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DATE: August 29, 2014 **PAGES: 5**
TO: Directors & Members **FROM: Rob Vandenheuvel, General Manager**

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE

Blocks	*+$.0675*	$2.3300
Barrels	*+$.0850*	$2.3450

Weekly Average, Cheddar Cheese

Blocks	*+$.0695*	$2.3010
Barrels	*+$.0675*	$2.3060

CHICAGO AA BUTTER

Weekly Change	*- $.0675*	$2.7550
Weekly Average	*+$.0405*	$2.7560

DRY WHEY

Dairy Market News	w/e 08/29/14	$.6600
National Plants	w/e 08/23/14	$.6740

NON-FAT DRY MILK
Week Ending 8/22 & 8/23

Calif. Plants	$1.7923	10,373,675
Nat'l Plants	$1.7887	19,606,449

Prior Week Ending 8/15 & 8/16

Calif. Plants	*$1.7551*	*14,436,743*
Nat'l Plants	*$1.8116*	*18,798,626*

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FRED DOUMA'S PRICE PROJECTIONS…

Aug 29 Final:	**Quota cwt. $23.42**	**Overbase cwt. $21.72**	**Cls. 4a cwt. $23.84**	**Cls. 4b cwt. $19.96**
Last Week:	**Quota cwt. $23.41**	**Overbase cwt. $21.71**	**Cls. 4a cwt. $23.82**	**Cls. 4b cwt. $19.96**

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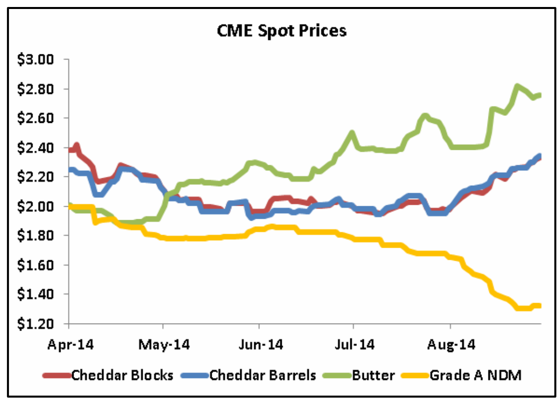
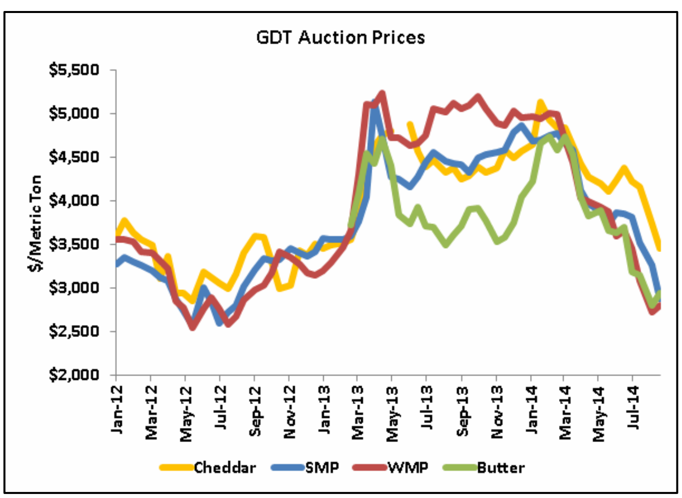
MARKET COMMENTARY: *(By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)*

Milk & Dairy Markets

Spot butter eclipsed the September 1998 record, settling at $2.8225/lb. last Friday. But the air was thin and the stay at all-time highs was brief. Butter retreated 6.75¢ and settled at $2.755 today. There was no lack of buying interest even at these still lofty levels; 29 loads changed hands this week. Cheddar prices continued their ascent. Blocks settled at $2.33, a price not seen since early April. Barrels reached $2.345, up 8.5¢ from last Friday. Class III futures followed cheese higher, with a surge in 2014 contracts and more tepid gains in 2015. Similarly, 2014 Class IV futures rallied while 2015 contracts were mixed.

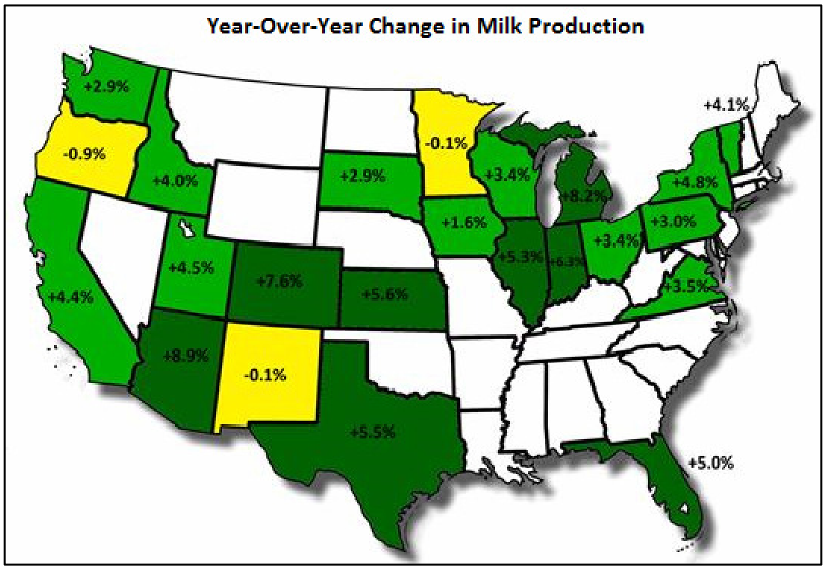




Spot nonfat dry milk (NDM) spent most of the last two months moving gradually but consistently lower. The market has finally fallen enough to tempt buyers from the sidelines. Spot NDM traded 13 times and ended the week at $1.325, up 2.5¢ from last Friday. On Wednesday the market logged its first uptick since July 3. As the spot market feels about for a bottom, the various powder indices are offering mixed signals. The National Dairy Product Sales Report (NDPSR) slipped this week, but stands at a much higher $1.79. The California Weighted Average Price rose 3.72¢ to match the NDPSR price. Meanwhile, *Dairy Market News* reported lower NDM prices around the country, with the midpoint of manufacturers' sales in the West at $1.555.

Overseas markets continue to slip. According to *Dairy Market News*, skim milk powder (SMP) prices fell 12% in Oceania and 14% in Western Europe over the past two weeks. Whole milk powder (WMP) prices held steady in New Zealand but dropped 13% in Europe. Butter lost 6% in Oceania and 12% in Western Europe. Oceania cheese prices slipped 5%. European markets have fallen in response to heavy supplies and the Russian import ban, while the Global Dairy Trade (GDT) auction pressured New Zealand's markets. The GDT index dipped 0.6%, and SMP fell 12%, its largest drop since debuting at the GDT six years ago. Cheddar also traded lower, but butter and WMP managed to rally.

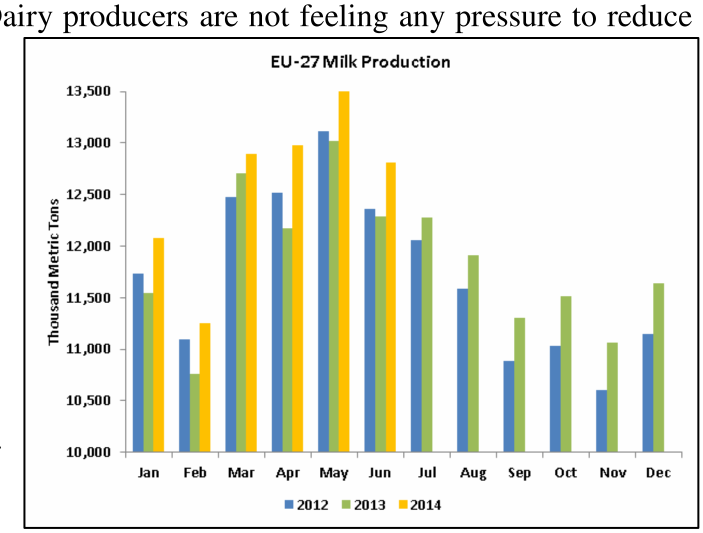
Tight domestic supplies have shielded the cheese and butter markets from declines like those seen overseas. Cheese stocks totaled 1.06 billion pounds on July 31, steady with June but down 8% from last year. At 170 million pounds, butter inventories declined 8.5% from June and were 42% lower than last year. With a strong currency, rising global milk production and upheaval in the export markets, the U.S. could soon face an influx of products from foreign competitors.



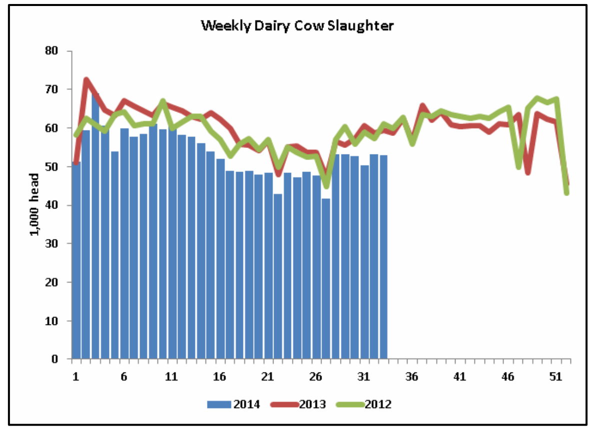
Strong U.S. milk flows could also help to curb the seasonal decline in cheese and butter stocks. Fall is approaching and students are switching from ice cream and sunshine to milk cartons and syllabi. Cheese and butter production typically reach their seasonal low in August. This year, mild weather in the Midwest and higher cow numbers have helped to offset seasonal declines.

July milk production was robust, totaling 17.45 billion pounds, up 3.9% from last year. Nearly every major dairy state reported increased milk production. Output was particularly strong in Arizona (up 8.9%), Michigan (up 8.2%) and Colorado (up 7.6%). There were 9.27 million cows in the milking herd in July, 37,000 more than in July 2013. Texas accounted for nearly the entire increase; producers there are milking 35,000 more cows than they did a year ago.

The milking herd is larger than it has been in two and a half years. But after peaking in the spring of 2012, the herd quickly shrunk. At the time, milk prices were already on their way down and producers had every incentive to cull aggressively. Today the outlook is very different. Milk prices remain elevated and producers have had plenty of opportunity to lock in large milk checks for months to come. The futures project that revenues will remain above the cost of production well into next year. Dairy producers are not feeling any pressure to reduce the herd; indeed, expansion is more likely. As prices begin to slip, low corn prices will leave farming dairy producers with few options. Rather than sell their corn at a loss, they'll probably choose to feed it. These producers will likely keep their barns relatively full even if milk margins signal the need for contraction. The dairy herd and milk supplies should remain large through much of the next year, which could pressure prices.



Foreign milk production is also robust. The European Union collected 27.8 million pounds of milk in June, a 4.3% increase from last year. Production in the first half of the year was 5% greater than last year. New Zealand's season has just begun in earnest, and production there exceeds last year's levels.



Weekly dairy cow slaughter totaled 53,307 head, down 9.4% from last year. For the year-to-date, slaughter is down 10.5% from a year ago.

Grain Markets

Corn futures have done nothing whatsoever in the past two weeks as the market awaits the harvest. The soybean market, on the other hand, has moved violently back and forth. The old crop September soybean contract has proven particularly schizophrenic. It is caught between empty bins and the looming abundance of harvest. Soybean crushers in the Midwest bid as much as $3.00 over the board to secure soybeans for immediate delivery.

Soybean meal prices plummeted and then bounced right back to the highs. The soybean meal market will likely be the last to fall, due to the lag between the assurance of a large harvest and the availability of fresh soybean meal. Rains were plentiful in August, and the soybean crop is flourishing. The harvest will bring welcome relief for feed buyers.

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USDA ANNOUNCES DETAILS OF THE MARGIN PROTECTION PROGRAM: *(By Rob Vandenheuvel)* This week, the U.S. Department of Agriculture released final details on the new Margin Protection Program (MPP), which regular readers of this newsletter will recognize as the new Federal program that replaces the Milk Income Loss Contract (MILC) program as a safety net for U.S. dairy farmers.

While there are many details that we will be going over – both in this newsletter and in membership meetings throughout the State over the coming weeks – the one critical detail you need to know now is that while signups are available starting September 2nd (next Tuesday), the signup period doesn't end until November 28th, giving you all the next few months to become more familiar with the program before you have to commit to signing up.

This is not a first-come-first-serve program – there is no reason to rush your decision. So the best advice at this time is to review the material put out by USDA (links below) and keep an eye out for an upcoming MPC area meetings where we can discuss the program and its requirements in more detail.

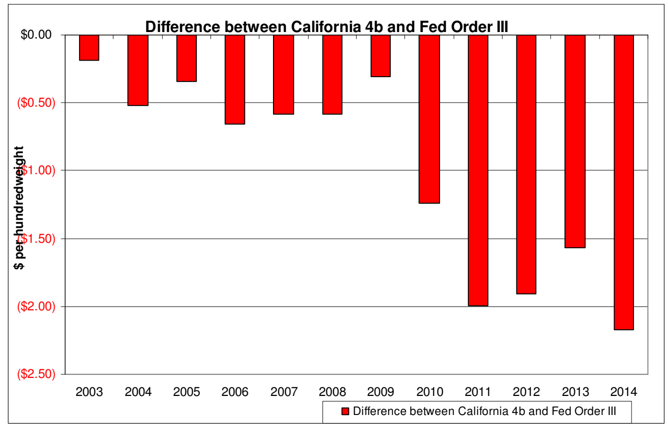
In the last issue of our newsletter, we included a link to a calculator that helped estimate what the premiums would be for various margin protection levels, given your dairy's size. If you missed that article, you can find it at: http://www.milkproducerscouncil.org/updates/081514.pdf. This week, USDA provided more reading material for you, in the form of a "Fact Sheet" and a "Frequently Asked Questions" document. You can find those at:

- Fact Sheet: http://www.milkproducerscouncil.org/mppfactsheet.pdf
- FAQ: http://www.milkproducerscouncil.org/mppfaq.pdf

While current milk prices and feed costs wouldn't trigger any payments under this new program, given what we know about the recent drops in global dairy markets and the volatility we are constantly subjected to, it's critical that every dairy explore this new potential tool and see whether it makes sense for your family. More on this to come…

A CRAZY MONTH IN SACRAMENTO – SO WHAT HAPPENED? *(By Rob Vandenheuvel)* By now, most of you have probably heard that there were serious efforts by the California Department of Food and Agriculture (CDFA) and Members of the California Legislature to craft a California bill that would make changes to the way we regulate our Class 4a/4b milk (which is milk sold to California's cheese, whey, butter and nfdm manufacturers). At the end of the day, while a bill was introduced in the California State Senate, it was never considered or voted on, and CDFA announced this week that they were ceasing their efforts to promote it.

Before getting into the details of the proposal, what it might have meant to the industry, and where we go from here, it's important to briefly go over some of the recent history that led to these developments.



<u>Our biggest issues started in 2007</u>, when then-Secretary A.G. Kawamura modified our Class 4b formula and opened the door to huge potential differences between California's Class 4b price and the Federal Order Class III price (the benchmark price for milk sold to cheese manufacturers around the country). While we could get into the specific change that was made (which many folks are already well-versed in, the "whey factor"), the practical impact was that the gap between our Class 4b price and the Federal Order Class III price, which had been relatively steady for many years at an average of $0.45-$0.55 per cwt, was now able to be significantly higher. And as we in this chart here, that's exactly what happened, starting in 2010 and continuing to this day.

<u>Over the course of the next five years</u>, producers and their organizations/cooperatives tried many different efforts to bring that gap back to the previous levels. Those included numerous hearing requests, legal action, protests/rallies, and an attempt at legislation in 2013 (and of course, a monthly accounting of the real-dollar impacts of the state-sponsored discount in this newsletter, just in case folks had forgotten). As evidence by the chart, none of those efforts brought any meaningful results, as the average gap in 2014 has been $2.18 per cwt. All told, since 2010, the discount has equated to a real-dollar impact of more than $1.4 Billion, or more than $830,000 for an average 1,000-cow dairy.

While all those other attempts at restoring a fair California milk price were unsuccessful, there have been two remaining efforts ongoing. Within CDFA, a "Dairy Future Task Force" was established by Secretary Karen Ross, made up of a hand-picked group of producers, processors and cooperative staff, with hopes of finding some sort of middle ground on either short- or long-term changes to the California pricing system. At the same time, the three major California cooperatives (California Dairies Inc., Dairy Farmers of America and Land O'Lakes) began working collaboratively in 2012 towards exploring a potential Federal Milk Marketing Order (FMMO) in California.

Both of these efforts have their own unique challenges. In the case of the Task Force, it's been seemingly impossible to find common ground between producers and the cheese manufacturers. Most of that can be attributed to the fact that while producers desperately need change, the processors do not. Change inevitably would mean higher prices paid for the milk they purchase; processors are no more excited about that as a dairy farmer would be about higher feed costs.

On the Federal Order effort, the primary challenge is the amount of time needed to go through that process. Best estimates indicate that a California Federal Order could be implemented within about two years of whenever a petition is submitted, assuming everything runs smoothly. While the three cooperatives have had staff working on putting that petition together, the final product has not yet been drafted, so that two-year timer hasn't started yet. Further, that process is entirely in the hands of the three cooperatives. Due to bloc voting, those three organizations can vote on behalf of roughly 80% of the milk in the state. So there's really nothing anyone else can do to speed up or assist in that process.

So if I had written this article several months ago, my status report would be that the Task Force is having discussions but moving nowhere, and the work towards a California Federal Order is occurring, but there's nothing to publicly report on. That began to change several months ago, when some concepts were presented to the Task Force that garnered interest from both producers and processors in the room. A working group that included producers, processors and cooperative staff presented some options for reforms that had potential for getting producer and processor support. The main idea was to allow some flexibility in how that milk is contracted – changes that were very similar to the way most Federal Orders around the country already operate –

and in return, the California Class 4a and 4b prices would be indexed to the Federal Order price. There were details that were left vague in the original concept, but the point was that there appeared to be an opening where both producers and processors could see value in a proposal – some flexibility in the system for processors, and a higher regulated milk price for producers.

After some back and forth between producers and processors at the subsequent Task Force meetings, Secretary Ross felt that this concept could have some merit as a legislative proposal, so she tasked her staff with exploring the option with the various industry groups.

Now there are many details we could get into here, but the bottom line is that CDFA proposed a bill that did a couple of things:

- Directly index our Class 4a/4b prices to the Federal Order Class IV/III prices, respectively. Starting next July, the bill would have set our Class 4b price at $1.00 below the FMMO Class III price (remember, it's averaged $2.18/cwt below so far this year). The following year, it would have set the Class 4b price at $0.50/cwt below the FMMO Class III price. The Class 4a would be on a different index initially, as it already maintains a closer relationship to the FMMO Class IV price, but at no point going forward would it be more than $0.50 below the FMMO Class IV price.
- Modify our system to only apply minimum pricing rules to Class 4a/4b milk that chooses to be part of the California pooling program, the same type of system that exists in Federal Orders throughout the country. Cooperatives would make that pooling decision on milk they purchase and sell, just like in the Federal Orders, and a pooling hearing would be held next year to determine the rules on how much milk a plant can move into or out of the pool at any given time (just as the hearing process would do in a Federal Order context).
- None of these changes would apply to Class 1, 2 or 3, and the quota program would remain intact.

This presented an interesting choice for producers and their organizations. On the one hand, our dairy farmers absolutely deserve a chance to operate on an even playing field with our out-of-state colleagues in Federal Order areas. This proposal did not get us a system with regulated prices equal to the Federal Order, albeit a lot closer than they currently are. On the other hand, the proposed bill presented an opportunity to start closing the gap next year, providing near-term price relief that the lengthy Federal Order process is simply unable to provide, and there was nothing about this plan that would prevent a Federal Order from still being considered by the California producers.

On balance, while it was a difficult issue to tackle, the MPC Board voted to support the proposal and work with fellow producer organizations and cooperatives to see if there was a way to make it a reality. **As an organization whose sole mission is to promote the interests of dairy farmers, we owed it to our members to see if this opportunity could lead to near-term price relief. The California discount on Class 4b milk of $2.18/cwt this year equates to about $30 million per month. Absent something happening to change that, the discount will continue month-after-month.**

In the end, the three major California cooperatives were not comfortable with the reforms being presented in the CDFA bill. There was no attempt to amend the proposed, but rather a firm opposition, which effectively ended the effort this week.

While the MPC Board was willing to engage in the discussions with CDFA over near-term price relief, we would fully agree with the notion that California dairy producers deserve a chance to operate on an equal playing field with our fellow out-of-state dairy farmers. We are hopeful that out of these recent discussions, the effort to move forward a Federal Order is reinvigorated. The three cooperatives made a bold statement by their actions. Their message was clear: they're not interested in patching up the State's current system, the Federal Order is where they want to focus their efforts. **It's time for California's producers to get on the same playing field as their out-of-state colleagues, and the three California cooperatives alone hold the keys to that solution. The time to act is now.**