Milk Producers Council

5370 SCHAEFER AVE. SUITE A - CHINO, CA 91710 - (909) 628-6018 - Fax (909) 591-7328
801 S. MOUNT VERNON AVENUE – BAKERSFIELD, CA 93306 – (661) 833-2549
E-mail: mpc@milkproducers.org *Website: www.MilkProducers.org*

DATE: January 15, 2010 **PAGES: 6**
TO: DIRECTORS & MEMBERS **FROM: John Kaczor**

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	*+$.0050*	$1.4150
Barrels	*+$.0325*	$1.4650

Weekly Average

Blocks	*-$.0115*	$1.4130
Barrels	*+$.0100*	$1.4450

CHICAGO AA BUTTER

Weekly Change	*+$.1800*	$1.5250
Weekly Average	*+$.0695*	$1.4020

DRY WHEY

WEST MSTLY AVG	w/e 1/08/10	$.4075
NASS	w/e 1/09/10	$.3879

NON-FAT DRY MILK
Week Ending 1/08 & 1/09

Calif. Plants	$1.3333	6,722,823
NASS Plants	$1.3507	11,738,129

CHEESE MARKET COMMENTS: Signs of strength showed up Wednesday on the CME and continued its show through the end of the week. Total price movements weren't great (blocks gained $.0050 per lb and barrels gained $.0325 per lb), but last week's offers to sell were replaced this week with bids to buy. The recovery of block prices could reflect the collective belief that the market is close to a balance or possibly stronger. Production is reported to be heavy in the West and light in the Midwest, reflecting seasonally higher milk production and, in the East, heavy Class 1 usage. The record long block-barrel positive price spread on the CME (fifteen days at more than $.20 per lb) ended three weeks ago and barrel prices are now $.05 higher than blocks. However, last week's sales reported to NASS were still $.16 per lb lower than blocks, moving down rapidly from the $.21 per lb spread a week earlier, lagging about three weeks behind the CME spot market. The lag between CME prices and market prices mainly reflects the effects of forward pricing contracts and pricing formulas indexed to a variety of market factors. This week's barrel price on Friday on the CME just happens to be close to last week's average market price, $1.465 vs. $1.478, and that relationship should steady. Whatever changes manufacturing plants made in production decisions over the past five or six weeks in terms of blocks vs. barrels likely have reverted to normal patterns, as buyers proceed to evaluate sales prospects and restock inventories. While this is not the kind of weekly stability that was looked for last week, it will do until a better one comes along.

BUTTER MARKET COMMENTS: Since the big price drop in mid-December, butter prices on the CME have been edging upward as production eased off and retail sales continued to be strong. That pattern of reasonable increases continued through Wednesday, then the price jumped $.05 on Thursday and $.105 on Friday. *Dairy Market News (DMN)* again noted that butter destined for export is still being produced. That, plus the expectation of lower volumes of milk compared to last year, strong retail sales, and continuing strong Class 1 and 2 sales, appears to have convinced buyers and sellers that butter supplies could be on the short side for some time. The sharp drop in butterfat inventories at the end of November was helped a bit by a five million lb increase in exports above October's shipments. The strength in butter prices on the CME helped boost butter futures prices by more than $.10 per lb for mid-year months, and contributed to sharp increases in the Class III futures prices for the year.

POWDER MARKET COMMENTS: "*Demand is fair and along expected levels to contract customers, but is slow to develop for new or export interest. Stocks are building at many locations.*" That quote from DMN market watchers this week doesn't bode well for near-term prices for nonfat dry milk. Apparently many plants didn't like to see inventories rise as much as they have. Some sales this week were reported to be **$.12 per lb below the low end** of the West's "mostly" price range. Yes, the market is unsettled. However, average prices for last week's sales reported to the two major price compiling agencies gained all that was lost the prior week when end of year sales boosted volumes but busted prices. A special notice from China this week, which stated they expect to increase their imports of milk powders by a huge amount in January, issued supposedly to alert all interested parties to the potential disruption to regular supplies, should help to bolster global powder prices. It's

believed that the principal kind of milk powder referred to is whole milk powder, something about which the U.S. dairy industry shows very little interest. Go figure this: the same day China gave its notice, prices for extra grade and grade A nonfat dry milk on the CME **dropped** by $.07 per lb, and are now below the weekly average prices for sales made last week.

WHEY PRODUCTS MARKET COMMENTS: The market for dry whey continues to be tight and cash prices are steady. The national average price for sales last week continued its steady upward movement. The West "mostly" price held steady for the week. Production is moving higher in step with the response by cheese manufacturers to what they see as growing demand. Export volume for dry whey and whey protein concentrate continues to be strong. Prices for whey protein concentrate (34% protein) are higher but, according to DMN, the tone of the market appears to be changing from steadily strong to something less so. Some sellers are reporting that premiums have fallen, mimicking what they see as weakness in the market for nonfat powders.

***

FRED DOUMA'S PRICE PROJECTIONS…

Jan 15 Est:	**Quota cwt. $ 15.54**	**Overbase cwt. $13.84**	**Cls. 4a cwt. $14.81**	**Cls. 4b cwt. $12.52**
Last week:	**Quota cwt. $ 15.48**	**Overbase cwt. $13.78**	**Cls. 4a cwt. $14.70**	**Cls. 4b cwt. $12.50**

***

AN INDUSTRY UPDATE…TIME TO TAKE OFF THE GLOVES? *(By Sybrand Vander Dussen, MPC President)* So here we are in January, 2010. When the milk price crashed to $10.00 last January, who would have thought we could make it to this point if the milk price didn't go up? Compared to last year, feed costs are now a bit down, the milk price is up a few bucks, but the losses, although less, continue. We're like boxers in the 12th round, punching and flailing without much strength and direction. We don't know what to do. Our bankers don't know what to do. Feed dealers don't know what to do. Our accountants don't know what to do. Co-ops just keep doing what they've always done; take our milk, place it wherever, for minimum prices. The processors such as Deans, Kraft, etc., are having record profits. And the milk keeps on flowing in ample supply to what we loosely call a market.

CWT, the only tool in our tool box, seems to have run its course. At only $5.25 per cwt, with the participant and the facility required to stay out for a year, resulting in a taxable sale, participation in the herd retirement has become impossible for most. Further, when all the equity is gone, isn't it sick, but predictable, logic for producers to just hang on and hope "things change"? This is a pretty sorry mess for a multi-billion dollar industry providing valuable food products for the U.S. public.

The process of producing dairy products for the consumer is such, that in the simplest terms, it can be described as milk production on the one side and milk processing/sales/distribution on the other. These two, although completely linked, are totally disparate. Milk producers live in a different world than the processing/distribution side. We producers work with a dynamic, living entity, where the goal is health, cleanliness and maximum output of a herd of cows. We are subject to dictated inputs such as feed costs, labor, financing, and of course, a price for milk, all of which we have little, if any, control. With these inputs, we try to make a living, by making sound decisions and caring for the herd in a myriad of ways, such as comfort, herd health, rations, breeding, etc. The constant battle we have is maximizing output in the most efficient manner, working so as to blend down costs. That clearly describes milk producers. Although formal education is valuable, and many younger producers are well-educated, the most critical elements are "cow sense" and honing our ability to juggle the inputs foisted on us.

The processing/distribution side is vastly different. That side deals with marketing, processing products to the markets' satisfaction, working with our arcane pricing systems, operating plants, fractionalizing milk into marketable products, dealing with demanding buyers, and, most of the time, at least for our co-ops, dealing with oversupply which alters what otherwise would be sound sale decisions. These people wear neckties, are well-educated and likely have never touched or milked a cow.

Although milk is the commodity these two entities have in common, that's also where the commonality ends. The efforts of each is so different, they might as well be on separate planets.

As producers, our "strength," or our "defense," lies with our co-ops. "They are us." The government has exempted us from anti-trust restriction, allowing producers to band together to offset the potential oligarchy that could, or may, exist. (Oligarchy is an economic term meaning "a small group that exercises control over many.") The reason is, all 56,000 producers *must sell* their product every day, but the few buyers do *not* have to *buy* every day.

So, we have co-ops. We have protection from unfair business practices. The buyers of our product are restricted from abusing us, under state and federal minimum pricing laws. Pretty good. Then why are we in such a terrible financial mess?

As stated above, the processing side lives in a different world. Other than controlling their operating costs, processors make profits in two areas. One, the consumer; processors have done an admirable job of maintaining retail prices even when they pay us less for the product. And two, the producer side; they will pay no more than they must. As long as the milk flows (and it continues in spite of low prices), they will do all they can to buy milk as cheaply as possible. Who can blame them?

The production side of our industry has had a pretty good run the last 40-50 years. It looks like the structure is good. Although there were downturns, we always seemed to come back. In 1983, there were 297,000 dairy producers in the U.S. There are now about 56,000. Each downturn eliminated thousands of producers, resulting in a drop in milk, which in turn, resulted in price recovery. Those left are stronger and more stubborn. So now, our downturns are deeper, and more sustained in the past. It's obvious that the past butchering off of producers can't continue; there simply are not enough left to sacrifice. So what's the solution?

The answer lies at the root finding of the Cornell University study. Three years ago, Milk Producers Council retained economists (Dr. Chuck Nicholson and Dr. Mark Stephenson) at Cornell to "model a production management program" that would provide clear signals to the producer side when the market needed milk and when it did not. That program turned out to be very simple; *give producers incentives and disincentives*. This became known as the Growth Management Plan (GMP, also referred to as the Dairy Price Stabilization Program, or DPSP).

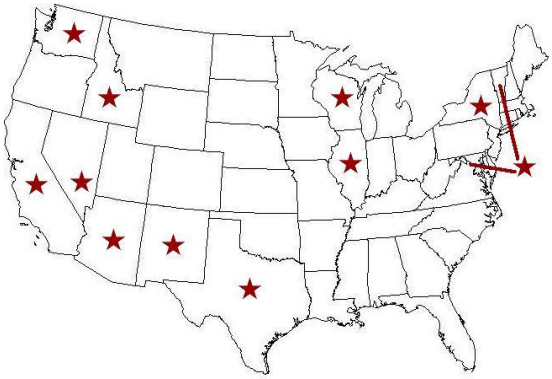
The GMP program works like this; a dairy board comprised of twelve producers, one economist, one processor representative, and a consumer representative, chaired by the U. S. Secretary of Agriculture, would meet each calendar quarter and look at supply, demand, heifers "in the pipeline," world production conditions, etc. Then two numbers would be published. One, an "allowable growth percentage" over established base. Two, a "market access fee," which is the amount of assessment to a producer if he exceeded that base. *It's that simple!* If a producer exceeds the Allowable Growth, he pays the Market Access Fee until that new higher level of production has been established for one year. All that money is paid back to the producers who did not exceed the Allowable Growth.

The computer model, which tracked years of producers' growth and activity, found that if an **in**centive is given to producers who hold or "manage" their milk production, and that incentive is funded by a reasonable **dis**incentive paid by producers that wish to grow, then the production growth we have will be much more in line with the growth we have in demand, avoiding our tendency to oversupply, or produce ahead of market demand. This is a program that could be an extremely powerful tool to *manage*, not control, our national production. Ever since pooling, there has been no clear demand or market signals presented to producers when milk is long or short, other than generally declining prices. Indeed, now when milk is long, and our overall price declines, we produce ever more milk to blend down our costs with that lowered price. This is nuts. *But it is also the only choice producers have.*

So, clearly understanding that market signals are muted, not clear and provide zero incentive for *individual*

producers to cut back production, Milk Producers Council, with unanimous board support and approval, took to the road and pitched the GMP to as many groups, trade associations and co-ops as would have us. Geoff and Rob Vandenheuvel and I spent (and continue to spend) many days, dollars and much effort to get the idea out to those groups. Doug Maddox and Gary Genske (well-known names, particularly in the Western U.S.) as well as Amanda St. Pierre (the fearless leader of Dairy Farmers Working Together, a producer group based in Vermont) also worked tirelessly, traveling around the country talking to producer groups about this plan.

So where has MPC traveled? It's difficult to capture all the meetings and conversations that have taken place, but here's a start at just some of the groups MPC presented to.



STATE	GROUP/INDIVIDUAL	DATE
Arizona	United Dairymen of Arizona's Board of Directors	June 2009
California	Western United Dairymen's Policy Subcommittee	June 2007
California	Senator Dianne Feinstein's staff	July 2007
California	Congressman Jim Costa and staff	May 2009
California	DFA's Western Area Council Board of Directors and Management	July 2007 / February 2009
California	Group of Land O'Lakes Producers	July 2007
California	Agricultural Lenders	February / June 2009
California	Western United Dairymen's "Industry Task Force"	February – March 2009
California	Group of dairy at Tulare's "Do Not Ship Milk Day" meeting	May 2009
California	Security Milk Producers	June 2009
Idaho	Presentation to Producer Forum hosted by Idaho Dairymen's Association (IDA)	June 2007
Idaho	Presentation to the IDA Policy Subcommittee	March 2009
Illinois	Key dairy representatives from Vermont, Florida and Wisconsin	August 2007
Illinois	Cornell University Economic Roundtable on the milk price volatility	June 2009
New Mexico	Dairy Producers of New Mexico's Board of Directors	June 2007
New York	Northeast Dairy Leadership Team	June 2009
Nevada	Dairy Today's Elite Dairy Producer Conference	November 2009
Texas	DFA's Southwest Area Council Board of Directors	March 2009
Texas	Select Milk Producers – Membership Meeting	October 2009
Vermont	Dairy Farmers Working Together Conference	March 2009
Washington	Dairygold's Board of Directors	February 2009
Washington	Large groups of Washington dairy farmers	August 2009
Washington, DC	Much of the California Congressional Delegation	May 2007 / September 2009
Washington, DC	Senate Staff Briefing	September 2009
Wisconsin	Group of Wisconsin dairy leaders	September 2009

And this is just the tip of the iceberg. There are undoubtedly many gatherings that have been left off this list, not to mention all the promoting of the GMP that Doug Maddox, Amanda St. Pierre and Gary Genske have engaged in. Those three individuals have spent considerable time in the Southeast, the Midwest and the Northeast. Between all of the members of the coalition, we have touched every area of the country.

What became obvious in our travels is that when *producers*, either without co-op staff present or when those producers were not wearing their "co-op hat," were overwhelmingly in favor of production management. The reasons are obvious; *this program allows producers to produce as much as they want – no control*. It rewards those who *manage* their production (keep it within allowable growth) by being paid out of the funds to be exacted from those who, within their individual business plan, see clear to grow. And the most attractive part of this program is that *all producers* are in the program – no free riders like in the CWT, which has *one out of three* not participating – a dastardly reflection of the foolish individualism of producers who are either "beyond hope" frustrated with our system, or adhere to the "last man standing syndrome" *(i.e. I have more equity to burn than my neighbor; I'll survive, and then there will be opportunity for me [at the expense of my neighbor]).*

Interestingly, and troubling, we found that resistance to the GMP was not unwilling producers, but people in "the other world" who have little incentive for change. Life seems to be good for them.

So why is that?

Well we can understand why the processors are opposed to this change. They seem to be comfortable with rivers of cheap milk coming their way. But why are we seeing so little movement by the co-ops, our first line of defense, to support this plan? Maybe because our co-ops have, for 40 years, been "instructed" (demanded) by producers to handle whatever amount of milk the members wish to produce. A co-ops' profit is made by the manufacturing allowance, which is deducted from sale proceeds before those proceeds go into the pool. In effect, the price that various milk or product is sold for, less the make allowance, is the amount of money the producers get. That means the co-op really has no incentive to raise the price of milk or product because that additional money is simply passed on to us in the pool. But we have producers sitting on co-op boards. Why then, do we have the situation that exists?

By definition, it would seem that with producers sitting on co-op boards, the long-term interest of producers would be addressed, including supply discipline. But remember, that processing/sale/distribution side of our industry is vastly different than the production side. Our co-op staff deals with stubborn buyers *every day*, the difficult logistics of placing milk and milk product faces them constantly; running a plant has its unending demands, and overarching all this is the constant expectation by us producers for decades to take all the milk we want to produce, all the time, no matter what. When those producer representatives walk into the board room, hear all the co-op problems, are made aware of the incestuous competition between co-ops, are told of the difficulty and resistance by buyers to raise prices, they seem to capitulate. Instead of working for the long-term interest of producers, they are directed to address the long-term interest of co-ops. The single, most difficult hurdle faced by co-ops is that milk production is a self-driving, unpredictable, uncontrollable, element of a co-ops make-up, and all efforts initiated by co-ops, are driven and influenced by that fact. It becomes impossible for co-ops to perform the job that in theory is expected of them, and, by default, simply do all they can to just operate the co-op, make a profit under the make allowance, and allow producers to produce as they see fit – ultimately the path of least resistance.

Indeed, the business decisions by co-ops in some cases is so off-track, it defies explanation. Think about a powder plant, simply and singly making nonfat dry milk, a product with a lousy value, and running that plant at full-capacity all the time, just to get rid of milk! This is a predictable *and necessary response* to the producer side expecting to produce whatever it wants with no regard to market demand. This renders co-ops impotent to perform the job envisioned by those who, years ago, structured cooperative marketing for Ag producers with a perishable product. Remember, when production exceeds demand, however little, the oligarchy takes effect, and the overall price goes down. Then, what do producers do? Produce more to pay the bills. The price goes down some more, we produce more. This is insanity. But because of pooling, *individual* producers get *no* signal from

the market-only generally lower prices, and the "last man standing" philosophy goes into effect again.

Think how our producer world would be if we already had the GMP! Then, back in 2007, when exports were rising, there would have been no limit to Allowable Growth. No Market Access Fee. Just produce all you want, because there was a market, *and a great price*! Then, when New Zealand and Australia came back on-line, when the dollar strengthened and our exports diminished, we would have had a low Allowable Growth (maybe zero or negative), a larger Market Access Fee, and we producers would have understood milk was losing demand. With those incentives in place, we would have had a clear market signal that was felt by all – and we would have responded in a businesslike fashion – not continued to cram milk into a flooded market. We would not have suffered the ridiculous economic disaster that took place in late 2008 and 2009. Remember, our oversupply is only a few percentage points; if clear market signals, felt individually, were in place and producers responded accordingly, that would have easily corrected the national oversupply.

So, if the GMP is so great, why is it not in effect already? The reason is, producers are paralyzed by the present system. The only thing we know, or can do, is produce more milk. No up-close market signals. Co-ops are simply doing all they can to meet our actions. Further, and most important, why should co-ops care? They are doing what producers "want." The structure – or the establishment – is in place, has been in place for decades, and there is little incentive to change. Yet we producers look to our co-ops for leadership. Our co-ops *will* do what the producers want. We just need to *think*, we just need to be *intelligent*, and we just need to think *nationally*, instead of our historic, myopic, short-sighted style of lasting longer than our neighbors.

Our co-op leadership *will* support the GMP – we just need to tell them to support it. We need to stop listening to those to whom we have surrendered control and power over us by virtue of our insane desire to be independent and produce all we want whenever we want.

It's time we face the fact that producers are the problem. Our inaction allows the continuation of equity-disappearance. If you like what happened the last 1 ½ years, do nothing. If you want this unnecessary financial blood-bath to end, take off the gloves! Call your co-op manager and board member representative and *demand* of them to support and help institute the GMP!!