



Milk Producers Council

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DATE: December 21, 2012
TO: Directors & Members

PAGES: 6
FROM: Rob Vandenheuvel, General Manager

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE

Blocks	+\$0.0150	\$1.7400
Barrels	+\$0.0300	\$1.6550

Weekly Average, Cheddar Cheese

Blocks	-\$0.0170	\$1.7290
Barrels	-\$0.0035	\$1.6405

CHICAGO AA BUTTER

Weekly Change	-\$0.0575	\$1.5375
Weekly Average	-\$0.0365	\$1.5575

DRY WHEY

Dairy Market News	w/e 12/21/12	\$0.6300
National Plants	w/e 12/15/12	\$0.6541

NON-FAT DRY MILK

Week Ending 12/14 & 12/15		
Calif. Plants	\$1.5274	7,733,091
Nat'l Plants	\$1.5456	15,451,213

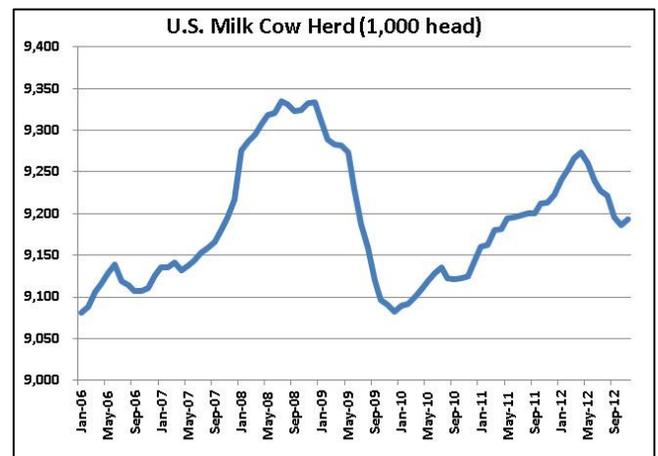
Prior Week Ending 12/7 & 12/8		
Calif. Plants	\$1.5162	5,307,139
Nat'l Plants	\$1.5436	14,370,691

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

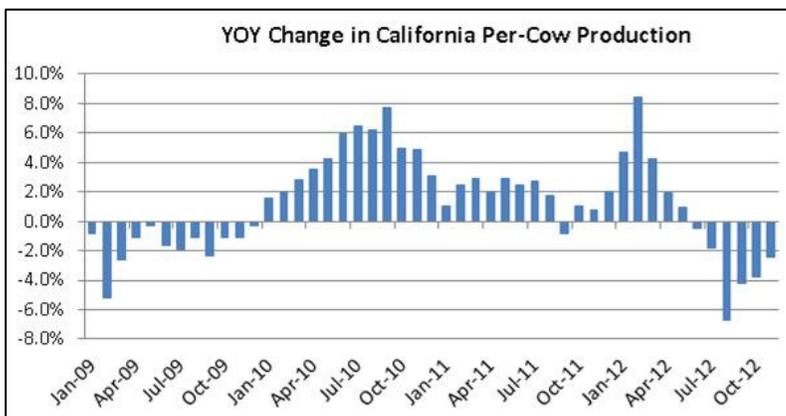
Milk & Dairy Markets

Class III futures suffered a volatile week, but January through April futures settled higher on Friday than the previous week, and May through December contracts were basically steady to a little lower. Class IV futures for the first half of 2013 moved lower.

The November Milk Production report was bearish, showing a larger than expected 1% increase in U.S. milk production relative to last year and a 1.5% increase relative to average daily production in October. Strong milk prices and favorable weather in all major dairy areas likely had a lot to do with the increase in production relative to last year. On a per-cow basis, national production was 20.38 pounds or 1.2% higher than November 2011. The milk cow herd increased from 9.186 million cows in October to 9.193 million cows in November.



The California dairy herd expanded to 1.78 million cows, an increase of 2,000 cows from the prior month and year which frankly strains credulity. After months of liquidations of large and small herds across the state and little to no expansion, it seems quite unlikely that the Golden State added cows in November. California milk production in November totaled 3.266 billion pounds, down 2.3% from November 2011. Production fell to 1,834.83 pounds per cow, down 2.4% from last year.

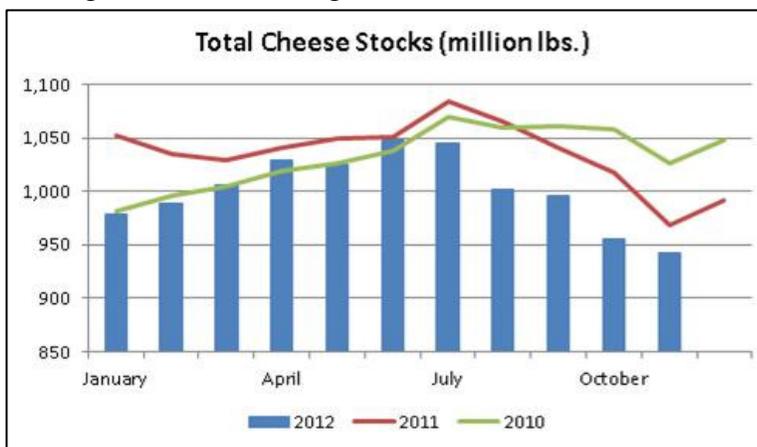


California was not the only state with reduced milk production. Production fell 4% in New Mexico, 3.7% in Texas, 2.3% in Florida, 2% in Arizona, 1.8% in Missouri and 0.6% in Washington. Production in the Midwest was generally 4-4.5% higher.

But while the Midwest has reported heavy milkflows, the region is showing signs of strain. Dairy cow slaughter in Region 5, which includes Illinois, Indiana, Michigan, Minnesota, Ohio and

Wisconsin totaled 23,400 head in the first week of December. This is the highest slaughter figure for the region in nearly eight years. National dairy cow slaughter was 67,806 head, the largest weekly slaughter since January 2009. The November Milk Production report notwithstanding, these numbers signal contraction.

For now, however, the market must contend with strong cheese production from the Midwest. The November Cold Storage report showed total cheese inventories down 13.4 million pounds, which is smaller than the typical seasonal drawdown and points to weakening cheese demand, heavy production or both. Cheese inventories of 942 million pounds are 4% lower than November 2011.



Butter stocks fell 18 million pounds from October to November, which is also a much smaller than normal decline as retailers typically stock up on butter before the holidays. Butter inventories were 11% larger than last year in October and a prodigious 35.9% higher in November. It is clear that the sharp drop in butter prices has been driven by burdensome butter supplies.

Product prices were mixed this week. Cheddar blocks and barrels gained 1 ½¢ and 3¢, respectively, to \$1.74 and \$1.655/pound. But the National Dairy Products Sales Report (NDPSR), which gives a less current indication of prices, showed a 4 ½ to 5¢ drop in Cheddar prices. At the Global Dairy Trade auction, the average winning price for Cheddar increased 4.9% to \$3,510/metric ton or \$1.59/pound, still well below U.S. spot prices.

Spot butter prices fell 5 ¾¢ to \$1.5375/pound. NDPSR butter shed just over 4¢, and GDT anhydrous milkfat (AMF) prices fell 0.1% to an 80% butter equivalent price of only \$1.16/pound. U.S. butter exports cannot compete with New Zealand AMF, but they are able to compete with Oceania butter after the recent and sustained price break. Kiwi milk production has been running well over 2011/2012's record-breaking levels. However, New Zealand's Ministry of Primary Industries forecasts that milk production in the 2012/2013 season will be steady with last year, which means production is expected to slow considerably after a formidable early season. Little of this heavy production has gone into storage as the export market has easily absorbed the majority of it. Indeed, Chinese imports of New Zealand dairy products are up 27% from last year in the first ten months of the year. As New Zealand milk production slows, it will provide greater opportunity for U.S. dairy exports to fill global needs, particularly in Asia.

Nonfat dry milk (NDM) was unchanged at the CME spot session and fractionally higher according to the NDPSR. Whole milk powder prices fell 0.6% to \$1.43/pound at the Global Dairy Auction, while skim milk powder prices added 1.1% to \$1.60. *Dairy Market News* reported a half cent increase in the average NDM price in the West, and the California Weighted Average Price for NDM was \$1.5274, up 1.12¢. The CWAP NDM price has moved higher for 17 consecutive weeks, adding nearly 34¢ since mid-August.

Grain Markets

Feed prices moved decidedly lower this week. China cancelled contracts to import 540,000 metric tons of U.S. soybeans and quickly deflated the soybean market. Conditions in South America are generally favorable, further pressuring prices. March soybeans shed more than 60¢ since last Friday. As soybeans have been the strongest sector in the feed complex, the grains followed suit. Corn and wheat lost 20-30¢, and nearby corn dipped below \$7.00 per bushel for the first time since the drought began in early July. Rain and snowfall across the Plains and Corn Belt likely further dampened bullish spirits, as moisture offers welcome replenishment for parched soils even in the off-season.

The break in prices stirred up a flurry of global crop exports, and the U.S. was able to book wheat exports to a variety of destinations. However, China remained conspicuously absent from the soybean market, and Argentina shipped its first cargo of corn to China after years of haggling over phytosanitary agreements and other quality

specifications. Argentina is likely to limit corn export quotas this year, but this nonetheless represents a potential loss of market share to the U.S. amidst minimal corn exports. Corn prices are likely to rebound from here as stocks remain tight despite the lack of export demand.

FRED DOUMA'S PRICE PROJECTIONS...

Dec 21 Est:	Quota cwt. \$19.01	Overbase cwt. \$17.31	Cls. 4a cwt. \$17.48	Cls. 4b cwt. \$16.31
Last Week:	Quota cwt. \$18.97	Overbase cwt. \$17.27	Cls. 4a cwt. \$17.41	Cls. 4b cwt. \$16.27

CDFA HOLDS HEARING TO DEBATE INCREASES TO CALIFORNIA'S MINIMUM MILK PRICES:

(By Rob Vandenheuvel) This week, the California Department of Food and Agriculture (CDFA) held a hearing to debate and discuss possible temporary increases to the minimum milk prices in California. While the hearing included discussion on all five classes, a majority of the testimony was predictably focused on the Class 4b price, which has been the subject of much discussion over the past two years. 20 witnesses testified at the hearing, of which 14 were either dairy farmers or their representatives. Six letters were also submitted by individuals who couldn't make the hearing, all in support of a significant increase in the minimum prices. Included in those six was a letter from Riley C. Walter, a bankruptcy attorney in Fresno, California, who testified that in the past two years, he has worked with "no less than 60 dairymen and their families...who have experienced extreme financial pressure due, in part, to low milk prices paid to California dairymen."

Through testimony and the letters submitted to CDFA, California dairy families made a strong case for why a significant increase in the pay price for milk is warranted, even if only for the six months CDFA has indicated any increase would be available. There were several proposals made by various producer groups and cooperatives providing suggestions for how those increases could be implemented, all of which would increase the overall pay price in California some between \$0.75 - \$1.00 per hundredweight. On the processor side, many of the witnesses testified that they believed no increase should be implemented, with the one proposal from the Dairy Institute (lobbying organization for many of the California processors) for an increase of about \$0.09 per hundredweight for a three month period.

We expect to hear the results of the hearing in late January 2013, with any changes to the prices expected to be implemented on February 1, 2013. To give you a flavor of the hearing, below is the testimony given by MPC:

Testimony from Milk Producers Council

December 21, 2012

Mr. Hearing Officer and Members of the Panel, my name is Rob Vandenheuvel and I am the General Manager of Milk Producers Council (MPC). MPC is a non-profit trade association with office locations in Ontario, Bakersfield and Turlock, California. We represent a voluntary membership of dairy families throughout Southern and Central California. My testimony today is based on positions adopted by the MPC Board of Directors.

CDFA's Responsibilities in the California Dairy Industry

On a recently created page of CDFA's website, the role of CDFA in pricing milk is stated as such:

"CDFA is the regulatory agency charged with balancing the needs of dairy farmers producing milk on the farm, manufacturers taking milk from the farm and converting it into dairy products, and consumers looking for a reliable supply of reasonably priced products."

It has been abundantly clear that the needs of manufacturers have certainly been a priority of CDFA over the years. Some examples include:

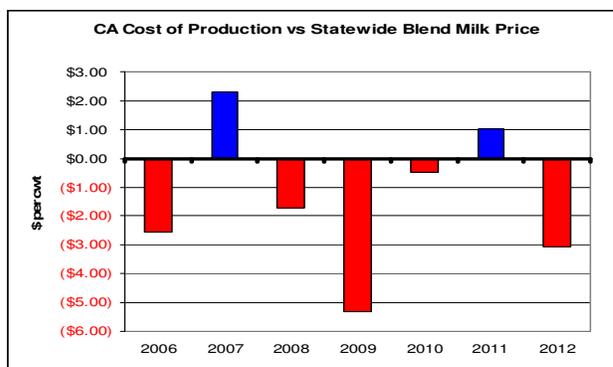
- An end-product pricing structure that largely mitigates the market risk for our manufacturers, through the use of make allowances in our formulas,
- A dry whey factor in our Class 4b price that is significantly limited when compared to the benchmark pricing formula used in the Federal Milk Marketing Order system (Class III),

- An f.o.b. adjustment in our Class 4a and 4b formulas to account for location challenges associated with being on the West Coast,
- A transportation subsidy program, funded by producers, to ensure that Class 1 plants have an adequate supply of milk, and
- A pooling plan that allows processors of all classes of milk to equally compete for a milk supply, regardless of how their Class price compares to the others.

All these items are aimed at providing opportunities for our dairy product manufacturers to: (1) secure an adequate supply of milk; and (2) have a reasonable opportunity for a return on their investment.

What has been missing is the other side of the coin: the “balance” of also looking at the economic needs of California’s dairy families. While our manufacturers have been able to enjoy some of the structural advantages listed above, our State’s dairy families have been financially massacred in recent years. To amplify this point, we need to go no further than CDFA’s own data on the cost of producing milk vs. the combined income from all five classes of milk (which is one of the outlined considerations included in California Food and Ag Code Section 62062(a)). The table and chart here show the average statewide cost of production, as calculated by CDFA’s own staff, compared to the statewide blend milk price.

	CA Cost of Production	CA Blend Milk Price	Difference
2006	\$14.17	\$11.62	(\$2.55)
2007	\$15.77	\$18.09	\$2.31
2008	\$18.54	\$16.81	(\$1.73)
2009	\$16.86	\$11.56	(\$5.30)
2010	\$15.23	\$14.77	(\$0.46)
2011	\$17.54	\$18.57	\$1.03
2012	\$18.75	\$15.68	(\$3.07)



As CDFA’s data demonstrates, California’s dairy families were subjected to financial losses in five out of the past seven years. To put these figures in perspective, a 1,000 cow dairy producing 65 pounds of milk per cow, per day, would reasonably assume to have lost – according to CDFA’s own economic data – **a combined \$2,135,523** during that seven year period. Testimony at today’s hearing will undoubtedly uncover the reality behind these financial estimates: massive debt accumulation, dispersal sales and bankruptcies.

California’s dairy families are hopeful that today’s hearing marks a change of course and the beginning of real “balance” among industry participants.

A Strong Case for Increasing the Regulated Minimum Price

We are in the midst of killing the dairy producer sector of California. Month after month, our dairy farmers are selling their milk at prices well below the cost of producing that milk. Some on the processing side of our industry have hinted that dairy farmers and their cooperatives ought to just negotiate better prices for our milk. What that statement ignores is the fact that our dairy farmers and their marketing cooperatives often sell their milk supplies under long-term contracts for economic stability. These contracts are typically – if not exclusively – pegged to the regulated prices announced by CDFA. Modest service premiums are often attached, mostly to compensate for balancing costs and encourage higher quality standards.

Why have dairy farmers and their cooperatives contracted milk using regulated prices as the benchmark? It makes perfect sense when you look at CDFA’s responsibilities, as outlined in the California Food and Agricultural Code:

- A goal of the regulations is to enable the dairy industry, with the aide of the state, to develop and maintain satisfactory marketing conditions...and bring about and maintain a reasonable amount of stability and prosperity in the production of market milk (Section 61805(d));

- CDFA shall establish prices that are in a reasonable and sound economic relationship with what comparable milk is worth around the country (paraphrase of Section 62062); and
- CDFA shall take into consideration that the reasonableness and economic soundness of market milk prices for all classes, giving consideration to the combined income from those class prices, in relation to the cost of producing and marketing market milk for all purposes, including manufacturing purposes. And that in determining the costs, the director shall consider the cost of management and a reasonable return on necessary capital investment (Section 62062(b)).

Dairies and their cooperatives rely on CDFA to follow the Food and Agricultural Code when they establish contracts to sell their milk to manufacturers. We rely on the fact that one of the stated goals of CDFA is to “bring about and maintain a reasonable amount of stability and prosperity in the production of market milk.” We rely on the fact that the prices must be competitive with what comparable milk is worth in other parts of the country. We rely on the fact that CDFA must consider producers’ cost of production, including a reasonable return on investment and a cost of management, when establishing prices.

Why would sellers of raw milk in California agree to long-term contractual relationships fundamentally based on CDFA-announced minimum prices if they thought those prices would result in on-the-farm losses in five of the past seven years? Why would we lock ourselves into contracts pegged to CDFA-announced prices if we knew those prices would be systematically discounted below the prices paid for comparable milk around the country? It’s simple; we wouldn’t.

Producers desperately need – and the California Food and Agricultural Code allows – for CDFA to make a meaningful upward adjustment to the minimum prices, even if only for the short time being allowed by the call of this hearing.

Support for Western United Dairymen’s Proposed Changes

The Milk Producers Council’s Board of Directors has had the opportunity to review the proposal put forth by Western United Dairymen, and we strongly support it. The proposal, if implemented, would result in much-needed additional market revenue being paid to our state’s dairy farmers.

Restoring Fairness and Equity in the System

The issues before us today are not new. The dairy producer community has been extremely vocal and active in the past two years, pointing out the desperate need for an increase in the pay price for milk, particularly with respect to the Class 4b price. While producers have been fighting for their financial lives, we’ve seen a specific line of rhetoric emerge from the State’s cheese manufacturers. Their basic argument is that minimum prices are fine where they are – some have even proposed lowering them – and premiums should be the only tool we use to increase our pay price for milk. A few of those examples are:

- “Hilmar Cheese Company supports a low regulated minimum price that allows the market to efficiently set high market-driven prices.” (*Testimony of David Ahlem, Hilmar Cheese Company, May 31, 2012 CDFA hearing*)
- “Cooperatives should use milk premiums over minimum pricing as a way to improve producers’ income based on the supply and demand of milk in a working market.” (*Testimony of Barry Murphy, Independent Consultant, May 31, 2012 CDFA hearing*)
- “Why don’t these producers merely go to their customers and raise their price?” (*Letter to CDFA from Michael Shotts, Farmdale Creamery, March 8, 2012*)
- “The role of regulated prices should be to undergird the market, providing some stability yet leaving room for market forces to work.” (*Testimony of Dr. Bill Schiek, Dairy Institute of California, June 30, 2011 CDFA hearing*)

Even CDFA has referenced this line of thinking in recent months:

- “Additionally, some milk buyers have announced they will add a whey revenue-sharing premium for their milk producers immediately, equating to an increase of approximately 50 cents per hundredweight. So we are seeing some positive activity in the milk market driven by changes in supply and demand.” (*CDFCA Statement on Milk Pricing, October 18, 2012*)

To those that don't fully understand how milk is marketed in California, this rhetoric sounds pretty logical. Why should we worry about the minimum prices? Why not just focus on generating higher premiums? One of those reasons that logic fails the smell test was discussed earlier in this testimony. But beyond that, there is another reason why proper minimum prices are needed.

One of the Secretary's considerations specifically spelled out in the California Food and Agricultural Code is the reasonableness and soundness of the relationship between the various classes (paraphrase from Section 62062(c)). That consideration was also specifically included in the official notice for today's hearing. Why is that in there? The reason is simple. While today's hearing is specifically on the five minimum prices established each month, we need to remember that these minimum prices do not exist in a vacuum. California operates under a Pooling Plan that pools the revenues from the sale of milk in each of the five classes. One of the fundamental tenets of that pooling structure is that each of the five classes must make a *fair and equitable* contribution to the pool.

We recognize that this does not mean all five class prices must be equal, but the Secretary is nonetheless tasked with maintaining a fair and reasonable relationship between the classes. Today, let's specifically look at the relationship in the past several years between our two main manufacturing classes: Classes 4a and 4b.

Over the past three years, since January 2010, the Class 4b price has averaged \$14.88 per hundredweight, while the Class 4a price has averaged \$16.33 per hundredweight – an average difference of \$1.45 per hundredweight. At the same time, the overbase price – which is the price plants are obligated to pay their milk suppliers – has averaged \$15.57 per hundredweight. What that means is that since January 2010, in order to be able to pay their producers the blended overbase price, Class 4b plants have collectively ***received almost \$344,700,000 out of the California pool***. At the same time, Class 4a plants have had to not only pay their milk suppliers the blended overbase price, but on top of that they have collectively ***contributed more than \$283,200,000 to the California pool***.

What does this mean? Through California's regulated pooling system, our butter/powder plants have been heavily subsidizing the cheese plants over the past three years. Without our pooling system, how much milk would our cheese manufacturers have been able to purchase in 2011 at the Class 4b price, which was \$2.45 per hundredweight below than the Class 4a price? Instead, those cheese plants were able to compete for milk on an equal playing field with the butter/powder plants, since hundreds of millions of dollars was being taken from the butter/powder plants and given to the cheese plants.

It's frankly dishonest for our cheese manufacturers to lecture dairy farmers and their cooperatives about “going to the marketplace” for additional revenue, while the regulated system has overseen the transfer of \$344,500,000 in pool revenues they did not earn in order to pay the market price for the milk they need. This is why Milk Producers Council believes that the Western United Dairymen proposal, which includes a significant increase in the Class 4b price while proposing no increase in the Class 4a price, is an appropriate adjustment for CDFCA to make. It's about fairness and justice; something the Secretary is sworn to uphold.

Conclusion

In conclusion, there is ample evidence that dairy farmers are in desperate need of a meaningful increase in the price they are paid for their milk. We've also demonstrated that a significant adjustment to the Class 4b price is in the interest of fairness and justice. CDFCA and Secretary Ross are empowered by California law to make these adjustments, and we, along with our fellow trade associations, marketing cooperatives, and the roughly 1,600 individual dairies left in California, are hopeful that Secretary Ross will heed our requests.