status quo – which includes a severely limited MILC program – or the Farm Bill – which not only includes a more generous and flexible margin insurance program, but also a tool to actually get us out of the industry downturns more quickly? The MPC board of directors has made it clear what our choice is: **We strongly support the approval of the 2012 Farm Bill.** While it obviously cannot go back in time and “fix” the 2012 issues, we see it as a vastly superior safety net program for the next five years.

If you agree with this assessment, **we need you to call your Congressman!** There is still time to get the 2012 Farm Bill approved before Congress adjourns for the year, but our elected officials need to know how important it is to the dairy families in their districts! As a reminder, below are phone numbers for many of the California Representatives from our dairy regions:

- **Wally Herger (Orland):** (202) 225-3076
- **Jerry McNerney (Escalon/Lodi/Tracy):** (202) 225-1947
- **Jeff Denham (Madera/Chowchilla/Kerman):** (202) 225-4540
- **Jim Costa (Fresno/Hanford/Bakersfield):** (202) 225-3341
- **Devin Nunes (Tulare/Visalia):** (202) 225-2523
- **Kevin McCarthy (Bakersfield):** (202) 225-2915
- **Joe Baca (Ontario):** (202) 225-6161
- **Gary Miller (Chino):** (202) 225-3201
- **Ken Calvert (Corona):** (202) 225-1986
- **Jerry Lewis (Redlands):** (202) 225-5861
- **Mary Bono-Mack (Moreno Valley):** (202) 225-5331

If you have any questions, feel free to give MPC a call at (909) 628-6018.

**CENTRAL VALLEY MONITORING PROGRAM CONDUCTING FIRST ANNUAL ELECTIONS:** *(By Kevin Abernathy, Director of Regulatory Affairs)* As our Central Valley dairies know well, the Central Valley Dairy Representative Monitoring Program (CVDRMP) is a not-for-profit group, organized and overseen by Central Valley dairy operators. The group’s purpose is to reduce regulatory costs for member dairies by administering a representative groundwater monitoring program for dairies. A dairy’s membership in good standing in CVDRMP can substitute for the current regulatory requirement to install monitoring wells, and is a lower-cost alternative.

The CVDRMP has an elected board of directors overseeing the organization. Annual elections for this board are currently being held. If your dairy is part of the CVDRMP, you should have received material in the mail in the past week. **Ballots are due by Friday, December 21st**, so dairies are encouraged to review this material and respond as soon as possible. **If you have any questions, please don’t hesitate to contact MPC at (209) 678-0666.**