



# Milk Producers Council

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## MPC FRIDAY MARKET UPDATE

### CHICAGO MERCANTILE EXCHANGE

Blocks +\$.2400 \$2.0500  
Barrels +\$.1425 \$1.9600

### CHICAGO AA BUTTER

Weekly Change - \$.0375 \$2.1425  
Weekly Average +\$.0220 \$2.1575

### NON-FAT DRY MILK

#### Week Ending 5/27 & 5/28

Calif. Plants \$1.5924 14,556,715  
NASS Plants \$1.6262 18,646,983

### Weekly Average

Blocks +\$.1778 \$1.9438  
Barrels +\$.1345 \$1.8975

### DRY WHEY

**WEST MSTLY AVG** w/e 06/03/11 \$.5263  
**NASS** w/e 05/28/11 \$.5035

**CHEESE MARKET COMMENTS:** Daily production of all cheese in April held steady with March's level, but daily cheddar production increased slightly. The amount of American cheese in cold storage at month end increased by about the normal change from March to April (based on a five year average). A recent study covering a twenty year period found that recent levels of cheese in cold storage relative to recent monthly production levels are not appreciably different from those over that entire period. Shorter term comparisons had overlooked the longer term data which supports a number of conjectures that the cheese market, despite immense growth over the past eight years, had undergone appropriate adjustments from the point of manufacture to the consumer's refrigerator. Oh yes, (not to suggest a connection to the previous note on cheese stocks), prices for blocks and barrels erupted this week; blocks rose \$.24 per lb and barrels added \$.1425 per lb. Only one sale occurred, today, in response to a bid; it tacked on a dime per lb to the 14 cents increase that came from bids on Tuesday through Thursday. The week ended with two unfilled bids for cheese at \$2.05 per lb. The week's news: some cheese was reported to be held off market in the Midwest, and CWT announced approval of more assisted exports. The much higher cheese prices should make milk much more accessible to cheese plants, which didn't have much to offer milk suppliers so far this year. Near term class III milk futures, with July at \$20.00 per cwt, are now about even with this week's average cheese price.

**BUTTER MARKET COMMENTS:** Daily butter production in April held steady with March's level, and the amount in cold storage at month end was slightly lower for the month. That news, along with higher prices bid this week for anhydrous milkfat in Fonterra's auction covering the August-February period, affirmed the continuing tight international supply/demand situation for butterfat. Although butter prices fell on Tuesday and Friday this week, prices remain historically high. For reasons that confound, domestic sales remain fairly strong even as higher prices confront food service operators and consumers. Recent comments about export interest suggest that overseas and over border orders continue to be active. Trading on the CME this week was active. Most buyers, while uneasy with the current level of prices, appear to indicate they do not expect any substantial declines any time soon. After today's price drop of \$.02 per lb on the spot market, futures prices adjusted downward for all months through November, to levels about equal to the cash prices. December's price, at a still robust \$2.04 per lb, reflects the first small sign of doubt.

**POWDER MARKET COMMENTS:** Daily production on nonfat powders in April increased somewhat above March's levels. *Dairy Market News* reports seem to indicate a general weakening in demand for nonfat powders. From coast to coast, many buyers are said to be hesitant to place orders while plants are looking for new orders. Demand is steady in the East and "tepid" in the Midwest. Production is clearing plants to contracted buyers. Stocks of NFDM on hand at the end of April increased about equal to the increase in production during the month. Prices reported to NASS for shipments last week were about a penny per lb higher than the week before; prices reported by California plants were about a penny and a half per lb lower. Volumes for both were about where they have been. This decidedly down beat report contrasts sharply with what happened in Wednesday's

international auction for skim milk powder: prices in the auction for August shipments increased by \$.215 per lb from two weeks ago, to \$2.06 per lb. There is either a definite disconnect between the domestic market for NFDM or there is something amiss with the auction. Demand for buttermilk powder is lower than expected because ice cream production is being held up by low sales caused by cold and wet weather in the northeastern part of the country. Prices are steady. Demand for whole milk powder is reported to be active, although inventories at the end of April rose by more than the increase in the amount produced during the month.

**WHEY PRODUCTS MARKET COMMENTS:** The average price for shipments of dry whey last week held about where it was a week earlier. Volume is steady. Supplies are tight and prices are firm. The west's "mostly" average price added a half cent per lb this week. Production of whey protein concentrate has increased to the point where DMN reports far fewer delays in shipments. WPC (34% protein) are higher for the week, averaging \$1.54 per lb.

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### **FRED DOUMA'S PRICE PROJECTIONS...**

<b>June 3 Est:</b>	<b>Quota cwt. \$20.87</b>	<b>Overbase cwt. \$19.17</b>	<b>Cls. 4a cwt. \$20.60</b>	<b>Cls. 4b cwt. \$18.29</b>
<b>May '11 Final:</b>	<b>Quota cwt. \$19.14</b>	<b>Overbase cwt. \$17.44</b>	<b>Cls. 4a cwt. \$19.94</b>	<b>Cls. 4b cwt. \$14.74</b>

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**A CLOSER LOOK AT HOW CALIFORNIA DAIRY FARMERS ARE PAID FOR THE VALUE OF THE WHEY STREAM:** *(By Rob Vandenheuvel)* As we reported last week, the California Department of Food and Agriculture (CDFA) has announced that they will be holding a hearing on June 30/July 1 to consider changes to the minimum price formulas for Class 4a (butter/nfDM) and Class 4b (cheese/whey) milk.

This week, we'll focus on the changes being proposed to the Class 4b formula, with specific attention paid to the way our Class 4b formula accounts for the value of the whey stream that is generated as part of the cheese-making process.

### **Background**

In order to fully comprehend the California minimum price formula for milk sold to cheese plants, we need a basic understanding of how the milk is utilized by these plants. To assist in that, CDFA has created a "Simplified Flowchart of a Cheese Plant with By-Product Processing." I've posted this chart on our website, so you can find it at: <http://www.milkproducerscouncil.org/cheeseflowchart.jpg>. While each cheese plant is unique, this flowchart captures the basic utilization of raw milk by a plant processing cheese and whey products.

As you can see on the flowchart, during the course of the cheese-making process, the curds and whey are separated, with the curds further processed into the different varieties of cheese. The whey stream is also available to be further processed, with the whey cream able to be skimmed from the whey stream and churned into whey butter. The flowchart shows that cheese plants can also take the whey skim and further process it into products like whey protein concentrate, lactose or skim whey powder (often referred to as "dry whey").

In past CDFA hearings, testimony from our state's cheese-makers pointed out that not every plant has the infrastructure to process their whey stream. In 2008, CDFA released data on this issue, showing that while only 14 of the 61 plants operating in California at that time processed their whey stream, those 14 plants represented almost 90% of the volume of milk being purchased by our cheese plants. So it's fair to say that while some of the smaller cheese plants in the state (many of whom are likely making a specialty cheese that receives a premium over cheddar cheese in the market) are not processing their whey stream, a vast majority of our milk sold to cheese plants is being processed into various whey products.

### **So why is this important?**

The reason we need to understand how our milk is used by our processors is because in California (as well as in Federal Order areas), we've chosen to set our minimum milk prices using an "end-product pricing system." That means in order to determine the minimum prices that producers must be paid for their milk, we start with the value of the dairy products being made (butter, nfdm, cheese and dry whey) and work backwards. *(That's one of the reasons that these commodity values and John Kaczor's weekly analysis of the cheese, butter, powder and whey markets is first and foremost in each of our weekly newsletters.)*

### **A little history**

Prior to 2003, the California Class 4b formula did not account for the value of dry whey when calculating the minimum price paid by our cheese plants. But starting in April 2003, the Class 4b formula was amended to include a "dry whey factor." That original formula to determine the dry whey factor was:

$$\text{Dry Whey Factor} = (\text{Dairy Market News' "Western" Dry Whey Price MINUS a "Make Allowance" of \$0.17 per lb.}) \text{ TIMES a "Yield" of 5.8}$$

*(The "yield" of 5.8 accounts for the fact that CDFA estimated that 5.8 lbs of dry whey could be manufactured from 100 lbs of standardized raw milk.)*

From 2003 until 2007, that formula was amended by CDFA twice through their hearing process, with both amendments resulting in a higher make allowance for dry whey *(first it was increased to \$0.20 per lb in 2005, then again increased to \$0.267 per lb in 2006)*. In 2007, after dry whey values that spring/summer had shot up above \$0.80 per lb (which added more than \$3.00 per hundredweight to the Class 4b minimum price during those months), CDFA held another hearing and decided to remove the formula used to calculate the "Dry Whey Factor," and instead assigned a constant value of \$0.25 per hundredweight as our "Dry Whey Factor." That's what has been in place since December 2007.

At the same time, the Federal Orders have maintained a variable "Dry Whey Factor" using a formula similar to the California formula referenced above:

$$\text{Other Solids Price} = (\text{NASS Dry whey price MINUS a "Make Allowance" of \$0.1991 per lb}) \text{ TIMES a moisture adjustment of 1.03 TIMES a "Yield" of 5.9}$$

One of the most notable differences between this Federal Order dry whey factor and the pre-2007 formula used in California is the substantial difference in Make Allowances (the Federal Order make allowance from 2003 – present has ranged from \$0.159 to \$0.1991 per lb while the California make allowance ranged from \$0.17 to \$0.267 per lb). This is an issue that warrants a larger article by itself, so I won't go into those points right now.

The main point being focused on now is that for the past 42 months, California's "dry whey factor" has been a constant \$0.25 per cwt, while the Federal Order "dry whey factor" has ranged from (\$0.26) to \$1.79 per cwt *(that's right...when the price of dry whey is below the make allowance level, the Federal Order formula – as well as the pre-2007 California formula – has a negative dry whey factor)*.

With dry whey values escalating in recent months above \$0.50 per lb, the gap between the California dry whey factor and the Federal Order dry whey factor is at it highest point in recent years – a difference of \$1.54 per cwt in May 2011.

This difference between how California dairy families and our counterparts in Federal Order areas are paid for the value of the whey stream creates two major problems. For starters, we are currently out of compliance with the California Food and Agricultural Code, which specifically states that: *"...formulas shall be reasonably calculated to result in prices that are in a reasonable and sound economic relationship with the national value of manufactured milk products"* (emphasis added). It's difficult to comprehend how we can be in a "reasonable and sound economic relationship" with the national value of manufactured milk products when we have a Class

4b formula that has a dry whey factor ranging from \$0.51 higher to \$1.54 lower than a comparable pricing formula used throughout most of the country.

Secondly, and of equal importance, is the difficulty this difference creates in participating in risk management strategies. The risk management tools that are available for milk sold to cheese plants use the Federal Order Class III minimum price to settle on. But as you can see, the California Class 4b formula doesn't track well with the Federal Order Class III price, particularly in recent years, largely due to the differences in how the whey stream is valued. For example, in the 42 months since California went to a flat \$0.25 per cwt dry whey factor, the average difference between the Federal Order Class III price and the California Class 4b price has been \$0.85 per cwt (that is, the Class III price has been \$0.85 higher than the Class 4b price). If that were the case month-in-month-out, you could adjust your risk management strategy to account for that. But the reality has been that the California 4b price has ranged from \$0.80 per cwt higher (February 2009) than the Federal Order Class III price all the way to \$2.64 per cwt lower (March 2011).

Milk Producers Council and other producer organizations have proposed alternatives to CDFA aimed at narrowing the gap between the California and Federal Order dry whey factors. While those alternatives have been rejected by CDFA in the past, this upcoming hearing presents another opportunity to make the case to CDFA.

### **The upcoming CDFA hearing on June 30/July 1**

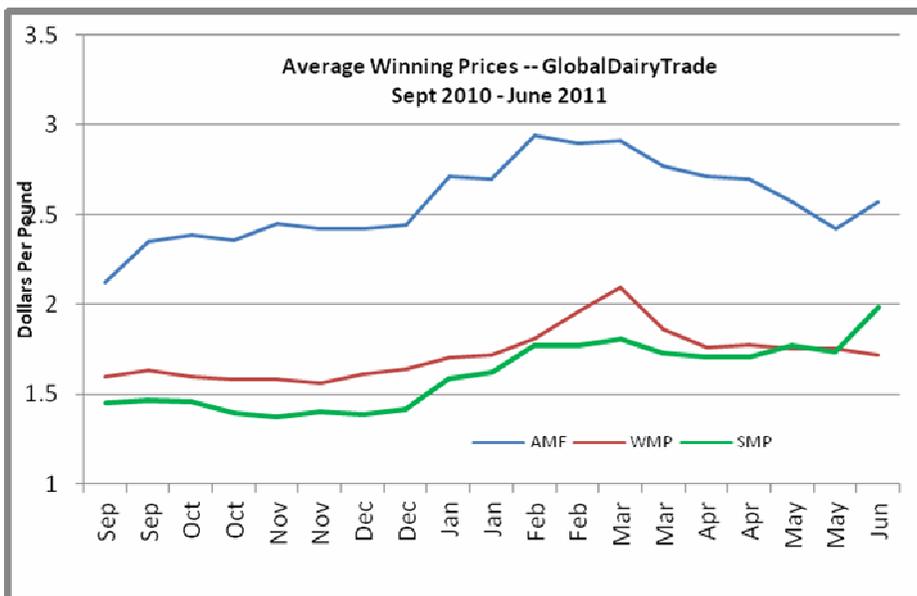
Land O'Lakes has put together a proposal for the upcoming hearing that attempts to address this huge gap between the California and Federal Order dry whey valuations. In future issues of this newsletter, we'll take a closer look at that specific proposal. So stay tuned...

**NATIONAL MILK PRODUCERS FEDERATION PLANNING TO TAKE THEIR PLAN TO THE GRASSROOTS:** *(By Rob Vandenheuvel)* The debate over Federal dairy policy reform is apparently heating up in Washington, DC. News reports indicate that the International Dairy Foods Association (IDFA) – the main lobbying organization for the nation's dairy product processors – is ramping up the rhetoric against key provisions in National Milk Producers Federation's (NMPF) "Foundation for the Future" (FFTF) plan. As NMPF continues to work with Congress to transform FFTF into a legislative bill that can be considered by Congress, IDFA is meeting with Congressional staff, in attempts to tear down pieces of the plan that they find objectionable (*mostly the Dairy Market Stabilization Program, which empowers dairy farmers to temporarily cut back milk production when farmer margins are severely compressed*).

NMPF has rightly realized that the only chance we have to overcome the strong IDFA objection is to collectively unite the grassroots dairy farmers behind Foundation for the Future. NMPF will be hitting the road next month for a 12-stop "Summer Grassroots Tour" to meet with dairy families around the country and talk about FFTF. The 2<sup>nd</sup> stop on this tour will be right here in California, at the Visalia Holiday in on June 13<sup>th</sup>. From their website ([www.futurefordairy.com](http://www.futurefordairy.com)), it looks like there will be two sessions: a 9:30 am – 12:30 pm session and a 1:30 – 4:30 pm session. Space is limited, so NMPF is asking that individuals interested in attending pre-register on their website.

**FONTERRA'S JUNE 1<sup>ST</sup> AUCTION HAS SOME GOOD NEWS AND SOME SURPRISES:** *(By J. Kaczor)* One of the more curious things about the curiously high prices for skim milk powder in Fonterra's latest internet auction is no one is saying much about them. The SMP winning price for the August Spot month is \$2.063 per lb – \$.358 per lb above the comparable winning price for whole milk powder. The only comments seen so far offer as a possible reason for this incredible price inversion is the relatively low volume of SMP available for bidding. That suggests that an expected result from a little less volume and a little more demand, along with a good measure of uncertainty, can be a huge price spike. It can; the total amount of SMP available for all months covered by this auction was lower than the amount offered in mid-May and the amount of WMP was higher. However, the maximum volumes of SMP and WMP offered for sale from mid-December through mid-May decreased by close to identical percentages from the mid December auction through Mid-May.

The graph shown here updates the weighted average winning prices for all volumes sold in the auctions from last September through June 2<sup>nd</sup>. The delivery period covered by all three contracts in this auction extends through February 2012. Prices for anhydrous milkfat and skim milk powder increased for all specifications for all contract periods. Prices for all whole milk powders decreased for all contract periods. The weighted average price index for all products rose.



The results for SMP should raise a question about whether they really reflect current supply and demand for that product. They are actual prices, which is one requirement of New Zealand’s commodities exchange, NZX, for using them to cash-settle futures contracts and options that were established as risk management tools to help industry participants manage price volatility. Because the prices are published they also satisfy the transparency objective. But the small amount of total SMP volume available for purchase, and the related futures securities, makes one mindful of concerns about the thinness of CME’s spot markets, and complaints about their vulnerability to price manipulation. Just one month ago, on May 4<sup>th</sup>, NZX reported all settlement prices for WMP from May through August to be higher than those of SMP, about in line with the auction’s winning prices for those products. Today, NZX reports all settlement prices for WMP from June through next February to be lower than those for SMP.

The pattern of winning prices for AMF and WMP seem to reflect consensus views on current and future international supply and demand. Because they are so contrary to industry data, for SMP’s winning prices to be considered a reflection of fair value for international buyers and sellers it’s almost needed to assume the only SMP supply source for the winning bidders is the auction – or to chalk it up to a huge speculative move. The winning average price for SMP on May 17<sup>th</sup> was \$.038 per lb lower than the winning price two weeks earlier. Two weeks later something made some bidders for SMP to keep their bid volumes in play much longer than usual. It is up to Fonterra, CRA International (the auction manager), and perhaps NZX, to sort out what happened.

**CENTRAL VALLEY DAIRIES – BE ON THE LOOKOUT FOR TRESPASSERS:** *(By Rob Vandenheuvel)*

We’ve received word that a couple extreme animal rights activists are driving around areas in Tulare County, attempting to get video footage of the local dairies. These extremists have apparently indicated that they are upset about having dairy cows confined in corrals. They are reportedly driving a blue/white Volkswagen bus and a maroon car. Central Valley dairies should be on the lookout for these trespassers. It’s important to remember that if you come across them or any other similar trespassers on your dairy, you are fully within your rights to ask them to leave your property, and if they don’t, you should contact local authorities to report the individuals.