



Milk Producers Council

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DATE: February 22, 2013
TO: Directors & Members

PAGES: 5
FROM: Rob Vandenheuvel, General Manager

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE

Blocks - \$.0475 \$1.6275
Barrels N/C \$1.6300

Weekly Average, Cheddar Cheese

Blocks - \$.0239 \$1.6431
Barrels +\$.0220 \$1.6300

CHICAGO AA BUTTER

Weekly Change - \$.0150 \$1.5900
Weekly Average +\$.0190 \$1.6000

DRY WHEY

Dairy Market News w/e 02/22/13 \$.5700
National Plants w/e 02/16/13 \$.6342

NON-FAT DRY MILK

Week Ending 2/15 & 2/16

Calif. Plants \$1.5597 11,929,091
Nat'l Plants \$1.5577 16,061,249

Prior Week Ending 2/8 & 2/9

Calif. Plants \$1.5664 5,952,057
Nat'l Plants \$1.5378 29,398,338

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

Milk & Dairy Markets

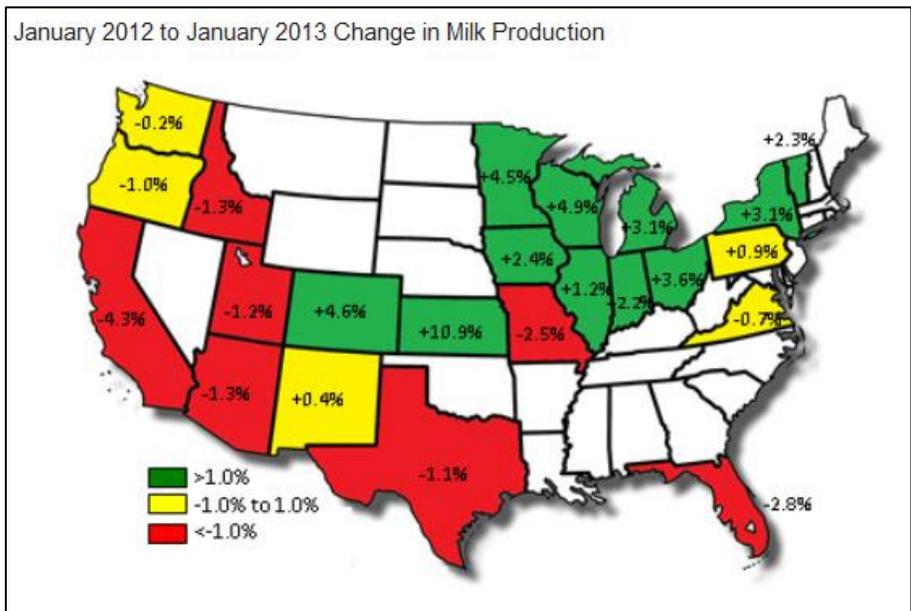
Class III milk futures moved incrementally lower this week. Contracts in the first half of the year remain in the \$17 to \$18 per cwt. range. Cheese sellers were active at the CME, and block Cheddar settled four cents lower. Barrels were unchanged, which allowed block prices to settle below barrels for the first time in over ten months.

Milk flows and cheese production in the Midwest have been heavy, and the U.S. was a net cheese importer in December. This pushed U.S. cheese stocks over one billion lbs. on December 31, according to revised figures in the Cold Storage report. Inventories climbed further in January. Total cheese stocks were up 0.9% and American cheese stocks increased 1.2% from December 31.

These ample cheese supplies have been pressuring nearby prices. However, prices were higher for all Cheddar contracts at the Global Dairy Trade auction earlier this week, and deferred contracts were particularly strong. Given slowing milk production in Europe and Oceania and heavy dairy cow slaughter in the U.S. and New Zealand, dairy product buyers anticipate tighter supplies in the future.

Spot butter lost a penny and a half this week. Reports of heavy churning activity were clearly not exaggerated. January 31 butter stocks totaled 206.6 million lbs., an increase of 35% from December 31 and the largest January volume since 1994. Inventories were 21.3% higher than at this time last year.

U.S. milk production in January totaled 17.1 billion lbs., an increase of 0.5% from January 2012. While slight, this increase was nonetheless impressive because it compounds exceptional milk production growth in January 2012, which was 3.8% higher than January 2011. The milk cow herd expanded to 9.225 million cows in



January, up 7,000 head from December. December cow numbers were revised 5,000 head higher, making for a 12,000-head report-to-report change. Dairy producers have added 36,000 head in the past three months, according to USDA. Still, there are 17,000 fewer cows than there were a year ago, implying very strong production per cow.

California milk production totaled 3.5 billion lbs., a decline of 4.3% from January 2012. Much of the decline was due to a 4.2% drop in per cow milk production. There were only 2,000 fewer cows than a year ago. Indeed, the Milk Production report showed an increase of 1,000 head in California from December to January. Given very heavy slaughter and a spate of liquidations, this month to month increase is surprising.

Perhaps per cow production did not fall as much as suggested, and this is masking a contraction in the California milk cow herd. The weather has been excellent for milk production, and cows are enjoying great pen conditions with a notable lack of mud. Dispersal auctions have provided a ready supply of fresh heifers to replace late lactation milk cows, and dairy producers may be able to cheat ahead on the lactation cycle and possibly raise their herd's average production for a time. With high beef prices, dairy producers can replace cull cows with replacement heifers at a very low net cost. If these factors are leading to higher milk production in California (and elsewhere), the increase will be as fickle as the weather and dependent on an accelerated turnover of late lactation cows.

For the week ending February 9, dairy cow slaughter totaled 67,030 head, 4.6% higher than the same week last year. January dairy cow slaughter totaled 296,900 head, the highest monthly slaughter since it spiked during the Dairy Termination Program in 1986. If slaughter continues at these levels, the dairy herd will contract eventually.

The dairy industry continues to consolidate, according to USDA's Farms, Land in Farms and Livestock Operations report. There were 58,000 dairies in 2012, a decline of 2,000 operations from 2011. Interestingly, the industry shed 200 operations with 2,000 or more cows last year. This is the first ever decline among the largest dairy operations. The remaining 1,750 facilities milking 1,000 head or more produced more than half of the nation's milk last year, but represented only 3% of all operations.

Grain and Hay Markets

Grain prices moved lower this week as a bout of storms in the Plains and Midwest brought deep snows in some areas and welcomed moisture. This improves prospects for the dormant winter wheat crop. In contrast, soybean prices moved sharply higher before falling Friday. Still, the net change since last Friday represents a notable uptick in soybean prices.

There were a number of factors behind the soybean rally. Rains in southern Argentina were disappointingly light, and the promise of rains next week is largely viewed as too little, too late. China reportedly booked several cargoes of U.S. soybeans, which came as a surprise because the Chinese have been buying as little soybeans as possible this quarter in anticipation of cheaper South American supplies which should hit the export market soon. Perhaps as inventories dwindled the Chinese became concerned about Brazil's ability to deliver cargoes on time. Brazil's ports are not large enough to handle all the soybeans that it would like to export in the next few months, and deliveries will drag out into summer. This week Brazilian port workers threatened to strike in mid-March at the peak of the export season. Meanwhile, with domestic supplies tightening due to slowed imports, Chinese soybean futures settled limit up on Friday, 4% higher than the previous settlement. The U.S. may attract some more Chinese soybean contracts to meet immediate needs.

FRED DOUMA'S PRICE PROJECTIONS...

Feb 22 Est:	Quota cwt. \$18.29	Overbase cwt. \$16.59	Cls. 4a cwt. \$17.95	Cls. 4b cwt. \$15.42
Last Week:	Quota cwt. \$18.32	Overbase cwt. \$16.62	Cls. 4a cwt. \$17.91	Cls. 4b cwt. \$15.51

A LOOK AT CALIFORNIA “POOLING”: *(By Rob Vandenheuvel)* Much of the recent discussion regarding the California milk pricing system has focused on the various monthly minimum prices that are announced by the California Department of Food and Agriculture (CDFA). The issue of how our Class 4b price is calculated vs. how the Federal Order Class III price is calculated has been a regular feature in this newsletter and other publications. But it’s important to recognize that those minimum prices are only part of the story. Dairy farmers in California are paid based on a blend – or “Overbase” – price, which is a weighted-average calculation that includes prices paid for milk in all five classes.

The five minimum prices that are announced each month determine what processors must pay for the milk they need. However, milk pooling is designed to allow every dairy in the pool to share equally in the pooled revenues from the sale of California milk. That means that a dairy farmer shipping milk to a fluid plant (Class 1) receives payment based on the same Overbase price as a dairy farmer shipping milk to a cheese plant (Class 4b).

Where the minimum price formulas and pooling collide is the relationship between the various class prices and the overall blended Overbase price. When a plant’s monthly minimum price is *below* the calculated Overbase price, that plant is entitled to a “pool draw” to make up the difference. On the other hand, when a plant’s monthly minimum price is *above* the calculated Overbase price, that plant must make a “pool contribution” for the difference. To demonstrate this, let’s take a look at the most recent data available for January 2013:

January 2013 California Pool Breakdown		
	Minimum Price	Difference from Overbase
Class 1 price (Northern CA)* - fluid	\$20.24	\$3.64
Class 2 price (Northern CA)* - soft products	\$18.54	\$1.94
Class 3 price – frozen products	\$18.49	\$1.89
Class 4a price – butter/powder	\$17.08	\$0.48
Class 4b price – cheese	\$15.84	(\$0.76)
CA Overbase Price	\$16.60	
<i>* CDFA announces both a Northern CA and Southern CA price for Class 1 & 2, which are less than \$0.30/cwt apart.</i>		

As you can see from the chart, when CDFA finalized the pool information for January 2013, the blended Overbase price that dictates what an individual dairy farmer receives was \$16.60 per hundredweight. However, each of the five classes had a different relationship to that Overbase price. For classes 1, 2, 3 and 4a, the price that plants had to pay for milk (the announced minimum price) was *above* the price their producers had to receive for their milk (the Overbase price). For Class 4b, the price that plants had to pay for milk was *below* the price their producers had to receive for their milk.

So how is this difference made up? That’s where the “pool draws” and “pool contributions” come into play. Looking at the two main manufacturing classes (4a and 4b, which account for about 75 percent of the milk produced and sold in California), a Class 4a manufacturing plant had to pay their producers the Overbase price of \$16.60 per hundredweight. But they were ultimately responsible for paying the full minimum price of \$17.08 per hundredweight. So in that case, the plant would pay \$16.60 per hundredweight to their producers, and the difference of \$0.48 per hundredweight into the pool as a “pool contribution.” Looking at the other side of the equation, a Class 4b manufacturing plant also had to pay their producers the Overbase price of \$16.60 per hundredweight, but were only required to have \$15.84 per hundredweight (the Class 4b minimum price) come out of their pockets. The difference of \$0.76 per hundredweight was made up by a payment from the pool, which is a “pool draw.”

(It’s important to note that these figures are used for simplicity purposes. The actual pool draw/contribution calculations for each plant are based on the amount of fat, solids-not-fat and fluid carrier (for Class 1) that is purchased by the plant. However, the end result can be fairly demonstrated by the broader “per-hundredweight” figures above.)

So even from this simple example, it's easy to see that while every dairy farmer participating in the California pool is entitled to the same Overbase price, the manufacturing plants from the various classes are exposed to different price dynamics within that system.

So why is this important? Over the past three years, producer groups have argued that our Class 4b price has been artificially discounted by CDFA compared to the Federal Order Class III price used as a benchmark price for milk sold to cheese plants around the country. We've pointed out that since January 2010, the California Class 4b price has averaged \$1.73 per hundredweight below the Federal Order Class III price, resulting in our State's cheese manufacturers putting significantly less money into the "California pool" than what they would if our Class 4b price more closely tracked with the Federal Order Class III price. We've calculated that the difference in real dollars is more than \$745,000,000 since January 2010 that our plants didn't have to put into the pool.

While that story has been told by dairy organizations and news outlets around the state (and even around the country), very little has been said about what impact that has had on the operation of the California pool. The impact has been significant, as demonstrated below:

January 2010 - January 2013 California Pool Information		
	Minimum Price	Difference from Overbase
Average Class 1 price (Northern CA)* - fluid	\$18.94	\$3.22
Average Class 2 price (Northern CA)* - soft products	\$16.67	\$0.95
Average Class 3 price - frozen products	\$16.62	\$0.90
Average Class 4a price - butter/powder	\$16.44	\$0.72
Average Class 4b price - cheese	\$15.05	(\$0.67)
Average Overbase price	\$15.72	

Looking at the two main manufacturing classes (4a and 4b, which as stated earlier, make up about 75 percent of the milk produced and sold in California), you can see that over the past three years, our Class 4a plants have had to pay an average of \$16.44 per hundredweight for their milk, with \$15.72 per hundredweight going to their producers and the other \$0.72 per hundredweight paid as a pool contribution. During that same time period, the Class 4b plants had to pay their producers the same Overbase price of \$15.72 per hundredweight, but only \$15.05 per hundredweight came out of their pockets, with the remaining \$0.67 per hundredweight received as a pool draw.

In real dollars, **Class 4a plants have made pool contributions in the amount of more than \$289,000,000 since January 2010.** Those contributions are *above* the amounts those plants had to pay to their producers for the milk they bought. At the same time, the **Class 4b plants received more than \$371,000,000 in the form of pool draws.**

Pooling, which was introduced in California through the Gonsalves Milk Pooling Act in 1967, brought benefits for both producers and processors. For producers, it allowed an equitable distribution of pool revenues to every producer, regardless of where their milk was being sold. For processors, it allowed all plants to compete equally for a milk supply, since the pool would allow each plant to pay the same Overbase price, regardless of the minimum price a plant is responsible to pay out of their pocket. However, what we have seen in the past three years is a situation where one of those classes (4b) is significantly discounted compared to the national prices paid for comparable milk, the impact on how the different classes are affected by the pool has been significant.

Processors and their organizations like the Dairy Institute of California have repeatedly opposed dairy producer efforts to raise the Class 4b price to bring it closer to Federal Order Class III price levels, arguing that a lower Class 4b price is appropriate and that over-order premiums should be used to move mailbox milk prices higher. Sounds logical, right? Maybe even sounds like a "free market" argument? What is left out of those arguments is the fact that our cheese manufacturers have been on the receiving end of a **\$371,000,000 subsidy from the California pool for the past three years!**

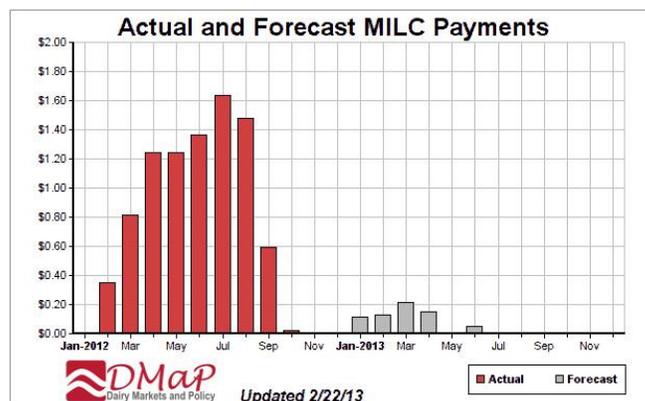
Here's a "free market" question: **How much milk would the Class 4b plants have been able to buy over the past three years at \$15.05 per hundredweight, while the Class 1, 2, 3 and 4a plants were paying significantly higher prices?** We know the answer: **Only whatever milk was left when the plants for the other four classes had what they needed.** Instead, our State's pooling system has allowed those cheese manufacturers to collect more than \$371,000,000 from the pool, allowing them to pay their producers the same Overbase price as those plants that are paying significantly more for the milk they buy. At the same time, the Class 4a plants – which are virtually all operated by dairy farmer owned cooperatives, had to not only pay their producers the Overbase price, but also kick in an additional \$289,000,000 into the California pool, which was directly handed over to the Class 4b manufacturers.

It's pretty gutsy for the State's cheese manufacturers and their representatives to make a "free market" argument when those same plants are collecting such a massive subsidy from the California pool. This inequity needs to be fixed, which is why MPC and other producer organizations/cooperatives are working together in the California Legislature to approve AB 31, a bill that would require our Class 4b price to more closely track the Federal Order Class III price. A hearing on the bill is expected to be held in the next 1-2 months, so stay tuned for more developments on this issue.

LESS THAN A WEEK LEFT IN "RELIEF PERIOD" FOR MILC PROGRAM: *(By Rob Vandenhoevel)*

As we have reported in recent weeks, dairies that are enrolled in the Milk Income Loss Contract (MILC) program have the ability to select any month (October 2012 – September 2013) as their "start month." **However, the flexibility to consider previous or current months as a start month is only available until February 28th.** Since nearly all California dairies will exceed the 2.985 million pounds of milk covered by the MILC program, the selection of a "start month" can have an impact on the possible payout under the program.

While no one knows what the future holds, there are several projections that are published and updated regularly (one such projection is included on the right). Those projections rely on best estimates for what the outlook is for not only dairy products, but also feed products (since feed costs can also impact MILC payments). While the projections can differ in their actual projected payouts, there seems to be general agreement that using the current dairy market levels, March 2013 will generate the highest monthly payout, with April 2013 projected to generate the next highest payout. Dairies just need to make sure that if they ultimately want to choose February or March as their start month, that paperwork will need to be filed with the Farm Service Agency by **no later than February 28, 2013.**



Any MPC members with questions about this can contact the office at (909) 628-6018.

MAKE PLANS TO ATTEND - CENTRAL VALLEY AIR BOARD WORKSHOPS ON FUNDING FOR IRRIGATION PUMP UPGRADES: *(By Kevin Abernathy, Director of Regulatory Affairs)* **Next Monday, Wednesday and Friday (February 25, 27 and March 1),** the San Joaquin Valley Air Pollution Control District (SJVAPCD) will be holding workshops aimed at providing more information on the permitting requirements for agricultural irrigation pump engines, as well as information about possible grant funding.

With upcoming regulatory deadlines approaching in 2015 for Tier 1 and Tier 2 diesel engines, dairies interested in pursuing grant opportunities should make plans to send a representative to one of these workshops. The locations of the workshops will be:

- Monday, February 25th at 1990 E. Gettysburg Ave in Fresno, CA
- Wednesday, February 27th at 4800 Enterprise Way in Modesto, CA
- Friday, March 1st at 34946 Flyover Court in Bakersfield, CA

A flyer on the workshops can be found at: <http://goo.gl/qRW1P>.