Milk Producers Council

13545 S. Euclid Avenue, Unit B ~ Ontario, CA 91762 ~ (909) 628-6018
801 S. Mount Vernon Avenue ~ Bakersfield, CA 93307 ~ (661) 833-2549
222 S. Thor Street, Suite 20 ~ Turlock, CA 95380 ~ (209) 250-1801
Fax (909) 591-7328 ~ office@milkproducers.org ~ www.MilkProducers.org

DATE: April 15, 2016 **PAGES: 9**
TO: Directors & Members **FROM: Rob Vandenheuvel, General Manager**

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE		
Blocks	+*$.0075*	$1.4275
Barrels	- *$.0075*	$1.4100
Weekly Average, Cheddar Cheese		
Blocks	- *$.0095*	$1.4250
Barrels	- *$.0115*	$1.4220

CHICAGO AA BUTTER		
Weekly Change	- *$.0500*	$2.0700
Weekly Average	+*$.0395*	$2.0880
DRY WHEY		
Dairy Market News	w/e 04/15/16	$.2425
National Plants	w/e 04/09/16	$.2498

NON-FAT DRY MILK		
Week Ending 4/8 & 4/9		
Calif. Plants	$0.7404	8,093,869
Nat'l Plants	$0.7359	20,153,163
Prior Week Ending 4/1 & 4/2		
Calif. Plants	*$0.7634*	*7,682,719*
Nat'l Plants	*$0.7461*	*19,162,355*

***

FRED DOUMA'S PRICE PROJECTIONS…

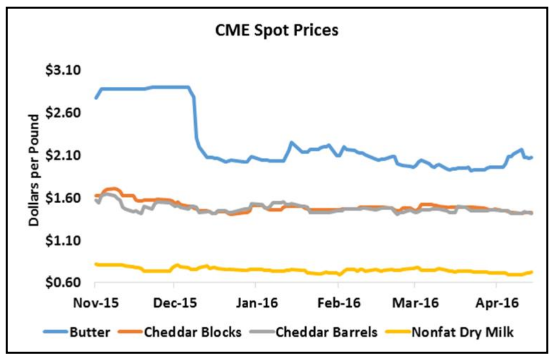
Apr 15 Est:	**Quota cwt. $14.35**	**Overbase cwt. $12.65**	**Cls. 4a cwt. $12.67**	**Cls. 4b cwt. $12.71**
Last Week:	**Quota cwt. $14.39**	**Overbase cwt. $12.70**	**Cls. 4a cwt. $12.85**	**Cls. 4b cwt. $12.68**

***

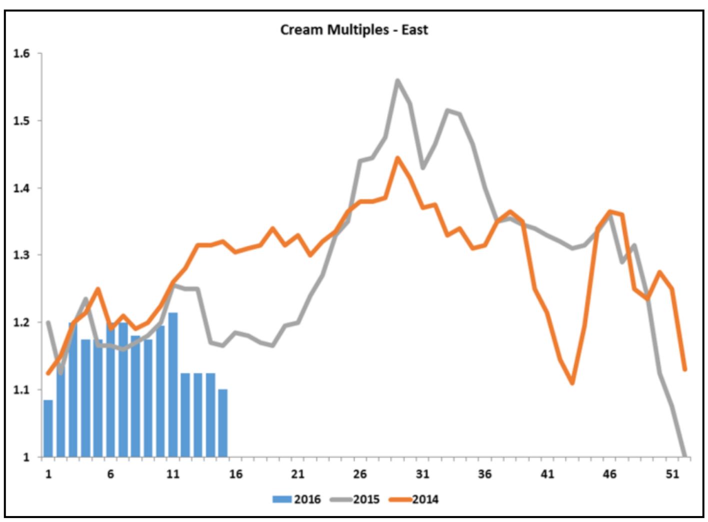
MARKET COMMENTARY: *(By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)*

<u>*Milk & Dairy Markets*</u>

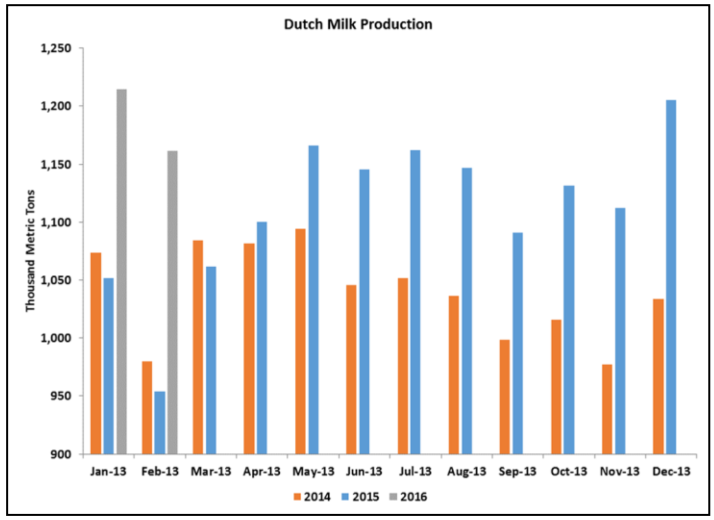
The CME spot butter market caught fire last week and pushed back over $2.00/lb. Things were still ablaze on Monday, when the spot market flared up to $2.17. But on Tuesday it fizzled, dropping hard to $2.07. Spot butter closed there today, a nickel lower than last Friday. The futures yo-yoed from sharp gains Monday to a limit down close on Tuesday. Class IV futures were steady to 44¢ higher than last week's settlements.



The butter market seems to be running on emotion rather than fact, leading to wild swings. In each of the past two years, butter buyers have suffered through a steep spring rally that didn't end until well into the fall. Their budgets are in shambles and they are easily spooked. They are quite willing to pay a little too much for butter now to avoid the possibility of paying substantially more later this year. Their fears are palpable and at least temporarily self-fulfilling.



By all accounts, both cream and butter are plentiful. *Dairy Market News* reports that in the East, cream supplies are overwhelming demand, and brokers have had some troubles moving product. Supplies are a little tighter in the Midwest as ice cream makers are ramping up for summer. Still, multiples in all regions are notably lower than they were a year ago, implying that end users feel no pressure to pay up for cream. Butter inventories are growing.



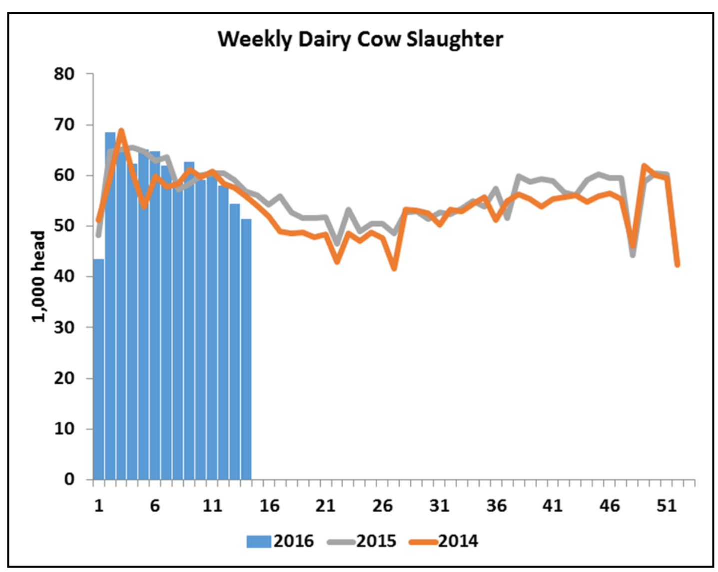
The milk powder market moved slowly but steadily higher this week. Spot nonfat dry milk (NDM) finished at 72.5¢, up 3.5¢ since last Friday. Milk production is moving seasonally lower in California, but in much of the country the flush is in full force. Driers are running hard and milk powder inventories are growing. Demand is spotty; many buyers are pushing for discounts and content to wait for even lower prices.

The spot cheese markets diverged this week and languished near the low end of their well-established trading range. Spot Cheddar blocks closed at $1.4275, up 0.75¢ from last Friday. Cheddar barrels slipped 0.75¢ to $1.41. Cheesemakers are busy, and supplies are building seasonally. Nearby Class III futures moved a little lower, but contracts throughout the second half of the year posted double digit gains.

Whey futures livened up a little this week, but other indications of the market remain depressed. Output remains heavy and according to *Dairy Market News*, "Demand is steadily waning in all regions of the country."

In Europe, milk output remains burdensome. Collections are slowing in France, but there are no signs of flagging elsewhere despite cold, wet conditions in much of northern Europe. Some nations have not yet published February production volumes, but those that have report formidable growth. After adjusting for Leap Year, output was up 32.3% from a year ago in Ireland, 17.5% in the Netherlands, 10.3% in Belgium, and 8.9% in Poland. The dairy product markets – and particularly milk powder – are unlikely to forge a meaningful recovery until European dairy producers tap the brakes.

U.S. cheese and butter remain decidedly uncompetitive in the global marketplace. But milk powder, whey, and lactose are selling well and they have gotten a bit of a boost in the last six weeks. Relative to a basket of currencies, the dollar has fallen nearly 4% since the beginning of March. That decline makes goods priced in dollars appear cheaper to buyers evaluating them in other currencies, and it helps to support the U.S. dairy market in real terms. Europe has set the intervention purchase price for skim milk powder (SMP) at €1,698 per metric ton. After adjusting for protein, this is equivalent to 93¢/lb. When the dollar was stronger, the SMP intervention purchase price was lower in dollar terms.



For the week ending April 2, dairy cow slaughter totaled 51,317 head. This was 9.7% lower than a year ago. After 14 weeks, slaughter is 1.5% lower than last year's pace.

Grain Markets

USDA issued its monthly update to its supply and demand estimates on Tuesday. There were no real surprises; global grains and oilseeds remain abundant. Nonetheless, the markets have run straight upward since the report, building on last week's rally. May corn futures settled today at $3.785 per bushel, 12.25¢ higher than last Friday. May soybean futures finished at $9.56, up nearly 40¢.

Planting season has arrived, and the trade is focused on the forecast. In the U.S., the weather is nearly ideal. Much needed rains are expected to fall in the Plains this weekend, which will benefit the wheat crop there. Sunny skies and warm temperatures will favor the Corn Belt for the next week or more, allowing tractors to start rolling. Last week, the grain market rallied on fears that a cold, wet pattern would delay planting and force farmers to plant more soybeans and less corn. Now that the forecast has changed, it would be reasonable to expect that rally to peter out.

Instead, last week's rally attracted the attention of large investment funds looking for a winning play in the commodity space. The funds are flush with cash and they have kept some resources sidelined after years of decline in most commodity markets. The fundamentals may be mostly bearish, but technical indicators in the corn market have shouted "Buy!" at fund traders, and they have responded.

There are also some fundamental reasons for a modest bounce. It is hot and dry in parts of Brazil, which is sapping yield potential from the second corn crop. Corn from the much smaller second crop typically goes straight from the combine to the ports, so Brazil's export potential is eroding.

The weather in Argentina is also imperfect. Heavy rains in the northern provinces have raised concerns about the quality of the soybean crop there. But conditions are exemplary in much of the country, and the moisture is likely to benefit the corn crop, which was planted late this year. With the benefit of a slightly weaker currency and weather issues in South America, the prospects for U.S. exports got a little brighter this week. The rally is likely to continue until the funds have exhausted their enthusiasm or their excess capital.

***

CDFA HEARING COMPLETED, NOW WE AWAIT THE RESULTS: *(By Rob Vandenheuvel)* On Monday, the California Department of Food and Agriculture (CDFA) completed their hearing on the calculation of the Class 4b monthly minimum milk price, specifically with regard to how dry whey markets impact the monthly price. The hearing had fairly predictable testimony, with MPC joining our fellow producer organizations, cooperatives and individual dairy farmers in advocating a ***closer*** relationship between California's Class 4b price and the Federal Milk Marketing Order Class III price. Also predictable was the testimony from the State's cheese manufacturers, who through their trade association – the Dairy Institute of California – advocated for a change in the calculation that would actually ***expand*** the devastating California Discount from its current level.

Just to remind the readers – we are currently in month nine of a 12-month adjustment to the Class 4b monthly price calculation. That temporary formula has resulted in a Class 4b price that has averaged $0.85/cwt below the Federal Order Class III price in those nine months. While this is still a significant California Discount, it is a far cry from the $2.41/cwt Discount we saw in 2014 under the previous calculation. Granted, much of this reduction in the Discount is due to the collapsing market price of dry whey, but the temporary calculation is nonetheless an improvement from the previous calculation.

As stated above, Monday's hearing was exclusively looking at the whey-related portions of the Class 4b formula. None of the other components of the formula (cheddar cheese and butter) were open for discussion. Therefore, even the producer proposal would not have established a final Class 4b price equal to the final Federal Order Class III price; we could only propose equalizing the whey-related portion.

CDFA's analysis showed that even under the producer proposal, the Class 4b price would have averaged

$0.46/cwt below the Federal Order Class III price over the past five years. **However, if you didn't already know that fact, you'd have no idea as you listened to the testimony from the State's cheese manufacturers of the impending doom they would experience under the producer proposal.** On multiple occasions, it was stated that numerous cheese manufacturers would have to shut down if the producer proposal were implemented. In one case, a cheese manufacturing witness stated that the producer proposal, "crosses the line of rational economics." **My how it would have been nice to be able to cross-examine some of the ridiculous claims made by the cheese manufacturers during their testimony, as we were able to do in the Federal Order hearings last fall!**

Of course, producers pointed out that failing to eliminate that California Discount has resulted in California dairies ***actually shutting down*** (not just threatening to) and 15 straight months of year-over-year declines in milk production. Our state's producers have apparently done such a good job over the years of providing our cheese manufacturers with all the milk they need to operate their business that they seemingly have no fear that the milk will be there for them regardless what they pay for it. Thank goodness these folks don't get to vote on a Federal Order!

I delivered testimony at the hearing on behalf of MPC, which is pasted below. Post-hearing briefs will be submitted over the next few days, and we should hear the results of the hearing sometime in the next two months. So stay tuned…

***

Testimony of Rob Vandenheuvel

General Manager, Milk Producers Council

California Department of Food and Agriculture
Whey Value Pricing Hearing

April 11, 2016

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 the State of California. My testimony today is based on positions adopted by the MPC Board of Directors.

Our dairy families appreciate the Secretary calling this hearing on her authority under the California Food and Agricultural Code (the "Code"). We believe the testimony we are about to give, as well as that of the other producer groups and cooperatives, will provide ample evidence that a permanent modification to the Class 4b monthly milk price calculation is warranted.

Before going into the details of the producer-sponsored proposal, the hearing notice published by CDFA asked that we address, "at a minimum, the economic conditions that would support extending the effective date of the temporary dry whey scale or adjustment to either the temporary or permanent dry whey scales contained therein."

Economic Conditions Facing California Dairy Producers

The most logical place to start is an analysis of CDFA's published "Cost of Production," compared to the average prices paid for milk throughout the State. In fact, as referenced in CDFA's notice of this hearing, Section 62062 of the Code specifically directs the Secretary to consider the "reasonableness and economic soundness" of California's milk prices – the combined income from all classes – in relation to the cost of producing and marketing that milk. It's worth noting that Section 62062 of the Code goes on to specifically note that, "In determining the costs, the director shall consider the cost of management and a reasonable return on necessary capital investment."

The table below displays the statewide cost of production for the past eight years, as well as the average milk prices received, as published by CDFA's Cost of Production Unit.

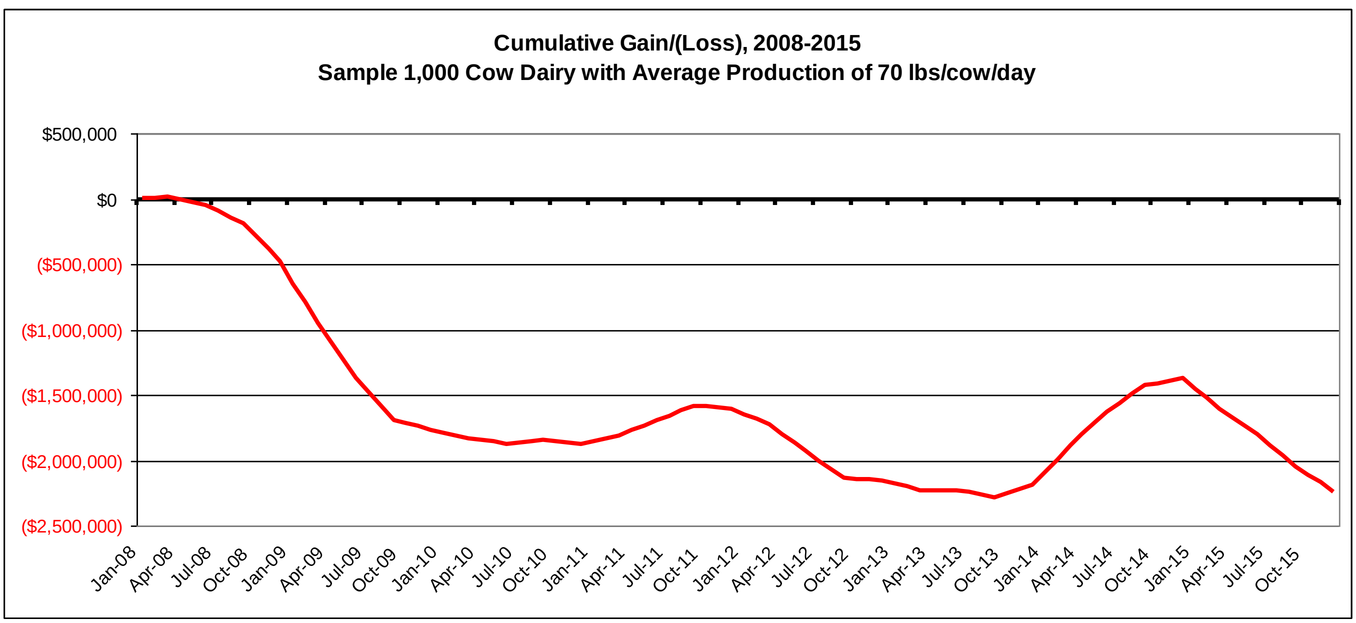
	Cost of Production	Milk Price Received	Difference
2008	$18.54	$16.66	($1.87)
2009	$16.86	$11.81	($5.05)
2010	$15.23	$14.81	($0.42)
2011	$17.45	$18.50	$1.05
2012	$19.08	$16.94	($2.15)
2013	$18.99	$18.83	($0.15)
2014	$19.11	$22.32	$3.21
2015	$19.34	$15.96	($3.37)
8-Year Average	**$18.07**	**$16.98**	**($1.09)**

**All figures are "per hundredweight" of milk produced.*

The next table applies these figures to a sample dairy with 1,000 milk cows, producing an average of 70 pounds of milk per cow per day.

	Gain/(Loss) per cwt	Gain/(Loss) Total
2008	($1.87)	($481,831)
2009	($5.05)	($1,284,500)
2010	($0.42)	($106,967)
2011	$1.05	$267,820
2012	($2.15)	($549,591)
2013	($0.15)	($37,674)
2014	$3.21	$817,271
2015	($3.37)	($861,511)
8-Year Cumulative Total		**($2,236,983)**

Plotting these data points on a line chart gives us a glimpse into what dairy farming in California has been like the past eight years.



As this chart based on CDFA's data clearly demonstrates, while 2014 was by all measures a year of strong milk prices that exceeded the cost of producing that milk, in the context of the past several years, we are still an industry trying to recover.

Some might point to general U.S. dairy market trends as the source of the volatility in producer profitability over the past several years. While there is certainly a cyclical nature at play generally in the U.S. dairy industry, California's dairy families have been consistently realizing lower milk prices than our out-of-state colleagues. CDFA maintains data on the mailbox milk prices in California, compared to other select regions of the country. Below is a summary of that comparison:

2015 Mailbox Milk Prices		
Reporting Areas	**2015**	**Difference from California**
Dollars Per Hundredweight		
California	$15.08	-
New England States	$18.56	+$3.47
New York	$17.21	+$2.12
Eastern Pennsylvania	$17.16	+$2.08
Appalachian States	$17.94	+$2.86
Southeast States	$18.20	+$3.12
Southern Missouri	$17.88	+$2.80
Florida	$19.20	+$4.12
Western Pennsylvania	$17.32	+$2.23
Ohio	$17.32	+$2.23
Indiana	$16.46	+$1.38
Michigan	$16.05	+$0.97
Wisconsin	$17.67	+$2.59
Minnesota	$17.44	+$2.35
Iowa	$17.09	+$2.01
Illinois	$17.33	+$2.25
Corn Belt States	$16.06	+$0.98
Western Texas	$16.06	+$0.98
New Mexico	$15.03	($0.06)
Northwest States	$16.43	+$1.34
All Federal Order Areas	$17.01	+$1.93
Source: CDFA website		

As demonstrated by this information, the current state of the California dairy families isn't simply a story of a national trend downward, but rather a story of a significant disadvantage to our out-of-state competition. When competing with dairy industries in other states, whether that be for animals and feed, our California producers are at a significantly weaker relative position than our competition. In addition to price alone, another indicator of this is the comparison of California's production growth compared to the other States.

Milk Production
Source: U.S. Department of Agriculture
(in millions of lbs)

	California	**Rest of U.S.**
2008	41,203	148,775
2009	39,512	149,690
2010	40,385	152,492

2011	41,462	154,793
2012	41,801	158,841
2013	41,256	159,962
2014	42,339	163,715
2015	40,898	167,735
Growth since 2008	-0.74%	12.74%

The past 15 months has been a period of particularly strong downward production trends:

Milk Production Source: U.S. Department of Agriculture *(in millions of lbs)*				
	California	**Year-Over-Year Change**	**Rest of the U.S.**	**Year-Over-Year Change**
December 2014	3,471	(0.06%)	13,871	+4.16%
January 2015	3,531	(2.57%)	14,154	+3.66%
February 2015	3,282	(3.47%)	12,884	+3.10%
March 2015	3,700	(2.91%)	14,385	+2.60%
April 2015	3,602	(2.01%)	14,186	+2.78%
May 2015	3,654	(2.66%)	14,774	+3.02%
June 2015	3,396	(4.31%)	14,108	+2.42%
July 2015	3,405	(3.32%)	14,260	+2.49%
August 2015	3,343	(3.13%)	14,060	+2.08%
September 2015	3,172	(3.62%)	13,445	+1.66%
October 2015	3,243	(5.53%)	13,887	+1.83%
November 2015	3,206	(4.44%)	13,483	+2.11%
December 2015	3,364	(3.14%)	14,109	+1.72%
January 2016	3,433	(2.78%)	14,284	+0.92%
February 2016	3,186	(2.93%)	13,040	+1.21%

A Reasonable and Sound Economic Relationship with the Federal Milk Marketing Order Prices

As has been referenced many times in previous hearings before this panel, producers interpret Section 62062 of the Code as a clear directive that CDFA must establish “methods or formulas” that 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.” While Milk Producers Council certainly continues to believe this legal standard exists in CDFA’s task of establishing our monthly minimum prices, it is worth noting that there is a real-world logic to that directive as well, beyond being just a legal requirement.

California producers do not operate on an island. We operate within the context of a national, and increasingly international, industry. The prices we are paid for our milk are in large part affected by the cumulative decisions of tens of thousands of dairies throughout the U.S., not to mention our overseas competition as well. Further, the dairy commodity markets on which we rely on in setting our regulated milk prices are national markets, which have been extremely volatile in the past decade, and show no signs of slowing down.

California producers have been at a distinct disadvantage through that volatility as our mailbox milk price has consistently lagged significantly below that of our competing dairy producers in the rest of the country. In short, California’s milk price “peaks” have been smaller and our “valleys” deeper.

Looking at our State’s milk producers as a whole, this reality has meant two things: (1) When California producers are losing money, often producers in many other areas of the country are not, resulting in financial stress on California producers, but no reasonable hope for a timely national supply response to low operating margins; and (2) When California producers are benefiting from higher prices, such as 2014, we are still falling behind most of the producers around the country in our relative position as they are experiencing even higher margins, better preparing them for any future financial challenges.

The point is that while the Legislature has given CDFA and the Secretary significant discretion in establishing regulated milk prices, they recognized the risk of putting our State's producers at a disadvantage to our out-of-state competition, and specifically included a directive in the Code to maintain a "reasonable and sound economic relationship."

The producer proposal put forth for this hearing is based on our premise: (1) that the Legislature was correct in prioritizing that reasonable relationship in establishing our regulated milk prices; and (2) that the monthly minimum prices used by the ten current Federal Milk Marketing Orders (FMMOs) provides us with the best benchmark available in determining the representative value for significant volumes of milk sold around the country.

The CDC/MPC/WUD Proposal – Revising the Sliding Scale

Given all the discussion above, MPC would have certainly liked to present a permanent proposal that would result in a Class 4b price equal to the monthly FMMO Class III price. However, given the specific limitations included in the hearing notice that all proposals address only the whey-related calculations in the formula, we testify today in full support of the joint proposal submitted by California Dairy Campaign, MPC and Western United Dairymen. Testimony has already been provided earlier today by Annie AcMoody of Western United Dairymen, delving into the details of this unified producer proposal. Therefore, I would simply echo Ms. AcMoody's comments with regard to those details.

As for the impact the proposal would have on California's prices, I would refer to the *"Summary Analysis of Estimated Impacts of the Alternative Proposals on California Class and Pool Prices,"* published by CDFA in preparation for this hearing. Table 1 of the analysis notes that under the CDC/MPC/WUD proposal, average Class 4b prices over the past five years would have been $1.38 per hundredweight higher than under the current permanent whey scale. Along the lines of my earlier testimony about the relationship between California's Class 4b price and the Federal Order Class III price, Table 2 indicates that under the CDC/MPC/WUD proposal, California's Class 4b price would have averaged $0.46 per hundredweight below the Federal Order Class III price. This CDFA data is consistent with our own internal analysis, which shows that addressing only the whey-related portions of the formula would continue to result in a lower California Class 4b price, relative to the FMMO Class III price, albeit a much smaller difference than we have seen in recent years.

The Dairy Institute of California Proposal

In addition to the unified producer proposal, MPC has had an opportunity to review and analyze the proposal submitted by the Dairy Institute of California (DIC), on behalf of the dairy manufacturers they represent. We are opposed to this proposal for two primary reasons: (1) We believe there are significant problems associated with using Whey Protein Concentrate 34% (WPC34) as an "end product" in the Class 4b milk price calculation; and (2) The real-world impact of the DIC proposal falls significantly short of what producers believe is appropriate.

First, the use of WPC34. The DIC proposal aims to utilize the market value of Whey Protein Concentrate 34% (WPC34) in calculating a Class 4b price. This concept was proposed in the last hearing before this panel and rejected due to significant questions regarding its implementation. MPC would echo the previous panel's position rejecting the idea of using WPC34 as the surrogate price in the Class 4b calculation. While all the concerns raised by the Panel Report were certainly valid, the most significant reason for MPC's objection is the potential it creates for added volatility in the relationship between California's Class 4b price and the benchmark Federal Order Class III price.

In addition it is also worth noting that embedded in the DIC's proposal is the theory that WPC34 is a better surrogate because, "The whey scale currently used in the Class 4b formula…is based on dry whey prices and costs that are no longer representative of the whey values received by cheese plants operating in California." Without conceding that point, I would note that there is no requirement that the end products within the California minimum price formulas be representative or even close to the market prices received by California's manufacturers. I would point out that according to CDFA's *Dairy Information Bulletin*, cheddar cheese made up only 15 percent of all cheese manufactured in California in 2015, and that included all types of packaging, from the 40-lb. blocks to be sold at bulk prices to individually packaged finished products sold at higher prices per lb. Mozzarella actually made up nearly 59 percent of all cheese manufactured in California last year. So under the DIC's logic, is it still appropriate to use 40-lb blocks of cheddar cheese sold in 40,000-lb lots at the Chicago Mercantile Exchange as the "end product" in the Class 4b formula when a majority of the actual cheese being produced is mozzarella, a higher-value product with significantly more moisture, resulting in much higher yields of cheese per 100 pounds of milk? That's obviously outside the scope of this hearing, but it's a question worth asking in the context of the DIC's supporting statements for their proposal.

Second, the analysis of DIC's impact. CDFA's own analysis of the impact the two proposals would have had on California milk prices over the past five years was very telling. When compared to the current permanent whey scale, the DIC proposal would have resulted in a lower Class 4b and Overbase milk price over the past year. This at a time when California producers were hemorrhaging milk production and experiencing year-over-year production declines for 15 straight months. Further, even in previous years, the increases over the permanent whey scale would have been modest, leaving California's Class 4b prices more than $1.50 per hundredweight on average below the Federal Order Class III price.

In addition, while CDFA's analysis compared this proposal to the current permanent whey scale, I also took the opportunity to compare it to the current temporary whey scale. Over the past five years from March 2011 – February 2016, the DIC proposal would have reduced the Class 4b price by $0.65 per hundredweight when compared to the current temporary whey scale.

To put it bluntly, we are a State that is in the process of bleeding off its valuable milk producing investment – reducing milk supplies that are essential to the continued success of the DIC's own members – and any proposal that attempts to structurally reduce our regulated milk prices beyond today's formulas should be firmly rejected.

Conclusion

The financial challenges facing California's dairy families are well-documented, backed up by CDFA's own data, and now clearly resulting in significant reductions in milk production. In a State Marketing Order that was set up to "enable the dairy industry, with the aid of the state, to…bring about and maintain a reasonable amount of stability and prosperity in the production of market milk" (excerpt from Section 61805(d) of the Code), there is ample evidence that a significant upward pricing adjustment from the current permanent whey scale is justified. We greatly appreciate Secretary Ross' initiative in calling this hearing, and we encourage both the Secretary and the Hearing Panel to strongly consider the joint producer proposal in establishing the whey portion of the Class 4b formula.

I thank you for the opportunity to testify. I am happy to answer any questions, and request the opportunity to submit a post-hearing brief.