



Milk Producers Council

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DATE: May 16, 2014
 TO: Directors & Members

PAGES: 6
 FROM: Rob Vandenheuvel, General Manager

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE

Blocks - \$.0475 \$1.9975
 Barrels - \$.0600 \$1.9600

Weekly Average, Cheddar Cheese

Blocks - \$.0410 \$2.0070
 Barrels - \$.0685 \$1.9720

CHICAGO AA BUTTER

Weekly Change - \$.0075 \$2.1600
 Weekly Average +\$.0200 \$2.1645

DRY WHEY

Dairy Market News w/e 05/16/14 \$.6663
 National Plants w/e 05/10/14 \$.6717

NON-FAT DRY MILK

Week Ending 5/9 & 5/10

Calif. Plants \$1.8386 15,424,063
 Nat'l Plants \$1.8987 28,897,396

Prior Week Ending 5/2 & 5/3

Calif. Plants \$1.9277 16,012,491
 Nat'l Plants \$1.9473 28,217,139

FRED DOUMA'S PRICE PROJECTIONS...

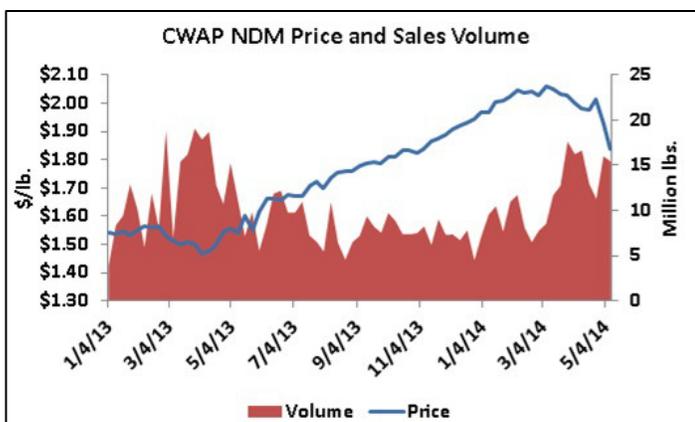
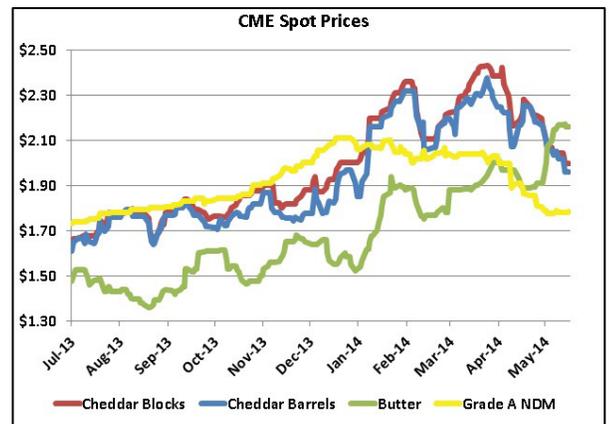
May 16 Est: Quota cwt. \$22.88 Overbase cwt. \$21.18 Cls. 4a cwt. \$22.78 Cls. 4b cwt. \$19.36
 Last Week: Quota cwt. \$23.15 Overbase cwt. \$21.45 Cls. 4a cwt. \$23.29 Cls. 4b cwt. \$19.58

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

Milk & Dairy Markets

CME spot Cheddar blocks and barrels fell below the \$2.00 mark for the first time this year. Cheddar blocks lost 4.75¢ Tuesday, sliding to \$1.9975. Barrels shed 6¢, closing at \$1.96. After that initial descent, the markets held. Buyers are living hand to mouth, hoping for a further set-back. Sellers do not seem anxious to test the market now that the \$2 level has been breached. Nearby Class III futures followed cheese lower. The June contract lost 74¢. Most deferred contracts posted modest gains.

After two weeks of steep climbing, the butter market took a breather. Spot butter closed at \$2.16 this week, down 0.75¢. Grade A nonfat dry milk (NDM) added 0.5¢ and ended the week at \$1.785. Class IV futures were decidedly mixed.



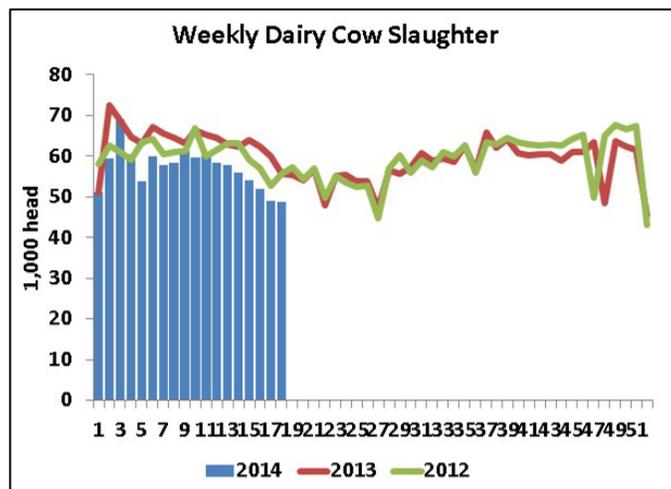
The National Dairy Product Sales Report (NDPSR) average price for butter rose 8.5¢ this week and further increases are likely in upcoming reports. U.S. butter prices have climbed in the face of weakening markets overseas, and interest in U.S. butter exports is fading.

Outside of Chicago, the milk powder market is plunging. Dairy Market News reported a notable decline in the price of NDM and other dry products. The NDPSR average price for NDM dropped almost a nickel. For the second consecutive week, the California Weighted

Average Price (CWAP) of NDM lost more than 8¢, falling to a five-month low. This, coupled with waning Cheddar block prices, will translate to smaller milk checks in California in the months to come.

The cheese and milk powder markets have clearly fallen from their highs. But while lagging indicators are sliding, the spot markets are holding at still lofty levels. Dairy product inventories are low and end users have a lot of purchases to make. The amount of patience on the part of these buyers will have much influence on the tone of the market. If end users are eager to buy every break in prices, the market will remain supported. But if they expect a sustained decline and continue to buy products only as needed, their expectations for lower prices will likely come to fruition.

Regional weather disparities have helped to mute the impact of heavy milk supplies in the Southwest over the past few months. Dairy producers in California and the surrounding area enjoyed an early flush that coincided with peak milk prices. Tepid production elsewhere provided an outlet for excess milk. But now milk production is finally picking up in the Midwest, just in time for the onset of summer vacation and lower fluid milk demand. The National Oceanic and Atmospheric Administration predicts a cooler than normal summer for Wisconsin and Minnesota. Spring-like weather could boost milk output well into the traditionally hot summer months.

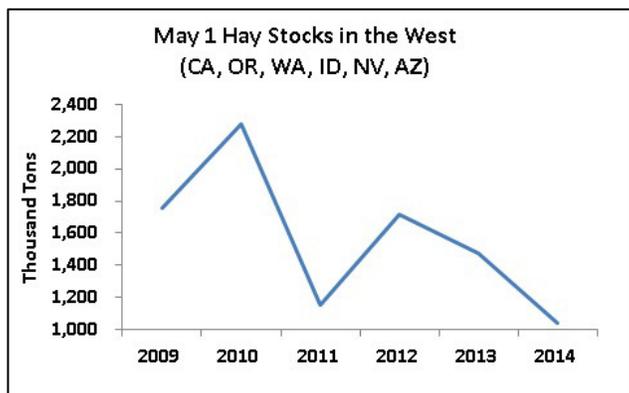
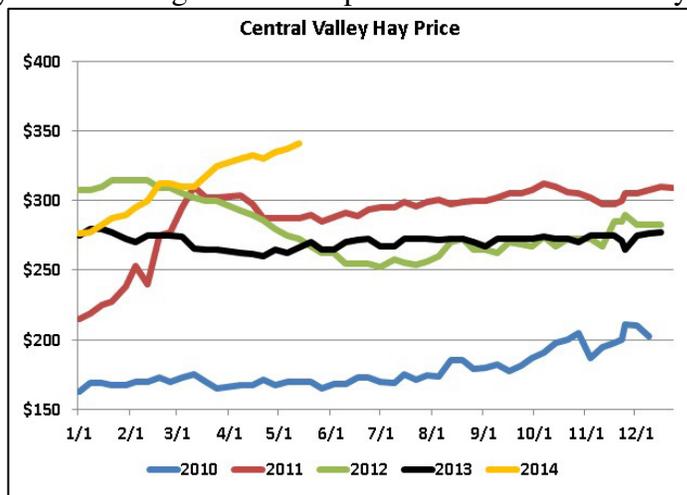


Even with most schools still in session, fluid milk demand has not been robust. Consumers are facing sticker shock and retailers are featuring milk less often. While output had been less than impressive in some areas, there has been no shortage of milk available to manufacturers. Meanwhile, ice cream demand has been slack, and grilling season is off to a very slow start. There were heavy frosts and light snows in parts of the Midwest today. There is little call for cheeseburgers given record high beef prices and frustratingly low temperatures.

Weekly dairy cow slaughter totaled 48,626 head, down 12.9% from the same week last year. This was the lowest non-holiday cull since June 2011. Year to date slaughter is 10.2% lower than at this time in 2013.

Grain and Hay Markets

National hay stocks totaled 19.2 million tons on May 1, an increase of 35.5% from last year. But hay stocks remain very low by historical standards and are still falling in the West. Total hay inventories in the six western-most states (California, Oregon, Washington, Idaho, Nevada and Arizona) reached just over one million tons and were 29.5% lower than last year. Premium quality alfalfa in Central California is going for upwards of \$340/ton. The combination of very low inventories and severe drought suggests that hay costs will not be falling anytime soon.



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Much of the corn crop is in the ground, and prices are falling. The July contract fell to two-month lows at \$4.835, down 24¢ from last Friday. December futures lost nearly as much. The cold is not helping emergence, and the mud is teaching patience in some areas. But with big machinery and a few sunny days, farmers have achieved much, and fears of a late crop and lower yields have been tamed.

July soybean futures settled at \$14.65, down 25¢ this week. Farmers across Argentina are reporting better than expected soybean yields. It seems that dry December weather did very little damage to the crop because the water table remained high. The majority of the crop did not pollinate in the driest weeks and fared very well. Estimates of South American crop production are on the rise and there is more talk of cargoes moving from the Southern Hemisphere to U.S. ports. Still, U.S. oilseed supplies will likely remain tight until the domestic harvest is assured.

AN UPDATE ON THE CDFA “TASK FORCE”: *(By Rob Vandenheuvel)* In 2012, the California Department of Food and Agriculture (CDFA) announced the creation of a “California Dairy Future Task Force.” This ad-hoc Task Force was selected by CDFA Secretary Karen Ross and consisted of producers, cooperative staff and processors. They met several times in 2012 and 2013, with a goal of “finding long term solutions” (CDFA press release: <http://plantingseedsblog.cdfa.ca.gov/wordpress/?p=2287>).

After several meetings, it became clear that the Task Force needed assistance in delving into specific issues, so four separate “Working Groups” were created. The efforts of those “Working Groups” has resulted in a renewed energy within the Task Force, and on May 2nd, a meeting was held to not only go over the recommendations of one of the Working Groups (Class 4 Pricing Reform), but also to discuss details of a specific proposal brought forth by five individual dairymen.

Much of the recent talks about pricing reform in California have been focused on the development of a Federal Milk Marketing Order in California (**which is continuing to move forward as it should be; California producers deserve an opportunity to see what a California Federal Order would look like and have the option available to them to consider**). However, the discussion in the Task Force indicates that there may be interest in exploring some reforms to the California pricing system that can be adopted in the near term (less than a year) while the longer-term Federal Order work continues (it’s been well-documented that the Federal Order adoption process could be about 18-24 months from petition to implementation).

No decisions have been made by the Task Force at this point. I’m also not aware of any decisions being made by the trade associations – like MPC – or any of the three major cooperatives. At this point, everyone is evaluating the work that has been done by the various Working Groups, as well as examining the details of the specific proposal put forth by five individual dairy farmers (more on that below).

Following are two items:

- A letter from CDFA Secretary Karen Ross, sent out this week, providing an update and her expectations on the work of the Task Force; and
- A narrative written by five individual dairymen with regard to a proposal they have put before the Task Force for discussion and consideration.

Letter from CDFA Secretary Karen Ross

May 14, 2014

Dear California Dairy Stakeholders:

This letter is to update you on the progress of the California Dairy Future Task Force and the established working group’s progress at their last meeting held on May 2, 2014. There has been a tremendous amount of collaboration and cooperation in the California’s dairy industry that has led to the progress made thus far. I am very confident this will continue and much more progress will follow in the near future.

The California Future Dairy Task Force (TF) with the Dairy Advisory Committee invited, met on May 2, 2014 to review presentations from the Class 4 Pricing Reform Group, Dr. Dan Sumner’s milk pricing alternatives modeling results and a specific comprehensive milk pricing/quota proposal from a group of five dairy producers.

This past year the Class 4 pricing working group (Pricing Group) has worked to achieve the objectives outlined by the TF which were to explore alternative solutions to pricing Classes 4a and 4b in California. The goal was to evaluate market-based and other alternative pricing models and develop pricing mechanisms that appropriately share risk between producers and processors, promotes competition, incents innovation and directs milk to the highest and best use. This working group spent a great deal of time and energy moving high level concepts on to specific options for the TF to discuss.

The Pricing Group presented two options they felt needed further exploration:

- 1. The Hybrid: Maintains the California system with two basic changes*
 - Allows Class 4a and 4b milk to be sold either in the pool, governed by regulated minimum prices or outside the pool, with the price negotiated independently between the buyer and seller*
 - Directly index the regulated manufacturing class prices with Federal Order announced minimum prices*
- 2. Pooling differentials:*
 - Eliminates regulated minimum prices for all classes of milk*
 - Milk prices would be established through competitive negotiations*
 - Differentials would be established for Classes 1, 2 and 3 which would be collected and paid to quota holders, with a range of fixed differentials from \$1.00 to \$3.00 to cover quota*

To assist the Pricing Group in their discussions, Dr Sumner was contracted to provide objective analysis, including economic model simulations of the impact of alternatives presented by the Pricing Group. Dr. Sumner and his team collected and analyzed data from many sources within the California dairy industry and prepared a summarized report on the results of their modeling at this meeting.

Dr. Sumner's presentation included:

- Background of recent history of supply, demand and prices*
- Explanation of his approach and limitations*
- Numerical indications of impacts*
- Economic reasoning*
- Interpretation and implications*

A comprehensive milk pricing/quota proposal was also introduced by a group of five dairymen (Geoff Vanden Heuvel, Tom Barcellos, Joey Airoso, Simon VanderWoude and Frank Mendonsa). This group convened independently and presented their proposal to the TF.

Their proposal:

- Couples the Class 4a price to the Federal Order Class IV price*
- Couples the Class 4b price to the Federal Order Class III price*
- Allows contractual agreements between milk producers and processors with specific guidelines. This would be for Grade A milk not subject to minimum pricing or pooling*
- Eliminates Regional Quota Adjusters*
- Lowers the quota differential from \$1.70/cwt to \$1.50/cwt or a dollar amount that will not exceed what Class 1, 2 and 3 contributes to the pool*
- Retires quota after 120 months*
- Requires all quota milk to be sold to a regulated handler to be eligible for payment*

After hearing all of the presentations the TF agreed to have the Pricing Group further explore and evaluate the comprehensive milk pricing proposal with the assistance of Dr. Sumner and to have the Quota Working Group further explore and analyze the quota piece of the comprehensive proposal. The TF will be convening within the

next 45 days to review the analysis from both working groups.

There has been much activity and progress made and there is still much more work to be completed in developing details on these proposals. To help facilitate the level of understanding necessary for this important dialog to continue, an email address dairytaskforce@cdfa.ca.gov has been established for questions and updates regarding the progress of the working groups. This email address will be functional by May 19, 2014. Please make use of this email address to communicate with us so that your input can be incorporated into the process. I believe we are all firmly committed to achieving results from the hard work completed so far and will tackle the hard work facing us so that California's dairy industry will continue its role as a global leader.

*Yours truly,
Karen Ross
Secretary, CDFA*

More on the Specific Proposal by Five Individual Dairymen

By Joey Airoso, Tom Barcellos, Frank Mendonsa, Geoffrey Vanden Heuvel and Simon Vander Woude

We are making a comprehensive California dairy industry reform proposal which includes both pricing and pooling/quota modifications.

In the early 1980's as the California dairy industry began to grow, producers supported a policy of using our State order to establish generous manufacturing allowances for plants as an incentive to expand capacity to accommodate the growing production. While there was always some controversy over the exact level of discount California plants should receive, there was general producer support for this policy. The California dairy industry did expand and by the mid 1990's we became the nation's largest milk producing state.

As time progressed, other regions of the United States began to adopt the large herd model developed in California and were able to encourage expanded manufacturing capacity even though they were operating in a federal milk marketing order where preferential government granted milk price discounts were not available. In the meantime, the cheap grain prices that had been the result of previous national policies changed and that together with increased competition in California for water and crop land have significantly cut into California's historical cost of production advantage. And yet the policy of discounting California's regulated prices, particularly for class 4b, have continued at even greater rates than was originally supported by producers. Today, California producers are virtually unanimous in their opposition to the current regulated pricing policies of CDFA. The department has continued to justify their policy of discounting California's regulated price by citing the fact that, as opposed to the FMMO regulation, in California all Grade A milk must by law pay the regulated minimum price.

So what we are proposing is essentially a trade. We will allow for milk to be sold outside of the regulated system through the use of well defined alternative milk marketing agreements which do not dictate price, in exchange for a regulated price for class 4a and 4b milk that is equal to the comparable federal milk marketing order regulated prices for class III and class IV milk. We think this meets the concerns outlined by the department. With this change we can see no reason to continue to discount the California regulated price and so propose to eliminate it in law.

On the pooling side, a market wide pooling system with a quota program was established in the 1960's as a way to create more equity among producers in the distribution of class 1 dollars and to limit the disproportionate leverage that class 1 bottlers had over producers under the plant by plant pooling system. Quota was originally issued to producers based on a historical percentage of class 1 utilization of that producer's milk. At that time, class 1 utilization was over 60% of pooled milk, so not all of those original producers received quota to cover all of their production. The commitment was made then to issue new quota as class 1 sales increased and give it to those producers who were "unequalized" . The increase in class 1 sales was slower than expected and in the

late 1970's legislation was passed to simply create more quota and equalize all those original producers. The effect of this was essentially to water down the quota payment. By the 1990's the growth of production in California meant that there were a lot of producers who held little or no quota and were therefore locked out of any benefits of market wide pooling of class 1 revenues. Changes were made to the law to fix the quota differential at \$1.70 per cwt. so that class 1 revenues in excess of that \$1.70 would flow to all producers. The class 1 price was then raised significantly to create funds that then could be distributed to non quota holders. In exchange for creating access to class 1 revenue, the cost of the transportation subsidy program which had been paid out of quota funds only was transferred to the whole pool.

In time, the higher regulated class 1 prices made importing milk into California attractive to out of state producers and as a result CDFA rolled back much of the class 1 increase that had been granted. The situation we find ourselves in today is that not only is there almost no benefit to non-quota holders from the sale of class 1 milk, in many months revenue from the sale of class 1, 2 and 3 will not even cover the \$1.70 quota differential so that the overbase price is lower than it would have been in the pre-1.70 fixed differential days. This problem will be made even larger when 4b again contributes an equitable share to the pool which would be the result of our pricing proposal. So the inequities that have caused change in the past have reemerged and are going to get worse.

Rather than try to seek a repair of the system that will perpetuate the quota portion of the market wide pooling system forever, we are proposing to put the industry on a path to eventually retire the quota portion of the market wide pooling system. What we are proposing is to eliminate the RQA's which have also caused some controversy among producers and lower the differential from 1.70 to 1.50, or a number that will be supported by the sale of class 1, 2 and 3 milk, less the cost of the transportation subsidy. Then we propose to retire quota from the pooling program 10 years from the enactment of the new law. After that, market wide pooling would continue with a uniform blend price. The reason we are proposing to do it this way as opposed to buying quota out sooner is that we avoid the problems of trying to find the money to buy it, trying to establish a price to buy it at, and we have avoided the consequences, both to the system and to individual producers, of forcing them to accept large amounts of cash in a short period of time for the immediate sale of their quota. This proposal allows folks with quota plenty of time to put a plan together to deal with quota's retirement. Because quota will maintain a return all the way to the end of the 10 year period, it will retain some sort of a capital value all the way to the end.

The California State order has served producers well over the decades by enabling the establishment of a large and vibrant dairy industry that has contributed greatly to the prosperity of California. It needs reform. We are putting this specific, comprehensive plan forward in a good faith effort to make the changes necessary to enable the industry to prosper for the generations to come.

MPC Manager's Note (By Rob Vandenheuvel): The proposal outlined in the preceding narrative is based on work that was done by the Working Groups in the Task Force – specifically the Class 4 Pricing Reform Working Group and the Quota Working Group. While one of the five dairymen that authored the proposal – Geoffrey Vanden Heuvel – serves on the Board of MPC, this proposal is not endorsed by MPC. The MPC Board of Directors has had an opportunity to receive a presentation on this proposal, and while there was both interest and concern expressed on various pieces of the proposal, no position of support or opposition has been taken at this point.

I would ask that if any of our members have questions, comments or concerns about the proposal, the work of the Task Force/Working Groups, or any other related issue, please either sending me an email at rob@milkproducers.org or give me a call at (909) 628-6018. The issues being discussed are critically important to all California dairy families, and I will be compiling any comments/concerns/questions I receive for review by the MPC Board of Directors.