



# Milk Producers Council

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DATE: June 14, 2013  
TO: Directors & Members

PAGES: 8  
FROM: Rob Vandenheuvel, General Manager

## A GREAT WEEK FOR THE FARM BILL; ANOTHER CRITICAL WEEK COMING UP

*By Rob Vandenheuvel*

This week, the U.S. Senate approved their version of the 2013 Farm Bill with a bipartisan vote of 66-27. MPC appreciates the work done by California's Senators – Barbara Boxer and Dianne Feinstein – both of whom voted in favor of the bill. Included in that bill was the “Dairy Security Act,” a package of reforms to our dairy safety net programs that MPC and other dairy organizations and cooperatives around the country have been working towards for the past several years.

**The focus now shifts to the U.S. House of Representatives, which is expected to debate and vote on their version of the Farm Bill next week.** The House version of the bill currently also includes the “Dairy Security Act,” but there are efforts by the nation’s processors and their friends in Congress to have the Goodlatte/Scott Amendment considered during the House debate. That amendment – *which has already been rejected twice by the House Agriculture Committee* – would significantly weaken the dairy reforms currently in the bill.

**MPC strongly encourages dairies to send a message to their Member of Congress, urging them to support the Dairy Security Act, and oppose any effort to remove it from the current version of the Farm Bill. You can send that message through the following website, with either a pre-written or customized letter: <http://capwiz.com/nmpf/issues/alert/?alertid=62582126&PROCESS=Take+Action>. We all need to do our part if the processor lobby is going to be defeated in their efforts to gut the dairy provisions from the Farm Bill!**

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### MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE			CHICAGO AA BUTTER			NON-FAT DRY MILK		
Blocks	-.0250	\$1.7225	Weekly Change	-.0100	\$1.5350	<b>Week Ending 6/7 &amp; 6/8</b>		
Barrels	+.0125	\$1.7725	Weekly Average	-.0010	\$1.5400	Calif. Plants	\$1.6622	8,334,585
<b>Weekly Average, Cheddar Cheese</b>			<b>DRY WHEY</b>			Nat'l Plants	\$1.6839	18,461,823
Blocks	+.0045	\$1.7360	Dairy Market News	w/e 06/14/13	\$1.5850	<b>Prior Week Ending 5/31 &amp; 6/1</b>		
Barrels	+.0450	\$1.7700	National Plants	w/e 06/08/13	\$1.5682	Calif. Plants	\$1.6159	5,553,499
						Nat'l Plants	\$1.6690	13,704,377

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

#### Milk & Dairy Markets

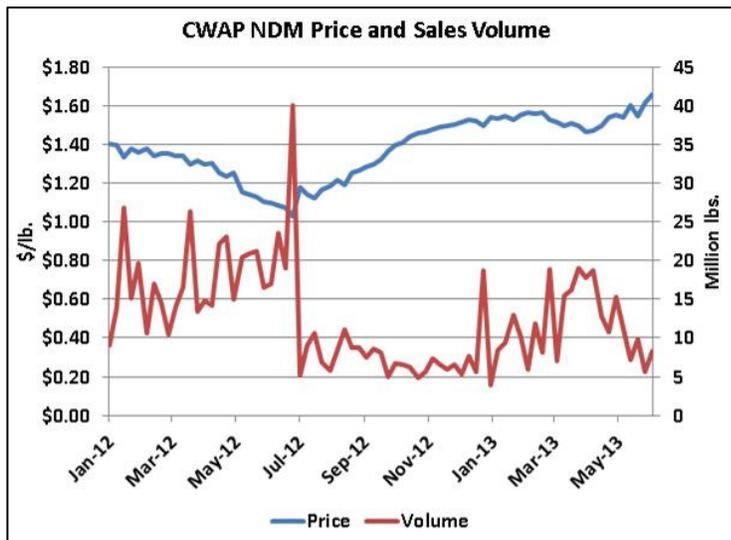
July and August Class III futures were the big losers this week, dropping around 50¢/cwt. September and October contracts posted more moderate losses, while November and December added a few cents. This week's declines were partially predicated on outside market weakness. Commodities in general came under pressure amid volatility in equity, currency and bond markets. Investors are addicted to easy money policies, and fears that central banks from the U.S. to Japan may step off the gas have created a more risk-averse trading environment.

Spot markets were mixed, and volume was much lighter than the prior week. Cheddar blocks dropped 2.5¢/lb., trading 12 times. The steady flow of block offers put nearby Class III futures on the defensive. Barrels moved up 1.25¢ and settled at \$1.7725, a nickel higher than blocks.

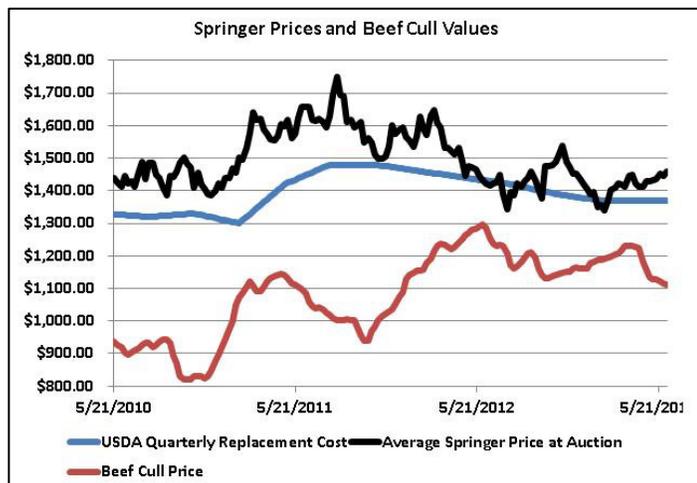
Class IV futures were mixed. June was unchanged, while the July and December contracts lost ground. August through November moved roughly a dime higher. CME spot butter settled a penny lower than last Friday at \$1.535. Butter remains the softest market in the dairy complex. Butter futures moved sharply lower this week even as activity at the spot market was almost nonexistent. The national average butter price declined 4.2% last week to \$1.55, according to the National Dairy Product Sales Report.

Spot Grade A nonfat dry milk (NDM) added a penny, rising to \$1.7025 as bids moved steadily higher. Extra Grade NDM was unchanged. The California Weighted Average Price for NDM was \$1.6622/lb. for the week of June 7, up 4.63¢ from the week before. Sales volume remains muted as prices rise; the CWAP NDM price has not been this high since January 2008.

The Danube and Elbe Rivers have swollen to record high levels in many areas, and Central Europe is struggling to contain the flooding. Heavy rains have kept livestock out of sodden pastures and prevented fieldwork. However, the floods have had little impact on milk production, according to *Dairy Market News*. Milk production is lower than last year in France, Ireland and the United Kingdom, but it is higher in other areas. Milk collections in the United Kingdom in May were down 1.8% from a year ago, but production has recovered significantly since reaching five-year lows in the first quarter.



At the end of May, European butter stocks were 45% lower than a year ago. They are projected to be only half as large as last year by the end of the month. Inventories are building, and last week's stock build was the second largest of the year. However, they are not keeping pace with seasonal trends.



Dairy replacement prices appear to be creeping higher. Approved springers at the New Holland, Pennsylvania Livestock auction averaged \$1,475 per head last week, up from \$1,350 at the end of May and \$1,200 earlier this year. Springer prices in California are generally a little higher than they were earlier this year.

Meanwhile, beef prices have fallen from their highs. Lean beef prices have been particularly soft, as supplies of ground beef are plentiful. Thus the net cost of culling and replacing is higher than it was earlier this year, but it remains at historically low levels.

Weekly dairy cow slaughter totaled 47,799 head for the week ending June 1, which included Memorial Day. Dairy producers extended a four-week streak of culling fewer cows than the same week a year ago. Year to date slaughter is up 3.7% from 2012.

Grain and Hay Markets

Old crop corn prices lost a dime this week, and new crop contracts were nearly 30 cents lower. Price movements were similar for soybeans, reflecting the market's bearish take on USDA's World Agricultural Supply and

Demand Estimates. USDA surprised the market by making no change to its acreage estimates. USDA is likely waiting until the next report, when it has a better grasp on how much acreage was switched to other crops, and how much was idled so that farmers could collect prevent planting insurance. USDA did, however, lower its yield estimate to 156.5 bushels per acre (bpa), from 158. USDA also lowered feed and export demand and increased its estimates of food, seed and industrial and ethanol demand. These changes resulted in a 55 million bushel decline in ending stocks for 2013-14, which was smaller than pre-report expectations.

USDA made a few small changes to its 2012-13 corn balance sheet, including shifting 50 million bushels out of export demand into the ethanol column. The June ending stocks estimate was 10 million bushels higher than the May forecast, at a still tight 769 million bushels.

Changes to the old crop soybean balance sheet were minimal and resulted in no change to ending stocks. USDA held its new crop soybean production estimates steady for now and made no changes to demand estimates.

Feed prices moved lower in the wake of this week's reports, but they remain vulnerable to sudden rallies. Given lower than intended acreage and a late-planted, shallow-rooted crop that is vulnerable to summer dry spells and an early frost, weather will have an outsized impact on feed prices this year.

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

June 14 Est:	Quota cwt. \$18.72	Overbase cwt. \$17.02	Cls. 4a cwt. \$18.00	Cls. 4b cwt. \$15.95
Last Week:	Quota cwt. \$18.74	Overbase cwt. \$17.04	Cls. 4a cwt. \$17.91	Cls. 4b cwt. \$16.06

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**REMINDER: MARK YOUR CALENDARS - MPC AREA MEETINGS SCHEDULED TO START NEXT WEEK:** (By Rob Vandenheuvel) Milk Producers Council has scheduled area meetings over the next two weeks throughout the Central Valley. These meetings – which are open to MPC members, other interested dairymen and allied industry folks – are an opportunity to hear the latest on many of the issues facing the California dairy industry, such as our challenges in California and the status of the U.S. Farm Bill.

The schedule for meetings is:

- **Monday, June 17<sup>th</sup> @ 5:00 p.m.** – Bidart Dairy (20400 Old River Road in Bakersfield) *\*note new time*
- **Tuesday, June 18<sup>th</sup> @ 1:00 p.m.** – Rancho Teresita Dairy (21744 Road 152 in Tulare) *\*meeting is at the Kasbergen's home on the dairy*
- **Tuesday, June 18<sup>th</sup> @ 4:00 p.m.** – Maddox Dairy (12863 W. Kamm Avenue in Riverdale)
- **Tuesday, June 25<sup>th</sup> @ 11:00 a.m.** – Vista Ranch & Cellars (7326 California 140 in Merced)
- **Tuesday, June 25<sup>th</sup> @ 4:00 p.m.** – Van Exel Dairy (18630 N. Thornton Road in Lodi)

If you plan to attend, please shoot an email to Kevin Abernathy ([Kevin@milkproducers.org](mailto:Kevin@milkproducers.org)) or myself ([Rob@milkproducers.org](mailto:Rob@milkproducers.org)). Or you can call the MPC office at (909) 628-6018.

**IN CASE YOU MISSED IT...A Q&A WITH HILMAR CHEESE COMPANY IN THIS MONTH'S HOARD'S DAIRYMAN:** (By Rob Vandenheuvel) As you may recall, *Hoard's Dairyman* published a Q&A with MPC's Vice-Chairman Geoffrey Vanden Heuvel in April of this year. If you missed that Q&A, you can find it on our website at: <http://www.milkproducerscouncil.org/updates/042613.pdf>.

This month, in response, a Q&A with Hilmar Cheese Company CEO John Jeter was published in *Hoard's Dairyman*. With permission from the magazine, the Q&A is being reprinted below:

**Yes, California's pricing system is killing its dairies**

*Leading cheese maker believes the reason isn't low prices, but the system itself*

By Hoard's Dairyman Staff

If the headline of this article looks familiar, it's because it is nearly identical to the one we used in our April 25 issue interview with Chino, Calif., dairy producer Geoffrey Vanden Heuvel. It is an understatement to say that the article caused a splash in the dairy industry, as it was linked and relinked to our website for distribution that put it in front of many more readers than in just the West.

It also prompted one of California's leading dairy industry executives, John Jeter, CEO and president of Hilmar Cheese Company, to volunteer for an interview to discuss the situation from a processor's perspective. Right from the start, it was obvious that he and Vanden Heuvel have great mutual respect for each other. They also agree on more things than they do not — including the premise that the state's pricing system has been outdated for years and no longer serves milk producers in a timely and effective manner.

Equally obvious was that the headline for Vanden Heuvel's interview also sums up Jeter's feelings about California's milk pricing system. The difference is, while Vanden Heuvel thinks the system can be fixed, Jeter thinks the low prices it generates prove it is diseased and he believes dairy producers would benefit most if it were killed.

**QUESTIONS & ANSWERS**

***Dennis Halladay, Hoard's Dairyman: Is the milk pricing situation in California right now as complicated as it looks?***

***John Jeter, CEO, Hilmar Cheese Company:*** “If you mean the current dynamics and hassle, I really don't think it is. I think it's fairly straightforward. But it has gotten very political; that's what makes it confusing and emotional. I absolutely agree with the headline on the article with Geoff. But he would say it's because of the low prices that dairymen are being paid, and I'm saying it's the leadership culture it has created and the ease with which plants can survive without doing what they need to do. That's what's killing dairymen. They need a change to a more market-oriented system that will drive higher prices.”

***Halladay:*** **Does the fact it has become so emotional and political reflect the degree of financial pain that is occurring at the producer level?**

“I think that's one of the things that is having a great bearing. I certainly think that the change of dynamics out here — high feed costs and the high volume of purchased feed that most dairies have historically used and that worked so well for so long — has definitely brought pressure to bear on the entire system. Now you don't have to put it into a cow to increase its value, you can just sell it. It's definitely a different dynamic.

“When you get in a difficult situation you look for the problem. In this case the focus has been the big delta between the federal order Class III price and California Class 4b; it's the flash point that your April 25 interview focused on. I think Geoff Vanden Heuvel and I agree that the situation out here is not working for dairymen. When the Gonsalves Milk Pooling Act was set up in the late 1960s, those minimum prices were really setting the milk price. They just aren't that anymore. What the act was started to do and what it's doing today are two different things, and it just doesn't work. So dairymen are suffering.

“At the public hearing May 1 for AB 31 [a proposal to bring California Class 4b whey values into much closer alignment with federal order Class III whey values], one of the dairymen who spoke and is a leader in the state said, “you [the legislature] are our only recourse to fix this.” That's a really important statement. We have 200 ag commodities in California and I guarantee you milk is the only one where that statement is made. But is it true?

No! Eighty-five percent of the dairymen in California own the entities they ship their milk to — the co-ops. And they are not small entities; two of them are \$12 billion [total sales] co-ops and another is a \$4 billion co-op. They are not tiny little companies that can't do anything. My point is, that dairyman is part of one of those co-ops and he told the legislators they are the only ones who can take care of this — and that's just not true.

“Actually, it is his statement that is probably at the core of the issue. I think both Geoff and I would agree that this system is really bad for dairymen and that it is not working.”

**Halladay: How much of the sentiment expressed by that producer was the result of going through the hearing process and going to court, but getting no results from either one?**

“Is that the right way to fix the hearing process? We're saying it's not. We need a market solution today, not a regulated solution. In this global dairy industry that we are in, if you have to go to a secretary of agriculture or a legislature, then we have problems. And we do. We should be tough enough marketers, be innovative enough, and be good enough investors to invest in this tremendous raw material that we have — not go to a secretary of agriculture who can't create value.

“That dairyman who told the legislators, ‘You are our only chance for improvement’ — that's just not true. But unfortunately the system has trained our industry to go to Sacramento for revenue increases, instead of turning to the marketplace to create value. As long as regulated pricing exists and regulators are there as the solution, the risk averse in our industry will go there for solutions and will not be forced to compete. Dairymen will continue to suffer as value is not created and it will not solve our most basic problems. It's more difficult to invest and create products and innovate, but it's a market-driven solution and it's the only sustainable way to create and increase value.”

**Halladay: It sounds like maybe you're saying co-ops are the problem; that instead of seizing market opportunities that exist they are holding on to the commodity product manufacturing business model they have used for decades.**

“I want to go back to some of Geoff's comments because I think they're good. When the pooling system was set up it established make allowances to create plant capacity. The regulators assured plant operators — the co-ops — they were going to make a return on investment. And frankly, it was a great strategy. It worked. Probably the most dynamic segment of agriculture during the last 50 years is the California dairy industry from 1980 to 2005. The regulators were working with the co-ops and private firms very effectively, but when the cheap feed situation changed the deal kind of ran out. And as global markets opened up it became imperative that if you were going to be successful you needed to be a global marketer.

“Because of the old environment where they could just build plants and make “churn and burn” commodities and do well and not do anything else, most California-based co-ops had no research and development, no business development and no applications group. Show me another industry where that occurs. I think we all got caught sitting here thinking, “wow, this is easy.”

**Halladay: Wasn't that approach just a product of the pricing structure that exists?**

“Yes. The comment Geoff made, ‘We have ended up with very lazy plants’ is a great statement that I totally agree with. Now take us. We came along in 1985 with a dozen owners and I recruited three other dairymen who were crazy enough to ship their milk to us. We were a little pip-squeak surrounded by big co-ops. We made stuff. We created things. All of a sudden we created competition. And to one extent or another, every dairyman in this state now gets paid more because of us.

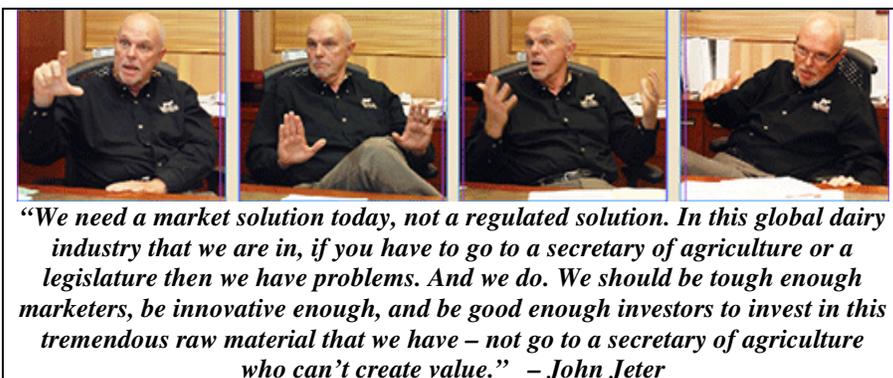
“For dairymen who haven't had experience with a milk buyer that innovates, creates and markets, in a lot of cases their solution tends to be regulation. But regulation is a poor solution. All it will do is get us further down the road of dependence and lack of innovation and investment. We agree with the Bain Study commissioned by

the Innovation Center for U.S. Dairy, that there are tremendous global dairy marketing opportunities. The U.S. has already made so much progress in terms of becoming a global supplier, but California's pricing system is a hindrance to that.

"In California, the minimum price is truly the price. In a federal order the minimum price is optional; only what you choose to pool is subject to it. In California it is not optional; if it is Grade A milk, it is subject to the minimum price. That's why California and federal order prices are not comparable and it's why the minimum price needs to be low and market-driven prices need to be above that.

"That's a different way of thinking. We started it in 1985 and we still believe that's the way to do it. It creates value and, frankly, it creates the opportunity to let dairymen share value. Last year in California we paid \$40 million in premiums over the state minimum. We do that because we've invested. The value to do it was in the milk, but it had to be created and we've invested quite a bit to be able to do it."

**Halladay:** Dairymen say that, by and large, the last four years have been a financial disaster for them. Are things as bad as they say, or are they blowing things out of proportion?



"I think they have been the toughest four years; I don't disagree with that. But I also think there are haves and have-nots. Guys that buy all of their feed are more of the have-nots, and guys that buy none or only some are on the haves side. And when you think of the guys in Southern California, they don't even have the opportunity to buy land to grow feed. It's a really tough dynamic for them.

"The question is, how did we get here? In a situation where massive investment has not been made by certain segments of the industry, they're really getting nothing extra for their milk. That's the issue. We think that rather than complaining in Sacramento to CDFA (California Department of Food and Agriculture) or the legislature, dairymen ought to be going back into their own organizations and saying, "We need to create more value."

**Halladay:** During that same four-year period, has the processing industry had as tough of a time?

"What did a couple of the big co-ops do with some of their cheese plants during that time? They shut them down or sold them. So we think there are haves and have-nots there too. What happened as a result of those combined moves was, all of them became much greater nonasset participants and they looked to the regulated price for solutions. That's a bad deal for dairymen.

"I think that dairymen are blaming Sacramento and us [Hilmar Cheese], when they really should be looking at the organizations they own. 'Dairymen say we are not sharing whey revenue when, in fact, we are. The way the system works in California, if the minimum price was increased to include premiums, then the \$40 million we paid in premiums would have to go into the pool and be redistributed to all dairymen in the state. Only a portion of the \$40 million would make its way back to our dairymen — meaning they would make less. We're already paying the money; they just don't want it to go to only our dairymen. They want it to go to everybody, including those who divested cheese plants.'"

**Halladay:** Isn't that just free enterprise? Can't they do the same thing?

"Absolutely. All of the major California dairy co-ops supply milk to cheese plants as milk brokers essentially. You ought to ask them if they went to those cheese plants and asked for more money; that if there really is a lot

of money in whey or whatever that is not being paid out, then they'd like some of it. In a lot of cases they never asked their customers for more money, they just went to the regulated price. It's a mind-set that is just wrong.

"We believe the dairy industry and dairymen would be much healthier if a regulated price was not there, that instead of going to the regulated system they went back to their co-ops and said, 'We need to invest. We need to be like Fonterra or Arla Foods.' There is no reason that U.S. entities can't be like them."

**Halladay:** Some California producers cite two sections of the State Agricultural Code in their arguments for higher minimum prices that they feel have been ignored by CDFA. Those say in part, "bring about and maintain a reasonable amount of stability and prosperity in the production of market milk ..." and "...methods or 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." Do you think CDFA is fulfilling those directives?

"I think what frequently happens is, they take that to mean their milk should be valued the same, but that's not what the law says. I guess the factor I disagree with is, the price of milk in California is a true minimum price. The price in federal orders, where that bigger whey factor is, is an optional price. The federal order Class III and the California 4b are different things. In federal orders the Class III doesn't have to be paid. When one of the co-ops has surplus milk I can buy it at \$3 under in Texas, but here I have to pay the minimum price. The point is, if you don't pool you don't have to pay the regulated price, and that's core to the issue. So we would be happy with a federal order in California, because we would have much greater flexibility [in what we pay for milk]."

**Halladay:** Exports today account for about 13 percent of all milk solids produced in the U.S.; they are clearly vital to the survival of the industry. California is not only the biggest dairy state in the country, but it is most ideally situated to serve Asian markets. What does the California dairy industry have to do to capitalize on those huge advantages?

"The regulated price presents some complications, because it's based upon the domestic market while we are selling into a global market. To the extent that those things are out of synch it can actually discourage you from exporting. That's why the Bain study said that the milk pricing system needs to be reformed in order for the U.S. to become a consistent supplier."

**Halladay:** To become a consistent supplier, is it a must that milk comes out of California?

"Yes. California is perfectly positioned to be an amazing exporter, just like we already are with so many other ag commodities. Our milk supply is basically the size of New Zealand's. Frankly, I need more plant capacity and I need it to fuel exports. But using an end product price formula that can change rapidly to extract more via regulation rather than via marketing skills is problematic."

**Halladay:** If a company started by 12 dairymen can do this, can't it be done by other organizations that are much older and larger?

"That's our point. Rather than going to the Secretary of Agriculture or the legislature for a regulated something, we just need to go out and create value. And it can be done. Back to that dairymen who told the legislators they were his only avenue for more money, if they believe him then it's bad. For one thing it's just not true. Other people can do this. And that's why in the end we think dairymen are struggling in this state. Yes, there is a feed issue, but we all need to get serious about creating value. All of us."

**Halladay:** If you had a magic wand, what would you change about California's pricing system?

"We need some type of transitional time frame. I would pick a date about three to five years out and say at that point it is going to end. It would let us get prepared financially for what's going to come. I think at that point there would be an investment boom, literally. Do you know why we think foreign entities don't come in here?"

Because of the milk pricing system. Fonterra should be here buying milk, but they aren't. Why do you think that is? I think we'd see a change in the players who are here if the current pricing system went away. We think competition is good for dairymen, and that's what needs to happen."

**Halladay:** Since there is no such thing as a magic wand, changes to the system will invariably take time. For producers who say they don't have the luxury of time, is there a reason for them to be hopeful in the short-term?

"I think in the short-term feed prices are moderating somewhat, and because of the growing global demand that we seem to be making progress tapping into, I think where prices used to be in a lower realm they are now in a higher realm. We believe they are going to stay there and Rabobank says they're going to stay there. We think feed prices certainly need to moderate and then we need to make regulatory price changes. Then I think you're going to see investment come into this state and there's going to be better competition for milk."

**Halladay:** You're a processor. You need producers to be successful, right?

"Yes. We want them and their co-ops to do well, because if they don't the dairymen go for regulated solutions and I think that will hurt our global competitiveness. If they invest hard and are successful they'll have to fight us, and that's okay. We'll all fight for milk and that will be great for dairymen. They need to have competition. But this regulated pricing system has really just been terrible for dairymen for the last 15 years."

*This article appears on pages 66 and 67 of Hoard's WEST in the June issue.*

**MANAGER'S COMMENT:** (By Rob Vandenheuvel) *First off, MPC would like to thank Hoard's Dairyman for their permission to reprint this interview. This is a critically important debate for our California dairy industry to have, as we try to map out the future of dairy farming in our State. In breaking down the comments made in this interview, a few facts would help put some things in context.*

*Hilmar Cheese Company processes more than 12 million pounds of milk per day in their Hilmar, California plant. That's about 25% of the milk purchased by California cheese manufacturers. Hilmar is well known for the competitive premiums they pay their producer-suppliers. The interview above reveals that in 2012, Hilmar paid \$40 million in premiums above the state minimum price.*

*To put that \$40 million per year in perspective, let's look at a couple other figures that didn't make it into the interview. We've reported in previous issues of this newsletter that the "California discount" (comparing California's Class 4b price to the Federal Order Class III price) was \$1.72 per hundredweight from 2010-2012. A simple calculation tells us that a plant purchasing 12 million pounds of milk per day paid \$225 million less into the California pool during those three years than they would have if our Class 4b price was equal to the Federal Order Class III price. That's an average discount of \$75 million per year.*

*Let's also look at the California pooling system. From 2010-2012, the average Class 4b price was \$15.02 per hundredweight. However, the average Overbase price during those three years was \$15.70 per hundredweight. So how is a cheese manufacturer able to pay their producers the Overbase price when their Class 4b price is averaging \$0.68 per hundredweight lower? Simple: they receive that difference from the California pool, from funds paid by manufacturers of the other classes of milk. A plant purchasing 12 million pounds of milk per day would have received almost \$90 million from the California pool during 2010-2012, or an average of \$30 million per year.*

*My intention is not pick on any individual cheese manufacturer, but rather to expose our readers to the realities of how the current system treats our State's cheese manufacturers (and compare that to the way the system treats our State's dairy farmers). The current system stacks the deck against dairy farmers, and as we look to the future, producers must be ready to make bold changes that will put us on a more even playing field with our fellow producers around the country and with the processors here in our State.*